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Regulation of Securities (January 18, 1972)

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REGULATION OF SECURITIES

January 18, 1972
Professor T. H. Jolls

I. 15 points

You are counsel for the College of Walter and Mildred. There has just been tendered to it by George Generous, a prominent alumnus, as a gift to its permanent endowment fund, a certificate for 5000 shares of common stock of Data Devices, Unlimited, registered in his name and duly endorsed for transfer. On the certificate is a legend as follows:

These securities have not been registered under the Securities Act of 1933. They may not be sold or offered for sale in the absence of an effective registration statement as to the securities under that Act, or an opinion of counsel satisfactory to the Company that such registration is not required.

Two or three dealers make a market in the stock at around \$2 per share. Company has 600 stockholders.

You cannot undertake an investigation of George's holdings, or the circumstances of his acquisition of the stock, because the college does not want to irritate him by inquiries "looking a gift horse in the mouth"; at the same time there is a college policy to hold its endowment funds, where possible, in "blue chip" securities (which this stock clearly is not).

In his letter transmitting the gift George states that he must get this stock out of his name right away for gift tax purposes, and that he has been told by the lawyer for Data Devices that the college should send in the certificate for transfer as soon as possible and that no transfer will be considered unless accompanied by an "investment letter" from the College.

As best you can, give the college some practical advice as to the course of action it should pursue for the short term and long term, and, regardless of your advice on the foregoing, prepare a brief version of an "investment letter."

II. 20 points. Select for answer any combination of the following which will total 20 points:

Points

- | | |
|---|---|
| 5 | 1. Discuss the risk in relying on the exemption from registration of intrastate issues. (3(a) (2) (11)) |
| 5 | 2. Distinguish permitted "stabilization" from forbidden "manipulation". Use examples if possible. |
| 5 | 3. In the Chinese Consol. Benev. Assn. case where the association was merely assisting the Chinese Government in raising funds from persons of Chinese descent, explain why its activities in using the mails were enjoined as violative of the 1933 Act. |
| 5 | 4. Any one or more of (a), (b), (c), (d) may be selected. In the Texas Gulf case you need not go beyond the CCA Second Circuit 1968 opinion. Comment briefly on the pros and cons, and state the holding in the following situations: |
| 5 | a) culpability of the corporation for withholding information from the public during drilling period. |
| 5 | b) Fogarty, Mollison et. al. (officers who were buying during the drilling period.) |
| 5 | c) Crawford (officer) who put in sale order at midnight April 15 to be executed at exchange opening April 16. |
| 5 | d) Darke for "tipping" friends and acquaintances during the drilling period. |

NOTE: "Drilling period" is November 12 to April 9. First press release is April 12; second is April 16.

III. 50 points

Henry Bumble, for 20 years general counsel for Eager Beaver Company, has passed away suddenly. You have just been offered his job, and, overcoming your grief at his demise, have accepted.

In many ways Eager Beaver, a small concern 20 years ago but a \$50,000,000 business today, outgrew Mr. Bumble. This fact is strongly brought home to you on your first examination of his files. While the Company has 50 stockholders of record, there is nothing anywhere to indicate that Mr. Bumble was ever aware of any laws (other than the general corporation law of the State) regulating the purchase or sale of securities.

From study of files, and conversations with officers and accounting staff, you have learned the following:

1. The Company has never employed independent public accountants.
2. Five years ago the Company (then having 45 stockholders) offered by mail and sold 50,000 shares of its stock at \$20 per share to its stockholders. Every holder subscribed pro-rata so there was no change in holders or in relative interests. The corporation act was complied with but there is no evidence of inquiry or compliance as to any other laws.
3. Three years ago Grandma Rich died; her estate had 15,000 shares but needed money for taxes. Her son Chauncey, an avant-garde artist with little knowledge of business, acted as administrator; he was persuaded to sell the 15,000 shares back to the Company at \$22 per share; it appears that two months later the Company bought a smaller holding from another stockholder at \$25 per share.
4. Just before Bumble's death, Eager Beaver had arranged to obtain a transfer to Eager Beaver of all of the assets of Dullsville Company in exchange for shares of Eager Beaver; each Dullsville stockholder to receive one share of Eager Beaver for each two shares of Dullsville owned. Dullsville stock was widely held by the public and listed on the Pacific Coast Stock Exchange, with control in Dennis and Daphne Dull holding 30%. Consummation ~~was~~ *will be* subject to approval by the Board of Directors of each company, and by a 2/3 favorable vote of the stockholders of Dullsville.

Now that you have these facts, answer the following in order:

- (a) Consider (1) what securities laws and regulations Eager Beaver must comply with in carrying out the mechanics of this acquisition and what, if any, constraints any or all of the Dullsville stockholders will be subjected to by reason of their new ownership of Eager Beaver shares.
- (b) Consider what matters of law and fact in Eager Beaver's history, as recounted above, must be investigated and evaluated and possibly disclosed in order to give Dullsville Stockholders all information they should receive under federal laws (which cite) to enable them to judge fairly of Eager Beaver's assets and liabilities, fixed or contingent.
- (c) A suspicion crosses your mind that the Eager Beaver officials may be a little bit gullible or careless on this deal -- that the Dullsville properties may not really be worth the amount of stock Eager Beaver is giving. Bearing in mind that as a lawyer the evaluation of the assets is not your job, is there any threat to your client Eager Beaver, or its officials, under the Federal Securities Laws that requires you to speak up? Discuss.
- (d) Now assume the acquisition of Dullsville is abandoned by mutual consent because of anti-trust problems. Is it still desirable to investigate Eager Beaver's history? Who might possibly sue it by reason of the past events mentioned and on what grounds, citing the possibly applicable statutes and rules as interpreted by the courts?

IV. 15 points.

Your growing list of corporate clients now includes Faithful Bank & Trust Co. Its senior officers have been talking with you about possible sale of the collateral for the delinquent personal loan of Mr. Bixby, Vice-President of the Bixby Barrel Company. The loan, secured by his 10% of the outstanding stock of the Company, was originally made for 6 months, to furnish funds for Mr. Bixby to invest in a real estate syndicate, which so far has done badly; the pledged stock is worth just about the amount of the loan, and the bank would like to sell it out to avoid loss. The Barrel Company stock trades over the counter (600 stockholders). Originally, it had been owned entirely by Mrs. Bixby's father; she and her sister together own 15% which is the only large holding other than Mr. Bixby's.

Your strictures on the subject of such loans fill your listeners with grave concern. Finally the bank president, Mr. Gottrox, says, "The plain fact is that our competitors are making loans to company officers secured by their company stock every day. I want you to write us a letter, explaining so that we can understand it, just what the area of legal concern is. You are going to have to give us some room to turn around in for the purpose of our future loaning policy, and if you can't then despite your erudition and personal charm, we are going to get us another lawyer who will be more easy-going." Write the letter, beginning with "Dear Mr. Gottrox:", but don't bother to polish its style as you would if you were being paid.