

THE LAWYER'S PROBLEMS IN THE REGISTRATION OF SECURITIES

ARTHUR H. DEAN*

The spirit of reform which swept Mr. Roosevelt into office in 1932 brought in its wake the Securities Act of 1933.¹ As a measure of social regulation, it was long overdue. But it imposed upon an almost completely *laissez-faire* market a strait-jacket of very rigorous regulation. The shock to such a delicate mechanism was naturally considerable. The jacket was made considerably more comfortable by amendments passed in 1934² and by a vigorous overhauling of the forms, on which securities were registered, by the Securities and Exchange Commission. The relative merits or demerits of the Act are now out of the realm of controversy and bitterness, and its permanence as a part of our social fabric definitely established. It has been said, in substance, that it represents the aspirations of a people who do not again wish to see their life savings put in jeopardy.³ Yet it must be said at once that while publicity is a great weapon, the Act alone cannot prevent economic cycles from pursuing their course, invention displacing invention, or the launching of ill-advised and badly managed enterprises with consequent losses to security holders.⁴

The Act itself does not proceed on any super-governmental agency's saying whether it is wise or unwise to issue or to buy the securities. Or even upon whether the securities are good or bad. But rather on the theory that those issuers who wish to avail themselves of the privilege of selling their securities in interstate commerce or through the mails must tell the truth and the whole truth or take the consequences. The Securities and Exchange Commission can determine whether on the face of a registration statement the complete truth appears to have been told (although the

* A.B., 1921, LL.B., 1923, Cornell University. Member of the New York Bar. Member of the committee formed by the Department of Commerce at the request of the President for the purpose of studying proposed legislation looking to the regulation of stock exchanges and commonly known as the Dickinson Committee, the report of which was transmitted to the Congress by the President under date of January 25, 1934. Contributor to various periodicals on securities regulation as set forth in note 13, *infra*.

¹ Pub. No. 22, 73d Cong., 1st Sess. (1933), 48 STAT. 74, 15 U. S. C., c. 2A, as amended by Pub. No. 291, 73d Cong., 2nd Sess. (1934), Tit. II, §§201-211, 48 STAT. 881, 15 U. S. C., c. 2B, §78a, hereinafter cited as the "Securities Act" and sometimes called "the Act."

² Pub. No. 291, 73d Cong., 2nd Sess. (1934), *supra* note 1.

³ See Address of James M. Landis before Investment Bankers Ass'n of America at Augusta, Ga., on Dec. 4, 1936, reported in *N. Y. Times*, Dec. 5, 1936, p. 29.

⁴ May, Memorandum regarding Securities Bill, H. R. 4314; Douglas and Bates, *The Federal Securities Act of 1933* (1933) 43 *YALE L. J.* 171; James, *The Securities Act of 1933* (1934) 32 *MICH. L. REV.* 624, 626-627; Dulles, *The Securities Act and Foreign Lending* (1933) 12 *FOREIGN AFFAIRS*, 33.

fact that a registration statement has become effective does not indicate that the Commission has passed on its correctness);⁵ and may dictate the form in which the story is told; but, if the truth is told, however worthless the securities, the Commission may neither approve nor disapprove of them.⁶

It may serve to clarify for the reader the writer's approach to the general problem by stating in advance that he is in full sympathy with the underlying purposes of both the Securities Act of 1933 and the Securities Exchange Act of 1934 and with the administrative problems facing the Commission.⁷ Even if a majority of individual investors should decide they didn't need these acts, he believes the financial community, purely from a selfish standpoint, cannot afford to be without them.

I

THE PROBLEM OF MATERIALITY

Now the task of furnishing a prospective investor, who presumably knows nothing about a company and its affairs, with all pertinent information concerning it, without misstating or omitting any material fact, is not a simple one. *First*, because we necessarily must tell the proposed investor about the past and leave him to draw inferences therefrom as to the future; *Second*, corporations and our economic society today are complex and not simple, and *Third*, to tell such prospective investor everything about a company without arrangement, correlation and synthesis may well confuse him. Arrangement, correlation and synthesis involve condensation. Condensation, in turn, involves omission. All involve emphasis. And to emphasize may be to distort.

In transmitting the draft of the original bill to the Congress on March 29, 1933, the President said "that no essentially important element attending the issue shall be concealed from the buying public."⁸ Surely there can be no quarrel with this statement. The rub comes in attempting to determine in advance what is an "essentially important element." There enters the human equation. For the registrant and its counsel must attempt to determine each "essentially important element" in advance of a decline in security prices and in advance of statements being attacked as mis-

⁵ Section 23 of the Act provides: "Unlawful representations.—Neither the fact that the registration statement for a security has been filed or is in effect nor the fact that a stop order is not in effect with respect thereto shall be deemed a finding by the Commission that the registration statement is true and accurate on its face or that it does not contain an untrue statement of fact or omit to state a material fact, or be held to mean that the Commission has in any way passed upon the merits of, or given approval to, such security. It shall be unlawful to make, or cause to be made, to any prospective purchaser any representation contrary to the foregoing provisions of this section."

⁶ While the above statement is true with respect to the activities of the Securities and Exchange Commission under the Securities Act of 1933, compare §6 of the Public Utility Act of 1935, Pub. No. 333, 74th Cong., 1st Sess. (1935), 49 STAT. 803, 15 U. S. C., c. 2C, forbidding any registered holding company or subsidiary company thereof, with certain exceptions, to issue or sell certain types of securities except in accordance with a declaration which shall have become effective under §7 of that Act and which in effect requires the approval of the Commission.

⁷ Memorandum on the Proposed Federal Securities Act, dated April 4, 1933, filed by the writer with the Senate Committee on Banking and Currency, April, 1933, Report of Dickinson Committee.

⁸ H. R. REP. No. 85, 73d Cong., 1st Sess. (1933), p. 2.

leading; they must strive not only to see that no "essentially important element" is omitted but to see that the story is presented to the investor in concise and readable form. And this is not simple. Because, although a statement must be judged years later in the light of what was known at the time it was made, nevertheless, that which may have seemed relatively unimportant at the time of filing a registration statement may later prove to have been distinctly material. A mistake in judgment? Yes, but the Act says that the issuer and not the investor must take the consequences for such mistake.⁹ It therefore behooves an issuer to know what is "material."¹⁰

In its instruction book for Form A-2, the Commission has defined "material" when used to qualify a requirement for the furnishing of information as to any subject, as limiting "the information required to such matter as to which an average prudent investor ought reasonably to be informed before purchasing the security registered." Since liability still exists in equity in rescission actions and at common law for damages caused by fraud,¹¹ and under various state "Blue Sky" statutes, in addition to the liability under the Securities Act of 1933,¹² it is, of course, necessary to determine in addition what will be deemed "material" at common law.

The American Law Institute, in its *Restatement of the Law of Contracts*, has attempted a definition so that materiality may be determined in advance, *i.e.*, the so-called "objective," rather than the "subjective," test. In Section 470(2) of this Restatement, it is stated:

"Where a misrepresentation would be likely to affect the conduct of a reasonable man with reference to a transaction with another person, the misrepresentation is material, except as this definition is qualified by the rules stated in §474."

⁹ Securities Act, §11.

¹⁰ Liability does not exist because of the misstatement or omission of any fact. For liability to exist, it must be a "material" fact. See Securities Act, §§11, 12(2) and 15. Obviously every fact stated cannot be "material," as otherwise the Congress would have omitted the qualifying adjective. As originally drafted, liability under §11 of the Act (see H. R. 5480, 73d Cong., 1st Sess., submitted May 3, 1933), was predicated on the omission to "state any material fact." This was later amended after long discussion as to whether or not this would require discussions of tariff laws, etc., by adding the additional language "required to be stated therein or necessary to make the statements therein not misleading." The theory on which the additional language was added was that a written statement might be false not only because of what it stated, but also because of what it concealed, or omitted, or implied, or otherwise stated, and that a selection from the whole truth so partial and fragmentary as to give a misleading impression should be ground for civil liability despite the literal truth of every statement made. See *Rex v. Lord Kylsant* [1932] 1 K. B. 442. See Note (1932) 45 HARV. L. REV. 1078.

¹¹ 3 WILLISTON, CONTRACTS (1st ed. 1920) §1490; *Colton v. Stanford*, 82 Cal. 351, 23 Pac. 16 (1890); *Flight v. Booth*, 1 Bing. N. C. 370 (1834).

¹² See, *e.g.*, ILL. REV. STAT. (Smith-Hurd, 1933) c. 121½, which classifies securities in various classes and provides for the filing of the different types of information for the various classes, dealers' permits, brokers' permits, etc. The New York "Martin Act," N. Y. GEN. BUS. LAW, N. Y. CONS. LAWS (Cahill, 1930) c. 21, art. 23A, is not of the general "Blue Sky Law" type which laws regulate the qualification and sale of securities, but rather what is known as the "Fraud Act" type of law, designed to prevent fraud in the sale of securities and in other securities dealings by giving the Attorney General of the State extensive power to issue subpoenas and to investigate transactions. Registration of securities under the New York "Martin Act" is not required, but a "Further State Notice" must be filed as to every non-exempt security.

And in Section 474:

"A manifestation that the person making has no reason to expect to be understood as more than an expression of his opinion, though made also with the intent or expectation stated in §471, is not fraud or a material misrepresentation, unless made by

(a) one who has, or purports to have expert knowledge of the matter, or

(b) one whose manifestation is an intentional misrepresentation and varies so far from the truth that no reasonable man in his position could have such an opinion."

The Restatement may not be followed in all jurisdictions, and we therefore cannot be sure that the test of "materiality" under the Act and in suits brought on prospectuses in state courts, not specifically based on the Act, will be the same.

In view of the constructive and coöperative attitude which the Securities and Exchange Commission has taken and of its constant willingness further to clarify the meaning of the Act, the questions in the forms and the instructions relating thereto, it may sound ungracious to state that the task of preparing a registration statement for an issuer is still no mean one. Nor should it be. But the mere fact that the Securities and Exchange Commission has promulgated some twelve forms and instruction books for the registration of various types of securities with the Commission under the Securities Act of 1933 and is constantly working on other forms and instruction books to meet different situations, may serve to indicate the complexity of the problem.

II

THE COMPLEXITY OF REGISTRATION STATEMENTS AND PROSPECTUSES

In this article the writer does not wish to engage in any controversial argument as to whether the liabilities imposed on an issuer of securities, its directors and officers, experts and underwriters are reasonable or unreasonable, or whether or not such liability should be modified. Nor does he wish to discuss the qualitative or quantitative measure of such liability as compared with that existing prior to the passage of the Act. Such subjects have already been covered at length.¹⁸ Suffice it to say,

¹⁸ Ballantine, *Amending the Federal Securities Act* (1934) 20 A. B. A. J. 85.

Bane, *The Securities Act of 1933*, PROC. NAT. ASS'N OF SECURITIES COMM'RS, 1933, p. 94.

Bane, Dean, and Richardson, Addresses before the Mining and Metallurgical Society of America, March, 1935, M. & M. Soc. BULL. No. 233, p. 23.

Berle, *New Protection for Buyers of Securities*, N. Y. Times, June 4, 1933, §8, p. 1; *High Finance: Master or Servant* (1933) 23 YALE REV. 20.

Brownell, *The Federal Securities Act of 1933*, BARRONS, July 10, 1933, p. 3; *How Can the Securities Act be Made Workable?* BARRONS, Nov. 6, 1933, p. 3; *Is the Securities Act Sound?* TODAY, Dec. 30, 1933, p. 6.

Chamberlain, *The Securities Act of 1933* (1933) 19 A. B. A. J. 643.

Cook, *Certainty in the Construction of the Law* (1935) 21 A. B. A. J. 19.

Dean, *The Federal Securities Act: I*, FORTUNE MAG., Aug. 1933, p. 50; *The Amended Securities Act*, FORTUNE MAG., Sept. 1934, p. 80; *Economic and Legal Aspects of the Federal Securities Act of 1933*, PROC. NAT. ASS'N OF SECURITIES COMM'RS, 1933, p. 160; *The Securities Act and The Securities Exchange Act* (address before Mass. Society of Certified Public Accountants, Boston, Mass., Oct. 22, 1934); *Securities Act of 1933—An Appraisal*, N. Y. Herald-Tribune, Jan. 2, 1935; *The Federal Securities Act: An Examination by a Critic*, N. Y. Times, Oct. 15, 1933.

however, that so long as the issuer and those in control of the issuer are, in effect, absolute guarantors of the complete accuracy of all "material" information in a registration statement and prospectus and are not allowed to reduce their liability by proving reasonable investigation and reasonable care, registration statements and prospectuses will probably continue to be unduly long and therefore unduly complex. For example, even though the issuer retains the ablest financial officers it can find, and an accounting firm of the highest reputation to examine and certify to its accounts, engineering experts to certify to its properties, and legal experts to advise it, and acts in the utmost good faith, it may, nevertheless, be liable to a purchaser in case the registration statement, as filed, contained material misstatements or omissions.¹⁴ The accounting officers, the firm of accountants and the other experts may

Dodd, *How Not to Amend the Federal Securities Act—The Fundamental Purpose Should Not Be Impaired* (1934) 20 A. B. A. J. 247.

Douglas and Bates, *The Federal Securities Act of 1933* (1933) 43 YALE L. J. 171; *Some Effects of the Securities Act Upon Investment Banking* (1933) 1 U. OF CHI. L. REV. 283.

Frankfurter, *The Federal Securities Act: II*, FORTUNE MAG., Aug. 1933, p. 53.

Flexner, *The Fight on the Securities Act*, ATLANTIC MONTHLY, Feb. 1934, p. 232.

Gordon, *Accountants and the Securities Act* (1933) 56 J. OF ACCOUNTANCY, 438; *Liability of Accountants Under Securities Exchange Act of 1934* (1934) 58 *id.* 251.

Hall, *Problems of Accountants Under the Securities Act of 1933* (1933) 56 J. OF ACCOUNTANCY, 452.

Hanna and Turlington, *The Securities Act of 1933* (1933) 7 So. CAL. L. REV. 18; *The Securities Act of 1933* (1933) 28 ILL. L. REV. 482.

Herlands, *Interpretation of the Federal Securities Act with particular reference to Criminal Liability, Part 1* (1933) 67 U. S. L. REV. 562; *Part 2*, 67 *id.* 615.

Isaacs, *The Securities Act and the Constitution* (1933) 43 YALE L. J. 218.

Kessler, *The American Securities Act and its Foreign Counterparts: A Comparative Study* (1935) 44 YALE L. J. 1133.

Landis, Address before N. Y. State Society of Certified Public Accountants, *Wall St. J.*, Nov. 1, 1933, p. 10.

Landis, Starkey, Broad, Thomas and Dean, Addresses before American Management Ass'n., Oct. 5 1935.

MacChesney, *The Securities Act and the Promoter* (1936) 25 CALIF. L. REV. 66.

MacIntyre, *Criminal Provisions of the Securities Act and Analogies to Similar Criminal Statute* (1933) 43 YALE L. J. 254.

Mead, *Amend the Securities Act* (1933) 1 ECON. FORUM, 425; *Legis.* (1933) 33 COL. L. REV. 1220

Means, *Protecting the Buyers of Securities; A New Approach*, N. Y. Times, April 9, 1933, §8, p. 3

Rayburn, *Is the Securities Act Sound?* TODAY, Dec. 30, 1933, p. 7.

Rodell, *Regulation of Securities by the Federal Trade Commission* (1933) 43 YALE L. J. 272.

Seligman, *Amend the Securities Act*, ATLANTIC MONTHLY, March 1934, p. 370; *An Analysis of the Securities Act Amendments*, N. Y. Times, June 6, 1934.

Shulman, *Civil Liability and the Securities Act* (1933) 43 YALE L. J. 227.

Starkey and Henderson, *Practice under the Securities Act of 1933 and the Securities Exchange Act of 1934* (1934) 58 J. OF ACCOUNTANCY, 451.

Wherry, *The New Federal Securities Act* (1933) 12 P. U. FORT. 123.

The Responsibility of Directors, THE ECONOMIST, Dec. 23, 1933, p. 1222.

Comment, *Civil Liability for Misstatements in Documents filed under Securities Act and Securities Exchange Act* (1935) 44 YALE L. J. 456.

Comment, *Liability of Directors and Officers for Misrepresentation in the Sale of Securities* (1934) 34 COL. L. REV. 1090.

Report of Special Committee of Am. Bar Ass'n on Amendments to the Securities Act of 1933, April, 1934.

Supplemental Report of Special Committee of Am. Bar Ass'n on Amendments to the Securities Act of 1933, April 15, 1935.

¹⁴ Securities Act, §11.

escape liability by sustaining the burden of proof imposed by Section 11 of the Securities Act of 1933 with respect to reasonable investigation and reasonable grounds to believe in the truth of the matters certified. But the issuer itself is held to a rigorous and inexorable standard. Admitting, for the purpose of discussion, that the burdens placed on an issuer under the Securities Act of 1933 may, in our complex society, be socially desirable, the fact remains that the public should not be surprised to find issuers setting forth in their registration statements all sorts of apparently irrelevant facts, in the greatest of detail, in an endeavor not only to avoid ultimate liability but to avoid such liability being asserted. It is not pleasant to be accused, even though the suit is later won, of having sold securities on the basis of misleading information. And since no one can assure an issuer that reasonable investigation and reasonable care will save it from liability, or can assure it in advance that data suggested for insertion in a statement definitely is not "material," it is hard to blame the issuer and its officers for inserting what seems like irrelevant data if they honestly believe it to be "material." Many counsel argue that the mere fact that reasonably-minded men can argue as to whether something is or is not "material" is a fairly good reason for its inclusion. To be sure, the Commission has, in its instruction book to Form A-2, sub-division 6, under "General Rules as to the Form," stated:

"Where 'brief' answers are required, brevity is essential. It is not intended, in such case, that a statement shall be made as to all the provisions of any document, but only, in succinct and condensed form as to the most important thereof."

This is distinctly helpful but it is also obvious that the issuer and its counsel must decide as to which are "the most important thereof" and must satisfy themselves that the statements in "succinct and condensed form" or in "condensed or summarized form" do not (so far as the registration statement is concerned)

"contain an untrue statement of a material fact or omit to state a material fact required to be stated in the registration statement or necessary to make the statements therein not misleading"¹⁵

and do not (so far as the prospectus is concerned)

"include an untrue statement of a material fact or omit to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading."¹⁶

In Rules 821 through 838 and in the instruction book for Form A-2, entitled "Instructions as to the Prospectus," the Commission has stated:

"The information set forth in a prospectus, except as to financial statements, may be expressed in condensed or summarized form."

Persons who are inclined to be critical of an issuer or its counsel for not following the admonitions of the Commission exactly should remember that each prospectus

¹⁵ *Ibid.*

¹⁶ *Id.* §12(2).

must also contain (presumably pursuant to Section 23 of the Act) the following statements:

"These securities have not been approved or disapproved by the Securities and Exchange Commission. The Commission has not passed on the merits of any securities registered with it. . . .

"It is a criminal offense to represent that the Commission has approved these securities or has made any finding that the statements in this prospectus or in the registration statement are correct."¹⁷

To avoid liability with respect to an allegedly deficient prospectus under Section 12(2) of the Securities Act, the seller must prove (if the purchaser has proved he did not know of the untruth or omission complained of) either that the prospectus did not include an untrue statement of a material fact, or that it did not omit to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading. Or else that "he (the seller) did not know, and in the exercise of reasonable care could not have known, of such untruth or omission." Since the prospectus is a digest of the registration statement, the status of a registrant, who is found to have condensed unduly in a prospectus data to be found in the registration statement, may be anything but a happy one when he endeavors to prove he "could not have known, of such untruth or omission." He must have known the full facts, since they are in the registration statement. He must accept the responsibility for determining, as a matter of law, that there has been no *undue* condensation.

Harold H. Neff, Director of the Division of Forms and Regulations, has said:

". . . The prospectus is meant to be an epitome or summary, and, obviously, cannot be as discursive as the longer registration statement. The rule clearly indicates that the prospectus is not to contain the same degree of particularity as the registration statement.

"It is patent, therefore, that condensation or summarization involves omission; for it is not to be assumed that surplusage is contained in the registration statement itself. Indeed, in most places in the registration statement, answers are required to be stated briefly. A summarization or condensation of matter which has already been stated briefly must, of necessity, involve a greater brevity and an increased terseness, which can be attained only by a reduction in word content. To repeat, this reduction can be achieved only by the omission of material."¹⁸

This is, of course, helpful but with the possibility of facing a vigorous cross-examination of why this, that and the other item was omitted or perhaps unduly condensed from a registration statement in questionnaire form, the issuer may be pardoned for not taking full advantage of this excellent but nevertheless only permissive advice. The registrant can always play safe by summarizing at length rather than briefly. He is not compelled to condense and hence cannot plead compulsion.

¹⁷ See subdivision 3 under "Instructions as to the Prospectus" in Instruction Book—Form A-2, Securities Act Release No. 598, Dec. 10, 1935; S. E. C. GEN. RULES AND REGULATIONS, Rule 825.

¹⁸ Securities Act Release No. 874, July 2, 1936.

He summarizes entirely at his own risk. Hence, there is no surety that if the advice quoted above is followed, it may not result in liability.

At the risk of being tiresome, it must be repeated that in case a suit is brought alleging that a registration statement on its effective date

“contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading”

the issuer has two defenses, and only two, *i.e.*:

1. That at the time of the acquisition of the security, the person suing knew of such untruth or mission, or

2. That any portion or all of the damages claimed represents depreciation in value of the security in question from some other cause than the one alleged in the complaint, *i.e.*, that a particular part of the registration statement on its effective date was not true or else that it omitted to state a material fact required to be stated therein, or necessary to make the statements therein not misleading.

According to the Rules of the Commission,¹⁹ although the Act does not require it, a prospectus must be filed as an exhibit to the registration statement, so that apparently an issuer may be sued under Section 11 as well as under Section 12(2) for errors or omissions in the prospectus.

The foregoing is all rather academic, of course. What are these great problems with which the issuer and his counsel are concerned? Why do they not assume their social responsibilities, tell the truth in a straightforward manner and be done with all this arguing?

III

STEPS IN THE PREPARATION OF REGISTRATION STATEMENTS AND PROSPECTUSES

It is difficult to discuss the problems an issuer faces in preparing a registration statement apart from a consideration of some of the work which has to be done in preparing and passing upon a securities issue. Most of the work listed below, with the exception of the preparation of the registration statement and of the prospectus in the form prescribed by the Commission, had to be done prior to the passage of the Securities Act of 1933. All of the work enumerated below may not, for one reason or another, have to be done on a particular issue. Each issue presents difficult and unique problems, and the writer does not intend to indicate that neglect or failure to investigate any one or more of the following items would be a failure to use due care. The mere statement of some of the problems may sound trivial. It is the multiplication of problems, however trivial, that causes difficulty, and many of these problems, however unimportant they may sound, frequently take many hours and days of hard work to solve. In order to discuss the problem in its true perspective, let us therefore enumerate some of the questions which must be considered, studied and decided.

¹⁹ Form A-2 contains the following: “This registration statement comprises: . . . (4) The prospectus, consisting of. . . pages.”

Let us assume we are preparing a registration statement for a public utility corporation which proposes to issue \$10,000,000 of bonds to refund an outstanding issue. In order to simplify the discussion, let us assume it can file its statement on Form A-2,²⁰ although the task of deciding which form to use frequently involves a detailed investigation and checking with the Commission. Reference will therefore be made to Form A-2, the simplest of all of the forms promulgated by the Commission for the registration of securities under the Securities Act of 1933. If it were necessary to use Form A-1, the work would be magnified many times. Since the outstanding bonds are, let us assume, only callable on an interest date on thirty days' notice, we obviously must start the work of preparing the registration statement and prospectus in time to permit the following:

1. *Assignment to Various Individuals of the Task of Assembling Information.*

(a) The assignment to various officers of the issuer and of its subsidiaries of the task of getting up the necessary data for the registration statement, with instructions to submit the proposed answers, with the supporting data, by a definite date. This date must be sufficiently in advance of the proposed filing date to allow time for checking the data, recasting it in proper form and correlating it with the whole. This involves a careful study of the various questions in the form and explaining

²⁰ Instruction Book for Form A-2 for Corporations provides in part as follows:

"Rule as to the Use of Form A-2 for Corporations.

This form is to be used for registration statements, except such statements as to which a special form is specifically prescribed, under the Securities Act of 1933, as amended, by any corporation which files profit and loss statements for three years and which meets either one of the following conditions: (a) such corporation has made annually available to its security holders, for at least ten years, financial reports (which may be reports consolidating the reports of the corporation and its subsidiaries) including at least a balance sheet and a profit and loss or income statement, or (b) such corporation had a net income for any two fiscal years of the five fiscal years preceding the date of the latest balance sheet filed with the registration statement. If such corporation has subsidiaries, such income shall be determined on the basis of consolidated reports for such corporation and its subsidiaries. Notwithstanding what is hereinabove prescribed in this paragraph, however, this form shall not be used by any corporation organized within ten years, if the majority of the capital stock thereof was issued to promoters of the corporation in consideration of property or services, or if more than one-half of the proceeds of the sale of securities of such corporation has been used to purchase property acquired by the corporation from the promoters of the corporation.

"(Note: If, under the foregoing Rule as to the Use of Form A-2 for Corporations, the applicability of this form to any corporation depends upon net income, for two fiscal years, and if either or both of such two fiscal years antecede the period for which profit and loss statements are required by the Instructions as to Financial Statements in this Instruction Book, such corporation shall furnish for the information of the Commission at the time the registration statement is filed, but not as a part of the registration statements, profit and loss statements, in addition to those required by the Instructions as to Financial Statements, for the earlier of such antecedent fiscal years and for any intervening period prior to the first year for which such statements are required by the Instructions. Such additional profit and loss statements shall be prepared in accordance with the Instructions as to Financial Statements, except that they need not be certified and no schedules need be furnished.)

"The form is to be used for all statements, falling within the conditions prescribed, filed on or after January 15, 1935, except that Form A-1 may be used for statements for which the rules otherwise permit or prescribe Form A-1, if such statements are filed on or before March 15, 1935."

In addition to the foregoing, there are special rules as to the use of Form A-2 for Corporations, instead of Form E-1, the form normally used in connection with the exchange of securities where the issuer is otherwise entitled to use Form A-2. The Instructions with respect to the use of the Form and the Instructions with respect to the balance sheet must be carefully followed.

what is wanted, supervising the preparation of appropriate questionnaires, agreeing on the officers to collect the data and arranging for a clearing agency.

(b) Assigning the task of investigating the history of the company and its subsidiaries, the general development of the business and of any important changes therein, to officers of the company and to engineering experts.

(c) Assigning the task of investigating the various types of business done, rate schedules, improvements of various types and development or decrease of various types of business done. This should include ascertaining whether materially important plants have been acquired, sold or abandoned; whether materially important changes have been made in the mode of conducting the business; whether there has been a change from steam to hydro or hydro to steam; whether there has been a pronounced drought or pronounced rainfall during the last past several years and if so what the general effect has been upon operating expenses or economies.

2. *Arrangements for the Examination of the Issuer's Accounts.*

(a) Giving of instructions to the accountants to make an examination of the issuer's accounts down through a date as near as practicable to the proposed filing date,²¹

²¹ Ordinarily, according to "Instructions as to Financial Statements" of the Instruction Book for Form A-2, there must be filed at the time of the filing of the registration statement a balance sheet of the issuer and a consolidated balance sheet of the issuer and its subsidiaries, prepared in accordance with the Rules of Consolidation set forth therein, both as of a date within ninety days. If such balance sheets are not certified, there must be submitted, in addition, certified balance sheets as of a date within one year; provided that if the fiscal year of the issuer has ended within ninety days of the date of filing, the certified balance sheets may be as of the end of the preceding fiscal year. There must also be submitted profit and loss statements of the issuer and consolidated profit and loss statements of the issuer and its subsidiaries prepared in accordance with the Rules of Consolidation therein set forth, in each case year by year, for the three years preceding the date of the latest balance sheet filed, and for the period, if any, between the close of the latest of such fiscal years and the date of such latest balance sheet. Such profit and loss statements must be certified up to the date of the last certified balance sheet.

In certain instances the balance sheets required need be only as of a date within six months of the date of filing the registration statement, and the balance sheets of unconsolidated subsidiaries need be only as of the latest fiscal year of the respective consolidated subsidiaries if all of the following conditions are met:

1. No funded debt of the issuer is in default as to principal, interest or sinking fund provisions;
2. The total assets of the issuer, as shown by the latest balance sheet of the issuer filed with the registration statement, amount to \$5,000,000 or more; and
3. The issuer has at least one class of its securities registered on a national securities exchange.

In addition, there are various other exceptions and there are special requirements as to financial statements in case a consolidation shall have occurred within ninety days prior to the date of filing. See Instruction Book for Form A-2, Special Rule 5B. Certified balance sheets and financial statements must be filed for subsidiaries which are not consolidated if the issuer's investment in such subsidiaries is significant in respect of either the assets represented or the sales or operating revenues of the subsidiary. While the Rules of the Commission in this respect are distinctly helpful to an issuer (although some leeway in certain instances of a few days would save much trouble and expense) the underwriters are frequently concerned by a real problem. In order to avoid liability under Section 11, they must prove, in the event of suit, that they had reasonable ground to believe that the statements in the registration statement were true and not misleading on the effective date of the registration statement. With respect to those portions of the registration statement not purporting to be made on the authority of an expert, an underwriter, director or officer of the issuer, if sued, must prove, to avoid liability, that he had, after reasonable investigation "reasonable ground to believe and did believe, at the time such part of the registration statement became effective, that the statements therein were true and that there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading." As regards any part of the registration statement purporting to be made on the authority of an expert, however, an underwriter,

and going over the forms and instructions as to financial statements with the officers of the issuer and accountants. Explaining to accountants that we shall also wish them to make the necessary investigation so they may certify as experts to the answer to question 45, and item 45A of Special Rule 3 and item 45B of Special Rule 5,²²

director or officer need only prove that "he had no reasonable ground to believe and did not believe, at the time such part of the registration statement became effective, that the statements therein were untrue or that there was an omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading." Since it is absolutely impossible for an underwriter, director or officer to make any examination of accounts which would be any protection to him, it is generally considered the better part of valor to have the accountants bring their examination of the financial statements down to as late a date as is practicable before the filing of the registration statement.

²² Question 45 and Item 45A of Special Rule 3 and Item 45B of Special Rule 5B 3(d) as to use of Form A-2 read as follows:

"45. Furnish the information required below as to the prospective captions on the registrant's balance sheet, the balance sheet of the registrant and its subsidiaries consolidated, and each individual or group balance sheet required to be furnished for unconsolidated subsidiaries:

- (a) If, since January 1, 1922, there have been any increases or decreases in Investments, in Property, Plant and Equipment, or in Intangible Assets, resulting from substantially revaluing such assets, state:
 - (i) In what year or years such revaluations were made.
 - (ii) The amounts of such write-ups or write-downs, and the accounts affected, including the contra entry or entries.
 - (iii) If in connection with such revaluations any adjustments were made in related reserve accounts, state the accounts and amounts with explanations.
- (b) If, since January 1, 1922, there have been restatements of Capital Stock, state the amounts of such restatements, and the contra entries. If, since January 1, 1922, there has been an original issue of Capital Stock any part of the proceeds of which was credited to surplus, state such amount.
- (c) If, since January 1922, any substantial amount or amounts of Bond Discount and Expenses, on issues still outstanding, have been written off earlier than as required under any periodic amortization plan, give the following information: (a) title of issue; (b) date of such write-off; (c) amount written off; (d) to what account charged."

Special Rule 3 as to the use of Form A-2 for Corporations provides in part as follows:

"Any corporation filing on Form A-2 by virtue of this Special Rule 3 shall set forth in its registration statement the following additional item, designated as Item 45A, and shall furnish the information required thereby:

Item 45A. As to each business acquired by the registrant directly or through the acquisition of securities in circumstances which would have prevented the use of Form A-2 except for the operation of Special Rule 3 as to the use of Form A-2:

- (a) Describe briefly the transaction by which such business or such securities were acquired, including a statement as to any write-up or write-down in Investments, in Property, Plant and Equipment, or in Intangible Assets, effected in connection with or in the course of the transaction.
- (b) If the business or the securities representative thereof were acquired by the promoter looking to their transfer to the registrant, or within six months prior to their transfer to the registrant, state the cost of such business or securities to the promoter and the total amount of securities and other consideration given to the promoter therefor."

Special Rule 5B 3(d) as to the use of Form A-2 for Corporations provides in part as follows:

"5. Any corporation which was formed by the consolidation of two or more corporations may use Form A-2, if each of the constituent corporations which collectively brought in a majority of the assets, as shown by the books of the constituent corporations prior to the consolidation, could have used Form A-2 if the consolidation had not taken place. In determining whether any such constituent corporation could have used Form A-2, the record of the registrant in regard to income or annual reporting to security holders shall be considered a continuation of such constituent corporation's record. In this rule, all the corporations consolidated to form the registrant are called the 'constituent corporations'.

"Any corporation using Form A-2 by virtue of this Special Rule 5 shall comply with the requirements set forth below: . . .

"B. Requirements as to Financial Statements. The requirements set forth below shall be in complete substitution for the provisions of part 1 of the Instructions as to Financial Statements in Form A-2, captioned 'Financial Statements of the Registrant and its Subsidiaries', except as otherwise specifically

an investigation which means going back to at least January 1, 1922. Checking whether answers will also require explanation on balance sheet and income account, such as, for example, explaining the effect on earned surplus and net income if unamortized bond discount has been charged off to capital surplus prior to the normal period for its amortization. Making sure the accountants will be able to certify the accounts down through the dates prescribed by the Commission. If for any reason the other work is delayed, and, if therefore the statement cannot be filed on the date contemplated, the accountants may have to bring the financial statements down to a still later date. This is expensive, as it means reprinting all the financial schedules and statements and may seriously delay the issue. A delay of one or two days in filing may mean weeks of extra work. While the rules of the Commission, under certain circumstances, permit the financial statements to be as of a date not more than six months prior to the date of filing,²³ if financial statements as of a later date are also included the underwriters have the problem of proving they had reasonable ground, as of the effective date of the statement, to believe such statements were true and correct.

(b) Checking with corporate officers and accountants to see if there are any unusual features in the accounts, such as past write-ups or write-downs of property; mergers or consolidations; acquisition of the assets of going companies; reduction of capital; retirement of securities; or payment of dividends out of current income when capital was impaired. If the registrant is a new corporation, formed as a result of a merger or consolidation as of a recent date, checking to see whether the accountants can prepare the financial statements called for by Special Rule 5B²⁴ of the Instruction Book for Form A-2, and checking with the accountants to see whether earned surplus of the constituent companies may be carried forward and if not what the effect on the surplus accounts will be. Checking with accountants and tax experts as to whether unamortized bond discount of constituent companies may be carried forward; and what the effect will be, if any, on the capital stock tax declarations of the constituent companies, filed pursuant to the Revenue Act of 1936, by reason of increases or decreases in adjusted declared values.

(c) Checking with the accountants as to the reason for and the basis of such write-ups or write-downs; what basis the assets are carried on the books; whether dividends in the past have been declared on a corporate or on a consolidated basis

provided in paragraph 3 below. All other instructions as to financial statements in Form A-2 shall be applicable. . . .

"(d) If no financial statements for constituent corporations are filed pursuant to paragraph 3(b) above, there shall be set forth in the registration statement the following additional item, designated Item 45B, and the information required thereby shall be furnished:

"45B. Briefly describe any increases or decreases in Investments, or Property, Plant and Equipment, or Intangible Assets, or any restatements of Capital Stock or the writing off of Bond Discount and Expense, which were effected in connection with or in the course of the consolidation by which the registrant was formed, and the related entries affecting other balance sheet accounts, together with a brief explanation thereof."

²³ See note 21, *supra*.

²⁴ See note 22, *supra*.

and whether on the basis of depreciated or undepreciated assets;²⁵ and, if on the latter basis, whether such dividends may have been paid from capital.

(d) Ascertaining from the accountants the basis used in determining maintenance, depreciation, retirements and depletion and numerous other questions which are ones of mixed law, accounting and fact.

(e) Examining the minute books of the issuer and its subsidiaries and consulting with the accountants to see whether charges which should have been made to earned surplus have been made to capital surplus and whether an accumulated earned surplus deficit has been charged off to capital surplus; and if so whether the approval of stockholders was obtained at a special meeting pursuant to the recommendations embodied in the exchange of correspondence between the American Institute of Accountants and the Committee on Stock List of the New York Stock Exchange;²⁶ and ascertaining whether, in general, the theories therein set forth have been followed.

3. *Arrangements for Obtaining Opinions of Local Counsel on Points of Law Relating to the Issuer's Capital Structure, Title to Property, Franchises, and to the Status of the Proposed Issue.*

(a) Checking with local counsel to see if the law of incorporation has been followed in all respects: on organization; in connection with the issuance of securities; on any capital reductions or increases and on the retirement of securities; checking statutes and court decisions in state of incorporation as to what constitutes surplus, income, full-paid and non-assessable shares, etc.; checking local decisions as to what assets, such as, for example, good will, intangibles, patent rights, unamortized bond discount, deferred assets, etc., may be included in assets for the purpose of determining surplus; and whether the decisions or law of incorporation distinguish between earned surplus and capital surplus.

(b) Arranging with local counsel to have a title search of all important units of property brought down to the date of (i) the filing of the registration statement, (ii) to a period just prior to effective date of the registration statement, and (iii) to the date of delivery of the securities; checking with local counsel as to what such a title search ordinarily covers in each jurisdiction where the property is located; ascertaining the nature and extent of the search made and whether it must be expanded to include all that such searches ordinarily and customarily cover; ascertaining whether it will actually be made by counsel of good standing or whether they will rely on abstracters; checking extent of abstracters' investigation; if it is made by local title company, checking its record, ascertaining the amount of its capital and surplus and the amount of its outstanding guarantees, etc.; checking whether such a search covers personal property, motor vehicles, etc., and whether it reveals judgment liens,

²⁵ *Guaranty Trust Co. v. Grand Rapids, G. H. & M. Ry. Co.*, 7 F. Supp. 511 (W. D. Mich. 1931).

²⁶ See Extracts from Correspondence between the Special Committee on Cooperation with Stock Exchanges, G. O. May, Chairman of the American Institute of Accountants, and the Committee on Stock List of the New York Stock Exchange (1932-1934).

tax liens, federal income tax liens, franchise tax liens, mechanics' liens, conditional sales contracts, chattel mortgages, etc.; whether an after-acquired property clause in an indenture is valid in all states whether the property to be mortgaged is located or whether intervening liens outrank it; how liens on real and personal property may be created in such jurisdictions and whether a mortgage on a shifting stock of goods is valid;²⁷ ascertaining the necessity for filing and refiling of the indenture, who can act as trustee and whether an individual co-trustee is necessary; method of foreclosure; whether trustee can enter and operate; right to appointment of receiver; right to deficiency judgment; validity of release provisions, of waiver of equity of redemption, of clause as to marshaling of assets, etc.; arranging for metes and bounds description of properties to be included in indenture and obtaining local counsel's approval to statements in registration statement and prospectus with respect to the lien of the indenture and of the security for the bonds.

(c) Arranging with local counsel to check granting and validity of all important franchises; indeterminate permits; rights to use public lands, forest lands, agricultural lands; right of any public body to acquire property by eminent domain; right to cancel franchises, permits, etc.; rights of public bodies to purchase property; basis of determining purchase price, etc.; whether any property escheats to public authority granting permit and if so under what conditions; if original grant of franchise, etc., required its publication, obtaining affidavits as to the manner in which publication was made, checking with statute, clearing defects, etc.

(d) Arranging with local counsel to render such opinions as are called for by the laws of various states in connection with whether securities to be issued are legal investments for savings banks, fiduciaries, etc.; checking with treasurer of issuer and accountants as to revenues derived from territory for which franchise was granted and checking basis of such calculation. Such calculations are usually most involved because of conflicting grants, overlapping territory, forfeitures, the consolidation of rural areas into cities, etc.²⁸

4. *Arrangements for Obtaining Engineers' Reports.*

(a) Arranging for an independent or a company engineer's report tying both the individual and the aggregate book value of all important units of property to the property and plant figures on the balance sheet; obtaining a certificate that all buildings and structures included in property and plant account are actually located on the property described by metes and bounds in the indenture; ascertaining any exceptions and the importance thereof and whether such exceptions are sufficiently material to be mentioned in the registration statement and prospectus; checking with the engineers whether any property included in property and plant account is no longer used and useful and, if so, the extent and value thereof and what footnotes, if any,

²⁷ *Benedict v. Ratner*, 268 U. S. 353 (1925); *Hammond v. Carthage Sulphite Pulp & Paper Co.*, 8 F. (2d) 35, (C. C. A. 2d, 1925); *Brown v. Leo*, 12 F. (2d) 350 (C. C. A. 2d, 1926). See, however, decision of Judge Incl. in *Matter of Bush Terminal Company* (E. D. N. Y., Dec. 16, 1936).

²⁸ See N. Y. BANKING LAW, N. Y. CONS. LAWS (Cahill, 1930) c. 3, §239.

should be put in the balance sheet and the income account; ascertaining if provision is being made for its amortization and, if necessary, explaining the basis.

(b) Determining whether underwriters will wish to have an independent engineer make an examination of the property; if so, whether he is to certify to the answers to certain questions and consent to a statement that they are made upon his authority as an expert in order to give the directors, officers and underwriters the additional protection afforded by Section 11 of the Act; consulting with the examining division of the Securities and Exchange Commission as to whether they will recommend the "acceleration"²⁹ of any amendments if portions of the registration statement are made on the authority of an expert or to what extent they will permit statements to be "certified" by an expert;³⁰ clearing the language in the statement,

²⁹In the case of a non-governmental issuer, if a registration statement is filed and if no amendments are thereafter filed and if it does not appear to the Commission that such registration statement is on its face incomplete or inaccurate in any material respect, it would become effective on the twentieth day after the filing thereof. Normally, however, the public offering price, the "spread" to the bankers (namely, the difference between the public offering price and the price at which the bankers purchased the issue), the redemption price of the bonds and certain other data are customarily filed in an amendment shortly before the normal effective date. Unless such an amendment is filed with the consent of the Commission prior to the normal effective date of the registration statement, the filing of an amendment starts the running of a new twenty-day period. Unless material data is filed too late for the registration division of the Commission to make an adequate examination or unless it deems no public interest will be served, the Commission usually consents to an issuer's request that amendments filed prior to the normal effective date shall be deemed to have been filed as of the same date the registration statement was originally filed. In such cases the registration statement becomes effective the twentieth day after its filing and the consent to the filing of such amendments is colloquially known as "accelerating" the amendments. Inasmuch as underwriters do not like to carry commitments for any longer period than is necessary and since the time factor is of tremendous importance in the success of an issue, it is essential that amendments be cleared with the Commission as rapidly as possible and their consent obtained to the filing thereof. Otherwise the filing of each amendment (and delay usually causes changes in the public offering price) would start a new twenty-day period running so that, unless the consent of the Commission be obtained, the statement would never become effective.

³⁰Although §11 of the Act distinguishes between statements not purporting to be made upon the authority of an expert (with respect to which officers, directors and underwriters in order to avoid liability for alleged misstatements or omissions must prove, first, reasonable investigation and, second, reasonable ground to believe that the statements complained of were true and not misleading) and statements purporting to be made upon the authority of an expert (with respect to which officers, directors and underwriters need prove only that they had no reasonable ground to believe and did not believe that the statements made on the authority of such expert were untrue, or misleading), the Commission recently has been attempting to limit the extent of statements which can be made in a registration statement upon the authority of a "person whose profession gives authority to a statement made by him, who has with his consent been named as having prepared or certified any part of the registration statement." Due to the peculiar wording of §11, an accountant, engineer or appraiser or other expert who "prepared" or "certified" any part of the registration statement which is subsequently proved to be materially inaccurate may apparently be held liable, but the officers, directors or underwriters apparently do not get the benefit of being able to rely upon such person as an expert, according to the Commission, unless the registration statement specifically states that such portion of the registration statement is made on the authority of such person as an expert. The Commission is apparently proceeding upon the theory that those named in §11 as being liable for misstatements or omissions can have either one defense or the other but cannot have both. They have therefore been attempting to limit the field in which experts can make statements purporting to be made on their authority so as not to give those named in §11 the benefit of this additional defence despite the fact that if such statements are only "prepared" or "certified," the person making or certifying such statements may be held liable. In practice it is exceedingly difficult carefully to distinguish between mixed questions of law and facts or between questions of facts and opinions based on such facts. Inasmuch as it is impossible for some underwriters or directors to make a physical examination of the properties, this becomes particularly important in the case of statements made by engineers or in the case

and ascertaining if the examining division of the Commission will object if references to the expert's report are made in the prospectus; holding conferences as to the scope of the engineering investigation; how long it will take; whether the engineer will report on original cost or present day values, or both; and, if the latter, whether on a basis of reproduction cost new only or on a basis of reproduction cost new less accrued depreciation; whether the engineers are to report on the adequacy of maintenance and depreciation and, if so, whether it is or should be on a straight line, sinking fund, retirement method or a combined maintenance-depreciation method; whether, if past appropriations for depreciation have been too small, the surplus account is overstated and whether past earnings statements have been correct; whether the engineers will report on the general efficiency of the plant and management; its adequacy for present needs; the issuer's future capital requirements; the stability of the demand for issuer's product; the operating costs of issuer in relation to operating costs in the industry; any general advantages or disadvantages of the issuer over its competitors; the correctness of the answers to Items 5, 6 and 7³¹ of Form A-2, etc. In practice, the Examining Division of the Commission also usually requires that the engineers making the report come to Washington, submit their working papers and undergo a rather rigorous examination as to the extent of the investigation which they have made and as to the reasonableness of the investigation which they have made in order to be able to certify the parts in the registration statement attributed to them.

5. Preparation of Mortgage Indenture and Corporate Documents for Proposed Issue.

(a) Arranging for the drafting of the terms and provisions of the securities to be offered and of the appropriate instruments under which they are to be offered, including, in particular, the indenture.

(b) The drafting of the indenture is a long, arduous and difficult task, particularly if the indenture is a so-called "open-end" one permitting the issuance of additional bonds against property additions. Among other things it will be necessary to define "property additions"; to describe in detail the terms and provisions which must be met in order for additional property to be bonded and for property no longer needed in the operation of the property to be released from the lien of the indenture; the terms and provisions on which the proceeds of released property may be withdrawn against property additions; the definition of the sources of earnings which can be included in determining, in connection with future applications for the issuance of additional bonds, whether the company has met the earnings test set forth in

of public officials with respect to foreign governmental issues. This whole question is being studied by the Commission and at the date of writing this article it is difficult to state precisely what rules govern in this connection.

³¹ Items 5, 6 and 7 refer to the general character of the business done and intended to be done by the registrant and its subsidiaries; the general development of the business for the preceding five years; and the general character and location of the principal plants and other important units of the registrant and its subsidiaries, and the manner in which any important units, not held in fee, are held.

the indenture; the drafting of covenants with respect to maintenance, depreciation and insurance; the terms and provisions on which bonds may be redeemed or retired for sinking fund; defining "events of default" and setting forth the manner in which the indenture may be enforced; setting forth the manner in which various terms of the bonds and the indenture may be amended by bondholders at bondholders' meetings; the provisions with respect to the trustee; the manner in which the indenture may be satisfied, and various other provisions.

(c) Preparing a summarization of the terms and provisions of the indenture for Item 15 of the registration statement and for the prospectus.

(d) Examining the ability of the issuer to carry out the proposed program under the law of its incorporation and of states where it is doing business and under existing contracts and indentures, including, if necessary, indentures of parent companies.

(e) Arranging to obtain consents of stockholders and of public authorities required, and attending to drafting of all notices, proxies, minutes, resolutions, documents, papers, notices of redemption, etc., necessary to validate the action proposed and clearing all such documents in advance of the time for their use with the underwriters and their counsel.

(f) Fitting the time schedule for all such action into the time schedule for preparing, filing and clearing the registration statement, the offering and delivery of and the payment for the securities, and publishing the notice of redemption of the outstanding bonds.

(g) Arranging for the summarization of all documents, indentures and contracts called for by Items 14 (funded debt, other than that to be offered), 16 (stock, other than that to be offered), 17 (stock, to be offered), 40 (material pending litigation), and 41 (material contracts), and for the checking thereof as to their accuracy and completeness.

(h) Arranging for the investigation by the underwriters and their counsel of all pertinent data and checking the preparation of all answers and documents with them.

6. Investigation of Legal and Beneficial Interests in Issuer of Officers, Directors and Underwriters.

(a) Sending out questionnaires to officers, directors, stockholders and proposed underwriters as to their holdings of record and beneficially of securities of the issuer and of their interest in any property sold to the issuer or of their interest in any property to be acquired with the proceeds of the issue, and checking and reconciling the replies with the corporate records of the issuer in order to answer Items 29(b), 33, 34, 35 and 38 of Form A-2.³² The preparation of the answers to these items

³² Items 29(b), 33, 34, 35 and 38 of Form A-2, read as follows:

"29(b). The names and addresses of the persons from whom acquired or to be acquired, specifying their relationship to the registrant, if any."

"33. Give the information required below for all persons owning of record or beneficially more than ten per cent of any class of voting stock of the registrant:

frequently presents very difficult and confusing problems to an issuer and its counsel. Thus, if an underwriter replies that it has no beneficial interest in any stock of the issuer but the issuer's records show that the underwriter is a record owner of certain of the issuer's stock, then reply and records must be reconciled. How far should the issuer go in obtaining replies from individual members of a partnership in addition to a reply from the partnership itself?⁸³ How far must an issuer investigate what the situation is with respect to officers, directors, stockholders and underwriters who are also executors of wills, trustees of estates or guardians of the property of infants or who are generally believed to be interested in other companies, when there are shares of the issuer owned by such estates, trusts, other companies, etc. The problem may be further complicated by the fact that directors, officers, stockholders and individual partners in banking firms which are underwriters may be named as legatees in such wills or may be life tenants or remaindermen under the trusts or may have stock of the issuer pledged with them as collateral for a loan or may be,

"As of

Owner of record Name and address	Beneficial owner (if known) Name and address	Title of issue	Amount owned	Per cent of the class"
-------------------------------------	--	----------------------	-----------------	------------------------------

"34. The following information as to the registrant's securities owned of record or beneficially by each director and officer of the registrant, each underwriter named in answer to Item 22, and each security holder named in answer to Item 33.

NAME	POSITION	Securities owned as of		Securities owned of (Approximately one year previous)	
		Title of issue	Amount	Title of issue	Amount"

"35. Full particulars as to the nature and extent of any substantial interest of every director, principal executive officer, underwriter named in answer to Item 22, affiliate, and of every security holder named in answer to Item 33, in any property acquired within two years, or proposed to be acquired, not in the ordinary course of business. Include the cost of any such property to any such person."

Note that the cost "to any such person" must be given even though such property were acquired over a period of years and may have been acquired many years ago.

"38. For all securities of the registrant sold by the registrant to any persons other than employees within two years, furnish the following information:

- "(a) Title of issue, and if stock, the par or, if no par, stated value, if any.
- "(b) Amount sold.
- "(c) Date of sale.
- "(d) Aggregate net cash proceeds, or the nature and aggregate amount of any consideration other than cash, received by the registrant.
- "(e) Names of principal underwriters, if any, indicating any such underwriters as are affiliates of the registrant."

Note that this requires the listing of securities issued even though issued upon the exercise of conversion privileges, warrants, options, etc.

⁸³ See Securities Exchange Act Release No. 79, Jan. 13, 1935, setting forth the opinion of John J. Burns, General Counsel of the Securities and Exchange Commission, as to the manner and extent returns should be filed under §16(a) of the Securities Exchange Act of 1934, in the case of securities held by personal holding companies, partnerships, etc., and Rule NA1 of the Securities and Exchange Commission. See also Exchange Act Releases No. 116, March 9, 1935, No. 175, April 16, 1935.

in turn, stockholders in, or own collateral trust notes of, a company which, in turn, owns securities of the issuer. What is the true meaning of "beneficial interest" in a security?³⁴ To what extent should the corporate fiction be disregarded?³⁵ Determining the correct answers to the questions in some cases presents metaphysical questions which would have delighted mediæval philosophers compelled to discuss such prosaic subjects as "how many angels can dance on the point of a pin," but as practical, everyday lawyers we may perhaps be excused for wondering at what point it is unwise to spend any more of the issuer's money to ascertain the non-ascertainable and also to wonder as to the value of such detailed information to an investor, even if ascertainable. While the issuer is excused, by the Commission's instruction book, from obtaining information where unreasonable effort and expense is involved, who is to be the final judge whether unreasonable effort or the expenditure of unreasonable sums of money is necessary to obtain this information?

7. Investigation of Issuer's Contracts, Pending Litigation, Patents, etc.

(a) Examining contracts of the issuer and subsidiaries in order to ascertain their materiality and whether they were made in the ordinary course of business in order to determine whether they must be summarized in the answer to Item 41.³⁶ Cross-examining officers of the issuer and subsidiaries as to the facts surrounding such contracts and ascertaining the following to the extent deemed "material" or appropriate:

- (1) How many contracts of a similar nature there are;
- (2) The gross profits derived from each contract and the relation thereof to total gross profits;
- (3) The estimated net profits derived from each contract to total net profits;
- (4) What items are deducted and what are not in arriving at "net profits"; whether the issuer's calculation of "net profits" is correct;
- (5) Whether the contract originally called for installation of special machinery to manufacture the article called for by the contract, which machinery could not be utilized in whole or in part to manufacture other products in case the contract were cancelled;
- (6) Whether the contract calls for a product of special specifications for which there is a limited market and whether it would be difficult to make equivalent profits with other products if the contract were cancelled;
- (7) Any additional capital outlay, if any, which would be required to compete for ordinary business if the answer to (5) and (6) is "yes" in whole or in part;
- (8) Whether the contract contains any unusual features not present in other contracts and whether an average prudent investor should be informed of such features;

³⁴ See note 33, *supra*.

³⁵ See BERLE AND MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* (1932) 80.

³⁶ Item 41 in Form A-2 reads as follows:

"Dates of, parties to, and general effect briefly and concisely stated of every material contract not made in the ordinary course of business, to be performed in whole or in part at or after the filing of the registration statement or made not more than two years before such filing. Only such contracts need be set forth as to which the registrant or a subsidiary of the registrant is a party or has succeeded to a party by assumption, assignment or otherwise, or has a beneficial interest."

See also Instruction Book for Form A-2 with respect to this item.

- (9) Whether the contract calls for the sale or purchase of goods above or below the market. If the sales price is above the market, whether such price is apt to affect the financial condition of the purchaser from the issuer so as to threaten its continued ability to take deliveries under the contract, and if so whether the issuer could obtain another purchaser, and at what price. If the sales price is below the current market, whether it is apt to affect the financial condition of the issuer and whether possible losses therefrom have been reserved against. If reserved against, in what manner was the reserve arrived at and is it reasonable and adequate. If the contract calls for the purchase of goods below the market, will the termination or cancellation of the contract affect future earnings, and is it sufficiently material to warrant the placing of a footnote in the earnings statement. And if it calls for the purchase of goods above the market, will it affect the issuer's ability to sell its goods at a profit.
- (10) Will the loss of the product called for by the contract, if the contract is cancelled, substantially affect the cost of producing the remaining product sold to others so that the ability of the issuer to compete would be substantially affected.
- (11) Checking the judgment of officers of the issuer on the above matters with others.
- (12) If the contracts are to be filed with the Commission as confidential, pursuant to Rule 580,³⁷ determine whether, even if the Commission grants confidential treatment, the substance of the contracts should be revealed in order to inform an investor in accordance with common law principles of disclosure.
- (13) Examining contract and in the light of new laws, such as the Robinson-Patman Act, and considering whether any notes should be appended to the income accounts because of possible changes in earnings, etc.

³⁷ "Rule 580. *Non-disclosure of Contract Provisions.* Public disclosure will not be made of the provisions of any material contract or portion thereof if the Commission determines that such disclosure would impair the value of the contract and is not necessary for the protection of investors. In any case where the registrant desires the Commission to make such a determination, the procedure set forth below shall be followed:

(a) The registrant shall omit from the registration statement as originally filed any reference to or copy of the portion of the contract which it desires to keep undisclosed, or, if the registrant desires to keep the entire contract undisclosed, any reference to or copy of the contract.

(b) The registrant shall file with the registration statement, but not bound as part thereof, (i) three copies of the contract or portion thereof which it desires to keep undisclosed, clearly marked "Confidential," and (ii) an application for an order making the above described determination. Such applications shall set forth the considerations relied upon for obtaining such order.

(c) Pending the granting or denial by the Commission of an application filed in accordance with paragraph (b), the terms and existence of the contract or portion thereof will be kept undisclosed.

(d) If the Commission determines that the application shall be granted, an order to that effect will be entered.

(e) Prior to any determination denying the application, confirmed telegraphic notice of an opportunity for hearing, at a specified time within ten days after the dispatch of such notice, will be sent to the agent for service.

(f) If after such hearing the Commission determines that the application shall be granted, an order to that effect will be entered.

(g) If after such hearing the Commission denies the application, confirmed telegraphic notice of the order of denial will be sent to the agent for service. In such case, within ten days after the dispatch of such notice, the registrant shall have the right to withdraw the registration statement in accordance with the terms of Rule 960, but without the necessity of stating any grounds for the withdrawal or of obtaining the further assent of the Commission. In the event of such withdrawal, the contract or portion thereof filed confidentially will be returned to the registrant.

(h) If the registration statement is not withdrawn pursuant to paragraph (g), the contract or portion thereof filed confidentially will be made available for public inspection as part of the registration statement; and the registrant shall amend the registration statement to include all information required to be set forth in regard to such contract or portion thereof."

See, however, Securities Act Release No. 1292, Feb. 26, 1937.

(14) Determining whether contracts which have expired or are about to expire should be noted in connection with the income account.

(b) Examining all papers and pleadings in pending or threatened litigation. Cross-examining officers and others as to the facts and materiality of such suits. Obtaining summarization of pleadings by counsel in charge and his consent to its use in reply to Item 4G.

(c) Consulting with patent or copyright counsel as to importance of patents or trade names in carrying on business of issuer and obtaining, if necessary, statement by engineer or other industrial expert or patent or copyright counsel or both, as to the part patents or trade names play. Obtaining from patent or copyright counsel summary of any material patent litigation and, if necessary, having patent or copyright counsel certify as an expert the answers to Item 40.³⁸

(d) Cross-examining officers whether they know of anything in relation to issuer and its affairs that an average prudent investor should know, even though not specifically called for by the form, such as, for example, any pronounced change in the trend of gross sales or net income, etc.

(e) Sending questionnaire to all experts so as to be able to answer Item 44.³⁹

8. Checking Pertinent Corporate Documents, Statements, and Reports, and Status of Outstanding Securities.

(a) Arranging with the secretary of the issuer for the collection of certified copies of charters, by-laws, indentures, contracts, franchises and other supporting documents; having them proof-read against originals and having the summarization thereof in the registration statement checked for accuracy.

(b) Checking information in all questions and in financial statements with recent annual reports, reports to trustees, listing applications on stock exchanges, reports to public bodies, income tax returns, correspondence, etc.

(c) Arranging for correlation of all work by examining all data presented, straightening out inconsistencies, obtaining additional information, filling in the gaps in the information and rechecking all of the answers in the light of all of the information at hand. In case the utility has been included in the Federal Trade Commission investigation, examining Federal Trade Commission reports for comments on write-ups, etc.

³⁸ Item 40 in Form A-2 reads as follows:

"Outline briefly the substance of the claims involved in, and state the title of, any material pending legal proceeding to which the registrant or one of its subsidiaries is a party or of which property of the registrant or of one of its subsidiaries is the subject, if such proceeding departs from the ordinary routine litigation incident to the kind of business conducted by the registrant or its subsidiaries, as the case may be; make a similar statement as to any such proceeding known to be contemplated by governmental authorities."

³⁹ Item 44 in Form A-2 reads as follows:

"If any expert named in the registration statement as having prepared or certified any part of the statement (a) has any interest of a substantial nature in the registrant or any affiliate thereof or is to receive any such interest as a payment for such statement or (b) is an officer or employee of the registrant or any affiliate thereof, or (c) has been employed upon a contingent basis; furnish a brief statement of the nature of such interest, office, employment or contingent basis."

(d) Arranging for and obtaining certificate from each transfer agent, registrar and warrant agent and from each trustee of an indenture as to securities of each class of issuer outstanding as of date of latest balance sheet of registrant filed with statement and of any material changes since then, and checking with answers to Items 9A and B, 10A and B, 11A and B, 12A and B and 13A and B.⁴⁰ Obtaining statement from each trustee as to amount of securities pledged and in any sinking fund.

9. *Conferences on Registration Statement and Prospectus.*

(a) Arranging for circulation of drafts of registration statement and prospectus among directors, officers of the issuer, engineers, accountants, underwriters, lawyers for the underwriters, and if need be lawyers for the accountants, and arranging for conferences at which everyone's comments will be gone over and checked.

(b) Arranging for meeting or series of meetings between principal executive officers of issuer, its counsel and underwriters and underwriters' counsel, the accounting and engineering experts to clear program, documents, text of registration statement, etc., and to enable underwriters to ask any questions that have occurred to them, in their investigation of the issuer and its affairs and in their examination of the registration statement.⁴¹

⁴⁰ These items call for detailed information with respect to authorized funded debt; funded debt to be offered under the registration statement; each class of authorized capital stock; capital stock to be offered under the registration statement; information with respect to each class of securities of other issuers guaranteed by the issuer; guaranteed securities to be offered under the registration statement; warrants or rights granted by the issuer to subscribe for or purchase securities of the issuer; warrants to be offered under the particular registration statement; information with respect to any other class of securities not previously called for by Items 9A, 10A, 11A, and 12A; and information with respect to any class of securities other than those called for by Items 9B, 10B, 11B and 12B, to be offered under the particular registration statement.

⁴¹ Such meetings have been described as presenting a "somewhat ludicrous picture of partners or perhaps office boys representing the ten, twenty, or more underwriters meeting in solemn session to 'investigate' the accuracy and sufficiency of the registration statement by having it read to them by counsel. When a law demands the impracticable it is not surprising to find business men performing rituals which are apt to be meaningful only to lawyers." See Bates, *Some Effects of the Securities Act upon Investment Banking Practices* (Jan. 1937) 4 LAW AND CONTEMPORARY PROBLEMS, 72, at 77.

If the only purpose of these meetings was to have the registration statement read by counsel, then that would present a somewhat ludicrous picture. One of the anomalies of the Act, however, may be that an "originating underwriter" may be able to sustain the burden of proof because of the thoroughness of the investigation made by its buying department, whereas a small underwriter with a limited participation would not, as a practical matter, make the same investigation. The writer has therefore advised all underwriters where they are not originating the issue, that they should carefully examine the registration statement and prospectus and that they should have some one in their buying department make a careful examination of the registration statement and prospectus, and has recommended to originating underwriters that they should afford non-originating underwriters full opportunity to cross-examine the members of their buying department making the investigation, the officers of the issuer, counsel for the underwriters, counsel for the company and the accountants certifying to the financial statements in order that all questions occurring to any of the underwriters in connection with the issue, the registration statement or the prospectus may be cleared up. The writer has never known office boys to attend such meetings and would not advise such a procedure. In view of the attempts of the Commission to limit the statements which can be made upon the authority of an expert (see note 30, *supra*) and since the Commission has never expressly ruled that a non-originating underwriter can rely upon the investigation made by the originating underwriter, it would seem that such meetings are more than "ritual." Since, in the event of suit one underwriter can receive contribution from another (unless he is guilty of fraud) in accordance with the provisions of §11(f), it is also advisable that the originating underwriter be careful to disclose everything that his investigation has revealed to a non-originating underwriter.

10. *Arrangements for Authorization of Issuance, Sale, and Listing of Proposed Issue.*

(a) Arranging to file application with all state commissions, Federal Power Commission⁴² and Securities and Exchange Commission,⁴³ if the issuer is a subsidiary of a registered holding company and is not otherwise exempt, and with all other public regulatory bodies having jurisdiction, asking for permission to issue and sell the securities at a price to be fixed, asking for authority to continue to amortize, for a period to be agreed upon, the remaining unamortized portion of the bond discount applicable to the issue to be refunded, etc., and preparing the necessary papers.

(b) Holding hearings on such applications before all such public regulatory bodies having jurisdiction.

(c) Obtaining order to sell the securities from each public regulatory body having jurisdiction.

(d) Arranging for qualifying the proposed issue under "Blue Sky" laws of various states in which it is proposed to offer and obtaining clearance in time to offer, and examining provisions of such laws to see if they have particular requirements as to what may and may not be said in the title or the text of securities.⁴⁴

(e) Arranging for reserving of space for underwriters' advertisement in newspapers on morning of offering,⁴⁵ clearing a hedge clause with Blue Sky Commissioner in each state where advertisement is to be published in case the names of the underwriters who are not qualified dealers in that state are to appear in the advertisement.

(f) Arranging to have listing applications prepared and cleared with all listing committees on national securities exchanges on which it is proposed to list the bonds, preparing Form 10 or other appropriate form under the Securities Exchange Act of 1934, and requesting an order of the Commission making registration under the Securities Exchange Act of 1934 effective on the morning of the offering or as soon thereafter as possible.

11. *Arrangements for Underwriting Agreement and "Red Herring" Prospectus.*

(a) Arranging for drafting of purchase contract (contract between several underwriters and issuer, sometimes known as underwriting contract), underwriting agree-

⁴² See Federal Water Power Act, Part II, §204(a), 49 STAT. 850, 16 U. S. C., c. 12, §824c.

⁴³ See Public Utility Act of 1935, Tit. I, §6, 49 STAT. 814, 15 U. S. C., c. 2C, §79f.

⁴⁴ The information called for by these various state laws, the procedure thereunder and the theory on which these laws are enacted, are wide and varied.

See Smith, *The Relation of Federal and State Securities Laws*, *infra*, p. 241. Ed.

⁴⁵ Ordinarily, a registration statement, unless delaying amendments are filed or unless the Commission finds deficiencies which cannot be corrected by amendment satisfactory to the Commission, becomes effective on the twentieth day after the date of its filing. The effective date is therefore 12:01 A.M. on the morning of the effective date. In the summer time, however, New York is on Eastern Daylight Saving Time, and Washington, D. C. is on Eastern Standard Time, and the effective date is 1:01 A.M. Eastern Daylight Saving Time. Certain lawyers believe it improper, under Section 5 of the Act, to allow advertisements of the securities to appear in the newspapers which are on the streets before the true effective date, although this causes real inconvenience and expense to newspapers. See, however, correspondence between Judge John J. Burns, General Counsel of the Securities and Exchange Commission, and *The Boston Post*, June 13, 15, and 18, 1936.

ment (agreement between several underwriters), selling group agreements (arrangements between underwriters and dealers), etc., and for summarization of purchase contract and of selling arrangements in registration statement and prospectus.

(b) Ascertaining from the underwriters if they wish to have inserted in the agreement between the underwriters any right to trade in the outstanding securities of the issuer or to trade in the securities to be offered or to over-allot them¹ or to go short with respect to them, the advisability of including such agreements being a matter of opinion, concerning which there is considerable disagreement because of the rigorousness of Section 9(a) (2) of the Securities Exchange Act of 1934; ascertaining whether the securities are to be listed and conferring with underwriters with respect to Section 9 of the Securities Exchange Act of 1934 and Section 15 of that Act if the securities are not to be listed; arranging to have a paragraph in the underwriting agreement authorizing the manager of the underwriting group to trade in the securities; arranging to have it included in the prospectus and to have a provision placed upon the front of the prospectus reading substantially as follows:

"For further details as to the terms of the offering and for a statement as to the purchases and sales of bonds or of other securities of the company which may be made in connection with the marketing of the bonds or otherwise by the several underwriters, or by, as representative of the several underwriters, for their several accounts, either for long or short account, in the open market or otherwise, within the limits and for the periods set forth in the agreements hereinafter referred to, see page of this prospectus."⁴⁶

(c) Arranging to have the underwriters circulate "red herring" prospectus among dealers and to circulate "red herring" letters to dealers, announcing the terms of

⁴⁶In addition to considering the provisions of §9 and §15 of the Securities Exchange Act of 1934 as to how far underwriters may lawfully go in trading in securities without violating the provisions of the Securities Exchange Act of 1934, there must also be considered the fact that the public should probably be advised that the underwriters have traded in or proposed to trade in securities of the issuer, including the securities to be offered. See *U. S. v. Brown*, 5 F. Supp. 81 (S. D. N. Y. 1933); *Harper v. Greshaw*, 82 F. (2d) 845 (Ct. App. D. C. 1936) (holding, Groner and Stephens, JJ., dissenting, that a trading account formed by stockholders and directors attempting to support the market in the stock of a bank in which they were interested might mislead buyers and sellers as to the true market value of the stock and therefore such account was void as against public policy). Cf. *Sanderson and Levi v. The British Westralian Mines and Share Corp. (Ltd.)* reported in the *Times* (London) Nov. 10, 1898, and set forth in full as an appendix to Judge Woolsey's opinion in *U. S. v. Brown, supra*, to indicate that all pool operations are not bad. In the Sanderson case, pool operations were conducted so as to permit the holder of a large block of stock listed on the London Stock Exchange to liquidate his shares without ruining the then existing market for the shares. See also *Willcox et al. v. Harriman Securities Corp.*, 10 F. Supp. 532 (S. D. N. Y. 1933); *Scott v. Brown* [1892] 2 Q. B. 724; Berle, *Liability for Stock Market Manipulation* (1931) 31 *Cox. L. Rev.* 264. See also *Securities and Exchange Commission v. Torr et al.*, 15 F. Supp. 315 (S. D. N. Y. 1936), (decree granting temporary injunction reversed, C. C. A. 2nd, Jan. 18, 1937); *Securities and Exchange Commission v. Otis Co.* (E. Div., N. D. Ohio, Dec. 8, 1936). See also Securities Act Release No. 748 and Securities Exchange Act Release No. 605, April 17, 1936, stating that "certain stabilizing operations do not fall within the prohibitions against manipulation set out in Section 9(a)(2)." At the time this article was written, the Commission had not yet promulgated regulations making certain practices unlawful, pursuant to the authority conferred upon it by §9(a)(6) of the Securities Exchange Act of 1934.

the proposed offering except price, commission to dealers, etc.,⁴⁷ so that dealers may investigate merits of issue prior to actual offering.

12. *Preparation of Prospectus.*

(a) Drafting prospectus after registration statement is in practically final form, checking against "Instructions as to the Prospectus" and clearing with all interested parties. The preparation of the prospectus, if well done, is a task of considerable magnitude. There has been criticism of their length and complexity and of the rôle lawyers play in the drafting of them.⁴⁸ The writer believes the prospectus can be made a readable and an intelligent document and has, in common with other lawyers of his acquaintance, spent many hours attempting to make them read clearly, but he believes the Commission will have to authorize the omission of a greater number of items in the registration statement and the prospectus or that the liability provisions of the Act itself will have to be overhauled before real improvement, in the form of materially shorter prospectuses, may be expected. Everyone knows it is

"the 'red herring' referred to above generally reads substantially as follows:

"A registration statement relating to the securities referred to herein has been filed with the Securities and Exchange Commission, but has not yet become effective. Information contained herein is for informative purposes only and is subject to correction and change without notice. Under no circumstances is it to be considered a prospectus or as an offer to sell or the solicitation of an offer to buy the securities referred to herein."

It is a criminal offense to sell or offer to sell securities with respect to which a registration statement has been filed prior to the effective date thereof and any one selling securities during the 20-day waiting period violates §5 of the Act and thereby subjects himself to civil liability pursuant to §12(1) of the Act. However, the theory of the waiting period is that dealers and the public should be informed as to the terms of the proposed security during such 20-day waiting period. While the distinction between merely circularizing information and selling or offering to sell securities within the 20-day waiting period is clear as a matter of theoretical legal definition in the Act itself, as a practical matter it is exceedingly difficult for houses of issue to circularize this information and yet at the same time be able to prove that they did not "offer to sell" or "solicit an offer to buy" within the 20-day period. This is especially true if there is a large demand for the issue, as dealers are very anxious to know how many bonds they may expect "firm" on the date of the public offering. As a practical matter, insurance companies and other large institutional buyers are also furnished with "red herring" registration statements or prospectuses during the 20-day period. Some underwriters also furnish "red herring" prospectuses to their retail customers during this period, but the writer has advised against this because of the practical difficulty first, of being able to control salesmen who are anxious to make a commission, and second, of being able to make the average citizen understand that when a salesman approaches him with information with respect to a security he is not being solicited to make an offer to buy. It would seem to the writer that the entire purpose of the 20-day waiting period would be served and operations under the Act would be greatly clarified if offers to sell or solicitations of offers to buy could be made within the 20-day waiting period, provided that the seller should not be obligated to sell and the buyer should not be obligated to buy until the public offering is actually made. See, however, letter of Baldwin B. Bane, Chief of Securities Division, Federal Trade Commission, incorporated in F. T. C. Release No. 70, Nov. 6, 1933. See also Securities Act Releases No. 464, Aug. 19, 1935, and No. 802, May 23, 1936.

⁴⁸ See Address by James M. Landis before Investment Bankers Ass'n of America at Augusta, Ga., on Dec. 4, 1936, reported in *N. Y. Times*, Dec. 5, 1936, p. 29. "*Problems of Prospectus.* Then, there are the problems that flow from the prospectus. The hope that adequate investment information would be widely circulated is perhaps the keynote of the Securities Act. Yet today, in a market that has a plethora of buyers, the selling document too rarely has the attention paid to it that it deserves. Its length results not so much from the requirements of the law, but from the fact that the writing of what should be popular portrayal of business facts is dominated by lawyers nurtured in the drafting of trust indentures. The responsibility for perfecting the mechanism of the prospectus rests not alone upon the Commission. The prospectus must be used, and its purposes honored. Otherwise, the objectives of existing legislation will be far from being reached."

harder to be brief than verbose and when there are no rewards for shorter prospectuses, but rather definite penalties for too concise prospectuses, it is hard to see where the incentive to be brief is going to come from. The writer admits many prospectuses are too prolix, but it must be borne in mind that they are a digest of a registration statement in question and answer form and the penalties for undue condensation are severe.⁴⁹ The writer is willing to take his share of the blame, but the record of the Commission itself in this respect is not entirely clear, as an examination of deficiency letters would reveal. While it may be fair to say, that "the writing of what should be popular portrayal of business facts is dominated by lawyers nurtured in the drafting of trust indentures,"⁵⁰ it is also only fair to say that in the opinion of some lawyers constantly working on security issues, the Commission itself has sometimes insisted that data, the materiality of which has seemed to such lawyers as rather remote, be inserted in the prospectus at the last minute and these lawyers thereafter have not been inclined to take the time to condense lest they be made to reinsert the omitted data. Since enormous inconvenience is caused by the delay of a public offering date, these last-minute requests are not popular, either with lawyers or clients. They are expensive to correct. It is, of course, only fair to say that in certain cases the amendments are filed too late to afford the Commission proper opportunity for examination and that complaints in those instances about changes at the last minute come with ill grace. Generally speaking, the Commission is most coöperative and the writer has always been impressed with the cordial spirit displayed in the Registration Division in helping to get a statement through on time. Coöperation and not "buck passing" is what is needed to solve this difficult problem of prospectuses, and solved it will be. In passing, it is interesting to compare a recent statement of the Chairman of the Commission,⁵¹ urging shorter prospectuses, with House Report No. 85 (at page 8), released at the time the Securities Act of 1933 was under consideration by the Congress:

"The purpose of these sections is to secure for potential buyers the means of understanding the intricacies of the transaction into which they are invited. The full revelations required in the filed 'registration statement' should not be lost in the actual selling process. This requirement will undoubtedly limit the selling arguments hitherto employed. That is its purpose. But even in respect of certain types of listed issues, reputable stock exchanges have already, on their own initiative, recognized the danger of abbreviated selling literature and insisted upon supervising the selling of [*sic*] literature distributed in connection with such issues, to make certain that such literature includes the same information concerning the issue required in a formal circular filed with and approved by such exchanges. Any objection that the compulsory incorporation in selling literature and sales argument of substantially all information concerning the issue, will frighten the buyer with the intricacy of the transaction, states one of the best arguments for the provision. The rank and file of securities buyers who have hitherto bought blindly should be made aware that securities are intricate merchandise."

⁴⁹ See Securities Act, §12(2).

⁵⁰ See note 48, *supra*.

⁵¹ *Ibid*.

(b) Drafting newspaper prospectus, if one is to be used, and checking against Release No. 523, constituting subdivision "II—Instructions as to Newspaper Prospectuses" in the Instruction Book for Form A-2.⁵²

13. *Arrangements for Completion, Execution, Filing and Amendment of Registration Statement.*

(a) Assembling registration statement, supporting documents and prospectus, having portions made on the authority of experts so certified and obtaining their consents to being named as experts and rechecking against form, instruction book and rules and regulations of the Commission.

(b) Examining whole statement and prospectus for any misstatements or any omissions which would make what is stated misleading. Examining prospectus in light of common law principles of disclosure.

(c) Holding board of directors' meeting to pass on and approve registration statement and various matters in connection with the program.

(d) Obtaining signature in behalf of the issuer, by majority of its directors and by its principal executive officers, principal financial officer, principal accounting officer, etc., and filing registration statement and supporting documents with the Commission.

(e) Examining, approximately ten days later, the deficiency letter, if any, received from the Commission. In a well prepared statement, the deficiencies are usually confined to pointing out that the offering price, the "spread" to the bankers, the commission to the dealers, a copy of the underwriting or purchase contract and statement as to the proceeds must be filed before the statement can become effective.⁵³

(f) Checking and correcting registration statement and prospectus and if need be holding conference with the Commission concerning alleged deficiencies and preparing and filing amendments to take care of any alleged deficiencies.

(g) Signing of underwriting or purchase contract.

(h) Obtaining signatures to and filing of all amendments, including underwriting contract, public offering price, spread to underwriters and dealers, including twenty copies of prospectus, with Commission with a request that amendments be deemed filed on same date as date of original filing of registration statement so statement will become effective on 20th day after filing pursuant to Section 8(a) of the Act and Rule 945 of the Commission and obtaining order of the Commission to that effect so that public offering can be made on morning of effective date.⁵⁴

⁵² A newspaper prospectus is not deemed to be a written prospectus meeting the requirements of §10 for the purpose of §2(10)(a) of the Act. Therefore, the actual securities must be preceded or accompanied by a prospectus meeting the requirements of §10 of the Act or otherwise the seller may be liable for rescission or damage suits under §12(1) for violation of §5 of the Act.

⁵³ The reason for these omissions from the registration statement when filed is indicated in note 29, *supra*.

⁵⁴ Rule 945 reads as follows:

"Rule 945. *Effective Date of Amendment Filed under Section 8(a) with Consent of Commission.*

"A registrant desiring the Commission's consent to the filing of an amendment with the effect provided in Section 8(a) of the Act may apply for such consent at or before the time of filing the amendment. The

14. *Transactions in Connection with Delivery of Securities following Public Offering.*

(a) Bringing of title, franchise and other opinions down to date and examining all proceedings and documents in order to be able to give opinion as to validity of issue.

(b) Clearing form of temporary and definitive bonds with each national securities exchange on which securities are to be listed; giving order for printing of temporary bonds; arranging for signature by company and authentication by trustee.

(c) Arranging for delivery of various officer's certificates called for by underwriting contract, including one setting forth that there have been no material changes since effective date of registration statement except those occurring in the ordinary and normal course of business.

(d) Arranging for delivery of accountant's certificate that there have been no substantial changes in net worth of the company since date of latest balance sheet filed with the registration statement; and having certificates by trustees, transfer agents, etc., brought down to date of closing, setting forth there have been no additional securities issued.

(e) Delivering of securities to underwriters against payment, depositing of money sufficient to redeem outstanding issue with trustee of issue to be redeemed, releasing of the indenture securing the outstanding issue, making arrangements to file the release agreement in all places where property subject to the outstanding mortgage is located, and to file new indenture in all places required by law; and making of arrangements for the publication of the notice of redemption of the outstanding issue in accordance with its terms.

(f) Arranging to obtain affidavit of publication of notice of redemption from proprietors of each newspaper in which it is published.

(g) Arranging to obtain opinion of local counsel that release of indenture securing the outstanding issue and the indenture securing the new issue have been filed and recorded in all of the places required by law.

V

THE DUTY OF THE LAWYER

The task of the lawyer in connection with the offering of securities is, as it has always been, to endeavor to the best of his ability to see that no essentially important element is concealed from the buying public and to approach this task with as great a degree of objectivity as possible. A lawyer must insist that all of his questions be answered fully, fairly and frankly and that no avenues of investigation be closed to him. Otherwise, the sooner he declines to pass upon the issue, the better. He cannot,

application shall be signed by the registrant and shall state fully the grounds upon which made. The Commission's consent shall be deemed to have been given and the amendment shall be treated as part of the registration statement upon the entry of an order to that effect."

of course, take responsibility for the financial statements, but he should examine them carefully and discuss all accounting questions that occur to him with the executive officers of the issuer and the accountants in order to be sure they have received proper consideration. On difficult questions, he should advise the accountants to consult independent counsel. Any lawyer can give his opinion, assuming all material facts have been revealed to him, that to the best of his knowledge and belief the registration statement on its effective date does not contain a misstatement or an omission of a material fact required to make what is stated not misleading, but he cannot and should not assume responsibility for the accuracy of the data presented (except in so far as it lies within the realm of his personal knowledge) and neither he nor any one can insure that all material facts have been correctly presented and that nothing material has been omitted. Such advice must and never can be more than a lawyer's opinion, *i.e.*, a reasoned conclusion on the basis of the data presented to him and disclosed as a result of his investigation in connection with the preparation of the registration statement. A lawyer can state that in his opinion certain documents and the terms and provisions of the material contracts are properly summarized but he cannot be sure there aren't other material contracts or other facts or factors affecting such contracts that diligent inquiry has not disclosed. Nor can he be sure there aren't contingent liabilities that are not disclosed or other facts which would tend to make what is stated misleading and if he attempts to assure his client that there are no such other facts, and that the registration statement as finally filed does not contain any misstatements of material fact, he may be misleading both his client and the investing public.

In working on a registration statement and prospectus, there is always a tendency to lose sight of the forest because of the trees. The primary purpose of the Act is, of course, to give an investor proper information before he invests. It is not designed to put unnecessary burdens on an issuer nor is it designed primarily to punish the unwary. The statements should therefore be drafted in as simple language as possible in an effort to help the investor. This aim should be stressed rather than stressing the drafting of statements in technical language which has as its primary purpose the protection of the issuer, the underwriters, etc. "Weasel" wording should be avoided.

Moreover, it must be remembered that the steps listed in the preceding section represent only a bare outline of some of the more important tasks which an issuer and its counsel charged with the responsibility of supervising the preparation of a registration statement under the Securities Act of 1933 must consider and decide. In addition to the numerous other questions of substantive law involved, the task involves considering and discussing with the executive officers of the issuer and with the underwriters the legal phases of the program, the best medium for financing and its effect upon the issuer. The great danger is that the preparation of the registration statement and prospectus will cause the consideration of substantive problems

and the substantive drafting to suffer and, of course, this must not be. If the work is started too early, it will cost the company money in double interest in the case of a refunding issue, *i.e.*, interest on the new issue and on the outstanding issue will run at the same time, and, if started too late, the closing schedule cannot be kept, a possibility which is not even to be considered. In general, it must be seen to that everything moves forward from day to day so that the time schedule may be kept, a task made especially difficult by the fact that, in view of the large number of people made liable, there are, of course, many cooks on a registration statement. All must be satisfied or the experts won't certify their particular little portions; and if they won't certify, then the directors won't sign, and then the underwriters and their counsel won't pass it, etc., etc. The lawyer's work is further complicated by the great difficulty which the Commission has encountered in framing precise questions which will be inclusive enough to educe all material facts and yet not be so inclusive as to make the answers to such questions difficult to prepare.

By way of summary, the main problems involved in the preparation of a registration statement may be briefly divided in the following categories:

1. Describing the type of business done, together with the history and development of the issuer. To get this both accurate and concise is difficult.
2. Summarization of complicated legal documents.
3. Obtaining accurate information as to the record ownership and beneficial ownership of securities of the issuer.
4. Determining what are "material" contracts and summarizing the provisions of and reasons why such contracts are deemed material.
5. Determining questions of control and who are or who were "affiliated interests."
6. Determining the cost of property to such persons in control or "affiliated interests," if such property has been or is to be acquired by the issuer.
7. Making sure that proper notes are appended to the balance sheet and income accounts.

VI

PROBLEMS RELATING TO PROPERTY PURCHASES FROM "AFFILIATES" AND "INSIDERS"

The time, expense and work involved in preparing, for example, the answers to some questions relating to these problems, notably Items 29(b), 33, 34, 35 and 38 in Form A-2 and Items 44 and 51 in Form A-1 and Instruction 1A(c) pertaining to the balance sheet of the issuer on Form A-1,⁵⁵ seem out of all proportion to their value

⁵⁵ Items 29(b), 33, 34, 35 and 38 of Form A-2 are set forth in note 32, *supra*. Items 44 and 51 of Form A-1 and Instruction 1A(c) pertaining to the balance sheet of the issuer in Form A-1, read as follows:

"44. A list of any of such properties purchased from an affiliate directly or through one or more intermediaries, together with the cost of each such property to the affiliated company, if known, and, where such cost is different from the cost to the issuer, a detailed explanation thereof."

"51. If the proceeds or any part of the proceeds of the security to be issued under this registration is to be applied, directly or indirectly, to the purchase of any business, submit a profit and loss statement of such business certified by an independent certified or independent public accountant for the 3 preceding

to the investor. The general character and content of these questions and the abuse of fiduciary relationships in certain outstanding cases in the past, unfortunately complicate the problem confronting honest issuers, underwriters and the Commission. However, an instruction permitting an issuer not to answer these questions, when the amounts involved do not exceed certain sums and when the "interests" of officers, directors, or underwriters in the securities of a vendor of property are not substantial, would be most helpful. For example, an issuer might have or be purchasing property additions from over fifty corporations including such corporations as General Electric, Westinghouse, United States Steel, Anaconda, etc. If, as the Commission claims, property additions are not made in the ordinary course of business the task of checking the "interests" of such persons in such vendors is a large one and the results are usually "nil."

Moreover, since the primary problem in preparing a prospectus is to inform an investor without misleading him, undue emphasis on the bad or so-called "dirt" aspects of an issue may mislead an investor as well as over-enthusiastic selling literature.

For example, some persons lay great stress on whether prospective investors are informed that "insiders" profited on the sale of any property owned by the issuer on the effective date of the registration statement, regardless of the date the issuer acquired the properties,⁵⁶ or the date or dates the "insiders" acquired the properties sold. Determining actual cost to "insiders" of property later sold to an issuer is sometimes a most difficult task. Sometimes the property is merely part of a large block acquired as a unit and there is no separate cost for the property sold to the issuer. Other property acquired at the same time may have been sold or exchanged. Changes in the price level between the date of acquisition by the "insider" and the date of sale to an issuer may also distort the result. Or the issuer may have issued securities with little or no market when issued, which the "insider" has carried for several years and then has sold at a time or from time to time when the securities were selling at high levels. A standard of business morality which permits "insiders" to profit at the expense of stockholders is naturally to be deplored and in so far as such transactions are material, complete publicity is essential. But from the stand-

fiscal years. The profit and loss statement shall be submitted approximately in the form required for the issuer. There shall also be submitted a balance sheet of such business, similarly certified, as of a date not more than 90 days prior to the filing of the registration statement or as of the date such business was acquired by the issuer, if the business was acquired by the issuer more than 90 days prior to the filing of this registration statement. This statement shall be submitted in approximately the same form as required for the issuer. If for any reason it is impossible to present such profit and loss statements or balance sheet, explain fully the circumstances. Consolidated statements for a parent and one or more of its subsidiaries may be furnished in lieu of separate statements of the parent and such subsidiaries."

"Instruction 1A(c). Profits to affiliated interests included therein (if any). If profits of this nature are included in fixed assets, give full details thereof including a brief description of the property, the name of the affiliated interests from whom acquired and the cost of the property to such affiliated interests."

⁵⁶ Form A-2 limits the question to property acquired by the issuer within two years of the date of filing the registration statement, but Form A-1 does not contain a similar limitation. See Item 35 in Form A-2, note 32, *supra*, and Item 44 in Form A-1, note 55, *supra*.

point of materiality, the test should be the value of the property on the date of its sale to the issuer and not the price the "insider" paid for it even though such "value" may be difficult to determine. Indeed, the "insider" may have sold property to the issuer at a loss to himself which may still be a bad bargain for the issuer. In the case of new enterprises or in the case of those formed within a few years prior to the filing of the registration statement or in case such property has recently been acquired, the information may be of real value to an investor, but its probative force fades with the years and may, in fact, confuse him. The very fact that stress is laid on the profit to an "insider" on a transaction taking place years ago may tend to make a prospective investor believe that the figures at which properties are carried on a balance sheet as of a recent date are necessarily indicative of their present-day value and he may therefore be misled in his efforts to appraise the true worth of the securities being offered. There are always a great many things one would like to put in a prospectus but, when one has to choose and condense, the test should be "is it really material?" and not "is it interesting or scandalous?"

Much of the difficulty encountered in the preparation of a registration statement also occurs in attempting to determine whether certain persons or groups of persons fall within the definition of "affiliate" laid down by the Commission. For example, in the Instruction Book for Form A-2, the term "affiliate" or "affiliated" refers to a person who directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, the registrant. The term "control" is defined as follows:

"The term 'control' (including the terms 'controlling,' 'controlled by' and 'under common control with') as used herein, means the possession, directly or indirectly, 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. If in any instance the existence of control is open to reasonable doubt, the registrant may state the material facts pertinent to the possible existence of control, with a disclaimer of any admission of the actual existence of effective control."

Does a person, owning 30% of the voting stock of a particular corporation, possess the power to direct or cause the direction of the management and policies of an issuer? He certainly does not possess the legal power through the ownership of voting securities although he may, in fact, exercise control and domination. Is mere exercise of control and domination sufficient to bring a person within the definition or must he also possess the power to direct? If he possesses the "power to direct" but doesn't use it, is he in "control"? What is the meaning of the phrase "or otherwise"? If a person "controls" the issuer or is "under common control with" the issuer, he is an affiliate and if he is an affiliate, then it is necessary to determine, in answering Item 35,⁵⁷ for example, whether he had any substantial interest in any property acquired by the issuer within two years, or proposed to be acquired, not in the ordinary course of business. If it is determined, first, that the person is an

⁵⁷ For text of Item 35, see note 32, *supra*.

affiliate, and, second, that he did have a substantial interest in the property acquired by the issuer within two years, and third, that the acquisition was not in the ordinary course of business, then the cost of such property to such affiliate must be determined and the difficulties in this connection have already been touched upon. It will also be necessary to ascertain what is "in the ordinary course of business" in order to ascertain what is "not in the ordinary course of business." For example, the Commission in a recent deficiency letter held that all property additions made within two years or to be bought from the proceeds of the issue were to be deemed to be made not in the ordinary course of business. If we examine for a moment the "Instructions pertaining to Balance Sheets of Issuer" for Form A-1, we find that in Instruction 1 we must set forth:

"Profits to affiliated interests included therein (if any). If profits of this nature are included in fixed assets, give full details thereof including a brief description of the property, the name of the affiliated interests from whom acquired and the cost of the property to such affiliated interests."

It will be noted that a person may have been an "affiliated interest" at the time the property was sold to the issuer, but the records of the issuer available today may not disclose that fact and, even if they do, the records of such "affiliated interests" may not be available to the issuer.

In paragraph 9 of "General Rules as to the Form" in the Instruction Book for Form A-2, it is stated that information need be given only in, so far as known or reasonably available to the issuer and that if the information required is not—

"reasonably available to the registrant either because the obtaining thereof would involve unreasonable effort or expense or because it rests peculiarly within the knowledge of another person neither controlling, controlled by nor under common control with the registrant, the registrant shall give such information as it possesses or can acquire with reasonable effort, together with the sources thereof. In such case, there shall be included a statement respectively showing either that unreasonable effort or expense would be involved, or indicating the absence of any relationship of control and the result of a request made to such person for the information; and the registrant may include a disclaimer of responsibility for the accuracy or completeness of the information given relating to that required by the particular item."

The regulation does not say, however, that if a registration statement containing such a disclaimer becomes effective that that is necessarily conclusive evidence that the obtaining of such information would have involved the issuer in unreasonable effort or expense. It therefore frequently becomes necessary to use unreasonable effort and expense in obtaining information of this character because of the worry that a court or jury, at some future time, may find that the obtaining of it would not have involved unreasonable effort or expense. It should also be noted that in order to take advantage of this instruction, it is, in effect, necessary to prove that the information rests peculiarly within the knowledge of another person "neither con-

trolling, controlled by nor under common control with the registrant." Since the concept of "control" does not depend upon the narrow legalistic one of ownership of 51% of the voting stock,⁵⁸ it is frequently a difficult task to obtain all of the facts necessary to decide whether "control" or "common control" exists. In addition, it should be noted that in addition to finding the facts, it is also necessary to arrive at a legal conclusion as to whether "control" does or does not exist and if the legal conclusion is wrong, the registration statement may possibly contain a material omission.

VII

WHAT DO BALANCE SHEET FIGURES MEAN?

Contrary to what seems to be the common belief, accounting does not ordinarily concern itself with present-day valuation of assets but rather with the correct presentation of the history of assets according to accepted principles of accounting consistently followed. Of necessity, a balance sheet cannot constantly be adjusted because of changes in the price level and consequently the figures at which fixed assets are carried do not necessarily represent the value at which they can be liquidated. From an economic standpoint, the figures at which assets are carried on the books of an enterprise, provided they are correctly labeled so that an investor may know the basis on which assets are carried, may have little or no significance, although the changes in these figures from year to year may have great significance.⁵⁹ It is rather what those assets will earn and cost to keep up that counts. Write-ups or write-downs are important to know in determining whether the management is setting aside enough to retire the property at the end of its useful life and whether the dividends received are earned, but from the standpoint of the true worth of the issuer, such write-ups or write-downs may have little or no significance for an investor, despite the fact that such write-ups or write-downs must be presented for a period as far back as January 1, 1922.⁶⁰ As Mr. Hoxsey so clearly points out in an address⁶¹ and as Mr. G. O. May has stated in the numerous papers compiled in his book recently published, *Twenty-five Years of Accounting Responsibility 1911-1936*, write-downs may be as detrimental as write-ups, and where a corporation has reasonably correct historical records of the cost of its plant, these figures should not be

⁵⁸ See H. R. REP. NO. 85, 73rd Cong., 1st Sess. (1933) p. 14: "The concept of control herein involved is not a narrow one, depending upon a mathematical formula of 51 percent of voting power, but is broadly defined to permit the provisions of the act to become effective wherever the fact of control actually exists."

⁵⁹ See exchange of correspondence between the American Institute of Accounts and the Committee on Stock List of the New York Stock Exchange, referred to in note 26, *supra*.

⁶⁰ See Item 45, note 22, *supra*.

⁶¹ See Address, *Writing Down Assets and Writing Off Losses* by J. M. B. Hoxsey, Executive Assistant, Committee on Stock List, New York Stock Exchange, before Mass. Society of Certified Public Accountants, Feb. 23, 1933, p. 9; see Address, *The Influence of Accounting on the Development of an Economy* by G. O. May before the American Institute of Accountants, Oct., 1935, p. 8, printed in *The Journal of Accountancy* for January, February and March, 1936. See dissenting opinion of Mr. Justice Brandeis in *United Railways v. West*, 280 U. S. 234 (1930); see also LIEF, *THE SOCIAL AND ECONOMIC VIEWS OF MR. JUSTICE BRANDEIS* (1930) 199.

lightly cast aside for other figures which, however accurate, can only be accurate for that instant of time. For example, you build a plant costing \$100,000 which earns \$20,000 per year and costs \$15,000 to run. The writer is given an identical plant, costing the same amount, earning at the same rate and costing the same amount to run. You carry yours in your balance sheet at \$100,000 and the writer carries his at 0. Does the figure at which each plant is carried affect either its value, its earning power or its cost of upkeep? If you write yours down to 0 and the writer writes his up to \$100,000, have we changed anything? Let us suppose two years later neither plant is earning anything. Must I write my balance sheet figures down? Then let us suppose two years later each plant is earning \$30,000. Should we write the balance sheet figures up? The mere statement shows how silly it is to talk about a balance sheet being an instantaneous photograph of the condition of a corporation. Or let us suppose some other organization in 1929 built a plant costing \$10,000,000. Let us suppose that the mortgage is foreclosed in 1932 and that the issuer buys this plant at the foreclosure sale for \$2,500,000. In 1932 when the foreclosure sale occurs, the plant is closed down and is earning nothing. In 1937 when a registration statement is filed, the plant is running full time and the proposed issuer is receiving substantial net earnings from this plant. Is the stock of Company A which carries this plant on its books at \$2,500,000 worth any less than the stock of Company B which carries a similar plant, built at the same time, on its books at \$10,000,000 but earning at the same rate? Yet the impression is rather widespread that the figures at which assets are carried on the balance sheet represent their present-day value. And it is this widespread misconception as to the function of accounts that complicates the problem of preparing a registration statement.

VIII

THE VALUE OF THE ACT

There is, of course, an honest difference of opinion as to the value to the investor and the materiality of certain items in Form A-2 and particularly in Forms A-1 and E-1. Some, of whom the writer is not one, doubt the value of the whole method of informing the investor on the ground that the publicity in connection with the Act will mislead investors into thinking they are trading in the full light of day, when this is obviously impossible, since it is the inferences to be drawn from information which is the important thing.

Many persons argue that prospectuses as prepared prior to the Act contained the materially essential elements in connection with an issue. Such prospectuses, when relating to the securities of well known companies or when the securities were being sold by underwriting houses of repute, generally contained, with the addition of certain financial statements, approximately the same information as the Commission now requires in a newspaper prospectus. Therefore people argue that the customary three- and four-page prospectus in use before the passage of the Act told the average

man far more than a complicated registration statement and prospectus, since such a short prospectus represented a screening of the thoughts of trained minds. While much can be said for this point of view, a view held by many honest and competent issuers and underwriters, it must be said with regret that it leaves too much to the individual conscience. An examination of some pre-Act prospectuses will show how ludicrously inadequate some of them were.

The writer is a strong believer in publicity, both as a deterrent to those in fiduciary relationships who, in the past, have not been fully conscious of their obligations, and who might tend to err in the future if their activities were not to be exposed to the light of day, and as a means of building up sound corporate finance.

It seems to the writer that the question is not how much the work on a registration statement costs the issuer, but whether this cost is justified as a necessary social measure in order to prevent the investor from being misled and whether the advantage to the individual investor more than offsets the red tape in which business men and bankers frequently find themselves entangled. Anyone's appraisal of the social worth of the measure will be largely a matter of individual viewpoint. There are those who insist that the advantages of a completely free market, whatever its dangers, and they are legion, outweigh its dangers. Others, conscious of their own moral integrity, resent the interference to their business, the delays and the expense and insist that their businesses are being placed in the hands of theorists, lawyers and accountants. They point out that they built up their business without assistance from the government, that they want none now, and all they want is to be let alone. Others insist that facts with respect to an issuer are not enough; that you must point out that the government is artificially maintaining low money rates and supporting the government bond market and that a rise of 1% in money rates would cause a drastic decline in the market prices of bonds; that new enactments, such as the Robinson-Patman Act, may change the trend of earnings; that the provisions of the Revenue Act of 1936 penalizing the non-payment of dividends have caused unwise disbursements which, in turn, have caused stocks to soar unduly high; that price levels depend on the gold and silver policies, the tariff policies, reciprocal trade agreements and a host of other factors; and that it is impossible to encompass the information an investor should have in a single document and it is misleading to the investor to try.

One can be sympathetic to these viewpoints but after the happenings of the 1920's, completely unregulated security markets seem unthinkable. It may well be doubted that regulation will accomplish all that its enthusiasts claim and too much regulation may be as bad as no regulation at all, but on the whole the writer believes the Securities Act of 1933 and the Securities Exchange Act of 1934, if well administered, are here to stay. Publicity and full revelation, of course, cannot prevent the inexorable operation of economic laws any more than complete regulation of railroads by the I. C. C. could prevent gigantic losses in railroad securities, as new methods of trans-

portation developed. The writer believes that the public will undoubtedly suffer losses in the next depression. Such losses must come as the price society pays for what we are pleased to call progress. If laws can be passed to prevent such losses, then we must be prepared to preserve the status quo and to stifle invention. We can only attempt to see that true and accurate information is made available to investors. We cannot guarantee the future.

In the writer's opinion it is impossible to state what effect the Act will have in accomplishing a simplification of financial structures. Even prior to 1929 the public was beginning to oppose complicated financial structures and of recent years there has been a tendency to avoid the issuance by any one issuer of too many types of securities. Any acts which are designed to inform the public of what their rights are and what are the rights of other security holders of the same issuer, are distinctly helpful. However, the provisions of the Revenue Act of 1936 may tend to undo the good which the Securities Act of 1933 and the Securities Exchange Act of 1934 were accomplishing in this direction inasmuch as a corporation is entitled to receive a dividend-paid credit for the market value of securities which it issues as a taxable dividend.⁶² If the Revenue Act of 1936 stays on the books in its present form, many corporations, in order to maintain their working capital, may issue securities as taxable dividends, and as a result we probably shall see some rather peculiar securities issued. On the whole, the larger the corporation, the simpler its corporate structure. Complicated corporate structures have usually arisen either in reorganizations or because various terms and provisions of indentures or of preferred stock issues prevented financing in a more orthodox way. The tendency toward simpler corporate structures is a sound one and it is to be hoped that the present trend toward the issuance of hybrid securities as dividends will not have to continue.

⁶² Revenue Act of 1936, §27(d) and (e).