REPORT OF THE COMMITTEE ON INFORMAL ACTION IN SUPPORT OF RECOMMENDATION NO. 19

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I. Introduction

This study examines the informal processes by which advisory opinions are rendered by the office of the Chief Counsel of the Division of Corporation Finance, Securities and Exchange Commission. The primary focus of study has been upon the processes by which that office renders "no-action letters": letters advising an applicant whether the staff would recommend Commission enforcement action if a sale of unregistered stock were to be made under the circumstances and in the manner proposed by the stockholder. That elliptical description is required to conform to the staff's view of the purpose of "no-action" letters; and the hypothetical phraseology is required because the process seldom involves any prospect of imminent enforcement action.

The range of inquiry is limited to the no-action process as it is administered in the Division of Corporation Finance. (Hereafter, "Division".) That Division was chosen as the focus of inquiry because of the significantly higher volume of advisory letters issued, as compared to the other Divisions of the SEC staff. Also dictating the choice was the estimate made by the Solicitor of the SEC, Mr. David Ferber, and the Division's Chief Counsel, Mr. Courtney Whitney, Jr., that approximately 80% of the no-action letters rendered by that Division deal primarily with the question whether one who receives unregistered stock may sell that stock without complying with the registration requirements of the Securities Act of 1933. (Hereafter, "1933 Act.") It was thought that concentration in a single substantive area would make possible a more thorough analysis of the extent of discretion exercised and the extent of consistency achieved. through extensive comparisons of cases representing specific types of transactions.

The supposition that concentration in this "single substantive area" would facilitate simple comparisons of representative cases was misconceived. Such a study would have involved an extensive "library" examination of the complexities of a large number of cases, to the exclusion of other types of inquiry. Even a study concentrating on one or two basic concepts would involve a detailed legal and factual analysis and comparison of complex transactions with many subleties that would have to be identified and compared. (See Appendix H, outlining the analytical factors necessary in an adequate study and comparison of similar cases; and see the discussion, *infra*, of discretionary factors which appear to have influenced decision.) Only such a study could fully demonstrate the degree to which discretionary factors influenced decision or the extent to which inconsistent application of standards affected staff advice. However, substantial sampling of cases and internal records, staff responses to a detailed questionnaire, and frequent discussions of specific cases with various members of the staff, together with the fortunate conjunction of this study with the extensive study of disclosure policy recently completed by the staff, provide an adequate basis for the judgments expressed here.

Because all divisions of the SEC staff render interpretive letters, it may seem somewhat artificial to have isolated that process as it is administered in only one division. Yet that process, as administered in the Division of Corporation Finance, is sufficiently distinct for independent study. The major portion of the advisory letters processed in that Division are not particularly "interpretive" in form and are not intended primarily to be informative about Commission or staff policies or interpretations. Rather, the letters are the instrument of a clearance process which authoritatively disposes of doubts about the right of a stockholder to sell his stock without registration. As a result, most specific, detailed questions concerning the application of the registration provisions of the 1933 Act are reduced to an answer to the practical question whether, on a given set of concrete facts, the staff would recommend enforcement action if the sale is consummated as proposed. Thus, the staff has stated that the letters prepared by this Division "rarely take the form of an interpretation as such." (See staff memorandum to Warner W. Gardner, Appendix E, p. 1.) In contrast, it appears that the letters generated by the Division of Corporate Regulation are substantially more interpretive—only 20%taking the form of "no-action letters." (*Ibid.*)

The form and content of the no-action letters, the volume of letters generated by the Division, and the rather routine nature of the bulk of the inquiries all indicate that these letters perform a distinct "clearance" or licensing function not generally understood to be the objective of agency advisory processes.

The staff reports that the Division generates no-action letters at a rate of approximately 5,000 per year, as compared to 640 per year in the Division of Corporate Regulation and 400 per year in the Division of Trading and Markets. (*Ibid.*) While it is possible to quibble about the exact number, it is clear that the letters are issued at a rate of substantially more than 4,000 per year and that considering and responding to requests for the letters consumes a significant part of the effort of the Division. Further, the large proportion of the requests which ask merely "When may I sell?" (without registration) present few interpretive problems of consequence for the development and elaboration of administrative policy. Thus, responses to the questionnaire submitted to staff attorneys indicated that most find their reservoir of experience adequate to prepare a letter in at least 70% of the cases. (See Appendix I, question 29.) That may suggest that most of the no-action letters can be handled with dispatch. But often the questions presented, though not of great interpretive difficulty, require discretionary judgments that call for careful and conscientious consideration. The former Chief Counsel of the Division has commented:

> [M]any members of the Bar and the securities industry have no idea of the volume of requests that are made for staff advice, or of the internal problems of administration that arise in providing this service. In particular, it is difficult for a person who has not had experience on the staff to appreciate the amount of time that must be devoted to answering even a routine request for staff advice. (Appendix B, pp. 5–6).

While a large proportion of the requests for no-action letters are of little or no interpretive significance, a significant number of them present important questions about established interpretations or policy which deserve extended consideration. Staff responses to those inquiries are prompt and thorough; but there is reason to doubt whether it is possible for the staff or the Commission to make optimum use of the unique interpretive opportunity offered by such requests so long as the no-action procedure is regarded as a clearance device for any stockholder who seeks to establish his right to sell. It would seem that only great solicitude for stockholders' needs for adequate legal advice, or a certainty that the system operates to encourage general compli-

ance with the regulatory statutes, could justify this allocation of effort.

The burdens of the clearance function performed by the no-action process in the Division of Corporation Finance are also recognized by the study, "Disclosure to Investors" (hereafter, *Disclosure Study*), recently completed by a special SEC staff under the supervision of Commissioner Wheat. Although that study concentrated on the substantive rules controlling registration obligations, one of the important motivations for that study arose from the burdens of the no-action process. After explaining the interpretive problems that have rendered the substantive law uncertain, the study describes one important consequence of that uncertainty as follows:

> (2) The Commission's staff is faced with a growing burden in responding to requests for interpretive advice and "no action" letters centered around the question: "when may I sell?" In fact, a large majority of all such requests under the 1933 Act pertain to the resales following a private offering. It is important that this burden be reduced. To the extent that certainty can be provided, "no action" requests would become unnecessary. (Disclosure Study at 175.)

The *Disclosure Study* seeks to ameliorate the burdens of the no-action process by simplifying the substantive rules. The present study attempts to examine the process itself, concentrating upon the "efficiency, adequacy and fairness" of this advisory and clearance process.

There is obvious advantage in concentrating on processes in a substantive field that was recently put under searching examination by the agency staff, for it is possible to examine the processes in light of substantive staff conclusions that would otherwise require substantial independent study. On the other hand, there was some reason to wonder whether there would be undue duplication of effort and whether the substantive proposals of the *Disclosure Study* would render the product of this study useless. For a number of reasons, that is not the case:

1. The no-action letter process is an important example of an informal advisory process in which important private rights are disposed of by both staff and Agency determinations, often with the same effect as a final order. The process has developed with the encouragement of the Agency, follows a rather well-defined set of procedures, but is described in only the most sketchy of published regulations. (See 17 C.F.R. sections 202.1 and 202.2, appendix K *supra*.) Thus, even if new rules proposed by the *Disclosure Study* substantially reduce the interpretive prob-

lems and the concomitant need for staff advice, analysis of the no-action process should yield valuable insights into agency advisory processes; and those insights should be helpful in framing general recommendations to the Administrative Conference. Further analysis of this process should be helpful in any later comparison with other agencies' advisory processes.

2. New substantive rules will not eliminate the need for advisory processes, even in the applicable substantive field. Although the *Disclosure Study* predicts that its proposed rules will very substantially reduce the need for advice about questions that presently are in doubt, advice inevitably will be needed in defining the boundaries of the new rules.

3. It is doubtful that any rules the SEC could adopt will resolve the interpretive problems created by the broad language of the statute. For example, the *Disclosure Study* specifically recognizes that it leaves two fundamental concepts for continued administrative elaboration: (a) the distinction between a "public offering" and a "private offering" of securities; and (b) the concept of a stockholder's "control" over or "control relationship" with the issuer of securities. (The rules proposed by the *Disclosure Study* do, however, narrow the coverage of the "control" concept by employing a negative definition that utilizes four hypotheticals to exclude certain circumstances from a statutory "control" relationship.)

II. The Substantative Context for No-Action Letters Rendered by the Division of Corporation Finance

The objective of most of the no-action letters rendered by the Office of Chief Counsel, Division of Corporate Finance, is to advise stockholders whether they must register their stock in order to sell it without risking SEC enforcement action. Both oral and written advice on that problem are given by the Chief Counsel's office. Oral advice tends to be general and interpretive; it assists counsel in identifying specific problems, often with a view to a more specific application for a no-action letter. Written advice in most cases is specific and conclusory; it includes little or no interpretive material, but expresses the staff's conclusion whether, on a particular set of facts, it would recommend that the Commission take action if a stockholder should sell stock without registration.

The assurance provided by a no-action letter is treated as binding by the Commission, though the estoppel effect of such a letter has not been judicially determined. See Loss, *Securities Regu-*

lation, pp. 1843–44 (2nd Ed. 1961). (Such an assurance may also tend to discourage private actions for sales made without registration. However, because the no-action letter is founded upon carefully exacted factual representations, it is not regarded by enforcement personnel as a bar to investigations of unregistered sales until it is determined that the sale in question conformed to the factual representations.

In a few instances, the collateral effect of a no-action letter has had an impact upon private litigation: for example, in determining the obligations of a transfer agent to record shares in the name of the acquiring stockholder. See *Donlon Ventures, Inc.* v. *Avien, Inc.*, 158 N.Y.L.J. No. 5, p. 10, 1966–67 CCH Fed. Sec. L. Rep. paragraph 91,961 (July 10, 1967). And in a recent case the defendant's disregard of a staff letter declining to take a no-action position may have played a role in determining the wilfulness of his violation, according to a staff attorney in the Division of Trading and Markets. See *United States* v. *Wolfson*, 269 F. Supp. 621 (S.D.N.Y. 1967) and 282 F. Supp. 775 (S.D.N.Y. 1968).

The substantive problems resolved by the no-action process in the Division are basically concerned with two sides of the single question whether stock must be registered before sale:

(1) Whether the registration provisions are applicable to the applicant's proposed sale of stock; and

(2) Whether the applicant is relieved of the registration obligations by various exemptions created by statute and rule.

The basic purpose of the 1933 Act is to assure that public distributions of securities are accompanied by disclosure of all information material to a prospective stockholder's investment decision. The disclosure objectives are accomplished through the registration and prospectus delivery requirements of section 5 of that Act, which apply to any "sale" of a "security" (or offer to sell). Failure to comply with those requirements may subject the seller to the Commission's injunctive remedies under section 20 of the Act, the absolute liability to purchasers provided by section 12(1), and possible criminal remedies under section 24. In addition to those sanctions, a broker or dealer who participates in a sale of unregistered securities is subject to a range of sanctions provided by section 15(b)(5), Securities Exchange Act of 1934 (hereafter, "1934 Act"), including censure and denial, suspension or revocation of his status as a registered broker or dealer.

In order to exempt regular trading transactions by persons

not involved in promoting the sale of a security, persons other than an "issuer, underwriter or dealer" are exempted by section 4(1) of the Act from the registration and prospectus requirements of section 5. A further exemption, also to protect ordinary trading transactions, is given to dealers, provided they are not participating in a general public distribution of the issuer's stock. Because a liberal application of these exemptions would defeat the disclosure objectives of the Act, the Commission and staff have sought to limit availability of the exemptions in order to reach public distributions of unregistered securities.

A primary means by which the Act reaches general public distributions of securities is by excluding an "underwriter" from the section 4 exemption and by broadly defining that term. Thus, one who falls within the statutory definition of "underwriter" must comply with the registration and prospectus requirements of the Act. "Underwriter" is defined, in section 2(11) of the 1933 Act, as follows:

> The term "underwriter" means any person who has purchased from an issuer with a view to, or offers 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, or participates or has a participation in the direct or indirect underwriting of any such undertaking; but such term shall not include a person whose interest is limited to a commission from an underwriter or dealer not in excess of the usual and customary distributors' or sellers' commission. As used in this paragraph the term "issuer" shall include, in addition to an issuer, any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer.

The interpretation and application of the "underwriter" definition is the interpretive problem presented by the bulk of the requests for no-action letters received by the Division. Noting that the interpretive process has centered on the language "with a view to . . . distribution," the *Disclosure Study* comments:

> As a result of this process of interpretation, the Commission and those affected by the 1933 Act soon found themselves tied to a wholly subjective test by which to determine when a person is an "underwriter." Does the person who buys from the issuer or controlling stockholder have the "view" or "intent" of later reselling his securities to the public? How can his true "intention" be accurately determined? (*Disclosure Study* at 163.)

Although the *Disclosure Study* condemns the subjective quality of these tests and their accompanying uncertainty, it is clear that the main dimensions of the interpretive positions taken by the staff are supported by judicial interpretations of the sec-

tions in question. See generally, Jennings and Marsh, *Securities Regulation, Cases and Materials*, pp. 271–363 (Foundation Press, 2nd ed. 1968).

Typical circumstances presenting interpretive problems which give rise to no-action requests are set forth below. For a more detailed description of the interpretive uncertainties that arise from the subjective tests traditionally applied, see *Disclosure Study*, at pages 164–177.

1. X Company issues a noncontrolling block of its stock to A, a director and controlling shareholder, relying on the exemption from registration provided by section 4(2) for private sales that do not involve a "public offering." A holds the stock for 6 months and now seeks to sell it through a broker in the over-the-counter market. If A sells, the staff will ordinarily conclude that he earlier purchased the security from his company (the "issuer") "with a view to . . . distribution" of the security, or that he is "selling for" the issuer "in connection with" a distribution. Under either construction, A would be regarded as an "underwriter" who must comply with the registration requirements before selling his stock.

The original sale by X Company to A may also be subject to challenge on the ground that A's conduct demonstrates that his purchase contemplated a "public offering," thus compromising the original claim of a private offering exemption. The determinative question—one of "fact" in the staff's view—is whether A's intent, at the time he took the stock, was to hold for investment or to distribute the stock. Even though A, at the issuer's insistence, may have executed a letter reciting his "investment intent" at the time he took the stock, the staff may conclude that the later sale is a more reliable index of A's state of mind. Hence, the staff would deny a request for a "no-action" letter.

Finally, A's control relationship, though suggesting a motive to distribute on behalf of his company, is not essential to the above-described application of the Act. Thus, a noncontrolling shareholder who acquired a noncontrolling block of shares in similar circumstances may also be viewed as having acquired the shares with the forbidden intent or "view to . . . distribution;" and a large number of no-action letters present just such circumstances.

2. A, in the above example, makes a further "private offering" of a noncontrolling block of X Company stock to a friend, B, who owns no other shares in X Company. B buys the stock with a representation of his investment intent, holds the stock for 6

months and then seeks to sell through a broker in the over-the-counter market. Section 2(11) provides (only for purposes of that definition of "underwriter") that an "issuer" includes one in a "control" relationship with the issuer. Hence, A, a controlling shareholder of X Company, is an "issuer" and B is an "underwriter" if he bought from A "with a view to . . . distribution" rather than investment. Again, the determinative "fact" is B's state of mind at the time of his purchase from A. If he should request a no-action letter, the staff would conclude that his sale after holding only six months demonstrates that he did not have sufficient investment intent at the time of his purchase. But if B suffers a severe financial setback that was not foreseeable at the time of purchase, that "change of circumstances" may support the inference that he bought for investment, despite his present desire to sell.

3. In example (1), a broker who executes a sale of A's stock will want to determine whether A is a "controlling person" of X Corporation, and hence an "issuer" under the underwriter definition. If A is a "controlling person", then the broker will be "selling for" an "issuer" and, under the definition, will be an "underwriter." The staff considers the question of control to be one of "fact" which must be determined by an analysis of all the circumstances and relationships between the person in question and the company and other controlling persons.

4. In examples (1) and (2), a broker who executes sales of stock for A or B will want to know whether either is an "underwriter": whether B took from A "with a view to distribution," or whether A took from the issuer with such intent. If that is the case, then, under section 2(11), the broker may also be an "underwriter" if he "participates or has a direct or indirect participation in" a sale by one who is a statutory underwriter. To avoid a charge (under section 15(b)(5)(D) or (E) of the 1934 Act) of willful violation of the Act and the accompanying possibility of disciplinary action, he should conscientiously investigate any facts which suggest that his seller occupies such an "underwriter" status.

5. In all examples, it is possible that the seller or broker might also want to determine whether the proposed sale constitutes a "distribution" of the X Company stock. The statute defining "underwriter" imposes that status only where there is a "view to . . . *distribution*" or where a transaction is consummated "in connection with . . . the *distribution*" of a security. (Emphasis added.) While a narrowing interpretation of the term "distri-

bution" might have provided some relief, that term "has always been regarded by the Commission as essentially synonymous with public offering." (*Disclosure Study* at 161–62.)

In defining the narrow statutory exemption for "brokers' transactions" (Section 4(4)) on behalf of controlling persons, the Commission has by rule defined a "distribution" to exclude "transactions involving an amount not substantial in relation to the number of shares or units of the security outstanding and the aggregate volume of trading in such security." (Rule 154.) The rule permits brokers' sales (for controlling persons) within certain quantitive limitations by excluding such sales from the definition of the term "distribution"; but that use of the term is applicable only for purposes of the exemption for "brokers' transactions." (Section 4(4) of the 1933 Act.) Thus, the broad statutory concept of "distribution," embracing any public sale, would be applicable to the term as it is used in the "underwriter" definition. And sales by a controlling person of stock privately acquired from the issuer, unless otherwise exempt, would involve a "distribution," rendering both the seller and the broker statutory "underwriters."

6. Although one who sells for an issuing company or for a person controlling the issuer ordinarily falls within the statutory definition of "underwriter," he may claim exemption under section 4(2) of the 1933 Act, which exempts "transactions by an issuer not involving any public offering." In accordance with *United States* v. *Ralston Purina Co.*, 346 U.S. 119 (1952), the fundamental test that determines availability of the exemption is whether the offeror's relationship to the offerees in the private transaction is such that the latter "need . . . the protections afforded by registration." (346 U.S. at 127.) But like the other interpretive problems described above, the question whether a transaction involves a public offering is viewed as "essentially a question of fact." And that fact question "necessitates a consideration of all surrounding circumstances, including such factors as the relationship between the offerees and the issuer, the nature, scope, size, type and manner of the offering." (Securities Act Release No. 4552, Nov. 6, 1962.)

III. Source of the Demand for No-Action Letters: Identity and Objectives of Applicants

The heavy demand for staff advice in the form of no-action letters, reflected in the volume of letters generated by the Division, makes it particularly important to attempt to uncover the

source of that demand. No general survey has been conducted among applicants to determine the motivations which prompt their requests; but inquiry and hypotheses suggest probable answers.

In form, virtually all applications for staff advice are submitted by a holder of stock who seeks to sell without registration, or by his counsel. Because of the costs and delays incident to registration, and in view of the elusive and subjective determinations of "ultimate fact" involved in deciding whether registration is required, it is understandable that staff advice might be sought. Yet very nearly 40% of the letters appear to be requested by nonlawyer stockholders, who ordinarily would be unaware of the legal restrictions on stock distributions and of the no-action process. The remainder originates with counsel, who should be accustomed to making similar kinds of determinations of "ultimate fact," without agency assistance, in advising clients about proposed transactions.

Requests for no-action letters also are submitted in the face of some substantial reasons for avoiding that process. Staff responses to requests for a no-action position are not sufficiently favorable to encourage submission of requests, particularly where the availability of an exemption from registration is doubtful:

> [The big practical limitation upon the utility of "no-action" requests is the difficulty of getting a reply from the Commission. The sad truth seems to be that you get "no-action" letters in the clear cases but have an awful time getting them—or don't even ask—in the cases where you really need them. (Israels, ed., S.E.C. Problems of Controlling Stockholders and Underwriters (P.L.I. 1962), page 19; comments of Mr. Gilroy.)

Analysis of no-action letters for two half-month periods in 1969, reflecting a total of 351 letters, demonstrated a rate of favorable response of approximately 60%. In view of the well-understood hazards involved in drawing regulatory attention to a proposed transaction, that rate of success could hardly be viewed as an inducement to submit no-action requests. Furthermore, though the usual delay in staff response to no-action requests is not excessive, the delay is undoubtedly substantial from the viewpoint of applicants anxious to realize on their assets or to take advantage of a favorable market opportunity. Carlos L. Israels, in his "Checklist" for assuring broker-dealers' compliance with restrictions on the sale of unregistered securities, comments: "'No action letter'—procedure available—but time consuming and does not protect against civil liability." (A.B.A., Selected Articles on Federal Securities Law, p. 79 (1968).)

The foregoing considerations suggest that it is not merely the generous availability of staff responses to no-action requests that produces the increasing demand for them. Rather, it seems that a combination of factors has produced that demand, including: (1) Issuers' fears of civil liability to purchasers under section 12(1) of the 1933 Act; (2) Broker-dealers' fears of disciplinary proceedings brought against them on account of sales of unregistered securities; (3) The enforcement practices of the Commission and staff; and (4) The unreliability of counsel's advice as an assurance against disciplinary proceedings.

Technically, the absolute liability imposed by section 12 (1) of the 1933 Act on anyone who, without registration, "offers or sells a security" would not appear to pose a threat to the issuing company, for the violation emanates from a further sale by the recipient of the earlier private placement. On further consideration, however, several very real threats to the issuer arise:

(1) The Commission may commence a formal investigation or bring injunctive proceedings to stop trading in the company's stock, with serious consequences in the securities market;

(2) The ultimate purchaser may claim extensive civil liabilities on the theory that the sale was made to him as part of a distribution on behalf of the issuer—a claim that is encouraged by the statutory definition of an underwriter as one who "sells for" the issuer;

(3) The latter threat is enhanced by the prospect that the issuer may be required to show the potential liability on its balance sheet as a contingent claim;

(4) Though it is more doubtful, it is possible that the original recipient of the private placement, if held liable to a later purchaser, will be able, in turn, to recover against the issuer because of the absolute liability imposed by section 12(1).

For all of these reasons, it has been traditional for the issuer in a private sale to require an investment commitment from the purchaser to protect against a later sale which may destroy the private offering exemption. And because judicial and administrative construction have increased that probability, issuing companies are commonly advised to stamp an investment restriction on the face of the stock certificates issued in a private placement and to issue "stop transfer" orders to the transfer agent, requiring notice to company counsel if the restricted shares should be

presented for transfer to a later purchaser. (See Israels, "Some Commercial Overtones of Private Placement," A.B.A., *Selected Articles on Federal Securities Law*, 125, 129–30, 135–43 (1968); and Wood, "The Investment-Intent Dilemma In Secondary Transactions," *Id.* at 145, 169–70.)

Similar threats of liability and disciplinary proceedings confront a broker-dealer who executes a sale found to have been made without exemption and thus in violation of registration and prospectus requirements. Division personnel uniformly agree that a large proportion of no-action requests originate with broker-dealers.

Even before the 1964 Securities Act Amendments, the Commission's exercise of its power over registration of broker-dealers had impressed upon them their vulnerability to sanctions for participating in distributions of securities acquired through private placements. (See, e.g., *Gilligan, Will & Co.* v. *Securities and Exchange Commission*, 267 F.2d 461 (2nd Cir. 1959); and list of revocation proceedings, 26th *Annual Report, Securities and Exchange Commission* 92–106 (1960).) And in SEC Release 4445 (1962), the Commission indicated that dealers would be held personally responsible for investigating the underlying facts supporting stockholders' claims of exemption, and that they are obliged "to make an appropriate investigation as to who their seller was not simply to rely upon the opinion of the seller's attorney that no control relationship existed."

The 1964 Securities Acts Amendments significantly expanded the disciplinary powers of the SEC, giving it power to proceed against individual registered representatives as well as against broker-dealer firms, to impose a wider range of sanctions including censure and suspension, and to prohibit association of named violators with any broker-dealers. (See generally, Greene, "Regulation of Entry Into The Securities Business," A.B.A., *Selected Article on Federal Securities Law* 487 (1968); and Sterling, "National Association of Securities Dealers and the Securities Act Amendments of 1964," *Id.* at 495.) In addition to seeking revocation or suspension of registration of broker-dealer firms, the Commission has enhanced the effect of such proceedings by substantial application of its new statutory power to proceed against individuals, bringing proceedings against a total of 387 individuals in the fiscal years 1966 through 1968. 32nd Annual Report, SEC, p. 58 (1966); 33rd Annual Report, SEC, p. 77 (1967); 34 Annual Report, SEC, p. 90 (1968).

Most broker-dealer firms that are members of a registered

exchange or of the National Association of Securities Dealers have established supervisory procedures designed to minimize the risk of violations by their registered representatives. The procedures tend to focus upon a wide range of financial standards and rules designed to promote "just and equitable principles of trade;" but if carefully followed, they would generally bring questionable transactions in "restricted" securities to the attention of supervising officers. It seems more doubtful whether ordinary supervisory procedures effectively control distributions of securities not stamped with an investment restriction; but some firms have established compliance procedures under a supervising officer designed to focus specifically on compliance with federal securities acts.

Although the formal training of representatives in matters of federal securities law is limited, the lore of the securities business supplements the formal supervisory structure. Both SEC enforcement personnel and representatives of the National Association of Securities Dealers indicate that the availability of the no-action process to clear "investment stock" is well understood by most representatives. And it seems likely that the lore of "no-action" letters is substantially contributed to by typical investigative practices. Though a no-action letter does not assure immunity investigations are more likely to focus upon those transactions in which a no-action letter does not appear in the file. Where an investigator from a regional office is analyzing a large, questionable distribution, he is likely to inquire why a no-action letter was not obtained to support the transaction.

All of these factors have undoubtedly begun to result in a closer control of unregistered distributions in most broker-dealer firms; and firms' supervisory or compliance officers are much more likely to insist upon either a no-action letter or the opinion of reliable counsel demonstrating the availability of an exemption from registration. However, the broker-dealers to whom a proposed sale of "investment stock" is presented are not particularly encouraged to have confidence in the opinion of private counsel. The Commission's comments in Release 4445 (1962) suggest the unreliability of attorneys' opinions as the basis for a claimed exemption authorizing trading in unregistered securities:

> In *United States v. Crosby* [294 F.2d 928 (2d Cir. 1961)] the court found persuasive the contention of defendant dealers that, in selling large blocks of unregistered stock of Texas-Adams Oil Co., Inc., in reliance on a legal opinion based upon incomplete facts, they were "doing business as usual" and, to their best knowledge, according to acceptable standards. The court perhaps found this argument persuasive in the con-

> text of that criminal conspiracy trial, since no evidence to the contrary was before it. The experience of the Commission, however, clearly demonstrates that the conduct of these dealers did not meet acceptable standards. . . . It was up to these dealers to make an appropriate investigation as to who their seller was and not simply to rely upon the opinion of the seller's attorney that no control relationship existed.
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> There have been a number of cases in which dealers have unsuccessfully sought to justify a claim to exemption under section 4(1) of the Securities Act simply by securing from the sellers, actual or ostensible, representations that such persons are neither officers, directors, nor large stockholders of the issuer, and submitting such representations to an attorney who then gives an opinion to the effect that, assuming the correctness of such representations, exemption under section 4(1) is available. Obviously, an attorney's opinion based upon hypothetical facts is worthless if the facts are not as specified, or if unspecified but vital facts are not considered. Because of this, it is the practice of responsible counsel not to furnish an opinion concerning the availability of an exemption from registration under the Securities Act for a contemplated distribution unless such counsel have themselves carefully examined all of the relevant circumstances and satisfied themselves, to the extent possible, that the contemplated transaction is, in fact, not a part of an unlawful distribution. Indeed, if an attorney furnishes an opinion based solely upon hypothetical facts which he has made no effort to verify, and if he knows that his opinion will be relied upon as the basis for a substantial distribution of unregistered securities, a serious question arises as to the propriety of his professional conduct.

Responsible counsel may legitimately feel some trepidation in rendering opinions, based on conclusions of "ultimate fact" and involving such extensive potential liability. Until recently, relatively few lawyers had studied or had experience with federal securities regulation. While a general understanding of the regulatory theory described, *supra,* is available from traditional sources, they contain very little reflecting the concrete application of doctrine. To a limited extent, examples of concrete applications of doctrine are available through private arrangements among SEC practitioners for the exchange and compilation of no-action letters as they are received. But those compilations are not generally accessible to the practitioners most in need of guidance. And this condition prevails in an area of law in which the *Disclosure Study,* after analyzing the substantive inconsistencies, concluded:

> In the area of statutory interpretation which is primarily involved, uncertainty and divergence of practice presently prevail to an unacceptable degree. Greater certainty and predictability are essential. (*Disclosure Study* at 152.)
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> Apart from the mere bulk of requests currently faced by the staff, there is a constant problem in providing reasonably consistent advice.

> Since the tests with which the staff must work are subjective, its reactions in given situations depend, to a degree at least, on a "feel" of the transaction conveyed by the request for "no action". Troublesome inconsistency is often the result. Yet that inconsistency, which exists within relatively compact staff operating under a single director, pales in comparison with the inconsistency in advice given by private counsel as to when and under what circumstances securities sold in private offerings may be resold.
>
> Any lawyer who has practiced in the securities field can recall instances in which several able counselors, viewing an identical set of facts, all reached differing conclusions. An overly conservative counsel may block a transfer of securities which other counsel would consider perfectly within the law, or (on occasion) an issuer of securities may advance a particularly rigid view of the law in order to prevent a transfer of securities from occuring which it does not wish to see occur for other reasons. Practical problems of this sort are not infrequent. (*Disclosure Study* at 176–77.)

In summary, private offerings have become increasingly popular as a means by which a company may acquire additional capital or compensate employees without undertaking the expense of registration. However, because of the potential liabilities to subsequent purchasers that may result from the sale of the unregistered stock by the immediate purchaser, the practice of stamping an investment restriction on the face of the stock certificate has increasingly been followed. That investment restriction may appear to the immediate purchaser to be a legalistic formality until he attempts to arrange for the sale of his stock through a broker-dealer. Because of the increasing frequency of Commission disciplinary and enforcement proceedings against broker-dealers, they are sensitized to the danger of selling unregistered "investment stock." When the prospective sale is brought to the attention of a supervising manager of the securities firm, he will ordinarily refuse to allow any sale to be executed until he receives a satisfactory opinion of counsel that a valid statutory exemption is available. Because of the understanding that many counsel will provide any opinion necessary to facilitate clients' sales, and because of Commission warnings that the opinion of private counsel will not necessarily insulate against disciplinary proceedings, many broker-dealers will insist upon a no-action letter unless the stockholder presents an opinion by counsel regarded as reliable. Further, it is a matter of general lore among broker-dealers and registered representatives that the safe thing to do, in any doubtful case, is to insist upon a no-action letter. And the investigation and enforcement practices of the Commission staff substantially contribute to

that lore, for experience suggests to dealers that in routine investigations much less question is raised about transactions for which a no-action letter appears in the file.

Finally, where counsel is asked to render an opinion on the kind of "ultimate fact" questions involved in determining the availability of an exemption, he may well conclude that the uncertainty of the interpretive rules, or the unavailability of a sufficient number of concrete applications, renders it advisable to take advantage of the no-action procedure rather than risking an independent opinion.

These sources of demand for no-action letters suggest some doubt about whether the demand will diminish. Private offerings continue to produce a very substantial share of the total estimated gross proceeds from new securities offered. (See generally, "Estimated Gross Proceeds from New Securities Offered for Cash in the United States," published monthly in Securities and Exchange Commission, *Statistical Bulletin.*) Undoubtedly, the rules proposed by the *Disclosure Study* will reduce the uncertainty that prompts many no-action requests. But because the proposed rules are in some respects more rigidly restrictive, particularly with respect to unregistered sales of stock in nonreporting companies, it seems possible that many transactions that are now executed without notice will be more clearly identified as doubtful transactions. This, in turn, may produce additional requests for no-action letters, particularly for proposed "private transactions," which are not redefined by the proposed rules. Perhaps this depends upon what proportion of the existing volume of private transactions are traceable to nonreporting companies.

Other factors may also produce additional demand for no-action letters. A more successful training program for registered representatives may be developed by the NASD, making representatives more aware of doubtful transactions, particularly if the *Disclosure Study* rules are adopted by the Commission. The expansion of Securities Regulation courses in the law schools, and the continuing expansion of practice in that field by inexperienced lawyers, both may add to the flow of requests for no-action letters. Continued aggressive enforcement and continuing doubt about the protection furnished by opinions of counsel will continue to induce broker-dealers to seek the security of a no-action letter where questions arise.

For these reasons, it may be desirable for the Commission, as well as other agencies, in structuring their advisory processes,

to further consider the impact of enforcement practices, the role of private counsel, and the possibility of avoiding routine "clearances" in order to give more extensive consideration to questions which advance their policy and technical thought, with broader public availability and fuller exposition of the grounds for their conclusions.

Organization of the No-Action Process; Channeling of Request, Responding Letters and Staff Review

The no-action process is administered through the Office of the Chief Counsel, Division of Corporation Finance as a distinct facet of the organization of that Division. The Chief Counsel is assisted in administering the process by two Assistant Chief Counsel (hereafter, "Assistant"), who devote at least 75% of their time to the process. They, in turn, are assisted by approximately 40 staff attorneys from the various sections of the Division who, on the average, devote slightly more than 15% of their time to the process. Two or three special counsel in the office of the Chief Counsel also assist in the process on special assignments from the Chief Counsel or his Assistants.

The Division is organized into 15 branches for the primary purpose of processing 1933 Act registration statements and letters of comment and 1934 Act reports and proxy materials. Each branch of the Division bears responsibility for processing these materials for an assigned group of companies, with new companies being assigned to the branches on a rotating basis. The branch chiefs are responsible to the Director of the Division for branch performance of these duties.

The no-action process administered by the Chief Counsel's office cuts vertically through this organizational structure: the staff attorneys in the various branches are directly responsible to the Chief Counsel's office for their performance. Assignments to prepare responses to requests for no-action letters are made to the staff attorneys by the senior Assistant through the branch chief or the senior attorney in the branch, who attempts to balance the work load.

All requests for advice respecting the need to register stock to be offered for sale, as well as other requests for information, are channeled from the branches to the Chief Counsel's office. (Exception: occasional calls received by a branch attorney who has previously dealt with a party or his attorney.) Verbal requests are generally handled as abstract interpretive questions, with only general guidelines stated. Conversations looking to

submission of a no-action letter may become more specific in identifying key issues, but, as a rule, no concrete conclusions *approving* a course of action are expressed orally. Where the advice sought involves a request for approval of a specific course of action, the parties are asked to submit a written statement of all of the pertinent facts and request a no-action letter.

All written requests for a no-action letter are initially channeled through the senior Assistant, who makes a rough appraisal of the problems it presents and assigns it to a branch. (He may occasionally retain a particularly difficult problem or assign it to one of the special counsel in the Chief Counsel's office.) The letters are assigned to the various branches according to the name of the company whose stock is to be offered for sale: the branch which has previously dealt with a company in connection with a prior registration (or other) matter will be assigned the no-action letters involving that company's stock. Where new companies are involved, the letters are assigned to the branches on a rotating basis.

After the branch chief or senior branch attorney assigns a staff attorney to the problem, the staff attorney would ordinarily proceed as follows:

(1) Analyze the apparent problems presented by the request.

(2) Write (or occasionally call) to ask for a further statement of facts if essential facts are missing.

(3) Conduct a file search to determine:

(a) Whether the Company has filed a registration statement with the Commission.

(b) Whether the Company is registered under the Securities and Exchange Act of 1934 and is currently rendering reports to the Commission pursuant to that Act.

(c) Whether the files indicate any securities violations by the Companies or individual involved, and if so, whether those violations are current.

(d) The current price at which the stock is trading.

(e) Whether the essential facts stated in the requesting letter comport with information about the Company on file with the Commission. (This search generally will involve a rudimentary examination of the amount of stock issued and outstanding, the relationship of "control" persons, and a quick search of the general correspondence file on each company. If possible incon-

sistencies with the facts stated in the requesting letter appear, a more thorough search will be conducted.)

(4) Do necessary research, if any.

(5) Prepare a recommended response and submit it to the Assistant, together with the requesting letter and a form reflecting the information obtained in the file search.

(6) In a very few cases the branch attorney may be asked to prepare a memo explaining the reason for his conclusion.

The recommended response, as submitted by the branch attorney, is then reviewed by one of the Assistants who signs the letter (under his title) if he finds it satisfactory. In a large proportion of the cases, however, the Assistant revises the recommended letter, often (30–40% of cases) reversing the conclusion recommended by the staff attorney. (See later discussion of reversals.) In another 10–20% of the cases, he may revise the form or content of the letter. Where the conclusion is reversed, the practices of the two Assistants diverge: unless the reason for the staff attorney's different conclusion is readily apparent (and reasonable), one Assistant discusses the matter with the staff attorney and explains the reason for his different conclusion; the other seldom discusses the change. In every case, however, the staff attorney is notified of the final result by receiving a copy of the responding letter in the form in which it was sent.

Where a no-action request presents a particularly difficult or unusual problem, the Assistants may discuss the matter with the Chief Counsel or Director of the Division before rendering their final determination. In some of those cases, or where the matter has been extensively discussed between the Chief Counsel and counsel for the stockholder, the Chief Counsel may sign or prepare and sign the letter. He also prepares some letters from time to time on a regular basis, though the total number handled by the Chief Counsel is small. He estimates that a relatively small proportion of his time (not more than 10–15%) is devoted to the no-action process. His predecessor, however, has estimated that he spent closer to half of his time on no-action matters. The disparity is probably explained by a recent Commission change of procedures, designed to minimize the number of no-action matters brought up for Commission consideration.

The no-action process appears to be administered on a substantially current basis. Relatively few cases involving significant delay came to my attention; and where delay occurred, it often resulted from requests that the applicant supply more fac-

tual data. A random sampling of the letters issued in 1969 indicated that approximately 50% of the affirmative responses and 70% of the negative responses had been pending for approximately one month or less; 30% of the affirmative responses and 20% of the negative responses had been pending for approximately two months; and an additional 20% of the affirmative responses and 10% of the negative responses had been pending longer than two months. Most of those pending more than two months had involved some additional correspondence intervening between the request and the concluding response.

The relative currency of the process is undoubtedly due to an effective check-off process maintained by the senior Assistant. He keeps track of every assignment of a no-action matter to a staff attorney and prods those who are slow in responding. While this presents some problem because the staff attorneys are primarily responsible to their branch chiefs, the system seems to be operating satisfactorily.

V. Initiation of the Process: The Parties and the Form of Advice Sought

A. *The Parties*

As indicated, the applicant for a no-action letter is generally a stockholder who seeks to sell his stock without registration. In some instances, the applicant may be a promoter of a new company, seeking exemption for an initial issue, or a promoter of a merger, seeking assurance that the merged company's stockholders may receive or dispose of the surviving company's unregistered stock. And occasionally, a pledgee seeks to realize upon pledged stock by obtaining a no-action position authorizing sale. But though many other parties, such as broker-dealers, may be interested in particular transactions, it is not the practice for interested parties to intervene; and in view of the substantive questions usually at issue, it seems doubtful that intervention would serve any purpose.

There are, however, some circumstances where the interests of third parties appear to affect staff or Commission judgments. For example, in one instance the Commission appeared to take into account the fear of administration officials that denial of an exemption and the resultant closing of the applicant's plant (for lack of funds) would produce unemployment in an already depressed area.

While such informal intervention on behalf of applicants by

administration officials appears to be rare, intervention by members of Congress is much more common. For example, a spot check showed responses to nine inquiries from Congressmen during the period of April 1–18, 1969. (During the same period, 218 no-action letters were sent.) Almost invariably, such an inquiry results in preparation of a memorandum for submission to the Congressman, explaining the circumstances, the status of the no-action request, and the basic statutory theory supporting the staff or Commission disposition of the matter. (See discussion, *supra*, of the lack of apparent effect of intervention by Congressmen.)

B. *The Form of Advice Sought*

1. Oral Advice—Most questions relating to registration obligations are directed to the Chief Counsel's office in the Division, and that office responds to 75–100 telephone calls per week, most of which involve a request for interpretive advice. The Chief Counsel and his Assistants give considerable oral advice about interpretive problems presented by particular transactions; but most such advice is designed to identify specific problems which are left for ultimate resolution by counsel. The staff generally will not express specific conclusions about the legal consequences of specific courses of action without a written request detailing all pertinent facts. Where the parties seek ultimate conclusions about the application of interpretive concepts to particular facts, particularly where inquiries relate to the "underwriter" problems that dominate the no-action process, the parties will be urged to submit a written request for a no-action letter. In such cases, oral advice will be directed to explaining the kinds of facts that may be helpful in submitting a no-action request.

At an earlier date, many no-action matters were handled by a conference at which the applicant's attorney appeared, bearing the form of no-action letter for which he sought staff approval. The issues presented were debated and often resolved in personal conferences, with the letter issuing immediately. Such conferences now play a considerably less significant role in the no-action process; and the responding letter is no longer negotiated and executed in the course of the conference. Personal conferences do, however, continue to provide an effective forum for advocacy on behalf of a particular application, with some apparent effect upon the outcome in some cases.

There is no prescribed procedure for recording telephone or

personal conferences. Some attorneys maintain a log of calls while most apparently do not. Where the information provided is material, notes are inserted in the correspondance file and generally referred to in the responding letter as the basis for the factual recitation.

2. *Written Advice*—The bulk of letters processed in the Office of Chief Counsel of the Division are no-action letters. A sampling of 322 letters issued in the period April 1–18, 1969, revealed that 218 were no-action letters, 97 were for general administrative or informational purposes (not interpretive), and only seven contained significant elements of interpretive content. All of the seven letters involved interpretive explanations of specific, generally complex, technical problems. However, few such letters contained advice on specific applications of the interpretive advice rendered.

Thus, substantially all of the advisory letters issued by the Division are no-action rather than interpretive letters, in the sense that they merely recite facts and state conclusions respecting the obligation to register stock, rather than overtly explaining the basis for the conclusions.

As might be expected, in view of the clearance function performed by no-action letters, the vast bulk of letters received by the Chief Counsel's office specifically request a responding no-action letter. As should be expected, there is also a significant burden of informational and administrative correspondence originating in the Chief Counsel's office.

VI. Processing No-Action Letters

A. *Defining the Questions to be Answered*

The no-action process does not provide any routine method for assuring that applicants understand the factual and legal questions that may determine the result of their request. Generally the written requests for no-action letters do not pose the specific questions to be answered, but merely recite facts relating to the amount of stock held, the source, date and price of the acquisition, and the extent of other holdings in the same stock, with source, date and price of those acquisitions. Questionnaire responses indicate that the no-action requests expressly state the determinative legal or interpretive question in about 35% of the applications. When the applicant identifies the question, however, he is correct (in the staff attorney's view) in

about 80% of the cases. (Questionnaire, appendix I, question 13.)

Where a request for a no-action letter provides insufficient information, the staff attorney ordinarily will respond with a written request for additional facts. That inquiry, however, seldom expressly identifies the questions considered to be at issue. (And in a large number of routine requests, of course, the questions merely seek to establish the source of acquisition, the length of the holding period and the reason for the present desire to sell.)

More often, a telephone inquiry by the staff attorney or a status inquiry by the applicant may result in a telephone or personal conversation which identifies the key issues. But staff attorneys estimate that in more than half of the cases there is no communication with the applicant that specifically identifies the determinative question. (Questionnaire, appendix I, questions 15 and 16.) In most of those cases, however, the nature of the inquiry is undoubtedly so routine that the staff assumes that the determinative issue is understood. And in many of those cases the staff's reasoning is apparent from its comment that it is unable to grant the request "in view of the short holding period."

The more sophisticated SEC practitioners, on occasion, will provide a full statement of facts, followed by a statement of their interpretive reasoning in support of the opinion which they propose to give their clients, and concluding with a request that the Division indicate its concurrence. However, it is not apparent that the staff conclusions turn on the form of application. And some staff attorneys suggest that counsel may often want to avoid committing themselves to a single rationale, or may hesitate to focus attention upon a particular problem.

Although the power to deny a no-action letter would seem to give the staff substantial power to compel modification of proposed transactions, it does not appear that the power is used extensively. Where discussion initiated by the applicant or his counsel focuses on available alternatives, staff attorneys may occasionally suggest specific modifications of a transaction. And in a few instances the Commission has suggested that a specific limiting commitment would enable it to authorize a no-action position. Ordinarily, however, where revisions are made to assure favorable treatment, the suggestion is offered by counsel for the applicant.

While discretionary factors may often play a substantial role

in the staff and Commission decision, few applications address any argument to such matters. Sophisticated SEC practitioners will occasionally point out that the small volume of the proposed transaction assures that the market will not be affected by the sale and that no special commission inducements will be necessary. And the relative insignificance of the holdings involved, compared to the total stock outstanding, will often be pointed out. But factors such as the difficulty of obtaining the issuer's agreement to register, or the pendency of enforcement proceedings and the applicant's relation to those proceedings, are seldom mentioned in the applicant's letter.

B. *Establishing the Facts*

No-action advice is usually given hypothetically, in the sense that the staff does not purport to determine questions of evidentiary fact. However, the staff insists that it will not give no-action advice without a full statement, from the applicant, of the facts material to the transaction in question. The letters essentially treat those statements as affidavits, scrupulously referring to or incorporating the factual assertions in the applicant's letter. But, with minor exceptions, no proof is required of the facts asserted by the applicant. This would seem to conflict with the Commission's own assertion in Release 4445 that a "serious question" concerning the propriety of an attorney's conduct would arise if he "furnishes an opinion based solely upon hypothetical facts which he has made no effort to verify," knowing that his opinion will be relied upon to support distribution of unregistered securities. It does appear that some of the asserted facts are verified against information available in the Commission's files. Ordinarily, however, those files would not provide means of verifying the transaction by which the shares were acquired unless they were acquired directly from the issuer. And even that information may be unavailable with respect to nonreporting companies.

It is estimated by the senior assistant that the facts initially provided by the applicant are inadequate in about 30% of the cases. In all but about 10% of the cases the missing facts can be supplied from Commission files in the course of a routine check of the issuer's file. Questionnaire responses suggest that it may be necessary to obtain additional facts from the applicant in 20–25% of the cases. (Questionnaire, appendix I, question 10.) But in only a negligible number of cases are the facts asserted

by the applicant materially inconsistent with facts found in the routine check of the issuer's file.

Though the staff seldom requires substantiation of factual assertions, it may make routine inquires where the applicant has not supplied sufficient information about the source or period of his holdings. And submission of an unaudited statement of the applicant's financial position, both currently and at the time that he acquired the stock in question, is frequently required. But in exceptional cases, the staff may require some further substantiation of the applicant's assertions. For example, an applicant who claims that a medical problem created a serious change of financial position may be asked to submit a doctor's certification. In other instances, applicants have been required to furnish a cancelled check to demonstrate the date of purchase of the stock in question; or to furnish a copy of an employment contract on which a claimed "change of circumstances" is based.

C. *Research*

The available research tools, in addition to those publicly available, include the following internal sources:

(a) A monthly summary of interpretations which recites the basic facts and reasoning of the more significant no-action matters passed on each month by the staff. The summary does not include the text of the related letter, but contains considerably more explanation of the grounds for the result than do the no-action letters.

(b) A large card file containing the same summaries of interpretations, in which the cumulative production of the monthly summaries is filed. The cards are indexed by subject heading and by statutory section, and are cross-referenced to the significant questions involved in each case summarized.

(c) A file of legal memos on selected problem areas is maintained in a file alongside the card file. Relatively few memos have been added to that file in recent times.

(d) "The Bible": An analytical treatise prepared for use and maintenance in the office of the Chief Counsel which analyzes the construction of each section of the 1933 Act.

(e) A file of Commission minutes on no-action matters which includes memos explaining the staff's conclusions and recommendations on matters brought up for Commission consideration.

(f) A chronological file of all letters and memoranda rendered by the Office of Chief Counsel, Division of Corporation Finance, which includes all no-action letters issued.

(g) A listing of all companies for which Commission files are maintained, with a classification code keyed to identify companies in which similar disclosure problems were encountered.

The summary of interpretations is prepared by a law student clerk under the supervision of the senior Assistant. (Summaries are never prepared by the originating staff attorneys.) The usual practice is for the law student, monthly, to select for summary a group of the more significant no-action letters sent by the office. Occasionally letters will have been marked for summary during preparation—particularly those signed by the Director of the Division. From the selected group of letters, the Assistant Chief Counsel selects those to be summarized. The law student summarizes the facts and reasoning underlying the letter and submits the summaries to the Assistant for review and approval. Those summaries are then utilized both in the card file of interpretations and in the monthly summary sheets distributed to the staff attorneys.

While the criterion for selection of no-action letters for summary is somewhat unclear, the general understanding of the law student is that he is to select the cases that have "precedential value." However, he is instructed not to prepare cards on "questions of fact" such as "control" or "change of circumstances," because each case is viewed as limited to its own facts. On the other hand, he usually selects most cases which are the subject of a commission minute.

Questionnaire responses suggest that none of the available internal research sources are very heavily utilized. Most favored by some staff attorneys (though apparently less than half) is reference to a personally-compiled file of previous no-action letters, which apparently is consulted in somewhat more than half of the cases by those who use such a file regularly. (30% of respondents.) Next most frequently relied upon, in 20–30% of the cases, by less than half of the responding attorneys, are personal conferences with other staff attorneys. And the card file of interpretive summaries, running a poor third, is apparently used quite infrequently. (See questionnaires, appendix I, question 27.)

Virtually no research use appears to be made of the monthly summaries of interpretations that are distributed to all staff attorneys. Apparently this results from the form in which the summaries are produced, primarily because of the absence of any indexing system. All of the same information is available in indexed form in the card file of summaries; but use of the card

file requires the staff attorney to go to the library in the office of the Chief Counsel.

In considering the relatively infrequent use made by the staff attorneys of the available internal research sources, it should be remembered that the routine nature of most of the no-action matters invites little research. Furthermore, the ad hoc and subjective quality of the typical determinations of "ultimate fact" tend to encourage the view that conclusions are to be drawn from the facts and not from research. Thus, though the Assistant Chief Counsel attempts to promote a view of no-action matters as legal and interpretive questions, rather than exercises of discretion, it seems doubtful that that view is generally accepted. Questionnaire responses indicate that the less-experienced staff attorneys find their own "reservoir of experience" sufficient in 70% of the cases, and the more-experienced staff attorneys in almost 90% of the cases. (Questionnaire, appendix I, question 29.)

D. *Review*

Internal review of staff responses to no-action requests is the primary responsibility of the two Assistant Chief Counsel of the Division, and appears to be thorough. Staff attorneys submit a proposed form of response to one of the two Assistants who, after review and any necessary revision, sends the letter under his own name, as Assistant Chief Counsel, Division of Corporation Finance. Review by the Assistants appears to be demanding, resulting in reversal of the disposition recommended by the staff attorney in approximately 30–40% of the cases. The staff attorneys apparently consider the rate of reversal to be considerably lower: slightly less than 5%. (See questionnaire, appendix I, question 25.) That disparity may be explained, in part, by the fact that one of the Assistants seldom discusses revisions with the staff attorneys. (In all instances, however, the originating staff attorney receives a copy of the letter in final form.) And the other Assistant may discuss the matter with the staff attorney, suggesting areas for further inquiry, without expressly rejecting the proposal. To a large extent, the senior assistant regards the review process as a training opportunity, discussing the matter with the staff attorneys wherever the initial draft suggests misunderstanding or inadequate research.

Unless a specific request is made applicants are not informed of the staff's conclusion prior to their receipt of the responding staff letter. Therefore, most opportunity for argument arises in

the course of the staff attorney's preparation of a recommended response. After receiving a response and *upon inquiry,* applicants are advised that they may submit additional facts or argument for staff consideration. But in a large proportion of the cases (70–90%), nothing further is heard from the applicant after the response is sent.

No information is volunteered to applicants about the possibility of appealing staff advice to the Commission; and disclaimers by the staff of authority to speak for the Commission may lead many applicants to suppose that appeal is unavailable. However, Commission minutes indicate that it generally undertakes to dispose authoritatively of those no-action matters brought to it by the staff for consideration.

Upon inquiry about the possibility of appeal, an applicant will be advised that he may request the staff to bring the matter before the Commission; and all such requests are, in fact, brought to the Commission (or to a duty officer—see *infra*). However, the applicant is not invited to appear before the Commission or to make a written submission; and he is discouraged from requesting an appearance of making a submission in at least two ways. First, upon asking about the availability of a procedure for taking the no-action matter to the Commission, the Assistant's standard response is substantially as follows:

> You may request to have your matter brought to the Commission for consideration. This is the procedure: We [the staff] prepare a statement of the facts and a memo in which we present your position and arguments and the staff's position and arguments, together with our recommendations to the Commission.

Second, no mention is generally made of an opportunity to appear before the Commission. And where an applicant inquires about the possibility of an appearance, the standard response is: "You have a right to request to be heard, but such requests are seldom granted." Generally the staff memo submitted to the Commission in such matters recommends against hearing the applicant or his attorney, on the ground that the staff believes he has nothing to add to the arguments submitted on his behalf by the staff.

Much of the staff resistance to appeals arises from a sense of obligation to preserve the Commission's time for important matters. Until recently the staff had been operating under instructions to bring the Commission all no-action matters involving a proposed offering valued at $1 million or more. As a result, though the Commission encouraged the staff not to adhere religiously to that rule, a substantial number of no-action matters

were brought to the Commission at the instance of the staff, in addition to those appeals arising from an applicant's persistence. However, most cases brought by the staff for Commission consideration were selected in order to obtain a clarification of policy.

The Commission has recently taken two steps designed to reduce the burden of no-action matters reaching it for review. The "automatic appeal" rule for matters exceeding $1 million has been withdrawn; and the Commission's "duty officer," a single Commissioner on a rotating assignment, has been delegated the power "to determine whether the Commission should or should not grant a request for Commission review of a no-action request which had been denied by the Division." (Commission Minute, May 19, 1969).

The urge to protect the Commission from an excessive burden of no-action matters may be partly responsible for the "cave-in" phenomenon—the staff's reversing an earlier denial rather than complying with a request for Commission review. It is difficult to trace concrete examples of that phenomenon, but it is acknowledged by the senior Assistant that such "cave-ins" occur from time to time where the staff regards an issue as a "close question." On the other hand, it has been asserted that the reason for the "cave-in" may be the staff's reluctance to give the Commission an occasion for reversing a favored interpretive position. In any event, rumor has it that the "cave-in" practice is well understood among the knowledgeable SEC practitioners, and that it presents difficult ethical problems: a request for Commission hearng is thought to consume the staff's good will"—with the result that counsel must choose which clients are entitled to deplete his "good will" with the staff.

In most instances, the form of Commission action in reviewing no-action matters appears to involve an authoritative Commission disposition, effectively constituting an "order." A typical minute entry relating to a no-action matter may read:

> Upon the recommendation of the Division of Corporation Finance, . . . the Commission denied the request of Mr. A for a "no-action" letter with respect to his proposed sale of ____ shares of X Corporation common stock and also denied his request to be heard by the Commission in the matter.

Or in another form:

> For the reasons stated in a memorandum dated _____ the Division of Corporation Finance recommended that the "no-action" request be granted. That recommendation was approved.

While the reasons for the Commission dispositions are seldom

reflected in the minute entries, there is no doubt that the Commission takes specific action on the particular case brought before it. There is no basis for supposing that it merely gives general approval or policy direction to an informal staff process which it authorizes but does not adopt.

An examination of Commission minutes for the period May 10, 1967, through May 14, 1968, revealed that 45 no-action matters were brought before the Commission for consideration. It is not apparent how many were brought at the instance of the applicant, but in nine instances the papers accompanying the submission to the Commission indicated that a request for appearance had been made. Five cases reflect an appearance by counsel; while four cases expressly reflect the Commission's refusal to hear counsel. The disposition of no-action matters before the Commission is reflected in the following summary:

Period: 10 May 1967—14 May 1968

No-action matters before the Commission	45
Commission reversals of staff recommendations	4
Reversals of recommended *denials* of sale	1
Reversals of recommended *approvals* of sale	3
Commission acceptance of recommended denials of sale	19
Commission acceptance of recommended approvals of sale	20

Period: 4 June 1968–30 December 1968

No-action matters before the Commission	11
Commission acceptance of recommended approval of sale	11

The reduced burden of Commission action in the period commencing 4 June 1968 obviously reflects the revised instructions pertaining to review of proposed sales exceeding one million dollars. But it also reflects the Commission's guidance of staff judgments *approving*, as well as disapproving sales.

E. *Form of the No-Action Statement*

Typically, a no-action letter makes reference to the requesting letter, recites all of the material facts supplied by the applicant (referencing the source) or incorporates the applicant's letter by reference, and—generally without interpretation—states a conclusion. In an effort to reduce the burdens of the no-action process, the Division at present frequently follows the practice of merely incorporating the applicant's letter by reference without repeating the facts. Obviously this practice would make no-action letters much less useful as precedential guides, both for internal purposes and in the event of ultimate publication or availability

pursuant to the Public Information Act. Some staff members also suggest that failure to repeat the facts renders no-action letters much less reliable as a protection for brokers who are asked to execute transactions in the unregistered stock, for it will be more difficult to satisfy their duty to investigate their seller.

The conclusions expressed in no-action letters typically follow the following patterns:

(a) "Based on the facts presented, we are not able to conclude that the sale of ____ shares of _____ Corporation to the public at this time would be exempt from the registration requirements of the Securities Act of 1933."

(b) "On the basis of the facts submitted, this Division will not recommend any action to the Commission, if _____ sells the ____ shares of _____ Corporation without compliance with the registration requirements of the Securities Act of 1933."

(c) "Based on the facts presented, this Division is unable to conclude that the ____ shares of _____ Corporation may be sold by ____ without complying with the registration requirements of the Securities Act of 1933."

(d) "Based upon the facts presented and particularly in view of the short holding period by the present owner and preceding owner, and the medical circumstances that arose before the purchase of the shares, this Division is unable to conclude that the shares which your client owns may be sold without compliance with the registration requirements of the Securities Act of 1933, as amended, or Regulation A, if available."

(e) "Based on the facts presented, including counsel's opinion that Mr. _____'s continued need for medical attention is a new and unanticipated circumstance, although an exemption from the registration requirements of the Securities Act of 1933 is not free from doubt, in view of the small amount of your client's holdings, this Division will not recommend any action to the Commission if the _____ shares of _____ Corporation stock are sold without compliance with such requirements."

(f) "Based on the facts presented, this Division will not recommend any action to the Commission if your client sells the shares in question without prior compliance with the registration requirements of the Securities Act of 1933 in reliance upon your opinion as counsel that the proposed transaction is exempt therefrom." (See appendix L–6.)

(g) "Based upon the above facts, as more fully set forth in your [counsel's] letter, we are unable to concur in your opinion.

Accordingly, no public offer or sale of the shares of X Company by Mr. B should be made without compliance with the registration requirements of the Securities Act of 1933." (See appendix L–7.)

VII. Relation of No-Action Letters to Compliance Programs

Former Chairman Cohen has commented that the no-action letter process is one "where an ounce of prevention is worth . . . a pound of enforcement." That view of the compliance benefits of the no-action process is widely held among the senior administrators on the SEC staff, and is probably well-founded. Yet that conclusion seems to be based primarily upon the administrators' experienced "feel" for their subject, for no available studies indicate how broadly the compliance benefits of the no-action process have reached into the securities business. Surely the results of the no-action process do not overwhelmingly favor the applicant—a fact which could induce many stockholders and brokers to take their chances rather than draw regulatory attention to a proposed transaction.

Earlier discussion suggests that the Division's liberal advisory practices, together with very real disciplinary threats, have produced the heavy demand for no-action letters and may continue to produce that demand. But no studies indicate how extensively the educational effects of the advisory processes have pervaded the industry. Discussions with N.A.S.D. personnel suggest that understanding among dealers may be largely limited to the view that stock with a restrictive legend may not be sold without a no-action clearance. There may be general understanding of the obligation to investigate "control" persons, but it is likely that most registered representatives make little or no effort at investigation unless they are independently aware of a seller's controlling status. And there may be little or no understanding of the need to determine whether a holder of unlegended stock may have obtained that stock from a controlling person. In any event, it is clear that nothing in the N.A.S.D. training program for registered representatives deals adequately with these problems; and there is nothing in the exams for either principals or registered representatives dealing with them.

There are no studies to indicate the extent of actual compliance where the staff refuses to take a no-action position. It may be inferred that most stockholders would comply. And those who understand the Securities Laws should, of course, be aware that a subsequent sale could provide the basis for a charge of willful

violation. But neither studies nor enforcement programs have focused upon the effect of a staff refusal; and all conclusions in this area must be based on inference.

Enforcement personnel generally regarded the no-action letter as an important part of the compliance program. Copies of all no-action letters are sent to the Regional (enforcement) Office nearest the city in which the proposed transaction would occur. But according to the Director of the Washington Regional Office, compliance benefits do not result from direct follow-up of staff refusals of no-action positions, and very few enforcement proceedings arise in that manner. (See also appendix B, p. 7.) Rather, no-action letters enable him to keep up with what is happening with particular companies and in the business generally; and they enable him to keep up with the thinking of the staff on particular interpretive and enforcement problems. To those ends, the letters forwarded to the Regional Office are circulated among the senior personnel in the Regional Office. Occasionally, also, a letter may prompt the Regional Director to object to a particular staff position, particularly if the same or similar transaction is under investigation in the field.

Where an investigation or enforcement proceeding is already underway, of course, the no-action process is administered to minimize the probability of any further illegal distributions that might prove damaging to purchasing stockholders. Thus, the processing of no-action letters routinely involves a file check to determine the pendency of any investigations. Typically, where an investigation is pending, the staff will refuse to take a no-action position, often in a letter that is almost totally uncommunicative. (See appendix L–2.)

Thus, it appears that from the standpoint of compliance the primary benefits of an unrestricted advisory process are in educating the industry for, and encouraging, voluntary compliance. It remains to be demonstrated that unrestricted availability of no-action letters is a promising means of achieving that end.

VIII. No-Action Letters As Nonpublic Public Law

In considering the status of no-action letters as "law," three different products of the no-action process should be segregated:

(a) "Orders" entered upon Commission review, determining an applicant's entitlement to a no-action letter, together with the related no-action response, staff memoranda to the Commission, and any interpretive summaries reflecting the result;

(b) No-action letters which, though not reviewed by the Com-

mission, provide the basis for internally-distributed interpretive summaries; and

(c) Other no-action letters rendered by the staff which are neither reviewed by the Commission nor summarized for internal distribution.

The Commission-reviewed no-action positions and accompanying statements would seem, in a lawyer's view, to constitute "law," for they involve a final official disposition of a concrete claim not unlike the mass of case law on which lawyers commonly rely for guidance. Surely such determinations are "orders" within the meaning of section 2(d) of the Administrative Procedure Act, for the agency renders "a final disposition . . . declaratory in form . . . in a matter other than rulemaking but including licensing." And such orders may well constitute a "license" within the broad language of section 2(e), for in reality, they constitute a "form of permission."

Furthermore, the staff and Commission appear to treat prior Commission-approved no-action dispositions as precedent. Throughout the supporting memoranda there are frequent citations to the precedents found in prior no-action dispositions, with many general citations and frequent specific citations. Thus, in the 45 no-action dispositions by the Commission between 10 May, 1967 and 14 May, 1968, there were at least 14 specific citations to the authority (or lack of authority) or prior Commission-approved no-action dispositions. (See the summary of citations to no-action dispositions compiled in appendix G.)

In considering the Commission dispositions as "law," it is important to recognize that they assume that status because they reflect Commission action and not because they are interpretive or analytical in form. The Commission minutes ordinarily do not reflect the Commission's reasons for its conclusions in particular no-action matters, and the reasons must be inferred from the facts, interpretations, and discretionary considerations set forth in the accompanying staff memoranda. While the Commission actions ordinarily appear to involve "interpretations," there is no assurance that that is the case, for often they may also reflect other concerns: the hardship imposed by compelling rigid compliance with registration requirements, an assessment of the "quality" of the company and the probability of injury to a purchasing stockholder if the proposed sales are made, and similar "discretionary" considerations.

The same considerations affect evaluation of all no-action letters except those very few that are, in form, expressly interpre-

tive. The former Chief Counsel of the Division of Corporation Finance has commented:

> I do not believe it is helpful . . . to attempt to make a distinction between no-action and interpretive letters. . . . By far the more numerous are those situations in which it is difficult, if not impossible, to tell whether the staff advice is intended as an interpretation, or merely as a statement that enforcement action will not be taken. . . . It is difficult for the reader to make a distinction between the two types of letters because of the rather peculiar phraseology . . . but more importantly because it is impossible for the reader to know what factors were, in the mind of the staff member who wrote the letter, determinative of the position taken. . . . Also, it is not always clear to the staff member whether he intends that the letter constitute an interpretation or merely a statement that enforcement action will not be taken. . . . It was my experience that normally when a request for advice was referred to the Commission . . . [it] considered the question as one of interpretation of the securities laws. This was true even though the person who had requested the advice may have desired nothing more than an assurance that no enforcement action would be instituted. . . . Conversely, in some instances when the staff referred matters to the Commission as interpretive questions, the Commission disposed of them as if they were nothing more than requests for assurance that no enforcement action would be instituted. (Appendix B, pp. 1–2.)

The uncertainty created by the interaction of legal interpretation and discretionary enforcement policy may compel careful appraisal of the statements of Commission and staff in order to reach a judgment about their interpretations or policies. But uncertainty about the motivations for official decisions is a problem that lawyers must continually puzzle from their days as a first-year law student. That uncertainty renders the "no-action" decision no less law, whether rendered by the Commission or by the staff.

Whether the staff interpretations, either as reflected in the original no-action letters, or as reflected in those letters taken together with related interpretive summaries, are "law," must depend upon the purpose for which that question is asked. For example, it seems likely that the summaries of interpretation, together with the applicable no-action letters, may well be viewed as "instructions to staff that affect any member of the public" within the meaning of the Public Information Act. 5 U.S.C.A. § 552(a) (2) (C) (1964).

There can be little doubt that the interpretive summaries, whether based upon a Commission disposition or upon an unreviewed staff letter, provide a body of internal precedents which "affect" members of the public who request no-action letters. The

senior staff counsel regard it as their function to maintain internal consistency in rendering no-action letters; and to that end the staff attorneys are urged to view the problems presented by no-action requests as legal questions to be resolved by traditional legal, interpretive techniques. The entire process of summarizing and circulating interpretive statements and maintaining a card file of interpretations can only be intended for that purpose. Thus, the senior Assistant states that he particularly expects the newer staff attorneys to "spend a lot of time in the cards;" and he discourages them from basing their recommended decisions on "discretionary" factors.

Of course it is essential to recognize that both the senior counsel and the staff attorneys are agreed that a large proportion of the routine no-action letters are not of precedential value. (Questionnaire responses indicate 7% : see appendix I, question 26.) In large part this is due to the routine nature of the questions usually presented, which also results in the relatively low staff use of the internal research tools. But use of the research tools continues at a rate roughly comparable to that proportion of cases in which the staff attorneys find their experience inadequate for preparation of a no-action response. (Questionnaire, appendix I, question 29.)

Another factor of importance contributes to the view that many no-action matters are not of precedential importance: the widely held staff position that many no-action matters reflect only conclusions of "ultimate fact" peculiar to the facts of a particular case. Thus, the practice has developed of treating most "change of circumstance" claims as single unique cases without precedential value. Yet certain patterns of decision are surely reflected in those cases. For example, it seems likely that the worsening of a medical condition that existed at the time of purchase of the stock in question will *not* support a claim of "changed circumstances," though such a claim *may be based* upon a new medical condition that arises after purchase of the stock. But if the medical condition, though it subsisted at the time of purchase, has grown worse, when the prognosis was that it would improve, sale may be authorized—at least, where no substantial distribution is involved. Similarly, claims of changed circumstances resulting from termination of employment are often rejected; but if the applicant can support his claim with a showing that he had a written, unqualified three-year employment contract, he may be successful.

While all of these applications of the "change of circum-

stances" concept may have been affected by the presence of other "discretionary" considerations, such concrete interpretive examples are helpful to staff counsel precisely because they indicate the quality of the "change" currently viewed as sufficient by the Assistant Chief Counsel. And for that reason, one of the more important research tools relied upon by the staff counsel are their own copies of previous no-action letters and consultation with their colleagues. (Questionnaire, appendix I, question 27 (f), (g) and (j).)

The effect upon an apparent "interpretation" of such discretionary considerations is not to be discounted, however. A good example is found in the no-action matter before the Commission in appendix L–5. There, the summary card is marked "card only" because it is considered too unique—as a "change of circumstance" matter—to be included in the summaries distributed monthly to the staff counsel. The card provides an interpretation of the Commission decision which appears to demonstrate that the Commission found no "changes" beyond earlier anticipation. And the card recognizes at least one of the typical "discretionary" types of considerations that affect judgment, noting that the applicant's investment intent was compromised by the fact that he had made earlier repeated attempts to obtain a no-action letter. But the card indicates nothing about the impact of yet another "discretionary" consideration found in examining the staff's supporting memorandum to the Commission. That memorandum shows that one of the applicants had been counsel for the president of the issuer, who was currently under investigation, and was thought to have been aware of the president's illegal activities. On that account, one of the Regional Offices had indicated that in the circumstances a no-action letter should not be granted. While such additional considerations may or may not have had an effect on the outcome in this instance, availability of that information is helpful to a full appraisal of the Commission action in denying the application, and in that sense is a part of the "law" of the case.

One other aspect of the file of interpretive summaries may render them unreliable as a basis for determining current interpretive positions: the file includes an historical accumulation of cards reflecting positions taken at various times in the past, many of which may have been superseded by new positions, also summarized in the cards. Informed researchers approach the cards with caution, frequently consulting one of the Assistants on apparent conflicts of position. That movement and conflict do

not, however, diminish the role of no-action determinations as "law," though it may be necessary to research thoroughly and resolve conflicting positions.

Finally, the caution required in using no-action letters as guides to interpretation is illustrated by comparing the letters reproduced as appendices L–6 and L–7. Here, one applicant is permitted to sell 225,000 shares representing 14.5% of the issuer's outstanding stock, the last 75,000 shares of which were acquired 14½ months earlier. The other applicant is denied the right to sell 5,006 shares (presumably much less than 14.5% of outstanding) which were acquired in an exchange effective approximately 16 months earlier. Both applications appear to be based upon a claim of unanticipated discharge from employment, and neither staff letter includes any explanatory rationale. While some theories might be elaborated to explain the difference, no adequate explanation appears on the face of the letters.

IX. The Role of Discretion

As suggested above, the body of law found in the staff and Commission interpretive positions may be heavily influenced by various discretionary considerations that are brought to bear on specific no-action determinations. Those discretionary factors, together with the ad hoc nature of many "fact" determinations, have created a body of interpretive law in which "uncertainty and divergence of practice presently prevail to an unacceptable degree," according to the *Disclosure Study*. (See pages 16–17, *supra*.)

While many discretionary considerations undoubtedly contribute to the uncertainy, others reflect staff efforts to provide means of protecting investors within a clumsy statutory and interpretive structure. Many of the concepts and distinctions required by currently-accepted interpretations of the 1933 Act have no real relevance to the protection of investors. The *Disclosure Study* commented:

> The most casual inquiry into the effects of prevailing interpretative pattern discloses its grave shortcomings. . . . Sale without registration may turn on events wholly unconnected with the needs of investors. . . . (Disclosure Study at 155–56.)
>
> * * * * * * *
>
> An obvious question may be asked: in what possible way is . . . "change of circumstances" relevant to the needs of public investors, so as to justify the sale of . . . shares without appropriate disclosure? The easy answer to the question is "none." (Disclosure Study at 170.)

* * * * * * *

In application, the present "fungibility concept" bears little relationship to the needs of investors for disclosure. It has never been formalized as a Commission rule or interpretative release, and hence introduces an additional element of uncertainty into an already clouded situation. (Disclosure Study at 174.)

It is apparent from the *Disclosure Study* discussion of these problems that many interpretive positions were taken, and many discretionary factors taken into account, in order to prevent the formal structure of registration from choking off legitimate securities transactions intended to be exempted from the Act. The framework of subjective, "ultimate fact" judgments provided the flexibility necessary to reach doubtful distributions, while permitting sales which appeared to be prompted by the financial needs of an innocent shareholder. But focussing on such subjective considerations often made confident judgment impossible precisely because the root of the matter involved shareholder's motivations. Thus, one staff attorney commented that the simple question of adequacy of a two to three-year holding period could be decided adequately by a G.S. 2, but "for those involving a change of circumstances a solon would fail."

It is little wonder that under such circumstances, often involving a determination which might as well be decided by a flip of the coin, various other factors more obviously pertinent to the protection of shareholders should be taken into account. Many of those factors, mentioned at various times in discussion with staff personnel, are listed in the Questionnaire, question 30, together with appraisals of their relative importance. And the frequency with which such discretionary considerations were instrumental in decision is reported to be between 37% and 45%. (Response to question 14.)

There have been occasional suggestions that political factors play a large role in obtaining a favorable no-action response from the staff or Commission. (See questionnaire, appendix I, question 31, remarks of Respondent #4.) And in at least one instance, available records seem to reflect "political" considerations. (See appendix L–4.) But a careful analysis of many cases in which Congressmen made written "status" inquires with the Commission failed to demonstrate any substantial effect, except possibly a prompt review of the matter and the preparation of an explanatory memorandum for the Congressman.

Undoubtedly the most significant "discretionary" factor that plays a role in the outcome of no-action requests is the pendency of an investigation or an enforcement proceeding. Where a re-

gional office or the Division of Trading and Markets indicates that a "hold" should be placed on no-action letters concerning stock of a particular issuer, a no-action request ordinarily will be met by a simple uncommunicative rejection. That practice seems often to be followed regardless of whether the immediate applicant appears to be involved in the potential proceedings. And it also seems that the staff is much more reluctant to authorize a no-action position for the benefit of a stockholder who has previously been found to be a securities violator.

Various other "discretionary" considerations which appear to play a part in decision reflect a desire to assure protection of the investor. Thus, particularly in close cases, the staff is more likely to look favorably on proposed sales of stock of a reporting company, or of the same class as that recently registered by the issuer, or sales which are within the ordinary trading volume of the stock in question.

The role of various discretionary considerations are demonstrated by the following brief explanations of some of the no-action matters reproduced in the illustrative appendix L:

Appendix L–2

(Commission Minute, Memorandum from Division of Corporation Finance and Memorandum from Division of Trading and Markets)

Here Mr. A has held the stock in question for what would ordinarily be an adequate "holding period" before seeking permission to sell. With respect to the interpretation by which Mr. A seeks to justify his sale, the Division *expressly* agrees that his "conclusion of law is correct." But because the Division of Trading and Markets suggests that the issuing company may be merely a shell, that some of the promoters of the Company have been involved in prior securities violations, and that the applicant had served the Company as counsel, a no-action letter is denied. In this case, after receiving three responses from the staff that were totally uncommunicative about the reasons for denial, Mr. A has threatened to make a sale of a portion of his holdings and to invite Commission enforcement personnel to witness the sale.

Appendix L–3

(Interpretive summary card, Commission Minute, and Memorandum from Division of Corportion Finance)

Appendix L–4

(Commission Minute and Memorandum from Divsion of Corporation Finance)

These matters should be considered together. The matter presented in L–3 demonstrates a routine disposition of a claimed "change of circumstances" arising out of pressing financial and business circumstances. The staff generally views such circumstances as ordinary financial risks which the stockholder may have anticipated. Similar considerations might have produced a similar result in L–4. Indeed, the Division memorandum so recommends because an accident and engineering difficulties put the applicant behind schedule and created his claimed "change of circumstances." In the staff's view, those contingencies would reasonably be expected as part of the risks of developing a new device. But the Commission was obviously swayed by the excessive burden of the risks involved, by the possible impact upon the many employees of the applicant, or by the intervention of administration officials. The second of these no-action matters does not appear to have been made the subject of an interpretive summary.

Appendix L–5

(Interpretive summary card, Commission Minute and Memorandum from Division of Corporation Finance)

This matter expressly reflects on the interpretive summary card the view that early and repeated attempts to obtain a no-action letter may compromise any claim of original investment intent. Further, it demonstrates that additional enforcement considerations may play a part in decision, though not reflected on the summary: in this case, the pendency of an investigation of the issuer and the applicant's possible involvement in the matter under investigation. For that reason, it leaves some doubt whether the interpretive summary reflects all of the reasons for the result.

Appendix L–8

(Commission Minute Only)

This case involved an apparently legitimate claim on the part of a former member of a controlling family group that family friction, and his resulting expulsion from any policy-making position in the company, constituted a "change of circumstances"

which could justify sale. Though such claims have not infrequently been approved, the Commission here disapproves because of a policy decision to deny no-action letters to all members of controlling family groups.

Appendix L–10

(Commission Minute Only)

Although the practice is not frequently followed, the Commission will occasionally extract a condition as the basis for granting a no-action letter. Here the Commission imposes such a condition, presumably because of the applicant company's affiliations with other management companies. In one instance, a variation of this theme (not included in appendices), the Commission "concluded that, under the special facts here involved, the staff might take a 'no action' position after the expiration of two years" from the date on which the applicant had acquired the stock in question—an authorization to the staff somewhat at odds with the theory that investment intent is proved *after* an appropriate holding period.

IX. Conclusions and Recommendations

A. *General*

The no-action process as administered by the Division of Corporation Finance appears to be a sophisticated and effective system of providing informed and specific staff advice under active Agency supervision. The basic conclusion of the Task Force On Legal Services and Procedure, Second Hoover Commission, appears to remain sound:

> By practice and precedent, letters of advice and staff opinions are given limited validity . . . [by several agencies.] This excellent practice in administrative procedure has been most effectively used by the Securities and Exchange Commission, which issues several thousand such opinion letters annually. . . . The satisfactory experience of agencies which have . . . followed the practice . . . suggests the advisability of a more general use of the advisory opinion by all agencies of the executive branch (Report, Task Force on Legal Services and Procedure, p. 189–90 (1955).)

That accolade is justly cited with pride by Division personnel; and the accessibility and pragmatism of Division personnel, as reflected in the no-action process, is an outstanding example of an agency making government work effectively within the in-

evitably rigid confines of governing statutes. By exercising discretion to modify statutory rigidity and grant advisory assurances concerning enforcement intentions, the staff and Commission enable businessmen, in compliance with law, to execute legitimate securities transactions, while restraining transactions that may appear to offend the basic policy objectives of the 1933 Act. But as the demand for advisory assistance has grown, the emphasis on accessibility and service to the industry has begun to overshadow the major objectives of the advisory processes.

The major objectives of the no-action advisory processes are, in part, set forth in a Division memorandum:

> The no-action letter procedure is used to assist persons to comply with the law in prospective transactions, and to assist in effectuating transactions that do not appear to be contrary to the intent of the statutes and rules. (Memorandum to Warner W. Gardner, appendix E, p. 3.)

To this statement of objectives should be added further objectives: "advising the staff in advance of activities that might be questionable" (appendix E, p. 2); and encouraging a flow of information about financial and regulatory problems to assist the staff and Commission in developing, elaborating and testing concepts and policies for current and future application.

The present policy of granting specific advisory clearances for specific transactions, including a mass of routine transactions, appears to operate on the implicit assumption that the best way to "assist persons to comply with the law in prospective transactions" is to run a clearinghouse for those transactions. Yet that objective may often be served far more effectively by emphasizing practices designed to broaden public understanding of staff and Agency interpretive and policy judgments—a goal that is defeated at present by the failure to make available a large part of the staff and agency interpretations.

The "clearinghouse" concept of the staff's advisory role also interferes with its effective performance of the important function of exploring new (and variants of old) regulatory problems and developing sound interpretive positions and rules. Many, perhaps most staff and Commission interpretive positions relating to registration obligations arise out of experience with problems presented for advisory assistance. The most experienced staff members should have ample opportunity to give full consideration to the implications of new or unique fact situations and to give attention to the development of a sound and consistent body of interpretive positions. But the present emphasis

upon providing routine assurances is in fundamental conflict with that objective. The rules proposed by Commissioner Wheat's *Disclosure Study* reflect a substantial effort to diminish that conflict; but additional steps should be taken to strike a better balance in favor of educating the bar and the public and giving adequate attention to the development of a sound and consistent interpretive structure. The staff should not continue the hopeless effort to respond to every routine request for an advisory assurance.

Discouraging the flow of routine no-action requests will, of course, diminish the opportunity for the staff to be advised in advance "of activities that might be questionable." However, no-action applications are not a prime source of information about questionable trading in unregistered stock; and few, if any, cases could be cited by enforcement personnel in which a no-action application first alerted the enforcement staff to such violations.

B. Specific Conclusions and Recommendations

1. *The Need to Minimize the "Clearance" Function of No-Action Letters and to Maximize Public Information About the Grounds for No-Action Dispositions*

At present the Division of Corporation Finance processes an excessive and unnecessary burden of requests for no-action clearance of transactions presenting routine interpretive or discretionary questions. As a result, it is doubtful that the major objectives of the advisory processes are well served.

The agency cannot hope, through its advisory processes, to reach the bulk of transactions which may present serious questions of compliance. And it is equally unrealistic to suppose that the rendering of unpublished responses to routine requests for advice will educate the public generally, or the bar in particular. While this practice may restrain some specific undesirable distributions, and may gradually educate a group of SEC specialists, the mass of questionable but routine transactions should be susceptible of restraint by other means.

The bulk of advice dealing with routine types of transactions consumes the time of some of the best informed and most experienced attorneys in the Division. Yet processing such advice adds little to their experience and presents few new fact situations to encourage new thought about the interpretive positions and policies of the agency. The capacity of the senior staff to

anticipate new problems and propose means of meeting them are well illustrated by the occasional interpretive releases. (See, *e.g.*, Securitites Act Release number 4982, July 2, 1969, "Application of the Act and the Securities Exchange Act of 1934 to spin offs of securities and trading in the securities of inactive or shell corporations.") But though the SEC is well advanced over most other agencies in this respect, the competition is poor. Promulgation of such releases remains an occasional thing, and they are seldom as specific or concrete as they might be made with a full infusion of the experience gained by the staff in rendering no-action advice. Furthermore, while staff effort is effectively devoted, from time to time, to the development of general interpretive releases, it is unrealistic to suppose that experienced administrators, sensitive to the complexity of interpretive problems, will ever be inclined to favor frequent or extensive statements of interpretive positions. The predictable reaction will more often be that of the staff as set forth in the case described in appendix L–1. There, after receiving Commission instructions to consider "formulation of a general policy," the staff responded:

> [T]he Division . . . concluded that it would be difficult to draft standards of general applicability to these situations. The staff also expressed the view that adoption of general standards would sacrifice a measure of administrative flexibility and recommended that for the time being each request be considered on an individual basis.

And after a further request:

> The Division still believes that these questions should be decided on a case by case basis. . . . Perhaps [in other circumstances than the instant no-action request] . . . a good reason [for a general exception to an interpretive rule] exists, but that need not be decided now. (Appendix L–1, pp. 3, 4.)

The best alternative to frequent, extensive and concrete interpretive releases would be general availability of the interpretive positions taken by the Commission and by the staff on a case by case basis. Yet the interpretive summary cards, designed to reflect those interpretive positions, are presently regarded as unreliable even by the senior staff attorneys. Rather than being central to the interpretive process and prepared concurrently with the related no-action letters, they are prepared by the most inexperienced man in the Division (though under supervision of the senior Assistant) long after the decision is made. And given the burden of no-action matters and the concentration on the interpretive end-product, the senior staff personnel could

hardly be expected to devote adequate effort to the distillation of interpretive explanations from concrete cases or to the necessary reviewing and sifting of interpretive positions. As a result, the consistency and development of interpretive positions are, to an unnecessarily large degree, embodied in the experience of the senior personnel of the Division. And embodiment of experience in mortal form (the Director is past retirement age) makes the Division over-dependent on key personnel and hampers the analysis of trends and patterns of interpretation and the continual re-examination of positions that are essential to the development of a sound interpretive structure. Further, such experience cannot readily be published as an interpretive guide.

The present burden of no-action matters appears to arise from a totally unrestricted advisory policy, from uncertainty about the interpretive positions likely to be taken by the staff, from the need of broker-dealers for reliable advice, and from the unreliability of counsel's advice as an assurance against enforcement or injunctive proceedings. See discussion at pages 11–19, *supra.*

The staff's unrestricted advisory policy, originating in a commendable effort to remain accessible to the public, has, for many routine transactions, become a clearance process akin to a licensing bureau. That does not seem to have been the intent of the act; and the staff is not manned to perform that function.

The uncertainty of the interpretive structure is well documented by the *Disclosure Study.* Much of that uncertainty results from the subjective quality of the determinations required of the staff and the artificiality of the fact basis for their decisions. In essence, the staff is required to make "jury" determinations of facts concerning motivation and intent without an adequate factual basis for judgment. While the rules proposed by the *Disclosure Study* may relieve much of the pressure to decide such questions, they are unlikely to obviate the need for further structuring of the advisory processes.

Finally, as discussed *supra,* pages 15–19, it appears that the applicants are inclined to favor the no-action process because the agency discourages reliance on private counsel and because private counsel are uncertain about current staff and agency interpretive positions. Agency policy, in turn, appears to be founded in part upon a lack of confidence in the competence or ethical reliability of counsel.

To the extent that the agency is concerned with competency, it should pursue policies, such as full disclosure of interpretive

positions, designed to maximize available interpretive tools. And it should exercise its power over practice before the agency to discourage the rendering of counsels' opinions on the basis of inadequate legal or factual investigation or in disregard of available interpretive positions. This would seem to be encouraged by the recently-revised A.B.A. Code of Professional Responsibility, which provides:

> DR 6–101 Failing to Act Competently
> (A) A lawyer should not:
> (1) Handle a legal matter which he knows or should know that he is not competent to handle, without associating with him a lawyer, who is competent to handle it.
>
> * * * * * * *
>
> DR 7–102 Representing a Client Within the Bounds of the Law
> (A) In his representation of a client, a lawyer shall not: . . .
> (2) Knowingly advance a claim or defense that is unwarranted under existing law, except that he may advance such claim or defense if it can be supported by good faith argument for an extension, modification, or reversal of existing law. . . .
> (7) Counsel or assist his client in conduct that the lawyer knows to be illegal or fraudulent.
>
> (American Bar Association Special Committee on Evaluation of Ethical Standards, *Code of Professional Responsibility*, pages 74 and 86–87 (A.B.A. 1969).)

Recommendations

(a) For the present, the no-action process should remain broadly available on a routine basis. After publication of adequate guidelines to interpretive positions, including full statements of specific no-action cases, as recommended *infra*, the process should be available on a selective basis under published procedural rules which authorize the staff to decline to render no-action or advisory letters with respect to matters fully covered by available interpretive materials.

(b) Where advice is regularly given which authorizes conduct that would otherwise be subject to potential enforcement proceedings, applicable interpretive rules governing staff advice should not depend upon subjective standards requiring staff determinations of an applicant's intentions or motivations. Where interpretive positions require such determinations, provision should be made for full hearing before an examiner for an advisory determination.

(c) The enforcement and compliance procedures of the regulatory structure should not place a premium on staff advice and "clearance" of prospective transactions in preference to reliable

private legal advice. Where the staff questions the reliability of legal advice it should propose rules which will facilitate reliance on the advice of private counsel. With respect to the SEC no-action process, the staff should prepare a form, required to be utilized by counsel in rendering advice relating to registration obligations, which will provide a full representation to counsel, by the client, of sufficient pertinent facts to assure that counsel have adequate information to render such advice. Upon publication of adequate guidelines to interpretive positions, the Commission should adopt rules of practice providing for disbarment from Commission practice of counsel who render advice that is incompetent or in disregard of available interpretive positions.

(d) The Commission should adopt a policy of full disclosure and publication of all interpretive positions that arise from advice given in concrete cases on the basis of specific facts. In furtherance of that objective, it should assure that a full summary of facts and reasons is prepared, for later publication, concurrently with the rendition of advice in each case in which the position taken may be of significance as an interpretive guide. (Preferably, the summary should be prepared by the initiating branch attorney.) And the Commission should assure that senior personnel involved in the advisory process have adequate opportunity to prepare and review interpretive summaries and to engage in continuing review of interpretive positions adopted by the staff or agency looking to such disclosures.

2. *The need for public availability of no-action letters*

No-action letters, together with related staff memoranda and Commission minutes, constitute a large body of law that is unavailable to the public in a field in which relatively few illustrations of the concrete application of interpretive positions are available and in which misconceptions abound. Available releases are infrequent and general when compared to the range of internal precedents developed, and it is doubtful that releases will be developed at a rate comparable to the development of staff and agency thinking on specific questions. See discussion at pages 47–48, *supra*. Therefore, it is desirable that all statements of advisory positions which have the effect of a substantial assurance of protection from enforcement or disciplinary proceedings should be made public.

All advisory determinations that are of significant importance as a guide to interpretation should be published in a manner that will make them generally available to the practicing bar.

Specifically, this embraces all no-action positions that have been the subject of Commission action (but not matters dismissed by the duty Commissioner as unimportant) and all staff letters which, though not the subject of Commission action, are summarized for use by the staff or Commission. Publication of matters decided by the Commission should include the Commission Minutes and a full summary of facts and reasons; if such a summary is unavailable, the related staff memoranda should be published. And because agency personnel regard many staff letters as interpretive guides even though they have neither been summarized nor the subject of Commission action, such letters should be made available to the public, after an adequate delay period, in the Commission's public reference room.

There is a significant body of opinion, both within the agency and among members of the securities bar, which opposes publication of no-action letters. See appendices D and F. The primary concerns appear to be that public disclosure of private financial details discussed in such letters will discourage many potential applicants from utilizing the service; and that the frequent involvement of discretionary considerations in the decisional process may often render the letters misleading and unreliable as guides to interpretive positions.

While the Public Information Act, sections (a)(D) and (b)(C), probably requires the publication or availability of these materials, if disclosure would constitute a serious threat to the continued viability of the no-action process, or would be seriously misleading, it is possible that amendments to the Public Information Act should be recommended. However, no very persuasive case is made with respect to either contention.

The uncertainty that may result from publishing apparently inconsistent letters pales in comparison to the uncertainty resulting from the unavailability of concrete illustrations of the application of interpretive concepts. The analytical techniques required of counsel in considering such letters as interpretive guides is not different in substance from that required of counsel in many other interpretive exercises. Furthermore, by publishing related staff memoranda, in matters that go to the Commission, much of the uncertainty would be reduced.

In most instances, the needs of confidentiality may adequately be met by a combination of delayed publication and substitution of symbols or descriptions for identifying names and details. (See discussion in appendix B, pages 5–7; appendix C, pages 3–6). However, because all no-action dispositions relied upon by

the staff as a basis for interpretive guidance are probably within the coverage of the Public Information Act, there is doubt whether such information should be kept confidential. Where specific information is within "confidentiality" exemptions of the Act, of course, there would be no objection to substituting symbols and descriptions. But it is impossible that the needs of no-action applicants for confidentiality would not adequately be met by substitutions only to the extent necessary to satisfy the exemptions provided by the Public Information Act. Unless that is demonstrated, however, all no-action determinations that are of significant importance as a guide to interpretation should be published, after an adequate delay period, substituting symbols and descriptions only to the extent necessary to comply with the exemptions for confidentiality available under the Public Information Act. All other no-action determinations should be available, in the form of the advisory letter, in the Commission's Public Reference Room after an appropriate period of delay.

Publication of interpretive positions arising out of no-action determinations should not, however, be viewed as precedent binding upon the agency. For that reason, any release announcing the recommended policy of general disclosure should also announce that published positions may be subject to withdrawal and reconsideration, and should prescribe a method for public withdrawal of specific summaries from the body of published positions. Similarly, the same release might indicate that qualifications to published positions may also be accomplished from time to time by means of published summaries of hypothetical cases designed to limit or qualify previously published positions.

Recommendation

All statements of advisory positions taken by the staff or agency which have the effect of providing substantial assurance against enforcement or disciplinary proceedings constitute the law of the agency. All such statements which reflect decisions by the agency, including agency minutes and interpretive summaries (or supporting staff memoranda), and all such statements by the staff which are of significant importance as a guide to interpretation, should be regularly published in a form generally accessible to the practicing bar, after removing identifying details to the extent such details are exempt from disclosure under the Public Information Act.

All other staff statements, of similar effect, after an ade-

quate period of delay, should be made available in the public reference room of the agency.

This disclosure policy should be announced in a release which indicates the manner of proposed publication and further indicates that published positions may be subject to withdrawal or qualification, either by means of published withdrawal or by means of further advisory summaries based upon hypothetical statements of fact.

3. *The need for public availability of the considerations that guide discretionary judgments*

It is apparent from discussion with senior personnel, from the questionnaire responses of branch attorneys, and from an examination of specific no-action determinations, that a significant range of discretion is exercised in deciding whether to take a no-action position. This is particularly true in cases which present "close" interpretive questions. Yet there is little publicly available material to suggest the types of nonlegal or noninterpretive considerations that may affect the no-action determination.

While it may be difficult to recite fully all of the considerations that may affect judgment, or the precise impact of any given factor, experienced staff personnel could provide a general description of the nonlegal or noninterpretive considerations that are most frequently taken into account.

Recommendation

That the staff prepare a general release, stating that in determining whether to grant requests for no-action letters, in addition to technical problems of interpretation of controlling statutes and rules, certain other factors are taken into account. The statement should describe those considerations, and the effect they may have on the no-action determination, as fully as is feasible.

4. *The need for a published description of the no-action process and of the effect of issuance of a no-action letter*

Staff and Commission procedures in rendering no-action letters are relatively well defined. Yet published regulations, appendix K *supra*, provide inadequate information about the process. In particular, they provide virtually no information about the extent of authority accorded a no-action letter or the availability and extent of Commission review.

In view of the Commission's recognition of a practical "estop-

pel" based on such letters, some fuller explanation should be made of the authority they carry. And in view of the Commission practice of hearing or assigning to a duty Commissioner all matters in which a Commission hearing is asked, it is somewhat misleading to assert, as is suggested in Appendix K, that hearing may be had only where the requests "involve matters of substantial importance and where the issues are novel or highly complex."

Recommendation

That revised regulations be prepared for publication in the Code of Federal Regulations, more fully describing the no-action process, stating the legal effect of a no-action letter and setting forth the Commission's practice in hearing appeals from staff denials.

5. *Need to develop procedures that will assure applicants an opportunity to meet dispositive issues*

Present procedures in handling requests for no-action letters do not provide any assurance that the applicant will have an opportunity to understand the factual and legal issues that may be dispositive of his request. Generally the staff, by letter or informal conversation, makes reasonably clear what matters are in issue; but no procedures assure that understanding. Further, even upon a final determination the form of the no-action letter seldom states reasons which would assure that the applicant will understand the grounds for the conclusion.

While procedures for refining the factual and legal issues in a no-action matter would be unduly burdensome, it would seem that both of the above procedural difficulties could be met adequately by requiring that each letter be supported by a statement of reasons for the determination; or at least, that each negative determination be supported. In view of the flexibility of the no-action procedure and the possibility of further application to the staff in the event of misunderstanding, such a procedure should be adequate to assure that the issues and reasons are understood. And the burden of complying with that requirement should not be excessive provided the routine no-action requests are disregarded, as recommended *supra*.

Recommendation

That every letter responding to a request that the staff take a no-action position with respect to a specific application there-

fore include a statement of the facts; and that every letter denying such a request also include a statement of the reasons for denial of that request.

APPENDIX A

Letter from Chief Counsel, SEC Division of Corporation Finance, to Harry Balterman, Esq., April 12, 1965 (See ¶ 91,606).

DEAR SIR: In your letter of April 2, 1965, you ask certain questions as to so-called "no action" letters; that is, informal opinions rendered by this Division concerning the securities laws upon certain facts presented by individuals or their counsel.

Two of your questions are, in effect, whether a "no action" opinion of this Division is binding upon the Commission.

The Division acts in an advisory capacity to the Commission, and recommendations of the Division may or may not be accepted by the Commission. A "no action" letter merely represents the recommendation the Division would make to the Commission on the basis of the facts presented; it is not a formal administrative act of the Commission. The Division's opinion, of course, is predicated upon the assumption that the facts presented are a true and complete statement of all the circumstances surrounding the transaction in question and is of no effect unless the facts are as stated.

Professor Loss, in his treatise on securities regulation, puts the matter this way:

> "It is understood that the [no action] opinions represent the views of the officials who give them and are not binding upon the Commission. The official says, in effect: 'This is my view based on the facts as you describe them. You may not rely on it as if it were a Commission decision. If you don't like it, you are at liberty to disregard it and follow your own construction, subject to the risk that I may recommend appropriate action to the Commission and the Commission may institute proceedings or take other steps if the Commission agrees with my view.' Loss, Securities Regulation, p. 1895 (1961).

This is an accurate summary of the scope of a "no action" opinion. Such an opinion, therefore, is not binding in a court of law on the question of the liability of an issuer for permitting a sale of its securities without registration under the Securities Act of 1933, nor would such an opinion preclude an issuer from maintaining that a sale of its unregistered securities by a stockholder would be in violation of Section 5 of the Securities Act of 1933.

APPENDIX B

December 16, 1968.

Orval L. DuBois, *Secretary*
Securities and Exchange Commission
500 North Capitol Street
Washington, D.C. 20549

DEAR MR. DUBOIS: This is written in response to the Commission's request for comments on whether staff interpretive and no-action letters should be

made available to the public (Release No. 33–4924).

It is not my intention to comment on the Commission's position as expressed in the Release that no-action letters and letters containing interpretive advice are not required to be made public under the provisions of the Public Information Act, 5 U.S.C. 552. In this connection, it is sufficient to note that under the provisions of that Act an agency may make records and documents available for public inspection, whether or not required to do so. My comments will be directed solely to the question of the desirability of making these documents available for public inspection.

Since I was the staff member in the Division of Corporation Finance charged with primary responsibility for writing interpretive and no-action letters during the period from January, 1965 to August, 1968, my situation is rather unique when compared to that of other persons who may submit their comments to the Commission. My exposure to the practitioners' problems relating to interpretations of the securities laws is rather limited, but my familiarity with the problems of the Commission's staff in this area is probably greater than that of any other practitioner. Accordingly, I expect that my approach in responding to the Commission's request for comments will differ rather substantially from the approach of other practitioners. In this connection, I shall feel free to make reference to particular experiences while I was a staff member, if such reference would be helpful in illustrating a point.

Initially I wish to mention several important factors relating to interpretive and no-action letters. First, I do not believe it is helpful for the purposes of the Commission's present request for comments to attempt to make a distinction between no-action and interpretive letters. There are situations in which a letter containing staff advice clearly falls into one or the other of the two categories, but these situations are limited. By far the more numerous are those situations in which it is difficult, if not impossible, to tell whether the staff advice is intended as an interpretation, or merely as a statement that enforcement action will not be taken if a specified transaction is consummated exactly in the manner described to the staff. It is difficult for the reader to make a distinction between the two types of letters because of the rather peculiar phraseology in which the letters typically are written, but more importantly because it is impossible for the reader to know what factors were, in the mind of the staff member who wrote the letter, determinative of the position taken by the staff. Also, it is not always clear to the staff member whether he intends that the letter constitute an interpretation or merely a statement that enforcement action will not be taken. This is particularly true in those instances where a request for staff advice is made on a set of facts which poses a close question and where the amount or value of the securities involved is not great.

An additional fact should be mentioned with respect to this point. It was my experience that normally when a request for advice was referred to the Commission (whether because the staff was requested to do so, or because the staff believed the matter was important or novel enough to bring to the Commission's attention), the Commission considered the question as one of interpretation of the securities laws. This was true even though the person who had requested the advice may have desired nothing more than an assurance that no enforcement action would be instituted if he engaged in the proposed transaction. Conversely, in some instances when the staff referred matters to the Commission as interpretive questions, the Commission disposed of them

as if they were nothing more than requests for assurance that no enforcement action would be instituted. Perhaps the best example of this latter situation was the request, approximately two and a half years ago, for an interpretation of Rule 133; specifically, for a determination whether that Rule applied to a situation in which the constituent corporation was owned by two persons, each of whom held 50% of its stock. This request was presented to the staff as a request for an interpretation, and the staff submitted it to the Commission as a request for an interpretation. The Commission, however, disposed of the matter as if it were a request for a "no-action" letter, and without resolving the interpretive question; the attorney who submitted the question was advised that no action would be instituted if the proposed transaction were consummated. The Commission need not be reminded of the difficulties that followed this incident; it is sufficient to note that knotty interpretive problems concerning this aspect of the Rule continued with some frequency for almost two years. Furthermore, the attorney who submitted the matter subsequently was presented with an almost identical factual situation, and he confessed that he did not know what advice to give his client because he did not know what was the basis for the determination made by the Commission.

As the above discussion has indicated, although the staff may intend a particular letter to be merely a statement that on a given set of facts no enforcement action will be taken, it frequently happens that when a similar factual situation is presented in a subsequent request for staff advice, to some extent the previous letter is looked to as a guideline for the determination that should be made with respect to the subsequent letter. It is inevitable that this should happen, since the staff does conscientiously attempt to preserve consistency in the position it takes in its letters, but the result is that what the staff had intended to be only a statement that no enforcement action would be taken is converted by the staff into an interpretation. Finally, if a number of similar letters are written by the staff with regard to a particular subject, those letters (which now receive some distribution among certain members of the Bar) come to be regarded as interpretations whether or not the staff intended them to be such.[1]

Second, I believe that the writing of staff letters is a service that is often useful to the public, the Bar and the securities industry, and that every effort should be made to make the service more useful and to obtain for the Commission the maximum value from the efforts that are expended in providing this service. The basic purpose in having staff members devote a considerable amount of their time to the writing of these letters is to inform the public, the Bar, and the securities industry as to what are the views of the Commission, or its responsible staff members, regarding the application of the securities laws. The maximum ultility is not realized when the positions taken in

[1] An excellent example of some of these phenomena is the history of staff advice concerning the application of the registration requirements of the Securities Act of 1933 to financing plans involving the issuance of industrial revenue bonds. Over a period of years prior to January, 1967, a dozen or so letters were written stating that no action would be recommended to the Commission if such plans were carried out without registration of any security under the Act. Although those letters were phrased as "no-action" letters, it is not at all clear that they were not intended by the staff to be interpretive letters. However, it was abundantly clear from the comments received on the Commission's proposal to adopt Rule 131 that members of the Bar and securities industry considered those letters to constitute interpretations, even when one makes allowance for the hyperbole that sometimes attends comments on Commission rule proposals.

those letters on important matters that may involve interpretive questions are given such little exposure as is the case under the present system. Furthermore, a large portion of the staff's time is being devoted to writing letters which do not involve vital interpretive questions. From the Commission's point of view, little of any significance is accomplished in furthering the overall administration of the securities laws and the Commission's rules when responsible staff members must devote a substantial amount of their time to writing letters which are not important. It is especially true today that the Commission cannot afford an uneconomical use of its staff's time and skills.

I also wish to express my concern (which results from my experiences as a member of the staff) that the enormous volume of requests for staff letters, and the tendency for letters of little substantive content to crowd out the more important letters, will ultimately diminish the value of this service to a point where the Commission will no longer be justified in having its more senior and capable staff members write these letters, rather than devote their time to matters of more pressing concern to the Commission in its administration of the securities laws. Therefore, any disadvantages or inconveniences that may be associated with making staff letters available for public inspection must be put in their proper context in relation to the value the Commission can derive from the services of its staff if some change is made in the present procedures.

At page 3 of Release 33–4924, the Commission refers to the existing policy of not making staff letters available to the public as being based upon the belief ". . . that a member of the public should be able to obtain the advice of the Commission's staff without fear that information provided to the staff for that purpose might be made public in a manner that might adversely affect his lawful business activities or invade his personal privacy." This policy actually involves two separate considerations.

First, with regard to lawful business activities, there is no need for placing letters in the public files at a time when the business activities could be adversely affected. Indeed, at page 4, the Release quite properly reflects the realization that it would be desirable in these situations to delay publication of the letters until a time when there would be no undesirable impact. Publication could properly be delayed until the transaction involved has been consummated and thus has become a matter of public record, or until a time when it is clear that the transaction will never be consummated, or such other time as may be necessary to avoid an undesirable impact. There does not seem to be any criticism that could be applied to this approach.[2]

Second, with regard to personal privacy, the staff does receive a large number of requests for advice in which determinations must be made on the basis of an individual's personal circumstances. In these situations information concerning a person's financial circumstances, state of health, marital status and other rather personal matters is normally presented either in the initial request for staff advice or subsequently in response to questions asked by the staff. While it is quite understandable that an individual would not care to publicize information concerning these matters, the information frequently is already in the public domain for one reason or another. For example, if a

[2] This would be true whether the Commission were to make staff letters available for public inspection voluntarily or pursuant to a determination that it is required to do so under the provisions of the Public Information Act. In this connection it should be noted that there is no provision in that Act which would require the Commission to make information publicly available at a time and in a manner which would cause harm to some member of the public.

person has had serious financial difficulties, or has been fired, or is in such a poor state of health that he cannot or is not allowed to work, or has had marital difficulties that culminated in divorce or is estranged from other members of his family, these facts, although perhaps not widely known, are not secret from the whole world. However, the placement of letters containing these facts in the Commission's public reference room would not be the equivalent of publishing them in a newspaper of general circulation, and any determination whether staff letters should be made available for public inspection should not be based upon the assumption that it would be. I do not foresee that there will be large numbers of persons waiting to inspect the staff's letters for the purpose of gaining knowledge of someone else's financial, medical or marital problems, and I do not know of any single incident in the Commission's administration of the securities laws that would indicate otherwise.

At this point I think it is appropriate for me to mention that many members of the Bar and the securities industry have no idea of the volume of requests that are made for staff advice, or of the internal problems of administration that arise in providing this service. In particular, it is difficult for a person who has not had experience on the staff to appreciate the amount of time that must be devoted to answering even a routine request for staff advice. Accordingly, I think it is proper for me to suggest to the Commission that comments received from persons who do not indicate an awareness of those administrative problems should be given little weight by the Commission in its deliberation as to what course it should follow in the future. As I have noted, any disadvantages or inconveniences that may be associated with making staff letters available for public inspection must be put in their proper context and weighed against the obligation of the Commission to derive the maximum advantage from the services of its staff members. The Commission must assign priorities to its business, and if procedures can be adopted to decrease the amount of time devoted to writing staff letters and to free staff members to devote more of their time to other more pressing matters, then the Commission should adopt those procedures even if some minor inconveniences do result.

I would expect that some of the comments the Commission receives in response to the requests contained in the Release will be to the effect that if counsel is required to spread information concerning a client's business affairs or personal circumstances on a public record, he would be reluctant to request a staff letter and that, accordingly, the effect of making these letters available for public inspection will be to dry up the flow of requests, then making a useful service unavailable. In my opinion any expression of this kind of concern would be misplaced for two reasons. First, as I have already noted, making these letters available for public inspection in the Commission's Public Reference Room will not be tantamount to a wide-spread publication of a client's business affairs. There is no reason to suppose that these letters will be referred to by any persons other than those who have legitimate reasons for analyzing the staff determinations. Second, once the staff letters are available for public inspection, it will be possible for attorneys to use these materials as a basis for formulating advice to their own clients, thereby reducing the need for persons to write to the Commission and reveal to the staff business plans or personal matters which they would rather keep as confidential as possible. A person who is in need of advice concerning the application of the securities acts or the Com-

mission's rules would then be in a position of being required to reveal this information only to his attorney, who would be in a better position to advise the client on the basis of publicly available materials. In short, once a sufficient number of staff determinations has been published and are available to the Bar, there will be no need for continuation of the existing flow of business and personal information to the Commission's staff.

From the point of view of the Commission, I do not think that the resulting reduction in the flow of this information to the Commission's staff would have any adverse impact. An argument might be made that information contained in requests for no-action or interpretive letters could be useful in connection with enforcement activities, but I do not believe such an argument has any merit. Aside from the fact that these procedures were not established for the purpose of providing enforcement information, I do not know of any case during my tenure as Chief Counsel of the Division of Corporation Finance when any information that was significant from the enforcement viewpoint was first learned by the Commission's staff as a result of a request for a no-action or interpretive letter.

On the basis of my experience on the Commission's staff, as well as my rather limited experience since leaving the staff, it is evident to me that there are widespread misconceptions among members of the Bar as to what the Commission's positions are on a large number of questions arising under the securities laws and the Commission's rules. Merely making staff letters available in the Public Reference Room will not be an adequate response to the problem of dispelling those misconceptions, since there is no way to assure circulation of all staff letters. Accordingly, I recommend that in addition to making all letters available for public inspection, the identifying details be deleted from letters that the staff considers important and those letters be published periodically by the Commission in its releases. Hopefully, the securities law services would reproduce the letters without identifying details, thus making the more important determinations available to anyone who is in a position to consult one of the services.[3]

Although I favor making staff letters publicly available and taking steps to disseminate the more important ones as widely as possible, I do no intend to suggest that by taking such steps the Commission will make all of its difficult interpretive problems disappear. The problems will continue for the reason that under the securities laws and the existing rules there are really no satisfactory solutions to many of them. This accounts for some of the changes in the Commission's position that do occur from time to time with respect, for example, to the application of Rule 133, the so-called "doctrine of fungibility, the question of who is a "person", or what is a "distribution," etc. I believe that these problems can never be solved to the satisfaction of everyone, and that consequently steps should be taken to avoid them in every possible situation. Since they cannot be avoided by adding additional complexities to an

[3] In this connection, a few comments should be made regarding the releases the Commission has already published and which have been reproduced in the services. Those releases represent an important and commendable effort to give advice publicly on important questions. They are not as helpful as they could be, however, primarily because they contain general discussions of problems, and thus are only the beginning points of any really serious inquiries. They also have the disadvantage of being in the form of a textual material given to persons who are trained to read cases and to reason by analogy. What the Bar really needs for its guidance is readily available materials in the form of cases (i.e., individual letters to which the usual skills of a *lawyer may be applied.*) (Italic portion missing; added by hypothesis.)

already complex statute and set of rules, I urge the Commission to take all possible steps to adopt procedures that are easy to comply with and that will provide an inexpensive way to sell securities under appropriate exemptions. I hope that the study being conducted by Commissioner Wheat will soon be completed and will recommend specifically a number of exemptive rules that can be used to avoid the complex problems that now exist.

I appreciate the opportunity the Commission has given to submit comments on the questions raised in its Release. Because of my rather unique situation, I have not attempted to incorporate the views of any other person, but have confined myself to expressing my own opinions.

Sincerely yours,
/s/ George P. Michaely, Jr.,

APPENDIX C

Robert E. Hone
Attorney at Law
120 South La Salle Street
Chicago 3

October 24, 1968

Securities and Exchange Commission
Washington, D.C. 20549

Re: Interpretative and No-Action Letters

Dear Sirs: This is in response to the Commission's request in Securities Act Release No. 4924 (Sept. 20, 1968) for comment on the suggestions that interpretative and no-action letters be made "*publicly available.*" On the assumption that the Commission will be sparing in publication, adoption of the proposal should be encouraged.

Nearly all interpretative and no-action letters relate to standard factual situations and thus are of little value as evidence of developments in federal securities law. Their publication, serving no useful purpose, would only add to the time that must be spent in study generally or in research on a particular problem. I would venture the estimate that not more than two or three letters, if that many, in each 100 issued by the Commission's staff tend to have any significance in the interpretative sense or as an indication of current trends in policy. I would urge again, as I have in the past, that these isolated letters be made "publicly available."

To repeat, the Commission should be extremely selective in choosing interpretative and no-action letters for publication. For example, I assume the Commission is still receiving numerous requests for no-action letters on the "control" issue. In the light of the material already available, the replies to these requests would add nothing of interpretative significance. It would be an extraordinary situation that would justify or warrant publication of a letter on the control issue.

Similarly, I am sure the Commission is still receiving numerous requests for no-action letters with respect to the much abused Section 4(2) of the Securities Act in which none of the indicia of a private offering, except perhaps

lapse of time, is suggested by the facts of the case. The replies to these requests would be of no interpretative value. I see no reason why any of them should be published unless all of a sudden the Commission were to decide that lapse of time was not an indication of investment intent unless it amounted to four or five years, or, on the contrary, that an interval of six months or less was indicative of investment intent. In the absence of any such extraordinary development, the practitioner may make out by relying in appropriate degree on the various formal or informal comments by Commission personnel about the significance of one year, two years, or three years as indicators of investment intent—realizing, of course, that some of the comments before bar associations and similar audiences mentioning two years or three may be more "lore" than they are "law" as illustrated by Item 6 of Form S–14, S.A. Rel. No. 1862 (Dec. 13, 1938), or S. A. Rel. No. 4552 (Nov. 6, 1962).

One area in which it might be well to publish some no-action letters are those dealing with the "negotiated transaction" exception engrafted by interpretative letters onto the indefensible "no-sale" theory as presently set out in Rule 133. The publication of such letters would serve a dual purpose. It would bring the practicing bar up to date on the degree of vitality left in that involuted interpretation, and it might introduce an appropriate element of self discipline. The Division of Corporation Finance has wandered all over the range in recent years on this point. Either this exception is or is not appropriate. In any case, the Commission should at this late date take a firm position for the public record on the validity, desirability, and scope of the exception, or, if that is not feasible, at least publish from time to time the currently fashionable minimum number of stockholders required to take a proposed merger or sale of assets out of the exception.

Great restraint should also be exercised in publishing letters of comment (or portions thereof) on registration statements, but there could be some useful periodic supplementation of the infrequently revised guide (S. A. Rel. No. 4666).

Requests for interpretative or no-action letters should *not* be made publicly available. There are, I believe, several reasons why these requests should not be published. *One*, for the purpose of evaluating the significance of the staff reply to the request as evidence of current interpretations or as an indication of current policy the information furnished by the applicant is irrevelant; the important thing is what the staff deemed to be the facts of the case—and that is to be determined by what is stated in the staff reply and not by what appears in the request. *Two*, to make the requests publicly available would add materially to the job of researching to determine current law or policy without the contribution of evidentiary material of any real value. *Three*, the publication of significant staff letters without making the requests public might encourage an important self discipline on staff lawyers similar in substance to that resting upon judges and also upon anonymous lawyers in public service who draft the interpretation which are published as "Opinions of The Attorney General." The staff lawyer will know that the letter which he prepares, either for his own signature or that of a superior, will stand or fall on its own inherent merit. It will have to be carefully written and will have to state accurately and briefly the material (i.e., the legally significant) facts. Pride of authorship is to be encouraged. On occasion staff letters are not as carefully thought out and drafted as one might wish, but, by and large, they are superior in quality to the general run of the requests there-

for.[4] I believe it would be most unfortunate if we were to be burdened with the necessity of wading through the verbose and often poorly drafted requests which the Commission receives for interpretative and no-action letters.

Release No. 4924 seems to demonstrate on the part of the Commission a hypersensitive approach to the problem of confidential information. Publication of interpretative and no-action letters ought not involve any problem with respect to the release or premature release of confidential information greater than that which the Internal Revenue Service faces in publishing its weekly bulletin. The rulings published in the IRS Bulletin are quite similar to SEC staff letters. For example, they describe elaborate and important financial plans or proposed transactions in detail and set forth the impact thereon of the Revenue Code. Arbitrary symbols are substituted for the names of companies and for the amounts (of dollars or securities) involved. Similar editing should be feasible for the SEC, except that in some instances reasonably close approximation of the amounts of securities involved or of the number of offerees or purchasers might be necessary. The omission of corporate names and the necessity on occasion of substituting approximations for accurate figures should not involve any "considerable costs" or involve the risk of rendering "meaningless if not affirmatively misleading the edited staff responses.

For the purpose of giving adequate confidential treatment to a proposed transaction or at least for the purpose of avoiding premature publication of information concerning a proposed transaction, it might be well to have an arbitrary policy of not publishing an interpretative or no-action letter until a fixed period of time after its issuance. A period of two months should ordinarily be sufficient.

There may well be isolated cases in which it would be undersirable for the interpretative letter or no-action letter to be published as soon as two months after its issuance or possibly at any time in the future. I do not believe it would be feasible to take care of these cases by entertaining requests for confidential treatment. Without doubt the confidential treatment technique would be abused, and a great many requests for no-action letters would unnecessarily contain a supplemental request for confidential treatment thereby throwing an additional, collateral and unprofitable burden on the Commission's staff.

If, in a particular case, a lawyer believes he must consult with the staff on an interpretative or policy issue and that publication of the staff reply would reveal confidential information which would be detrimental to his client, he should be content (i) to seek a conference with the appropriate staff member to discuss the interpretative or policy problem, (ii) to submit a memorandum of the material facts but not a letter or request for a no-action letter, and (iii) to accept the oral comments of the staff member on the problem in lieu of an interpretative or no-action letter. This procedure would serve as a re-

[4] The Division of Corporation Finance seems to have curbed the practice quite common some years ago of retyping the applicant's statement of facts on the Commission's stationery and appending thereto a no-action recital. It is, therefore, disquieting to find the Chairman of the Commission referring to this abomination as though it were a routine and acceptable practice (see Panel Discussion, Public Information Act and Interpretative and Advisory Rulings, 20 Admin. L. Rev. 1, 30 [1967]) rather than a regrettable and temporary makeshift response to an excessive workload. The administrative vice in this practice is the creation of a record which does not show that the responding staff member was, in fact, aware of the significance of the information submitted; but perhaps that is less important than the loss of professional pride inherent in any such anthill process.

straint on lawyers and discourage them from making unnecessary requests for confidential treatment. If the Commission decides to experiment with this procedure, it might be well to require the lawyer seeking the conference to submit a conference memorandum to the staff within a few days after the conference so that the staff member participating in the conference will have some assurance that there was no unfortunate misunderstanding with respect to the significance of his remarks at the conference.

There is some vague language in Rel. No. 4924 that should not be passed over without comment. The release repeatedly refers to making interpretative letters and no-action letters "*publicly available*" without indicating in any way what that means. It would be an outrage to do no more than to make such letters "publicly available" by placing copies thereof in the public reference room. If it is decided that such letters should be made "publicly available," they should be published periodically, preferably not more than once a month on a predictable date, as a release, as a separate bulletin by the Government Printing Office, or as part of the SEC News Digest. Of these three, it seems to me that separate publication as a bulletin by the Government Printing Office (perhaps quarterly) would be preferable, although publication from time to time in the manner illustrated by I.C. Rel. No. 5510 (Oct. 8, 1968) would be satisfactory.

Release No. 4924 sets forth the following as an objection to making interpretative and no-action letters "publicly available":

> "* * * the danger also exists that undue significance might be attributed to the positions reflected in no-action and interpretative letters by persons overlooking the context in which they were given, particularly if all relevant facts are not included or policy considerations are not articulated. Some persons also might not appreciate the fact that not all no-action letters reflect an interpretation of the statute or rules, since in some instances no interpretation is involved but merely in the expression of a judgment with respect to conforcement policy."

Federal securities law is a fairly complicated matter with respect to which careful laymen might prefer to seek the advice of counsel. Those who do not are in far more danger of misunderstanding the statutes and the regulations than they are of misunderstanding staff letters. In brief, in speaking of "some persons not appreciating the significance of staff letters, the Commission is, in substance, speaking primarily of the practicing bar, and the fair inference to be drawn from the above quoted statement is that there is a danger lawyers are more apt to give incorrect advice if they have access to staff letters than if they are wholly ignorant of the content of such letters. I don't believe the five Commissioners, whatever their private views may be, would wish consciously to invite any such inference.

Release No. 4924, without direct attribution, quotes the Chairman as saying:

> "A no-action letter may, in fact, be an interpretation of the statute; most often, however, it is something entirely different. It may be a policy decision in a particular case, after considering the priorities and problems before the agency, the manpower available [and] the effects on the public . . . , whether it is necessary to crank up a proceeding if someone should proceed in the manner suggested."

The quantitive implications in that quotation do not really allow for the fact that quite frequently interpretations masquerade as no-action letters, and on

occasion with unfortunate results. The no-action letter actually has been, in many instances, in the past a technique for avoiding decisions or for performing the necessary analysis to be assured that the conclusions reached are legally sound. I would hope that a revision of policy leading to the publication of staff letters would lead to a decrease in the number of no-action letters which are in fact interpretations masquerading as policy decisions and to a more effective articulation of the legal theories involved.

Release No. 4924 quotes Professor Kenneth Culp Davis as stating that "* * * some of the most important law of the SEC is embodied in this big batch of no-action letters. This is law. The interpretations are law." The quoted comment was made by Professor Davis at the Panel Discussion on the Public Information Act and Interpretative and Advisory Rulings on April 7 and 8, 1967 (20 Admin. L. Rev. 1, 29). The Commission goes on to state in Rel. No. 4924 that it "* * * does not agree that this much significance should be attached to the views expressed by the staff * * *." This is a substantially milder statement than the response made by the Chairman of the Commission to Professor Davis at the aforementioned panel discussion:

> "This is not secret law. It is true however it may be lore, l - o - r - e, but it is not law, 20 Admin. L. Rev. 1, 29 (1967)".

I doubt there is anything in the history of Anglo-American law or in the history of the Securities and Exchange Commission that would tend to support the proposition that such letters are not law. Interpretative letters are law in much the same sense as an opinion of the Attorney General or a decision by a District Court of the United States is law. The important point is the degree of authority inherent in an interpretative letter. They are not perhaps as authoritative as a District Court opinion or even an opinion of the Attorney General. They are not binding on the Commission or the staff in subsequent cases. The Commission and the staff should not and do not hesitate to overrule those letters that experience demonstrates to have been erroneous or unwise. Certainly and obviously such letters are far less authoritative than opinions issued by the Commission in formal proceedings. All of these limitations should be obvious to lawyers who find administrative law a part of their practice. In fact, it would not be demanding too much to expect lawyers also to understand that opinions issued by the Commission in formal proceedings (e.g., the *Unity Gold* opinion, 3 SEC 618 [1938] or the *duPont* opinion, 34 SEC 531 [1953]) cannot be effectively overruled by no-action letters emanating from the Division of Corporation Finance or the Division of Corporate Regulation.

In brief, it is hoped the Commission will adopt a definite policy of publishing significant interpretative letters; that it will be highly selective in such publication; that such policy will lead to a substantial decrease in the number of applications for interpretative or no-action letters; that the decrease in this part of the workload will result in a substantial improvement in the quality of interpretative letters including incorporation therein of some traces of the legal reasoning connecting the facts with the conclusion; and that the controversy over the question whether such letters are "law" will effectively impress the Commission and its staff with an awareness that the staff lawyers preparing these letters are performing an essential and important judicial function in responding to applications.

Very truly yours,
/s/ Robert E. Hone.

APPENDIX D

WILLIAM B. MATTESON
Chairman
320 Park Avenue
New York 10022
PL 2-6400

THE ASSOCIATION OF THE BAR
OF THE CITY OF NEW YORK
42 West 44th Street
New York 10036

Committee on Securities Regulation

October 31, 1968.

Securities and Exchange Commission
500 North Capitol Street, N.W.
Washington, D.C. 20549

Securities Act of 1933
Release No. 4924

DEAR SIRS: This letter is submitted by the Committee on Securities Regulation of the Association of the Bar of the City of New York in response to the "Request for Comments on Whether Staff Interpretative and No-Action Letters Should be Made Available to the Public," as contained in the above-mentioned Release.

The Committee on Securities Regulation represents a large segment of that portion of the Bar of the City of New York which deals on a regular basis with the Commission and its staff. As such, the members of the Committee are keenly interested in maintaining and developing channels of communication with the Commission and its staff in order that they may more effectively advise and protect their clients. In the past, informal interpretative assistance by the staff of the Commission has been most helpful in this regard, and the Committee would be opposed to any change in practice which would inhibit or cut down this assistance in the future.

In general, it is the consensus of the Committee that there is no general dissatisfaction with the present practice of issuing interpretative and no-action letters on a non-public basis. Moreover, the publishing by the Commission from time to time of releases on significant interpretative or policy questions, or summarizing in general interpretations given by members of the staff, or dealing with policies and procedures pursued by the staff in administering the Federal securities laws, has been of great value. We note with interest the statement in Release No. 33-4924 that this policy will be "increasingly pursued" in the "months ahead." However, we strongly urge that whenever possible or appropriate an opportunity be given to the members of the bar and to the public to review and comment on any releases of general interest before they are adopted.

In the opinion of the Committee, the drawbacks of publication of interpretative and no-action requests and replies outweigh the possible advantages to be gained from such publication. Thus, the Committee would be against making interpretative and no-action letters generally available to the public.

On the other hand, the Commission might consider, in conjunction with stepping up its program of issuing general releases, the issuance from time to time of releases summarizing some of the factual situations presented and interpretations and positions taken by the staff in significant past interpretative and no-action letters (without disclosing identifying facts or names). If this is done, we would hope that it would include positions which were favorable as well as unfavorable to the applicant. In this way, some of the more important and perhaps more helpful examples of positions taken by the staff

could be made known without running into the difficulties and problems arising from publishing all letters indiscriminately. (The Commission may, to some extent, have anticipated this suggestion, as indicated by Investment Company Act of 1940 Release No. 5510, issued October 8, 1968).

While we think the Release touches on the major considerations pro and con publication of interpretative and no-action letters, it may be helpful to refer to those that in our view militate most strongly against a change in the Commission's practice.

Interpretative and no-action letters from the Commission containing rulings on specific facts by the staff of the Commission will often be confusing and misleading unless tempered with many more caveats and much more reasoning than normally is found in interpretative and no-action letters from the staff. Moreover, there is no question in our mind that "writing for the public" would not only inhibit requests but justifiably inhibit the number of cases in which the Commission would be willing to issue replies. From the applicant's point of view, we feel strongly that many business transactions could not be the subject of an interpretative or no-action request if the facts automatically became part of the public domain. Moreover, the facts detailed in a no-action letter may not be those which the individuals involved (including those not involved in the application) want, for personal reasons, to receive wide publicity.

We agree that interpretative and no-action letters are presently effective methods for assisting the bar and the public and for administering the laws by the Commission. We agree that a denial of a no-action letter or an adverse interpretation will inhibit action contrary to such advice as the parties involved are put on notice that they will face opposition by the Commission. Moreover, if litigation subsequently develops, the fact of prior negative advice from the staff of the Commission will undoubtedly influence the court in making its decision. Any change in practice which would decrease the opportunities of the Commission to pass on fact situations before they happen would, in our view, be detrimental.

We do not believe that the non-public nature of these letters violates any concept of fairness in dealing with the public. All members of the public are equally in a position to ask for an interpretative or no-action letter. As to apprising the public and the bar of the law, we would rather rely on the Commission (often upon the urging of private practitioners and bar association committees) to publish general statements of policy and interpretations where they are needed or would be helpful. In our view this should be adequate to disclose the "law."

We do not agree that publication of the letters will make people more candid in setting forth the details of a transaction. Quite the contrary, we would think that lawyers would be constantly pressed by their clients to disclose no more information than is absolutely necessary, if the information disclosed was automatically made public. No client likes to see his private business dealings spread over open documents or in the newspapers.

As to work load, it has always been within the discretion of the staff of the Commission to refuse to issue interpretative or no-action letters. We think it is within the discretion of the Commission to discourage requests where they are unnecessary. Administratively, the Commission might want to consider simplifying the form of its reply to requests by such devices as not restating the facts contained in the request letter. Publication of interpretative or no-

action letters would, in our view, only increase the burden on the Commission as the wide dissemination of such letters would demand much more in the letters in the way of reasons for the Commission's position than is now often included in such letters.

We do not consider a delay in publication to be an answer as the private nature of some of the inquiries does not always change with time. Moreover, the suggestion to cull identifying facts and names out of the correspondence would not only be tremendously time consuming for the staff, but could be very misleading in the final product.

To summarize, the Committee is of the opinion that on balance the publication of interpretative or no-action requests might well destroy the useful channels of communication now open between the staff of the Commission and the bar and the public. Moreover, it would tend to reduce the flexibility of the staff's administration of the law and its ability to deal with the many difficult and diverse questions presented to it. Thus, we urge the Commission to adhere to its long-standing practice of non-publication of interpretative and no-action letters.

Respectfully submitted,
/s/ WILLIAM B. MATTESON
Chairman.

APPENDIX E

MEMORANDUM IN RESPONSE TO LETTER OF JULY 8, 1968, FROM WARNER W. GARDNER RE NO-ACTION LETTERS

1–2. *Volume of business and complexity or difficulty of issue.*

No precise statistics are kept of all no-action letters. The great bulk of these is issued by the Division of Corporation Finance, which estimates that these letters are currently being issued at the rate of approximately 5,000 per year (in that Division letters rarely take the form of an interpretation as such). The Division of Corporate Regulation sent out approximately 640 letters of interpretation or no-action letters during fiscal 1968, of which less than 20% were no-action letters. That Division also estimates that during that period it has given as many as 4,000 telephone responses to inquiries involving interpretations of various sections of the acts and rules and regulations thereunder. The Division of Trading and Markets has issued approximately 400 interpretations and no-action letters during the past fiscal year. Inquiries as to interpretations are also answered by our regional offices, but these normally relate to generally well-settled interpretations and rarely take the form of a no-action position.

The issues involved range from relatively simple questions that can be answered in a matter of moments to questions involving highly complex facts and extremely troublesome problems. Because of this, case load figures would probably not be very meaningful and for the most part no such statistics have been kept.

3. *How the matter arises.*

There is no statutory requirement that the Commission's staff provide members of the public with no-action letters. As a public service, however,

the staff provides such letters upon request by members of the public for *ad hoc* determinations of whether, with respect to the particular facts presented, the staff will or will not recommend enforcement action to the Commission.

4–5. *Basis of action and availability of sources therefor.*

No explanation of favorable action is usually sought or given and normally no more than a very general explanation, if any, is given for unfavorable action. No-action requests are granted or denied on the basis of the staff's interpretation of the statutory provisions and rules involved, relevant court and Commission decisions, and Commission releases to the public. In addition, consideration is given to the position taken in previous no-action letters and whether or not there appears to be a possibility of injury to the investing public if the proposed activity is undertaken. Except for the latter two categories, all of these sources, of course, are available to the applicant.

From time to time the Commission has made public interpretative summaries of particular areas of the securities laws. See examples attached. In the past it has been felt that it was not feasible to make no-action letters publicly available. Normally it was believed that the applicant felt the facts contained in his request would be treated as confidential, and in some instances disclosure of the information might have an unwarranted effect on the stock market. Moreover, taken out of context the no-action letter in some instances might be misleading; and if the letter had to be made public, there might be greater delay in its issuance in order to include additional background material that might be deemed necessary to eliminate possible misunderstanding. Similar considerations it has been felt apply to digests of such letters that have been kept for staff use. Another consideration in not making no-action letters public has been the belief that these letters assisted in enforcement of the statutory provisions by advising the staff in advance of activities that might be questionable; if the letters were to be made public, it was feared this procedure might be discouraged.

The Commission is about to undertake, however, to publish for public distribution on a periodic basis summaries of the more important staff rulings. In addition, the Commission is giving active consideration to the possibility of making future letters responding to no-action requests public.

A comprehensive digest of past staff rulings does not appear to be feasible, since indices now used by the staff are at best helpful only if the letters referred to are available and because the manpower required to make a useful public digest could be spent on much more important things.

6. *"Evidence" on which staff acts.*

In reaching its decision on a no-action request, the staff normally relies on the material submitted by the applicant. If the staff is in possession of reliable information which raises a question as to the good faith of the applicant, it may refuse to give a no-action letter and may or may not advise the applicant of the reason for such refusal, depending upon whether or not there is a pending investigation.

7–9. *The process of decision and review procedures.*

A recommendation in a no-action matter is normally initially drafted by a staff attorney and is then reviewed by one or two senior staff members.

The final decision on a no-action request is reached by staff members at the senior staff level (GS–14, –15 and above, often the division's chief counsel).

In effect, the Commission has provided for a limited review on its own motion in a no-action matter through standing instructions to the staff that novel matters or questions involving important policy determinations are to be referred to the Commission, along with a recommendation of the referring division. Upon receiving unfavorable advice from the staff on a no-action request, the applicant may always request that the matter be referred to the Commission for a review by it, on policy or legal grounds, of the determination reached by the staff, and the Commission will, on occasion, review the matter. The Commission might reach its decision immediately or might require several weeks.

The applicant normally presents his views to the staff by letter; but, at the applicant's request, this may be supplemented by a conference prior to the staff's determination.

The length of time required to reach a decision ranges from several minutes to several months—depending upon the difficulty of the questions involved, whether the issues presented are so novel or complex that the staff deems it appropriate to advise the Commission of the disposition the division proposes to make, and any attendant urgency.

Attempted intercession by members of Congress is very rare.

8. *Attitude of decider.*

The no-action letter procedure is used to assist persons to comply with the law in prospective transactions, to discourage unlawful transactions, and to assist in effectuating transactions that do not appear to be contrary to the intent of the statutes and rules. With respect to a particular request, any or all of these considerations might be involved.

10. *Availability of judicial review.*

No judicial review is available from the denial of a no-action request, as such, because the denial is essentially the informal advice of the staff that should the applicant undertake the proposed activity the staff may recommend that the Commission take enforcement action. While it is by no means clear, it has been held that the Commission may grant a declaratory judgment with respect to the type of question that often arises in a no-action request.[5] Except in rare situations the Commission is not required to do so,[6] but if it should, there would, of course, be judicial review. Otherwise the position of the staff could be tested only by an enforcement action brought by the Commission should the applicant ignore the staff's advice.

11. *Formulation of staff advices into regulations.*

In view of differing facts involved in each no-action request, it is often impossible to formulate meaningful regulations that will take care of such matters; but where particular questions are frequently presented for no-action

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[5] U.S.C. 554(e) [formerly Sec. 5(d) of the Administrative Procedure Act]; *First Savings & Loan Association of the Bahamas, LTD.* v. *Securities and Exchange Commission,* 358 F.2d 358, 360 (C.A. 5, 1966). But see *Attorney General's Manual on the Administrative Procedure Act* 59 (1947).

[6] Certain statutes administered by the Commission provide for declarations of status. See, *e.g.,* Public Utility Holding Company Act of 1935, Sec. 2(a)(7)(B).

consideration, if possible the advice generated by the question may be formulated into a regulation.

APPENDIX F

For release Friday, September 20, 1968

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C.

SECURITIES ACT OF 1933
Release No. 4924

SECURITIES EXCHANGE ACT OF 1934
Release No. 8410

HOLDING COMPANY ACT OF 1935
Release No. 16166

TRUST INDENTURE ACT OF 1939
Release No. 253

INVESTMENT COMPANY ACT OF 1940
Release No. 5494

INVESTMENT ADVISORS ACT OF 1940
Release No. 229

REQUEST FOR COMMENTS ON WHETHER STAFF INTERPRETATIVE AND NO-ACTION LETTERS SHOULD BE MADE AVAILABLE TO THE PUBLIC

There have recently been suggestions made that interpretative advice and "no-action" letters provided by staff officials of the Commission to inquiring persons should be made publicly available.[7] The Commission has been weighing the advantages and disadvantages of following such a procedure and would appreciate receiving the comments of interested persons.

Initially, the Commission notes that under its interpretation of the Public Information Act, 5 U.S.C. 552, this information is not required to be made public. That Act requires "those statements of policy and interpretations which have been adopted by the agency" to be made available for public inspection and copying, 5 U.S.C. 552(a)(2)(B), and provides generally that identifiable records of an agency must promptly be made available to any person upon request, 5 U.S.C. 552(a)(3). The Commission has by rule described the means by which the Commission itself may, in its discretion, provide informal policy and interpretative statements upon request, but has made clear that "opinions expressed by members of the staff do not constitute an official expression of the Commission's views. . . ." 17 CFR 202.1(d). Furthermore, the rule adopted by the Commission to implement the Public Information Act, in reliance upon an exemption from its provisions, 5 U.S.C. 552(b)(4), at present provides that "[t]rade secrets and commercial or financial information obtained from a person and privileged or confidential,

[7] See, Remarks of Professor Kenneth Culp Davis, Panel Discussion, Public Information Act and Interpretative and Advisory Rulings, 20 Admin. L. Rev. 1, 28–29 (1967); Report of Committee on Public Information, 5 Annual Reports of Committees, Section of Administrative Law, A.B.A. 74 (1968).

including . . . [i]nformation obtained in connection with interpretative letters or no-action letters which is deemed to have been submitted in confidence unless the contrary clearly appears" will not generally be published or made available to any person. 17 CFR 200.80(c)(4).

We also note that the Commission has an established policy of publishing from time to time releases which state its views or those of responsible members of its staff with respect to significant interpretative or policy questions arising under the Acts which it administers, or reflect and summarize interpretations which have been issued by the staff with respect to various matters, or state the procedures and policies pursued in the administration of various aspects of the Federal securities laws. It is intended that this policy will be increasingly pursued in the months ahead, regardless of what decision is ultimately reached with respect to the availability of staff interpretative and no-action letters.

The informal advice given by members of the Commission's staff to the public frequently takes the form of interpretative letters and no-action letters.[8] The former, of course, are opinions of the application of the law to contemplated factual situations. In a no-action letter, an *authorized* officer of the Commission's staff may state with respect to a specific proposed transaction that the staff will not recommend to the Commission that it take enforcement action if the transaction is consummated exactly as it has been described.[9]

In the past, neither interpretative letters, no-action letters, nor the inquiries upon which they have been based have generally been made available to the public. In part, this policy has been based upon a belief that a member of the public should be able to obtain the advice of the Commission's staff without fear that information provided to the staff for that purpose might be made public in a manner that might adversely affect his lawful business activities or invade his personal privacy. Untimely disclosure of information might also prejudice the interests of others and in some instances could have an unwarranted impact upon the public securities markets. The willingness of the staff to state its position with respect to particular proposed transactions has undoubtedly promoted compliance with the statutes by reducing uncertainty and by deterring persons from consummating transactions which they might otherwise proceed with in the mistaken belief that no enforcement action would be called for. If fear of public disclosure should reduce the flow of requests for such letters, certain of these benefits might be lost. The danger also exists that undue significance might be attributed to the positions reflected in no-action and interpretative letters by persons overlooking the context in which they were given, particularly if all relevant facts are not included or policy considerations are not articulated. Some persons also might not appreciate the fact that not all no-action letters reflect an interpretation

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[8] Part 202 of Title 17 of the Code of Federal Regulations describes the informal and other procedures that may be employed by members of the public in dealing with the Commission. Section 202.2 pertains to prefiling assistance and interpretative advice, noting that inquiries may be directed to an appropriate officer of the Commission's staff.

[9] "A no-action letter may, in fact, be an interpretation of the statute; most often, however, it is something entirely different. It may be a policy decision in a particular case, after considering the priorities and problems before the agency, the manpower available [and] the effects on the public . . ., whether it is necessary to crank up a proceeding if someone should proceed in the manner suggested." Panel Discussion, Public Information Act and Interpretative and Advisory Rulings, 20 Admin. L. Rev. 1, 24 (1967).

of the statute or rules, since in some instances no interpretation is involved but merely the expression of a judgment with respect to enforcement policy.

On the other hand, it has been stated that "it would seem anomalous that an agency which embraces disclosure as a fundamental philosophy should adopt a flat non-disclosure policy with respect to administrative determinations it generates," [10] and it has been contended that ". . . some of the most important law of the SEC is embodied in this big batch of no-action letters. This is law. The interpretations are law." [11] While the Commission does not agree that this much significance should be attached to views expressed by the staff, it may nevertheless be true that practitioners might find these letters helpful, even if available in a modified form, as, for example, with identifying details deleted. Further advantage of public disclosure may result from the fact that some persons may be less than candid in purporting to provide the complete and accurate information requested by the staff; if a procedure were adopted by which all requests for no-action and interpretative letters were made public in the form in which received, it is argued that this would be less likely to occur. Another possible advantage of public disclosure might be that of discouraging unnecessary requests. The Commission's staff has been faced with a growing volume of requests for no-action and interpretative letters and has found it increasingly difficult to devote to each the degree of analysis it deserves. It may be that the informal advisory procedures are increasingly being employed by attorneys as a substitute for their own examination of applicable precedents and other materials from which an attorney may and should be able to draw his own conclusions without imposing upon the time of the Commission's staff and that in such situations public disclosure of their requests might serve to discourage them. It is argued, however, that even full public disclosure may not be considered too high a price to pay for the expert views of the staff on novel questions of law or on the application of existing principles to novel or unusually complex factual situations.

In light of the foregoing factors, it appears to the Commission that the legitimate concerns that suggest the necessity for public disclosure on the one hand and those which on the other hand would seem to militate in favor of the present policy of non-disclosure are largely related to interests of members of the public. Indeed, an attorney who may today seek the fullest possible access to statements previously made by the staff to other persons, as well as the facts upon which they are based, may tomorrow vigorously resist public disclosure of the facts related to his own client's inquiry. From its viewpoint, the Commission is satisfied that neither administrative necessity nor convenience compels either adherence to or rejection of the present policy of non-disclosure.

An approach that has been suggested to, and which is under consideration by, the Commission would be the public disclosure of all interpretative and no-action letters, and the requests to which they respond, but only after an appropriate length of time has elapsed—such as two or three months. It is argued that this would eliminate the possibility in many cases of a premature public disclosure of the facts involved in the re-

[10] Report of Committee on Public Information, 5 Annual Reports on Committees, Section of Administrative Law, A.B.A. 74, 78–79 (1968).

[11] Remarks of Professor Kenneth Culp Davis, Panel Discussion, Public Information Act and Interpretative and Advisory Rulings, 20 Admin. L. Rev. 1, 29 (1967).

quests when such disclosure might adversely effect significant lawful interests and might thus permit full and unabridged disclosure of both inquiry and response. Such a procedure could be made flexible to provide that disclosure in an appropriate case could be accelerated or delayed.

This approach would assure the fullest practicable disclosure of useful information and would have the additional advantage of ease of operation—a significant factor at a time of budgetary limitations and manpower reductions. Those benefits would be obtained, however, by denying confidential treatment to persons seeking advice in all but the most exceptional cases—a result which, it is argued, may significantly impair the usefulness of the informal procedures to members of the public.

As indicated above, consideration has also been given to the possibility that the inquiries received from members of the public might be retained in confidence while the no-action or interpretative letters written by the staff are made available with identifying details deleted. But it would appear that such an attempt to afford confidential treatment may, at considerable cost, render meaningless if not affirmatively misleading the edited staff responses.

To some extent, no-action requests stem from uncertainty as to the correct legal answers to particular problems. Some measure of uncertainty is inevitable in the application of general propositions to concrete cases. The Commission has in the past attempted through rule making and other efforts to reduce the extent of the area of uncertainty. At the moment, a broad study of disclosure policy is underway at the Commission. It is hoped that these steps will, in time, reduce the need for no-action letters in particular fact situations.

All interested persons are invited to submit their views and comments, in writing, to the Securities and Exchange Commission, Washington, D.C. 20549, on or before November 1, 1968. Such communications will be considered available for public inspection.

By the Commission.

ORVAL L. DUBOIS
Secretary.

APPENDIX G

COMMENTS OF STAFF OR COMMISSION DEMONSTRATING RELIANCE UPON INTERNAL PRECEDENTS IN STAFF MEMORANDA TO THE COMMISSION OR COMMISSION MINUTES ON NO-ACTION MATTERS

Minute date:	(*Blanks substituted for identifying details.*)
6/5/67	"Action was deferred, it being understood that the staff would prepare a memorandum for the Commission's consideration setting forth the facts and circumstances involved in previous cases of this type where 'no-action' letters had been granted." (Commission minute.)
5/15/67	"Based upon the opinion expressed in our letter regarding _____ Stock (memorandum dated July 19, 1966 and Commission minute dated July 21, 1966) and similar cases the Division recommends that the request for a 'no-action' letter be granted." (Staff memo of 5/10/67 in connection with Commission minute of 5/15/67.)

6/12/67 Request for exemption from prospectus delivery requirements: "The Commission approved similar requests for exemption from the requirements of Rule 425A and Section 4(3)(B) in connection with the following registration statements: [Listing 9 cases under various file numbers.] (Staff memo.)

6/19/67 (*From commission minutes*):

"Mr. Michaely reviewed the circumstances of the request for the 'no-action' letter, as set forth in the Division's memorandum of June 7, 1967; expressed concern over the precedential effect which a 'no-action' position in the instant case might have, but indicated that he would not recommend a Court action to enjoin a sale; and stated that, under the particular circumstances of the case, the Division proposed to advise counsel for the trustees that, if they wished to withdraw the request for a 'no-action' letter in the matter, they should proceed to do so and the request would be deemed withdrawn."

8/15/67 "The question was presented whether the recipients of the _____ shares would be free to sell the stock without registration under the Securities Act of 1933 pursuant to provisions of Rule 133 thereunder. The Commission declined to authorize the issuance of further 'no-action' letters in situations such as this pending a reconsideration of past rulings and interpretations in this area and the issuance by the Commission of further or amended rules."

9/7/67 "We believe that the instant request may be distinguished from the recent no-action request of _____, former Board Chairman and President of _____ Corporation which was denied by the Commission on April 3, 1967, upon recommendation of this Division. [Goes on to distinguish on question of control] (Staff memo, September 4, 1967.)

Same Case "Unlike the _____ situation adequate information concerning _____ is in the public domain as the company is subject to FCC jurisdiction and files periodic reports with this Commission pursuant to Section 13 of the Sec. Ex. Act." (Staff memo, September 4, 1967).

9/13/67 Commission's comment after accepting Division's recommendation of denial: "However, the Commission indicated that it does not necessarily accept the arguments as articulated in the memorandum, particularly the discussion with respect to mergers." (Commission minute.)

11/8/67 "The Division and the Commission have generally taken the position that when an individual who has purchased securities for investment subsequently dies, a sale of such securities by his estate is not inconsistent with the decedent's investment intent . . . 1 [Footnote].

Footnote 1 reads:

[1] In Estate of _____, Commission Minute July 23,

1962, and Estate of _____, Commission Minute February 4, 1963, upon the Division's recommendation, the Commission held *inter alia*, that death was a change of circumstances sufficient to justify the sale by the decedents' estates of securities which the decedents had acquired for investment." (Staff memo.)

11/27/67 On presentation of *general counsel* Commission approved "no-action" position (rather than requested declaratory order)—reluctantly in view of some conflict with *Guild Films. Then* said:

"This determination should not be taken as a reflection of the Commission's position in other similar situations not involving pre-*Guild Films* undertakings and commitments." (Commission minute.)

12/22/67 "The Commission has approved numerous similar requests for exemption from the requirements of Rule 425A and Section 4(3)(B) in connection with registration statements of various Canadian governmental filings." (Staff memo.)

1/22/68 "The same questions that are presented by this request were last considered by the Commission on August 17, 1964, in connection with the request by _____ Company for a no-action letter covering a proposed sale of . . . ."

"In [that] matter the Division took the position that the shares were an unsold allotment and consequently could not be publicly sold, except in compliance . . . [with registration and prospectus requirements.]"

"The Commission approved the Division's recommendation that the request for a no-action letter be denied. (See Division's memorandum dated August 13, 1964 and Commission minute dated August 17, 1964.) . . .

"The circumstances relating to the proposed sale of the _____ stock were similar to the circumstances presented by the present request." [Goes on to cite fact comparisons.] . . .

"The Division had recommended that the requests by _____ be denied, citing the Commission's position in the _____ case. In the Commission minute dated March 25, 1965, the Commission indicated, however, that these two cases might be distinguished from the "underwriter-unsold allotment" category and suggested that consideration should be given to the formulation of a general policy, perhaps setting forth conditions relating to the granting of such requests. The staff was instructed to give further consideration to those requests and to the overall question and to report to the Commission later."

"On April 13, 1965, the Division submitted a memorandum in which it stated that it had considered the questions and concluded that it would be difficult to draft

standards of general applicability to these situations. The staff also expressed the view that adoption of general standards would sacrifice a measure of administrative flexibility and recommended that for the time being each request be considered on an individual basis." (Staff memo, 1/17/68.)

APPENDIX H

Factors To Be Analyzed in Studying and Comparing No-Action Matters Presenting the Application of the Concept of "Changed Circumstances"

1. Company name.
2. Party originating the request and party proposing to sell stock.
3. Lawyer: Name and location.
4. Number of shares to be sold; present price and trading volume.
5. Number of shares personally owned. Number of shares controlled with others.
6. Total number of shares outstanding and other facts relating to possible control by applicant or by person from whom he acquired the stock.
7. Date of acquisition of the stock to be sold. Date of the letter requesting a no-action letter. Date of other acquisitions of stock of the same class.
8. Holding period to date of no-action letter.
9. Manner of acquisition of the stock to be sold. Was stock subject to a formal investment restriction?
10. Proposed manner of disposition.
11. Claimed "special circumstances" and extent of detail provided.
12. Substantiation, if any, of claimed special circumstances.
13. Staff processing:
    (a) Whose signature on the responding staff letter? Which staff attorney originated it?
    (b) Does the file reflect a file search? Which files were searched? Results?
    (c) Further staff fact inquiry made? How? What facts sought?
    (d) Further written statements received from applicants? Recorded oral statements?
    (e) Written submission on legal issues?
    (f) Date of the original inquiry? Date of final staff response?
14. Factors expressly stated in the staff response as affecting the determination:
    (a) Facts
    (b) Interpretation
    (c) Conclusions
15. Additional factors appearing to affect the determination but not expressly stated in staff response.
    (a) Implication
    (b) Expressly stated in file, but not stated in response?
16. Date that reconsideration sought? How communicated?
17. Grounds urged for reconsideration?

18. Processing of reconsideration: applicable items 1–15 above.
19. Manner of reconsideration sought? (Staff? Commission?)
20. Date brought to the Commission?
21. Form of Commission consideration requested? (Hearing? Written submission?)
22. Form of Commission consideration given? Date?
23. Disposition recommended by staff? Grounds for that recommendation?
24. Commission disposition? Date?
25. Grounds stated by Commission for disposition? Indicate views towards grounds recommended by staff?
26. Any unstated grounds appear to have affected the disposition?

APPENDIX I

The following questionnaire was submitted to 43 staff attorneys in the Division of Corporation Finance. Probably because of the length and complexity of the questionnaire, only ten replies were received. Five of the replies were from attorneys who had been handling no-action matters for one year or less, and three were from attorneys with experience of six months or less. On the other hand, four responses came from attorneys with experience ranging from 18 months to 3½ years. In view of the relative instability of the force of attorneys in the Division as a whole, this is probably a satisfactory cross-section.

While some responses seemed so conflicting or inconclusive as to render them unreliable, many of the other answers seemed worth analyzing and recording. Those considered unreliable are left blank on the following form; but summaries or averages of the more reliable answers are inserted in, or follow, the appropriate blanks. Where the variations in the answers of the more experienced staff attorneys seemed possibly significant, their answers are separately averaged and recorded in parentheses following the cumulative report of all responses.

The staff attorneys were invited to comment on the fairness or effectiveness of the no-action process, and five respondents supplied comments, which are reproduced following question number 31.

ADMINISTRATIVE CONFERENCE OF THE UNITED STATES
726 Jackson Place, N.W.
Washington, D.C. 20506

May 16, 1969.

QUESTIONNAIRE RELATING TO THE ADMINISTRATIVE PROCESSES OF THE DIVISION OF CORPORATION FINANCE IN HANDLING "NO-ACTION LETTERS"

(Submitted on behalf of the Administrative Conference of the United States by William J. Lockhart, consultant to the Conference)

INTRODUCTION

The Administrative Conference of the United States is a Federal administrative agency established by statute (5 U.S.C.A. §§ 571–576) "to study the

efficiency, adequacy, and fairness of the administrative procedure used by administrative agencies" and to make recommendations to those ends.

A Committee of the Conference has undertaken a few test studies in the area of informal procedures, among which is a study of the Division's procedures in rendering interpretive advice, focusing primarily on "no-action" letters. This study, together with information developed in interviews and examination of files, will ultimately form the basis for recommendations to the Administrative Conference, and presumably by it to the Securities and Exchange Commission. It may also form the basis for broader recommendations to other agencies relating to their advisory processes.

The following questions are designed to obtain the views of the branch attorneys on the processing of no-action letters and other interpretive advice by this Division. The questions relate to both oral and written requests for interpretive advice, with the major focus on the processes resulting in the rendition of "no-action letters." However, with stated exceptions, the inquiry *excludes* advice given in connection with the processing of registrations, proxy statements or '34 Act reports.

Except where otherwise specifically indicated, questions concerning "no-action letters" or "no-action requests" refer to the process of rendering written advice respecting the position the staff would take if stock were sold without registration under the Securities Act. This, of course, is somewhat broader than the mere question of "may I sell" because it encompasses advice on such questions as private offerings, intra-state exemptions, and the like which also are routed through the office of the Chief Counsel of the Division.

The time necessary to respond to this questionnaire should be approximately an hour. Most questions call only for percentage estimates based on your own experience; no specific count is requested. Where questions range beyond matters in which you generally have first-hand experience, your best judgment is nonetheless requested, *but please circle the response.* In some instances different questions are designed to deal with a single problem; in those cases your tolerance is solicited.

Responses will be kept fully confidential, though the full substance of the responses will be compiled and reported. Because further discussion of problems raised by your responses may be helpful, you are invited to sign your name; but if you prefer to remain anonymous, your completed questionnaire will still be most helpful. Merely return the completed questionnaire by mailing it in the enclosed, franked envelope to the undersigned.

The Chief Counsel of the Division has approved the distribution of the questionnaires, but his approval implies no endorsement of the questions. Responses, of course, are voluntary, but will be of great assistance in making an informed appraisal of the process. I would appreciate receiving your response not later than June 9, 1969.

Thank you for your thoughtful assistance.

WILLIAM J. LOCKHART
College of Law
University of Utah
Salt Lake City, Utah 84112.

Name _____.

1. Approximately how long have you been employed in a position involving some responsibility in the "no-action" process? _____.

2. Approximately how many written responses to no-action requests do you prepare per month? 18.
3. How many written statements of interpretive or general advice *other than* no-action letters (and excluding registration matters) do you prepare per month? few.
4. How many requests for oral interpretive advice (excluding registration matters and inquiries relating to pending no-action letters) do you respond to per month? few.
5. Please provide your best estimate of your allocation of time to the following functions:
   (a) Analysis of registration filings, '34 Act reports, proxy materials, and letters of comment. 62%
   (b) Oral or written advice relating to (a). 7%
   (c) Preparation of no-action letters, other interpertive statements, and oral advice on matters other than those involved in (a) and (b) above. 21%
   (d) Other funtions? (Please indicate generally) 3–6%

   _____
   _____
6. What proportion of the requests for oral advice (*excluding* registration and '34 Act matters *and* pending no-action letters) do you make a record of? _____%. How and where recorded? _____. _____ No consistent practice _____. _____.
7. In what proportion of *the requests for oral advice* (*excluding registration and '34 Act matters*) does your advice include approval or recommendation of a specific course of action?_____%. (Wide variation: 6=0%; 2=50%; 2=10+25%.)
8. In what proportion of *the requests for oral advice* (excluding registration matters) do you render specific advice about staff or Commission thinking on interpretive problems relating to statutes, rules, releases, or judicial or administrative precedents? _____%. (Similar wide variation.)
9. In what proportion of *the requests for oral advice* (excluding registration matters) do you find it necessary or desirable to confirm the position you take by research, followed by a return call? _____%. By discussion with your branch chief or with other branch attorneys? _____%. With attorneys in the office of the Chief Counsel? _____%. Others (specify) _____%.
10. In what proportion of the written no-action requests is it necessary to obtain supplementary material facts from the party? 24% From Commission files? 44%. By independent investigation? 3%(5). Other? _____ _____.
    (Please indicate source)
11. In what proportion of the written no-action requests are the facts submitted by the applicant materially inconsistent with facts available to the staff in Commission files? 2%.
12. Give your best estimate of the proportion of the requests for no-action letters that are instigated as a direct result of the refusal of a broker or transfer agent to execute a transaction without such a letter? 49%. (41%)
13. What proportion of the written no-action requests *expressly state* the specific legal or interpretive questions which, in the applicant's view, are critical to determining his request? 37%. In what proportion of those cases is the *stated* question *actually determinative*? 77%.
14. In what proportion of the no-action requests do the following kinds of questions play a decisive role?
    (a) Legal-interpretive questions concerning the meaning and boundaries of statutes, rules, releases, and judicial and administrative precedents? 32% (48%).
    (b) Partially-interpretive questions of "ultimate fact" essential to

resolving the no-action request. (E.g., "control"; "investment intent"; whether stock has "come to rest"; the "sufficiency of access" to information by private offerees, etc.) 50% (43%).

(c) Discretionary questions concerning: (1) the practicality of requiring the holder to obtain registration; (2) the need for registration for protection of investors; (3) the desirability of authorizing previous SEC violators to sell; (4) the urgency of the holder's need to sell; etc. 37% (45%).

15. In what proportion of the no-action matters are the *decisive* questions expressly identified in the correspondence between the applicant and the Commission staff? 41%.

16. In what proportion of the no-action matters are the *decisive* questions expressly identified in *discussions* with the applicant? 42% (61%)

17. Where the staff attorney prepares a recommended draft refusing the request to take a no-action position, in what proportion of *those* cases is the recommendation discussed with the applicant *before* it is submitted to the Chief Counsel's office for final review? 3%. Before the Preparation in the Chief Counsel's office? _____%. After receipt by the applicant?_____%. Never? approx. 95%

18. In what proportion of the cases involving refusal to take a no-action position are the applicants advised that council may *request* to be heard before the Commission? very seldom% (after Ever so advised except upon inquiry made by the applicant or inquiry) his counsel? no %

19. In what proportion of the cases involving refusal to take a no-action position are the applicants who seek a hearing advised that the staff will oppose such a hearing? _____%

20. In what proportion of cases involving refusal to take a no-action position are the applicants advised that it is possible for the staff to bring the matter to the Commission for review? very seldom %

21. In what proportion of the cases involving refusal to take a no-action position is the applicant advised that he may submit a written memorandum for Commission consideration? very seldom %

22. In what proportion of the cases involving refusal to take a no-action position do the applicants thereafter submit written memoranda for Commission consideration? very seldom % For staff consideration? _____%

23. In what proportion of the *requests* for no-action letters are the applicants advised that some adjustment of the proposed transaction will make it more likely that the staff will support a no-action position? very seldom % In what proportion is such an adjustment made? _____%

24. In what proportion of the requests for no-action letters is the recommended response, as prepared and submitted to the Chief Counsel's office by the staff attorney, supported by an explanatory or analytical memo? 5% In what proportion of the cases are the grounds for the response discussed orally between the staff attorney and a reviewing attorney in the Chief Counsel's office? 7%

25. In what proportion of the requests for no-action letters is the recommended response prepared by the staff attorney revised by the reviewing attorneys in the Chief Counsel's office on any substantive grounds? 4% In what proportion is the recommended result reversed? 4%

26. What proportion of the no-action requests present interpretive or substantive problems whose solutions would provide useful precedent for resolving future interpretive problems? 7%

27. Do you ever prepare interpretive summaries or memos reporting or analyzing problems resolved in responding to particular no-action requests? Yes 2 responses (Comment: "2 a year.") No 8 responses. How many have you prepared in the last month? 0 Six months? ___ Year?___

28. What distribution is usually made of such memos? _____

Research Source:	Proportion (%) of cases in which this is the exclusive source relied upon:	Proportion (%) of cases in which you check this source:	Proportion (%) of cases in which this sources is instrumental in resolving the no-action request:
(a) Monthly summary of interpretations.	%	1 response =20% 2 responses =5% 7 responses =0−%	%
(b) Card file of summaries of interpretations.	%	3=15−25% 3=5% 3=0−2%	%
(c) Legal memos originating in the office of the Chief Counsel or elsewhere in the Division (other than your own compilation).	%	%	%
(d) Your personally-compiled file of legal memos.	%	%	%
(e) Direct reference to previous no-action *letters* prepared within the Division (other than your own compilation).	%	1=40% 1=100% 2=5−10% 6=0%	%
(f) Direct reference to a personally-compiled file of previous no-action *letters*	%	3=60−70% 3=5−-10% 4=0%	%
(g) Any previous no-action *letters* as supplemented by information in the related company files.	%	4=75−100% 4=5−% 2=0%	%
(h) Memos to the Commission and specific Commission action reflected in Commission minutes (other than monthly summaries).	%	1=5% 1=20% 8=0%	%
(i) Discussion with reviewing attorneys in the Chief Counsel's office.	%	7=5% 3=0−1%	%
(j) Discussion with other staff attorneys.	%	3=20−40% 4=5−10% 3=0−2%	%
(k) Any other research sources not generally available to the public. (Please specify.) _____	%	%	%

29. In what proportion of the no-action cases do you find that your reservoir of experience is sufficient to enable you to prepare a response without research? 69% (87%)

30. In what proportion of no-action requests do you believe that the following considerations play a significant role in determining the staff's disposition? (Please indicate percentages *as a proportion of the instances in which the stated fact is present.*) (Two respondents did not answer)
(a) The fact that the stock in question may be of the same class as that registered in a recent registration? _____% 5=5–10%, 1=20%, 3=0%
(b) The fact that the company involved is a reporting company? _____% 1=0%, 4=5–10%, 2=15–25%, 1=60%
(c) The fact that the individual applicant may have been involved in an earlier SEC violation? _____% 4=70–100%, 4=0–2%
(d) The fact that the issuing company may have been involved in an earlier SEC violation? _____% 1=95%, 3=50–60%, 1=20%, 3=0–1%
(e) The fact that the company or the individual involved may currently be under investigation with respect to possible SEC violations? _____% 4=90–100%, 2=5%, 2=0–2%
(f) The fact that the individual seeking to sell without registration has a contractual claim entitling him to demand registration? _____% 1=80%, 2=20%, 2=2–5%, 3=0%
(g) The extent to which the stock involved is currently being actively traded? _____% 3=20–40%, 3=5–10%, 2=0–1%
(h) The fact that the stock involved is a relatively small proportion of the total stock of the same class currently outstanding? _____% 1=75%, 2=40–50%, 2=20%, 3=10%
(i) The fact that the dollar value of the stock to be sold is small? _____% 3=50=75%, 2=10–20%, 2=5%, 1–0%
(j) The urgency of the applicant's need to sell the stock in question? _____% 1=70%, 2=40–50%, 3=20–25%, 2=10–15%
(k) Other factors? (Please specify) _____
Length of holding period _____ 80–95%
_____ _____%

31. Your further comments about the fairness or effectiveness of the no-action or advisory processes are invited:

Respondent #4 (Experience—less than 1 year):

One of the most striking aspects of the no-action process in regard to fairness is what might be called the political facts of life. A little assistance from a Congressman or Senator will enable a good lawyer to permit almost any shareholder to sell his stock. The only exception which I have observed was a case of a man who wished to sell without any basis in law or fact, and at the time the company was under investigation by the Commission.

In regard to investigations, there seems to be a real distinction drawn between a formal SEC investigation and an informal one, even if the staff is fully aware that illegal actions have been taking place. The motivation basically has been that if the Commission should make some kind of public announcement in the near future about the company in question, the Division would look bad if it had permitted a sale to take place.

An interesting area of our procedure is "taking a letter to the Commission". This is done when the person who has requested a no-action letter is dissatisfied with the answer which he has received from the staff. What is involved at the staff level is the writing of a memorandum by an attorney. This is checked by the Chief Counsel's Office and sent to the Commission. Such memoranda are an added burden on a staff which is already considered overburdened. In addition, the members of the Chief Counsel's Office do not like to have the Commission

second-guessing their decisions unless they are positive about being affirmed. The result is that the mere threat of "taking a letter to the Commission" will enable the attorney involved to get his no-action letter which he would not have gotten otherwise. In regard to fairness, it is only persons employing sophisticated counsel who are able to avail themselves of this benefit.

I am afraid that the accuracy of your study may be diluted by the large number of routine letters which we process. Probably half of all the letters we receive are from stockholders who have held shares of stock for one to three years and now want to sell. The same legal issues are involved in most of these letters. To see how dilution of the results could come about, notice my answers to 27 (b) and (g). Both of these questions have similar answers. One reason they are similar may be that out of the total, including routine letters, they are both small. Theoretically, the answers should be equally accurate whether taken as a percent of total letters or as a percent of total letters minus the routine. In practice, this is not so. One cannot really remember whether a procedure takes place 5 or 10 per cent of the time. What is given is a rough estimate. In retrospect, my answer that I find both methods instrumental 5 per cent of the time is misleading. I find (g) instrumental far more often than (b), but since it was such a small part of the total letters, I put it in the same general range as (b), which it is. Maybe this is all you want but to me it shouldn't be. The routine letters may be largely eliminated through the Wheat study and other efficiency measures. If you have not discriminated sufficiently among the other letters, which are the ones which require some analysis, your results may have little value.

Respondent # 6 (Experience—more than 18 months):

This questionnaire evidences a lack of understanding of the no-action procedure.

Approximately 80% of the no-action requests involve small shareholders, who have no other relationship with the company and the only question is one of "investment intent." A G.S. 2 could decide those that concern whether there was an adequate 2–3 year holding period. For those involving a change of circumstances a Solon would fail.

The failure is not with the fairness of the no-action procedure, but with the Commission in not more forcefully enforcing the Securities Act, with criminal proceedings if necessary. Almost 60 to 70% of the above mentioned letters from small shareholders concern a small number of companies with a history of violations of Section 5 of the Securities Act. Some of these have even been enjoined from further violations. These companies continue, however, issuing stock to employees and creditors. Until these companies are stopped we will continue the travesty of examining the investment intent of what are for most part unsophisticated and often poor investors. The more sophisticated and wealthy investors rarely resort to this procedure since they have protected themselves with contractual rights of registration.

Respondents # 7 (Experience—more than 18 months):

I find the SEC's policy extremely unfair in that in over 90% of the requests, the determining factor is whether or not the stock was held

for 2 years, 2½ years, or 3 years (depending upon the chief counsel or his assistant's mood). A request for a no-action letter in many cases is of great importance to the applicant and the lack of standards in this area and subjective judgment without much consideration is at times shocking. There is a great need for specific public guidelines and dissemination of this information.

Respondent #8 (Experience—more than 18 months):

The no-action decisions are basically fair with some arbitrariness concerning length of holding periods and unforeseeable change of circumstances. It appears that guidelines or even rules of thumb could be instituted since those questions are the great majority of the requests.

Almost no advice is oral but the no-action work could be handled faster and more efficiently over the phone, especially no-action rejections and requests for supplemental information. Often parties who are turned down do not understand the reason and write again. A telephone reply would avoid this problem.

An application form or forms could be devised to permit speedy processing and would also eliminate the need for supplemental information requests.

Letters mailed out in response to requests should state the reasons for denial, other remedies available or include a copy of a pertinent commission release. This would eliminate additional repeat correspondence and support public confidence. Most no-action responses are boiler plate today and the processing could be less time consuming through programing of responses.

Chief Counsel's library filing system needs an overhaul. Often legal memoranda is more on the point and reference cards on the same are too sketchy. Many cards are obsolete or duplicates and should be removed. Indexes are worn or missing; there appears to be no master index or cross-references.

The process of distributing recent cases, summary of interpretations and releases to the staff attorneys would be more beneficial if also indexed and cross-referenced into a filing system.

There is no list of bibliographical or other sources for staff attorneys to aid in research.

Correspondence is given priority based on person to whom it is addressed rather than urgency of the request and other more important criteria.

Respondent #9 (Experience—6 months or less):

This questionnaire is not related to our staff operations in any way. The responses to be elicited have no bearing on the actual no-action requests submitted. A better questionnaire could have been prepared if someone had bothered to analyze actual operations first.

Respondent #10 (Experience—extensive):

Since the basic question in connection with proposed public sales is whether registration is required or an exemption is available, the process appears to be fair.

(APPENDIX J OMITTED)

APPENDIX K

CODE OF FEDERAL REGULATIONS

TITLE 17, CHAPTER II

PART 202—INFORMAL AND OTHER PROCEDURES

Sec.

202.1 General.
202.2 Pre-filing assistance and interpretative advice.
202.3 Processing of filings.
202.4 Facilitating administrative hearings.
202.5 Enforcement activities.
202.6 Adoption, revision and recission of rules and regulations of general application.
202.7 Submittals.

AUTHORITY: The provisions of this Part 202 issued under secs. 19, 23, 48 Stat. 85, 901, as amended, sec. 20, 49 Stat. 833, sec. 319, 53 Stat. 1173, secs. 38, 211, 54 Stat. 841, 855; 15 U.S.C. 77s, 78w, 79t, 77sss, 80a-37, 80b-11.

SOURCE: The porvisions of this Part 202 appear at 25 F.R. 6736, July 15, 1960, unless otherwise noted.

§ 202.1 General.

(a) The statutes administered by the Commission provide generally (1) for the filing with it of certain statements, such as registration statements, periodic and ownership reports, and proxy solicitation material, and for the filing of certain plans of reorganization, applications and declarations seeking Commission approvals; (2) for Commission determination through formal procedures of matters initiated by private parties or by the Commission; (3) for the investigation and examination of persons and records where necessary to carry out the purposes of the statutes and for enforcement of statutory provisions; and (4) for the adoption of rules and regulations where necessary to effectuate the purposes of the statutes.

(b) In addition to the Commission's rules of practice set forth in Part 201 of this chapter, the Commission has promulgated rules and regulations pursuant to the several statutes it administers (Parts 230, 240, 250, 260, 270 and 275 of this chapter). These parts contain substantive provisions and include as well numerous provisions detailing the procedure for meeting specific standards embodied in the statutes. The Commission's rules and regulations under each of the statutes are available in pamphlet form upon request to the Superintendent of Documents, U.S. Government Printing Office, Washington, D.C., 20402.

(c) The statutes and the published rules, regulations and forms thereunder prescribe the course and method of formal procedures to be followed in Commission proceedings. These are supplemented where feasible by certain informal procedures designed to aid the public and facilitate the execution of the Commission's functions. There follows a brief description of procedures generally followed by the Commission which have not been formalized in rules.

(d) The informal procedures of the Commission are largely concerned with the rendering of advice and assistance by the Commission's staff to members of the public dealing with the Commission. While opinions expressed by members of the staff do not constitute an official expression of the Commission's views, they represent the views of persons who are continuously working with the provisions of the statute involved. And any statement by the director, associate director, assistant director, chief accountant, chief counsel, or chief financial analyst of a division can be relied upon as representing the views of that division. In certain instances an informal statement of the views of the Commission may be obtained. The staff, upon request or on its own motion, will generally present questions to the Commission which involve

matters of substantial importance and where the issues are novel or highly complex, although the granting of a request for an informal statement by the Commission is entirely within its discretion.

§ 202.2 Pre-filing assistance and interpretative advice.

The staff of the Commission renders interpretative and advisory assistance to members of the general public, prospective registrants, applicants and declarants. For example, persons having a question regarding the availability of an exemption may secure informal administrative interpretations of the applicable statute or rule as they relate to the particular facts and circumstances presented. Similarly, persons contemplating fillings with the Commission may receive advice of a general nature as to the preparation thereof, including information as to the forms to be used and the scope of the items contained in the forms. Inquiries may be directed to an appropriate officer of the Commission's staff. In addition, informal discussions with members of the staff may be arranged whenever feasible, at the Commission's central office or, except in connection with matters under the Public Utility Holding Company Act of 1935 and certain matters under the Investment Company Act of 1940, at one of its regional offices.

APPENDIX L–1

January 22, 1968.
10:20 a.m.

Memorandum to:

MR. WORTHY
MR. BAGLEY
MR. SHREVE
MR. HOCKER
MR. MICHAELY
MR. DOLLET
MR. HAGGERTY

Re: *X Company*—Request of *Y Company* for a "no action" letter in connection with proposed sale of stock

(Messrs. Michaely and Huge were present.)

Upon the recommendation of the Division of Corporation Finance contained in its memorandum dated January 17, 1968, the Commission denied a request of counsel for *Y Company* for a "no action" letter in connection with *Y Company's* proposed sale of 16,250 shares of the common stock of *X Company*, without registration under the Securities Act of 1933.

ORVAL L. DUBOIS,
Secretary

MEMORANDUM

January 17, 1968.

To: The Commission
From: The Division of Corporation Finance
Re: Request for no action letter regarding the public sale of 16,250 shares of *X Company* (File No. ____) common stock by Y Company.
Recommendation: That the request be denied.

On December 5, 1966 the staff received a request for a no action letter regarding the public sale of shares of *X Company* by *Y Company*. The staff

denied the request on December 20, 1966; however, counsel for *Y Company* has now requested that the matter be submitted to the Commission.

X Company had 1,666,268 shares of common stock outstanding as of August 31, 1967. The common stock is listed on the American Stock Exchange where the trading volume for each of the four weeks for the period ended January 5, 1968 was 34,300, 17,400, 45,700 and 59,100 shares respectively. The stock closed at a price of 9⅝ on January 16, 1968 and thus the total market value of the subject shares is approximately $156,406.

Facts Regarding the Request

On March 20, 1962 *X Company* issued warrants to *Y Company*, the principal underwriter of its registered public offering (File No. ____), covering an aggregate of 35,000 shares of common stock.[12] The warrants and underlying shares were included in the registration statement and *X Company* undertook to file a post-effective amendment to cover any public offering of such securities.

All of the 35,000 warrants were exercised by *Y Company* and its assignees (partners and their associates) into 48,064 shares of common stock (adjusted for stock dividend distributions) in October 1963. *Y Company's* assignees subsequently sold their 31,814 shares on the American Stock Exchange prior to December 31, 1965 pursuant to a post-effective amendment filed May 28, 1965. *Mr. A*, a partner in *Y Company*, is a director of *X Company*. The staff has been advised that *X Company* does not plan to have a registered offering of its securities in the near future.

Discussion

The same questions that are presented by this request were last considered by the Commission on August 17, 1964 in connection with the request by *Z Company* for a no action letter covering a proposed sale of 10,353 shares of *M Company* common stock, and on March 25, 1965 and April 15, 1965, in connection with requests by *N Company* and *O Company* for no action letters covering proposed sales of 10,000 shares of *P Company* common stock by *N Company* and 14,062 shares of *Q Company* by *O Company*.

In the *Z Company* matter the Division took the position that the shares were an unsold allotment and consequently could not be publicly sold, except in compliance with the registration and prospectus requirements of the 1933 Act or under a Regulation A filing. In that case, *Z Company*, which was the principal underwriter for an offering of 500,000 shares of *M Company's* common stock, purchased the shares at the public offering price and placed them in the accounts of partners. The partners wished to sell the stock in order to provide funds necessary for the reorganization of that company as a corporation and to diversify their investment. In the purchase contract *M Company* agreed, if requested, to prepare and file a post-effective amendment for the public sale of the shares acquired by the *Z Company* partners. *M Company's* shares were listed on the American Stock Exchange.

The Commission approved the Division's recommendation that the request for a no action letter be denied. (See Division's memorandum dated August 13, 1964 and Commission minute dated August 17, 1964.)

On March 25, 1965, the Commission first considered requests relating to the *Q Company* and *P Company* stock. *N Company* was one of the underwriters

[12] The underwriter paid $.01 per warrant.

in a public offering of 400,000 shares of *P Company* stock and purchased the *P Company* shares for its own investment account at the public offering price. The registration statement contained an undertaking by *P Company* to file a post-effective amendment with respect to such shares prior to any public offering of them. *P Company* stock was listed on the New York Stock Exchange.

The circumstances relating to the proposed sale of the *Q Company* stock were similar to the circumstances presented by the present request. A predecessor of *O Company* had been an underwriter with respect to 30,000 shares out of 67,000 shares covered by a registered offering in January 1961. *O Company* obtained warrants at $.05 per warrant and by exercising the warrants purchased 3,750 shares at a bargain price.[13] In February 1964 a request for a no action letter was made by counsel for *O Company* and was denied by the Division. In March 1965 the request was renewed and the matter presented to the Commission. *Q Company* shares were listed on the American Stock Exchange.

In the cases relating to *M Company* and *Q Company*, the market value of the stock involved was less than $300,000 and the number of shares represented approximately 1% of the outstanding and was less than the trading volume in at least one of the four weeks preceding the receipt of the requests. The same is true of the request relating to *X Company*. In the case of *P Company*, the stock had a market value of approximately $500,000 and represented about ¼ of 1% of the outstanding. In each case the issuer had agreed to file a post-effective amendment to cover any public offering of the stock in question and in each case the broker requesting the no action letter argued that the time, inconvenience and expense involved in preparing the post-effective amendment was not warranted by the value and amount of the stock.

The Division had recommended that the requests by *N Company* and *O Company* be denied, citing the Commission's position in the *M Company* case. In the Commission minute dated March 25, 1965, the Commission indicated, however, that those two cases might be distinguished from the "underwriter-unsold allotment" category and suggested that consideration should be given to the formulation of a general policy, perhaps setting forth conditions relating to the granting of such requests. The staff was instructed to give further consideration to those requests and to the overall question and to report to the Commission later.

On April 13, 1965, the Division submitted a memorandum in which it stated that it had considered the questions and concluded that it would be difficult to draft standards of general applicability to those situations. The staff also expressed the view that adoption of general standards would sacrifice a measure of administrative flexibility and recommended that for the time being each request be considered on an individual basis. The staff further recommended that the request by *N Company* relating to the sale of the *P Company* stock be granted, taking the position that although the status of those securities as part of an unsold allotment was not free from doubt, taking a no action position would not appear to subvert purposes of the Securities Act. The staff noted that the stock had been held for more than five years, that *P Company* had a history of substantial operations, that the company was a re-

[13] Because of stock splits and a stock dividend, the number of shares covered by the no action request became 14,062.

porting company and the stock was actively traded on a national securities exchange. The staff also noted that there were no unusual circumstances which would indicate that an unregistered sale at that time would be inconsistent with the public interest or with the protection of investors.

With respect to the request by *O Company* the staff was not prepared to recommend that the *Q Company* shares could be sold without registration. This position was based, however, on the fact that the Division of Trading and Markets was at that time conducting an informal market quiz to determine the causes for a price rise in the company's stock from $13 in January 1965 to about $25 in April 1965. The staff stated were it not for that fact it would recommend that a no action letter be issued after a holding period of four years.[14]

The Division still believes that these questions should be decided on a case by case basis, and it is our view that stock obtained by underwriters in connection with a public offering should be regarded as unsold allotment unless there appears to be some good reason to the contrary. Perhaps where shares are purchased by an underwriter at the public offering price without any underwriter's discount a good reason exists, but that need not be decided now.

There is an alternative reason for taking the position that in cases such as the one presented the underwriter should not be permitted to make a public sale of the securities without registering them. Where an underwriter acquires shares upon exercise of warrants obtained at the time of the offering, the circumstances indicate quite clearly that the warrants are being issued as additional underwriting compensation. It is reasonable to impute to the underwriter an intention to exercise the warrants and sell the underlying stock when the market price of the stock has risen sufficiently to allow him to make an acceptable profit; hence the underwriter cannot be considered to have taken the stock for any investment purpose. In Securities Act Release No. 4552 the Commission stated:

> "There is no legal justification for the assumption that holding a security in an 'investment account' rather than a 'trading account,' holding for a deferred sale, for a market rise, for sale if the market does not rise, or for a statutory escrow period, without more, establishes a valid basis for an exemption from registration under the Securities Act." [15]

The same argument can be made whenever an underwirter obtains, in connection with a public offering, any options to purchase the issuer's share or any so-called "cheap stock."

In the present case the issuer is obligated to file any necessary post-effective amendment, as was true in each of the other cases mentioned. We note that the policy of requiring registration of shares and warrants sold to underwriters with an undertaking by the issuer to file the necessary post-effective amendments is unequivocally stated in paragraph 29 of Securities Act Release 4666 and paragraph 10 of Securities Act Release 4890. It would be inconsistent with this clearly defined policy to adopt the attitude that because of the relatively small amounts involved, requests such as the present one should be granted, since it can be anticipated that underwriters will normally

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[14] See Division memoranda of March 23 and April 13, 1965 and Commission minutes dated March 25 and April 15, 1965.

[15] Footnote referring to the almost identical statement in Securities Act Release No. 3825 is omitted.

not acquire warrants for such large numbers of shares that the cost of filing a post-effective amendment would be insignificant in comparison to the market value of the stock.

The arguments that the number of shares involved is not substantial and that the prospectus delivery requirements are not effective because the company is listed are the same as those that were made when the Commission considered requests for no action letters under Rule 133 for transactions in which one and two man corporations were acquired by listed companies. Although these arguments may have some emotional appeal, and although the Commission authorized no action letters under Rule 133 on the basis of these arguments, the Commission will recall that it was ultimately impelled to reverse that position because of the interpretive mire that resulted. On the basis of that experience, and in order to avoid similar confusion, those arguments should be rejected here.

Recommendation.

For the foregoing reasons, it is recommended that the request for a no action letter be denied.

APPENDIX L–2

March 17, 1969.
10:00 a.m.

Memorandum to:

MR. SHREVE
MR. HOCKER
MR. WHITNEY
MR. HAGGERTY
MR. POLLACK
MR. SPORKIN
MR. WILLIAMS
MR. HYMAN
DENVER R. O.

Re: *X Company*—Request of Attorney, *Mr. A* for a "no action" letter

Upon the recommendation of the Division of Corporation Finance contained in a memorandum dated March 14, 1969, the Commission denied the request of Attorney, *Mr. A* for a "no action" letter with respect to his proposed sale of 25,000 shares of common stock of *X Company* and also denied his request for an opportunity to be heard by the Commission in the matter.

NELLYE A. THORSEN,
Assistant Secretary.

MEMORANDUM

March 14, 1969.

To: The Commission
From: The Division of Corporation Finance
Re: (1) Request for a no action letter for the sale of 25,000 shares of the common stock of *X Company*
(2) Request by applicant for an opportunity to be heard by the Commission.
Recommendation: (1) That the no action request be denied
(2) That applicant's request for an opportunity to be heard be denied.

This Division has received a request for a no action letter from Attorney, *Mr. A* with regard to his proposed sale of 25,000 shares of *X Company* common stock. Based upon quoted over the counter bid prices on March 7, 1969 for *X Company* stock of 12 and 14 by two dealers, the amount of the proposed transaction is approximately $300,000 to $350,000.

By letter dated February 7, 1969, *Mr. A* advised the Division of the following facts relating to the proposed sale:

In September 1966, *Mr. A* represented a group of investors who acquired control of *X Company*, a Colorado corporation. At that time *X Company* was a public company but completely inactive and not engaged in any operations whatever.

Mr. A's clients owned what appeared to *Mr. A*, based on competent geology reports, to be valuable *mineral* properties which were transferred to *X Company*. At the time control was acquired in September 1966, *Mr. A* purchased under investment letter from *Y Company*, a member of the control group, 25,000 *X Company* common shares, and subsequently *Mr. A* became a director and secretary of the company. Less than a year later when it became apparent to *Mr. A* that the company did not have the financial ability to proceed with the development of the *mineral* property, *Mr. A* resigned as an officer and director of the company and has had no further contact with the company since that time. *Mr. A* understands that since that time control of the company has been sold to new interests. In view of the above facts, *Mr. A* concludes that he may effect a sale of the 25,000 shares of *X Company* common stock pursuant to the exemption provided in Section 4(1) of the Securities Act of 1933 as a "transaction by any person other than an issuer, underwriter, or dealer." The Division agrees that *Mr. A's* conclusion of law is correct.

On May 16, 1967, the Division of Trading and Markets by Memorandum requested the Commission to enter a formal order of investigation naming *X Company* to determine if there had been violations of the registration and anti-fraud provisions of the Federal securities laws, for the reasons set forth in the attached copy of such Memorandum in File No._____. Thereupon the Commission entered a formal order authorizing the investigation which as of this date continues. On February 27, 1969, David Hyman, Chief Enforcement Attorney, Division of Trading and Markets, asserted in a memorandum to this Division that in view of the pending investigation involving *X Company* and because of the belief that such company has no assets of any substance and that the market price of *X Company* may therefore represent the effect of manipulation, it is the recommendation of the Division of Trading and Markets that no action requests with respect to *X Company* common stock be denied.

Mr. A was advised by letter dated February 28, 1969, that the Division was unable to conclude that his shares could be publicly sold without compliance with the registration requirements of the Securities Act, and he replied by letter dated March 3, 1969, requesting reconsideration of this Division's determination and an opportuntiy to appear before the Commission for oral argument.

Based upon the facts hereinabove set forth, the Division recommends that the requests of *Mr. A* for a no action letter relating to his proposed sale of

25,000 shares of *X Company* common stock and for the opportunity to be heard by the Commission be denied.

Attachment
PGross

MEMORANDUM

May 16, 1967.

To: The Commission
From: Division of Trading and Markets
Subject: *X Company* (File No.____)
Recommendation: That the Commission enter a formal order of investigation naming the subject company to determine if there have been violations of the registration and anti-fraud provisions of the Federal securities laws (Section 5 and 7 of the '33 Act and Section 10(b) of the '34 Act and Rule 10b–5 thereunder).

The Denver Regional Office has reported the following information:

X Company was incorporated in 1954 as *XY Company* and between 1954 and 1957 filed 4 Regulation A offerings in which it raised approximately $240,000 from the sale of common stock. The company's name was changed to *X Company* in 1960 at which time control of the corporation appears to have passed into the hands of *Mr. B* and *Mr. C*. Both *Mr. B* and *Mr. C* have been the subject of numerous Commission investigations and should be considered major securities violators.

Virtually no market existed for the stock of *X Company* in 1965 and 1966 and it is believed that the company is virtually a shell corporation. In September 1966 attempts were made to reactivate the company. New management consisting of *Mr. D* and *Mr. A* purportedly took over *X Company* and brought in *Mr. E* (*Mr. E* was recently convicted of securities violations in the SDNY in connection with the *M Company* case). *Mr. E* purportedly arranged to sell certain *mineral* mining claims near *City of* _____, California to *X Company* in exchange for 150,000 shares of *X Company* common stock. In December 1966 *Mr. D* advised the Denver brokerage firm of *Z Company* by letter that *X Company's mineral* properties had a value in excess of $400,000,000 and also a *mineral* mining claim valued in excess of $500,000. Subsequently, *Z Company* mailed a post card to 2,000 stockholders of *X Company* advising them that there was a market for *X Company* stock of $5 bid and $6 asked. Recently *Z Company* and occasionally other brokers have appeared in the pink sheets with this quotation. An examination of *Z Company's* trading records reveals no retail transactions in this stock. However, examination of *X Company's* transfer records reveal that in March 1967 *Mr. D* and *Mr. E* caused several large denomination certificates to be broken down into smaller certificates. One of these certificates for 5,000 shares was issued to *Mr. F* of _____, Florida and this stock has in turn been pledged with the *Q Bank* in *City of* _____. Additional reports have been received stating that *Mr. D* and *Mr. E* and others have attempted to sell the *X Company* stock.

It appears that there is no genuine market for *X Company* securities and that the quoted prices may be fictitious. Further, the valuation of the mining claims is in all likelihood false and misleading.

In view of the past background of the individuals connected with the *X Company*, it is believed that these persons will not give testimony or other information without a subpoena and that subpoena power will be necessary to obtain bank records and other evidence. It is therefore recommended that the Commission issue a formal order of investigation in this matter to determine if there have been violations of the registration and anti-fraud provisions.

MDHyman:rls

APPENDIX L–3

Section 4(1); Change of Circumstances

June 7, 1968—Commission Minute—Mr. A proposed to sell 15,186 shares of X Company common stock without registration under the Securities Act of 1933.

Mr. A acquired 7,143 X shares in Dec. 1965, 7,143 shares of X in March 1966 and 900 X shares in Oct. 1966, all for investment. In connection with his initial purchase in Dec. 1965, A received an option to acquire 1,250 shares at an exercise price of $2.80 on or before Dec. 1970, and another 1,250 shares on or before March 1971.

A contends that he has undergone an unforeseeable change of financial circumstances. In July 1966 he left a position which had provided a gross earning of $300,000 per year and became principal stockholder, an officer and a director in another company from which he has been receiving a salary of only $60,000 per year. Furthermore, in Feb. 1967, A borrowed $300,000, and used $60,000 to pay various mortgages on real estate, $50,000 to repay a debt owed to one of his clients, and the balance to buy call options. The bank is now pressing for repayment of the debt. In addition, A owes $59,000 in Federal income taxes for 1964 and 1965 and $107,000 is due on his 1967 taxes.

The staff considered that the income tax liabilities were not unforseeable change of circumstances. Moreover, the 1964 and 1965 asserted deficiencies represent only a potential liability. With respect to Mr. A's obligation to repay the $300,000 loan, the incurrence of this new debt to pay old debts existing at the time he acquired the X stock and to speculate in the stock market does not constitute an unforeseeable change of circumstances.

Registration required.

CARD ONLY

June 7, 1968.
10:00 a.m.

Memorandum to:

MR. BAGLEY
MR. SHREVE
MR. MICHAELY
MR. MILLER
MR. KOEPPEL
MR. HAGGERTY

Re: *X Company*—Proposed sale of stock by *Mr. A*

Consideration was given to a memorandum dated June 3, 1968, from the Division of Corporation Finance in the matter of a request by counsel for *Mr. A* for a "no action" letter with respect to *Mr. A's* proposed sale of 15,156 shares of common stock of *X Company* without registration under the Securities Act of 1933.

Upon the recommendation of the Division, for the reasons stated in the memorandum, the Commission denied the request for a "no action" letter and also denied counsel's request to be heard in the matter.

ORVAL L. DUBOIS,
Secretary.

MEMORANDUM

June 3, 1968.

To: The Commission

From: The Division of Corporation Finance

Re: (1) Request for a no action letter for a sale of *X Company* common stock
(2) Request by counsel for an opportunity to be heard by the Commission

Recommendation: (1) The no action request be denied
(2) Counsel's request for an opportunity to be heard be denied.

Background:

In a series of letters which began on March 1, 1968, counsel for *Mr. A* requested a no action letter for a proposed sale by *Mr. A* of 15,186 shares of common stock of *X Company.*

Mr. A acquired 7,143 shares in December of 1965, 7,143 shares in March of 1966 and 900 shares in October of 1966, all for investment. The shares have a present market value of approximately $400,000. In connection with his initial purchase in December 1965 he received an option to acquire an aggregate of 2,500 shares at an exercise price of $2.80, exercisable half on or before December 29, 1970, and the remaining half on or before March 10, 1971.[16]

The request for a no action letter is premised upon a change of *Mr. A's* financial circumstances. The relevant facts concerning this matter are as follows:

Until July of 1966 *Mr. A* was a registered representative and an officer of *Y Company* and had gross earnings of approximately $300,000 per year. He then became principal storkholder, an officer and a director of *Z, Inc.*, a member firm on the New York Stock Exchange. He now receives a salary of $60,000 a year.[17] In February 1967 *Mr. A* borrowed $300,000, using shares of *a widely held company* owned by one of his associates as collateral for the loan. Sixty thousand dollars was used to pay various mortgages on real estate owned by *Mr. A*, $80,000 was used to buy art, furniture, and antiques, $50,00 was used to repay a debt owed by *Mr. A* to one of his clients, and the balance of approximately $130,000 was used to buy call options.

Counsel's position:

Counsel claims that *Mr. A* has experienced a change of circumstances that would justify a present sale of the *X Company* shares. The bank is now pressing for repayment of the debt which stands in the amount of $272,500,

[16] At present the option has not been exercised.

[17] In addition, the firm earned more than $200,000 after taxes in 1966, of which *Mr. A's* interest (26 percent) would be $57,000. We have not been informed of the firm's earnings in 1967, but in the first quarter of 1968 it lost approximately $100,000.

and *Mr. A's* associate is demanding return of the stock that was used as collateral for the loan. In addition, counsel asserts that *Mr. A* owes $59,000 in federal income taxes for 1964 and 1965 and that $107,000 is due on his 1967 taxes.

Since January 1968 *Mr. A* has purchased call options covering a total of approximately 11,000 shares of various securities. Some of the options were purchased after we received the first request for a no-action letter.

Counsel also advises: (1) that *Mr. A* has granted other shareholders in his brokerage firm an option to purchase his shares at book value (approximately $187,000), but the option was not exercised; and (2) that *X Company* has offered to include in a pending registration statement up to five percent of the shares held by certain shareholders, including *Mr. A*, who would be entitled to include 750 shares.

Division's position:

We do not believe the facts demonstrate that *Mr. A* has had a change of circumstances that would justify a present sale of his shares. His financial difficulties derive from two sources: (1) income tax liabilities; and (2) the need to repay the $300,000 loan.

Concerning the income tax liabilities, we cannot understand how these can be considered unforeseeable changes in circumstances. Furthermore, the amounts owed for 1964 and 1965 are still in the category of an asserted deficiency and presumably subject to settlement. In any event, the $59,000 sum represents only a potential liability. Insofar as the 1967 taxes are concerned, counsel has not pointed to any unusual situation to indicate that *Mr. A's* taxes were any greater than could reasonably be anticipated on the basis of his income for that year, or that he should have been surprised when he was expected to pay the tax when due.

In the Division's opinion *Mr. A's* reliance on his obligation to repay his loan as a basis for obtaining a no-action letter is also misplaced. As noted above, the $300,000 was used to pay some existing debts, to buy art objects and to speculate in the stock market. The fact that he had existing debts to pay at the time he acquired the *X Company* shares certainly would not support a claimed change of circumstances; neither would the fact that he incurred a new debt to enable him to pay the old ones. Concerning his market speculations, we have never understood that adverse experience in this kind of activity by someone in the brokerage business would constitute an unforeseen change of circumstances.[18]

Recommendation:

For the above reasons, the Division recommends that the no-action request be denied.

At counsel's request we are attaching copies of letters he has asked to have presented to the Commission. We do not believe he has anything material to add to the information contained in this memorandum and stated in somewhat more detail in his letters, and accordingly recommend that his request to be heard also be denied.

Attachments
GPMichaely, Jr.

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[18] It is not clear that *Mr. A's* speculative activities have been adverse, but we do not believe it is necessary to elaborate on that question.

APPENDIX I–4

July 9, 1964.
11:00 a.m.

Memorandum to:

MR. WORTHY
MR. BAGLEY
MR. SHREVE
MR. LESE
MR. HOCKER
MR. DOLLETT
MR. HENEGHAN

Re: *X Company* (File_____). Request of *Mr. A* for a "no action" letter

(Messrs. Shreve, Lese, Heneghan and Ficca were present.)

Consideration was given to a memorandum dated July 6, 1964, from the Division of Corporation Finance with respect to *X Company*, (File _____), in particular a request of counsel for *Mr. A*, for a "no action" letter with respect to *Mr. A's* proposal to sell his holdings of 55,555 shares of *X Company* common stock without prior registration under the Securities Act of 1933. For reasons outlined in its memorandum, the Division recommended that the request for a no action letter be denied. During the discussion, however, the representatives of the Division conceded that a "close question" was presented under the facts here involved, in particular the nature of the "changed circumstances" presented in behalf of *Mr. A*.

After due consideration, the Commission concluded that the changed circumstances in this case were such that the Division could appropriately take a no action position with respect to *Mr. A's* proposed sale of stock without registration thereof.

ORVAL L. DUBOIS,
Secretary.

July 6, 1964.

MEMORANDUM

To: The Commission
From: Division of Corporation Finance
Re: X Company (File No._____)
Subject: Request for a "no action" letter for the proposed sale of 55,555 shares of common stock of *X Company* by *Mr. A*
Recommendation: The request be denied.

Facts

Mr. A has requested a "no action" letter for the sale of 55,555 shares of common stock of *X Company* (approximately 1.5% of the 3,328,972 shares of common stock outstanding). This would represent approximately $798,000 based on the high bid price of 12¾ on July 2, 1964. *X Company*, which made an offering of 2,200,000 shares at $11 a share under a registration statement effective October 30, 1963, is engaged in *business* in the Los Angeles and San Francisco areas.

On August 13, 1963, *Mr. A* purchased the 55,555 shares at $9 per share pursuant to a letter of investment. *Mr. A* was one of the 14 original investors who purchased, subject to an investment representation, an aggregate of 1,328,972 shares of *X Company* on various dates in August, 1963. *X Company*

agreed that if it filed a registration statement after December 31, 1964, these shares would be included in the registration statement.

Mr. A is the president and sole stockholder of *Y Company* of *City of* _____, *State Q*, which was incorporated in late 1962 for the purpose of designing and building *an expensive device of general application*, is the chief designer of the *device* in which the Department of Defense is said to have an active interest. *Mr. A* has invested over $9,000,000 in the *device's* development. The development program called for completion of the *device* in time for certification by *a federal agency* in early (*date*) with the *device* to be available for delivery in the middle of that month. *Bank Z* extended to the company a line of credit to carry the *device's* development through to certification with a total credit of $5,450,000 having been extended. As a result of engineering difficulties the program fell behind and certification was then scheduled for *several months later.*

Certification was again delayed because of an accident (attributed by *X Company* to the negligence of *the government*) which destroyed a test *device* valued at approximately $2,000,000. The *device* was insured up to $500,000.

Mr. A's line of credit with *Bank Z* for up to $12,000,000 was collateralized by a $10,000,000 note and a consultant contract which he received from *W Company* with which he was formerly associated. *Bank Z* decided to terminate its line of credit to *Mr. A* because of the proposed cut in defense spending which the Bank feared would have an adverse effect on *W Company's* business and because of a strike suit filed against *W Company.*

Mr. A has requested *X Company* to register his shares but *X Company* has refused on the grounds: it has no legal obligation to do so; the company is in the process of setting up operations and could not take time at this critical period to file a registration statement; and the company does not want to set a precedent for others who took in the same private offering to demand that their shares be registered.

Mr. B, former Undersecretary of the Treasury and counsel for *Mr. A*, and *Mr. A* have asserted that *Mr. A* could not have foreseen in (*date*) the termination of his line of credit which as available at that time would have been more than adequate to carry his development plans to certification by the *federal agency.* This, coupled with the engineering difficulties and subsequent accident, are factors which *Mr. A* asserts could not have been reasonably foreseen at the time he purchased the *X Company* stock for investment. In further support of his "no action" request, *Mr. A* has indicated that because of the delays and lack of funds, he has been forced to discharge 250 of the 700 employees at his plant and others have had their salaries deferred. If he is unable to sell the *X Company* shares, he indicates he will be forced to close his plant thereby resulting in economic hardship to all persons working at the plant. In this connection, Mr. Richard Cohen of the Department of Commerce spoke with a member of the staff by phone on behalf of Undersecretary Roosevelt. He indicated that the Commerce Department was instrumental in the *Y Company* plant being located in the *city of* _____, *State Q*, where there is an unemployment problem. Mr. Cohen indicated that Mr. Roosevelt would forward to the Division information regarding background as to *Y Company* and the Basis for the interest of the Department of Commerce in *Y Company.* As yet we have not received this letter.

We received a letter dated July 1, 1964 from Congressman *C* of *State Q* requesting favorable action on the "no action" request.

Mr. A has advised that he has attempted to sell an interest in his company, borrow at usurious rates, sell his *X Company* stock privately, borrow from various financial institutions including small business investment companies but has only been successful in borrowing from his family trust funds which are presently exhausted. He has indicated that if he is free to sell his *X Company* stock, certification should be forthcoming in 30 days, after which he will have no additional financing problems.

Division's Position

On May 19, 1964, the Division informed *Mr. A* that in view of the short period of time the stock had been held and the nature of the change in circumstances, we were unable to conclude that the *X Company* held by him might be sold to the public without compliance with the registration requirements of the Securities Act of 1933. Although *Mr. A* has submitted certain additional information since that time, we find no basis for reversing our conclusion. It is the Division's position that when a company is in the experimental stages of building a new *device*, it should be able to foresee that engineering and other difficulties are likely to arise. When *Mr. A* purchased the *X Company* stock in August, 1963, *Y Company* had only been in existence for about eight months. At that time all the mechanical and engineering problems had not been faced so that it is questionable that such problems could not have been reasonably foreseen. In addition to the foregoing, if a "no action" letter were granted to *Mr. A*, it might be difficult to find a basis for denying similar requests from persons who required *X Company* at the same time as *Mr. A*.

On the basis of the foregoing, it is the recommendation of the Division of Corporation Finance that the requested "no action" letter be denied.

APPENDIX L–5

Section 4(1); Change of Circumstances; Investment

July 3, 1968—Commission Minute

Two stockholders of the company proposed to sell without registration under the Securities Act of 1933 10,000 shares of its stock taken for investment in February 1967 on account of certain legal services. The two stockholders alleged that they were entitled to receive an additional 20,000 shares of stock on account of such legal services and that they might institute suit against the issuer to recover such shares.

The two stockholders contended that they have suffered unexpected reverses in their financial affairs since their income from law practice has declined, various loans which were outstanding at the time the shares were taken were called, the Internal Revenue Service has threatened enforcement action to collect Federal income taxes due for 1966, and they had to spend substantial sums to renovate their law offices.

However, such financial obligations existed at the time the stock was acquired. Furthermore, the repeated attempts to obtain a no action letter in September and October 1967 and March, May and June 1968, raise considerable doubt as to whether the stockholders ever had a bona fide investment intent.

Request denied.

July 3, 1968.
10:00 a.m.

Memorandum to:

MR. SHREVE
MR. BAGLEY
MR. LEVENSON
MR. MICHAELY
MR. HAGGERTY
MR. POLLACK
MR. SPORKIN
MR. ROTBERG
MR. BLOCK
MR. WILLIAMS
MR. MATHEWS
MR. HYMAN
MR. ROSSEN
MR. FINKELSTEIN
NEW YORK REGIONAL OFFICE

Re: *X Company*—Request of *Mr. A* and *Mr. B* for a "no action" letter re their proposed sale of *X Company* stock

Upon the recommendation of the Division of Corporation Finance contained in a memorandum dated June 28, 1968, the Commission denied a request made on behalf of *Mr. A* and *Mr. B* for a "no action" letter in connection with their proposed sale of 10,000 shares of common stock of *X Company* without registration under the Securities Act of 1933.

NELLYE A. THORSEN,
Assistant Secretary.

MEMORANDUM

June 28, 1968.

To: The Commission
From: The Division of Corporation Finance
Re: Request for a no-action letter for the sale of 10,000 shares of common stock of *X Company*
Recommendation: That the request be denied.

The Division has received a request on behalf of *Messrs. A and B* for a no-action letter for their proposed sale of 10,000 shares of *X Company* common stock.[19]

Messrs. *A and B* are associated as partners in the practice of law and the shares in question were received in February 1967 on account of legal services rendered to the issuer prior to that time. The shares were not registered under the Securities Act of 1933 but were issued in reliance upon the exemption afforded by Section 4(2) of such Act. It is alleged that *Messrs. A and B* are entitled to receive (but have not as yet received) an additional 20,000 shares of *X Company* on account of such legal services and that suit might be instituted against the issuer to recover these additional shares.

Messrs. A and B first requested a no action letter with respect to their X Company shares in September 1967 and this request was denied by the Division. They requested reconsideration of the matter in October 1967, March 1968 and May 1968 and in each case their request was denied. On June 3, 1968, they requested that the matter be reviewed by the Commission.

[19] *X Company* common shares are traded in the over-the-counter market. The recent price is approximately $31 per share. The company has approximately 670,000 shares outstanding and *Mrs. C*, wife of *Mr. C* who is president of *X Company*, is the record owner of 405,000 of such shares.

Messrs. A and B allege in support of their request that they have suffered unexpected reverses in their financial affairs since February 1967 in that their income from law practice declined, various loans which were outstanding at the time the shares were taken have been called, the Internal Revenue Service has threatened enforcement action to collect federal income taxes due for 1966, and in that they spent substantial sums in renovating the building in which they maintain their law offices. According to the information submitted, the firm's obligations on the loans amount to approximately $150,000, and the taxes due amount to a total of $5,800.

The Division is of the view that a sale by Messrs. *A and B* of their *X Company* shares would not be consistent with an investment intent at the time the shares were taken. Indeed, it appears that the financial obligations that are relied upon in support of the request existed at the time the stock was acquired. Furthermore, the repeated attempts to obtain a no-action letter for the sale of these shares, initiated only eight months after their receipt, raise considerable doubt as to whether Messrs. *A and B* ever had a *bona fide* investment intent with respect to their shares.

There is an additional factor of which the Commission should be aware in considering this request. The New York Regional Office has advised that *Mr. A* had served as counsel for *Mr. C*, the president of *X Company*, as well as for other related corporations and they believe that he was aware of certain of *Mr. C's* activities in *X Company* which resulted in a suspension of trading of such issuer's securities on two occasions and also led to an injunctive proceeding against *Mr. C* and the issuer. Although the litigation has been terminated by the entry of consent decrees, the New York Regional Office is still reviewing the case in order to determine what further action, if any, should be taken in this matter, and does not believe that in the circumstances, a no-action letter should be granted.

For the reasons outlined above, the Division recommends that the request of *Messrs. A and B* for a no-action letter relating to their proposed sale of 10,000 shares of *X Company* be denied.

H. Garson

APPENDIX L–6

July 11, 1969.

Messrs. *A & B, Esq.*
—— *Broadway*
New York, New York 10005

Re: *X Company*

GENTLEMEN: This refers to your letter of June 6, 1969 concerning the proposed sale by your client, *Mr. C*, of 225,000 shares of *X Company* (the "Company") common stock, which shares were acquired at the following times: 10,000 in April, 1966, 140,000 on September 26, 1967, and 75,000 on April 26, 1968, representing 14.5% of the 1,550,600 shares of the Company's outstanding stock.

As more particularly discussed in your letter, *Mr. C* was a principal officer and director of the Company until his employment was terminated by the

board of directors on April 23, 1969. He had no notice of this termination until immediately prior to its occurrence.

It appears that *Mr. C* has considerable financial obligations such that he is not able to maintain his investment in the Company without the compensation which would attend his full time employment as one of the company's principal officers.

Based on the facts presented, this Division will not recommend any action to the Commission if your client sells the shares in question without prior compliance with the registration requirements of the Securities Act of 1933 in reliance upon your opinion as counsel that the proposed transaction is exempt therefrom.

Sincerely yours,

JOHN HENEGHAN,
Assistant Chief Counsel.

bcc NYRO
HMcCart
BOROCHOFF (6)
7/10/69/mkt

October 2, 1967.
4:00 p.m.

Memorandum to:

MR. WORTHY
MR. BAGLEY
MR. SHREVE
MR. MICHAELY
MR. HAGGERTY
MR. LOOMIS
MR. FERBER
MR. NORTH
MR. I. POLLACK
MR. RAE
MR. ROTBERG
MR. SPORKIN
MR. FREEDMAN
MR. DUDLEY
MR. LEVY
MR. MOSTOFF
MR. ROUTIER
MR. KELLY
MR. M. MILLER
MR. O'TOOLE
MR. RUSSELL
MR. WEEKS
MR. GONZALES

Re: *X Company*—Request for "no action" letter with respect to proposed sales of certain securities

(Messrs. Shreve, Michaely, Loomis, Rae, Freedman and Mostoff were present.)

Discussion was had of the request of *X Company* for a "no action" letter relating to its proposed sales of the following companies without registration under the Securities Act of 1933: *Y Company*, *Z Company*, *P Company*, and *Q Company*. (See memorandum dated September 28, 1967, from the Division of Corporation Finance.)

Following a discussion, the Commission determined that the staff should request of counsel for *X Company* a written commitment that *X Company* would not in the future purchase any shares of United States management companies. (Counsel had advised the staff to that effect orally.) Subject to obtaining that commitment, the Commission granted the request for a "no action" letter with respect to the proposed sales of shares of *Y Company*, *Z Company*, and *Q Company*. The Commission indicated that it had problems

concerning the request for a "no action" letter applicable to the sale of shares of *P Company*, and, accordingly, it declined to grant the request at this time.

NELLYE A. THORSEN,
Assistant Secretary.

APPENDIX L–7

July 31, 1968.

Mr. A, Esquire
C and A
Suite ———
—— Walnut Street
Philadelphia, Pennsylvania 19102

Re: *X Company*

DEAR MR. A: This is in response to your letter of July 9, 1968 requesting a no action letter in connection with the proposed sale of 5,006 shares of *X Company* by *Mr. B*.

Your letter states that *Mr. B* received his shares of *X Company* in exchange for his shares of *Y Company* on March 27, 1967, as represented by a temporary certificate for 424 shares issued on that date, and subsequently exchanged for a permanent certificate dated July 27, 1967, together with a certificate for the remaining 4,582 shares. *Mr. B* entered into an employment contract with *Y Company* on March 27, 1968. As a result of a breach of that contract in June, 1968 as well as the financial commitments of *Mr. B*, it is your opinion that the sale of these shares to the public should be exempt from the registration requirements of the Securities Act of 1933.

Based upon the above facts, as more fully set forth in your letter, we are unable to concur in your opinion. Accordingly, no public offer or sale of the shares of *X Company* by *Mr. B* should be made without compliance with the registration requirements of the Securities Act of 1933.

Sincerely yours,

WILLIAM E. TOOMEY,
Assistant Chief Counsel
Division of Corporation Finance.

LOgg/jlh
Branch #10—Whitney
July 31, 1968

APPENDIX L–8

July 6, 1967.
3:30 p.m.

Memorandum to:

MR. WORTHY
MR. BAGLEY
MR. SHREVE
MR. DAVIES
MR. MICHAELY
MR. SCANLAN
MR. HAGGERTY

Re: *X Company*—Proposed sale of stock by *Mr. A*

(Mr. Michaely was present.)

Consideration was given to a memorandum dated June 28, 1967 from the Division of Corporation Finance in regard to the request of *Mr. A* for a "no action" letter in connection with his proposed sale of 120,611 shares of *X Company* common stock. It was the Division's recommendation that the request be granted.

Upon due consideration, the Commission concluded that as a matter of policy it should not grant "no action" letters to any member of a family group which controlled the company in question. Accordingly, since *Mr. A* was a member of the family group in control of *X Company*, the Commission denied his request for a "no action" letter.

ORVAL L. DUBOIS,
Secretary.

APPENDIX L–9

August 15, 1967.
10:10 a.m.

Memorandum to:

MR. WORTHY
MR. BAGLEY
MR. SHREVE
MR. HOCKER
MR. MICHAELY
MR. DOLLET
MR. HAGGERTY

Re: *X Company*—Rule 133

(Messrs. Shreve, Michaely, and Huge were present.)

Consideration was given to a memorandum dated August 2, 1967, from the Division of Corporation Finance with respect to *X Company*, which proposed to acquire substantially all of the assets of *Y Company*, and of *Z Company*. In connection therewith, *X Company* would issue (a) 65,000 of its common shares to *Y Company*, which would be distributed to that company's two shareholders upon its dissolution, and (b) 6,795 of its common shares to *Z Company*, which would be distributed to that company's three shareholders upon its dissolution. The purchase agreements provided for the later issuance of additional shares to the selling companies, which would be similarly distributed.

The question was presented whether the recipients of the *X Company* shares would be free to sell the stock without registration under the Securities Act of 1933 pursuant to provisions of Rule 133 thereunder. The Commission declined to authorize the issuance of further "no action" letters in situations such as this pending a reconsideration of past rulings and interpretations in this area and the issuance by the Commission of further or amended rules.

ORVAL L. DUBOIS,
Secretary.