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SECONDARY DISTRIBUTION  
OF CORPORATE SECURITIES

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THE existence of a market for corporate securities has played an important and significant role in the development of this country, both as a source of equity capital for business corporations and as a relatively safe and generally profitable means of investing for the general public. The original distribution of corporate securities by an issuing corporation is, of course, one source of funds for such corporation. However, the initial distribution of corporate securities would be almost impossible without the existence of a secondary market in which securities may be bought and sold. Transactions in this secondary market may range from the sale of one share of common stock of a corporation to the sale and distribution to the general public of all of the stock of a corporation by a person who had previously acquired such stock from the corporation making the original issue. It is this latter situation with which this Article is generally concerned, but it will readily be seen that aside from the two extremes there is no clear line of demarcation between the two transactions.

Some idea of the size of the securities market can be obtained from the 22nd Annual Report of the Securities and Exchange Commission published in 1956.1 According to this report, during 1956 the total volume of securities registered under the Securities Act was 13.1 billion dollars, which was the highest volume for any fiscal year in the history of the Securities Act.2 This figure covers all securities registered including new issues sold for cash by the issuer, secondary distributions, and securities registered for other than cash sales, such as exchange transactions and issues reserved for the conversion of other securities. The figure does not include those securities issued and traded during the year as to which no registration statement was effective.

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The Annual Report states that of the dollar amount of securities registered in 1956, 70.3 per cent was for the account of issuers for cash sale, 21.5 per cent was for the account of issuers for other than cash sales, and the remaining 8.2 per cent was for the account of others. This last group of 8.2 per cent of the total volume of registered securities would include securities registered for distribution by controlling stockholders. Such securities are primarily common stocks, but preferred stocks and bonds, debentures, and notes are also the subject of certain registrations by controlling stockholders. For example, in 1956, of the total value of $1,070,778,000 of securities registered for distribution other than for issuers, $11,290,000 was bonds, debentures, and notes, $2,421,000 was preferred stock, and the remaining $1,057,067,000 was common stock. 1955 was apparently a big year for controlling stockholders, for in 1955 the total value of securities registered for distribution by persons other than the issuer totaled $371,637,000, of which $2,450,000 was bonds, debentures, and notes, $22,251,000 was preferred stock, and the balance of $346,936,000 was common stocks.

The specific point of inquiry is the regulation of this type of distribution of corporate securities by the federal government and by the State of Texas.

I. Federal Regulation

A. General Purpose of the Federal Statutes

In order to understand the specific problems relating to secondary distribution of corporate securities, it is necessary to understand the general intent and scope of the federal statutes. Of primary concern is the Securities Act of 1933 as it has been from time to time amended. To a certain extent the problem is also governed by the Securities Exchange Act of 1934. The Securities and Exchange Commission has set forth the following as being the general purpose and policy of the Securities Act:

The general policy of the Securities Act is to provide for "full disclosure of every essentially important element" attending a distribution

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Ibid.
of securities. This policy is equally applicable to the distribution of a new issue and to a redistribution of outstanding securities which "takes on the characteristics of a new offering by reason of the control of the issuer possessed by those responsible for the offering." The disclosure required takes the form of a registration statement filed with this Commission and a prospectus, summarizing the information in the registration statement, which must be furnished to prospective investors. Unless and until these requirements are fulfilled, the mails and the channels of interstate commerce are closed to the distribution or re-distribution of an issue. Thus Section 5(a) prohibits the use of the mails or any means of interstate commerce to sell, or to deliver after sale, any unregistered security and Section 5(b) prohibits any such transaction with respect to registered securities unless a prospectus containing the required information is used.

Sections 3 and 4 of the Act provide certain specific exemptions from these requirements. These exemptions are plainly designed to do no more than mark out specific situations in which Congress considered the protection afforded by registration either unnecessary, unduly burdensome, or an inappropriate subject for Federal Legislation. The general pattern of the Act—a sweeping prohibition, subject to a number of carefully defined exemptions—considered together with the nature and particularity of the exemptions themselves emphasizes rather than obscures the basic purpose of the Act to protect investors and stresses the generality of its intended application. In this setting, it is clear that the exemptions must be strictly construed and that the claimant of an exemption has the burden of showing that he falls within the terms of the exemption he claims.*

The report of the House Committee considering the adoption of the Securities Act contains the following statement with regard to secondary distribution:

... [A]ll the outstanding stock of a particular corporation may be owned by one individual or a select group of individuals. At some future date they may wish to dispose of their holdings and to make an offer of this stock to the public. Such a public offering may possess all the dangers attendant upon a new offering of securities. Wherever such a re-distribution reaches significant proportions the distributor would be in the position of controlling the issuer and thus able to furnish the information demanded by the bill. This being so, the distributor is treated as equivalent to the original issuer and, if he seeks to dispose of the issue through a public offering, he becomes subject to the Act. The concept of control herein involved is not a narrow one depending upon the mathematical formula of 51% of voting power, but is broadly defined to permit the provisions of the Act to become effective wherever the fact of control actually exists.*

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It is thus apparent that under certain situations the distribution of corporate securities by a stockholder, as opposed to the issuer of such securities, is intended to be regulated by the Securities Act just as an original distribution of such securities to the public would be regulated. The purpose of this Article is to consider the statutory basis of such regulations, to explore certain exemptions from such regulations, and to elaborate on certain features of this particular type of registration.

It should be noted at the outset that there has been relatively little litigation under the Securities Act. Thus, in many instances, the only guiding precedents under the Securities Act, apart from the act itself, are the rules, regulations, and practices of the Securities and Exchange Commission.

B. The Statutory Scheme of Regulation

Under the Securities Act there are three sections which are of primary importance in connection with the problem of the secondary distribution of corporate securities. One of these seems to require registration in any sale or distribution of corporate securities by any stockholder, another seems to exempt all such transactions, and still another seems again to impose the requirement of registration under certain limited circumstances. In part, the seemingly complex nature of the statutory treatment arises because most of the sections do double or triple duty, and it is only through a consideration of the interrelation of all of such sections that the full scope of federal regulation can be determined.

The heart of the Securities Act is section 5, which is as follows:

(a) Unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly—

(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell such security through the use or medium of any prospectus or otherwise; or

(2) to carry or cause to be carried through the mails or in interstate commerce, by any means or instruments of transportation, any such security for the purpose of sale or for delivery after sale.

(b) It shall be unlawful for any person, directly or indirectly—

(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to carry or transmit any prospectus relating to any security with respect to which a registration statement has been filed under this title,

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10 § 5.
11 § 4(1).
12 § 2(11).
unless such prospectus meets the requirements of section 10; or

(2) to carry or cause to be carried through the mails or in inter-
state commerce any such security for the purpose of sale or for
delivery after sale, unless accompanied or preceded by a prospectus
that meets the requirement of subsection (a) section 10.

(c) It shall be unlawful for any person, directly or indirectly, to
make use of any means or instruments of transportation or communi-
cation in interstate commerce or of the mails to offer or sell or offer
to buy through the use or medium of any prospectus or otherwise any
security, unless a registration statement has been filed as to such se-
curity, or while the registration statement is the subject of a refusal
order or stop order or (prior to the effective date of the registration
statement) any public proceeding or examination under Section 8.

Without discussing the various forms of activity which may be
undertaken during the period before the filing of the registration
statement and during the period after such filing and before its ef-
fective date, all of which is beyond the scope of this Article, it is
sufficient to say that under the provisions of this section it would
be unlawful to make any sale of any corporate security by use of the
mails or in interstate commerce unless a registration statement was
effective as to such security. The reference to the use of mails or of
instruments of transportation or communication or interstate com-
merce is, of course, inserted in the act to provide a basis for federal
control. The terms are used disjunctively so that any use of the mails
makes one subject to the provisions of the act even though such use
of the mails is entirely intrastate.\textsuperscript{13} Use of any means of interstate
commerce or of the United States mail in any phase of the trans-
action from the beginning of negotiations for sale to delivery of the
security is sufficient to make section 5 of the Securities Act applicable
to the transaction.\textsuperscript{14} It will be readily seen that it would be
almost impossible to make any extensive distribution of corporate
securities, by either an issuer or a stockholder, without the use of the
mails or of instruments of interstate commerce. Fraud is not a ne-
necessary element in any violation of section 5, but mere use of mails
or channels of interstate commerce is sufficient.\textsuperscript{15} Thus, because of
the dependence of the securities business upon the use of mails and
means of interstate commerce, for all practical purposes, the provi-
sions of section 5, and hence the entire Securities Act, are generally
applicable to any extensive secondary distribution of corporate se-
curities. Even within a single state it would be difficult to make any
substantial number of sales without either the voluntary or involun-

\textsuperscript{13} Shaw v. United States, 131 F.2d 476 (9th Cir. 1942).
\textsuperscript{14} Crosby v. Weil, 382 Ill. 538, 48 N.E.2d 386, 145 A.L.R. 1244 (1943).
\textsuperscript{15} Price v. United States, 200 F.2d 632 (5th Cir. 1953).
tary use of the mails; however, in such situations it is possible that one or more of the statutory exemptions would be applicable to the transaction.

Just as section 5 seems to make the Securities Act applicable to every sale of a corporate security by any stockholder, section 4 of the act seems to exempt every such transaction. The pertinent part of such section 4 is as follows: “The provisions of section 5 shall not apply to any of the following transactions: (1) Transactions by any person other than an issuer, underwriter, or dealer . . .”

The term “issuer,” as defined in section 2(4) of the Securities Act does not include stockholders of corporations whether they are controlling stockholders or not.16 Section 2(12) of the Securities Act defines the term “dealer” as any person who engages for either all or a part of his time in the business of buying, selling, or otherwise dealing in securities, and the general terms of such definition do not include one who is a controlling stockholder.17 However, it is, of course, possible for one who is a dealer incidentally to be a controlling stockholder but, conversely, one who is a controlling stockholder is not by virtue of such fact alone a dealer, and that is the important aspect of the question for purposes of this discussion.

The remaining part of the exemption provided by the first clause of section 4(1) of the Securities Act is an exemption for transactions by any person other than an “underwriter.” The term “underwriter” is defined in section 2(11) of the Securities Act and, because of its importance insofar as transactions by controlling stockholders is concerned, it will be well to set forth the definition in full. Such section is as follows:

The term “underwriter” means any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking; but such term shall not include a person whose interest is limited to a commission from an underwriter or dealer not in excess of the usual and customary distributors' or sellers' commission. As used in this paragraph the term “issuer” shall include, in addition to an issuer, any person directly or indirectly controlling or controlled

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16 Section 2(4) provides that the term “issuer” means every person that issues or proposes to issue any security; with respect to corporate securities, this would be the corporation itself.

17 Section 2(12) provides that the term “dealer” means any person who engages either for all or a part of his time, directly or indirectly, as agent, broker, or principal, in the business of offering, buying, selling, or otherwise dealing or trading in securities issued by another person.
by the issuer, or any person under direct or indirect common control with the issuer.

Definition of the term "underwriter" refers to particular transactions; one who is not generally engaged in any phase of the securities business as a business or profession may, as to certain particular transactions, be an underwriter within the meaning of this definition. In determining whether or not a person is an underwriter it is therefore necessary to look at the particular transaction rather than the usual business of the person in question. However, the fact that a person is in the securities business and has in the past purchased and distributed securities would tend to indicate that a present purchase of corporate securities might also result in their distribution to the general public. As was the case with the definition of "dealer," a controlling stockholder may be an underwriter as to some particular transaction, and an underwriter may also be a controlling stockholder, but a controlling stockholder is not necessarily an underwriter. It should be noted that in general under this definition a person is not an underwriter unless he has purchased from an issuer with a view to making a distribution of the security. The concept of distribution is fully discussed below, but the concept of purchasing from an issuer should be examined at this time. In addition to the term "issuer" as defined in section 2(4), an "issuer" under section 2(11) includes "any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer." Since the concept of control is also discussed below, it is sufficient at this time to note that the definition clearly includes a controlling stockholder of the actual issuer. It is just as though the section were written so as to define the term "underwriter" to mean any person who has purchased from or sold for either the issuer or a person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer, with a view to, etc.¹⁸

Thus, where any person purchases stock from a controlling stockholder (who is an issuer for the purposes of section 2(11) of the Securities Act), with a view to, or offers or sells for such an issuer in connection with, the distribution of any security, the person making such purchase is an underwriter under the definition of section 2(11). Thus, the transaction itself becomes one involving an underwriter, thus meaning the exemption of the first clause of

section 4(1) is not available and making the broad provisions of section 5 applicable. This means that when a controlling stockholder sells corporate securities to a person who is an underwriter within the terms of section 2(11) of the Securities Act, such sale is not legal unless a registration statement is in effect and the provisions of section 5 of the Securities Act are complied with.

An important consideration in determining whether or not these sections are applicable is whether or not the stockholder is a controlling stockholder within the meaning of section 2(11) of the Securities Act. If it is established that such person is a controlling stockholder, it would next be important to determine whether or not one who is purchasing corporate securities from such person does so with a view to the distribution of them as defined in section 2(11) of the Securities Act. If this be the case, the provisions of section 5 are applicable unless one or more of the other exemptions of the act are applicable. It would therefore be important after determining whether or not control exists and whether or not there is a plan of distribution of the corporate securities to determine whether or not any of the other exemptions of the act are applicable either to the securities themselves or to the particular transaction.

C. What Constitutes Control

As outlined above, section 2(11) of the Securities Act provides that the term “issuer” shall include in addition to an issuer “any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer.”

The word “control” is defined by Rule 405 as follows:

The term “control” (including the terms “controlling,” “controlled by” and “under common control with”) means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise.19

It is obvious from the definition contained in Rule 405 that its application to specific facts is considerably more complex than a mere statement of the rule. There are other sections contained in some of the other Securities Acts which are helpful in analyzing the various factual situations to which these standards must be applied in attempting to determine whether or not control exists within the meaning of section 2(11). Although the basic philosophy of the

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19SEC Rule 405, 17 C.F.R. § 230.405 (1949). These Rules will hereinafter be referred to as “Rule” with the appropriate number being given.
Investment Company Act of 1940\(^{20}\) and the Public Utility Holding Company Act of 1935\(^{21}\) is different from the Securities Act in that both of these acts are basically regulatory acts whereas the Securities Act is basically one requiring full disclosure in connection with distribution of securities, the control concept is extremely important under all of the acts.

1. **Directly or Indirectly Controlling the Issuer**

   This portion of the definition in section 2(11) obviously relates to control of a corporation which, according to Rule 405, can be effected through the ownership of voting securities, by contract, or otherwise. It is clear that the ownership of fifty-one per cent or more of the voting securities of a corporation would place the owner of such securities in control of the issuer and would subject such person to being included within the meaning of an issuer under section 2(11). It has also long been established that the ownership of considerably less than fifty-one per cent of the voting securities of a corporation can in many instances give to such owner actual control of the corporation. This is particularly so where the ownership of securities, except for the block owned by the principal stockholder, is scattered among a large number of stockholders. As indicated above, the exact percentages have not been prescribed by either the Securities Act or by the Rules thereunder. Whether or not control exists must therefore be determined by a study of all of the pertinent facts in any given case. It would seem, however, that some of the fixed standards prescribed by the Holding Company Act and the Investment Company Act may be of assistance in determining some of the factors going into a determination of control.

   The Holding Company Act defines a holding company as any company which owns, controls, or holds with power to vote, ten per cent or more of the outstanding voting securities of a public utility company or of a company which is a holding company.\(^{22}\) The Holding Company Act also grants the power *after* notice and opportunity for hearing to determine that any person, either alone or pursuant to an arrangement or understanding with one or more persons, exercises such a controlling influence over the management or policies of a public utility or of a holding company to

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\(^{22}\) § 2(a)7(B) of the Holding Company Act.
make it necessary or appropriate in the public interest that such person be subject to the provisions of the Holding Company Act.\textsuperscript{23} Thus, the basic test for the degree of voting control required to subject a person to regulation under the Holding Company Act is ten percent, with the right being vested in such person to prove to the Commission that his control is not such that he should be subject to the act; if his holding is less than ten percent, the burden is upon the Commission to prove that he should be subject to the act.\textsuperscript{24} It would therefore seem that in attempting to determine whether or not a given stockholder controls an issuer that, depending upon the facts of the case, if such stockholder owns as much as ten percent of the outstanding voting securities of such corporation, it might be advisable to make a detailed review of all of the facts and circumstances surrounding his ownership of the stock and his relationship with the management and board of directors of the corporation to determine whether he, in fact, does control the management and policies of such corporation. In this regard, it has been held under the Holding Company Act that the latent power of an individual to exert control over the business and affairs of a public utility constituted a "controlling influence" upon such public utility which is admittedly something less than control.\textsuperscript{25} It apparently has not been decided specifically whether the power to control under section 2(11) of the Securities Act would constitute control of a corporation if it could be conclusively proved that the power, although existing, had never been exercised. The question has been decided under the Holding Company Act, but under the facts of the case there under consideration the power to control had been exercised in the past and had been discontinued for a period of several years prior to the time that litigation was instituted.\textsuperscript{26} It also should be pointed out that the holding under the Holding Company Act was that the latent power to control constituted a "controlling influence" as distinguished from control itself.

Control under the Investment Company Act is substantially the same as the definition contained in Rule 405 under the Securities Act. However, the act contains a presumption of control by anyone who owns beneficially, either directly or through one or more controlled companies, more than twenty-five percent of the voting securities of a company.\textsuperscript{27} Thus, for purposes of the Investment

\textsuperscript{23} § 2(a)(7)(B) of the Holding Company Act.
\textsuperscript{24} § 2(a)(7)(B) of the Holding Company Act.
\textsuperscript{25} Public Serv. Corp. v. SEC, 129 F.2d 899 (3d Cir. 1942).
\textsuperscript{26} Id. at 902-03.
\textsuperscript{27} § 2(a)(9) of the Investment Company Act.
Company Act where the definition of control is the same or substantially the same as the definition contained in Rule 405 of the Securities Act, a presumption of control is established upon the ownership of twenty-five per cent of the voting securities of a company. It would seem that the analogy is more direct between the Securities Act and the Investment Company Act because of the similar nature of the definitions of control. It would also seem, however, that in both cases it should be remembered that the Holding Company Act and the Investment Company Act are based upon the regulation of the corporations which are affected with a public interest to the extent that regulation has been deemed advisable by Congress.

It is apparent that control of an issuer may be vested in a family group, a group held together by similar and related business interests, or a group who originally organized a corporation. For an enumeration of some points which the Commission has considered pertinent in determining whether or not an issuer was controlled by a group, the following quotations are of some assistance:

The Division contends that the six selling stockholders, by virtue of their participation in the organization and management of Columbia, stockholdings, affiliations, and including family, business and social relationships, were members of the group in control of Columbia . . . .

The various persons who participated in the organization of Columbia and in the conduct of its affairs were bound together by close business and social relationships. Hopper, Swartweter and Smith were friends and business associates of long-standing. Hopper was President and a Director of Buick-Youngstown Company and Buckeye-Pontiac Company, both of which he and his family controlled and both of which Swartweter and Smith were Directors. In addition Swartweter and Hopper, as has been stated, were also members of Aetna's Board of Directors, which included T. La Marr Jackson, a law partner of Smith. This law partnership served as counsel for Aetna, for Buick-Youngstown, for Columbia, and for Swartweter personally. We have already noted the friendship and business relationships that existed between Swartweter and both Joseph E. O'Connell and William L. Thompson.

The selling stockholders, either directly or through their representatives in the Columbia management, constituted a cohesive group which had organized Columbia and directed its affairs through their control of its Board of Directors and management.

The financial relationship between stockholders and the corporation has also been pointed out as one factor to be considered in determining whether or not an issuer is controlled by a given stock-

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29 Ibid.
holder or group of stockholders. Where a stockholder had from time to time advanced funds to the issuer as needed and had on occasion guaranteed the obligations of the corporation, the Commission has pointed out that this is a factor to be considered, although it is doubtful that this factor standing alone would be determinative. Since the management of the business and affairs of a corporation is vested in its board of directors, the relationship existing between the board of directors and the stockholder or stockholders should most certainly be considered in determining whether or not a given stockholder or group of stockholders controls a corporation. Also, a factor to be considered in determining whether control exists is whether a stockholder, regardless of the percentage of his stock ownership, can direct business to or from the issuer and in this manner exert control over the management of the business and affairs of the issuer.

In connection with the control of an issuer by a group of persons of the character enumerated above, an interesting problem is the extent to which a sale by an individual member of such group could be considered to be a sale of the stock of a corporation by a person in control of the issuer. The answer, of course, must depend upon whether or not such person standing alone is in fact in control of the issuer, and probably will turn upon the point of whether or not such stockholder has the power to cause the officers and directors of the issuer to execute a registration statement. In this connection, a United States District Court has said that "The defendants were in control because they possessed and exercised the power to direct the management and policies of Micro Moisture and particularly were in a position to obtain the required signatures of Micro Moisture and its officers and directors on a registration statement."

Therefore, whether or not an issuer is controlled by a given stockholder or group of stockholders depends upon the power of such stockholder or stockholders to direct or cause the direction of the management and policies of such issuer, and this is a fact question to be determined from a consideration of all of the factors enumerated above.

A very practical consideration in determining whether or not such a degree of control does in fact exist would be whether such stockholder or group of stockholders has the power not only to compel the required signatures of the officers and directors of the corporation upon a registration statement, but also whether they possess the power to cause the cooperation of the corporation in

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30 Ibid.
furnishing the detailed information necessary to enable a registration statement to be prepared. This could constitute a very real problem from the standpoint of the stockholder or stockholders.

2. Controlled by the Issuer

The reference in section 2(11) to persons controlled by the issuer obviously relates basically to a subsidiary of the issuer. Rule 405 contains a definition of subsidiary which reads: "A 'subsidiary' of a specified person is an affiliate controlled by such person directly, or indirectly through one or more intermediaries."

A majority-owned subsidiary is defined by Rule 405 as follows: "The term 'majority-owned subsidiary' means a subsidiary more than fifty per cent of whose outstanding securities representing the right, other than as affected by events of default, to vote for the election of directors, is owned by the subsidiary's parent and/or one or more of the parent's other majority-owned subsidiaries."

Without question, one coming within the definition of a majority-owned subsidiary of an issuer would be a person controlled by the issuer, and a sale of securities by such person to an underwriter with a view to distribution would require registration. It would also seem that if one falls within the definition of a "subsidiary" as defined in Rule 405, such person would be controlled by the issuer for the purposes of section 2(11). Since the definition of subsidiary is based upon whether such person is controlled by another, the same basic concepts set forth herein with respect to whether a person is controlled by the issuer for the purposes of Rule 405 would seem to be applicable in determining whether the issuer controls another person for the purposes of section 2(11). Once again, however, it might be helpful to point out the definitions of a subsidiary contained in the Holding Company Act and the Investment Company Act as indicating the degree of ownership which furnishes somewhat of a presumption that such subsidiaries are controlled by the holding company or the investment company under those acts.

The only definition of subsidiary contained in the Investment Company Act is the definition of a majority-owned subsidiary which is the same as the definition contained in the Securities Act.\(^2\) It is important to note, however, under section 2(9) of the Investment Company Act that:

\[...\]

\[^2\] § 2(23) of the Investment Company Act.
within the meaning of this title. Any such presumption may be rebutted by evidence, but except as hereinafter provided, shall continue until a determination to the contrary made by the Commission by order either on its own motion or on application by an interested person.

A subsidiary company of a holding company under the Holding Company Act is defined to be any company of which ten per cent or more of the outstanding voting securities are directly or indirectly owned, controlled, or held, with power to vote by a holding company, or by any person which the Commission determines after notice and opportunity for hearing to be subject to a controlling influence, directly or indirectly, by a holding company. It should be noted that the rule of thumb with respect to the degree of ownership and control in determining a company to be a subsidiary company is the same as the degree of ownership and control required of one company over a public utility for such company to be a holding company under such act. It has been held that the latent power to control, even though unexercised for a number of years, is sufficient to subject the subsidiary to regulation as a subsidiary company of a holding company. It would therefore seem that determination of control by the issuer is to be based upon all of the facts surrounding the relationship between the issuer and the natural person or other entity alleged to be controlled by the issuer, with the basic standards being the same as those discussed above with respect to control of the issuer.

3. Common Control With The Issuer

Inasmuch as persons under common control with the issuer are affiliates, within the meaning of most of the Securities Acts, it may be helpful to consider briefly the definition and treatment of affiliates under some of the securities acts. "An 'affiliate' of or person 'affiliated' with, a specified person, is a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, the person specified." The Investment Company Act defines an affiliated person as:

(A) Any person directly or indirectly owning, controlling, or holding with power to vote, 5 percentum or more of the outstanding voting securities of such other persons; (B) Any person 5 percentum or more of whose outstanding voting securities are directly or indirectly owned, controlled, or held with power to vote, by such other persons; (C) Any person directly or indirectly controlling, con-

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\[2\] $2(a)(8)$ of the Holding Company Act.

\[3\] Public Serv. Corp. v. SEC, 129 F.2d 899 (3d Cir. 1942).

\[4\] Rule 405.
trolled by, or under common control with, such other person; (D) any officer, director, partner, co-partner or employee of such other person.\textsuperscript{36}

The definition of an affiliate under the Holding Company Act is substantially the same.\textsuperscript{37} It should be remembered once again with respect to the Holding Company Act and the Investment Company Act that the definitions of affiliate or an affiliated person therein contained are inserted in some instances for regulatory purposes peculiar to such acts and, therefore, that the percentages and tests therein contained are probably not conclusive in any sense in determining persons under common control with the issuer for purposes of section 2(11) of the Securities Act. It does seem safe to assume, however, that the test of five per cent of outstanding voting securities specified in both the Holding Company Act and the Investment Company Act is significant, particularly when section 9(a)(2) of the Holding Company Act requires the consent of the Commission for a company to become an affiliate of more than one public utility. It would seem once again that the presence or absence of control based upon all of the facts and all of the relationships between the issuer, its stockholders, and the persons alleged to be under common control with the issuer, must be considered and that the same criteria discussed in this section would be applicable in the determination of control.

The determination of whether the seller is in control of, is controlled by, or is under common control with the issuer is a question of importance not only to the seller but also to the dealer who buys from a stockholder with a view to distribution. Most of the reported cases discussing control within the meaning of section 2(11) of the Securities Act have related to broker-dealer revocation proceedings under section 15 of the Exchange Act. These violations in each instance were found to be willful violations under the circumstances.\textsuperscript{38}

D. Distribution

Inasmuch as this Article is written from the standpoint of the controlling stockholder\textsuperscript{39} and since one concern of the controlling stock-
holder in a sale of securities is whether they are purchased with a view to or in connection with their distribution, it is important to consider what constitutes a distribution of securities, which is the factor of importance to the controlling person. The Commission has treated distribution within the meaning of section 2(11) as being more or less synonymous with public offering as used in section 4(1) of the Securities Act.\(^4\) The factors to be considered in determining what constitutes a public offering are set forth in an opinion of the general counsel of the Commission released in 1935 in which such factors as the following were stated: “1. The number of 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 offering.”\(^1\) The opinion points out that whether a public offering is involved and therefore, by analogy, whether a distribution within the meaning of section 2(11) is involved, is a question of fact to be determined from all of the circumstances surrounding any particular sale or offering and further points out that although the number of offerees is certainly of importance in determining whether or not a public offering is involved, consideration should also be given to the manner in which the offerees are selected. The relationship to the issuer may be considered important in determining the information which the prospective purchasers may have with respect to securities of the issuer. It is apparent that offerees selected at random from the general public would not have as accurate information concerning securities of the issuer as would a group made up of officers and employees of the issuer. The number of units offered by an issuer to the public is important in determining whether a public offering is involved, and the denominations in which the securities are delivered tend to indicate whether a public distribution might be contemplated. The opinion also indicates that the size of the offering may be of importance, as the larger the size of the offering, the greater is the likelihood that the securities will in turn be redistributed by the purchaser from the issuer.

The manner of offering the securities to the public should be considered since securities marketed through direct negotiations between the issuer and the purchaser are much less likely to be the subject of a public offering than where the issuer negotiates and markets the securities through brokers and dealers.\(^4^2\) It would seem that the various matters to be considered in connection with determining

\(^4^0\) See Loss, op. cit. supra note 17, at 346.
\(^4^2\) Ibid.
whether there is a public offering under section 4(1) would also be applicable in determining whether a distribution of securities had taken place or was contemplated in a purchase by a person from a controlling stockholder under section 2(11).

In connection with distribution, the Commission has said that:

"Distribution" is not defined in the Act. It has been held, however, to comprise "the entire process by which in the course of a public offering the block of securities is disbursed and ultimately comes to rest in the hands of the investing public." In this case, the stipulated facts show that Schulte, owning in excess of 50,000 shares, had formulated a plan to sell his stock over the Exchange in 200 share blocks "at 19 and every quarter up" and that the trust, holding 165,000 shares, specifically authorized the sale over the Exchange of said 73,000 shares "at Eighty Dollars per share or better." A total of 93,000 shares was in fact sold by a respondent for the account of the Schulte interests pursuant to these authorizations. We think these facts clearly fall within the above quoted definition and constitute a "distribution".... Nor do we think that a "distribution" loses its character as such merely because the extent of the offering may depend on certain conditions such as the market price. Indeed, in the usual case of an offering at a price, there is never any certainty that all or any specified part of the issue will be sold. And where part of an issue is outstanding, the extent of a new offering is almost always directly related to variations in the market price. Such offerings are not any less a "distribution" merely because their precise extent cannot be pre-determined.43

The Commission therefore found that there had been a distribution within the meaning of section 2(11), and inasmuch as control by the selling stockholders had been conceded, Ira Haupt & Company was an underwriter within the meaning of section 2(11).44

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 (6) months, will not exceed the following:

(1) If the security is traded only otherwise than on a securities exchange, approximately 1% of the shares or units of such security outstanding at the time of receipt by the broker of the order to execute such transaction, or

(2) If the security is admitted to trading on a securities exchange, the lesser of approximately (A) 1% of the shares or units of such security outstanding at the time of receipt by the broker of the order to execute such transactions, or (B) the largest aggregate reported volume of trading on securities exchanges during any one week within the four calendar weeks preceding the receipt of such order.

It would seem, therefore, where a broker who purchases from a controlling stockholder is within the exemption afforded by Rule 154 that no distribution is involved within the meaning of section 2(11) of the Securities Act even though the broker does in fact contemplate a distribution of the particular securities purchased by him.

From the above, it is apparent that registration is not required if a controlling stockholder can sell to a person who purchases for investment and not with a view to distribution. As evidence of the intent of the purchaser with respect to the securities being purchased, it has been the practice of controlling stockholders in the process of selling to procure a written representation from the purchaser as to the purpose for which he is acquiring such securities. Such representations have come to be commonly known as "investment letters." A recent development with respect to the right of a selling stockholder to rely upon an investment letter or a representation of a purchaser with respect to the securities being purchased arose with respect to Crowell-Collier Publishing Company. The matter there under consideration did not involve the disposition of holdings by a controlling stockholder. It concerned the disposition by an issuer of its shares in a transaction in which such issuer procured an investment letter from the purchaser with respect to convertible debentures which were being issued and which were immediately convertible into common stock. However, the language used in the release is pertinent to this discussion. In such release, the Commission said

Counsel, issuers and underwriters who rely on investment representations of the character obtained in these transactions as a basis for a claim to a non-public offering exemption under Section 4(1)
of the Securities Act do so at their peril. It is apparent that most of the persons giving the so-called "investment representation" in this case had no clear understanding as to what it meant. The representations apparently did not reveal the real intent of the persons giving them. The persons purporting to rely upon them did not know what the person giving the representation intended. Such bare representations that securities are being purchased for "investment," obscure in their meaning and unreliable as to the intention and purpose of a purchaser, are meaningless. An exemption under the provisions of Section 4(1) is available only when the transactions do not involve a public offering and it is not gained by the formality of obtaining "investment representations." Holding for the six months capital gains period of the tax statutes, holding in an "investment account" rather than a "trading account," holding for a deferred sale, holding for a market rise, holding for sale if the market does not rise, or holding for a year, does not afford a statutory basis for an exemption and therefore does not provide adequate basis upon which counsel may give opinions or businessmen rely in selling securities without registration.

Purchasing for the purpose of future sale is nonetheless purchasing for sale and, if the transactions involve any public offering, even at some future date, the registration provisions apply unless at the time of the public offering an exemption is available.46

It is thus apparent that a selling majority stockholder who relies upon an "investment representation" in connection with the sale of securities to establish the fact that such securities are not being bought with a view to distribution does so at his peril according to the view expressed by the Commission in this release. This seems to place an almost impossible burden upon a controlling stockholder who is actually negotiating a sale of securities in a private transaction in good faith. The purpose for which a purchaser is acquiring securities from a controlling stockholder is known only to the purchaser. It is true that if there are surrounding circumstances from which it is apparent that the purchaser does not in fact intend to acquire the securities for investment, the Commission's views would seem to be more realistic. However, much of the language contained in the release is such that it would be equally applicable to an investment representation or investment letter taken by a selling controlling stockholder from a purchaser in good faith and with no indication or knowledge that the purchaser intended to distribute the securities. Although the Crowell-Collier release concerns a distribution by an issuer as distinguished from a distribution by a controlling stockholder, it seems apparent that what the Commission has said with respect to the Crowell-Collier case would be equally ap-

46 Ibid.
pplicable to a sale by a controlling stockholder in determining whether the purchaser acquired with a view to a distribution. It is important to note in the Crowell-Collier case that although there were some circumstances which could be interpreted as evidence of the fact that certain of the purchasers did not intend to abide by their "investment representations," there seemed to be no evidence of the fact that Crowell-Collier had any knowledge that the securities were in fact to be distributed to the public by the purchasers. A controlling stockholder who intends to sell at private sale to a person who represents that he is buying for investment and without a view to distribution would seem to be in a position of being at the mercy of the person who purchases if such person does not in fact intend to acquire such securities for investment.

E. Exemptions of Section 3 of The Securities Act

1. Pre-1933 Offerings

Section 3(a) (1) of the Securities Act exempts "any security which, prior to or within sixty days after the enactment of . . . [the Securities Act] has been sold or disposed of by the issuer or bona fide offered to the public, but this exemption shall not apply to any new offering of any such security by an issuer or underwriter subsequent to such sixty days."

It has been claimed that this section of the Securities Act would exempt the secondary distribution of corporate securities by a controlling stockholder where such security was initially sold prior to 1933. In the Haupt case referred to above, it was claimed that this exemption was applicable. The Commission in that case ruled that the transaction in question was through an underwriter and that such transaction also involved a distribution or new offering of the securities, and that consequently the exemption of section 3(a) (1) of the Securities Act was not applicable. The exemption afforded by this section is qualified by its own terms, and it is expressly provided that such exemption shall not apply to any "new offering" of any such security by an issuer or underwriter subsequent to 1933. It is thus clear that a distribution or a "new offering" (which the Commission in the Haupt case deemed to be synonymous for all practical purposes) by a controlling stockholder through an underwriter is a transaction which is not covered by the exemption of section 3(a) (1) of the Securities Act.

This would seem to be in accordance with the intent of Congress in providing such exemption. In the House Committee Report it is
provided that the exemption does not apply to any redistribution of outstanding issues which would otherwise come within the scope of the Securities Act.\textsuperscript{47}

If there is no underwriting involved in such a distribution the transaction would be exempt under the provisions of section 4(1) of the act regardless of when the securities were originally issued, and under such circumstances, exemption of section 3(a)(1) is not an important factor.\textsuperscript{48}

2. Securities of Public Authorities and Banks

The exemption provided for in section 3(a)(2) of the Securities Act applies to securities issued or guaranteed by the United States, any state and other political subdivisions or public instrumentalities, and to securities issued or guaranteed by national banks or state banks, and certain other limited types of securities. The section by its terms exempts securities, rather than transactions, and if the security involved is of the type covered by this section, the exemption would be applicable regardless of whether a sale or distribution was made by the issuer or by a controlling stockholder.

3. Other Miscellaneous Exemptions

The provisions of sections 3(a)(3)-3(a)(8) exempt from the provisions of the Securities Act various types of securities defined in such section. The exemptions are not of particular interest to a controlling stockholder as such, but, in general, the exemptions apply to securities, again as opposed to transactions, and as such are available to a controlling stockholder as well as to the issuer thereof.

4. Voluntary Exchanges

Under the provisions of section 3(a)(9) of the Securities Act there is exempt from the act "any security exchanged by the issuer with its existing security holders exclusively where no commission or other remuneration is paid or given directly or indirectly for soliciting such exchange."

This exemption is very limited and by its terms applies only to a security exchanged by the issuer. As such, it is not available to a controlling stockholder seeking to sell or distribute any corporate securities.

This exemption is an example of what was pointed out above in that it actually applies to transactions rather than securities. In other


words, if a controlling stockholder receives securities of an issuer as a result of an exchange by the issuer in a transaction which is exempt under the provisions of section 3(a)(9), such transaction would be exempt, but the security acquired by the controlling stockholder is not actually an exempted security in that in the hands of the controlling stockholder it is just like any other corporate security. If such controlling stockholder wants to make a distribution of such security through an underwriter he must still comply with the other provisions of the Securities Act.

5. Other Exchanges

Section 3(a)(10) exempts certain securities which are issued in exchange for one or more other securities where such exchange has been approved after a hearing by any court, official or agency of the United States, or of any state or territorial banking or insurance or other governmental authority. The exemption is similar to the one just discussed in that it actually applies to a particular transaction. The type of transaction is not one in which a controlling stockholder would be involved and as such, the exemption is not available to a distribution of corporate securities by a controlling stockholder. The exemption actually applies to the transaction defined in such section, and in the hands of a controlling stockholder any securities received as a result of such exchange are not in fact “exempt securities.” Therefore, if the controlling stockholder wishes to make a distribution of such securities through an underwriter he must comply with the other provisions of the act.

6. The Intrastate Exemption

Section 3(a)(11) exempts from the provisions of the Securities Act “any security which is a part of an issue sold only to persons resident within a single State or Territory, where the issuer of such security is a person resident and doing business within, or, if a corporation, incorporated by and doing business within, such State or Territory.” The scope of this exemption is well explained in an opinion of the General Counsel of the Securities and Exchange Commission released in 1937. The particular problem with regard to this exemption is whether or not it is applicable to a distribution of corporate securities by a controlling stockholder where such stock is sold only to persons resident within a single state, and also, what the requirements are as to the residence of the controlling stockholder.

Insofar as corporate securities are concerned, it is clear that under the express terms of the section the issuing corporation must be incorporated by and doing business within the same state or territory in which the persons purchasing such stock are resident. By its terms, the exemption is not necessarily limited to a sale by the issuer, and should therefore be available to a sale or distribution by a controlling stockholder where there is compliance with the other provisions of the section.

The exemption does not contain any specific requirement as to the state of residence of the controlling stockholder, and there would seem to be no reason for imposing such a requirement. There do not seem to be any decisions on this particular point. However, Mr. Loss makes the following statement as to this matter:

What is the application of 3(a)(11) to secondary distributions by controlling persons? It used to be thought around the Commission that it could not apply at all unless the entire issue had been initially sold intrastate by the issuer, no matter how long previously. [Citing Throop and Lane, Some Problems of Exemption Under the Securities Act of 1933, 4 LAW & CONTEMP. PROB. 89-100 (1937)]. It seems more consonant with the legislative contemplation of local financing, however, to construe the exemption as applicable to secondary distributions, divorced in time and circumstances from the original issuance of the securities, if both the issuer and the controlling person, as well as all the offerees, are residents and the other conditions of the exemption are satisfied. This is understood to be the Commission's present position, and it would have been codified in the 1941 amendment program.\(^6\)

This reference by Mr. Loss to the secondary distribution being divorced in time and circumstance from the original issuance is a part of the requirement of the exemption to the effect that the important factor in determining residence of the persons purchasing the stock is the residence of the ultimate purchaser. The position of the Commission as stated by Mr. Loss seems to be a reasonable interpretation of the act except that it is difficult to see the justification for the requirement as to residence of the controlling stockholder. This is possibly another example of the extension of the scope and coverage of the act by the Commission.

7. Regulation A Exemption

Under the provisions of section 3(b) of the Securities Act the Commission is authorized to prescribe rules and regulations from time to time for adding any class of securities to the securities ex-

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\(^6\) Loss, op. cit. supra note 17, at 375-76 n.247.
empt by the provisions of section 3, provided that no issue of such securities shall be exempt when the aggregate amount at which such issues are offered to the public exceeds $300,000. Pursuant to this authority, the Commission has adopted several sets of rules and regulations relating to exemptions for specialized types of securities as well as a general exemptive provision. Primary concern here is only with the general exemptive provision which is incorporated in Regulation A.\textsuperscript{51}

The entire coverage of Regulation A is beyond the scope of this Article, but there are certain specialized features of the exemption afforded by Regulation A which are of particular concern to a controlling stockholder. The general scope of Regulation A is not so much to provide an exemption, but rather a simplified means of effecting a quasi-registration of securities where the total offering price to the general public during any one twelve month period does not exceed $300,000. Generally speaking, at least ten days before any offering is made under Regulation A there must be filed in the Regional Office of the Commission a notification to the effect that such offering is proposed to be made.\textsuperscript{52} In addition, there are other requirements for the filing and use of an offering circular\textsuperscript{53} and of sales material used in connection with such offering.\textsuperscript{54}

Rule 251 contains definitions of certain terms used in Regulation A, and in this rule, an “affiliate” of an issuer is defined as being a person controlling, controlled by, or under common control with such issuer, and an individual who controls an issuer is also an affiliate of such issuer. This is substantially the same definition of control as is contained in section 2 (11) of the Securities Act which has been discussed above.

Rule 254 is of special interest because Regulation A contains certain special restrictions on the amount of such securities which may be offered by an affiliate, who, in the situation here under consideration, is a controlling stockholder. Under this rule the maximum amount of securities which may be offered by an issuer and by all of its affiliates in any one twelve month period may not exceed $300,000. And with respect to affiliates, the rule contains the following provision:

\begin{quote}
Notwithstanding the foregoing, the aggregate offering price of all securities of such persons so offered or sold on behalf of any one
\end{quote}

\textsuperscript{51} SEC Reg. A, 16 C.F.R. § 162.11 (1949). This will hereinafter be cited as “Regulation A.”

\textsuperscript{52} Rule 255.

\textsuperscript{53} Rule 256.

\textsuperscript{54} Rule 258.
person other than the issuer or issuers of such securities shall not exceed $100,000, except that this limitation shall not apply if the securities are offered on behalf of the estate of a deceased person within two years after the death of such person.

Thus, if an issuer itself sells $300,000 worth of securities in a twelve-month period, the controlling stockholder, as an affiliate, may not make use of such exemption. If the issuer had issued only $150,000 worth of such securities an affiliate could have used the exemption afforded by Regulation A for the sale of an amount not to exceed $100,000 worth of securities of such issuer, with the exception for the special case of the sales by the estate of a deceased stockholder.

Likewise, if a controlling stockholder sells $100,000 worth of securities of an issuer pursuant to the exemption afforded by Regulation A, then during the twelve month period only $200,000 worth of securities of the issuer may be sold, and other affiliates may sell individually no more than a total of $100,000 worth of such securities.

Mr. Loss states that as a result of these limitations "there may be a race of diligence between the issuer and its affiliates or among different affiliates." It would seem that control would also imply that the controlling corporation would not engage in such a race with its controlling stockholder. This might confirm a suspicion that the Commission tends to find control where it does not actually exist or where it is not of a very firm nature. Likewise, where affiliates and an issuer are under common control it would seem that if such control actually exists that it would extend to matters such as this, and the races for diligence would not, as a practical matter, be a problem.

In the case of a filing of a notification with regard to a proposed sale of stock by a controlling stockholder, it is provided that the issuer must, in addition to signing the notification statement, submit a statement "representing that the proposed offering will not interfere with any needed financing by the issuer under this regulation." This requirement is certainly in keeping with the intent and purpose of Regulation A, which is to aid small businesses in raising new capital. However, if control actually exists there would seem to be no problem for a controlling stockholder to cause the issuer of the securities to make such a representation.

55 Loss, op. cit. supra note 17, at 167.
56 Regulation A, Form 1-A, Item 11.
F. Exemptions of Section 4 of The Securities Act

1. Section 4(1), First Clause

The first clause of section 4(1) of the Securities Act exempts "transactions by any person other than issuer, underwriter or dealer." This provision has already been discussed in connection with transactions by controlling stockholders. As has been noted the exemption applies to transactions, and since the controlling stockholder is not an issuer and is usually not a dealer or an underwriter, a transaction by the controlling stockholder is an exempt transaction. However, as has been previously noted, where the controlling stockholder makes a distribution of corporate securities through an underwriter the transaction is no longer exempt under the provisions of this section.

2. Section 4(1), Second Clause

The second clause of section 4(1) provides that the provisions of section 5 shall not apply to "transactions by an issuer not involving any public offering." The exemption by its terms applies only to transactions by an issuer, and consequently a transaction by a controlling stockholder would not be entitled to the benefit of this exemption. But it seems of little importance, however, since a sale of securities by a controlling stockholder is not subject to the provisions of section 5 of the Securities Act unless it involves a distribution through an underwriter which is, for all practical purposes, the same as a public offering. This has been fully discussed above in relation to the question of distribution.

3. Section 4(1), Third Clause

The third clause of section 4(1) exempts certain transactions by dealers.87 The only aspect of this exemption which is of present concern is whether or not it is available to a controlling stockholder

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87 The exemption is as follows:
The provisions of Section 5 shall not apply to any of the following transactions:
(1) . . . transactions by a dealer (including an underwriter no longer acting as an underwriter in respect of the security involved in such transaction), except transactions taking place prior to the expiration of forty days after the first date upon which the security was bona fide offered to the public by the issuer or by or through an underwriter and transactions in a security as to which a registration statement has been filed taking place prior to the expiration of forty days after the effective date of such registration statement or prior to the expiration date of forty days after the first date upon which the security was bona fide offered to the public by the issuer or by or through an underwriter after such effective date, whichever is later (excluding in the computation of such forty days any time during which a stop order issued under Section 8 is in effect as to the security), and except transactions as to securities constituting the whole or a part of an unsold allotment to or subscription by such dealer as a participant in the distribution of such securities by the issuer or by or through an underwriter.
wishing to make a disposition of securities of a corporation. In the Haupt case, supra, the matter was expressly raised and considered by the Commission, which found that where there was a new offering of stock to the public made through an underwriter, the exemption of the third clause of section 4(1) was not applicable. As a basis for this decision the Commission found that the controlling stockholder was making a distribution of his stock through an underwriter, and that the transaction constituted a new offering to the public. These factors were necessary to make the registration requirements of the Securities Act applicable. The decision was based upon the language in the statute which provides that the exemption is not available to transactions in a security within one year (since the Haupt case, the one year period has, by amendment, been reduced to forty days) after the first date upon which such security is "bona fide offered to the public . . . by or through an underwriter." This ruling would seem to be in general accord with the intent of the act. Where the elements of a new offering through the underwriter are not present, the sale of stock by a controlling stockholder would not be one that would require registration anyway, and, in such event, it would be a moot question as to whether or not the exemption would be applicable.8

4. Brokers’ Transactions and The Haupt Doctrine

It is provided in section 4(2) of the Securities Act that the provisions of section 5 do not apply to “Brokers' transactions, executed upon customers' orders on any exchange or in the open or counter market, but not the solicitation of such orders.” The apparent purpose of this provision is to exempt ordinary brokerage transactions and to provide a means by which individuals may dispose of their securities without restrictions even though a distribution of the securities by the issuer may have been halted.59

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8 The question of the applicability of the so-called dealers exemption of Section 4(1), Third Clause, to transactions involving secondary distributions by controlling stockholders may have been fairly well settled by the Haupt case, as in several subsequent cases arising out of similar fact situations this exemption does not seem to have been claimed to be applicable. See Beer & Co., SEC Exchange Act Release No. 5002 (Feb. 17, 1954); J. C. Flannery & Co., SEC Exchange Act Release No. 4459 (June 23, 1950); S. T. Jackson & Co., SEC Exchange Act Release No. 4459 (June 23, 1950); W. H. Bell & Co., SEC Exchange Act Release No. 4292 (Aug. 5, 1949).

59 This purpose was explained by the House Committee in H.R. Rep. No. 85, 73d Cong., 1st Sess. 16 (1933) as follows:

Paragraph (2) exempts the ordinary brokerage transaction. Individuals may thus dispose of their securities according to the method which is now customary without any restrictions imposed either upon the individual or the broker. This exemption also assures an open market for securities at all times, even though a stop order against further distribution of such securities may have been entered. Purchasers, provided they are not dealers, may thus in the event that a stop order has been
An obvious question under this exemption is whether or not it is applicable to secondary distributions through brokers by controlling stockholders and if so, to what extent. According to Mr. Loss, until 1946 the Securities and Exchange Commission took the following position:

The fact that a broker effects an isolated transaction for an affiliate [controlling stockholder] of the issuer does not make the broker an underwriter, even though he is selling for an “issuer” within the meaning of Section 2(11). Consequently, the broker’s part of the transaction is exempt under Section 4(2), and the affiliate’s part under the first clause of Section 4(1) because the affiliate is neither an issuer nor an underwriter nor a dealer. This assumes, however, that the broker does not exceed ordinary brokerage functions. If he does, he becomes an underwriter, with the result that his part of the transaction loses the 4(2) exemption and the affiliate’s part loses the 4(1) exemption. What constitutes ordinary brokerage functions is a question of fact. Presumably the delegation of unusual discretion as to the time and manner of executing the affiliate’s order, or the payment of more than the customary brokerage commission, would be fatal. And, although solicitation would normally seem to be part of the ordinary brokerage function, any solicitation which destroys the 4(2) exemption for the broker’s part of the transaction is also deemed to destroy the 4(1) exemption for the affiliate’s part of the transaction. The caveat was always added, however, that a broker engaged in distributing any substantial block of securities would probably be compelled to perform functions beyond those exercised by brokers.\(^6\)

In 1945 and 1956 the Commission permitted the sale under the Holding Company Act by the United Corporation of approximately 600,000 shares of common stock of a subsidiary, Columbia Gas & Electric Corporation. Control of the subsidiary was obvious, and since no registration statement was in effect it was apparent that the Commission assumed that the exemptions under section 4(1) and section 4(2) were available. During this period of time it was possible to sell large blocks of securities in the market without solicitation or any concentrated sales effort, and the Commission apparently thought that a re-study of the broker’s exemption was due.

In the \textit{Haupt} case, the Commission undertook such a review and by its decision in that case severely limited what had apparently been the scope of the broker’s exemption as applied in the \textit{United Corporation} case. In the \textit{Haupt} case, Ira Haupt & Company had sold a large block of shares of common stock of Park & Tilford, Incorpo-
rated, on behalf of a controlling stockholder. The sales took place over a period of several months on a rising market and allowed the controlling stockholder to dispose of a large portion of its stock at a substantial profit without having a registration statement in effect. In this case, the Commission expressly considered the availability of a broker's exemption to an underwriter who effects a distribution for the account of a controlling stockholder. The Commission pointed out that it was clear from reading section 4(1) of the Securities Act in conjunction with section 2(11) that distributions by controlling persons through underwriters were intended generally to be subject to the registration requirements of the act. The Commission examined the House committee report on these sections and pointed out that they raised a distinction between distribution activities and trading by individuals, and summarized the distinction by stating that "Section 4(2) permits individuals to sell their securities through a broker in an ordinary brokerage transaction, during the period of distribution or while a stop order is in effect, without regard to the registration and prospectus requirements of Section 5." But the process of distribution itself, however carried out, is subject to section 5.

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," and expressly overruled any conflicting interpretation of the exemption arising out of the United Corporation case. The Commission had previously found in the Haupt case that the broker was acting as an underwriter and that a distribution of the stock was being made, and consequently, in applying the rule set forth above, found that the exemption of section 4(2) was not available under the facts of the existing case.

The result in the Haupt case was met with considerable resistance by the brokerage fraternity, which claimed that its application was unduly harsh and would impose severe liabilities and penalties on innocent brokers. In an attempt to satisfy certain of the objections, the Commission adopted Rule 154, which attempted to define what would constitute broker's transactions under section 4(2) and to define the term "distribution" as applicable to such transactions.

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62 Ibid.
63 Rule 154 contains the following:
   Definition of Certain Terms Used in Section 4(2).
   (a) 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
The application of the rule is complex and is beyond the scope of this Article, but it is set forth in full in a footnote.

G. Civil and Criminal Liability and Injunctive Proceedings
Under the Securities Act

Section 11 of the Securities Act contains provisions for civil liabilities on account of untrue statements or omissions in registration statements. Section 12 contains other civil liabilities with regard to violations of section 5 of the Securities Act and with regard to the selling of securities by the use of a prospectus or oral communication containing untrue statements or certain material omissions. Section 15 provides that:

every person who, by or through stock ownership, agency, or otherwise, or who, pursuant to or in connection with an agreement or understanding with one or more other persons by or through stock ownership, agency, or otherwise, controls any person liable under section 11 or 12, shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled

controlling, controlled by, or under common control with, the issuer of the securities which are the subject of the transactions where —

1. the broker performs no more than the usual and customary broker’s function,
2. the broker does no more than execute an order or orders to sell as a broker and receives no more than the usual or customary broker’s commission, and the broker’s principal, to the knowledge of the broker, makes no payment in connection with the execution of such transactions to any other person,
3. neither the broker, nor to his knowledge his principal, solicits or arranges for the solicitation of orders to buy in anticipation of or in connection with such transactions, and
4. the broker is not aware of circumstances indicating that his principal is an underwriter in respect of the securities or that the transactions are part of a distribution of securities on behalf of his principal.

(b) For the purpose of paragraph (a) of this Rule, the term “distribution” shall not apply to transactions involving an amount not substantial in relation to the number 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 one percent of the shares or units of such security outstanding at the time of receipt by the broker of the order to execute such transactions or (2) if the security is admitted to trading on a securities exchange the lesser of approximately (A) one percent of the shares or units of such security outstanding at the time of receipt by the broker of the order to execute such transactions or (B) the largest aggregate reported volume of trading on securities exchanges during any one week within the four calendar weeks preceding the receipt of such order.

(c) The term “solicitation of such orders” in Section 4(2) of the Act shall be deemed to include the solicitation of an order to buy a security, but shall not be deemed to include the solicitation of an order to sell a security.

(d) Where within the previous 60 days a dealer has made a written bid for a security or a written solicitation of an offer to sell such security, the term “solicitation” in Section 4(2) shall not be deemed to include an inquiry regarding the dealer’s bid or solicitation.
person is liable, unless the controlling person had no knowledge of or reasonable ground to believe in the existence of the facts by reason of which the liability of the controlled person is alleged to exist.

This is clearly applicable to impose the civil liability provided under sections 11 and 12 upon the controlling stockholder. And such provisions are also applicable even if such controlling stockholder is not selling any of his own securities.

In addition, the fraud provisions of section 17 are by their terms applicable to "any person" and are thus just as applicable to an issuer making an original sale or distribution of its securities as to a stockholder, whether controlling or not, making a sale of such corporate security.

Similarly, the injunction provisions of section 20 authorize the enjoining of the violation of any provisions of the Securities Act or of any rule or regulation prescribed under the authority thereof and are also applicable to enjoin violations of the act or of rules and regulations prescribed under the authority thereof by "any person." All this is obviously sufficient to bring within the scope of the injunctive provisions those activities by a controlling stockholder that would constitute a violation of the Securities Act or of any rule or regulation prescribed under the authority of such act.

The criminal penalties imposed by section 24 of the Securities Act are applicable also to "any person who willfully violates any of the provisions of" the Securities Act or the rules and regulations promulgated by the Commission under the authority thereof, and as such are sufficiently broad to include the controlling stockholder. The second portion of section 24 imposes criminal penalties on "any person who willfully, in a registration statement filed under this title, makes any untrue statement of a material fact or omits to state any material fact required to be stated therein or necessary to make the statements therein not misleading." Since the controlling stockholder is not ordinarily a party to the registration statement, this portion of the section would not seem applicable to a controlling stockholder. The provisions of section 15 referred to above do not seem applicable to extend this criminal penalty to the controlling stockholder. If, however, there were a conspiracy between a controlling stockholder and officers of a controlled corporation to violate the Securities Act, it is possible that the criminal penalty could be imposed.

There are, of course, many problems of procedure, jurisdiction, venue, and the like arising out of both the criminal and civil liability provisions, but they are generally beyond the scope of
this Article. It is sufficient for present purposes to note that most, if not all, of the civil liability provisions of the Securities Act are applicable to a controlling stockholder and that the criminal liability provisions are applicable to the controlling stockholder in a very material sense.

H. Corporate Securities Other Than Stock

Although the management of a corporation with a large number of creditors might think otherwise, control of a corporation, at least for purposes of the Securities Act, is primarily manifested either directly or indirectly through the ownership of common stock. Throughout this Article, discussion has been concerned primarily with the problems arising when a controlling stockholder wishes to make a distribution of his stock in such corporation. The Securities Act is not limited to this situation; if a controlling stockholder owns other securities of the corporation which he controls, such as bonds, debentures, or preferred stock, then any disposition of such securities through an underwriter is subject to the same registration requirements as if common stock were being sold. Another way to state this is to say that the Securities Act is applicable to the disposition of corporate securities through an underwriter by a controlling stockholder even though the securities being distributed are not the same securities through which control is held. As was noticed above, certain of the registrations filed with the Commission by or for the account of persons other than the issuer have been for bonds and debentures and preferred stock.

A similar situation might arise if all of an issue of corporate securities such as a bond issue were acquired by a person who was not a stockholder of the corporation. Under such circumstances the purchaser of the securities would not control the corporation and presumably would be free to make a public distribution of such securities without filing a registration statement with the Securities and Exchange Commission. Such exemption would seem clearly applicable under the first clause of section 4(1). Of course, if such person acquired the securities with a view to making such distribution he would himself be an underwriter and the transaction would not be exempt. In similar situations it would thus be possible for similar issues of corporation securities, such as bonds, to be distributed to the general public by the initial purchaser of all of such issue with a registration not required where such person was not in control of the corporation, but with registration being re-

quired if such person also happened to be a controlling stockholder. Insofar as the interest of the public is concerned, there would seem to be no reason for the distinction. However, in an act of this type there has to be some stopping point, and this is apparently a situation in which the line of division is not entirely logical.

I. Acceleration of Effective Date of Registration Statement

Section 8(a) of the Securities Act provides that the effective date of the registration statement shall be the twentieth day after the filing thereof or such earlier date as the Commission may determine, having due regard to the adequacy of the information respecting the issuer theretofore available to the public, to the facility with which the nature of the securities to be registered, their relationship to the capital structure of the issuer, and the rights of the holders thereof can be understood, and to the public interest and the protection of investors. This section also provides that if any amendment to any statement is filed prior to the effective date of such statement, the registration statement shall be deemed to have been filed when such amendment was filed; except that an amendment filed with the consent of the Commission, prior to the effective date of the registration statement, or filed pursuant to an order of the Commission, shall be treated as a part of the registration statement.

It is a practice of the Commission to accelerate the effective date of a registration statement under proper circumstances, and, in fact, acceleration is probably the rule rather than the exception. Under present practices involving any distribution which involves the use of an underwriter, the price at which the securities are to be offered to the public is usually not determined until one or two days before the anticipated offering. Since this price must be made a part of the registration statement by the so-called “Price Amendment,” the filing of such amendment would have the effect of deferring the effectiveness of the registration statement for an additional twenty days. In practice, after the matters referred to in the Commission’s deficiency letter have been satisfied, the price amendment is usually filed in reliance upon the Commission’s informal agreement to grant acceleration.

Acceleration is not a right of a registrar but is granted by the Commission in its discretion. Thus, the right of acceleration, or conversely, the threat of its denial, is a powerful weapon in the hands of the Commission which does not hesitate to use it.
Rules 460 and 461 under the Securities Act pertain to acceleration. Rule 461 provides that requests for acceleration of the effective date of the registration statement must be made in writing by the registrar, the managing underwriters of the proposed issue, and the selling stockholders, if any. Thus, in the case of a distribution by controlling stockholders, it is necessary for the controlling stockholders to sign the written request for an acceleration of the effective date of the registration statement even though, as has been noted above, such selling stockholders are not required to sign the registration statement itself. Rule 460 contains certain general provisions regarding acceleration and states certain factors to be considered by the Commission in granting or denying a request for acceleration.

Since acceleration is usually just as important in the case of a registration on behalf of selling stockholders, the Commission has also used this sanction to enforce certain of its opinions in connection with such a type of registration.

On June 28, 1957, the Commission adopted a note to Rule 460 which further emphasized the factors which it will consider in determining whether or not to grant a request for acceleration. In this note the Commission set forth certain situations in which the Commission considered that the statutory standards of section 8(a) of the Securities Act may not be met and under which the Commission might refuse to accelerate the effective date of the registration statement. One of such provisions is where provision is made for indemnification by the registrant of a director, officer, or a controlling person of the registrant against liabilities arising under the act. Such indemnifications are discussed below insofar as they expressly relate to the present topic.

It is also provided in paragraph (c) of the note that acceleration might be refused under conditions “where the Commission is currently making an investigation of the issuer, a person controlling the issuer, or one of the underwriters of the securities to be offered, pursuant to any of the acts administered by the Commission.” This would seem to be a reasonable ground for denying a request for acceleration.

Before adopting this note the Commission published a draft of a proposed note which contained a paragraph indicating that the Commission would deny acceleration in the case of an offering by a selling stockholder who does not bear a fair share of the expenses

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of registration and sale. This provision was not included in the note as actually promulgated by the Commission. It is understood that at least to a certain extent this represents the Commission’s policy. To the extent that this is true, it seems to be an unwarranted abuse of the Commission’s discretion. So long as the registration statement discloses the fact that the issuer is paying a certain portion of the expenses, the registration requirements of full disclosure are met, and since a prospective purchaser of stock of the registrant would purchase with the knowledge that expenses were being paid by the issuer rather than the controlling stockholder, there would be no element of fraud or improper conduct as to the purchasing stockholders. To the extent that the payment of any portion of such costs by the issuer for the benefit of the controlling stockholder is improper as a matter of corporate law, the existing stockholders of the issuer would have an adequate remedy against the management of the corporation. Certain expenses incident to a registration even for the full benefit of a controlling stockholder are beneficial to the registrant, such as preparation of certain financial statements which might be a regular annual audit of the issuer. Similarly, an appraisal of certain of the properties of the registrant for use in the registration statement might also be of general benefit and value to the registrant. In such cases, it would be proper for the registrant and the controlling stockholder to share such expenses, and this, presumably, is not contrary to the Commission’s view. However, the Commission must still be satisfied as to the proper division of such cost. Additionally, where a registration statement is filed on behalf of both the issuer and the controlling stockholder, a division of expenses would clearly be in order, but here again the division of such cost is directly or indirectly subject to review and approval by the Commission.

J. Indemnification of Officers and Directors of Registrant

Although the general problem of indemnification of officers and directors of a registrant is beyond the scope of this Article, there are certain special problems that might arise in connection with the registration of stock to be sold by a controlling stockholder. As noted above, in a note to Rule 460 the Commission stated its opinion that with regard to acceleration of the effective date of the registration statement, the necessary standard may not be met where provision is made for indemnification by the registrant of a director, officer, or controlling person of the registrant against liabilities arising under the act. In such a situation, the Commission will generally
grant acceleration where there is a waiver of the benefits of such indemnification. Acceleration may also be granted if the registration statement contains a brief description of the indemnification with an agreement that if the Commission feels that the indemnification is opposed to the policy of the Securities Act and if a claim to this effect is asserted, the registrant will submit this question to an appropriate court to determine whether the indemnification is unenforceable, unless registrant's counsel determines that this question has been settled by controlling precedent.

The provisions of the note to Rule 460 are applicable by their terms only in the case of an indemnification by the registrant, as opposed to indemnification by a controlling stockholder. Where a registration statement is filed for the sole benefit of a controlling stockholder there would seem to be reasonable grounds for permitting the stockholder, if he is willing, to indemnify the officers and directors of the registrant from certain liabilities arising under the act. In fact, as noted above, it appears that the Commission's action with regard to indemnification is in all probability beyond the scope of its powers in any event. If a stockholder is really in control of a corporation it would seem that such control would enable the stockholder to cause the corporation to file a registration statement, and conversely, if the stockholder were not able to cause such a registration statement to be filed, with or without indemnification of the officers and directors of the corporation, it would seem that the element of control is missing. However, the concept of control is somewhat nebulous, and there are undoubtedly many stockholders who own a substantial amount of stock in particular corporations who have never actually put to test the full extent of their control. An exercise of control by the force of stockholder action might in many cases be extremely detrimental to the well being of the corporation, and indirectly to its stockholders, with the result that many stockholders who are uncertain of the full extent of their control of a corporation will suggest the filing of a registration statement and use methods of persuasion rather than dictatorial powers of control. This might be particularly true where there are one or more disinterested or independent directors on the corporation's board of directors. In these types of situations, it is quite possible where a registration statement is being filed for the sole benefit of a controlling stockholder that such stockholder will agree to indemnify the issuer and/or its officers and directors from certain lia-

67 See Rule 460 (Commissioner's Note).
bilities arising out of the Securities Act. The Commission has apparently given its approval to such an indemnification, at least to the extent of not making it a factor in determining whether or not it will grant a request for an acceleration of the effective date of the registration statement.

II. THE TEXAS ACT

A. Registration

1. Registration by Coordination

In the event that a controlling stockholder is contemplating a distribution under circumstances which require that the securities to be distributed be registered under the Securities Act, his problem with respect to registration in Texas is fairly simple. The procedure for registration by coordination in the State of Texas is contained in section 7C of the Texas Securities Act.

In addition to the information which must be furnished, the filing fee must be paid, and if the offering is being made by the issuer or by a dealer who is acting as the agent of the issuer in making the offering and if the issuer is not incorporated under the laws of the State of Texas or is not qualified to do business in the State of Texas, a consent to service of process must be filed appointing the Securities Commissioner as its agent for service of process in the State of Texas with respect to matters arising out of the Texas Act.

After all of the information and documents specified in section 7C(1) of the Texas Act have been furnished to the Commissioner, the registration statement under the Texas Act becomes effective at the same time that the registration statement filed with the Securities and Exchange Commission becomes effective if (1) the Commissioner has not entered an order denying registration of the securities, (2) the registration statement has been on file with the Commissioner for at least ten days, and (3) a statement of the maximum and minimum proposed offering prices and the maximum underwriting discounts and commissions has been on file with the Securities Commissioner for two full business days or shorter period as the Securities Commissioner permits and the offering is made within such limitations.

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69 Section 7C(1)h of the Texas Act provides for payment of $5.00 plus one tenth of one percent of the aggregate amount of securities to be issued in the state based upon the offering price to the public.

70 §§ 7C(1), 8 of the Texas Act.

71 § 7C(2) of the Texas Act.
The Securities Commissioner may deny registration if he finds:

that the registrant has not proven the proposed plan of business of the issuer to be fair, just and equitable, and also that any consideration paid, or to be paid, for such securities by promoters is fair, just and equitable when such consideration for such securities is less than the proposed offering price to be public, and that the securities which it proposes to issue and the methods to be used by it in issuing and disposing of the same will be such as will not work fraud upon the purchaser thereof.72

The registrant can procure advice from the Commissioner as to whether the conditions have been satisfied and whether an order denying registration is contemplated by advising the Commissioner of the date when the registration statement filed under the Securities Act is expected to become effective.73 Although the information to be furnished to the Commissioner in the registration by coordination procedure is fairly brief, the registrant must still meet the fair, just, and equitable standards required for registrations or permits under the Texas Act. This, at least in theory, imposes a burden in addition to registration under the Securities Act, since the Securities Act basically requires full disclosure rather than imposing a burden of proving that the proposed plan of business is fair, just, and equitable.

2. Registration by Notification

If a registrant is exempt from the registration provisions of the Securities Act and is concerned only with registration or qualification under the Texas Act, and if an exemption is not available under either section 5 or 6 of the Texas Act, a consideration of the type of security to be offered by the registrant becomes important in determining the procedure to be followed in the registration of the securities under the Texas Act. Section 7B(1) of the Texas Act sets out standards which an issuer must meet if its securities are subject to registration by notification.74

72 § 7C(2) of the Texas Act.
73 § 7C(2)c of the Texas Act.
74 These standards are as follows:

Securities may be registered by notification under this Subsection B that they are issued by an issuer which has been in continuous operation for not less than three (3) years and which has shown, during the period of not less than three (3) years next prior to the date of registration under this section, average annual net earnings after deducting all prior charges, including income taxes, except charges upon securities to be retired out of the proceeds of sale, as follows:

a. In the case of interest-bearing securities, not less than one and one-half times the annual interest charges on such securities and on all other outstanding interest-bearing securities of equal rank;

b. In the case of securities having a specified dividend rate, not less than one and
The controlling stockholder would be well advised to follow the registration by notification procedure if the issuer of the securities to be issued measures up to the standards imposed by section 7B(1). The information required to be furnished to the Commissioner is not nearly so great, and the registration automatically becomes effective five days after all information required has been furnished to the Commissioner unless the Commissioner enters an order requiring that the applicant who filed the registration statement cease and desist from selling securities until there is filed such information as may be necessary to establish in the opinion of the Commissioner that such securities are or were subject to registration by notification. Apparently, the finding of fair, just, and equitable with respect to the plan of business and the other matters required in the registration by coordination and registration by qualification procedure is not required under section 7B(2).

3. Qualification of Securities

The controlling stockholder who desires to distribute securities which do not meet the standards imposed by section 7B(1) of the Texas Act who is exempt under the Securities Act, and who does have an exemption available under either section 5 or 6 of the Texas Securities Act must obtain a permit from the Commissioner under the procedure prescribed by section 7A of the Texas Act. This section prescribes the information to be contained in the application, which is made in the form of a sworn statement and must be filed with the Commissioner as a prerequisite to the issuance of a permit. This statement is to be filed by "the issuer of such securities or a dealer registered under the provisions of this Act." It would seem, therefore, that the controlling stockholder would be forced to register as a dealer before he could file the information required. It is apparent that if the controlling stockholder possesses a sufficient degree of control over the issuer to cause the issuer to sign the application that the problem would be solved. The definition of issuer contained in sec-

\textsuperscript{a} one-half times the annual dividend requirements on such securities and on all outstanding securities of equal rank;
\textsuperscript{c} In the case of securities wherein no dividend rate is specified, not less than 5% on all outstanding securities of equal rank, together with the amount of such securities then offered for sale, based upon the maximum price at which such securities are to be offered for sale. The ownership by an issuer of more than 50% of the outstanding voting stock of a corporation shall be construed as the proportionate ownership of such corporation and shall permit the inclusion of the earnings of such corporation applicable to the payment of dividends upon the stock so owned and the earnings of the issuer of the securities being registered by notification.

\textsuperscript{7b} § 7B(2) (c) of the Texas Act.
tion 4G of the Texas Act should be pointed out. That section reads as follows: “‘Issuer’ shall mean and include every company or person who proposes to issue, has issued, or shall hereafter issue any security.” There seems to be no authority in Texas which tends to clarify under what circumstances a person might be held to have “issued” securities. It is possible that a controlling stockholder could be construed to be an issuer under section 4G; however, it seems that if such construction is intended, the section should be expressly amended to include a controlling person by definition.

Upon the filing of an application under section 7A for the qualification of securities, the Commissioner is directed to issue a permit to the applicant authorizing it to sell and dispose of the securities covered by such application if the Commissioner finds:

That the proposed plan of business of the applicant appears to be fair, just and equitable, and also that any consideration paid, or to be paid, for such securities by promoters is fair, just and equitable when such consideration for such securities is less than the proposed offering price to the public, and that the securities which it proposes to issue and the methods to be used by it in issuing and disposing of the same are not such as will work a fraud upon the purchaser thereof."

Section 10 of the Texas Securities Act requires affirmative action on the part of the Commissioner, and the Texas Act does not prescribe any time limit within which the Commissioner must issue a permit or refuse to issue the same. An applicant, therefore, is dependent entirely upon the diligence of the Commissioner in proceeding with the sale of its securities, which is a point to be remembered in connection with the planning of a timetable for the marketing of a security in Texas when a permit must be obtained under the procedure set forth in section 7A.

B. Exempt Securities Under the Texas Act

The first clause of section 6 of the Texas Act reads as follows: “Except as hereinafter in this Act expressly provided, the provisions of this Act shall not apply to any of the following securities when offered for sale, or sold, or dealt in by a registered dealer or salesman of a registered dealer.” Therefore, if a controlling stockholder desires to sell and dispose of securities which are of the kind and character specified in section 6 and if he is willing to register as a dealer under the Texas Act, he is free to dispose of such securities without registration or qualification. The attention of the reader is directed to section 6 for a detailed consideration of the specific classes of

78 § 10A of the Texas Act.
SECONDARY DISTRIBUTION OF SECURITIES

securities covered. It shall be pointed out, however, that one of the more important subsections exempts securities which at the time of sale have been listed upon the New York Stock Exchange, the American Stock Exchange, the Midwest Stock Exchange, or the Boston Stock Exchange. Listing upon other stock exchanges meeting certain standards prescribed in the act will also exempt other securities."

C. Exempt Transactions

The first clause of section 5 of the Securities Act of the State of Texas reads as follows:

Except as hereinafter in this Act specifically provided, the provisions of this Act shall not apply to the sale of any security when made in any of the following transactions and under any of the following conditions, and the company or a person engaged therein shall not be deemed a dealer within the meaning of this Act; that is to say, the provisions of this Act shall not apply to any sale, offer for sale, solicitation, subscription, dealing in or delivery of any security under any of the following transactions or conditions. . . .

Section 5C(1) reads as follows:

Sales of securities made by or in behalf of a vendor, whether by dealer or other agent, in the ordinary course of bona fide personal investment of the personal holdings of such vendor, or change in such investment if such vendor is not engaged in the business of selling securities, and the sale or sales are isolated transactions not made in the course of repeated or successive transactions of a like character; provided, that in no event shall such sales or offerings be exempt from the provisions of this act when made or intended by the vendor or his agent, for the benefit, either directly or indirectly, of any company or corporation except the individual vendor (other than a usual commission to said agent), and provided further, that any person acting as agent for said vendor shall be registered pursuant to this act.

Based upon the above-quoted provisions, it would seem that the sale by a controlling stockholder is exempt under subsection C(1) of the Texas Act provided that the stockholder is not engaged in the business of selling securities and the holdings of the stockholder are not sold in successive transactions. The exemption is destroyed if the vendor acts as the agent of the corporation in selling the securities.

The controlling stockholder can also sell and dispose of his holdings to any bank, trust company, loan and brokerage corporation, building and loan association, insurance company, surety or guaranty company, savings institution, or to any registered dealer, provided

77 § 6F of the Texas Act.
that such dealer is actually engaged in buying and selling securities."

Subsection O of section 5 of the Texas Act reads as follows:

The sale by a registered dealer of securities which have theretofore been issued to the public in this or in any other state by an entity domiciled in the United States and which securities then form no part of an unsold allotment to or subscription by such dealer as a participant in the distribution of such securities by the issuer thereof or by or through an underwriter thereof when such securities are offered for sale, in good faith, at prices reasonably related to current market price of such securities at the time of such sale; provided that:

(1) No part of the proceeds of such sale are intended to inure, either directly or indirectly, for the benefit of the issuer of such securities; and

(2) Such sale is neither directly nor indirectly for the purpose of promoting any scheme or enterprise having the effect of violating or evading any of the provisions of this Act; and

(3) The right to sell or re-sell such securities has not been enjoined by any court of competent jurisdiction in this state by proceedings instituted by an officer or agency of this state charged with enforcement of this act; and

(4) The right to sell such securities has not been revoked or suspended by the Commissioner under any other provisions of this Act, or, if so, such revocation or suspension is not in force and effect; and

(5) At the time of such sale, information as to the issuer of such securities shall appear in either Moody's, Standard & Poor's, or Fitch, or in a nationally distributed manual of securities approved for use hereunder by the Commissioner; or the information is furnished in writing to the Commissioner in form and extent acceptable to the Commissioner; such information either in the manual, or other form, shall include at least a statement of the issuer's principal business, a statement of the assets and liabilities of such issuer as of a date not more than eighteen (18) months prior to the date of such sale, and a net income and dividend record of such issuer for a period of not less than three (3) complete fiscal years ended not more than eighteen (18) months next prior to the date of such sale or for the period that the issuer has actually been engaged in business if the issuer has been in business for less than three (3) years; and

(6) At the time of such sale, the issuer of such securities shall be a going concern actually engaged in business and shall then be neither in an organization stage nor in receivership or bankruptcy.

It would seem that a controlling stockholder, if a registered dealer, could avail himself of the provisions of this subsection which would enable him to sell and dispose of a fairly large class of securities under authority of such subsection.

§ 5H of the Texas Act.
The Commissioner has the authority to suspend the exemption contained in subsection O of section 5 if it appears that the plan of business of the issuer of such security, the security or the sale thereof, would tend to work a fraud or deceit upon the purchasers thereof. This exemption is not, therefore, absolute, but it is available subject to the Commissioner's suspension power.

III. Conclusions

From the foregoing it is possible to draw a very simple conclusion. If it is necessary for the states and for the federal government to regulate the distribution of securities by the issuer thereof, it is certainly necessary to regulate the public distribution of such securities by controlling stockholders. As to the desirability of regulation, it is certainly within the duty and province of the various states to undertake such regulation, and it must be admitted that there was some need for regulation of securities on the national level. As to the application of the statutes enacted by the federal and state governments, it is apparent that insofar as the federal statutes are concerned, the application to controlling stockholders is consistent with the application to issuers. Insofar as the Texas Act is concerned there is insufficient judicial or administrative experience to formulate a positive opinion, but it can be presumed that the act will be equitably administered and fairly applied.