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Leon A. Conrad

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## **DISTRIBUTION OF EXEMPT SECURITIES UNDER SECTION 4(1) OF THE SECURITIES ACT OF 1933**

The purpose of this comment is to examine the problems which may confront investment purchasers and "controlling persons" when they attempt to resell securities taken under an exemption from federal registration.

Under section 4(1) of the Securities Act of 1933, "transactions by any person other than an issuer, underwriter, or dealer; transactions by an issuer not involving any public offering . . ."<sup>1</sup> are considered exempt transactions,<sup>2</sup> and securities issued under this exemption are free of the extensive registration requirements of the act.<sup>3</sup> Purchasers of securities issued pursuant to this section may broadly be classified as investment purchasers. Because registration is costly and time-consuming, the prospect of coming under an exemption from registration has an immediate appeal. By the ever vigilant effort of the Securities and Exchange Commission to prevent unlawful "distribution"<sup>4</sup> of securities without prior registration, restrictive limits have been set on the use of this section.<sup>5</sup> Further, the investment purchasers of these exempt securities may find themselves severely curtailed when they attempt to dispose of their holdings, if indeed they are legally able to sell them at all.

Investment purchasers, as used herein, are persons who have taken stock under an exemption with the avowed purpose of holding it, and not with a view toward distribution.<sup>6</sup> Controlling persons are those investment purchasers whose holdings place them in a position in which they can influence the direction of the company. Sometimes the intent of holding the stock for investment purposes is evidenced by an investment letter,

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1. 68 Stat. 684 (1954), 15 U.S.C. § 77d(1) (1958).

2. Mergers, consolidations and sales of assets are also exempt under SEC Rule 133, 17 C.F.R. § 230.133 (Supp. 1962).

3. The introduction to § 4 provides that § 5 "shall not apply to any of the following transactions."

4. Distribution has been defined as "the entire process by which in the course of a public offering a block of securities is dispersed and ultimately comes to rest in the hands of the investing public." *Oklahoma Texas Trust*, 2 S.E.C. 764, 769 (1937), *aff'd*, 100 F.2d 888 (10th Cir. 1939).

5. Each factual situation must be inquired into to determine the availability of the exemption. It has been held that the number of offerees is not the most important factor, *SEC v. Ralston Purina Co.*, 346 U.S. 119 (1953); and that the principal factor is the number of offerees, *Campbell v. Degenther*, 97 F. Supp. 975 (W.D. Pa. 1951). A statement fairly summarizing the modern approach was made in *Central Bank & Trust Co. v. Robinson*, 137 Colo. 409, 417, 326 P.2d 82, 87 (1958), in which the court said: "An offer can be made to a large class and not be public, and conversely, to a small class and be public. The real test is—whether the particular class of persons affected need the information available by registration."

6. See *LOSS, SECURITIES REGULATION* (Supp. 1955, at 410). If an individual purchaser, not a dealer in securities, purchases with a view to distribution, he is a statutory underwriter, and the exemption is lost.

though this is not always true; nor if it is given is it conclusive evidence of investment intent.<sup>7</sup>

Generally speaking, the section 4(1) exemption extends to private offerings, as opposed to "public offerings."<sup>8</sup> There is presently no clear definition of what constitutes a private offering, and it is doubtful if a definite meaning can ever attach in view of the Commission's reluctance to set precise standards in this area. Guideposts, established in some instances by the errors of others, are available, however.<sup>9</sup>

Shortly after the act became law, the Commission, through its General Counsel, set out certain factors to be used as criteria in determining whether an offering came within the sphere of an exempt transaction. They are: (1) the number of the offerees and their relationship to each other and to the issuer; (2) the number of units offered; (3) the size of the offering; and (4) the manner of the offering.<sup>10</sup> It must be emphasized that no combination of these elements will automatically result in an exempt transaction. Courts have on occasion discounted the importance of one or more of these factors if the overall intent of taking for investment was lacking.<sup>11</sup> Should it be determined that the stock was taken with a view to distribution, and a resale was effected, the party making this sale might be viewed as a statutory underwriter under section 2(11) of the Securities Act.<sup>12</sup> Being an underwriter, the exemption of section 4(1) which specifically *excludes* underwriters<sup>13</sup> is destroyed, and the party will be in violation of section 5 of the act, which prohibits non-exempt transactions and sales of non-exempt securities "unless a registration statement is in effect as to [these securities] . . . ."<sup>14</sup> It should also be noted that if one party violates the investment intent requirement, the exemption is lost for the entire group. As stated by Professor Israels:

[T]he law is clear that responsibility can be imposed, in effect, retroactively, if it should be determined that a single purchaser's resale was motivated by circumstances reasonably contemplated

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7. Crowell-Collier Publishing Co., SEC Securities Act Release No. 3825 (Aug. 12, 1957): "A representation by a purchaser that he is taking for 'investment' when in fact he concurrently is dividing a participation among others or reselling a portion of a commitment to others is worthless."

8. See Securities Act of 1933, § 4(1), 68 Stat. 684 (1954), 15 U.S.C. § 77d(1) (1958).

9. See SEC v. Ralston Purina Co., 346 U.S. 119 (1953); Campbell v. Degenther, 97 F. Supp. 975 (W.D. Pa. 1951); Central Bank & Trust Co. v. Robinson, 137 Colo. 409, 326 P.2d 82 (1958).

10. SEC Securities Act Release No. 285, Jan. 24, 1935.

11. Crowell-Collier Publishing Co., SEC Securities Act Release No. 3825 (Aug. 12, 1957).

12. 48 Stat. 75 (1933), as amended, 15 U.S.C. § 77b(11) (1958).

13. 68 Stat. 684 (1954), 15 U.S.C. § 77d(1) (1958).

14. Securities Act of 1933, § 5(a), 68 Stat. 684 (1954), 15 U.S.C. § 77e (1958). The terms of this section make it unlawful to use the mails or other interstate means of communication to sell securities when a registration statement is not in effect.

when the original purchase was made, and that therefore his representation of "investment" intent was an unacceptable basis for the exemption.<sup>15</sup>

Due to the civil and criminal liabilities which may be incurred,<sup>15a</sup> it is imperative that every precaution be taken to ascertain true investment intent and to preserve the exemption. One of the most common methods employed to this end is the use of the investment letter.

Not all holders of securities obtained under an exemption have signed investment letters. This is particularly true with reference to controlling shareholders. However, most companies for their own protection as well as for that of the group in general, insist that parties to whom investment stock is issued sign an investment letter. Basically, it is not the letter itself that is of importance, but rather the expression of intent to purchase for investment which is manifested by the letter.<sup>16</sup> An integral part of the concept of purchasing for investment is the holding for a substantial length of time prior to resale. A period of time such as six months or one year is not enough to satisfy the requirements of intent, whether an investment letter is given or not.<sup>17</sup>

#### THE INVESTMENT LETTER

In general the letter represents that the purchaser is buying for investment and not with a view to distribution.<sup>18</sup> In form, the letter sets forth that:

[T]he purchaser knows that the issuer is selling the securities without registration in reliance upon the representations contained in the letter, . . . also that he realized that intent to resell upon the occurrence or non-occurrence of a reasonably foreseeable event is not enough upon which to ground the availability of the exemption.<sup>19</sup>

Obviously, the mere taking of an investment letter without providing the necessary machinery for enforcement of it may prove as valueless as taking none at all. Additional protection may be afforded the company

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15. *Israels, Some Commercial Overtones of Private Placement*, 45 VA. L. REV. 851, 855 (1959).

15a. Securities Act of 1933, § 12, 48 Stat. 84 (1933), as amended, 15 U.S.C. § 77l (1958); Securities Act of 1933, § 20, 48 Stat. 86 (1933), as amended, 15 U.S.C. § 77t (1958).

16. *Crowell-Collier Publishing Co.*, SEC Securities Act Release No. 3825 (Aug. 12, 1957).

17. *Israels, supra* note 15, at 853: "The concept of 'purchase for investment' never included any holding period analogous to the six months required under the Internal Revenue Code to establish long-term capital gains."

18. See Securities Act of 1933, § 2(11), 48 Stat. 75 (1933), as amended, 15 U.S.C. § 77b(11) (1958).

19. *Israels, supra* note 15, at 861.

by the placing of a restriction on the transfer of the shares. Notice of this restriction, or reference to it, should be placed on the face of the certificate and a stop order given to the transfer agent. The power of a company to require this is well settled, because "the signer of an investment letter consents, at least by implication, to a restriction upon the transfer of his holdings . . . ."<sup>20</sup> This implied consent permits the issuer to set a restriction on the face of the stock supported by a "stop transfer" "the effect of which is to sound the alarm when the securities are presented for change of registration."<sup>21</sup>

Circumstances may arise, such as a resale to another investment purchaser, which require lifting the stop transfer. To effectuate this, a letter from the issuer to the transfer agent is required. The issuer in turn must be satisfied that he may safely permit this transfer without violating the securities laws. The usual method of allaying the issuer's anxieties in this regard is for the purchaser to obtain a no-action letter from the Securities Commission. A resolution is then passed by the issuer's board of directors permitting the transfer of the particular securities involved pursuant to the letter. Notice of this resolution is sent to the transfer agent, who can then transfer the shares safely. If the issuer, after receipt of a no-action letter, refuses to order that the stop transfer be lifted, the party may resort to court action. In *SEC v. Guild Films Co.*,<sup>22</sup> a bank pledgee brought an action against the issuing company to compel transfer of the stock. The court ordered the transfer, "based . . . on the referee's report which found that the stock was exempt from the Securities Act of 1933."<sup>23</sup>

Once true investment intent has been ascertained by means of the investment letter and its associated devices, the question arises as to when an investment purchaser or controlling person, who actually took with investment intent, may resell his holdings. It is necessary to discuss these two groups separately since differing rules have been applied to each.

#### DISPOSITION BY AN INVESTMENT PURCHASER

There are few circumstances, absent registration, when an investment purchaser may undertake a public distribution of his holdings. One of these occurs when he has held his stock for a sufficient length of time.

##### A. *Length of Time Held*

Although some cases have held that specific periods of time were inadequate, neither the courts nor the Commission has set a precise germi-

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20. *Id.* at 862.

21. *Ibid.*

22. 279 F.2d 485 (2d Cir. 1960).

23. *Id.* at 489.

nation period, after which time exempt securities may be distributed safely to the public. In *Gilligan, Will & Co. v. SEC*,<sup>24</sup> a resale within approximately ten months was held to be indicative of no investment intent. The *Crowell-Collier* release stated that "holding for the six months' capital gain period of the tax statutes . . . does not afford a statutory basis for an exemption . . ."<sup>25</sup> On the other hand, it appears that holding investment securities for a period of two years may be enough to satisfy the investment intent requirement. In *United States v. Sherwood*,<sup>26</sup> the Commission sought to have the defendant Sherwood declared a statutory underwriter. Sherwood had obtained his shares in September 1955, as an investment purchaser. In September 1957, he began distribution of these shares to the public without filing a registration statement. The court held that "the passage of two years before the commencement of distribution of any of these shares is an insuperable obstacle to my finding that Sherwood took these shares with a view to distribution thereof . . ."<sup>27</sup>

Any distribution without registration prior to the lapse of a two year period probably would be looked on unfavorably by the Commission. Justification for this position becomes readily apparent if one considers the ease with which the registration requirements could be circumvented should the Commission adopt a substantially shorter holding period. Additional factors, such as the amount of stock which is intended to be distributed, the amount of public information available and disseminated regarding the issuer, and the amount of the issuer's stock outstanding together with the active trading in that stock, may have some influence with the Commission as to when an unregistered distribution may be made.

When a resale of this nature is contemplated, it is always advisable to seek a no-action letter from the Commission, regardless of the length of time held or other circumstances. This course of action will not only ease the mind of the prospective seller, but will also afford protection to other members of the group holding under the same exemption.<sup>28</sup>

### B. *Change in Circumstances*

A change in circumstances may provide an alternative for an investment purchaser who wishes to sell to the public prior to the expiration of a two year period.<sup>29</sup> This change may be in the circumstances of the purchaser, such as "severe business reverses necessitating the liquidation of *all*

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24. 267 F.2d 461 (2d Cir. 1959).

25. *Crowell-Collier Publishing Co., SEC Securities Act Release No. 3825* (Aug. 12, 1957).

26. 175 F. Supp. 480 (S.D.N.Y. 1959).

27. *Id.* at 483.

28. *Israels, supra* note 15, at 861.

29. *Id.* at 855.

outside investments,"<sup>30</sup> or in the circumstances of the issuer, such as when "a drug company . . . goes into the machinery business on a large scale."<sup>31</sup> The latter situation has been referred to as a "crystal clear" case.<sup>32</sup> A question may arise as to the importance of the length of time the securities are held, prior to the attempted distribution based on a change of circumstances. A hypothetical example would be a real estate company engaged solely in the acquisition and development of real estate and mining properties when the investment purchasers acquired their stock, which subsequently, without the consent of the investment purchasers, embarked upon a program of divesting itself altogether of its mining and real estate properties and enters the utilities business on a major scale. Assume that the investment shareholders had never been officers or directors of the company, had only recently acquired their stock, and had held it for substantially less than two years. A clear case of change in circumstances would appear to be demonstrated, and it is highly doubtful if a short holding period would prove to be an obstacle to a public distribution of the shares.

It is clear, however, that mere failure of the issuer to live up to the purchaser's expectations is an inadequate foundation upon which to base the exemption. The argument has been broached that the resale was undertaken "only after a change of the issuer's circumstances as a result of which petitioners, acting as prudent investors, thought it wise to sell."<sup>33</sup> The change alluded to was the failure of the issuer, a publisher, "to increase its advertising space"<sup>34</sup> as anticipated by the shareholder. The court agreed with the Commission that when the purchaser intended to hold the securities only if the company continued to operate profitably, he did not purchase with investment intent.

It appears that in a proper case, an unforeseen change of circumstances may prove a worthwhile field of exploration for a distribution-minded investment purchaser.

### C. *Registration*

The requisite preliminary to a public offering of non-exempt securities is registration. In view of the Commission's readiness to recommend prosecution even when an investment purchaser who has held for a long time undertakes a public distribution,<sup>35</sup> the inference seems justified that the Commission would also prefer all public offerings of exempt securities to be registered. Unfortunately, in many cases this may produce severe hardship. There is very little that a shareholder can do to persuade an unwilling issuer

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30. *Ibid.*

31. *Ibid.*

32. *Ibid.*

33. *Gilligan, Will & Co. v. SEC*, 267 F.2d 461, 468 (2d Cir. 1959).

34. *Ibid.*

35. *United States v. Sherwood*, 175 F. Supp. 480 (S.D.N.Y. 1959).

to register his shares. Problems of expense arise, as well as management's desire to maintain the price of the shares, which may be adversely affected by a large secondary distribution. An advisable procedure is for the purchaser, at the time of purchase, to secure an agreement from the issuer under which the shares will be registered at a later date, possibly upon the demand of the holders of a specified number of shares. Failure by an investment purchaser to obtain this agreement may result in his being compelled to hold his shares for a long time, regardless of the company's activities, general market conditions, or his own financial requirements.

The situation would be eased somewhat if exempt securities were considered to be good collateral, but financial institutions and individuals are loath to lend money against collateral which, in event of default, cannot be sold for the protection of the lender. In a recent decision<sup>36</sup> a bank took the borrower's exempt securities as loan collateral. Seven months later, upon the debtor's failure to repay the bank, it proceeded to dispose of the securities to the public. The court of appeals affirmed the Commission's ruling that these sales were not exempt, and that the bank was a statutory underwriter, selling unregistered stock. Neither the "good faith" of the bank in accepting these securities for collateral, nor the fact that the bank did not purchase from the issuer, influenced the court.

#### *D. Sale to Another Investment Purchaser*

There appears to be no restriction on the resale of exempt securities to another investment purchaser. Of course, the same requirement of investment intent as evidenced by an investment letter applies to this transaction as it did from the issuer to the initial purchaser. In view of this fact, resales of this type are usually below the trading market price of the stock, since the new purchaser will be faced with the same problems of disposition as his predecessor. Even in this situation, a no-action letter must be obtained from the Commission to reassure the issuer's counsel and to give him grounds upon which to authorize the transfer of the shares.

#### DISPOSITION BY CONTROLLING PERSONS

Perhaps the most important method of disposition referred to thus far is the potential public distribution after a two year holding period. This avenue is not open for a controlling person. However, it has been suggested that section 4(2) of the Securities Act of 1933<sup>37</sup> provides a limited method of distribution for controlling shareholders not available to investment purchasers. Prior to a consideration of this section, a comment on the concept of "control" is in order.

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36. *SEC v. Guild Films Co.*, 279 F.2d 485 (2d Cir. 1959).

37. 48 Stat. 77 (1933), 15 U.S.C. § 77d(2) (1958).



As indicated by the House Report, for purposes of the Securities Act:

The concept of control herein involved is not a narrow one depending upon a mathematical formula of 51 percent of voting power, but is broadly defined to permit the provisions of the Act to become effective wherever the fact of control actually exists.<sup>38</sup>

The point will resolve itself into the question of whether a party is in a position, by virtue of stock ownership, to exercise controlling influence over the management or policies of a company. As suggested by the House Report, this influence may be exercised by parties who own substantially less than fifty-one per cent of the voting stock. The courts have complied basically with the congressional intent in their interpretation of situations of control, although "there has been very little litigation with respect to control . . . ."<sup>39</sup>

#### A. *Controlling Persons and Section 4(2)*

*In the Matter of Ira Haupt & Co.*<sup>40</sup> was an action instituted against an underwriter for the public sale of stock held by a controlling person and not covered by a registration statement. One of the defenses raised was that the provisions of section 4(2) ("brokers' transactions, executed upon customers' orders on any exchange or in the open or counter market, but not the solicitation of such orders"),<sup>41</sup> were intended to cover this transaction and free it from the registration requirement. The Commission, however, held that read together with section 4(1)<sup>42</sup> "public distributions by controlling persons, through underwriters, are intended generally to be subject to the registration and prospectus requirements of the Act."<sup>43</sup> The true purpose of section 4(2) was to assure "an open market for securities at all times, even though a stop order against further distribution of such securities may have been entered."<sup>44</sup> Finally, the Commission concluded that "Section 4(2) cannot exempt transactions by an underwriter executed over the Exchange in connection with a distribution for a controlling stockholder."<sup>45</sup>

In this state of affairs, brokers were understandably hesitant to execute sale orders of even small blocks of stock for a party who might be determined to be a member of the controlling group. An attempt at clarification was made by the Commission and embodied in rule 154,<sup>46</sup> pertinent parts of which follow.

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38. H. R. REP. NO. 85, 73d Cong., 1st Sess. 14 (1933).

39. LOSS, *SECURITIES REGULATION* 461 (1951).

40. 23 S.E.C. 589 (1946).

41. 48 Stat. 77 (1933), 15 U.S.C. § 77d(2) (1958).

42. 68 Stat. 684 (1954), 15 U.S.C. § 77d(1) (1958).

43. *In the Matter of Ira Haupt & Co.*, 23 S.E.C. 589, 601 (1946).

44. *Id.* at 603. (Italicized in original.)

45. *Id.* at 604.

46. SEC Rule 154(a), 17 C.F.R. § 230.154(a) (Supp. 1962).

The term "brokers' transactions" in section 4(2) of the Act shall be deemed to include transactions by a broker acting as agent for the account of any person controlling, controlled by, or under common control with, the issuer of the securities which are the subject of the transactions . . . . For the purpose of paragraph (a) of this section, the term "distribution" shall not apply to transactions involving an amount not substantial in relation to the numbers of shares or units of the security outstanding and the aggregate volume of trading in such security. Without limiting the generality of the foregoing, the term "distribution" shall not be deemed to include a sale or series of sales of securities which, together with all other sales of securities of the same class by or on behalf of the same person within the preceding period of six months, will not exceed the following: (1) if the security is traded only otherwise than on a securities exchange, approximately 1 per cent of the shares or units of such security outstanding . . . .

Further provision is then made for shares of stock traded on a securities exchange. The rule seemed to settle clearly an *Ira Haupt* type of situation, establishing the upper limits of sale by a controlling person at one per cent each six month period for holders of unlisted stock, and prescribing a formula for listed stock. The broker's fear of participating in an illegal distribution of unregistered shares was apparently allayed. Rule 154 became thought of as a vehicle whereby controlling persons who held exempt securities could dispose of their holdings up to one per cent of all outstanding shares each six months, regardless of the time for which they had been held. It was and is used today as a unique method of disposition, available only to controlling persons, for the purpose of distributing securities obtained under an exemption, as long as the transaction does not involve an amount "substantial in relation to the number of shares or units of the security outstanding . . . ." <sup>47</sup> This interpretation of rule 154 appears to be shared by noted authorities in the securities field. With reference to "secondary distribution" by "an affiliate of an issuer," <sup>48</sup> Professor Loss says: "[T]he Commission came up with a new formula which still does not go back to the pre-*Haupt* test but does prescribe a rule-of-thumb definition of the troublesome word 'distribution.' " <sup>49</sup>

After quoting pertinent sections from rule 154, he goes on to state that:

[T]he rule provides that there shall not be deemed to be a "distribution" so long as the transaction in question and all other sales of the same class of securities by or on behalf of the same person within the preceding six months do not exceed approximately one

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47. SEC Rule 154(b), 17 C.F.R. § 230.154(b) (Supp. 1962).

48. SEC Rule 154(a), 17 C.F.R. § 230.154(a) (Supp. 1962). For purposes of the Securities Act an "affiliate of an issuer" would be any "person controlling, controlled by, or under common control with" the issuer.

49. Loss, *op. cit. supra* note 6, at 410.

per cent of the shares or units of an over-the-counter security and, in the case of a security traded on an exchange, the lesser of that amount or the aggregate reported volume of exchange trading during any week within the preceding four weeks.<sup>50</sup>

Presuming that the broker met the other stipulations of the rule, it would appear that any controlling person, holding under the exemption of section 4(1), or any other exemption to which the rules apply, could dispose of one per cent of his holdings each six months irrespective of how long he had held the securities.

Additional weight is added to this position by another prominent writer who suggests that the purpose of section 4(2) "is to exempt casual sales, even by controlling persons for whose 'distributions' [public offerings] through an underwriter registration would be required."<sup>51</sup> In line with this analysis, and his feeling that this registration-free resale provision in favor of controlling persons is a desirable provision, he suggests that: "logically there is good basis for similar administrative treatment of sales by an 'investment purchaser' and perhaps even of sales by the issuer itself."<sup>52</sup> Finally, he concludes that a beneficial change could be made in the form of an "amendment of rule 154 to make it applicable to transactions on behalf of an investment purchaser, or by the issuer."<sup>53</sup> Neither of these writers suggests any limitation on the use of the rule by virtue of the length of time held, the information available to the public concerning the issuer and its operations, or the number of shares attempted to be sold publicly, so long as they meet the technical one per cent requirement.<sup>54</sup>

However, in conversations with Professor Sowards,<sup>55</sup> it was stated that this interpretation and use of rule 154 is far broader than the construction placed on the rule by the Securities Commission. Professor Sowards has stated that in recent talks with a representative of the Securities and Exchange Commission,<sup>56</sup> he was informed that in the view of the Commission, the availability of the one per cent rule is limited to those controlling persons who are not attempting to dispose of their holdings piecemeal. In short, use of the rule once or even twice is acceptable, but repeated sales which reflect a pattern of disposal would in all probability be labeled a "distribution" and thus would be violative of the act.

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50. *Ibid.*

51. *Israels, supra* note 15, at 865.

52. *Ibid.*

53. *Id.* at 868 n.78.

54. Presumably, the affiliate of an issuer which has recently issued two million shares could himself sell to the public, through a broker, without registration, twenty thousand shares during the ensuing six months period, and twenty thousand shares each six month period thereafter.

55. Mr. Hugh L. Sowards, Professor of Law, University of Miami, Coral Gables, Fla. (1961).

56. Mr. Manuel Cohen, Commissioner, United States Securities and Exchange Commission.

In view of the overall language of the rule, it is highly questionable that a controlling person who met all the other prerequisites would, under all circumstances, be permitted to sell up to the one per cent limit. "[A]n amount not substantial in relation to the number of shares or units of the security outstanding"<sup>57</sup> could be interpreted as a further limitation. One per cent of the outstanding shares might be construed as a *substantial amount* of shares. In addition, the rule explicitly states that the one per cent formula was not intended to limit the generality of the "not substantial" portion.<sup>58</sup> Such factors as the number of shareholders, distribution of the stock, and general public knowledge of the company and its operations may affect potential use of the rule.

Exemptions have been developed to meet specific needs, or to permit sales of securities to parties who by experience or position may be considered sophisticated investors and do not require the protection of registration with its full disclosure provisions. When attempts are made to sell securities to the public without proper registration, severe handicaps are placed in the path. This is exemplified by the provision of rule 154 that the exemption is lost if the broker or his principal "solicits or arranges for the solicitation of orders to buy in anticipation of or in connection with such transactions . . . ."<sup>59</sup> If this means that the rule is not available when the broker has solicited offers from purchasers to buy the securities, its availability for transactions in the over-the-counter market may be doubtful, by virtue of the mechanics of that market.

This would restrict the practical usefulness of section 4(2) as interpreted by rule 154 to securities traded on an exchange and to a select few controlling persons selling through a broker. Against this stands the fact that provision is made in the rule for trading "otherwise than on a securities exchange,"<sup>60</sup> which at least raises an inference that these transactions may occur off an exchange. It should be borne in mind that sales by controlling persons to the public, unless through a broker, are never exempt under section 4(2) since it applies only to brokers' transactions.<sup>61</sup>

#### CONCLUSION

The avenues of disposition of exempt securities, outside of registration, are narrow indeed for the investment purchaser, and even more restricted for the controlling person. It appears fairly certain that investment intent is demonstrated by holding stock for two years, and that an investment

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57. SEC Rule 154(b), 17 C.F.R. § 230.154(b) (Supp. 1962).

58. *Ibid.*

59. SEC Rule 154(a)(3), 17 C.F.R. § 230.154(a)(3) (Supp. 1962).

60. SEC Rule 154(b)(1), 17 C.F.R. § 230.154(b)(1) (Supp. 1962).

61. 48 Stat. 77 (1933), 15 U.S.C. § 77d(2) (1958).

purchaser may engage safely in a public distribution after that time. The same is not true for a controlling person. Nor, as is commonly thought, may parties in control make free and uninhibited use of the so called "one per cent rule." Perhaps justification for the Commission's view may be found in the fact that a person in control is in a position, by virtue of his influence on company affairs, to cause the company to register his shares at will. On the other hand, it may be argued that the import of the words of rule 154 seems to warrant resale by any person in a control position within the specifications as set out and without regard to the length of time for which the securities have been held. Whatever arguments may exist for a contrary interpretation, it would be foolhardy, in view of the Commission's stand in this area, for a controlling person to incur the risk of civil and criminal liabilities which could follow in the path of a non-exempt distribution. When a distribution to the public is contemplated by a controlling person, the better course is registration.

LEON A. CONRAD