1971

Regulation of Securities (January 1971)

William & Mary Law School

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I - 25 points

A owns 5% of the outstanding 10,000,000 shares of stock of X corporation. There are 25,000 stockholders; the only holders of 1% or more, other than A, are B and C, brothers, who each own 15% and are, respectively, Board Chairman and President of X Corporation. They are not on speaking terms with A and have repeatedly refused to employ him or give him a place on the Board.

The corporation, to raise funds for expansion, makes a rights offering to all stockholders whereby they may buy 1 share for each 2 shares owned within 10 days, at a favorable price. A does not want any more stock but decides that a sale of his large holding of rights would unduly depress the rights market, and that he would be better off to enter a subscription himself for the 250,000 shares to which he is entitled, and then sell the new shares over a period of time.

NOTE: For the purpose of answers to the following questions, I do not consider that Rule 154 or any other formal exemptive rule of the SEC has any bearing.

(a) Was the offering by the corporation to its stockholders required to be registered under the 1933 Act? Explain.

(b) The subscription price for the 250,000 shares subscribed for by A is made up of $1,000,000 cash put up by him, and a loan of $1,500,000 granted by Bank B to A secured by the 250,000 new shares. Bank B is fully informed about A’s affairs and regards this loan as well secured in view of his ownership of 500,000 other shares, and other wealth. However there is a severe market drop after the end of the subscription period; A ignores the bank’s calls for additional collateral; per the loan agreement the bank offers the 250,000 shares for public sale pursuant to public notice which was mailed to brokers and dealers in 4 states. One buyer paid $2,000,000 for the lot, leaving a surplus to A after the loan was paid. The buyer furnished a letter saying he was buying for investment and not for resale. Discuss whether, from a federal securities law standpoint, the bank’s sale would have been subject to injunction and whether the purchaser can sue the bank if the stock declines in price. Assume there has been no misrepresentation of any kind.

(c) Now assume that question (b) did not arise, instead, A utilized only funds of his own to make the subscription. He sold 150,000 out of the 250,000 new shares through Broker X, on the New York Stock Exchange. Broker X did not inquire from A or elsewhere as to the source of the stock, and took for granted that it came from A’s original holding of 500,000 shares.

Discuss as to A and X respectively whether they could have been, because of federal securities law violations, subjected to injunction. Also discuss whether A could be held liable to his purchasers because of federal securities law violations, assuming that the transactions could be traced and that the price went down. Again, no misrepresentation occurred.
II - 10 points

3/15/67 M purchased 280,000 shares of C Corporation at $6.75 per share. This stock is listed on the New York Stock Exchange. On 3/17/67 M was elected a director.

7/20/67 M gave S an option to purchase 272,000 of these shares at $9 per share, exercisable on or before 10/1/67. A "binder" of $350,000 cash was paid to M by S, applicable to the purchase price if the option should be exercised; otherwise to be forfeited. The stock certificates were placed in escrow and M gave S an irrevocable proxy to vote the stock up to 10/1/67.

7/22/67 M resigned from the Board at the request of S, and a nominee of S took his place.

9/22/67 S exercised the option, and the stock was delivered and the balance of $2,098,000 was paid, M's profit being $612,000.

Can M be required to pay over his profit to C Corporation? Discuss.

III - 45 points

Attached is an advertisement which appeared in local newspapers, and a 2 page offering statement regarding Giant Open Air Market Bonds. These bonds were offered and sold direct to the public at stations in the offeror's stores.

Company counsel has resigned to take a position with a retail chain in New York, and you are now retained in his place. Assume the following hypothetical events, and deal with them.

A. The offeror states that in order to reach a wider market it is considering a change to a public offering to be registered under the Securities Act of 1933, through an underwriter on a "best efforts" basis." The question is asked, "How do we get started?"

Outline, as you would for the corporate officers, in such detail as to make your requests understandable, what showings, statements, representations, expert opinions, etc. would have to be worked up before a SEC registration statement could be drafted and filed. Refer if you wish to anything in the present offering statement which you consider inadequate to meet federal standards.

B. Suppose the parties find your list of federal requirements so burdensome that they decide to simply continue with sales of bonds in the stores. What steps will you take now to assure yourself as company counsel that freedom from liability under any securities laws arising from such future sales is reasonably assured to the company and its principals?

What area or areas of particular concern occur to you?

C. The sales in B continue, and six months later, suppose it turns out that the attached offering statement, through carelessness, contained a statement that was material and false. Under what sections, if any, of Federal Statutes would the company be liable to a purchaser who received the statement when he purchased and whose securities have declined in value? What would be the elements of the plaintiff's case under each statute?
D. Suppose that plaintiff A, who bought some outstanding bonds of this issue from a third party, B; made his purchase from B after reading a newspaper article, based on a press release issued by the company, announcing that its earnings for the past fiscal year had increased 40%. The company had relied on high-grade independent public accountants for earnings figures, but the accountants had misinterpreted a tax ruling. In fact the earnings increased only 2%. B had no knowledge of this newspaper story and had no intent to defraud A.

Discuss possible statutory liability of the company to A, if A's bonds decline in value.

IV - 20 points

(a) Explain "gun-jumping" and give examples.

(b) Where security A, convertible into security B, was originally distributed in a so-called private offering with the seller accepting an "investment letter" from the purchaser, why has the SEC been always ready to claim that the investment letter should not have been relied on and that sale of security B requires a registration?

(c) State guidelines for determining what is a public offering.

(d) Comment briefly on the interplay between the Securities Exchange Act of 1934 and the anti-trust laws, insofar as the New York Stock Exchange is concerned.
FIRST ISSUE GIANT OPEN AIR MARKET BONDS SINCE 1963!

1,000,000 BOND ISSUE - GIANT OPEN AIR MARKETS

8% INTEREST ANNUALLY

PAID SEMI-ANNUALLY BY NEGOTIABLE COUPONS...

Handle like cash at Virginia National Bank, GIANT and Tinee GIANTS

Denominations of $100, $500 and $1,000 (Eight-Year Maturity)

OR 8% BONDS MAY BE PURCHASED AT THESE GIANT OPEN AIR MARKETS...

Beginning 8 A.M. Monday, December 1, and daily thereafter, Monday thru Saturday 8 AM to 5 PM

Wards Corner-Norfolk
156 Compostella Road-Norfolk

- 1849 E. Little Creek Road-Norfolk
- Alexander's Corner-Portsmouth
- 2412 Churchland Boulevard-Portsmouth
- Mercury Mall Shopping Center-Hampton

- 6013 E. Virginia Beach Boulevard, opposite Janaf-Norfolk

also

General Offices 1187 Azalea Garden Road, Industrial Park,
Norfolk, Virginia. Open Monday thru Friday 8 AM to 5 PM

NOTICE TO OUR PRESENT BONDHOLDERS:
We will exchange presently outstanding 6% bonds for our 8% new issue upon presentation at our head-
quaters offices 1187 Azalea Garden Road, Industrial Park, Norfolk, Monday thru Friday 8 A.M. to 5 P.M.

Offer limited to bona fide Virginia residents over 21!
INFORMATION CONCERNING EIGHT PER CENT (8%) BONDS
OF
ROSSO & MASTRACCO, INCORPORATED
TRADING AS
GIANT OPEN AIR MARKET

1. What are we selling?
A $3,000,000.00 issue of eight year bonds, paying 8% per annum interest, payable semi-annually, in denominations of $100, $500, and $1,000 dollars. Payment to be made by cash or certified check.

2. What is a bond such as the one being offered?
This bond is a certificate acknowledging a debt and promising payment on a certain date. Rosso and Mastracco, Inc. promises to pay these bonds on or before December 1, 1977. This bond is practically the same as a debenture or a note. This issue, or any part thereof, is subject to call by the company on or after June 1, 1971.

3. To whom are we offering these bonds?
Bona fide residents of Virginia over the age of 21 years. The company reserves the right to whom and in what quantity it may sell these securities.

4. Who is Rosso and Mastracco, Inc.?
Rosso and Mastracco, Inc. is the parent company trading as Giant Open Air Markets and currently operates in the Tidewater area through its divisions or subsidiaries the following:
(a) Seven Giant Open Air Markets which are prime retailers of complete lines of food-stuffs including six restaurants.
(b) Twenty-two convenience stores trading as "Tinee Giant" and more in progress.
(c) The Mercury Plaza Mall Shopping Center, Hampton, Va. - the only enclosed and fully air-conditioned Mall shopping center on the Peninsula.
(d) Biase and Console, Inc. - A wholesaler of foodstuffs to over 300 accounts in Tidewater, Eastern Shore, and North Carolina.
(e) Shumadine Dairies, Inc. - Bottlers of milk and manufacturers of ice cream and related products.
(f) Campro Corporation - Owns Campostella Road Giant store property.
(g) Garro Corp - Owns substantial properties adjacent to Campro Corp.'s property.
(h) Alexander Land Co. owns the Portsmouth Giant property at Alexander's Corner.
(i) Wards Corner Land Improvement Co. - Holder of the leasehold interest for the Wards Corner Giant Store.
(j) Food Processors Center, Inc., located in Norfolk Industrial Park - Is the owner of this large, new modern plant, probably one of the finest of its kind in the world, for manufacturing and distributing food products to all the Giant outlets as well as selling its products to hundreds of other firms. Here is also located the general offices for all the Giant Family Complex. In 30 years, Rosso and Mastracco, Inc., and its predecessors, have built this impressive complex and every year has shown a steady profitable growth.

5. What will the Giant Open-Air Markets do with the money from the sale of these bonds?
The money received from the sale of these bonds will be used primarily to assist the company's expansion program.

6. Where may the bonds be purchased?
The bonds may be purchased at any of the following Giant stores between the hours of 8:00 A.M. - 5:00 P.M. on Monday thru Saturday.
1. 135 Canlile Road, Norfolk, Virginia
2. 2550 Airline Blvd., Portsmouth, Virginia
3. 6013 Virginia Beach Blvd., Norfolk, Virginia
4. 230 East Little Creek Road, Norfolk, Virginia (Neds Corner)
5. 2223 Mercury Blvd., Hampton, Virginia
6. 1849 East Little Creek Road, Norfolk, Virginia
7. 2412 Churchland Blvd., Portsmouth, Virginia
8. General Office, 1187 Azalea Garden Rd., Norfolk, Va.- Monday thru Friday only

7. If a bondholder has to sell his bond before maturity, how shall he go about it?
Bonds are legally redeemable at maturity 8 years after the date of issue, December 1, 1969. These bonds are negotiable and unregistered. Although they are purchased for investment, they may be re-sold by the purchaser. Anyone having to sell before the maturity date, may ask the company for assistance.

5. When is interest paid on the bonds?
Every six months - on the 1st of June and the 1st of December of each year, clip coupons and cash or use as cash at any of the Giant Markets, or Three Giants, or cash at any of the branches of the Virginia National Bank.

6. Should the bond be lost, destroyed, or mutilated, how may a duplicate be obtained?
The corporate resolution submitted to the State Corporation Commission is as follows:
That in case any Bond shall become mutilated, lost or destroyed then, upon the production of such mutilated Bond or upon receipt of evidence satisfactory to Rosso and Mastrocco, Incorporated of the loss or destruction of such Bond and upon receipt, also, of indemnity satisfactory to it, Rosso and Mastrocco, Incorporated shall execute and deliver, at the cost of the applicant, a new Bond marked "DUPLICATE", bearing the same number, in exchange for and upon cancellation of the mutilated Bond or in lieu of the Bond so lost and/or destroyed.

10. Why does Rosso and Mastrocco, Inc. wish to sell these bonds to the public?
By employing this method of financing its expansion program, it enables the company to offer this lucrative rate of interest to the public and simultaneously will effect a savings for itself. Additional advantages to the company may accrue if purchasers of these bonds become loyal customers and friends. 

ROSSO AND MASTROCCO, INCORPORATED
TRADING AS GIANT OPEN-AIR MARKETS