Denver Law Review

Volume 34 | Issue 3 Article 4

January 1957

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Recommended Citation
Leland E. Modesitt, Secondary Distributions of Securities, 34 Dicta 156 (1957).

SECONDARY DISTRIBUTIONS OF SECURITIES

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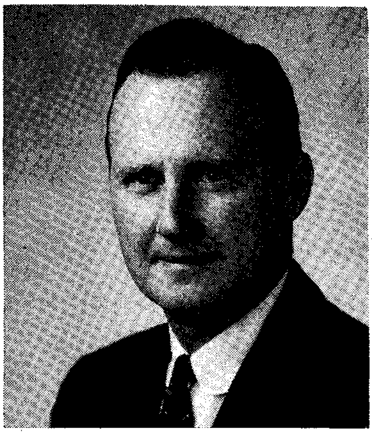

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The emphasis which has been placed upon the qualification of public offerings of securities by issuing corporations, known as primary distributions, has tended to obscure the problems which arise after the completion of such offerings. A large part of what has been said and written to explain the "latent ambiguities" of federal and state securities laws deals with the obligations of an issuer in quest of public financing. The insider in quest of public financing stays backstage, well beyond the footlights where he may, if he is so inclined, unobtrusively change the scenery.

Generally speaking, a secondary distribution is a distribution by persons other than the issuer of securities. A distribution, as the name implies, involves indiscriminate sales of a substantial amount of securities and not a few sporadic, restricted transactions. Thus, offerings by large stockbrokers such as promoters, officers, directors, trusts and insurance companies usually constitute secondary distributions.

It is a common practice to issue substantial amounts of stock to promoters in exchange for properties and services, prior to the solicitation of the public for required corporate financing. When the primary offering is made by the corporation the prospectus or offering circular discloses the nature of the properties and business and how much promotional stock there is in relation to the shares sold for cash. Hence, the buyer is in a position to consider how much "water" there is, and whether the issue is relatively attractive at the stated offering price.

The promoters, officers and directors generally hold their shares until the corporation's public financing has been completed. At least they are fairly discreet about any sales made during this period. Although this is required by law where the primary offering has been made pursuant to Regulation A,[1] there is a sound

[1] 17 C. F. R. § 230. 251-62 (Supp. 1957).

business reason in that concurrent sales by insiders would undermine the primary distribution of the issuer. After the primary offering has been completed and a market for the shares so distributed has been established, most insiders can never be completely indifferent to the market situation. The amount, and the time when they sell varies according to individual conceptions of legal restrictions, the inherent value and growth potential of the shares, the desire for immediate cash funds and various other factors, but sooner or later these promotional shares reach the market.

The provisions of the Securities Act of 1933[2] with respect to the sale of securities by an issuing corporation are reasonably explicit; but, considering that some control of sales by affiliates is equally in the public interest, the statutory provisions applicable to such transactions are remarkably devious. These provisions are:

> Sec. 4. [Exempted Transactions] (1) "Transactions by any person other than an issuer, underwriter, or dealer; transactions by an issuer not involving any public offering; or 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 first effective date of such registration statement or 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 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 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 the underwriter."

[2] 48 Stat. 74, 15 U. S. C. § § 77 (a) to (aa) (1952).

(2) "Brokers' transactions, executed upon customers' orders on any exchange or in the open or counter market, but not the solicitation of such orders."

. . .

Sec. 2 (4) "The term 'issuer' means every person who issues or proposes to issue any security; except that with respect to certificates of deposit, voting-trust certificates, or collateral-trust certificates, or with respect to certificates of interest or shares in an unincorporated investment trust not having a board of directors (or persons performing similar functions) or of the fixed, restricted management, or unit type, the term 'issuer' means the person or persons performing the acts and assuming the duties of depositor or manager pursuant to the provisions of the trust or other agreement or instrument under which such securities are issued; except that in the case of an unincorporated association which provides by its articles for limited liability of any or all of its members, or in the case of a trust, committee, or other legal entity, the trustees or members thereof shall not be individually liable as issuers of any security issued by the association, trust, committee, or other legal entity; except that with respect to equipment-trust certificates or like securities, the term 'issuer' means the person by whom the equipment or property is or is to be used and except that with respect to fractional undivided interests in oil, gas, or other mineral rights, the term 'issuer' means the owner of any such right or of any interest in such right (whether whole or fractional) who creates fractional interests therein for the purpose of public offering."

. . .

Sec. 2 (11) "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 by the issuer, or any person under direct or indirect common control with the issuer.*"[3]

[3] *Ibid.* Emphasis supplied.

As in the case of many problems arising under this federal law, it is impossible to weave the statutory provisions into a categorical rule governing all sales by insiders. A number of factors remain undefined. What constitutes "distribution," "direct or indirect participation" or "direct or indirect common control" under section 2 (11)? Does section 4 (2) mean what it says, and if so, what constitutes an unsolicited order?

In the Matter of Thompson Ross Securities Co.,[4] it was held that the president of a corporation who owned 18% of the outstanding stock and who had managed and formulated policies for the corporation for over ten years was a controlling person, and a dealer purchasing from him was held to be an underwriter under section 2 (11). In discussing the question of control the Commission stated:

> "The question of 'control' is a factual question. 'Control' is not synonymous with ownership of 51% of the vot-

[4] 6 S. E. C. 1111 (1940).

ing stock of a corporation. Where power exists to direct the management and policies of a corporation, 'control' within the meaning of Sec. 2 (11) exists even though the persons who possess that power do not own a majority of the corporation's voting stock."[5]

Possibly the most controversial case involving a number of the problems of secondary distributions was *In the Matter of Ira Haupt and Co.*[6] From December 15, 1943 to June 1, 1944 Ira Haupt and Co., a New York Stock Exchange firm, sold approximately 93,000 shares of the common stock of Park and Tilford Inc., on behalf of the Schulte interests, who together owned some 91% of the outstanding stock. On December 15, 1943, when the market price of the stock was about $57, Schulte publicly announced that Park and Tilford, Inc., was considering a distribution of whiskey to its shareholders at cost. Following the announcement the price steadily advanced to a high of 98¼ on May 26, 1944. On that day Park and Tilford, Inc., offered to sell to its stockholders at a reduced price six cases of whiskey for each share of stock. On May 31, 1944, the Office of Price Administration limited the negotiability of the purchase rights and the maximum profits on resale of the liquor. The price of the stock dropped 10⅛ points that day and reached a low of 30⅝ in June. During this period the Haupt firm transacted all sales for Schulte over the New York Stock Exchange. The sell orders commenced with 200 or 300 share blocks but within three months the firm was authorized to sell up to 50,000 shares at 80 or better. It was stipulated that during the period of five and a half months when the 93,000 shares were sold, approximately 89,000 had been sold without any solicitation.

In an administrative proceeding against the Haupt firm it was argued that the transactions were exempt as broker's transactions under section 4 (2). One of the principal contentions of Haupt was that a precise number of shares to be publicly dispersed is an essential element of a distribution.

The Commission had no trouble tying the Haupt firm into the violation. It stated: "Nor do we think that a distribution loses its character as such merely because the extent of the offering may depend upon certain conditions such as market price."[7] The Com-

[5] *Id.* at 1119. See also S. E. C. v. Kaye Real & Co., 122 F. Supp. 639 (S. D. N. Y. 1954).
[6] 23 S. E. C. 589 (1946).

mission also rejected the firm's claim that it was not aware of the distribution intended by the Schulte interests. The Commission pointed out that only 7,000 shares of the stock had been traded on the exchange in the entire month of November; that 24,500 shares had been traded in the first two days following the announcement of the impending whiskey dividend; and that an additional 115,000 shares had been traded during the rest of that month. Under all the circumstances the Commission found that the only reasonable conclusion that could have been reached was that it was intended that a large block would be sold.

Haupt also contended that substantially all sales were unsolicited transactions within the section 4 (2) exemption, but the Commission stated:

> "We conclude that Section 4 (2) cannot exempt transactions by an underwriter executed over the Exchange in connection with a distribution for a controlling stockholder. Respondent has suggested that this conclusion is contrary to administrative interpretations issued by our staff and to the implications in recent orders issued in connection with applications of *The United Corporation* under the Public Utility Holding Company Act with respect to United's sale of common stock of a subsidiary through brokers on the New York Stock Exchange. The administrative interpretations referred to were to the general effect that an underwriter selling for a controlling stockholder over the ex-

[7] *Id* at 600.

> change might conceivably be entitled to the exemption under Section 4 (2) if his activities were confined strictly to the usual brokerage functions, but that, as a practical matter, his activities could not be so confined in connection with a distribution of any substantial block of securities. These interpretations arrived at the same ultimate result as that which we have reached here. But the theory and the qualification of the interpretation—which we agree are inconsistent with our conclusion herein—were developed against the background of a very different market than is now prevalent. It has been only comparatively recently that the problem has been presented in the context of a market in which large blocks can frequently be sold without solicitations or other sales activity. In that context, the invalidity of the theory on which the interpretations were based has become apparent. We have reached our present conclusion on this phase of the case after careful consideration of the entire problem and, to the extent that the administrative interpretations referred to and the principle involved in the *United* case may be inconsistent with that conclusion, they must be overruled."[8]

The United Corporation was a public utility holding company order to divest itself of the stock of operating subsidiaries under the Holding Company Act. Between December, 1945 and May, 1946, it sold on the New York Stock Exchange 600,000 shares of common stock of its subsidiary, Columbia Gas & Electric Company. An exemption under section 4 (1) & (2) was assumed from the Commission's silence, because there was clear control and no registration statement.

The above quoted excerpt from the *Haupt* case served to support the view of the securities industry that the Commission's inaction on the United Corporation offering, which was a secondary distribution if there ever was one, was consistent with the policy it had theretofore followed to the effect that unsolicited trans-

[8] *Id.* at 607. The proceeding against Haupt was based upon § 15 (b) of the Exchange Act of 1934, which provides for the revocation of the registration of a broker dealer for a willful violation of the 1933 act and the regulations and rules thereunder as well as for other reasons. The Commission found that there had been a willful violation of the 1933 act but withheld revocation of the license because the Commission had reversed its previous position on the § 4 (2) exemption. The Nat'l Ass'n of Security Dealers followed this up with a twenty day suspension.

actions for an affiliate of the issuer did not make the broker an underwriter notwithstanding that he was selling for an issuer within the meaning of section 2 (11). Thus, under this policy the broker's part of the transaction was exempt under section 4 (2) and the affiliate's part of the transaction was exempt under section 4 (1) because the affiliate was not an issuer, underwriter or dealer.

The Commission's remarks about the *United* case were unfortunate. It is rather difficult to accept the explanation that the administrative interpretations (which apparently prevailed as late as 1946 in favor of United Corporation) "were developed against the background of a very different market" from that which existed at the time of the *Haupt* case, considering that the *Haupt* sales occurred almost two years prior to the *United* sales. In several cases prior to *Haupt* it was clearly stated that dealers purchasing from controlling stockholders with a view to distribution, as well as persons selling for such stockholders in connection with the distribution, are "underwriters."[9]

The *Haupt* case was consistent with established precedent. The *United* case was no part of such precedent. It was an exception. Perhaps the exigency of divestment under the Holding Company Act of 1935[10] justified the exception, but the Commission in the *Haupt* case, rather than climbing back over this thorny limb simply sawed it off.

In any event the *Haupt* case clearly pointed up the precarious position of a selling affiliate and his broker. Where would the line be drawn between the egregious transactions of the Schulte interests and the case of Assistant Secretary Joe Pumpernickel, who has waited three years to sell a few shares of Uncompagre Oil, Inc.?

In 1951 the Commission promulgated Rule 154 which provides:
"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 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,

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[9] In the Matter of Resources Corp. Internat'l, 7 S. E. C. 689 (1940); In the Matter of Thompson Ross Securities Co., 6 S. E. C. 1111 (1940); In the Matter of Sweets Steel Co., 4 S. E. C. 589 (1939); SEC v. Saphier, 1 S. E. C. Jud. Dec. 291 (1936).

[10] 49 Stat. 838, 15 U. S. C. §§ 79 (a)-(z) (6) (1952).

(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 per cent 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 exchange 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."[11]

As a practical matter, this rule afforded very little relief. It codified the conclusions reached in the *Haupt* case, including certain subjective tests, such as the broker's knowledge of his principal's activities, and provided a laborious formula for determining what transaction shall be deemed not to constitute a "distribution" by a selling stockholder.

[11] 17 C. F. R. 230.154 (Supp. 1957).

The availability of the section 4 (2) exemption remains a complex question of fact with respect to which the broker and the selling stockholder must act as their judgment dictates. Now that the Regulation *A* exemption is not available for secondary offerings by stockholders of newly organized corporations the restraint of conscience may well diminish.

In practice insiders generally observe a minimum holding period of one year to establish the requisite initial intention of purchasing from an issuer for investment and not with a view to distribution. Such intention is not established *ipso facto*, but by that time many corroborative circumstances can be established. The holder of investment stock by reason of promotional services rendered may divorce himself from management, or may sell in small blocks to meet unanticipated financial reversals. The business and purposes of the issuer may change drastically. There may be a merger which disrupts the original corporate plans and dilutes the control attributable to ownership of equity securities.

Selling unregistered securities allegedly taken for investment, even where the seller is not in common control of the issuer, is not without some risk to both principal and dealer,[12] but experience indicates that the risk is largely theoretical. Assuming there is no

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[12] The General Counsel of the Commission received an inquiry whether a dealer might resell to the public, without registration, a block of securities bought from an initial purchaser who had acquired the securities in connection with a "private offering." Part of his reply, with respect to the matters above discussed, reads: "I call your attention to my opinion set out in the next to the last paragarph of Release No. 285, which states in substance that the answer to your question depends upon whether the initial purchaser acquired the securities with a view to distribution, and further points out that if his acquisiton was wth such intent, he would be an underwriter, so that in general sales by dealers of securities bought from him would not be exempt from registration.

"You will appreciate that the intent of the initial purchaser at the time of the acquisition is a question of fact upon which I can express no opinion.

"I wish to make clear, however, that I do not believe the fact that the initial purchaser has stated that his original purchase was for investment and not for resale is necessarily conclusive on this question. In my opinion there should be considered such other factors as: (1) the relation between the issuer and the initial purchaser; (2) the business of the latter, as for example, whether such purchaser is an underwriter or dealer in securities, and, if not, whether the purchase of such a block of securities for investment is consistent with its genearl operations; and (3) the length of time elapsing between the acquisition of the securities by the initial purchaser and the date of their proposed resale.

"Of course, if the securities in question were in fact purchased by the initial purchaser for investment rather than for resale, dealers' sales thereof to the public would not necessitate registration under the Securities Act.

"In conclusion, I feel that I should point out that even though a dealer is satisfied that a particular block of unregistered securities was bought by an initial purchaser for investment, he nevertheless takes the risk that, if his determination is incorrect sales by him of such securities will be in violation of the registration requirements of the Act."—Op. of Gen'l Counsel, SEC Release No. 603 (Class C), 11 Fed. Reg. 10955 (1935).

fraud (fraud being difficult to prove in the absence of flagrant market manipulations) the Commission may do no more than investigate and enjoin the selling stockholder, and in the case of a broker or dealer it may take disciplinary action under section 15 (b) of the Exchange Act,[13] if it can prove a *willful* violation.[14] The purchaser can invoke the civil liability provided by section 12 (1) of the Securities Act, but usually, in relation to the amount involved, the time and expense incurred in such proceedings are substantial, not to mention the problems of discovery encountered in an action based upon a secondary distribution.

The rash of mergers and consolidations in recent years, particularly in the case of promotional companies has not been without Securities Act ramifications. Mergers are carried out under the "no sale theory" pursuant to Rule 133 which provides:

> "For purposes only of Section 5 of the Act, no 'sale,' 'offer to sell,' or 'offer for sale' shall be deemed to be involved so far as the stockholders of a corporation are concerned where, pursuant to statutory provisions in the state of incorporation or provisions contained in the certificate of incorporation, there is submitted to the vote of such stockholders a plan or agreement for a statutory merger or consolidation or reclassification of securities, or a proposal for the transfer of assets of such corporation to another person in consideration of the issuance of the securities of such other person, under such circumstances that the vote of a required favorable majority (1) will operate to authorize the proposed transaction so far as concerns the corporation whose stockholders are voting (except for the taking of action by the directors of the corporation involved and for compliance with such statutory provisions as the filing of the plan or agreement with the appropriate state authority), and (2) will bind all stockholders of such corporation except to the extent that dissenting stockholders may be entitled, under statutory provisions or provisions contained in the certificate of incorporation, to receive the appraised or fair value of their holdings."[15]

This rule is not to be confused with section 3 (9) of the Securities Act which exempts from registration any security exchanged by the issuer with its existing security holders exclusively where no commission or other remuneration is paid for soliciting such exchange. Hence the statutory provision is limited to situations where the securities surrendered and those taken in exchange are both issued by the same corporation.

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[13] 49 Stat. 1380 (1934), 15 U. S. C. § 78 (1952).

[14] *In the Matter of Thompson Ross Securities Co.*, 6 S. E. C. 1111 (1940), the Commission found a dealer had willfully violated §§ 5 (a) & 17 (a) (2) of the Securities Act in effecting sales by use of a prospectus which stated that the stock was being sold at the market and which failed to state that 60% of the outstanding stock was restricted from transfer, which operated as a restraint upon market action. In the circumstances, the dealer's reliance upon advice of counsel was held to be no defense to the charge of "willfull" violation.

[15] 17 C. F. R. 230.133 (1957 Supp.). On October 2, 1956 the Commission announced a proposed revision of Rule 133. (Securities Act Release No. 3698). In effect it would rescind the existing Rule 133 and substitute therefor a rule which would define an "offer" to include the solicitation of a vote, consent of authorization of stockholders of a corporation in favor of such mergers, consolidations, reclassifications of securities and transfers of assets. Under the revised rule a "sale" would be deemed to occur when the approval of stockholders to such corporate action occurs.

An implicit condition of Rule 133 is a bona fide corporate purpose. It was not intended merely as a device for affecting an unregistered secondary distribution, notwithstanding the more than occasional efforts to so use it. In *SEC v. Micro Moisture Controls, Inc.*,[16] it was held that section 4 (1) and Rule 133 of the Securities Act of 1933 were inapplicable to an exchange of stock of one corporation for assets of another corporation where the acquiring corporation was controlled by stockholders of the acquired corporation and the exchange was merely a step toward the public sale of stock issued in exchange. The court found that the persons who were selling the stock controlled the issuer, since they had the power to direct its policies and to obtain the required signatures on a registration statement.

Also, contrary to a rather popular misconception, securities issued pursuant to a Rule 133 transaction do not automatically acquire an exempt status. In the jargon of the brokerage fraternity this misconception is referred to as "freeing-up front end stock by a merger or consolidation." *In the Matter of Thompson Ross Securities Co.*, mentioned above, it was contended by a registered broker dealer that securities issued under section 3 (a) (9) are forever exempted from registration. In holding against this contention the Commission stated:

> "Unlike securities which fall within Sec. 3 (a) (2) to 3 (a) (8) inclusive, of the Act, there is nothing in the intrinsic nature of securities falling within Sec. 3 (a) (9) which justifies their permanent exemption from registration. The basis of the exemption under Sec. 3 (a) (9) is merely the circumstances surrounding the issuance of securities. The sale to the public of a large block of securities previously exempted from registration when they were exchanged for other securities possesses all of the dangers attendant upon a new offering of securities to the public by the issuer. Section 3 (a) (9) does not therefore permanently exempt securities offered in a transaction of exchange."[17]

This holding is equally applicable to merger exchanges pursuant to Rule 133.

[16] 148 F. Supp. 558 (S. D. N. Y. 1957).
[17] 6 S. E. C. at 1118.

Assuming that the merger, consolidation, reclassification or transfer of assets is motivated by a bona fide corporate purpose it should be noted that Rule 133 begins, "For purposes of Section 5 only. . . ." Thus stock issued in reliance thereon is exempt from registration only.

The Colorado and Delaware statutes on merger and consolidation, which are more or less standard, contain no specific requirements about the information to be set forth in the proxy statement. It is not an uncommon practice to submit the merger proposal without financial statements and with very little factual data. Frequently, the stockholders of the constituents are only told how many shares they will exchange for each share of the continuing corporation, and the approximate market value of each. Such facts as assumed liabilities, outstanding stock purchase options, management contracts, fees and costs of the merger, royalty burdens on properties to be acquired and other material facts may not be mentioned. As this is the type of omission and half truth prohibited by section 17 (a) of the Securities Act of 1933 and Rule X 10 (B) (5)[18] under the Securities Exchange Act of 1934, it was believed that there would be no serious abuse of the section 5 exemption pursuant to the "no sale" theory. Moreover, companies with listed securities are also subject to the detailed proxy regulations adopted pursuant to section 14 of the Exchange Act. Rule X 14 (A) (9)[19] requires that proxy statements contain a full disclosure of material facts.

Experience under Rule 133 indicates that this view was highly sanguine. It became apparent under the Investment Company Act of 1940[20] to which the "no sale" rule was extended shortly after its enactment that there was insufficient protection to shareholders against consolidation of affiliated companies on unequal terms. Section 17 (a) of the Investment Company Act prohibits sales of assets or securities between corporations controlled by a registered investment company, unless the sales have been approved as fair and equitable by the commission.

In *Phoenix Security Corp.*,[21] two corporations controlled by a registered company decided to merge. The Commission decided that

[18] 17 C. F. R. 240.10 (b) (5) (1949).
[19] *Id.* at 240.14 (a) (9).
[20] 54 Stat. 847, 15 U. S. C. § § 80 (a) (1)-(52) (1952).
[21] 9 S. E. C. 241 (1941).

since the definition of the word "sale" in the Investment Company Act is practically the same as in the Securities Act, the "no sale" rule should be held applicable to the transaction in question and, hence, the terms of the merger did not have to be approved. Under such literal interpretation, two affiliates controlled by a third might well decide to merge on unfair and inequitable terms, and minority shareholders would have as little protection as in case of a conventional sale of securities between the companies. In 1953, the Commission reversed the *Phoenix* case stating that continued experience under the Investment Company Act demonstrated that application of the "no sale" theory to section 17 thereof tended to defeat the legislative purpose of that section.[22]

One of the few cases involving an alleged civil liability grounded upon a merger transaction is *National Supply Co. v. Stanford University*.[23] Denial of recovery was based primarily on the stockholder's negligence in failing to make timely objection to the plan of consolidation. The contention that the proxy statement was misleading was rather summarily disposed of by the court. Stanford argued that it was led to believe that it might retain its preferred stock, nothwithstanding the consolidation, and that it was not advised of its right by a timely objection to claim the appraised value of its shares. The court said that a dissatisfied stockholder should be held to a degree of diligence in informing himself of, and in asserting, his rights.

> "He may not by inaction speculate upon the outcome of the merger. He is not permitted to plead ignorance of the law of the state of incorporation if he has negligently failed to inform himself thereof. He may not unreasonably delay the bringing of suit, either for the value of his shares or for equitable relief against what he claims is an unfair merger, to the prejudice of existing shareholders or those who may become such in the interim."[24]

The court stated that certain of the findings of the trial court (which had held in Stanford's favor) indicated that the trial court was influenced by the contention that the Securities Act of 1933 had been violated. However, since the SEC had filed a brief *amicus curiae* indicative of its view that the consolidation did not involve a "sale" of securities, and that the civil liabilities provisions of the Act were inapplicable, the court considered neither the questions of section 5 violation nor possible violations of section 17 (a) or Rule X 10 (B) (5). It merely concluded "Without going into the matter, we may say that we are in accord with the views of the Commission."[25]

Whatever the respective merits and defects of the proposed revision of Rule 133 may be, it must be considered in the light of an era of numerous facile mergers and consolidations.

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[22] In the Matter of E. I. Dupont Investment Co., Act Release No. 1837 (1953), C. C. H. Fed. Sec. Law Rep. P. 76, 213.
[23] 134 F.2d 689 (9th Cir.), *cert. denied*, 320 U. S. 773 (1943).
[24] *Id.* at 692.
[25] *Id.* at 694.