PROPOSED REVISION OF REGULATION A UNDER THE SMALL ISSUES EXEMPTION OF THE SECURITIES ACT OF 1933

THE SECURITIES ACT OF 1933[1] is designed primarily to protect individual investors and to provide federal supervision of the initial distribution of investment securities offered through the mails or in interstate commerce.[2] Implementation of these objectives is achieved by requiring fair disclosure of information essential to the evaluation of an offered security and by imposing civil and criminal sanctions for fraud and misrepresentation, as well as nondisclosure, with respect to its sale.[3] Normally, full disclosure is assured by compelling an issuer to file with the Securities and Exchange Commission[4] a registration statement containing specified material with regard to the issuer, the security, and its underwriters and to make available to the investing public a prospectus containing similar, though less detailed, information.[5] Recognizing, however, that the high cost of compliance with the registration and prospectus requirements could result in the undesirable elimination of small public offerings, the Securities Act empowers the Commission to exempt small issues from these requirements[6] unless such would be inconsistent with the underlying purposes of the Act.[7] Pur-

[1] 48 STAT. 74 (1933), 15 U.S.C. §§ 77a-77aa (1951) as amended 15 U.S.C.A. §§ 77a-77aa (Supp. Aug. 1956).

[2] *Hearings Before the Subcommittee on Commerce and Finance of the House Committee on Interstate and Foreign Commerce*, 73rd Cong., 1st Sess. 741 (1933).

[3] Johnson & Jackson, *The Securities and Exchange Commission: Its Organization and Functions Under the Securities Act of 1933*, 4 LAW & CONTEMP. PROB. 3 (1937).

[4] Hereinafter referred to as the Commission.

[5] The prospectus must include such items as description of business, description of properties, securities offered and their distribution, use of proceeds, capitalization, promoters, management, financial statements and other matters of significance to the prospective buyer. 17 C.F.R. § 230.376 (1939).

[6] The authority is granted under § 3b of the Act. 48 STAT. 75 (1933), 15 U.S.C. § 77c (b) (1951).

[7] The small issues exemption is not the only exemption provided in the Act. See Throop and Lane, *Some Problems of Exemption Under the Securities Act of 1933*, 4 LAW & CONTEMP. PROB. 89, 91 (1937) where the exemptions are classified in four categories: (1) securities exempt by reason of the character of the issuer; (2) securities exempt by reason of the character of the security or the issue of which the security is a part, regardless of the character of the issuer; (3) securities exempt by reason of the manner of their distribution, regardless of the character of the issuer or security; (4) particular transactions exempt regardless of the character of the issuer, security or manner of distribution.

suant to this statutory authorization, the Commission has promulgated Regulation A,[8] which today affords an exemption from the registration and prospectus requirements to all issues the offering price of which does not exceed $300,000.[9] Recent proposals of the Commission, however, indicate that additional restrictions on the availability of the exemption may soon be imposed, that the exemption may be limited to issuers satisfying certain net earning requirements and to issues not exceeding a specified number of units.[10] The regulatory[11] impact of these proposals would mark a sharp change in the Commission's exercise of the exempting power suggesting the need for analysis not only of the proposed revisions, but also of the evolution of the small issues exemption.

Initially, Regulation A exempted eleven specific types of securities but required a modified form of disclosure.[12] These provisions remained operative until 1941, when all eleven rules were repealed in favor of a single exemption and the disclosure provisions were replaced by the requirement of a simple letter of notification to a regional office of the Commission.[13] The Commission announced, "The new regulation shifts

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[8] CCH Fed. Sec. L. Rep., ¶¶ 4251-62 (1956).

[9] Congress set the aggregate limit for the exemption of small issues at $100,000. 48 Stat. 75 (1933), 15 U.S.C. § 77c (b) (1951), which amount has been increased to $300,000. See note 17 *infra*. The exemption is available only from the requirement of full registration and from the quasi-fiduciary relation imposed on directors of the issuer by § 11 of the act. Section 11, *inter alia*, provides a civil remedy in the form of money damages to be recovered from directors, officers, underwriters, certifiers and signers of the registration statement who are connected with the issuer or issue, for any untrue statement or material omission of fact, if such purchaser has in fact been defrauded. The exemption provided is not an exemption from the sanctions provided in § 17 for fraud perpetrated in a sale of securities in interstate commerce or through the mails. The common law is determinative of what constitutes an "untrue statement" or "omission of material fact."

[10] Securities Act Release 3664 (July 23, 1956), CCH Fed. Sec. L. Rep. ¶ 76,398 (1956).

[11] "Regulatory" is used in the sense of state "Blue-Sky" legislation, though these qualifications are but a step in that direction. The fundamental distinction between federal securities legislation and state "Blue-Sky" laws has been that the former was designed to provide the means whereby the investor could protect himself if he so desired, while the latter protected him from his own folly by providing supervision which in effect eliminated non-meritorious stocks.

[12] 17 C.F.R. §§ 230.200-230.210 (1939). Captions of these rules were: Rule 200 Exemption $100,000; Rule 201 General exemption of securities sold for cash; Rule 202 Exemption of stock in a corporation or similar interests in a trust or unincorporated association; Rule 203 Exemption of first mortgage notes and bonds; Rule 204 Exemption of certificates of deposit; Rule 205 Exemption of securities exchanged for outstanding securities; Rule 206 Exemption of voting trust certificates; Rule 207 Exemption of certain mineral rights; Rule 208 Exemption of certain securities issued in connection with reorganizations of banks; Rule 209 Exemption of certain mortgages and trust agreements; Rule 210 General exemption of securities sold for cash in compliance with State law.

[13] 17 C.F.R. § 230.222 (Supp. 1941). This letter of notification sought only names

administrative emphasis from the disclosure requirements of the act to the fraud prevention provisions."[14] In reality, however, the change was more basic, reflecting a departure from the duality of purpose of the act to the single objective of fraud prevention, leaving enforcement to the initiative of the injured investor. The transition did not, of course, pre-empt the function of the state "Blue Sky Laws"[15] but simply permitted greater freedom in the sale of small issues by requiring less information to be filed prior to distribution.[16]

Regulation A continued to operate as a single anti-fraud exemption during World War II and for a short while thereafter, the only significant change occurring in 1945, when Congress authorized the raising of the aggregate exemptive limit of small issues from $100,000 to $300,000,[17] which was implemented immediately by the Commission.[18] By 1950, however, certain abuses in the issuance of securities which were afforded the advantage of the exemptive provisions had become apparent.[19] The Commission, after studying the problem, concluded that although the individual significance of these small issues was infinitesimal when seen in the context of all new offerings, the aggregate price to the public was sufficient to warrant more extensive supervision than that afforded by the simple fraud-prevention techniques then in effect.[20] The

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and addresses of the issuer, directors and officers; the persons on whose behalf the offering was to be made and the principal underwriter; the title of the security offered with principal amount and price per share, and aggregate amount offered within one year previous to the proposed offering; the date and jurisdictions in which the offering was to be made; and the purposes for which the net proceeds were to be used. This requirement enabled the Commission to determine the availability of the exemption without the necessity of scrutinizing the past financial record of the issuer. Its function, in effect, was to put the Commission on notice that an issue was about to be offered.

[14] Securities Act Release 2410 (1940).

[15] See note 11 *supra.*

[16] Consistent with the philosophy underlying the small issues exemption as then interpreted was this relaxation of the requirement of disclosure. In practice this allowed issuers the benefit of the exemption and virtual freedom from liability for fraud, since even if a purchaser discovers he has been defrauded it is generally recognized that he is apt to remain silent rather than to admit that he has been duped or to expend the money necessary to establish fraud in civil litigation which may result only in an uncollectable judgment.

[17] 59 STAT. 167 (1945), 15 U.S.C. § 77c(b) (1951).

[18] 1 CCH FED. SEC. L. REP. ¶2253.10 (1945), 17 C.F.R. § 230.220 (Supp. 1945).

[19] Although evidence of fraud in small issues was often difficult to obtain from defrauded purchasers, the Commission, since 1941, nevertheless has been cognizant of various devices used to perpetrate fraud, and has reported that "evils of high pressure salesmanship and of selling on the basis of inadequate information are particularly prevalent in small issues." SEC *Report on Proposals for Amendments to the Securities Act of 1933 and the Securities Exchange Act of 1934* (1941).

[20] The significance of these small issues may be illustrated by a comparison with the

product of these studies was the 1953 revision of Regulation A, which once again shifted administrative emphasis, this time from fraud prevention back to disclosure.[21]

The 1953 revision required disclosure not only to the Commission through one of its regional offices, but also to the public by means of an offering circular[22] which was designed to provide adequate information relating to a particular issue without imposing an unduly heavy burden on the issuer by requiring him to furnish unnecessary details. In announcing the revision, the Commission stated that it still was placing its emphasis in general on fraud prevention and that the offering circulars were required primarily in order to determine whether the minimum basic facts were revealed and whether these facts indicated the existence of fraud in connection with the proposed offering.[23] Professor Louis Loss has commented: "Nevertheless, Regulation A . . . provides not so much an exemption as a simplified form of registration for certain issues —by no means all issues—up to $300,000."[24]

In July 1956, the Commission further amended Regulation A, this time by tightening control of the exemption rather than shifting its emphasis.[25] The Regulation now requires a more complete disclosure in the offering circular and compels its revision every nine months if the offering is still being made. Moreover, a semi-annual report of sales must be made to the Commission until the offering has been terminated. As an additional ground for suspension of the exemption, the Commis-

amount and percentage of registration offerings. In 1935 the amount proposed to be offered was $15,734,812 or 1% of the proposed registration offering. In 1940 this amount had increased to $22,602,694 but was only 1.2% of the registration offering. In 1945 the amount under Regulation A had increased to $38,848,893 but the percentage as compared with registration had dropped to 0.9%. In 1945 the aggregate limit for each offering was raised to $300,000 and in 1946 the offerings totalled $181,600,155 or 2.5% of the proposed registration offering. In 1950 $171,743,472 was proposed, being 3.3% of the offerings proposed under registration. This figure was increased to $273,471,548 in 1955, amounting to 2.7% of the registration figure. The foregoing figures were taken from an unpublished study made by the staff of the Commission, which study was made available to the DUKE BAR JOURNAL. (Hereinafter referred to as STAFF STUDY.)

[21] Securities Act Release 3466, 1 CCH FED. SEC. L. REP. ¶ 2253.10 (1953). Of course the disclosure emphasis was complemented by the anti-fraud provisions which were not in the least sublimated by the shifting policy.

[22] The offering circular was not required for issues less than $50,000 aggregate, although notification was still requisite. Under the 1956 provision, note 28 *infra*, an offering circular is now required for newly organized companies that are in promotional or developmental stages even if the amount to be offered is less than $50,000.

[23] Securities Act Release 3466, 1 CCH FED. SEC. L. REP. ¶ 2253.10 (1953).

[24] LOSS, SECURITIES REGULATION, 166-67 (Supp. 1955).

[25] Securities Act Release 3663 (July 23, 1956), CCH FED. SEC. L. REP. ¶ 76,397 (1956).

sion has included any failure by the issuer or any of its promotors, officers, directors, or underwriters to cooperate in any investigation by the Commission of any offering under the Regulation.[26] Furthermore, the availability of the exemption is eliminated, henceforth, if any sanction[27] by the Commission, a national securities dealers' association, or a securities exchange has been imposed on any underwriter of the issuer or any partner, director, or officer of the issuer.[28]

Simultaneously with the July 1956 revision, the Commission announced that it was considering still further amendment of the exemptive regulation.[29] Four alternative proposals were presented which would limit the exemption to issues having no more than a specified number of units and/or to issuers which could be regarded as "seasoned businesses."

Perhaps the major factor prompting the proposed restriction of Regulation A has been the Commission's fear that the investing public is still not adequately protected from dangers inherent in certain speculative small issues which are making extensive use of the small business exemption.[30] Moreover, the need for prompt action appears to be acute

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[26] *Ibid.* This sets forth the full text of the revision which apparently requires cooperation from an issuer, underwriter, etc., in any Commission investigation of the offering in question.

[27] "Sanction" includes any conviction, stop order, suspension order or disciplinary action.

[28] Securities Act Release 3663 (July 23, 1956), CCH FED. SEC. L. REP. ¶ 76,397 (1956). It is to be noted that the entry of a cease and desist order under a state "Blue-Sky" law is not itself a ground for denial of the exemption; however, grounds on which a state cease and desist order is issued may also be grounds for the suspension of the exemption under Rule 261.

Comments received by the Commission concerning this revision of Regulation A generally favored the anticipated effects of the proposed changes, although a fear was expressed that the additional circular requirement would negate the benefits of the exemption. Forty letters were received from attorneys, private individuals, stock exchanges, state and provincial authorities, engineers and consultants, trade associations, issuers and brokers. These comments point out the narrowing of the distinctions between exempt securities and those which must register, but generally support the broad objective of the strengthened requirements. One lone comment simply challenges the whole revision.

[29] Securities Act Release 3664 (July 23, 1956), CCH FED. SEC. L. REP. ¶ 76,398 (1956).

[30] *Ibid.* "In its consideration of these proposals, the Commission received and considered a great deal of information with respect to offerings exempted under Regulation A, including that developed by the Committee on Interstate and Foreign Commerce of the House of Representatives in the course of that Committee's consideration of H.R. 5701 and H.R. 9319 both of which bills related to offerings exempted under regulations adopted by the Commission pursuant to Section 3(b) of the Securities Act of 1933. Information so received, together with the Report of the Interstate and Foreign Commerce Committee of June 28, 1956 (House of Representatives Report No. 2513, 84th Congress, 2nd Session), including the minority report which particularly

because similar fears in congressional circles have resulted in proposals which would effectively destroy the small issues exemption.[31] Apparently, the principal objects of congressional criticism are those "penny stock" issues which are rendered particularly speculative by the financial instability of their issuers.[32] Each of the four alternative proposals now under consideration would effectively deprive such issues of the exemption. Three of the proposals, however, would have a much broader impact, denying the exemption to issues which appear still to be deserving of the advantages it affords.

The first proposed alternative[33] would limit the exemption to a

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discussed H.R. 11308 led the Commission to believe that further consideration should be given to revisions of the regulation which would make the exemption afforded thereby available only to issuers and offerings meeting specified standards based either upon earnings or upon the limitation of the number of securities to be offered as distinct from the aggregate offering price of the securities to be offered."

[31] Conflicting opinions as to the scope and purpose of the small issues exemption have been evident in Congress. Since the Act was adopted, systematic attempts to raise the aggregate limit of the exemption have been initiated in both houses without success. S. 4006 and H.R. 9807, 76th Cong. 2d Sess. (1940) sought to raise the exemptive limit to $1,000,000. S. REP. No. 1036, 83rd Cong. 2d Sess. (1954) indicates that the Senate voted to raise the limt to $500,000 but the House disagreed. H.R. REP. No. 1542, 83rd Cong. 2d Sess. (1954).

Of particular concern to the Commission were the three bills offered in the House of Representatives in 1956 which were designed, (a) to eliminate entirely the small issues exemption, H.R. 5701, 84th Cong. 2d Sess. (1956); (b) to make applicable the sanctions provided for in § 11 to certain responsible persons for untrue statements or material omissions in the offering circular, H.R. 9319, 84th Cong. 2d Sess. (1956); and (c) to extend § 12 of the Act to permit an action of recission by the defrauded purchaser, H.R. 11308, 84th Cong. 2d Sess. (1956). The Commission favored this last bill which was proposed as a compromise measure by Representative Arthur G. Klein, Chairman of the Subcommittee on Commerce and Finance of the House Committee on Interstate and Foreign Commerce.

[32] H.R. REP. No. 2513, 84th Cong. 2d Sess. (1956). There has been a veritable flooding of the market with penny-stocks in connection with the uranium boom. Issuers who fall within the $300,000 limit have made extensive use of this type of stock, but companies issuing securities in aggregate more than $300,000 have not generally utilized penny-stock.

[33] Securities Act Release 3664 (July 23, 1956), CCH FED. SEC. L. REP. ¶ 76,398 (1956). The proposal would be effected by amending the existing Rule 252, paragraph (a) as follows: "[S]ecurities issued by any of the following persons shall be exempt from registration under the Act if offered in accordance with the terms and conditions of this regulation: (1) Any corporation, unincorporated association or trust (i) which is incorporated or organized under the laws of the United States or Canada or any State or Province thereof, (ii) which has or proposes to have its principal business operations in the United States or Canada; or any individual who is a resident of, and proposes to have his principal business operations in any State or Province, if such corporation, unincorporated association, trust or individual has had a net income, computed in accordance with generally accepted accounting principles, from operations of the character in which the issuer intends to engage, for any one full fiscal year within the period of five years immediately preceding the date of filing the notification required by Rule 255." This requirement or one of similar import, was suggested in conjunction with other

corporation, unincorporated association, or trust, which has a net income for any one full fiscal year within the period of five fiscal years immediately preceding the date of filling for the exemption. The most obvious effect of adopting this proposal would be the elimination of new company promotional stock from the exemption.[34] A newly-formed company would, thus, be required to register fully, though rigor of this requirement might be alleviated to some extent by the comparative facility with which the registration of a new company can be accomplished.[35] Another obvious effect would be the denial of the exemption to a rela-

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suggestions by the President's Cabinet Committee on Small Business in its report. See release of August 9, 1956 by Murray Snyder, Acting Press Secretary to the President, of Letters to the President from the Cabinet Committee Chairman and the Progress Report of the Committee.

[34] Some impression of the probable impact of this regulation may be drawn from an analysis of registration figures for the calendar years 1954, 1955 and the first six months of 1956. In 1954 there were 1374 filings under Regulation A ($237, 433,590 in the aggregate), and, of these, 713 were by companies less than two years old. Of this latter group, only 253 were urauium companies and 460 were non-uranium companies.

In 1955 there were 1661 filings ($313,551,246 in aggregate) under Regulation A, with 1050 of these being by companies less than two years old. Of this 1050, less than one-half, 464 (over $105,000,000 in aggregate) were by uranium companies and 586 filings (over $104,000,000 in aggregate) were by other types of companies.

In January through June of 1956, there were 676 Regulation A filings, of which 353 were by companies in existence for less than two years. The most interesting development manifested in this period was that only 91 of these were by uranium companies while 262 were by other types of companies. The foregoing figures were taken from the STAFF STUDY.

That this proposal would have had resounding effect on uranium issues is obvious, but equally apparent is that a similar impact would be felt in non-uranium issues.

In addition, it is of interest to note, as to the particular effect of this provision in the uranium field, that in the April 1953 through October 1954 period uranium issues numbered 224 ($46,515,000 in aggregate) of which eighty percent were filed within the last six months of this nineteen month period. The really pertinent fact is that ninety percent of the uranium issuers were organized less than one year prior to filing. STAFF STUDY.

The effect of this "seasoned company" requirement on non-uranium companies is even more clearly indicated by the fact that in the April 1953 through October 1954 period, 133 of the notifications under Regulation A, by issuers classified as "Manufacturing," were by companies less than one year old. The proportion of "new" companies to "old" companies in the notificatious filed by companies classified as "Commercial and Others" was even greater. 202 of the 374 notifications in this classification were by new companies and only 172 by old companies. STAFF STUDY.

[35] See note 5 *supra*. For an unseasoned company the requirement of financial statements is of little significance, since such information does not exist until the company has had at least one year's operation. The burden of registration is reduced considerably, therefore, for new businesses which desire to market securities. Indeed, it has been said that for a new business wishing to issue securities, the requirements are virtually identical under registration and under the exemption. See *Hearings Before the Subcommittee on Commerce and Finance of the House Committee on Interstate and Foreign Commerce*, 84th Cong. 2d Sess. (1956) on H.R. 5701 and H.R. 9319.

tively new corporation which has potential earning power but which has failed to show a net income in any one of the few years of its existence.[36] Furthermore, an established firm without a net income in any one of the preceding five years, would not be eligible for the exemption regardless of its earnings in any period prior to the last five years.[37] An analysis of sixty issues offered during October 1955 and April 1956 indicated that sixty-seven per cent of those companies required to give the information could not have met this net-income test,[38] thus suggesting the possibility that two-thirds of the small business otherwise eligible would be deprived of the exemption by this "seasoned company" requirement. While financially insecure issuers of "penny stock" would be compelled by this proposal to register and publish a prospectus, its adoption would further deny the exemption to all issuers without the requisite earnings record, irrespective of the nature of the issue.

Alternative number two[39] would limit the number of units in aggregate to 3,000 in the case of bonds, debentures, or any other from of debt security and to 100,000 in the case of all other securities if the offering is to qualify for the exemption. In order to realize the full advantage of the $300,000 maximum under the exemption, therefore, the minimum allowable price of the stock issued would have to be three dollars per share. This proposal would accordingly virtually deprive all "penny stock" issues of the exemption, regardless of the financial stability of the issuer.[40]

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[36] Of course, the alternative of full registration is always available.

[37] A company which has had financial difficulties during the last five years might, at first glance, appear to be a poor risk, but many industries go through transitional periods and make strong returns to financial soundness. It is the revitalizing influence of new capital that the proposed net-income standard will make more difficult to secure.

[38] STAFF STUDY. See also address by J. Sinclair Armstrong, Chairman of the Commission, before the Indianapolis Downtown Kiwanis Club, October 12, 1956. Chairman Armstrong stated: "We made a study of all Regulation A filings filed with us during October 1955 and April 1956, and discovered that approximately two-thirds of those filings were made by companies which had no history of earnings."

[39] Securities Act Release 3664 (July 23, 1956), 1 CCH FED. SEC. L. REP. ¶ 76,398 (1956). Rule 254, paragraph (a) would be amended to read: "(a) The aggregate offering price of all of the following securities of (i) the issuer, (ii) its predecessors and (iii) all of its affiliates which were incorporated or organized, or became affiliates of the issuer, within the past two years, shall not exceed $300,000 and the aggregate number of all of such securities offered shall not exceed 3,000 units in the case of any bond, debenture or other evidence of indebtedness or 100,000 units in the case of any other security. The term 'unit' as used in this paragraph, shall mean the smallest unit of any security which may be separately sold and transferred as a unit and in the case of a stock shall mean one share. . . ."

[40] Of the filings made in October 1955, and April 1956, 116 of 186 stock offerings would not have been affected by this limitation since they were of 100,000 shares or less, but 70 of these offerings would have been excluded. During this period the

The third alternative proposal[41] is a combination of alternatives one and two and would limit the exemption to an issuer who has enjoyed net earnings in one of the last previous five years and limit the number of units he may offer to 100,000 or, in the case of debt securities, to 3,000 units. The adoption of this proposal would effectively deny the exemption to all "unseasoned" companies and to all "penny stock" issues.

Denver Regional Office had only twenty-five percent of its Regulation A offerings that were of 100,000 units or less. This is considerably below the national figure. STAFF STUDY. Still the fact that a large percentage of national offerings would be adversely affected points to the significance of this limitation.

If the proposal to raise the exemptive limits to $500,000 is adopted, see note 31 *supra*, the increase would make more difficult the position of a company desiring to issue stock at a low figure. If the company should wish to take full advantage of the exemption, it would have to issue stock at a five dollar minimum. The President's Cabinet Committee on Small Business has recommended that the Commission exclude "issuers of so called penny-stock" and raise the exemptive limit to $500,000. See note 33 *supra*.

From August 18, 1954 through April 22, 1955, of thirty-four uranium stock issues only two were offered at one dollar per share, and none at more than one dollar. Of this same group of issues, thirteen were offered for one cent per share. The average of the thirty-four issues was twelve cents, but the median offering was three cents per share and the mode was one cent per share. Compiled from Table I presented at the *Hearings of the Subcommittee on Commerce and Finance of the House Committee on Interstate and Foreign Commerce on H.R. 5701 and H.R. 9319*, 84th Cong. 2d Sess. (1956). The very real problem in the penny-stock issue is not in the initial offering, but arises in the trading market. The offering circular required since the 1953 revision of Regulation A is carefully reviewed by the Commission staff in an attempt to prevent the use of a circular which is misleading on its face in the initial sale of a security. However, after the initial offering is sold, trading in the security takes place without the use of an offering circular. Thus, an offering made at the price of thirty cents per share could, as a result of verbal representations in over-the-counter transactions, careen upward to $1.50 per share in a short time. Restricting the number of units that can be sold initially under Regulation A would necessarily restrict the units thereafter available for trading. Furthermore, the psychology of the market place makes it less likely that a stock initially sold at three dollars per unit will increase to $15.00 than that a stock initially sold at, say, thirty cents per share will increase to $1.50, or than that a three-cent share will increase to fifteen cents. Apparently issuers and promoters capitalize on buyer psychology which leads prospective purchasers to believe that a low-priced stock results in a better bargain and a greater chance of price appreciation than a higher priced stock, quite apart from the book value or earnings potential of the issuer and without taking into account the total units of stock outstanding or the proportional interest in the corporation which the shares represent. One of the evils which might be eliminated by the proposed alternatives is the advantages taken by the promoters and issuers of this psychological quirk.

One article on the changes proposed on July 18, 1955 (see Securities Act Release 3555, CCH FED. SEC. L. REP. ¶ 76,351 (1955)), was entitled "SEC Wars on Uranium, Oil Promotions." Business Week, July 23, 1955, p. 66. Several of the more stringent proposals made at that time were later eliminated in the revision of Regulation A in July, 1956.

[41] Securities Act Release 3664 (July 23, 1956), CCH FED. SEC. L. REP. ¶ 76,398 (1956), paragraph (a) of Rule 252 would be amended as in note 33 *supra*, and paragraph (a) of Rule 254 would be amended as in note 39 *supra*.

The fourth alternative[42] would limit the exemption to an offering of 100,000 units or, in the case of debt securities, to 3,000 units, only if the issuer could not qualify as having had a net income for one of the last five fiscal years. Thus, a company which fails to meet the requirements as to net earnings, whether an old company without a record of net earnings or a newly-formed company, would still have the opportunity to avail itself of the exemption but would be subject to the 100,000 unit limitation. This alternative, denying the exemption to "penny stock" issues only when the issuer is an "unseasoned" company, seems best designed to eliminate the abuses which allegedly have arisen as the result of the small issues exemption, without unduly hampering small businesses in their efforts to obtain public financing. If, as has been asserted with some probable justification, mining stock cannot be sold except at a relatively low price per share, adoption of a unit limitation on all issues, irrespective of the issuer's stability, could effectively eliminate exploratory mining ventures by all except new companies.[43] Under the fourth proposal, however, only the company in operation for some time without the requisite indicia of financial stability would be severely restricted, and compliance with the registration and prospectus requirements may well be desirable under such circumstances.[44] A new company, though also compelled to register, could do so with little diffi-

[42] Securities Act Release 3664 (July 23, 1956), CCH FED. SEC. L. REP. ¶ 76,398 (1956). A new paragraph would be added to Rule 254, in substance as follows: (d) In the case of any issuer which has not had a net income computed in accordance with generally accepted accounting principles, from operation of the character in which the issuer intends to engage, for any one full fiscal year within the period of five years, immediately preceding the date of filing, the notification required by Rule 255, the aggregate amount of all the securities of (i) the issuer, (ii) its predecessor and (iii) all of its affiliates which were incorporated or organized or became affiliates of the issuer within the past two years shall not exceed 3,000 units in the case of any bond, debenture or other evidence of indebtedness or 100,000 units in the case of any other security.

[43] Correspondence directed to the Commission commenting on the proposals has been meager despite the fundamental nature of the change to be wrought by the adoption of any one of the proposals. At the announced date for the termination of submission of public comments, October 15, 1956, there were less than twenty letters in the public comment file of the Commission which dealt specifically with the proposed revision. The tenor of the comments was generally critical ranging from well considered criticisms to accusations of favor to big business. Comments from mining concerns and allied sources expressed the fear that there would be a virtual elimination of public finacing of mining ventures. Other comments stated that twenty-five cents per share was the maximum price at which such stocks could be sold. See note 40 *supra*.

[44] A company which lacks the requisite indicia of financial stability obviously should be subjected to more stringent regulation before it is granted the privilege of seeking public financial support. Emphasis should be placed on the fact that these alternatives are proposed standards necessary for issuance under the exemption. Thus, failure to comply with the standard means only that the exemptive procedure is unavailable, but does not mean that the stock cannot be offered under the registration process.

culty, and the practical advantages of "penny stock" would still be available to it.[45]

Adoption of any one of the four alternatives would be a departure both from the emphasis on fraud prevention utilized by the Commission during the 1941-1953 period[46] and the emphasis placed by the Commission on disclosure from 1933-1941, and, more recently, from 1953 to the present.[47] This new treatment of the small issues exemption would place administrative emphasis in part on regulation, an aspect not heretofore extensively considered by the Commission.[48] It appears unlikely, however, that this shift in emphasis, although significant, is indicative of the future course of the Commission. In fact, the Commission has disclaimed any desire to administer a regulatory policy in the field of investment security.[49] This apparent inconsistency probably reflects a fear on the part of the Commission that, should it fail to correct the alleged deficiencies of the exemption, Congress, in an effort to solve the problem, would so restrict the general exemption as to make its benefits negligible, or would eliminate it entirely.[50]

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[45] See note 35 *supra.*

[46] Securities Act Release 2410 (1940).

[47] See notes 12 and 22 *supra* and text thereto.

[48] See Securities Act of 1933, 3a (1-11), 48 STAT. 74, 15 U.S.C. § 77c (a) (1951) for requirements of other exemptions which in part are of a regulatory nature. For example, see § 3(a) (10) which provides for the exemption of securities issued in reorganization if approved by court or governmental authority.

[49] Chairman J. Sinclair Armstrong stated in his testimony before the Subcommittee on Commerce and Finance that the basic philosophy of the Act is disclosure and fraud prevention. *Hearings of the Subcommittee on Commerce and Finance, of the House Committee on Interstate and Foreign Commerce, on H.R. 5701 and H.R. 8319,* 84th Cong. 2d. Sess. 36 (1956).

In his Indianapolis address the chairman said "The basic Congressional purpose expressed in the Securities Act is to provide the public investor with business and financial information about new issues on which to base his decision whether to buy the securities or not. It is the public investor that the Securities Act seeks to protect, but the protection sought to be afforded, absent fraud in the offering, is to put the investor in an informed position to make his own investment decisions, not to protect him against making his own decisions or to have a federal agency make his decisions for him." Address cited note 38 *supra.*

Despite disclaimers by the Commission of any desire to enter into any "Blue-Sky" type measures on a federal level, it appears that the Commission is gingerly moving into this phase of security regulations. See note 11 *supra.* Perhaps congressional suggestions of even more stringent requirements are driving the Commission into this undesired field.

[50] See notes *ubi supra;* in his Indianapolis address, the Chairman said, "Since 1954 other legislation has been introduced in the House which we felt would have an adverse effect on the legitimate raising of capital by small business organizations and which we have opposed in the 84th Congress. Among such proposed legislation were bills which would repeal the exemption so that all issues of securities, no matter how small in size, offered in inter-state commerce and not otherwise exempt, would have to be fully registered.

Some restriction of the exemption appears certain, and the likelihood is that it will be achieved by adoption of one of the four alternatives proposed. The Commission's final choice among the four proposals may well depend upon the extent to which it feels compelled to restrict the availability of the exemption in order to save it from congressional obliteration. The limited restriction imposed by the fourth alternative specified above appears to be the most desirable of the proposals. The Commission, however, may be forced to effect a more stringent revision of the exemption in order to satisfy its critics and, thereby, salvage at least some of its benefits.

"Another was a bill which would apply to persons associated with an offering under our exemptive regulations the same strict civil liabilities . . . that pertain to persons associated with an offering under full registration. We likewise opposed this bill on the ground that it would in substance require the equivalent of full registration of small issues and that this would have the indirect effect of repealing the exemption." Address cited note 38 *supra*.