1973

Regulation of Securities (January 1973)

William & Mary Law School

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Hercules Corporation, doing a nation-wide business in thumb tacks, was 100% owned by George Gottrox; Walter Worker, president, had brought the company from a tiny shop to a business with $10,000,000 of assets and no debts. Gottrox wanted to dispose of all his shares (1,000,000) at $20 per share and Walter who had a large personal following agreed to help. So, early in 1971 Walter bought 8% for himself and sold the rest in varying small amounts to 42 persons, including his friends at the country club, customers, suppliers and even his minister. Once away from single ownership, during 1971 the stockholder list expanded to 800 persons and a vigorous national over-the-counter trade developed.

Now it is the summer of 1972 and the company needs money for expansion. It offers shareholders the right to buy, one additional share for each 10 held, at $40 per share; the stock was fully subscribed and Walter bought the 8000 shares he was entitled to subscribe for. This 100,000 share offering was duly registered under the 1933 act.

Spring of 1973 has arrived. Now Walter has at hand what he has always wanted - a chance to own a race track which will require a $750,000 down payment by June 1. At the market price of $40 this will require sale of almost 20,000 shares - he has one block of 80,000 and one of 3,000, and he wonders if he has any legal problems. He asks you as his lawyer:

1. What effect does the failure to register the early 1971 sales have?

2. Whether the registration of the 8000 shares on subscription will permit their resale with minimum formalities or none at all.

3. Whether channels of sale without registration can be opened on either holding.

4. Whether he has any other securities law hurdles to surmount.

5. And while you are at it (riding on the same fee) he would like to bring up the problem of his brother-in-law, Hector Hopeless, whom he has kept in a sinecure of Vice President in the Company and who bought 400 shares in the 1971 transaction and hopes he can sell out now without any legal folderol.

Explain to Walter his rights and obligations and those of his brother-in-law. Not to be fudged in a matter of fees, you determine to justify substantial compensation by spinning out every web there is in this situation, to impress Walter, even though some of the webs may be caused to disappear under the force of your analysis. Do not forget though to wind up by telling Walter exactly what your best advice is.

II - 30 POINTS

Discuss briefly each of the various private rights of action which the Courts have indicated may be implied from substantive provisions of the 1933 and 1934 Acts and rules thereunder, citing the appropriate Sections.

III - 60 POINTS

The attached is a selling circular used a few years ago by a Virginia grocery chain. The offering was advertised in several newspapers, presumably having some interstate circulation through the mails. The advertisement itself was brief; it identified the issue, stated the terms, and included the statement "Offer limited to bona fide Virginia residents over 21."
Assume further that there was a valid filing under the Virginia Blue Sky Law, and that all telephone inquiries coming into the stores were answered "Come in to our store and we will tell you all about it." Suppose the offering started in August 1972 and as of January 1973 only half of the bonds have been sold.

A. You are called upon as a specialist in securities law to consider the possibility of a public offering of the remaining bonds by registration under the Securities Act of 1933. Indicate, in as many respects as you can think of, the areas of missing information that must be presented in such form that prospective buyers will have a prospectus meeting the standards of the 1933 Act.

B. Explain what possible risks, if any, you see the Company incurring under the Federal Securities Laws (with specific citations) if it continues to offer bonds on the basis of the attached circular without effective registration under the 1933 Act.

IV - 20 POINTS

Explain briefly each of the following:

a) The difference between broker, underwriter, and dealer. May one firm act in all 3 capacities?

b) The difference between permitted "stabilization" and forbidden "manipulation"

c) What is the purpose of the "group" element in the determination of what is a "person" under the Williams Act?

d) Up to the time of the April 12 and 16 press releases, in the Texas Gulf case, was the withholding of information on drilling progress justified or unjustified? Why?

e) What is the main consideration on which the decision should turn where the question is posed "Is this a Federal 10-b-5 violation or a corporate mismanagement problem cognizable only under State law?"
INFORMATION CONCERNING EIGHT PER CENT (8%) BONDS
OF ROSSO & MASTRACCO, INCORPORATED
TRADING AS GIANT OPEN AIR MARKET

What are we selling?
A $5,600,000.00 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.

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. Rossco 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, 1977.

Who 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.

Who is Rossco and Mastracco, Inc.?
Rossco 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 "Times 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) Diesso and Consal, Inc. - A wholesaler of food-stuffs to
over 500 accounts in Tidewater, Eastern Shore, and North Carolinas.
(e) Shumadian Dairies, Inc. - Bottlers of milk and manufacturers
of ice cream and related products.
(f) Compro Corporation - Oms Costanzella Road Giant Store
property.
(g) Gars Corp. - Oms substantial properties adjacent to Compro
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, Rossco and Mastracco, Inc.,
and its predecessors, have built this impressive complex
and every year has shown a steady profitable growth.

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
for the following:

Funds may be purchased at any of the following Giant stores between
the hours of 8:00 A.M. - 9:00 P.M. every day unless specified otherwise.

The bonds may be purchased at any of the following Giant stores between
the hours of 8:00 A.M. - 9:00 P.M. on Monday thru Saturday.
It a bondholder has to sell his bonds before maturity, how shall he go about it?

Bonds are legally redeemable at maturity 8 years after the date of issue, December 1, 1940. 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.

What 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 Tino Giants, or cash at any of the branches of the Virginia National Bank.

What if the bonds 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 Mastracco, Incorporated of the loss or destruction of such Bond and upon receipt, also, of indemnity satisfactory to it, Rosso and Mastracco, 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.

Why does Rosso and Mastracco, Incorporated wish to sell these bonds to the public?

By employing this method of financing its expansion program, it enables the company to offer a lucrative rate of interest to the public and simultaneously will affect a saving for itself. Additional advantages to the company may accrue if purchasers of these bonds become loyal customers and friends.