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THE PRIVATE PLACEMENT EXEMPTION: WHAT TO DO ABOUT A FORTUITOUS COMBINATION IN RESTRAINT OF TRADE

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WHEN Congress passed the Securities Act of 1933,¹ an exemption was made in the second clause of section 4(1) for "transactions by an issuer not involving any public offering."² That is, "privately placed" securities,³ as the investment banker would say, were excused from registration. Nor was the exemption thought by anyone to be significant; at most only a relatively few securities would be so issued, and those to persons already fully conversant with the issuer's business.⁴ The important thing that

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¹ 48 Stat. 74 (1933), 15 U.S.C. § 77 (1958).

² 48 Stat. 77 (1933), 15 U.S.C. § 77d(1) (1958). The text of section 77d(1), relating to exempted transactions, reads in part as follows: "The provisions of section 77e of this title [which provides generally for registration] shall not apply to any of the following transactions: (1) Transactions by any person other than an issuer, underwriter, or dealer; transactions by an issuer not involving any public offering. . . ."

³ The investment banker has long used the term "placed" rather than "sold" to make the point that the underwriter's job is to put securities into the hands of investors who may hold them for some appreciable time. Securities that are merely "sold" may come back on the market (for a quick profit) even before the issue has been fully distributed, and thus put a strain on the bankers' efforts at stabilization and price maintenance. The term is therefore not a new one, but a "private" placement has come to mean one which is exempt from registration under the Securities Act.

⁴ There was a dearth of comment as to the scope of the exemption, when the act was being debated. Professor Frankfurter, in a general discussion, said merely that: "Transactions between private persons, not with a view to public offering, are exempt." *Fortune*, Aug. 1933, p. 55.

Congress had in mind was to make sure that, in the future, the public should have free access to all relevant financial information concerning the great numbers of securities that each year were coming into the market.⁵ Registration of these, it was hoped, might help avert another market crash such as occurred in 1929.⁶

But the exemption, no larger than a man's hand in 1933, soon took on substantial proportions. In fact, during the next four years, 1934-1937, securities with an aggregate value of more than a billion dollars were issued without registration.⁷ These were mainly debt issues (notes, bonds and debentures) that were placed directly with large institutional investors. Percentage-wise they represented more than fifteen per cent of all debt securities which were issued during those years. In all but one of the next four years, 1938-1941, the figure jumped to over thirty per cent, and the aggregate value to nearly three billion dollars.⁸ Since then, except for three years, 1944-1946, the ratio has continued above thirty per cent; in 1959 it was thirty-eight per cent, and represented a total of 3,755,000,000 dollars for that year alone.⁹

These statistics, of course, are well known; indeed, it would be difficult to hide them. But, while Congress and the SEC have from time to time shown concern at what appears to be a wholesale evasion of the Securities Act, neither has presented a viable suggestion for change.¹⁰ The Investment Bankers Association, which at one time strongly urged that the section 4(1) door should be closed, changed its position in 1941, for reasons that have remained obscure.¹¹ Possibly its members, or at least the larger New York

⁵ See President Roosevelt's message to Congress, March 29, 1933. H.R. REP. No. 85, 73d Cong., 1st Sess. (1933).

⁶ The sharp break in security prices on May 28, 1962, would suggest that the hope was not realized. But it should be noted that, contrary to the situation in 1929, there was little distress selling, due in part to the Federal Reserve margin requirements. Again, contrary to the situation in 1929, the great bulk of the securities being traded represented actual, not fictitious, values, thanks to the work of the SEC over the last twenty-nine years. The May sell-off was a matter of price, and that is something which is and should be left wholly for the investment community to decide for itself. If prices were bid up too high because of an unfounded fear of inflation, the investor did the bidding, and he can himself correct it.

⁷ 26 SEC ANN. REP. 244 (1960); 1960 MOODY'S IND. MANUAL, Special Features Section, p. a19. See also 1958 LIFE INSURANCE FACT BOOK 72, 77.

⁸ 26 SEC ANN. REP., *supra* note 7, at 244.

⁹ *Ibid.*

¹⁰ Amendments to section 4(1) have been proposed but failed to pass. *Hearings before the House Committee on Interstate and Foreign Commerce*, 77th Cong., 1st Sess. (1941); *Hearings Before the Joint Committee on the Economic Report*, 79th Cong., 1st Sess., pts. 1 & 2 (1949); *Hearings Before the Subcommittee of the House Committee on Interstate and Foreign Commerce*, 82d Cong., 2d Sess., pts. 1 & 2 (1952).

¹¹ The actual proposal was to leave section 4(1) much as it is, but to define the words "public offering" in the section as including a category "affected with a public interest." Then, by defining that term to cover the large debt issues that were currently going to the big insurance companies, such issues would no longer be exempt. This was the wording:

houses, felt basically uncomfortable at urging an *increase* in registration. Thus, only the life insurance companies have actively, and quite skillfully, defended the exemption.¹² Or, to be more accurate, only the twenty or more largest have done so, for the several hundred smaller companies—in common with other institutional investors—have found little in the exemption to their liking.¹³ It has been the unhappy role of the small institutional investor, over the last quarter century, to stand on the sidelines and watch while great numbers of the top grades of private debt securities have gone directly to the big insurance companies.¹⁴ That this should be so would now almost seem to have become a prerogative of the big company.¹⁵

But the small institutional investor—like the small investment banker—has not been without friends, though he may not have recognized them as such. In 1941 the SEC adopted rule U-50 to require competitive bidding for the securities of registered public utility holding companies.¹⁶ And, in 1944, the ICC adopted a similar rule applicable to the sale of new railroad debt securities.¹⁷ In each case this was done—over sharp banker and insurance company opposition¹⁸—so that rail and utility issuers (and hence their exist-

“The term ‘offering affected with a public interest’ means any offering, not otherwise an offering to the public, in an amount in excess of \$3,000,000 if the securities are sold in whole or in part to any person which holds itself out as regularly receiving funds from investors, policy holders, or depositors and which invests its funds in substantial part in securities, except . . .” REPORT ON CONFERENCES WITH THE SECURITIES AND EXCHANGE COMMISSION AND ITS STAFF ON PROPOSALS FOR AMENDING THE SECURITIES ACT OF 1933 AND THE SECURITIES EXCHANGE ACT OF 1934, 31 (July 30, 1941). See also 7 SEC ANN. REP. 18–19 (1941).

¹² Mendel, *Institutional Investment Through Private Placement of Corporate Securities*, 53 COLUM. L. REV. 804 (1953); Rodgers, *Purchase by Life Insurance Companies of Securities Privately Offered*, 52 HARV. L. REV. 773 (1939). Mendel was Counsel for The Equitable Life Insurance Society at the time he wrote, and Rodgers, Ass’t Gen’l Counsel for the Metropolitan Life Insurance Company.

¹³ Conklin, *Direct Placements*, 6 JOURNAL OF FINANCE 85, 112 (1951); Conklin, *Direct Placement of Securities*, 173 COMMERCIAL AND FINANCE CHRONICLE 154, 174 (1951); Patrick, *Do Small Companies Get Their Share of Direct Placements?* SPECTATOR, June, 1953, p. 19; Rothschild, *Do Small Companies Get Their Share of Direct Placements?* SPECTATOR, June, 1953, p. 18.

¹⁴ *Hearings Before a Subcommittee of the House Committee on Interstate and Foreign Commerce*, 82d Cong., 2d Sess., pt. 2, 956, 1121–35 (1952).

¹⁵ See generally COREY, *DIRECT PLACEMENT OF CORPORATE SECURITIES* (1951); McCAHAN, *INVESTMENT OF LIFE INSURANCE FUNDS* 66 (1953); Bell & Fraine, *Legal Framework, Trends and Developments in Investment Practices of Life Insurance Companies*, 17 LAW & CONTEMP. PROB. 45 (1952).

¹⁶ SEC Holding Co. Act Release No. 2676, April 8, 1941.

¹⁷ In the Matter of Competitive Bidding in the Sale of Securities Issued under Section 20a of the Interstate Commerce Act, 257 I.C.C. 129 (1944).

¹⁸ Briefs were filed by the Investment Bankers’ Association before both the SEC and the ICC in opposition. The insurance companies have been more circumspect, but they too oppose competitive bidding if for no other reason than because it increases their costs for security purchases. See generally EMBLEM, *COMPETITIVE BIDDING FOR CORPORATE SECURI-*

ing security holders) would have the benefit of a competitive price upon the sale of new securities.¹⁹ Moreover, this has been the result.²⁰ But a not less significant result has been that substantial numbers of first quality rail and utility issues were thus blocked off from private placement, and so came into the public market. This, with advantage first to many investment bankers, who were thereby given an opportunity to make an entrepreneurial gain for their services not otherwise possible;²¹ and second, with advantage to many small institutional investors, who were thus given an opportunity to invest—on equal terms with the larger companies—in securities not otherwise offered to them.²²

Probably, however, the competitive bidding rule has been of most advantage to issuers. Certainly it has given them wide distribution for their securities,²³ at demonstrably full competitive prices,²⁴ and with low distribution costs. Nonetheless, except where government has taken them by the scruff

TIES (1944); MCCLINTOCK, *COMPETITIVE BIDDING FOR NEW ISSUES OF SECURITIES* (1939); Robbins, *Competitive Bidding in Sale of Securities*, 27 HARV. BUS. REV. 646 (1949).

¹⁹ SEC, P.U. DIV. REPORT ON THE PROBLEM OF MAINTAINING ARMS LENGTH BARGAINING AND COMPETITIVE CONDITIONS IN THE SALE AND DISTRIBUTION OF SECURITIES OF REGISTERED PUBLIC UTILITY HOLDING COMPANIES, AND THEIR SUBSIDIARIES, D-2 to D-10 (1940); SEC REPORT ON PROPOSALS FOR AMENDMENTS TO THE SECURITIES ACT OF 1933 AND THE SECURITIES EXCHANGE ACT OF 1934, 71st Cong., 1st Sess. 21-22 (Comm. Print. 1941).

²⁰ Peterson, *Negotiated vs. Competitive Debt Financing*, 1 VAND. L. REV. 531, 540, 546 (1948). See also *Hearings Before the Subcommittee on Study of Monopoly Power of the House Committee on the Judiciary*, 81st Cong., 1st Sess., ser. No. 14, pt. 1, 459 (1949).

²¹ In the negotiated deal each member of the buying syndicate, perhaps twenty-five in number, has an opportunity upon selling his participation to earn the agreed spread (the difference between price to issuer and public offering price) of, say, one point or more. The same is true when securities are sold at competitive bidding, with the difference that spreads in such cases are customarily smaller. But in the private placement only the originating banker stands to gain, if a banker figures at all, and here merely receives a fee for his services. In recent years these fees have been creeping up to larger and larger amounts, and bankers are more generally employed. See SEC, *PRIVATELY-PLACED SECURITIES—COST OF FLotation* 9 (1952); FRATNE, *Direct Sale of Security Issues*, 16 J. AMER. ASS'N UNIV. TEACHERS OF INS. 40, 48 (1949).

²² No statistics are at hand to show the relative holding in these issues of the large insurance companies, on the one hand, and the many smaller institutional investors, on the other. Buying syndicates customarily make group sales to the large insurance companies, but the greater part of most issues is distributed generally. Indeed, in the case of securities sold at competitive bidding, the large institutions sometimes prefer to sit on the sidelines; they can better meet their needs by the private placement route. Then, too, if the issue was overpriced, they may be able to pick up substantial amounts on termination of the syndicate, at a lower cost.

²³ With competitive bidding, not only are syndicates often larger, but sometimes one and then another (having a different distribution set-up) has won in the bidding.

²⁴ Comparing private placements with competitive bidding, Loss makes this statement: "And it represents an initial saving in underwriting costs—although there is some indication that, over the life of the bonds, issuers which finance through competitive bidding may more than make up for the underwriting costs by virtue of the higher prices received through competition." LOSS, *SECURITIES REGULATION* 402 (1st ed. 1951). For a detailed study to the same effect, see Peterson, *supra* note 20.

of the neck, so to speak, and required them to do so, issuers have not sold their securities competitively.²⁵ Their choice—perhaps to indulge the banker and the large institutional investor—has been either to make a public offering through a buying syndicate of investment bankers, with the price privately negotiated,²⁶ or, to sell directly and privately to the large institutional investor. One may justly say that issuers have shown a certain timidity in this, but their feeling is strong that they are best advised to conform with Wall Street usage.²⁷

It is not the purpose of this study to favor one or another of the actors in this drama. In the spirit of free enterprise, let them fight it out, and the devil take the hindmost. But it is proposed to examine the existing section 4(1) exemption, carefully, to see whether it may be squared with congressional policy as declared (1) in the Securities Act and (2) in the anti-trust laws. It may be that the exemption has operated, more or less fortuitously, in a way contrary to the spirit of those acts.

NOT INVOLVING ANY PUBLIC OFFERING

The Securities Act has no description of what constitutes a “public offering.”²⁸ Nor does the legislative history throw much light on the meaning of the term as used in section 4(1). The House report merely states that it “exempts transactions . . . to permit an issuer to make a specific or an isolated sale of its securities to a particular person,” but insists “that if a sale of the issuer’s securities should be made generally to the public that the transaction shall come within the purview of the Act.”²⁹ And, in the later House and

²⁵ The industrial companies that have voluntarily put up an issue of any size at competitive bidding during the last quarter century can almost be counted on the fingers of one hand. Only American Telephone and Telegraph has made a practice of using this method, and it has sold, with evident satisfaction, securities aggregating well over \$2 billion in value at competitive bidding since 1941. So far as appears the AT&T practice was adopted voluntarily, although the possibility of regulation was never remote. For a study of the prior financing of AT&T, on a negotiated basis, when J. P. Morgan, and later Morgan, Stanley and Company, acted as syndicate managers, see 23 TNEC 11, 829 (1939).

²⁶ See the description in *United States v. Morgan*, 118 F. Supp. 621, 635 (S.D.N.Y. 1953). Only a relatively small number of strong issues have been sold on an agency, or “best efforts” basis, in recent years.

²⁷ It was held, in *Otis & Co. v. Pennsylvania R.R.*, 61 F. Supp. 905 (E.D. Pa. 1945), that directors are not necessarily liable, in a minority shareholders action, for having sold an issue on a negotiated basis through the company’s regular bankers, even though a better price could have been had at competitive bidding. On the facts before it the court refused to interfere with what was regarded as a matter of “business judgment.”

²⁸ The term came up in *United States v. Morgan*, 118 F. Supp. 621 (S.D.N.Y. 1953) it being a government contention that the Securities Act referred to one general offering for only a limited period, that stabilizing and price fixing after such time were plainly contrary to the Sherman Act. Moreover, it was contended that the public offering price itself was unlawful, if arrived at by non-competitive practices. See, Steffen, *The Investment Bankers’ Case: Some Observations*, 64 YALE L.J. 169 (1954).

²⁹ H.R. REP. NO. 85, 73d Cong., 1st Sess. 15, 16 (1933). See also S. REP. NO. 47, 73d Cong., 1st Sess. (1933).

Senate Conference report, the following appears: "Sales of stock to stockholders become subject to the Act unless the stockholders are so small in number that the sale to them does not constitute a public offering."³⁰

Probably the section derives from section 5(g) of the Uniform Sale of Securities Act, as did several of the other exemptions.³¹ But this, too, is not very helpful. Section 12(e) of the proposed act (which was identical with section 5(g) of the Uniform Act) exempted: "Bonds or notes secured by mortgage . . . where the entire mortgage together with all of the bonds or notes secured thereby are sold to a single purchaser at a single sale."³² Then, on April 4, 1933, counsel for the IBA suggested that the section be amended to allow sale "to not more than five purchasers, and not intended to be offered directly or indirectly to the public."³³ This appears to have been the first suggestion that exemption should turn on whether there was to be public participation. The suggestion, however, was picked up by the Committee, for section 12(e) was thereafter eliminated and, when the act emerged, the short phrase, "transactions not involving any public offering," appeared in section 4(1).

Plainly this wording greatly broadened the proposed exemption, for it was no longer limited to mortgage bonds; transactions involving securities of any sort might be exempted. But it is not so plain that, since the limitation to one (or at most five) purchasers was omitted, there was to be *no* limitation as to numbers. More likely, when one considers the atmosphere of guarded hostility toward the financial community that prevailed when this legislation was drafted, the Committee intended a positive limitation. It chose not to set an arbitrary one, however, but to draw a line at the illusive point where a private transaction becomes a public offering. Congress may well have thought it could do this safely. There was nothing in the record to suggest that private placements were ever made to more than a few places; and, nothing whatever to indicate that, in the next quarter century, such placements might be made in an amount aggregating over fifty billion dollars.³⁴

Nonetheless a way was opened to escape the publicity and the burdens of registration, and the financial community was not slow to take advantage of it. Counsel for the Commission was soon called upon to give a comprehensive opinion in the matter. In his view—and his opinion has set Commission policy since—the scope of the exemption was "essentially a question of

³⁰ H.R. REP. No. 152, 73d Cong., 1st Sess. 25 (1933).

³¹ See Miller & Thompson, *A Study of the Economic and Legal Aspects of the Proposed Federal Securities Act, a statement prepared for the Hearings Before the House Committee on Interstate and Foreign Commerce*, 73d Cong., 1st Sess. 108 (1933).

³² *Id.* at 7.

³³ *Id.* at 192.

³⁴ See 1952 hearings, *op. cit. supra* note 10, at 960–61. The Committee's conclusion on H.R. 2508, 82d Cong., 2d Sess. (1952), was that: "The Congress therefore could not have foreseen the developments to date when tremendous bond offerings amounting to billions of dollars each year, and totaling over \$22 billion since 1934, are not being registered." *Id.* at 127.

fact,"³⁵ in which a number of circumstances were of moment, as for example: the number of offerees; their relationships; the number of units offered; and, the type and size of the offering. In no case was "the question to be determined by the number of prospective offerees."³⁶ That was one factor, but only one. Thus, he said, "preliminary negotiations or conversations with a substantial number of prospective purchasers would . . . cause the offering in question to be a public offering, thereby necessitating prior registration"³⁷

Counsel's construction of the section 4(1) exemption was by no means unwelcome to the large institutional investor. That he could easily tailor his operations to come within the exemption was clear, and, most important, it handed him and his associates—as upon a silver platter—the advantage of a built-in restriction upon competition. The issuer was warned in solemn terms not to shop around for a better price, or better terms, since "conversations" with a "substantial" number of offerees might turn the issue into a "public offering."

The settled practice in making private placements, as explained by Churchill Rodgers, is as follows:

Where more than one purchaser participates, the company to which the major portion of the issue has been offered customarily assumes the principal burden in consummating the transaction. The basic terms must be cleared by the issuer with each purchaser, and each purchaser is given an opportunity to assist in preparing the essential documents. A separate purchase contract, in the form previously approved by all purchasers, is entered into between the issuer and each purchaser, and the closing involves in effect several simultaneous transactions each, however, complete in itself.³⁸

It is not clear from Rodgers' statement just how a group of private placees is brought together. That they should each buy severally is, of course, to be taken for granted, if for no other reason than to avoid any suggestion that they are engaging illegally in the securities business.³⁹ Probably, though, one company here too takes the lead, and approaches at least some of the others with which it will be associated.⁴⁰ Unfortunately the SEC has no information on the point, as it customarily has none concerning the terms of the purchase, when one is finally agreed upon.⁴¹ Being an exempt transaction—unless per-

³⁵ SEC Securities Act Release No. 285, Jan. 24, 1935.

³⁶ *Id.* at 1.

³⁷ *Id.* at 2.

³⁸ Rodgers, *supra* note 12, at 775-76.

³⁹ N.Y. INS. LAW § 78(2) provides that, "No insurer shall participate in an underwriting of the purchase or sale of securities."

⁴⁰ Much as an investment banker does in forming a buying syndicate. See INVESTMENT BANKERS' ASS'N OF AMERICA, FUNDAMENTALS OF INVESTMENT BANKING 46 (1946). At times a banker gets the insurance group together, but it is customary to approach no more than twenty or twenty-five companies. COREY, *op. cit. supra* note 15, at 189-223.

⁴¹ When an issuer applies to be excused from competitive bidding under rule U-50, the SEC will presumably be furnished with the proposed private placement contracts. The same

chance too many prospective investors were approached—private placees may each, severally, disregard the SEC.

ABILITY TO FEND FOR THEMSELVES

Section 4(1) has had only a brief career before the courts. Moreover, there has been no case involving a large issue of securities placed privately with institutional investors. Nonetheless, there are some definite indications of how the term “public offering” would be construed in that context.

It will suffice to discuss two cases. The offering in *SEC v. Sunbeam Gold Mfg. Co.*,⁴² which consisted of “shareholder’s receipts,” was made to a special class. That is, it was offered solely to two sets of shareholders, those in Sunbeam and those in another company which Sunbeam was acquiring. Counsel contended, quite literally, that a “public offering” is one made generally to *any* member of the public. Thus, since the particular offering was limited to shareholders, it was not public, even if some 530 persons had been solicited. While the court had little difficulty in rejecting that construction, it was at a loss how to state where the line should be drawn between “public” and “private,” except to say that, “it is essential to examine the circumstances under which the distinction is sought to be established and to consider the purposes sought to be achieved by such distinction.”⁴³

Then, getting down to the case before it, the court paid very little attention to “circumstances” and “purposes.” Indeed, a fair argument could be made on that basis that the shareholders involved in a merger operation are a private group. But the court turned instead to the reports, discussed above, and said they “clearly demonstrate that Congress did not intend the term ‘public offering’ to mean an offering to any and all members of the public . . .”⁴⁴ In fact, they showed that an offering limited to shareholders “other than a very small number, was a public offering.”⁴⁵ Nor, the court said, was it required to determine whether “an offer becomes private rather than public if each of the 530 shareholders were shown to know everything about the mining properties, their operations, and the financial condition of the company . . .”⁴⁶ Counsel had chosen to rest his case on the bare fact that they were shareholders, and he had therefore failed to sustain his burden of proof.

Thus the case stands for little more than the proposition that 530 is not “a very small number.” But it set the stage for *SEC v. Ralston Purina Co.*,⁴⁷

is true when a subsequent issue is offered publicly. But otherwise there appears to be no SEC record of such papers.

⁴² 95 F.2d 699 (9th Cir. 1938).

⁴³ *Id.* at 701.

⁴⁵ *Ibid.*

⁴⁴ *Id.* at 702.

⁴⁶ *Ibid.*

⁴⁷ 346 U.S. 119 (1953). The Court here, as in *Sunbeam*, put the burden on the issuer to show that the § 4(1) exemption applied.

where the contention was that an offering of shares made to "key employees"—some 165 in number—was not a "public offering." The trial court so ruled: "We find nothing in the statute and statutory scheme making the number of offerees the sole test as to whether a stock offering is public or private."⁴⁸ And, on appeal, the ruling was affirmed, but Judge Sanborn for the Eighth Circuit was careful to put his decision on the nature of the offering. "There are obvious distinctions," he said, "between an offering of securities to all of the stockholders of two companies [as in *Sunbeam*] . . . and an offering, without solicitation, of common stock to a selected group of key employees of the issuer"⁴⁹

When the case reached the Supreme Court it was easy for Mr. Justice Clark to say that "there is no warrant for superimposing a quantity limit on private offerings as a matter of statutory interpretation."⁵⁰ The Commission had urged that an offering "to a substantial number of the public" is a "public offering," and so not exempt under section 4(1). But the Court did not feel free to pick some number out of a hat, so to speak, in order to fix a ceiling, however convenient that might be administratively.⁵¹

"The natural way to interpret the private offering exemption," Mr. Justice Clark said, "is in the light of the statutory purpose."⁵² That, surely, is an unassailable proposition; but it does not solve the problem of how to discover just what was the purpose of Congress. The Court was persuaded virtually to disregard the several explicit statements, above noted, that unless the offering were an "isolated" one, or one made to a group "small in number," it would be a "public offering." It chose rather to find congressional purpose in a cursory statement thrown out to explain why exemptions of that sort might be justified. That is, the Committee had said there would be "no practical need" for registration in such cases; "the public benefits" would be "too remote."⁵³ Here, then, was the essence of statutory purpose, from which it was said to follow that: "An offering to those who are shown to be *able to fend for themselves* is a transaction 'not involving any public offering.'"⁵⁴

Whatever else may be said of this dictum, it too could not have been displeasing to the large institutional investors. Of course, the actual holding was

⁴⁸ SEC v. Ralston Purina Co., 102 F. Supp. 964, 967 (E.D. Mo. 1952).

⁴⁹ SEC v. Ralston Purina Co., 200 F.2d 85, 91 (8th Cir. 1952).

⁵⁰ 346 U.S. at 125.

⁵¹ The Court (*id.* at 125, n.11) quoted with approval Viscount Sumner's dictum: "The 'public' . . . is of course a general word. No particular numbers are prescribed. Anything from two to infinity may serve: perhaps even one, if he is intended to be the first of a series of subscribers, but makes further proceedings needless by himself subscribing the whole." *Nash v. Lynde*, [1929] A.C. 158, 169.

⁵² 346 U.S. at 124-25.

⁵³ H.R. REP. No. 85, 73d Cong., 1st Sess. 5 (1933).

⁵⁴ 346 U.S. at 125. (Emphasis added.)

that it had not been shown that all "key employees" were able to fend for themselves, and hence there could be no exemption from registration. But the principle announced was one that the larger institutional investor could applaud. It was useful in two ways: on the one hand, it excused registration in his case for obvious reasons; on the other, it was a further reason why the circle of offerees should be kept small, lest some be included who could not "fend for themselves." Besides, the Court had not fully repudiated the numbers limitation, for Mr. Justice Clark also said that it might well be that "offerings to a substantial number of persons would rarely be exempt."⁵⁵

MORE ON STATUTORY PURPOSE

It would be in order now to look to the first clause of section 4(1),⁵⁶ for—even if we adopt a "fend for themselves" test—it might still be necessary to have the issue registered. That is, if one or more of the institutional investors is found to have had an intent to resell the securities, that fact may make them "underwriters," and hence take the issue out of the exemption. But it is proposed, first, to examine further the process by which the Court ascertained congressional purpose. Notwithstanding general approval of the result,⁵⁷ the method was a strange one. Had Congress so intended, it could easily have written section 4(1) to exempt: "transactions *with persons able to fend for themselves*"; but that it did not do, nor is there much in the record to show that it intended to do so.

The way to construe words in a statute, or so we have been told, is to look first to the general aims and purposes of the legislation in question.⁵⁸ Indeed, in *United States v. Hutcheson*,⁵⁹ the Supreme Court consulted parts of "three interlacing statutes," that is, the Sherman Act, section 20 of the Clayton Act and the Norris-LaGuardia Act, spanning a period of forty years or more, to discover one "harmonizing text."⁶⁰ But, without going that far, the Court in

⁵⁵ *Id.* at 125.

⁵⁶ *Supra* note 2.

⁵⁷ See Note, *Non-Public Offerings Under the Securities Act*, 48 NW. U.L. REV. 771 (1954); Comment, *Employees Stock Offerings Under the Securities Act—the Ralston Purina Case*, 21 U. CHI. L. REV. 113 (1953).

⁵⁸ In construing the term "securities," as used in the 1933 act, to include assignments of oil leases, Mr. Justice Jackson said: "Some rules of statutory construction come down to us from sources that were hostile toward the legislative process itself and thought it generally wise to restrict the operations of an act to its narrowest permissible compass. However well these rules may serve at times to aid in deciphering legislative intent, they long have been subordinated to the doctrine that courts will construe the details of an act in conformity with its dominating general purpose, will read text in the light of context and will interpret the text so far as the meaning of the words fairly permits so as to carry out in particular cases the generally expressed legislative policy." *SEC v. Joiner Leasing Corp.*, 320 U.S. 344, 350-51 (1943).

⁵⁹ 312 U.S. 219 (1941).

⁶⁰ *Id.* at 231-32. For a suggestion that the Court should also have given "hospitable scope" to § 6 of the Clayton Act, which was directly in point, and to congressional purpose as stated in the Wagner Act, see Steffen, *Labor Activities in Restraint of Trade: The Hutcheson Case*, 36 ILL. L. REV. 1, 13 (1941).

the *Ralston Purina* case⁶¹ might well have examined the section 4(1) exemption more plainly in the light of the general purposes underlying the securities acts of 1933 and 1934. No doubt the outcome of the particular case would have been the same, but we might then have been spared the "fend for themselves" dictum.

The Court appears tacitly to have assumed that the *sole purpose* of the Securities Act of 1933 is to protect the *new* purchaser.⁶² And, of course, there is much in the congressional debates to support that view. But it must be remembered that because of very real constitutional doubts, as well as for overwhelming practical reasons, it simply was not realistic to enact that all security transactions—past as well as present—should be registered. Congressional debate, perforce, ran mainly in terms of the new investor. Not that general registration was undesired, but the only feasible way of achieving it was by registering new issues as they came on the market. With patience and in time, substantially all security issues would thus become registered.

It is in this light that President Roosevelt's recommendation to Congress, in his March 29, 1933 message, should be read: "There is, however, an obligation upon us to insist that every issue of new securities to be sold in interstate commerce shall be accompanied by full publicity and information, and that no essentially important element attending the issue shall be concealed from the buying public."⁶³ It is fair to say that the main thrust of this proposal was upon "full publicity"; registration of new securities was a means to that end. The persons for whose benefit the act was proposed consisted not alone of new purchasers, but those who might decide not to purchase, that is, it included "the buying public."⁶⁴

Consistently, the preamble to the act was couched in broad terms: "An Act to provide full and fair disclosure of the character of securities sold in interstate and foreign commerce and through the mails, and to prevent frauds in the sale thereof, and for other purposes."⁶⁵ Surely the thrust here is for "full and fair disclosure," concerning substantially all securities that Congress had the power to reach. Moreover, by its very lack of specification, the act was designed to benefit whoever might be concerned: new buyers unable "to fend for themselves"; holders of previously issued securities put out by the same issuer;⁶⁶ indeed, the whole business and investment community. The

⁶¹ 346 U.S. 119 (1953).

⁶² The point appears to have been taken more or less for granted. For example, in *A.C. Frost & Co. v. Coeur D'Alene Mines Corp.*, 312 U.S. 38, 40 (1941), Mr. Justice McReynolds said: "The essential purpose of the statute is to protect investors by requiring publication of certain information concerning securities before offered for sale."

⁶³ H.R. REP. No. 85, 73d Cong., 1st Sess., 2 (1933).

⁶⁴ *Ibid.*

⁶⁵ Securities Act of 1933, 48 Stat. 74 (1933).

⁶⁶ It would be hard to defend the proposition that, while Congress took such elaborate pains to protect the new buyer, it lost all interest in him thereafter; that subsequent issues—

events of the decade culminating in the 1929 crash had shown that all were in much the same boat and, in a sense, unable to "fend for themselves."

Even this account understates the ends Congress hoped to accomplish by "full and fair disclosure." Underwriting and distribution costs had come to be extremely high; therefore, the facts should be disclosed for all to see.⁶⁷ Accounting procedures were often designed to hide facts, rather than to inform the investor; these should be corrected, thus helping existing security holders as well as buyers of new issues. Phony promotions had too often hampered or defeated "honest" business enterprise, and hence the existing shareholders, in the competition for funds.⁶⁸ A House report stated the matter plainly: "Alluring promises of easy wealth were freely made with little or no attempt to bring to the investor's attention those facts essential to estimating the worth of any security. . . . Whatever may be the full catalogue of the forces that brought to pass the present depression, not the least among these had been this wanton misdirection of the capital resources of the Nation."⁶⁹ In a word, "full and fair disclosure" was thought to be essential if the nation's economy was to be kept in order.

It is against this background that the phrase, "not involving any public offering," must be construed. If congressional purpose is to be served, it would seem that any offering that is in a substantial amount, or made to more than a few persons, may be of such public concern as to call for registration. It may well be that large institutional investors have the ability to "fend for themselves"—though they are by no means infallible—but it does not follow that security purchases by them aggregating over three billion dollars each year do not involve "any public offering."

This is not to say that institutional buyers have been engaged in any "wanton misdirection of the capital resources of the Nation," or anything of the sort; but it does suggest that it is contrary to the broad purposes of the act that security transactions involving such vast sums should be made secretly. Interest and financing charges have been imposed without free competition, and without that "full and fair disclosure" thought essential in other areas. Many ingenious clauses restrictive of free business activity have been used,⁷⁰

vitality affecting his interests—might be brought out without registration, so long as the subsequent buyers were able (perhaps only too able) to "fend for themselves."

⁶⁷ 48 Stat. 89 (1933), 15 U.S.C. § 77aa(17) (1958).

⁶⁸ The Senate Report states that among other things the act was intended: "to protect enterprise, seeking capital by honest presentations, against the competition afforded by dishonest securities offered to the public through crooked promotion . . . to bring into productive channels of industry and development capital which has grown timid to the point of hoarding; and to aid in providing employment and restoring buying and consuming power." S. REP. NO. 47, 73d Cong., 1st Sess. 1 (1933).

⁶⁹ H.R. REP. NO. 85, 73d Cong., 1st Sess. 2 (1933).

⁷⁰ Restrictions upon the payment of dividends, or upon incurring other indebtedness, or even upon paying the particular obligation before maturity, are common examples. Clauses of this type become part of the public record, if the issue is registered.

which for the sake of a healthy economy are elsewhere promptly made a matter of public record. Such has been the hunger for investments that it is even possible some improvident borrowing has been arranged. When the Securities Act of 1933 was adopted, full and fair disclosure, not ability to fend for themselves, was the "dominating general purpose" of Congress.

UNDERWRITER: WHO IS?

Securities issued and sold to an underwriter, being obviously for public distribution, must be registered. On the other hand securities purchased privately within the section 4(1) exemption need not be, and likewise need not be upon subsequent resale to the public.⁷¹ That is, this is true unless the initial purchaser may be described as either an "issuer, underwriter or dealer," for registration is excused as to all others. Since the large institutional investor is clearly not an "issuer," or a "dealer," the only question has to do with the "underwriter" category. Section 2(11) provides the statutory answer: "the term 'underwriter' means any person who has purchased from an issuer with a view to, or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking"⁷²

Reference to a typical private placement will illustrate the problem. Late in 1961 the Wall Street Journal reported that the Hertz Corporation had placed a forty million dollar, twenty year, note issue with the Metropolitan Life Insurance Company and the Equitable Life Assurance Society of the United States.⁷³ The report said that the transaction had been negotiated by Lehman Brothers, investment bankers; but it said nothing as to the interest rate, the fee paid to the bankers, or the restrictive terms, if any, in the indenture or loan agreement. Nor was the loan agreement itself made a matter of public record by filing with the SEC. In other words, this was a usual private placement transaction, and it is referred to here solely for that reason. Assuming that not too many offerees were approached, and we may be sure the bankers were careful about that,⁷⁴ the transaction would seem to fall well within the section 4(1) exemption, as currently construed. No one really doubts that Equitable and Metropolitan are able to "fend for themselves."

It is a separate question whether either Metropolitan or Equitable might be found to be an "underwriter." That, it seems, depends on their *intent* at the time of purchase. Did they take the securities "with a view" to their subsequent "distribution"? It is inconceivable that institutions of their stature would per-

⁷¹ This is the evident meaning of the first clause of § 4(1). See note 2 *supra*.

⁷² 48 Stat. 74 (1933), 15 U.S.C. § 77b(11) (1958).

⁷³ Wall Street Journal, Dec. 26, 1961, p. 8.

⁷⁴ For at least two reasons: (1) the fewer the buyers, the less risk of having the transaction called a "public offering"; and (2) of having some buyer included who might later be found to be an "underwriter." Of course there is always the practical reason that a deal is easier to arrange with few buyers, and fees are paid for a deal.

mit themselves to buy these and other securities, amounting in the aggregate to many millions of dollars each year, with no thought of a possible resale in the future. Indeed, a proper regard for the protection of their policy holders would seem to require that they preserve a free hand to dispose of any security at any time as good insurance sense might dictate. Nonetheless, each company no doubt gave Hertz the usual letter of intent⁷⁵ saying that it did not purchase the securities in question "with a view" to their subsequent "distribution." Hence, on the face of things, neither was an "underwriter."

The key word here is "distribution." But, since distribution has been said always to include a "public offering,"⁷⁶ we are back where we started. Probably the large private placee does not *intend* at the time of purchase to make a subsequent "public offering." It will require the issuer to agree, upon demand, to convert the issue into 1,000 dollar bonds in the amount of the loan, and also to take any other steps necessary to facilitate a public sale,⁷⁷ but this is a cautionary matter. Circumstances conceivably could arise when the lender would need to make a public distribution.⁷⁸ There appear to have been very few such sales, but there have been instances when parts of an issue have been sold privately, after a discreet time interval, to other institutional investors.⁷⁹ These buyers, being few in number and usually smaller in size than the initial purchasers, may be assumed to be only slightly less able to "fend for themselves." At most, therefore, there has come to be a sort of private placement market in unregistered securities.⁸⁰

The question then is whether an insurance company becomes an "underwriter" upon reselling privately placed securities in this market. There is not much law on the point, but the case of *Gilligan, Will & Co. v. SEC*,⁸¹ at least raised some lively doubts. There a three million dollar issue of five per cent convertible debentures had been put out by Crowell-Collier in 1955, the company having engaged the firm of Elliott and Company to sell the issue privately, without registration. Elliott approached Gilligan, of Gilligan, Will & Company and told him that he could buy—but only for investment—as much of the issue as he wished (except for five hundred thousand dollars that Elliott's wife was taking), and that any debentures not purchased would be offered to

⁷⁵ See Orrick, *Non-Public Offerings of Corporate Securities*, 21 U. PITT. L. REV. 1, 13 (1959); Victor & Bedrick, *Private Offering: Hazards for the Unwary*, 45 VA. L. REV. 869, 873 (1959).

⁷⁶ H.R. REP. NO. 1838, 73d Cong., 2d Sess. 41 (1934).

⁷⁷ Even to use its best efforts to have the issue registered. Rodgers, *Purchase by Life Insurance Companies of Securities Privately Offered*, 52 HARV. L. REV. 773, 786 n.35 (1939).

⁷⁸ COREY, *DIRECT PLACEMENT OF CORPORATE SECURITIES* 80 (1951).

⁷⁹ Corey has stated that: "In a second fundamental respect institutional lenders have remained within the intent of the law: private placements have been resold only in rare instances. When resale has occurred, the purchasers have almost always been other institutional investors." *Id.* at 81.

⁸⁰ *Id.* at 144.

⁸¹ 267 F.2d 461 (2d Cir. 1959).

certain friends of Elliott. Gilligan agreed to purchase one hundred thousand dollars and on receiving the securities signed a letter saying "that the undersigned has no present intention of distributing the same."⁸² Actually, forty-five thousand dollars had already been sold to Louis Alter and five thousand dollars to Mooney, and five thousand dollars were to be placed in the firm's trading account. Later, on receiving their securities, Gilligan, Alter and Mooney each signed a similar statement; the securities were being "purchased for investment," and the signers had no "intention of distributing the same."⁸³

Based on these transactions alone, although there was also a 1956 issue, the SEC found that Gilligan, Will & Company had failed to sustain its burden of proof, that is, it had failed to show that it had *not* acted as an "underwriter" in connection with a public "distribution" of unregistered securities.⁸⁴ Hence the firm's registration as a broker-dealer under the 1934 act was revoked. In sustaining this action Judge Lumbard for the court of appeals said that it was not a defense that the firm had participated in only a few sales. The Supreme Court in *Ralston Purina* had clearly rejected a numbers test. Besides, the firm was well aware that many sales were in fact contemplated. It would not do to look only at the sales that registrant had made, for if that were the rule "a general public placement could be effected by a series of transfers to small numbers of buyers . . ."⁸⁵

But the case was also put on a different ground. It was pointed out that, in *Ralston Purina*, Mr. Justice Clark had said, in effect, that "the governing fact is whether the persons to whom the offering is made are in such a position with respect to the issuer that they either actually have such information as a registration would have disclosed, or have access to such information."⁸⁶ Since the registrant had stipulated that it did not have, or have access to, such information—nor was there any indication that either Gilligan, Alter or Mooney had any greater information—it followed that the offering was "public" and, hence it had to be registered for that reason. Thus, quite apart from whether Gilligan had acted as an "underwriter," the transaction was not exempt within section 4(1). This may well have influenced the earlier determination, but the court did not say as much.

Incidentally, it is not clear why the court backed away from the "fend for themselves" test, but Judge Lumbard made no mention of it. That test, if applied, might well have brought a different result, for early in 1956 the registrant, along with Gilligan and Alter, had converted its securities and sold the shares on the exchange at a profit—thus giving cogent proof of their fending

⁸² *Id.* at 465.

⁸³ *Ibid.*

⁸⁴ This applies, as to "underwriters," the *Ralston Purina* holding as to "issuers," that the person claiming exemption has the burden of proof.

⁸⁵ 267 F.2d at 467.

⁸⁶ SEC v. *Ralston Purina Co.*, 346 U.S. 119, 127 (1953).

ability. However, in view of the stipulation, one may not quarrel with the way the case was decided; it was not even necessary for the court to test the question whether "access to the kind of information which registration would disclose,"⁸⁷ as contrasted with *having* such information, would suffice. That "access" alone is enough seems quite dubious.⁸⁸

Thus the *Gilligan* case raises at least a doubt as to the vitality of the "fend for themselves" test. And, more to the point, there is little in the case as so far considered to give assurance that an institutional investor may resell securities in the private placement market, so-called, without fear of being found to be an "underwriter."

CONVERTIBLE SECURITIES

Convertibility adds a further complication. In *Gilligan* the Commission found that the sales of the converted securities "'clearly constituted a public distribution'";⁸⁹ and, the court agreed. Nor was it any defense that the debentures had been held for ten months before being converted; or that they were then converted only because it was noticed that Crowell-Collier had failed to increase its advertising space as anticipated. In the Commission's opinion, these facts showed that registrant had taken the debentures in the first place "with a view to distribution," and so was an "underwriter" within section 2(11). Again the court agreed; to hold otherwise Judge Lumbard said would permit "a dealer who speculatively purchases an unregistered security . . . to unload on the unadvised public what he later determines to be an unsound investment . . . although it is in precisely such circumstances that disclosure is most necessary and desirable."⁹⁰

Plainly this holding was of concern to institutional investors, for they customarily have held substantial numbers of convertible securities. The SEC likewise was interested and embarked on a general study of the matter.⁹¹ Of course it could be argued that Metropolitan, for example, is not *Gilligan*, and that ordinarily it would not make a subsequent public distribution, or have any purpose initially to do so. But the SEC posed the question: Why does anyone buy a convertible security, unless he contemplates realizing upon the convertibility feature at some time, either by selling the security itself, or by converting it and selling the underlying securities when the relation between the market price and the conversion price makes it profitable to do so? There is no good reply. Likewise, as the analysis states, "it must be presumed that the issuer understands that such is the intention of the purchaser."⁹²

⁸⁷ There is no intimation in the Act of 1933, or in the debates, that registration should be excused in the case of sophisticated buyers.

⁸⁸ 267 F.2d at 467.

⁸⁹ *Ibid.*

⁹⁰ *Id.* at 468.

⁹¹ SEC Securities Act Release No. 4162, December 2, 1959.

⁹² *Id.* at 3. And he may not sustain his burden of proof to the contrary "simply by obtaining from purchasers assurances that they are acquiring the convertible security with no present intention to distribute that security, or even with no present intention to distribute the underlying security."

But the SEC, in its analysis, went beyond a matter of presumption. In its view, when a private placement is made of a debenture convertible into an equity security, the debenture is the only security issued at the time; the purchaser gets in addition a mere right to have stock issued later upon delivering up the debenture. Thus, "it cannot be said," as generally supposed in the industry, "that a purchase of the convertible security includes a simultaneous purchase of the underlying security."⁹³ The reasoning thus far is surely unassailable. Nor can it be questioned, as the analysis further stated, that the transaction thus involves "a continuous offering by the issuer of the underlying security."⁹⁴ That is, this is true until conversion is made, when it would seem the issuer's part in the transaction is ended. At all events, the SEC now provides by Rule 155, effective February 7, 1962, that section 4(1) does *not* exempt (1) a public offering by a private placee of the convertible security itself, nor (2) a public offering of the security acquired upon conversion, unless the placee can establish that he was not acting as an underwriter within the meaning of section 2(11) of the act.⁹⁵

Rule 155 thus makes it clear that the institutional investor, *i.e.*, the private placee,⁹⁶ may make no "public offering" of a convertible security, unless the issue is registered. The door is firmly closed on such transactions. On the other branch of the case—concerning the converted security—while the new Rule recognizes that a public offering may be made without registration,⁹⁷ the door is only partly closed. It is incumbent upon the private placee to show, in spite of all the presumptions against him, that in so doing he did not act as an "underwriter" within section 2(11). It might seem that the same privilege, for what it is worth, should be available with respect to sales of the convertible security. But in such case there is no real question that the placee would be an underwriter, since he would certainly have "a direct or indirect participation"⁹⁸ in the ultimate distribution of the stock or other underlying security. Hence the Rule there is absolute; but as to sales of the converted security—as with any security taken in a private placement—presumably the matter is left in the realm of initial purpose or intent.

But the question is this: What effect does the new Rule have upon intermediate sales in the so-called private placement market? On its face, it would seem to put a stop to such transactions unless the security is registered. It

⁹³ *Id.* at 2. The converted security was regarded as "free stock," not requiring registration, since the holder was neither an issuer nor an underwriter. Moreover, the view was not without plausibility, since section 3(a)(9) of the act expressly exempts: "Any security exchanged by the issuer with its existing security holders . . ."

⁹⁴ *Ibid.*

⁹⁵ SEC Securities Act Release No. 4450, February 7, 1962.

⁹⁶ I am sorry to have to use this term, but at least it is unambiguous.

⁹⁷ See note 95 *supra*.

⁹⁸ 48 Stat. 74 (1933), 15 U.S.C. § 77b(11) (1958).

might seem, in fact, that the Rule would also apply to the multi-million dollar debenture that may be broken, *i.e.*, converted, into smaller pieces for resale. But the SEC has stated that the Rule is not intended to apply to the latter; it relates to changes from one security to another, that is, changes in kind, not in denomination.⁹⁹ And, although it involved some eating of words, the Rule, as put into effect, likewise does not even apply to intermediate private sales of convertible securities.¹⁰⁰ These, it would seem, are no longer to be regarded as steps in the ultimate public distribution of the underlying security.¹⁰¹ The "aim of the rule," we are told, is merely "to make clear that the ultimate public offering is subject to the registration and prospectus provisions of the Act."¹⁰²

And so things have not changed adversely for the private placee. In fact, to have it declared that the initial placee, and "any intermediate" placee, may make such private sales as they please, was a positive gain.¹⁰³ This regularizes the private placement market. It is true the Rule applies in terms only to convertible and converted securities, but, that being so, there is no apparent reason why it should not apply, *a fortiori*, to any security. Of course there are doubts: What for example becomes of the *Gilligan* warning¹⁰⁴ that if the number of such transactions, as a whole, is large, that may make it a public offering, thus requiring registration? If so, at least the private placee has little concern, for it will be noted the Rule has been carefully worded to exonerate any particular holder so long as *he* did not acquire the security with a "view" to distribution, or has not *himself* effected, caused, or arranged a public offering. Sales in the private placement market may well constitute a public distribution, but it would seem only the issuer may still be vulnerable.

WHAT OF ANTITRUST POLICY?

Before considering the Sherman Act, it is well to sum up briefly. The private placee must walk a narrow path. Despite many dicta that there is no numerical limit upon the size of a purchase group,¹⁰⁵ it is better to keep the number small, and such, indeed, is the practice. In the first place, since the question

⁹⁹ SEC Securities Act Release No. 4248, p. 3, July 14, 1960.

¹⁰⁰ Rule 155(b), SEC Securities Act Release No. 4450, p. 2, February 7, 1962. The subparagraph reads: "The phrase 'transactions by any person other than an . . . underwriter' in Section 4(1) of the Act shall, in the situations covered in paragraph (a), be deemed to include transactions by the initial, and any intermediate, holder of the convertible security or of the underlying security who (1) has not acquired the convertible or underlying security with a view to the distribution of either of them, and (2) is not effecting, is not causing to be effected, and has not arranged for, a public offering of either security within the meaning of and subject to paragraph (a) of this rule."

¹⁰¹ See SEC Securities Act Release No. 4162, p. 6, July 14, 1960.

¹⁰² SEC Securities Act Release No. 4248, p. 6, July 14, 1960.

¹⁰³ See note 100 *supra*.

¹⁰⁴ See note 85 *supra*.

¹⁰⁵ SEC v. Ralston Purina Co., 346 U.S. 119, 125 (1953).

is one of fact, it is well to err on the side of safety. But, more important, it is clearly essential that each placee either have, or "have access to the kind of information which registration would disclose."¹⁰⁶ The point is not clear whether a particular placee may be charged as an "underwriter" because he participated in the distribution with some other placee who may not have had the requisite information, but *Gilligan*¹⁰⁷ would suggest as much. And, whether so or not, the issuer would surely be responsible, so that registration would still be necessary. Thus the cautious course, again, is to keep the circle small and insist that it be made up only of well informed buyers.

On the resale side, there is also doubt. Rule 155 tacitly recognizes that a private placee may make a subsequent *public offering* in the usual case, for otherwise it would not have been necessary to provide that convertible securities may not be so sold unless registered. But the scope of this right is largely untested. And, while an initial placee may make subsequent *private placements* as just discussed, the scope of this right is also uncertain. A first condition would seem to be that each subsequent private buyer have "access" to such information as a registration statement would provide. Next, there must surely be some limit on the number of such transactions, or else the initial placees would in sum be making what an untutored court might later say could not be distinguished from a public distribution. Finally, such sales must not be made too soon, or without some plausible reason—such as an imbalance in the seller's portfolio¹⁰⁸—for otherwise the seller would be vulnerable to the charge that the securities were purchased in the first place "with a view" to their later distribution.

The picture is, thus, one of a highly restricted market. Issuers—that is, American businesses—may not even offer their unregistered securities freely to sophisticated purchasers—those able to fend for themselves—lest they be found to have made a public offering. The consequence is that they are denied the price advantages of free competition.¹⁰⁹ More important, they must accept many indenture restrictions that—in a free market—might well be written differently, or perhaps eliminated altogether. The restraints on the smaller

¹⁰⁶ *Id.* at 127.

¹⁰⁷ 267 F.2d 461 (2d Cir. 1959). What the Court meant by "access" is not clear, but it is very dubious that a mere statement by the issuer that he thereby gave access to all his books and records would suffice. And, if it satisfied the SEC, it surely should not the Insurance Commissioner. What the term really means, and what good practice requires, is that the issuer should prepare and give to each placee substantially the same data as would be given upon registration.

¹⁰⁸ This should cover most cases, for no one knows when a portfolio is in balance. It will not do to say, as *Gilligan* did in effect, that the investor had come to regard the investment as slow, or perhaps as unsound.

¹⁰⁹ The private placement market is itself a separate, easily distinguishable market, and has no special claim to be exempted from the play of competitive forces. See, *United States v. Paramount Pictures, Inc.*, 334 U.S. 131 (1948); *United States v. Aluminum Co. of America*, 148 F.2d 416 (2d Cir. 1945).

institutional lenders are no less obvious. Excluded entirely from dealing directly with the larger issuers, they must be content with such small pieces of an issue as one of the big placees may later decide to sell, to adjust its portfolio. To go no farther, this surely presents a state of facts deeply in conflict with the basic philosophy embraced by Congress when it adopted the Sherman Act.

The question is not one of guilt. It may be assumed that this is a situation of the sort referred to by Judge Hand in the *Alcoa* case,¹¹⁰ that is, the large placees may have "become monopolists by force of accident,"¹¹¹ or may have had their preferred position "thrust"¹¹² upon them. The question, nevertheless, is whether there are grounds for so exempting the private placement market from congressional policy. The broad reach of that policy has nowhere been better stated than by Mr. Justice Black in *Northern Pac. R.R. v. United States*,¹¹³ when he said:

The Sherman Act was designed to be a comprehensive charter of economic liberty aimed at preserving free and unfettered competition as the rule of trade.¹¹⁴ It rests on the premise that the unrestrained interaction of competitive forces will yield the best allocation of our economic resources, the lowest prices, the highest quality and the greatest material progress, while at the same time providing an environment conducive to the preservation of our democratic political and social institutions. But even were that premise open to question, the policy unequivocally laid down by the Act is competition.¹¹⁵

There is no lack of direct precedent to show that the restraints existing in the private placement market are contrary to policy.¹¹⁶ It will suffice to cite one of the early cases, *Swift & Co. v. United States*,¹¹⁷ where the essential charge was that the defendant packing companies had *agreed* not to bid against each other in the purchase of livestock on the several midwestern markets. In the words of Mr. Justice Holmes: "The scheme as a whole seems to us to be within the reach of the law."¹¹⁸ If we substitute bonds for beef and assume

¹¹⁰ 148 F.2d 416 (2d Cir. 1945).

¹¹² *Id.* at 429.

¹¹¹ *Id.* at 430.

¹¹³ 356 U.S. 1 (1958).

¹¹⁴ Mr. Chief Justice Hughes wrote in *Appalachian Coals, Inc. v. United States*, 288 U.S. 344, 359-60 (1933), that the Sherman Act is "a charter of freedom" with "a generality and adaptability comparable to that found in constitutional provisions."

¹¹⁵ 356 U.S. at 4.

¹¹⁶ The commerce question is no longer debatable. *United States v. South-Eastern Underwriters Ass'n*, 322 U.S. 533 (1944). But following that case the McCarran Act, 61 Stat. 448 (1947), 15 U.S.C. § 1012 (1958), was passed giving a limited Sherman Act exemption to insurance companies where they are under state law enacted "for the purpose of regulating the business of insurance."

¹¹⁷ 196 U.S. 375 (1905).

¹¹⁸ *Id.* at 396. Similarly, in *United States v. Swift & Co.*, 52 F. Supp. 476 (D. Colo. 1943), a system of turn bids was condemned as a price-fixing scheme. Four large buyers of fat

that the large private placees have agreed to buy bonds only according to the restrictions necessary to get through the section 4(1) loophole, the two cases are on much the same footing. In effect the issuer receives, and may receive, only one price-offer for his securities, that of the first investor group which he approaches. Of course, the issuer is not compelled to accept this offer; he may draw back and later offer his securities publicly; but this does not alter the fact that he does not have free access to a free private placement market.¹¹⁹

Nor may it be said—if that ever is a justification—that the private placement market just grew the way it has, as a result of economic forces alone. Rodgers, in fact, says frankly that an issuer when seeking to sell his securities privately “must be guided by the necessity of strictly limiting the number of offerees in order to preserve the exempt character of the transaction.”¹²⁰ Thus, it happens, that “the larger issues are naturally offered to a few companies,”¹²¹ and, he might have added, are purchased with virtually no competition. Moreover, as Mendel points out, “the managements of the investing institutions welcomed the opportunity [so afforded] to assume direct responsibility for their own protection and to teach—first to the managements of public utilities and later to the managements of industrial enterprises and railroads—the value to themselves, as well as to investors, of stringent indenture patterns.”¹²² Of course, as he further says, it is “readily possible for the lender, by means of restrictive covenants . . . to impose limitations on future expansion and dividend distribution,”¹²³ but in the case of large issuers, at least, “the institutional purchaser will normally impose very few such restrictions on the issuer’s management.”¹²⁴

Plainly, the culprit is section 4(1). And while some good may have come from the efforts of the large institutional investor to administer the private placement market, that is not the question. Long ago it was said of the Sherman Act that: “the law is its own measure of right and wrong, of what it permits, or forbids, and the judgment of the courts cannot be set up against it

lambs at the Denver Livestock Exchange had agreed among themselves upon a system whereby each took turns in making bids. The court said the vice in the scheme was that: “The seller has only one offer, or bid, for consideration at any single time.” *Id.* at 477–78. See *United States v. American Tobacco Co.*, 328 U.S. 781 (1946).

¹¹⁹ The limitations upon resale, likewise, are contrary to the policy of the antitrust laws. See *Eastern States Lumber Ass’n v. United States*, 234 U.S. 600 (1914). In some measure these restrictions must also enter into the calculations when an issue is being purchased; they thus tend to deprive the issuer of a full price for his securities.

¹²⁰ Rodgers, *supra* note 77, at 787.

¹²¹ *Ibid.*

¹²² Mendel, *Institutional Investment Through Private Placement of Corporate Securities*, 53 COLUM. L. REV. 804, 807 (1953).

¹²³ *Id.* at 811.

¹²⁴ *Ibid.*

in a supposed accommodation of its policy with the good intention of the parties, and it may be, of some good results."¹²⁵

BANKER V. INSURANCE COMPANY

The question of what to do about the section 4(1) exemptions seems never to have been heard on its merits. In the early years, 1936–1941, the investment banker was greatly distressed at the large volume of choice financing that was escaping him and going directly to the institutional investor without registration. His response, as noted above,¹²⁶ was to urge that section 4(1) be amended to close the loophole. This would not wholly eliminate the private placement,¹²⁷ but it would take away its competitive advantage; the expense, delay and publicity incident to registration could no longer be avoided by direct borrowing. But, while this would make for a certain fairness, it was not enough to make a case. Nor was the supporting argument, that private placement deprives the Insurance Department of a market valuation for portfolio securities, sufficient, although it too had merit. The final point, that issuers, like investors, need the banker as a sort of "umpire" to see that terms and prices are fair, while not without some substance, seemed at best a bid for business.¹²⁸

Then, in late September, 1941, the American Telephone and Telegraph Company put up a ninety million dollar debenture issue at competitive bidding. This was a sharp departure from the company's long-standing practice to do all major financing on a negotiated basis, with J. P. Morgan, and later Morgan, Stanley and Company, acting as banker. Worse still from the banker's standpoint, it was found when the bids were opened that three insurance companies—Metropolitan, Mutual, and New York Life—had won the issue.¹²⁹ It thus became obvious that if the big insurance companies chose to do so, they could outbid the banker whenever they saw fit. For, as Lewis Douglas of Mutual said at the time, "this is because a banking syndicate bids for resale," and must take into account the costs of resale, as well as some

¹²⁵ *Standard Sanitary Mfg. Co. v. United States*, 226 U.S. 20, 49 (1912).

¹²⁶ Note 11 *supra*.

¹²⁷ That is, the issuer might register and still sell his entire issue privately to a few large investors.

¹²⁸ Harold Stanley, in his letter to Nehemkis, Special Counsel to the SEC, April 15, 1940, summarized the disadvantages of private placement as being: "the loss of wide distribution of a company's securities, the loss of a demonstrated public credit, the loss of the good will and advertising value which accompany a successful public issue, the limited character of the security which can be sold to institutional purchasers, the possibility of ultimate higher costs of the borrowing if sinking fund provisions are included, and the loss of whatever value there is—and we think that it is substantial—in having a third party, *i.e.*, the investment banker, stand as an umpire between the borrower and the investor."

¹²⁹ *Wall Street Journal*, Sept. 30, 1941, p. 7, col. 7. The insurance company bid covered that of the regular Morgan, Stanley and Company syndicate by \$8.32 per \$1,000 debenture. Halsey, Stuart and Company, with Mellon Securities Corporation, formed a large new syndicate of 179 houses, but its third-place bid was covered by \$15.79 per debenture.

profit, "whereas the insurance companies bid for their own investment."¹³⁰ Douglas also pointed out that—like insurance company purchases at private placement—bidding tended "to give the big investing institutions a monopoly in the purchase of high grade securities," and to put "smaller investors at a competitive disadvantage in the matter of investment supply."¹³¹ While Douglas said he was "strongly opposed" to such trends, he nevertheless insisted that the large insurance companies must keep the right to bid "as a protection to themselves against inordinate 'banking spreads' in the sale of new security issues."¹³²

There followed a series of meetings among investment bankers, and others among representatives of the insurance companies. On December 5, 1941, at the invitation of Louis H. Pink, Superintendent of Insurance, a small joint meeting was held.¹³³ The bankers, naturally, wanted to be rid of competitive bidding by insurance companies; they also had pending the IBA proposal to amend section 4(1) to restrict private placements. But it appears that the insurance companies likewise had complaints. Aside from the matter of "inordinate" fees, mentioned by Douglas, their basic point seemed to be that under the usual syndicate method of distribution, with bonds being parcelled out to many selling group members over the country, it was often not possible for the big companies to purchase their requirements; or, they could do so only piecemeal, as bonds filtered back to New York. The matter finally came to a head on May 5, 1942, at a large general meeting also called by Superintendent Pink, at which representatives of the leading bankers, the big New York insurance companies, a few large out-of-state companies, and at least one representative of the many smaller companies, were present.¹³⁴

Judge Medina, in *United States v. Morgan*, where certain documentary evidence of the foregoing was presented, bemoaned the fact that no live witness was called to say just what had transpired at the May fifth meeting.¹³⁵

¹³⁰ Remarks of L.W. Douglas, Annual Convention of Mortgage Bankers Association of America, New York, October 1, 1941.

¹³¹ *Ibid.*

¹³² *Ibid.* Two registered AT&T refunding 3¼% debenture issues, one for \$150,000,000 and the other for \$140,000,000, that were distributed publicly by the Morgan, Stanley and Company syndicate in 1936, illustrate Douglas' argument. The spread in each case was 2 points, which meant that investors paid an aggregate of \$5,800,000 in distribution costs for securities that were in good demand. See Prospectuses, dated October 15, 1936, and December 2, 1936. Out of this sum the managing banker received fees on the order of \$1,000,000 all told. These were among the first securities to be marketed under the Securities Act of 1933.

¹³³ *United States v. Morgan*, 118 F. Supp. 621, 826 (S.D.N.Y. 1953). It does not appear that Superintendent Pink took any part in the matter, other than to provide a forum where the parties could work out their differences.

¹³⁴ *Id.* at 825-26.

¹³⁵ *Id.* at 826. It is not clear why Judge Medina felt that he must have live witnesses, since the Fulton report was far more precise as to what happened at the May 5th meeting than

However, there was in evidence a five page report by James A. Fulton, of the Home Life Insurance Company, that made quite clear, at least *prima facie*, what was discussed and what action was taken. The report, which was circulated among bankers and insurance companies alike, carefully stated that there were no "agreements or understandings arrived at that would in the slightest degree restrict the freedom of action of anyone."¹³⁶ But it went on at once to say that the "purpose of the series of conferences has been to enable the parties interested to get a better understanding of each others' problems, with the idea that such a better understanding would *make for a sounder procedure*, as well as a better feeling."¹³⁷

There is nothing in the Fulton report which states that the insurance companies would in the future refrain either from competitive bidding or from private placements. But the report *starts* with a reference to "a steady tendency for large life insurance companies, either individually or in groups, to buy at private sale, substantial issues of securities." The report continues with a statement that with "the introduction of competitive bidding, an extension of this same trend got under way." In each case the adverse effects upon investment bankers and the small investor are pointed out. The report *ends* with a statement that certain bankers "have indicated their intention to try the following general pattern in the distribution of substantial issues of securities." That is, first, they would "retain for direct offering to interested life companies approximately 50% of the issues."¹³⁸ Second, "the balance of the issue would be distributed through normal channels," thus permitting dealers to sell to smaller investors. And, third, "there would be no differential in price" between large group sales and sales by dealers at retail.¹³⁹

The outcome, thus, seems to have been that the bankers undertook to mend their ways—certainly, any reluctance at making group offerings disappeared—

any testimony could be. Moreover, oral testimony takes time, and the case was already unduly long. See Steffen, *The Prima Facie Case in Non-Jury Trials*, 27 U. CHI. L. REV. 94, 105-06 (1959).

¹³⁶ Fulton Report, May 14, 1942.

¹³⁷ *Id.* at 4. (Emphasis added.) Judge Medina, in *United States v. Morgan*, 118 F.Supp. at 826, quoted the first sentence, but made no reference to the second. Since the charge in the *Morgan* case was that the defendants had conspired to eliminate price competition in the purchase and sale of securities, it surely made no difference whether one of the "means" used to that end was an "agreement" or merely a "procedure"; nor would it be material whether all of the defendants used the same "procedure." In fact, an attempt to ward off insurance company competition, even if wholly unsuccessful, would be significant evidence. See Steffen, *The Investment Bankers' Case*, 64 YALE L.J. 169, 863 (1954-1955).

¹³⁸ Following the May 5th meeting, Coggeshall of First Boston sent out a list of the twenty-seven largest insurance companies, ranked by assets, to those bankers who had attended the meetings and noted that this "becomes relatively important in the light of the expressed desire of the insurance companies that any group offerings be based in the first instance on their relative size."

¹³⁹ There was no instance brought forward in the course of *United States v. Morgan* to show that bonds or debentures, of investment quality, were ever subsequently distributed on a two-price basis, although on occasion other securities have been sold in that way.

while the insurance companies promised nothing. But it is implicit in the *Fulton* report that the insurance companies for their part would not make a practice of competitive bidding.¹⁴⁰ Moreover, the specific data submitted in the *Morgan* case showed that they have not done so.¹⁴¹ But the private placement practice continues unabated, with the difference that the leading bankers have come to take a larger and quite lucrative part in the negotiations between issuer and insurance company,¹⁴² and that most of the investment bankers' demands that section 4(1) be amended have disappeared.¹⁴³ It is not possible to say whether any of this came about by agreement, and the point is not important. What is significant is that the banker lost his argument against the private placement;¹⁴⁴ it has come to stay. But it does not follow that the monopoly position enjoyed by the large insurance companies, because of section 4(1),¹⁴⁵ can be defended either as being necessary or in the public interest.

¹⁴⁰ And it was so hailed in the press. The *New York Sun*, June 3, 1942, reported in part: "No papers were signed and no formal pronouncement of policy was made as a result of the conference, but it is understood that after a free discussion of the subject from every angle, bankers were given to understand that, in deference to small institutional investors who are not in a position to participate in insurance company groups, the large units will refrain from competing. The agreement is understood also to cover private sales of large bond issues to insurance companies, in which the interests of small institutions are just as much involved."

¹⁴¹ Judge Medina, in *United States v. Morgan*, 118 F. Supp. at 826, states that the Coggeshall list of insurance companies was of "little significance," since the "insurance companies continued to bid for security issues," and there was no "pattern of uniform or consistent action." The last, of course, is immaterial, but as to the first, the data submitted to the court showed that the insurance companies, except in a few small instances, *did not again* engage in competitive bidding against investment bankers. Indeed, the court might well have taken judicial notice of the fact that no practice has ever developed to bid as in the AT&T case, though many billions of investment securities have since been sold at competitive bidding.

¹⁴² Corey describes in detail the work done by Morgan, Stanley and Company in 1949 in placing a \$75 million Standard Oil Company (New Jersey) note issue with a group of insurance companies. The banker's fee and the other expenses amounted to approximately \$90,000. COREY, *DIRECT PLACEMENT OF CORPORATE SECURITIES* 192 (1951). Of course, this is small money compared with that gained when an issue is sold on a negotiated basis; also the many small bankers who otherwise would be members of the buying syndicate have no share.

¹⁴³ Stanley said in 1940: "I would not advocate, as a cure as some have suggested, that the law be changed to require that all new issues should be registered prior to their sale, at least not until the present registration requirements are materially simplified." Letter to Nehemkis, *supra* note 126.

¹⁴⁴ Harrison of New York Life, who was concerned to preserve investment banking machinery "as a necessary adjunct to a broad and healthy capital market," warned that if "the private placement practice grows and competitive bidding by large institutional buyers continues, there is a very reasonable doubt whether investment banking as such may not be seriously impaired in its effectiveness to do a necessary job." Address before the Savings Banks Association of New York, Oct. 20, 1941.

¹⁴⁵ Perhaps this overstates the case, for Mendel insists that: "Private placement is not a phenomenon dependent for survival on exemption from federal securities regulation." *Supra* note 122, at 816. But if he is right, there should be no insurance company objection to removing the exemption.

TWO MARKETS

It is clear that, when section 4(1) was adopted, Congress had no purpose to create a two-market system of securities distribution. In fact, though the point is not important in the present context, it may be that—as industry spokesmen insist—other causes explain the great increase in direct borrowing that has taken place over the last quarter century. To mention only one, there has been a tremendous increase of investment funds during the period for which it has been necessary to find an outlet.¹⁴⁶ Moreover, whatever its shortcomings, the existence of a direct placement market has been of inestimable value to industry; that too is not questioned. As a matter of simple pragmatics, therefore, it is proposed in what follows to recognize that there are two securities markets. The question, then, is this: What may be done to bring the direct placement market into line with basic congressional policies? And so, by hypothesis, to increase its usefulness?

One proposal, with a certain plausibility about it, is to open the section 4(1) door still wider. Or, as Corey puts it—and he argues the point persuasively—the suggestion is “to broaden the private placement markets.”¹⁴⁷ In the first place, Corey points out that this market consists in great part of debt securities and that these are purchased almost entirely by institutional investors fully able to look out for themselves.¹⁴⁸ Hence, an issuer should be free to offer his securities widely to any and all institutional buyers, without risk of having made a “public offering.” It is implicit in Corey’s position that the small institutional investor, like the large one, does not need the protection afforded investors generally by registration. In fact, he says as much, but then goes on to say: “The bargaining strength and the analytical skills *especially of the larger institutional investors* seem sufficiently great to assure their receipt of the necessary information relative to security issues.”¹⁴⁹

But Corey has a second point. The present direct placement market, he says, has tended “to deprive both issuers and investors of maximum competition.”¹⁵⁰ That is to say: “The private market is reserved in effect, to a relatively few large investors whose decision to reject private offerings yielding less than a certain rate can rule out direct financing for the issuer.”¹⁵¹ Moreover, Corey is at pains to illustrate with observed cases just how the system works. He continues: “The ability of large institutional investors to ‘hold out’ for a certain rate in this way seems to be a result of the small number of investors

¹⁴⁶ Fulton, for example, states that: “It is obvious that this whole problem arises out of an excess of funds for investment and a scarcity of securities.” *Supra* note 136, p. 4.

¹⁴⁷ COREY, *op. cit. supra* note 142, at 150.

¹⁴⁹ *Id.* at 150. (Emphasis added.)

¹⁴⁸ *Id.* at 140.

¹⁵⁰ *Id.* at 150.

¹⁵¹ *Id.* at 146. The reason, of course, is that after an issuer has gone this far with one investor group, any further negotiations with a second group would almost certainly become a public offering.

in the private market, which in turn is a result of the concept that a direct placement becomes a public offering if offered to more than an unspecified, but presumably small, number of prospective purchasers.”¹⁵² Corey concludes that the present regulatory framework—as it applies to direct placements—is “obsolete,” and should be reshaped “to produce those results most conducive to economic growth and development.”¹⁵³

One may agree wholeheartedly with Corey’s diagnosis and yet doubt that non-registration is the cure. On the other hand, to go to the other extreme and require general registration of private placement securities—the cure once suggested by the IBA¹⁵⁴—may also not be acceptable.

It will be useful to explore the point. Much has been said about the expense, delay and publicity incident to registration, but these have not been substantial objections. In the first place, the expense of registration in the case of a typical large private issue is *de minimus*; nor is the additional publicity involved a point today, although there may still be a few diehards who think otherwise. And, while delay might seem to be a valid objection, it—like expense—cannot be used too boldly by the large insurance company as a basis for opposing registration. That is to say, such companies owe an over-riding duty to their policy holders not to act with haste, and most certainly not to act until the essential facts concerning an issue have been fully developed. The time consumed and the cost involved in preparing adequate financial data, therefore, are (or should be) much the same in the one case as in the other.¹⁵⁵

There is one argument, however, that the IBA proposal did not meet. Throughout the debate over the last quarter century, issuers and institutional investors alike have insisted that the ability to close a deal at once is of great importance.¹⁵⁶ And, of course, to require that private placement securities should be registered, as other securities are, would mean that no sale could be made until after the usual twenty-day waiting period had elapsed.¹⁵⁷ There is probably more myth than fact in the danger of “missing a market,” especially with top-rated debt securities. And, one suspects that many issuers sacrifice something in price by asking for a quick decision, particularly where their

¹⁵² *Id.* at 147.

¹⁵³ *Id.* at 153.

¹⁵⁴ REPORT ON CONFERENCES WITH THE SEC AND ITS STAFF ON PROPOSALS FOR AMENDING THE SECURITIES ACT OF 1933 AND THE SECURITIES EXCHANGE ACT OF 1934, 31 (July 30, 1941).

¹⁵⁵ See generally, SEC, COST OF FLATATIONS, 1945–1947 (1949). It will be noted that the comparison here is not with a public distribution where banker’s fees and larger printing costs would be involved.

¹⁵⁶ “The primary advantage to be achieved through direct placement is the ability on the part of the issuer to obtain a firm commitment as to terms at the close of negotiations. Before the financing is consummated and regardless of market conditions, the insurance company, as the ultimate purchaser, offers the corporate issuer the possibility of carrying out his proposed financing on the basis of mutually acceptable terms.” COREY, *op. cit. supra* note 142, at 52.

¹⁵⁷ Securities Act of 1933, 69 Stat. 684 (1954), 15 U.S.C. § 77e (1958).

financial showing is incomplete, and that they would be better advised to act with normal circumspection. Nonetheless, the point is not without substance, especially if there is added to the twenty-day period any further time needed to supply additional data requested by the SEC—data essential perhaps for general registration, but not necessarily important in this market.

This prompts the question, how important is a “waiting period” in the private placement market? Not very, it would seem. Here, at least, the “ability to fend for themselves” doctrine may have full play. The Securities Act was drafted on the theory not only that the essential facts concerning an issue should be made available to the investing public, but that there should also be time allowed in which the information could be digested.¹⁵⁸ High pressure selling and blind buying on the part of inexperienced investors were evils to be eradicated. But a bare recital of these purposes shows that they have little point in the private placement market; if anything, the shoe is on the other foot. So it may be agreed that the “bargaining strength” and “analytical skills”¹⁵⁹ of the institutional investor are such as reasonably to insure that he may undertake to purchase an issuer’s securities at any time.

With this obstacle removed, the case against registration largely disappears. And, as a result, it may well be possible both to broaden the private placement market—to let in enough competition to square with antitrust policy—and also to provide for full and fair disclosure—to conform with the purposes of the Securities Act.

WHAT TO DO

It is beyond the scope of this article to state, as precise changes in rule or statute, what should be done to establish a sound private placement market. While no one, surely, is happy with things as they are, there is not a consensus as to basic ends. Some writers would go no further than to eliminate the uncertainties that now plague the market;¹⁶⁰ but while that is essential, the price seems too high if it means a continuation of the present non-competitive, non-disclosure system. Corey, as discussed above,¹⁶¹ would go another step to promote a competitive market. That too is desirable, but the logic of the foregoing analysis would support a more comprehensive solution. The main points at least may be listed, as follows:

¹⁵⁸ Loss writes that “the whole theory of the waiting period is that the information contained in the registration statement will be disseminated so that the investing public will be able to make an intelligent determination whether to buy when the statement becomes effective.” Loss, *SECURITIES REGULATION* 149 (1st ed. 1951).

¹⁵⁹ COREY, *op. cit. supra* note 142, at 192.

¹⁶⁰ Victor & Bedrick, *Private Offering: Hazards for the Unwary*, 45 VA. L. REV. 869, 882–83 (1959). These writers, in the name of certainty, would define “public offering” to permit issuers to offer their securities to as many as one hundred buyers, “if each purchaser signs an investment covenant,” and would exempt from registration “all sales to banks, insurance companies, pension or profit-sharing trusts or all other institutional buyers.”

¹⁶¹ See text accompanying note 147 *supra*.

First, assuming a separate private placement market is to be recognized, it is necessary to define the securities that may be traded there. These, at present, consist in very large part of debt securities, put out in issues of three million dollars or more. For present purposes that is an adequate description of "direct placement securities."¹⁶²

Second, it is important to specify who may buy and sell on this market. It is suggested that any person (insurance company, bank, pension fund or any other) with one million dollars invested in securities should be qualified to trade as an "institutional investor." This is a rough, but easily applied, test, and one, moreover, that graphically conforms with the "ability to fend for themselves" test.¹⁶³

Third, a separate calendar should be established for the registration of all "direct placement securities." It seems quite possible, once it is agreed to have a special market, that some of the detail essential to general registration can be eliminated. Perhaps the waiting period can be reduced to ten days.

Fourth, issuers of placement securities should be permitted to make direct sales freely to any institutional investor, at any time, without any hocus-pocus about investment intent. This is a departure from the scheme of the Securities Act, but it is suggested that it can be made here with reasonable safety.

Fifth, institutional investors should be permitted, after an interval of two years,¹⁶⁴ to resell all or any part of an initial direct purchase of securities to any other institutional investor, with no questions asked. The present under-the-counter resale market is an indefensible way to do business.

Sixth, the SEC should be given authority, at the request of an issuer, to post an issue for sale.¹⁶⁵ Then, under suitable rules, any institutional investor, or any investment banker having such investors as customers, might enter a bid for the securities during the waiting period.

It may seem anachronistic to provide for registration, and for a waiting period, when the issuer's securities may already have been sold. But that is not necessarily so. In the first place, while some issues may be sold at once, it is a fair guess that many are not. More often, only a tentative price will have

¹⁶² It would be possible, also, to restrict the market to the top four grades, but this would only add an unnecessary complication. The market itself will fix the quality.

¹⁶³ The amount, \$1 million, is admittedly arbitrary. But still, Senator Huey Long used to draw the line there: "I am not against private property," he would say, "I am for private property. But \$1 million is enough for any man."

¹⁶⁴ Such a test is both reasonable and certain of application. Moreover, some restriction is necessary, since institutional investors may not engage in the securities business. See note 39 *supra*.

¹⁶⁵ The pattern here is suggested by the Lloyd's custom of posting insurance risks, it being the practice for any member to "underwrite" such part of a risk as he is willing to take, by writing his name under that of the principal insurer. Of course the present suggestion goes much farther. For a general description of the Lloyd's practice, see *Ell Dee Clothing Co. v. Marsh*, 247 N.Y. 392, 160 N.E. 651 (1928).

been agreed on "subject to approval of counsel" and "provided your accounts are found to be as you say."¹⁶⁶ Secondly, even if a firm price is given, the knowledge that the essentials of the deal must be spread on the public record will have had an effect on the negotiations. Indeed, the Securities Act rests on the premise that publicity alone will ordinarily make for a fairer deal.¹⁶⁷ True, the act was promoted in aid of investors, but there is no reason why, with relative bargaining positions reversed, it may not serve issuers equally well.

However, registration may be supported on the traditional ground, that it is needed to inform the investing public. This becomes particularly true if many more investors are to enter the direct placement market, for it may not be safely assumed that all these will have the "bargaining strength and the analytical skills"¹⁶⁸ of the large institutional investors. In fact, quite the contrary. Moreover, if some of the bargaining advantage of the large investors is removed, it may not be a wholly safe assumption even in their case,¹⁶⁹ if it ever was, for size gives no assurance of infallibility. But, beyond that, with the secondary market freed of its present doubt and restrictions—as it clearly should be—a minimum safeguard for purchasers on this market is initial registration.

So much to satisfy the Securities Act, but what of antitrust policy? Broadening the private placement market, in and of itself, may not be enough.¹⁷⁰ The habit is to drive a bargain privately with a few large companies, and "shopping around" here, as with investment bankers,¹⁷¹ is no doubt severely frowned upon. Thus it may be that some means should be established—as outlined in the sixth point—whereby an issuer can take his case in a quick and orderly manner to the full investment securities market. Perhaps it would seldom be necessary to go so far. If it should be widely used, that might upset the balance that has prevailed between insurance company and banker since the 1941–1942 Pink meetings.¹⁷² But, if so, the paramount need to give industry full and unfettered access to the capital market is justification enough.

¹⁶⁶ That is, the practice now is to use a waiting period before a deal is consummated.

¹⁶⁷ See generally, Loss, *op. cit. supra* note 158, at 126.

¹⁶⁸ COREY, *op. cit. supra* note 142, at 150.

¹⁶⁹ It is only courting trouble to permit the present construction of section 4(1) to stand. In *SEC v. Guild Films Co.*, 279 F.2d 485 (2d Cir. 1960), Judge Moore went so far as to say that: "The exemption in § 4(1) was intended to permit private sales of unregistered securities to investors who are *likely* to have, or who are *likely* to obtain, such information as is ordinarily disclosed in registration statements." *Id.* at 490. (Emphasis added.)

¹⁷⁰ The SEC felt impelled in 1941 to announce Rule U-50, as a means to insure competition in the marketing of securities for the public utility companies under its jurisdiction, notwithstanding that the investment banking industry at the time was large and financially strong.

¹⁷¹ *United States v. Morgan*, 118 F. Supp. at 821.

¹⁷² *Supra* note 133. In 1941, prior to the Pink meetings, one Wall Street firm, at least, advocated that bankers might well represent groups of small insurance companies to bid competitively, but the plan seems never to have been carried out.