# Securities Regulation Outline – Buell
Jamie Rehmann

## Topic | Page
--- | ---
I. Background | 1
   A. Why Securities are different | 1
   B. Why Regulate | 1
   C. Modes of Regulation | 1
   D. Valuing Securities | 2
II. Defining Terms- Threshold Questions | 4
   A. Is it a Security | 4
      1. Investment K | 4
      2. Stock | 6
      3. Notes | 7
   B. Materiality | 7
      1. Specific Disclosures | 8
      2. Defenses | 9
III. Public Offering Process/Registration – the ’33 Act | 11
   A. Generally – The Economics of Public Offering | 11
   B. Registering a Public Offering | 12
      1. Three categories of info to disclose | 12
      2. Info contained to two primary documents | 12
      3. Two basic forms for RS | 12
      4. RS Forms for small business issuers | 13
      5. Summary Chart | 13
   C. The Gun-Jumping Rules – Prohibited Disclosures and Delivery Requirements | 13
      1. Policy Behind the Rules | 13
      2. Categories of Issuer | 14
      3. Pre-Filing Period | 14
      4. Waiting Period | 16
      5. Post Effective Period | 19
   D. Updating in the Post Effective Period | 20
   E. Post Effective Trading Practicing by Participating Parties | 22
   F. Summary Charts | 23
IV. Exempt Offerings – Don’t require registration under §5 | 24
   A. §4 Exemptions | 24
   B. Policy | 24
V. Issuer Exempt Offerings | 24
   A. §4(2) Exemption | 24
   B. Reg. D Safe Harbor | 25
      1. Why its necessary | 25
      2. Promulgating Statutes | 25
      3. Rule 501 Definitions | 25
      4. Rule 504 | 25
      5. Rule 505 | 26
      6. Rule 506 | 26
      7. Rule 502 Conditions that apply to all Reg. D Offerings | 26
      8. Summary Chart | 27
VI. Exempt Transaction for Other Parties – Secondary Mkt Resales | 28
   A. General Rule | 28
      1. §§4(1), 4(4) Exemptions | 28
   B. How to determine if UW present in transaction | 28
C. §4(1) Exemption for Control Persons Re-sales..................................................28
D. Rule 144 Safe Harbor from Def. of UW............................................................29

VII. Civil Liability for ’33 Act Violations.................................................................29
A. Policy..................................................................................................................29
B. Private Causes of action....................................................................................29
C. §11 Liability........................................................................................................29
D. §12(a)(1) Liability..............................................................................................34
E. §12(a)(2) Liability..............................................................................................34
F. See Master Causes of Action Chart at end for summary.................................35

VIII. 34 Act
Registration/Disclosure.........................................................................................36
A. Mandatory Disclosure.......................................................................................36
   1. Generally.........................................................................................................36
   2. When its required to register..........................................................................36
   3. Why would company want to stay private....................................................37
   4. What is required.............................................................................................38
   5. Other disclosure venues................................................................................39
   6. Solution: Reg. FD Prohibitions....................................................................39
B. Accuracy of Disclosure.......................................................................................39
   1. Books and Records Violations.....................................................................39
   2. Gatekeepers....................................................................................................40
      a. Generally.....................................................................................................40
      b. Outside Auditors.......................................................................................40
      c. Lawyers......................................................................................................41

IX. Agency Enforcement..........................................................................................42
A. SEC Enforcement of Disclosure/Accuracy Regime..............................................42
   1. The process....................................................................................................42
   2. Administrative Proceedings..........................................................................44
   3. Judicial Review of Administrative Proceedings.........................................46
   4. SEC Civil Remedies.......................................................................................47
B. Criminal Enforcement.........................................................................................48
   1. Parallel Proceedings.......................................................................................48
   2. Criminal Sanctions.........................................................................................49
   3. Why have criminal sanctions.......................................................................49

X. Private Enforcement – Rule 10b-5.................................................................51
A. Purpose.............................................................................................................51
B. Plain Language of the Rule.............................................................................51
C. Overlap Issues..................................................................................................51
D. Class Actions....................................................................................................52
E. Who can sue under 10b-5: Two limiting rules..............................................52
F. Defendants under 10b-5..................................................................................54
G. Elements.........................................................................................................55
   1. Conduct by D.................................................................................................55
   2. Scienter...........................................................................................................56
   3. Reliance..........................................................................................................56
   4. Loss Causation...............................................................................................56
   5. Damages........................................................................................................57

XI. Civil Causes of Action Summary Chart.........................................................58
I. Background
A. Why are Securities different
   1. The health of the capital mkts are crucial to our society
   2. Securities are intangible
   3. Investors are prone to irrationalities
   4. Collective action problem – an indiv. investor may not have incentive to comb through all information or hold company/seller liable for fraud
B. Why Regulate? To protect investors!!!
   1. Information Asymmetry
      a. Arg. for Regulation – Need regulation/disclosure to level the playing field
         i. This is Primary Goal
      b. Arg. against Regulation – Economics will force disclosure: investors will buy from those companies disclosing information, thus giving them competitive advantage
   2. Potentiality for Fraud
      a. Arg. for Regulation – Paternalism: Ppl. invest with the assumption of no fraud
      b. Arg. against Regulation – social norms (influence honesty), mkt forces (if widespread fraud no one could raise capital), econ. forces (reputation)
   3. Agency Costs – Discl. allows investors to better evaluate efficacy and compensation packages of mngr (who have an incentive not to discl.). Makes mngrs./directors more accountable to stock holders.
   4. Lemons Problem – If companies not discl. investors will not be able to tell the “lemons” from the good companies and demand deep discount to offset risk. Companies will then not have an incentive to avoid fraud and will either commit fraud or pull out. Mtk. will then left with only “lemons” and collapse.
   5. Coordination Problems – Info on a company is more valuable if can compare to other companies, need same kind of info to compare it against
   6. Collective Action Problem – gov’t worried that individual investor may not have enough incentive to bring action on their own
   7. Allocate efficiency
      a. Don’t want to have investors putting money in overpriced stocks, rather have $ invested in more efficient way rather than waste
      b. Info is valuable, but only the first to produce the info profits and duplicative efforts are wasted. By the company providing inside info (the most valuable info) for everybody this discourages duplicative info.
      c. Usually cheapest for company to discl. info rather than forcing investors/analyst to do the research
   8. Lessons learned from the past -1929 crash caused by overpriced securities and fraud. Regulation created to prevent another crash
      a. Query as to whether this was really the cause and if mandatory discl. solves the problem
      b. Social importance – even more imppt. now that b/f to protect mkt b/c more $/investors involved
   9. Gen’l arg. against regulation
a. Disclosure is costly – drives up prices
b. If particular mkt already has a pervasive regulatory system, then less need for securities reg. (e.g. housing mkt)
c. Investor is sophisticated enough that doesn’t need protection

C. Modes of Regulation
1. Merit – merit regulation should be a job for state laws/ct.s, not federal
2. Disclosure – mandate and control through ex ante (rules) and ex post (sanctions)
   a. Where to intervene is a big question – Sec. laws try to find balance
      i. By company (industry, size, maturity), by security (debt v. equity), by transaction (who is on what side), by investor (Mom&Pop/dummy v. Institutional/sophisticated)

3. Education

D. Valuing Securities
1. Efficient Capital Mkt. Hypothesis (ECMH)
   a. Semi-Weak – mkt price reflects all past price changes which doesn’t help predict what will happen in the future (“random walk”)
      i. probably true but doesn’t show the whole picture
   b. Semi-Strong - mkt price reflects all publicly available info. and price adjusts quickly to release of new info
      i. probably true and most widely accepted
      iii. counter arg – false b/c stock price reflects trading activity and many investors trade irrationally (noise trading)
   c. Strong – mkt price reflects all public and inside info
      i. probably false otherwise sec. reg. wouldn’t be necessary
      iii. this is the arg. for why insider trading should be legal
   d. Expansion on Efficiency – two kinds
      i. Informational efficiency – speed by which info gets incorporated into mkt price
         a. most ppl. believe mkts are informationally efficient
      ii. Fundamental efficiency – info reflected in price is accurate
         a. this is probably not always true or else how would we get mkt bubbles from overpriced stock

2. Present Discount Value
   a. Average investor value security based on present discount value – the price willing to pay today for $X return at t time in the future ($ willing to pay shouldn’t be more than expected return minus discount for risk):
      i. Expected return – take best guess at home much expect to make off the investment at given time intervals (probably never have immediate return)
      ii. Risks
         a. Time value – $1 today worth more than $1 tomorrow b/c inflation
         b. Other risks
            i. systemic – risks that are uniform across the mkt
            ii. unsystemic – risks that are peculiar to that particular invest’mt
a. ex. stocks have more risk than bonds b/c price of stock depends on a lot more variable

iii. Equation:

a. \[ PDV = \text{expected immediate return (usually $0)} + \left( \frac{\text{expected return for 1st yr.}}{1 + \text{risk in 1st yr.}} \right) + \frac{\text{expected return for 2d yr.}}{(1 + \text{risk in 1st yr.})(1 + \text{risk in 2d yr.})} \ldots \text{for every year doing investment} \]

b. Point – the greater the risk, the less the expected return, thus investors need access to information to accurately assess risks
II. Defining Terms – Threshold Questions

A. What is a “Security”?  
1. Threshold Issue – instrument in question must be a security for securities laws to apply  
   a. This is basically asking whether the transaction at issue is susceptible to concerns of securities laws so as to justify being swept in.

2. Look to plain language first – 33 Act §2(a)(1) broad definition of security  
   a. “any note, stock, . . . investment contract, . . .”  
   b. if characterized as “note” or “stock” look to specific tests below  
   c. if not characterized as instrument that falls under plain language for §2(a)(1) then look to ec. realities and apply “investment K” catch all

3. Investment Contract – gen’l catch all used if instrument not specifically enumerated in §2(a)(1)  
   a. Howey test (K to buy land w/ orange groves that others harvest and sell then split profits held to be an invest K)  
      i. A person invests money  
      ii. In a common enterprise and  
      iii. Is led to expect profits  
      iv. Soley from the efforts of others  
   b. Invests money  
      i. Test: Gives up valuable consideration in exchange for separable financial interest in something characteristic of a security  
         a. IBT v. Daniel – pension fund held not be an invest K b/c workers giving up work for their salary not for their pension payment  
      ii. Factors  
         a. Economic realities – what is investor really giving up consideration for, an investment or something else (e.g. house to live in, gambling for fun)?  
         b. Value – what is the worth of the consideration?  
         c. Choice – how much control does investor have over consideration she is giving up?  
         d. Congressional Intent  
            i. is there another pervasive regulatory system governing the investment  
            ii. does the investment have an impact on capitol mkts?  
            iii. similarity to enumerated securities under §2(a)(1)  
   c. Common Enterprise – 3 ways to show  
      i. Horizontal commonality – pooling of interests b/t investors so that investors either succeed together or fail together  
         a. all boats rise and fall together  
         b. all ct.s agree this is “common enterprise”  
      c. Elements  
         i. investors pool money  
         ii. investors all share in the risks and profits  
            a. examples
i. ponzi scheme – some of new investor money used to pay older investors

ii. pyramid scheme – old investors get referral fees for recruiting new investors/customers

iii. both of the above are HC b/c all investor success/failure dependent upon influx of new participants (SG Ltd.)

ii. Vertical commonality – split whether this is “common enterprise”
   a. Broad VC – investor success linked to promoter’s efforts
      i. promoter’s effort effect all boats equally
   b. Narrow VC – promoter and investor’s success is interwoven and dependant upon each other
      i. promoter’s boat rises and falls w/ investor

iii. Main question is whether investors fortunes are all tied together. If not, are investors fortunes w/ promoter’s fortune.

d. “Led” to Expect Profits
   i. Key is whether investor “led” – how would a reasonable investor perceive the situation (objective test)
   ii. Economic Realities – regardless of what the instrument is labeled (e.g. “stock”) look to substance of K over form.
      a. Foreman – Co-op City K weren’t securities even though labeled “stock” b/c ec. realities
         i. Name of the instrument is only impt. if leads investor to believe that it is protected by securities reg.
         ii. For “stock” label to apply, must possess some common characteristics of stock
            a. dividends based on profits, negotiability, ability to pledge, proportionate voting rights, ability to appreciate in value
      iii. No expectation of profits if true motivation was consumption

iii. Profits = income or return (Edwards – phone booth case)
   a. doesn’t matter whether variable (stocks) or fixed (interest on loan)
   b. Purpose of sec. reg. supports encompassing fixed returns
      i. unsophisticated investors attracted b/c of low risk
      ii. if don’t cover, promoters will just structure investments at fixed returns to get around securities reg.

e. “Solely” from Efforts of Others
   i. Why important? The more investors rely on others, the less access to info they’ll have (increase info asymmetry)
   ii. Solely doesn’t mean solely – if it did then promoters get around sec. reg. by giving investors minimal amount of control
      a. Investor can still have some control but not meaningful enough to fall outside of need for protection
      b. Look at whether control so significant that investor couldn’t have had reasonable expectation of profits solely from other
      c. Look at on scale b/t type of investor control and quality of investor control – more investor control = less likely prong met
      i. then make arg. about whether need for protection applies
ii. mainly applicable in the context of partnerships and franchises

iii. Timing element – if most of promoter efforts took place b/f sale or little impact of profitability \(\rightarrow\) less likely element met.

f. Specific Applications

i. Gambling? No, none of factors met b/c of ec. realities

ii. Ins. K? No, b/c no promoter efforts, only collect if something fails

iii. Real Property? No, other regulatory scheme, actual expectation is for consumption not profit, if there is profit its not from efforts of others

iv. Syndication (investing in housing w/ real estate developer to buy, build, and sell)? Yes, b/c no consumption only profit

v. Time Shares? SEC said look to following factors:

   a. expect profits from promoters efforts, income from property being pooled by promoter w/ other properties, mandatory rental period, mandatory agent?

vi. Partnership?

   a. Limited Partnership – Limited econ./mng. participation. Presumption of security unless limited partner has some control

   b. Gen’l Partnership – Broad econ./mng participation. Presumption not a security. P can only rebut by show GP not able to exercise that control

      i. but choosing to remain passive does not rebut presumption or else it would provide a perverse incentive

      ii. entering K that allows for control but investor not have knowledge to exercise it doesn’t rebut presumption b/c perverse incentive/freedom of K

vii. Franchise? Are franchisor’s efforts undeniably significant in determining profitability of the venture. Most franchises not securities b/c amount of control franchisor would have to exercise would make widespread operations inefficient

4. Stock

a. Sale of business vs. sale of stock in business

   i. Sale of assets of business – does not fall under plain language of §2(a)(1) and fails Howey test

   ii. Sale of all stock in business – not a security b/c “sale of biz. doctrine”

   iii. Sale of some/almost all stock in business

      a. Landreth – held owner transferring 85% of shares to new owner was sale of stock b/c stock had usual characteristics and purchase motivated by expectation of profits (see next test)

b. If characterized as “stock” then falls under plain language of statute but still must see if possess usual characteristics (Foreman Rule)

   i. usual characteristics

      a. dividends based on profit, negotiability, ability to pledge, proportional voting rights

   ii. must not have all the usual characteristics, but if it doesn’t look to policy of sec. reg. (do the investors need to be protected b/c info asymmetry) to see if should be covered
iii. other considerations
   a. motivated by expectation of profits
   b. promoter still exercised some control (didn’t transfer 100% of biz)

5. Notes
   a. Generally
      i. Def. – A promise to pay. Borrowing money is a K, and the promise to
         pay back in the note.
         a. Thus the issuer is the borrower of the money (the one who
            promised to pay back)
      ii. Not all notes covered otherwise every time a purchase is made on
          credit it would come under securities reg.
          a. “Any note” doesn’t mean any note
   b. Particular note covered falls under §2(a)(3)?
      i. Reeves v. Ernst & Young – held notes issued by Co-op raising money
         for agricultural project was a security and further held:
      ii. Howey Test rejected for analyzing notes
      iii. Family Resemblance Test – look to factors that cts in other cases held
           made a note a security and apply it to case at hand (Reeves)
           a. Presumed to be a security if can be redeemed after 9 mo.
              i. B/c if note long term, more likely being used for investment
                 purposes.
              ii. Okay if can be redeemed in less than or after 9 mo.
           b. NOT a security if note for consumer finance, home mortgage, short
              term w/ home lien, “character loan” from bank, loan by bank for
              current biz. operation
           c. Probably a security if:
              i. Issuer (borrower) has biz. operations motive (rather than
                 consumption) AND
              ii. Buyer (lender) has profit motive
      d. Other factors
         i. Are the notes being offered to the public at large
         ii. What are the reasonable expectations of the investing public
         iii. Any other regulatory scheme that covers the notes
            a. if note secured w/ collateral, arg. less need for sec. reg.
   c. Securitization – Bank selling interest in home mortgages to 3d pty who
      then pools a bunch of mortgages together and sells security in that pool.
      i. Profit – off payment in the mortgage
      ii. Risk – if homeowner defaults
      iii. Analysis – even through these are notes, analyze like under Howey b/c
           interest in a pool of notes is actually an investment K.

B. Materiality – information that is important to investors (if information is the goal
   and disclosure is the means, then policing disclosure requires know what is
   important info to investors)
   i. Definition – “substantial likelihood that the disclosure of the [info] would
      have been viewed by the reasonable investor as having significantly altered
      the ‘total mix’ of info made available” (Basic quoting TGS Industries)
2. Tests for **forward looking/speculative info**
   a. Mergers – Test is balancing the probability of even occurring against the magnitude of the event (Basic)
      i. Probability factors – interest upper level mgmt is taking in the matter
         a. board resolutions, talks with underwriters, actual negotiations
      ii. Magnitude factors – size of the entities, premiums over mkt value
      iii. Objective test
   b. Speculative Studies/Drug Tests – Alito’s rules from (Oran v. Stafford)
      i. Burlington Rule: If disc. of info doesn’t alter the stock price → immaterial as a matter of law (and vice versa) b/c under ECMH info impt. to investor immediately incorporated into mkt price.
         a. The mkt must be an open mkt.
      ii. No duty to discl. test results unless statistically significant (conclusive)
      iii. Arg.s against
         a. If more info discl. then it could have raised the alarm/altered price
         b. Need to take into account behavioral biases (see pt. 6 below)
   c. Tests rejected by ct.s
      i. Disclose everything – too much info, overwhelms investors so can’t find impt. info, imposes too much costs on corp.
      ii. Agreement in principle rule (for mergers) – both over inclusive and under inclusive b/c bright line rule doesn’t give ct. ability to weigh relevant factors, this problem outweighs benefit from bright line rule
      iii. Prior denial = always material – denial needs to be regarding a material fact
   d. Note: Discl. of forward looking info is disfavored in “quite period” b/f reg. effective date but PSLRA provides safe harbor for 10b-5

3. Test for **Historical Facts** (when reporting past revenue as current revenue)
   a. Look to quantitative and qualitative factors to determine if misstatement would been significant. in making investment dec. (Ganino v. Citizens)
      i. quantitative – how large the misrepresentation was
      ii. qualitative – whether misstatement masks a change in earnings/trends, whether misstatement hides failure to meet analyst expectations
         a. impt. b/c qualitative factors may effect even small numbers
   b. Bright line quantitative test rejected by ct.
      i. Small numbers can still be material in light of qualitative or circumstantial factors
      ii. if use bright line test for number amount that is material, provides incentive for companies to walk right up to the line

4. Test for **Opinions**
   a. For opinions to be actionable, it must be both factual and material
      i. see puffery as an affirmative defense below

5. Test for **Mngt Integrity Discl.**
   a. Various Forms (e.g. 10-Q) and Regs. (e.g. SK – 400 pg. 415 Hazen) call for discl. of specific mgmt integrity info.
      i. S-K – disclosure of info in 3 broad categories to assess quality of mgnt.
a. mngrs. past biz. performance (to predict future biz. performance)  
b. mngr. interests that may conflict w/ duty of loyalty to company  
c. benefits given to mngt. and transactions b/t mngt. and company  

b. Test: Must include enough info to keep info specifically called for in these Forms and Regs. from being misleading.  
i. Point – can’t get around purpose of law by strictly following language.  
ii. Disclose info re. mngr. reputation and relationship w/ company b/c investors rely on these things when investing  
c. Counter Arg. – this appears to start looking like merit regulation, which federal laws are not supposed to do.  

6. Other points  
a. When looking at materiality – need to consider the info at issue in relation to other info disclosed and how the “total mix” would have been altered  
b. **No gen’l duty to disclose**  
i. Thus, an omission can’t be material unless there was an SEC rule giving duty to disclose OR needed to disclose to keep another statement from being misleading.  
ii. If do disclose need to include enough info. so that there is not a material misstatement  
a. “silence is golden” – don’t say anything less have to  
iii. Just b/c something is disclosed/omitted doesn’t make it material – need to perform the “total mix” test  
c. If a particular SEC rule states another test for materiality – that test applies only to that rule  
i. ex. SK-303 states test for discl. of forward looking info that is different from Basic Test  
d. Test for materiality take into acct. behavioral biases (protect unreasonable investor)?  
i. Arg. against:  
a. too unworkable b/c behavioral tendencies inconsistent  
b. can’t police mkt based on irrational tendencies  
c. moral hazard problem – policing based on irrational tendencies encourages those tendencies  
ii. Arg. for:  
a. behavioral biases been shown to be present in individuals → if results systematic then must account for them in “average person”  
iii. Examples of behavioral biases  
a. hindsight bias, over optimism, availability bias, endowment effects, group think  

7. **Defenses** – counter arg. to whether something effects the “total mix”  
a. Truth on the mkt – the mkt already knew about the undisclosed info and incorporated it into security price  
b. Bespeaks caution doctrine – forward looking statements immaterial if accompanied by discl. that projection may not come to fruition  
i. not a hard and fast rule – securities is not a “buyer be ware” mkt
c. Statement was puffery – everybody knows the kind of info given isn’t the kind that reasonable ppl. should rely on.
   i. if everybody knows its puffery then wouldn’t effect reasonable investor’s decision
   ii. not a factual or meaningful statement (too vague)
   iii. terms we routinely throw around w/out meaning
   iv. ex. – “everybody loves us,” “you’ll get 100% return” –too unbelievable
III. Public Offering Process/Registration – the ’33 Act

A. Generally – The Economics of Public Offering
   1. Go public to raise capital (money) – Capital formation
      a. Businesses need money for:
         i. Up front expenses that will bring in later profits (Timing)
         ii. Need large amounts which individual investors can’t provide (scale)
      b. Types of capital and how to raise
         i. Equity (owning a share in business)
            a. Business owners generate their own funds
            b. Get money from individual outside investors (venture capitalists)
            c. Public/private equity offerings (stocks)
               i. Downside – dilutes % of biz. profits for equity owners
         ii. Debt (loan that business has to repay)
            a. Loans from bank
               i. Bank may not approve b/c risk, have to make interest payments
            b. Public/private debt offerings (debentures, notes, etc)
      iii. Remember – securities are just K giving issuer capital in exchange for
            giving purchaser a bundle of rights (profits, liquidate, voting)
   2. The process
      a. Issuer starts by consulting an Underwriter (UW) who provides
         i. Proper pricing advice – UW has incentive to price properly b/c wants
            offering to sell out (gets piece of the pie)
         ii. Expertise in securities regulation process
         iii. Marketing of the security
         iv. Reputational advantage of being a repeat player
      v. Added level of comfort to investors that there is another gatekeeper
         a. Potential problems w/ UW
            i. Investors may not be able to tell the good from the bad
            ii. Free riding problem if there is a syndication, if they all free
               ride then nobody is doing the work
            iii. Agency costs – indiv. UW employee has incentive to sacrifice
               UW reputation for indiv. monetary gains
            iv. Corruption of the UW- UW has incentive of guaranteeing a
               good analyst projection in exchange of issuer business.
      b. Issuer and UW decide on type of offering
         i. Firm Commitment – syndicate of Uws purchase all the shares at a
            discount then sell to mkt at face value
            a. UW keeps spread (lead UW keeps largest portion of spread)
            b. UW acts as the issuer
            c. Value of UW rep. comes most into play here b/c putting up most $
            d. Less risk for investors b/c guarantee all shares will sell out
         ii. Best Efforts – UW pledges best effort to sell all shares but no guarantee
            a. UW risk is much lower
b. Conditional best efforts – all or nothing, if all shares don’t sell everybody gets their money back (better for investors)

iii. Direct Offering – No UW. Issuer sells directly to mkt for set price.
  a. When issuer is very reliable/mature, may not need UW

iv. Dutch Auction – No fixed price. Investors bid on range of shares willing to purchase and price. Issuer then sets price at highest bid price that allows all shares in the offering to be sold.
  a. Solves problem of under pricing (leaving money on the table) for issuer but investors like under pricing b/c allows quick profit
  b. Issuer and UW reorganize the various ownership interests of issuer into single corporate form w/ common stock ownership

3. Must comply w/ Gun-Jumping rules
  a. Register Security w/ SEC
  b. Distribute statutory prospectus to investors
  c. Restriction on information that is not part of the RS or SP

B. Registering a Public Offering – Mandatory Disclosure

1. Three categories of information to disclose
  a. Transaction relation info
     i. Consists of offering amount, use of proceeds, UW info, ect
  b. Company info including
     i. Consists of audited financial and non-financial information
  c. Exhibits and undertakings

2. The above categories of information are contained in 2 primary docs:
  a. Statutory Prospectus
     i. Makes up part I of RS
     ii. Consists of Transaction info and Company Info
     iii. Must be distributed to investors
     iv. Liability: §12(a)(2) and
  b. Registration statement
     i. Part I is the Statutory Prospectus
     ii. Also contains exhibits and undertakings
     iii. Must be filed w/ SEC
     iv. Liability: §11 and due diligence (DD) def. for non-issuers

3. Two basic Forms for RS
  a. S-1: available to all issuers
     i. Required info
        a. All three categories of info
           i. SP contains transaction info and company info
              a. Financial company info must comply w/ Reg. S-X req. of 3 yrs. audited financial statements
        b. May incorporate by reference if 34Act reporting issuer for 1 yr.
  b. S-3: available to 34Act reporting issuer of at least 1 yr. AND over $75mil. of capitalization in hands of non-affiliates
     i. Required Info:
        a. Same as S-1 but may incorporate by reference
i. Incorporation by reference relies on integrated discl. and assumption of how capital mkts function
b. Not required to give investors an annual report
4. RS Forms for “small businesses issuers”
a. Def. of “small biz” – revenues under $25mil. in most recent fiscal yr.
b. Two types of RS – filed w/ SEC
   i. SB-2: All small businesses eligible
      a. Required Info:
         i. All three kinds but references Reg S-B
            a. Provides plain language instructions
            b. Simplified version of Reg. S-K for and less extensive discl. for non-financial info
            c. Only 2 yrs. audited financial statements
               i. financial info must comport w/ GAAP but not S-X
   ii. SB-1: Small businesses offering up to $10mil in any 12 months
      a. Required Info:
         i. Same as SB-2 but even more streamlined
            a. Provide discl. in simple Q and A form
            b. But must have same audited financial statements as SB-2
   c. Why small biz. have different discl. docs
      i. Cost of going public can be high (atty, auditor, reorg., UW fees, ect.)
      ii. Costs can outweigh benefit if only need to raise small capital
      iii. More danger w/ larger companies b/c can defraud more ppl.
         a. BUT few analysts following small companies which increases opportunity to mislead
5. Summary Chart

<table>
<thead>
<tr>
<th>RS Form</th>
<th>Issuers Eligible</th>
<th>Info contained in RS filed w/ SEC</th>
<th>Info contained in SP sent to investors – makes up Part I of RS</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Company Info</td>
<td>Transaction Info.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Financial Info</td>
<td>Non-Financial Info.</td>
</tr>
<tr>
<td>S-1</td>
<td>All issuers (may incorporate by reference if 34 Act reporting)</td>
<td>3 yrs. audited fin. statements complying w/ Reg. S-X</td>
<td>Reg. S-K req.</td>
</tr>
<tr>
<td>S-3</td>
<td>-34 Act reporting &gt; 1yr. - $75mi. in non-affiliates</td>
<td>Same but incorporate by reference</td>
<td>Same but incorporate by reference</td>
</tr>
<tr>
<td>SB-2</td>
<td>All issuers w/ revenue under $25mil. most recent fiscal yr.</td>
<td>Reg. S-B req. 2 yrs. audited fin. statements complying w/ GAAP</td>
<td>Reg. S-B req. (less extensive discl. than S-K)</td>
</tr>
<tr>
<td>SB-1</td>
<td>- Same as SB-2 - offering less than $10mil. in 12 mo. period</td>
<td>Same</td>
<td>Same but Q and A format (even simpler)</td>
</tr>
</tbody>
</table>

1. Policy behind the rules
a. Investors want clarity in capital structure, reduced risks, and visibility of price v. value
   i. All of this requires disclosure
b. So why prohibit certain types of disclosure during certain times?
   i. Heightened info asymmetry w/ IPOs
      a. Less worry in secondary mkt b/c ECMH
   ii. Investor has little hard data on company doing IPO to compare their statements against → avoid speculative frenzy
   iii. Assumptions about investor sophistication/cognition
2. The rules differ based on:
   a. Time Period AND
      i. Pre Filing | Waiting period | Post-Effective Period
   b. Class of Issuer – 4 classes (Defined by SEC in 2005 Public Offering Reforms)
      i. Non-Reporting Issuer
         a. Issuer not required to file reports under 34 Act §§ 13 or 15(d) and don’t voluntarily file
      ii. Unseasoned Issuer
         a. Issuers required to file under §§13 or 15(d) but doesn’t qualify for Form S-3 (has less than $75mil in non-affiliates)
      iii. Seasoned Issuer
         a. Issuers eligible to register under Form S-3 (includes parent/sub. companies)
         iv. Well-known Seasoned Issuer (WKSI) – Def. in R. 405
            a. Meets following req. by the “determination date” (date of most recent shelf registration, amendment thereto, or 10K if no SRS):
               i. Eligible to use Form S-3 AND
               ii. W/in 60 days of the determination date has either:
                  a. A minimum of $700mil. in common equity held by non-affiliates OR
                  b. Issued $1bil. aggregate of non-convertible securities in registered offerings during past 3 yrs. AND
                  c. Will register only non-convertible securities other than common equity w/ full and unconditional guarantees.
            iii. Basically must be huge AND meet temporal requirement
   b. But issuers disqualified if:
      i. Not current in 34 Act filings
      ii. Issuer is an investment or biz. development company
      iii. Ineligible under 405 def:
         a. w/in 3 yrs. were a shell company or issued penny stocks
         b. w/in 3 yrs. filed for bankruptcy, unless after emergence filed an annual report w/ audited financial statement
         c. w/in 3 yrs. filed anti fraud prov. of securities laws
         d. w/in 3 yrs. subject to refusal/stop order under 33 Act §8
         e. subject to pending proceedings under 33 Act §8
3. Pre-Filing Period
a. §5 prohibits “any person, directly or indirectly” from:
   i. (a) selling a sec. using interstate omm.. until RS becomes effective
   ii. §5(c) offering a sec. using interstate omm. prior to filing of RS
b. What is an offer?
   i. §2(a)(3) – vague statutory definition
   ii. SEC interpretation – interprets statutory definition broadly to
       accomplish goals of 33 Act (dissemination of adequate/accurate info)
       a. Anything that conditions the market – publicity/selling efforts
          (communications) by issuer/UW that “conditions the public
          mind”/arouse public interest in a security prior to filing a RS
          i. Goal it to prevent whipping up a “speculative frenzy”
             a. B/c info disseminated prior to RS is not registered, there is
                not check to make sure that it isn’t misleading/incomplete
          ii. Factors to consider whether conditions public mind
             a. Motivation of the communication
             b. Type of information distributed
             c. Breadth of the distribution
             d. Form of the communication
             e. Description of UW
       iii. R. 433(e)(1) – Hyperlinks to 3d pty websites are also offers
b. Examples of impermissible offers
   i. Projections/predictions of revenues/earning per share
   ii. Opinions concerning value of the shares
c. Permissible communications
   i. In response to inquires, can disclose factual info about
      company’s financial condition or business operations
      a. But no projections or opinions outside of SP
   ii. ex. can advertise products or continue to announce factual info.
   d. Note: Aspects of this cut against Reg. FD which requires
      dissemination of info to EVERYBODY not just those that ask
c. Safe Harbors
   i. Note: UW not eligible for any of these safe harbors except R. 135
   ii. R. 163A – §5(c) doesn’t begin until 30 days prior to registering, but
       can’t refer to the offering
      a. Must take reasonable steps to stop distribution w/ 30 day window
      b. Not available for shell companies or penny stock issuers
      c. Reg. FD prohibition against selective discl. applies
   iii. Safe Harbors from §5(c), §2(a)(10) factual info
      a. R. 168 – For 34 Act reporting issuers
         i. (a) Factual biz. info and forward looking statements excluded
            from def. of offer
            a. Periodic filings are included
         ii. (d) Must be similar “timing, manner, form” as released
             previously in “regular course of business.”
      b. R. 169 – For non 34 Act reporting issuers
         i. (a) Factual biz. info excluded from def. of offer
a. Does not exclude forward looking info
ii. (d) Must be similar “timing, manner, form” as released previously in “regular course of business”
iii. (d)(3) Disseminated to those acting in capacity other than investors (e.g., customers/suppliers)

iv. R. 163 – Safe Harbor from §5(c) for WKSI
   a. (a) Exempts all oral/written offers
      i. Exempts for pre-filing period only
   b. (a)(1) Must treat the offer as a free writing prospectus (FWP)
      i. File it w/ SEC promptly after filing RS
      ii. Written communications must include legend informing investor of statutory prospectus and how to get it
   c. Reg. FD prohibition on selective disclosure applies

v. R. 135 – Safe Harbor from §5 for notice of offering
   a. Exempts short, factual statement of proposed registered offering
      i. (a)(2) Only identify: issuer, amount, basic terms, and timing of offering, purpose of offering (w/out stating UW name)
   b. (a)(1) Must include statement that the notice doesn’t constitute an offer
   c. Note – for small business, this is the only way to get the word out

vi. §§ 5, 2 don’t apply to preliminary communications b/t issuer and UW
vii. See summary chart of these safe harbors
viii. These safe harbors are cutting on two important distinctions
   a. Kind of information and Kind of issuer
      i. bigger the issuer → more info can disseminate → more info available for public to compare → less info asymmetry

   d. Remedy for violating §5(c) is delay of offering for frenzy to subside

4. Waiting Period – after RS filed but b/f SEC declares effective

a. §5 prohibits “any person, directly or indirectly” from
   i. (a) sales still prohibited
   ii. (b)(1) using interstate commerce to transmit any prospectus after a RS has been filed unless it meets §10
   iii. (c) no longer in effect b/c RS filed (oral offers okay)

b. What is a prospectus?
   i. §2(a)(10): broad def – “any…communication, written or [broadcast] which offers…or confirms the sale of any security”
   ii. Point – We are back to prohibition against offers unless
      i. requirements of §10 are met OR
      ii. offer is not written or broadcast → face to face is okay

c. How to meet §10 requirements for a prospectus?
   i. §10(b) Preliminary SP: Prospectus can omit some info for purposes of satisfying §5(b)(1)
      a. R. 430 – can omit price of offering and price dependant info.

d. Safe Harbors (anybody can use, need this for issuer to gauge the mkt) – Offers are okay during this period if:
   i. Safe Harbors that carry over from pre-filing period
a. Either R. 168 or 169 offers (by issuer only) OR R. 135 statement by anybody
ii. Just include a Prelim. SP w/ the offer and file it w/ SEC (see last point under FWP)
iii. Oral Road Shows pitches not covered by §5 if not broadcast
iv. R. 134 Tombstone adds exempt from def. of prospectus
   a. Similar to R. 135 short and factual statement but a bit broader
      i. (a) Can include same info as 135 plus business of issuer, price of the security, and name of all UW.
   b. But list of inclusive items is VERY specific, if include something not on list, exemption doesn’t apply
      i. ex. can’t include forward looking statements
   c. (d) Can solicit offers if:
      i. Send a SP (FWP doesn’t count) w/ the solicitation or before the solicitation
         a. (f) If solicitation is electronic, a like to the SP is fine
      ii. Include a legend stating security can’t be sold prior to RS becoming effective and offer can be withdrawn.
   v. See summary chart of these safe harbors
   vi. R. 164 Free Writing Prospectus (FWP)
      a. A FWP that meets the definition of R. 433 will be considered same as §10(b) prelim SP
      b. What is a FWP?
         i. R. 455: Gen’l Def. FWP – Written communication that offers to sell or solicits an offer to buy a security that has RS filed
            a. Written = print, broadcast, graphic (electronic media)
               i. But not real time electronic commucation
            ii. Basically any offer or solicitation that isn’t face to face
      c. Requirements of R. 433:
         i. R. 164(e)(f): Investment co., shell co, and penny stock offerings are excluded and same ineligibility under R.405 as applies to WKSI (basically if done anything bad)
         ii. (c)(1) FWP can’t contain info contrary to SP
         iii. (c)(2)Include legend saying RS has been filed w/ SEC and where investor can get SP
            a. Non-Reporting and Non-Seasoned issuers must also include the SP w/ the FWP unless:
               i. (b)(2)(i)FWP made by non-paid, unaffiliated source.
               ii. Already sent SP to the investors and there have been no material changes
                  iii. FWP is electronic and included a hyperlink to SP
         iv. (g)Must retain a copy of the FWP for 3 yrs. after date of offering
         v. (d)(1)Issuer must file the FWP made by issuer or participants based on issuer info w/ the SEC on or bf/ date of first use unless:
a. (d)(1)(i)(B) FWP made based on information which the issuer didn’t provide
b. (d)(5) The terms of the offering contained in the FWP are not the final terms, in which case must file final terms w/in 2 days of being determined.
c. (d)(3) FWP doesn’t contain substantive changes/additions from previously filed FWPs
d. (d)(8)(i) It is a pre-recorded roadshow
   i. (ii) Except that non-reporting issuers doing common equity offering must file pre-recorded roadshows unless they make it available to the public
e. (f)(1) If made by an uncompensated media source on info provided by issuer/participant then only have to file /w 4 days of becoming aware.

vi. Other participants must file FWP w/ SEC if:
   a. (d)(1)(ii) They used it to achieve “broad unrestricted dissemination”
      i. SEC says large mailing to customer list is not broad unrestricted dissemination
   b. (f)(1) If made by an uncompensated media source on info provided by issuer/participant then only have to file /w 4 days of becoming aware.

vii. R. 164(b)(c) Can cure a missed filing/omitted legend if made unintentionally/good faith and fix as soon a possible
d. Point – Any issuer/UW can make offers or solicit offers so long as they include a SP and file it w/ SEC.
e. If violate 433 – no §11 liability but §12(a)(2) antifraud liability

f. Safe Harbors for analysts/broker/dealers:
   i. Def. of research report – Written communication of opinions/analysis of an issuer’s security (i.e., an “offer”)
      a. includes broadcast and graphic communication
      b. Note – none of these apply if issuer has been shell co. or penny stock issuer in last 3 yrs.
   ii. NON PARTICIPATING broker-dealers
      a. R. 137 Research report not included under §2(a)(11) def. of “offer” thereby excluding broker from def. of UW and allowing him to take advantage of §4(3) and R. 174 safe harbors if:
         i. (b) broker dealer has not received compensation from a participant
         ii. (c) broker dealer publishes the research report in the regular course of business
   iii. Safe Harbors for PARTICIPATING broker-dealers
      a. The Issuer must be a 34Act reporting co. up to date on filings AND
      b. R. 138 – limited safe harbor for §2(a)(10) and §5(c)
         i. Issuer’s offering falls into one of two classes of securities
            a. common stock or security convertible into common stock
b. debt or securities not convertible into common stock

ii. Broker-dealer may report on the class of securities that issuer IS NOT offering (the class already in secondary mkt) AND

iii. Broker dealer regularly publishes report on this class of sec.

c. R. 139 – broader safe harbor

i. Report can be specific to the issuer if:
   a. Issuer is eligible to register under S-3 AND
   b. B/D has regularly published reports on this issuer

ii. Report can comment on the issuer if:
   a. Report devotes no more space to the issuer than it does to other issuers in the same industry
   b. B/D regularly publishes these type of reports

iv. R. 164 – just structure it to meet the requirements of a FWP

5. Timing to going effective

a. §8(a) – RS becomes effective 20 days after filing
   i. But not final until amend preliminary prosecutes w/ price then 20 day period restarts b/c of amendment

b. R. 473 – Issuers usually file a delaying amendment until SEC approves.
   i. Then file an acceleration request pursuant to §8(a)
      a. reason – don’t want to set price then wait 20 days
   ii. R. 461 – factors SEC looks at in deciding to approve acceleration
      a. Lots of things, but mainly whether adequate info to public.

c. SEC ways to stop going effective
   i. §8(b) – refusal order if RS is incomplete
   ii. §8(c) – stop order after RS goes effective if find omitted or misleading statements of material fact

6. Post Effective Period

a. §5 prohibits “any person, directly or indirectly” from
   i. (b)(1) – Prohibition on prospectuses that don’t meet §10 still applies
      a. §10 requires a final §10(a) prospectus now that RS effective
   ii. (b)(2) – using interstate omm.. to delivery a security or confirm a sale w/out prospectus that meets §10(a) req. (must be final SP w/ price)

b. What is a §10(a) final statutory prospectus?
   i. Contains final pricing, UW info, ect.

c. Effect of the rules – delivery requirement
   i. All written/broadcast offers (§5(b)(1)) and confirmation of sales (§5(b)(2)) must:
      a. Meet the requirements of a §10(a) prospectus OR
      b. Be preceded or accompanied by a §10(a) prospectus
         i. Then the communication is called a “free writing” under §2(a)(10)(a)
            a. This replaces the R. 164 FWP safe harbor
   ii. R. 15c2-8(b) – If the issuer is a non 34Act reporting company, confirmations must be preceded at least 48 hrs. by prelim. prospectus
   iii. Policy – why require delivery of SP if investor probably won’t read it?
a. SEC will still review which encourages honesty
b. Analysts will review and provide info to investors indirectly
c. Most offerings purchased by instit. investors who influence mkt $

d. Delivery requirements last indefinitely, unless meets one of the following craveouts:
i. §4(1) – transactions that don’t involve an “issuer, UW, or dealer” are exempt from §5
   a. For secondary mkts – see next section
ii. §4(4) In unsolicited broker transactions, brokers are exempt from §5
iii. §4(3) For dealers (including UW no longer acting as UW in the offering):
   a. R. 174 - §5(b) delivery requirements don’t apply after:
      i. 0 days if issuer was 34 Act reporting issuer prior to the offering
      ii. 25 days if issuers securities will be listed on a nat’l exchange
   b. §4(3) - §5 doesn’t apply after:
      i. 40 days if issuer NOT doing an IPO
      ii. 90 days in all other cases
iv. R. 172 – Access = delivery in all transactions
   a. (a)(c) – If effective RS and final §10(a)SP on file w/ SEC then delivery not required under §5(b)(1)
   b. Rule doesn’t apply:
      i. When sending a “free writing”
v. Note – For issuers and UW selling their allotment delivery/notice requirements last indefinitely
e. See Summary Chart of Gun Jumping Rules

D. Updating in the Post Effective Period
1. No Gen’l duty to update EXCEPT
2. Updating the SP
   a. §10(a)(3) – If SP has to be delivered more than 90 days after RS effective date → must update info that is more than 16 mos. old
   b. If doing Shelf Registrations:
      i. R. 415 – must update SP to reflect any “fundamental changes” to info included pursuant to an S-K Item 502 Undertaking
         a. fundamental = something more than material (SEC interp.)
c. Antifraud liability – no matter what the time frame, still liable for inaccurate info in SP under §12(a)(2) and R. 10b-5
   i. 2d Cir – If SP “grossly misleading” then violates delivery requirements giving rise to §12(a)(1) liability
3. Updating the RS Generally
   a. R. 424(a) – Substantive changes to SP must be filed as a post effective amendment to the RS (b/c SP is part of RS)
      i. “substantive” = material
      ii. amendment to RS resets the effective date for liability purposes
4. Updating the RS – Only when doing a Shelf Registration
   a. Policy – this is a the most salient example of attempt to regulate by company
i. Rule allows the SR for large companies b/c so much info is out there already, not as much asymmetry

b. Gen’l Rule §6(a) (as interp. by SEC) – Can’t register securities not intending to be offered immediately or in near future
   i. §2(a)(3) – but if security is convertible → conversion is not separate

c. Exception – Shelf Registrations (offerings done on continuous or delayed basis) can be done if:
   i. R. 415 Conditions must be met
      a. (a)(1)Types of offerings that qualify
         i. Securities being offered/sold by somebody other than the registrant or a parent/subsidiary of registrant
         ii. Securities being converted
         iii. Securities being offered continuously from the effective date through longer than 30 days
         iv. Securities registered under S-3
   b. Time limits on Shelf Registration
      i. (a)(2)2 yrs. for securities being not registered under S-3 and being sold on continuous basis above
      ii. (a)(3)3 yrs. for all other qualified offerings

   c. Updating
      i. (a)(3) Must do a S-K 512 undertaking which requires filing a post-effective amendment to RS for:
         a. §10(a)(3) changes to SP
         b. “fundamental changes” to info in RS
         c. material changes in plan of distribution
      ii. Exception – S-3 registrants do not have to file the this info as a post effective amendment if info contained in periodic filings
      iii. But ALL issuers reset the effective date of the RS for liability purposes when they update the undertakings info

   ii. Additional Features
      a. 415(a)(6) Automatic Shelf Registrations
         i. Just file an ASR every 3 yrs. and it becomes effective immediately
         ii. Qualifications
            a. Must be a WKSI
            b. Must be a RS on file
            c. Must be for the kind of offering filed on S-3
            d. Indicate name or class of security
               i. but don’t have to specify quantity
               ii. can add more classes at a later time by filing post effective amendment

      iii. Benefits
            a. WKSI can continuously sell indeterminate amounts of almost any class of securities w/out delays

b. Base Prospectus
i. Issuers may omit info such as price, and UW from SP when file w/ shelf reg.
   a. Satisfies §5(b)(1) def. of prospectus during waiting period BUT NOT §5(b)(2) during post effective period until the omitted information has been added.
   b. R. 424(b)(2) must add the omitted info w/in 2 days of determining price
      i. Can file through a incorporation by reference, prospectus supplement, or post effective amend.
   c. Item 512(A) & R.430(B) filing the omitted info resets the effective date of the RS for liability purposes

E. Post Effective Trading Practices by Participants
1. Policy – the participating party’s have an incentive to boost trading price:
   a. Need to sell allocated shares
   b. Green shoe option – UW purchase additional shares at discount
   c. Reputation
2. Reg. M – Purpose to prevent fraudulent manipulation of mkt price of offered security
   a. Rule 101, 102 – Participating ptys are not allowed to bid, or induce others to bid on the offering during the “restricted period” except to sell the offering.
      i. Restricted period
         a. Large offerings – begins the day b/f offering price determined and ends after pty stops participating (e.g., sells their allotment)
         b. All other offerings – begins 5 days b/f offering price determined and ends after participation
   b. Exception that applies to all but issuer
      i. Stabilization – bids/purchases designed to maintain the price
         a. R. 104 – can do to keep price from dropping only if price if fixed
            i. Can not be greater than last independent transaction price
            ii. Must give way to independent bids at same price regardless of size
            iii. Must give notice to the mkt
## Gun Jumping Rules

<table>
<thead>
<tr>
<th>Rule</th>
<th>Pre-Filing Period</th>
<th>Waiting Period</th>
<th>Post-Effective Period</th>
<th>§4(3) SP delivery time limits</th>
</tr>
</thead>
<tbody>
<tr>
<td>R. 163A 30 Day Window</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>§5(c) prohibits offers</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>§5(a) prohibits sales (extends b/f 30 day window too)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

| §5(b)(1) prohibits transmitting a prospectus unless it meets §10 |
| §5(b)(2) prohibits transmitting securities or confirmation of sale w/out prospectus that meets §10 |
| §10(b) requires prelim. prospectus w/out price |
| §10(a) requires final prospectus w/ price |

## Safe Harbors in Pre-Filing Period

<table>
<thead>
<tr>
<th>Rule</th>
<th>Exempt From</th>
<th>Eligibility</th>
<th>Content</th>
</tr>
</thead>
</table>
| 163A | §5(c)       | Issuers     | -ANY statements occurring > 30 days b/f filing RS  
- Don’t mention offering |
| 168  | §5(c), §2(a)(10) | 34 Act reporting issuers | -Factual biz. info, forward looking info regularly released  
- Don’t mention offering |
| 169  | §5(c), §2(a)(10) | Non-34 Act reporting issuers | - Factual biz. info regularly released (no forward look)  
- Can not send to those acting in investor capacity |
| 163  | §5(c)       | WKSI’s      | - Offers (treat as FWP – file w/ SEC after filing RS, include legend on how to get SP) |
| 135  | §5          | Issuers     | -Short factual statement of proposed offering  
- Can’t refer to UW name |
| §5, §2 | §5, §2     | Issuers, UW’s | - Communications b/t UW syndicate and issuer |

See also – Analyst safe harbors under Waiting Period Section

## Safe Harbors in Waiting Period

<table>
<thead>
<tr>
<th>Rule</th>
<th>Exempt From</th>
<th>Eligibility</th>
<th>Content</th>
</tr>
</thead>
</table>
| 168  | §5(c), §2(a)(10) | 34 Act reporting issuers | -Factual biz. info, forward looking info regularly released  
- Don’t mention offering |
| 169  | §5(c), §2(a)(10) | Non-34 Act reporting issuers | - Factual biz. info regularly released (no forward look)  
- Can not send to those acting in investor capacity |
| 135  | §5          | Issuers     | -Short factual statement of proposed offering  
- Can’t refer to UW name |
| §5, §2 | §5, §2     | Issuers, UW’s | - Communications b/t UW syndicate and issuer |

### Carry overs from §5(c) safe harbors

### New safe harbors from §5(b)(1)

<table>
<thead>
<tr>
<th>Rule</th>
<th>Exempt From</th>
<th>Eligibility</th>
<th>Content</th>
</tr>
</thead>
<tbody>
<tr>
<td>§5(b)(1)</td>
<td>Complies with §5(b)(1)</td>
<td>Issuers, participants</td>
<td>Any offers so long as include a SP</td>
</tr>
<tr>
<td>§5(b)(1)</td>
<td>§5(b)(1)</td>
<td>Issuers, participants</td>
<td>Any ORAL offers, including roadshows, not broadcast</td>
</tr>
</tbody>
</table>
| 134  | §2(a)(10)   | Issuers, participants | - Like 135 but can include a bit more specified info  
- Can solicit offers if include SP and boiler plate legend |
| 164/433 | Treated as §10(b) Pros. | Issuer, participants - but not investment or shell co’s, penny stocks, or R. 405 disqualifications | - Unrestricted in what you can include BUT  
- Can’t contain contrary info to SP on file w/ RS  
- Include a legend (but non-reporting and unseasoned issuers must deliver SP)  
- Retain for 3 yrs.  
- File w/ SEC in most circumstances (see exemptions) |
IV. Exempt Offerings– Offerings that don’t require registration under §5

A. §4 Exemptions – Specific instances where §5 doesn’t apply
1. (1) – transactions by anybody other than UW, dealer, issuer (secondary mkt)
2. (2) – transactions by issuers that aren’t a public offering (private placements)
3. (3) – transactions by dealers after specified times
4. (4) – brokers in unsolicited transactions
5. (6) – certain transactions not exceeding certain amounts

B. Policy
1. What’s at stake?
   a. No worries about violating all the complicated rules
      i. No filing RS, SP, or gun-jumping violations
      ii. No 33 Act causes of action - §11, §12(a)(1), §12(a)(2)
2. Why allow exemptions?
   a. Information asymmetry may not be as great in certain types of transactions
      i. Type of issuer – larger issuers have more info in the hands of investors
      ii. Type of offering – how big is it/how many investors will there be
      iii. Type of investor – some need our help less than others
   b. Cost benefit analysis – Is the asymmetry great enough to justify the high costs of disclosure?
      i. Well regulated mkts attract investors (capitol) BUT
      ii. Costs may be so high that company’s go else to find money so
        investors never get the chance to invest → need to find balance
   c. There will still always be liability under 10b-5
   d. Path dependency – Tendency to address new issues/concerns about info asymmetry by building up additional layers b/c to just start all over again entail huge costs and waste of what we already have

V. Exempt Offerings for Issuer
A. §4(2) Exemption
1. “Transaction by issuer not involving any public offering”
   a. What does “public offering mean”?
      i. No definitions in the statute
      ii. SEC factors
         a. The number of offerees
         b. The relationship of the offerees to each other and the issuer
         c. The number of units/total size of the offering
         d. The manner of the offering
      iii. Ralston Purina – Test: whether the particular class of investors needs protection
         a. Number of offerees is not the determinative factor
         b. Determinative factor: Does the person have access to the kind of information that would normally be included in a 33 Act RS.
            i. Held: Offering to “key employees” was public b/c class included those that don’t have access to the info (janitors)
         c. What does “access” mean (Doran)?
            i. Actual access to the information (disclosure) OR
a. Not really an investor sophistication inquiry here b/c this is almost identical to a public offering to just one person

ii. The kind of relationship w/ the issuer that would give you the possibility of getting the information AND bargaining power that would force the issuer to give it to you.
   a. Bargaining power = close relationship or the level of sophistication so know what questions to ask.

b. Look to entire class of offerees when determining whether public, not just those that wound up purchasing

B. Reg. D – Safe Harbor for §4(2) b/c “public offering” is uncertain

1. Important b/c if do a §4(2) and wrong then face harsh consequences under §5
   a. Remember that if you make an offer under Reg. D but get it wrong then still violate §5.
      i. Why liability for offers even if offeror doesn’t accept?
         a. Prevent speculative Frenzy
         b. Ex ante fear – increases deterrence

2. Promulgating statutes
   a. §3(b) – public offerings under $5mil. may be exempt from §5
      i. R. 504 – exemption for offerings under $1mil.
      ii. R. 505 – exemption for offerings under $5mil
   b. §4(2) – offerings of any dollar amount may be exempt from §4(2)
      i. R. 506 – if meet conditions are not considered 4(4) public offering
   c. Note: But can also just argue that its not a public offering under Ralston

3. Rule 501 Definitions
   a. (a) accredited investors – laundry list of ppl. who don’t need protection
      i. Large institution
      ii. Officer, director, or partner of the issuer
      iii. Any person w/ net worth, or net worth w/ spouse > $1mil.
      iv. Any person w/ income > $200K or income w/ spouse > $300K for 2 most recent yrs. and reasonable expects same income for current yr.
      v. Any entity where ALL the members are accredited investors
      vi. Note: Issuer need only “reasonably believe” investor qualifies
         a. No strict liability if accredited investor lies about qualifications
   b. (e) Categories of purchasers excluded from numbers cap
      i. spouse/relatives that live w/ the purchaser
      ii. accredited investors

4. Rule 504 Qualifications
   a. May not be a 34 Act reporting co, investment or blank check co.
      i. Basically only small companies
   b. Up to $1mil. in aggregate offering
      i. But must reduce offering by amount of other offerings done under §3(b) or in violation of §5 w/in past 12 month
   c. Unlimited number of purchasers
   d. No disclosure requirements – R. 502(b)
   e. Other benefits unique to 504 – if the security complies w/ state law registration requirements then:
5. Rule 505 Qualifications
   a. May not be a an investment co.
      i. All 34 Act reporting co. are eligible
   b. Up to $5mil. in aggregate offering
      i. But must reduce offering by amount of other offerings done under §3(b) or in violation of §5 w/in past 12 month
   c. Only have 35 purchasers
      i. Accredited purchasers and live in relatives don’t count as purchasers
   d. Some limited disclosure – R. 502(b)
   e. Disqualification if the issuer, affiliate, UW, officer/director, or 10% owner has been involved in specified conduct which violates securities laws

6. Rule 506 Qualifications
   a. All issuers eligible
   b. No limit on offering amounts
   c. Only have 35 “sophisticated purchasers – either alone or w/ purchaser’s representative
      i. Lang. of 506(b)(ii): issuer must reasonably believes that purchaser/rep.“has such knowledge and experience in financial and business matters that he is capable of evaluating the merits and risks of the prospective investment”
      ii. Factors (not from the rule)
         a. Wealth/income, experience, education, investment status
         b. Better to play it safe and just not offer to these guys
      iii. Accredited purchasers and live in relatives don’t count as purchasers
   d. More disclosure of financial info based on amount of offering – R. 502(b)

7. Gen’l points that apply to all 3 Reg. D Offerings
   a. Rule 502 – Conditions
      i. (a) integration – Offerings that take place w/in a 6 mo. window on either side of the offering at issuer may be considered all part of the same offering (for purposes of det. no. of investor limits, ect.)
         a. Factors in determining whether 6 mo. safe harbor applies
            i. Single plan of financing
            ii. Same class
            iii. 2 of securities
            iv. At or about the same time
            v. Same type of consideration received
            vi. Sales made for the same gen’l purpose
         b. Exception to the safe harbor – Offerings of the same class w/in the 6 mo. window will ALWAYS be integrated.
            i. Not only the offering amount, but also the # of investors gets aggregated.
      ii. (b) limited discl. – offerings under R. 505, 506 require limited disclosure to non-accredited investors
         a. 34 Act reporting issuers – disclosure same regardless of amount
i. Most recent annual report and proxy statement OR
ii. Most recent 10-K if it contains info in annual report AND
iii. Any more recent 34 Act filings made since info above AND
iv. Brief description of the securities
b. Non 34 Act reporting issuers: discl varies based on amount
i. Non financial info – same for regardless of amount
   a. The type of info as would be found in Part I of a RS
ii. Financial info – varies based on amount of offering
   a. Up to $2mil – Item 310 of S-B
   b. Up to $7.5mil – Financial info contained in Form SB-2
   c. Over $7.5mil – Financial statement info contained in RS
c. Info that must be provided by all 505, 506 issuers
   i. Give non-accredited investors a description of material written
      info that has been provided to accredited investors
   ii. Give purchasers the chance to ask questions/receive answers
   iii. Any additional info purchaser requests necessary to verify
        accuracy of any of the mandatory disclosures
   iii. (c) prohibition on gen’l solicitations – prohibition on making gen’l
        solicitations on any of the Reg. D offerings (this is the biggie)
        a. This only applies if solicitation is arguably gen’l – offer to a
           handful of ppl is fine even if you don’t know them.
        b. If solicitation is arguably gen’l then:
           i. Kenman Corp. - Must be a pre-existing relationship the type
              which issuer can determine if offeree is sophisticated
           ii. Note - meeting where attendees have been invited by a gen’l
               solicitation also counts – R. 502(c)(2).
        c. Can get around this by creating a stable of clients prior to offering
        b. Rule 503 – Must file a Form D w/ SEC w/in 15 day of first sale
           i. If ct. has ordered an injunction from violation → can’t use Reg. D
        c. Rule 508 – Safe harbor from private liability for a §5 violation if:
           i. Mistake did not pertain to a requirement directly intended for investor
              protection
           ii. Mistake was insignificant w/ respect to the offering as a whole
               a. violations of gen’l solicitation, aggregation, # of investors is never
                  insignificant
               iii. “Good faith and reasonable attempt was made to comply”

8. Summary Chart

<table>
<thead>
<tr>
<th>Issuers Eligible</th>
<th>R. 504</th>
<th>R. 505</th>
<th>R. 506</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aggregate Offering</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Amount</td>
<td>No 34 Act cos, Investment or Blank Check cos.</td>
<td>No Investment cos.</td>
<td>All Issuers</td>
</tr>
<tr>
<td>Number of Purchasers</td>
<td>Unlimited</td>
<td>35 (less accredited/family members)</td>
<td>35 sophisticated (less accredited/family members)</td>
</tr>
<tr>
<td>Disclosure?</td>
<td>None</td>
<td>Limited</td>
<td>Limited</td>
</tr>
</tbody>
</table>
VI. Exempt Transactions for Other Parties – Secondary Mkt Resales

A. Gen’l Rule: 33 Act § 5 – Nobody can offer or sell a security unless it has a RS in effect.
   1. This poses a problem for investors that want to sell a security which they purchased b/c don’t always know if a RS is in effect.
   2. How to solve?
      a. §4(1) – Transactions not involving “issuer, UW, dealer” are exempt from §5
      b. §4(4) – Broker is exempt from §5 in unsolicited broker transactions.
         i. Note §4(2) no good b/c private placement purchasers can’t resell.
      c. These exemptions create breathing room necessary to create a secondary mkt. But key to qualifying is not having UW present in transaction.

B. How to determine whether UW present in transaction
   1. §2(a)(11) def. – “any person who purchased from an issuer with a view to…distribution” OR, “offers or sells for an issuer, in connection with, the distribution of any security”
      a. Two big terms in the def. “with a view to” and “distribution” that BOTH must be present for the purchaser to be an UW (two prong test)
         i. Note – the person must also have purchased from an issuer. If it wasn’t a purchase from an issuer then not an UW and any later re-sales are exempt from §5.
   2. “With a view to” – inquiry into purchasers mental state or purpose for the purchase at the time of the purchase.
      a. If it was an investment purpose – then the view was not to distribution and not an UW.
      b. Inquiry is whether there was a change in purchasers circumstances to change his mind from view to investment when purchased to view to distribution when sold or whether the view to distribution was there all along.
         i. Passage of time (Ackerberg)
            a. If purchase held for 2 yrs. then presumption they have “come to rest” and initial purchase was made w/ investment intent
            b. If purchase held for 3 yrs. then “conclusive presumption” they have come to rest.
         ii. Unexpected change in purchasers circumstances (Gilligan, Will)
            a. Must be an expected change in investor’s circumstances (not a downturn in issuer) that forces investor to sell.
   3. “Distribution” – purchaser can purchase with a view to anything, so long as it wasn’t distribution.
      a. Distribution interpreted to mean “public offering” under Ralston Purina.
         i. This brings us back to our §4(2) exemption analysis. Is the transaction the type that requires investor protection?
            a. Thus the “view to” can even be other sales, so long as it wasn’t a public offering.
4. Note on participation – a person may be held liable as an UW in the
distribution of unregistered securities if they continuously solicit offers on the
security → even if they have no contractual relationship w/ the UW

5. Consequences if seller found to be an UW
a. The sale from UW to investor is collapsed into sale from issuer to
investor. If security is unregistered and §4(2) doesn’t apply, issuer is
liable for private and SEC sanctions for §5 violations and UW may be
liable too.

C. §4(1) exemption for Control Persons Re-sales
1. §2(a)(11) Def. of control persons for determining whether UW present in
transaction.
   a. Control Persons = Persons directly or indirectly under the control of the
issuer or controlling the issuer.
2. Two step analysis:
   a. Is control person offering directly to investors w/out the use of a 3d pty?
      i. If yes, then use same analysis to determine if acting as an UW as
         would use fore everybody else (above).
   b. If control person offering to investors w/ help of a 3d pty then:
      i. §2(a)(11) – control person is considered same as the issuer.
         ii. Must determine if 3d pty acting as an UW:
            a. Test: Are the securities being “distributed”? This is Ralston Purina
               inquiry – Can the investors fend for themselves?
            b. If securities are not being “distributed” then § 4(1) exempts entire
               transaction → this is referred to as exemption 4(1 ½).
               i. Note: 3d pty participation as the broker does not count as a
                  “dealer” under §4(1) (Ackerman)
                  a. If it did, then nearly all secondary mkt transactions would
                     get swallowed up by §5 requirements.
                  b. “Dealer” under §4(1) is more like an UW w/ stake in the
                     offering, not a neutral broker.
            c. If securities are being distributed (b/c doesn’t pass Ralston Purina
               test) → 3d pty falls under §2(a)(11) def. of “UW” and destroy the
               §4(1) exemption to the transaction. All ptys on the hook for §5
               violation if security not registered.
               i. But 3d pty broker can be exempt under §4(4) if the transaction
                  was unsolicited.
                  a. §4(4) is a personal exemption only for the broker
                     (Wolfson).

3. Policy – Why make it harder for control persons?
   a. Control persons have an information advantage that the investor doesn’t
      share.
   b. Control persons have the ability to force the issuer to register the security

D. Rule 144 Safe Harbor from Def. of UW
1. R.144 – If meet the conditions of the rule, then won’t be considered an UW
for purposes of §4(1) exemption regardless of investment intent (distribution)
   a. Conditions:
i. Must be adequate information on the mkt about the issuer
   a. All 34 Act reporting co.s meet this requirement
ii. If the security is “restricted” the seller must have held for 1 yr.
   a. restricted security = gained directly or indirectly (through broker) from the issuer or affiliate (control person) through a 505, 506 offering or transaction not involving a “public offering.”
iii. Restriction on amount of security sold in a 3 mo. period
iv. Sale must take place through an unsolicited transaction
v. Must file From 144 notice of sale w/ SEC no later than placing first order for sale w/ the broker
   a. Doesn’t apply to small sales w/in a 3 mo. period
b. R. 144(k) – Safe Harbor to the Conditions
   i. Non affiliates (non control persons) can sell the securities w/out restrictions if hold on to for 2 yrs. from purchase.
VII. Civil Liability for ’33 Act Violations

A. Policy – Why does ’33 Act have own liability rather than just 10b-5?
1. Greater incentive for fraud b/c profits more direct
   a. Offerings must more direct – You took caused me to part w/ my money and you took it
2. Great lemons problem – Sellers who aren’t committing fraud will have harder time distinguishing themselves from fraudster
3. No arg. here about investors coming out even on a net basis

B. Private Causes of action
1. §11 – fraud in the registration statement
2. §12(a)(1) – violations of §5
3. §12(a)(2) – fraud in the prospectus and related statements

C. §11 Liability – D’s are more narrow but elements relaxed
1. Standing – Who may sue?
   a. Strict Tracing – P must show w/ “reasonable certainty” that specific shares she purchased where part of the public offering under the fraudulent RS
      i. Mere possibility that P’s shares came from the offering or that shares where commingled in a fungible mass w/ shares from the offering is not enough (Abbey v. Computer Memory)
      ii. §11 is stricter in scope b/c reliance is presumed
   a. Other causes of action for those more indirectly harmed
2. Statutory Defendants
   a. (a)(1) – Those who signed the RS (pursuant to §6(a) includes issuer, CEO, CFO)
   b. (a)(2), (3) – Directors, or named as soon to be directors, or performs similar functions
   c. (a)(4) – Experts who prepared or certified a part of RS
   d. (a)(5) – UW
   e. §15 – Control Persons of any of the above
3. Elements
   a. Material misstatement/omission in the RS
   b. Reliance on the misstatement required only if:
      i. D released an earnings statement covering at least a 12 mo. period after the effective date
         a. filing of post effective amendment re-sets the effective date
      ii. But P does not have to prove that she read the RS
      iii. Otherwise reliance is presumed
   c. No requirements of scienter – but see defenses below
4. Defenses
   a. One of the above two elements weren’t proven
   b. §11(a) – P had actual knowledge of the fraud (also goes to no materiality)
      i. D could announcement misstatement to entire mkt
      ii. Once correct misstatement in “total mix” in mkt, no longer material
   c. §11(b)(1) – D blew whistle (must quit and tell SEC)
   d. §11(e) loss causation defense – P’s loss from depreciation in stock price was due to factors other than the misstatement in the RS
i. if price actually went up, could also argue not material (Ackerman)
ii. Goal of D here is just to muddy the waters

**e. §13 – SOL**
i. Must file w/ 1 yr. of when P should have found out about fraud through reasonable care AND
ii. No matter what, can’t bring suit more than 3 yrs. after fraud

**f. §11(b)(3) Due Diligence – for everybody but issuers**
i. Two distinctions
   a. Experts v. non experts – experts are the accountants doing audit, non-experts are all the other Ds
   b. Expertised portion of RS v. non expertised – expertised portion is only the audited financial info certified by auditor (Worldcom)
      i. Includes 10-Ks if incorporated by reference b/c require audit
      ii. Does not include 10-Qs or other info even w/ a comfort ltr b/c no independent audit done.
   ii. Experts DD requirements
      a. Expertised portion - Reasonable investigation AND reasonable grounds to believe AND did believe the truth
         i. Can’t just rely on mngt integrity (Worldcom)
         ii. Must comply w/ GAAS when doing audit
      b. Non-expertised portion – no liability (§11(a)(4)
   iii. Non-Experts
      a. Expertised portion - Reasonable grounds to believe AND did believe the truth
         i. But does not have to make separate investigation
      b. Non-expertised portion - Reasonable investigation AND reasonable grounds to believe AND did believe the truth

iv. **§11(c) Reasonable Investigation Standard - that required by a prudent man in management of his own property (Escott v. BarChris)**
   a. Bar Chris Factors to take into account:
      i. How high up in the org. D was
      ii. How much D participated in preparing the RS
      iii. D’s background education/knowledge
   b. SEC Rule 176 Factors
      i. Type of Issuer, Type of security, Type of person, Office held
      ii. Reasonable reliance on employees whose documents should have given the D knowledge of the particular facts
   c. Worldcom factors for UW
      i. Can’t just ignore expertised (audited) info
      ii. Can’t rely on expertised portion if “red flags” raised
         a. red flag – place reasonable pty in UW positions on notice that audit done improperly (don’t have to be clear)
         i. ex. company really profitable

v. Policy considerations
   a. DD defense is hard to win! But why?
      i. Want to incentivize mngt/underwriter gatekeeping
ii. If allowed to rely on comfort ltrs. then full blown audits would stop b/c comfort ltrs cheaper for auditor.

iii. Want to promote ongoing relationships w/ UW and issuer so UW always on top of the biz. info

b. Counter arg
i. Judges have hindsight bias
ii. CEOs need to be able to rely on their minions
iii. UW have time constraints and economic waste to repeat audits
iv. Ongoing UW/Issuer relationships could lead to corruption

vi. For test – if going to argue DD def. not apply, have to argue what D should have done.

5. Damages - §11(e)
a. Difference b/t price P paid (but not exceeding offering price) and
i. If P sold shares prior to filing suit – Price at which P sold shares
ii. If P still owns shares at disposition of suit – Value of shares at time of filing
iii. If P sold shares after filing suit but b/f disposition – Price at which P sold the shares
a. Unless D can show value of the shares was greater than mkt price
b. Is this right? see 3) bottom of pg. 515
b. How to determine “value”
i. Value can be different than mkt price b/c multiple factors could effect price of stock and only one of them may be D’s misstatement
a. Take mkt price then add or subtract for the outside factors
   i. ex. value = mkt price + $2 to make up for panic selling
ii. P must argue – Depreciation in mkt price from D’s misstatement would have been even greater had it not been for other factors (“value” is lower than mkt price or at least equal to mkt price)
   a. Make sure I have the direction P wants to argue correct
b. Exogenous positive news lessened the decline
c. The news of the misstatement leaked slowly (lessened the decline) b/c mkt thin
d. No such thing as a “true value” – value is what mkt says it is.
e. To rebut no decrease (or an increase) after misstatement release:
   i. Price decline occurred b/f formal release b/c misstatement had leaked b/f formal release (Ackerman)
iii. D must argue – Depreciation in price after P bought came from factors other than D’s misstatement (“value” is greater than mkt price”)
   a. Panic selling (Beecher case)
b. Price drop due to litigation, mngt distracted
c. Exogenous negative info exaggerated decline (poor mkt overall)

6. Shared Liability
a. Gen’l §11 Rule – All D’s are jointly and severally liable
b. Exceptions
i. §11(f) – Outside directors limited to their proportionate share
ii. §11(e) – UW limited to total price at which the securities were offered
iii. K for Indemnification/contribution
   a. §11(f) – Explicit right to contribution by other ptys (but must K)
      i. If a D settles early, jury will still assess proportionate liability
         of all D’s and non-settling D’s only have to pay their
         proportionate share
   b. Indemnification – View is not allowed b/c runs counter to policies
      of securities laws (SEC interp., Eichensholtz v. Brennan)

D. §12(a)(1) Liability – Private cause of action for violating §5
1. Elements
   a. Standing - Any person who purchases a security that violates § 5 can
      sue...
   b. Potential Ds - Any person who offered or sold the security in violation of
      § 5 to the P.
      i. Seller = issuer
      ii. Offerer = UW, broker, promoter if motivated by his own financial
          interests (can’t be offering to gratuitously benefit issuer).
          a. Ex. (from Pinter case)
             i. Direct financial interest in the sale
             ii. Serving financial interests of the issuer (e.g. employment)
                a. Ct’s split over whether ministerial financial interest counts
   c. The offer or sale must violated §5
2. Defenses
   a. Strict liability if §5 violation except for § SOL (1yr/3yr.)
   b. Offerer arguments
      i. Employees don’t have a stake in how well their employers do
         a. Financial interest is getting salary the employer
      ii. Tip given gratuitously (e.g., to a friend) → extend liability too far
         a. Counter arg – Tip given w/ financial interest that friend would give
            you a tip. Plain language reading of the rule (offer = promoting)
3. Remedy
   a. Rescission – If P is still holding the security
      i. P is only going to sue if the price drops
      ii. Turns out to be like a “put option” – if price drops below a certain
          point then P can resell back to seller
   b. Damages – If P has sold the security
      i. Diff. b/t P’s purchase price and sale price
   c. D’s are entitled to contribution

E. §12(a)(2) Liability – Private cause of action for misstatements is prospectus
1. Elements
   a. Standing – Any P who purchases a security from
   b. Potential Ds – Any person who offered or sold the security through
      i. Same analysis as §12(a)(1) applies for offerers
   c. Interstate Commerce “by means of”
   d. A Prospectus
      i. Must be a §10 prospectus (only for registered offerings) or the more
         broad §2(a)(10) prospectus?
a. Gustafson answers (investment K called “prospectus” covered?)
   i. **Majority** – §10 and §2(a)(2) prospectuses are the same and they both are: A document available to the public that describes a public offering of securities by issuer/controlling shareholder
   ii. Dissent - §10 meaning of prospectus is entirely diff. than §2(a)(10) gen’l def., which should apply in §12(a)(2) actions
   iii. Point – even through majority was formalistic, it actually came to a meaning that was somewhere between the two definitions
b. Point/Subsequent Interp. – It must be a public offering AND there must be a §5 delivery obligation
   i. Secondary and Private placement transactions not covered
e. That contained a material misstatement/omission
f. Note: “By means of” – implied as a limited causal inquiry that the misstatement played a part in P’s decision to purchase
   i. Sanders case – P doesn’t actually have to read prospectus, can prove through efficient mkt hypothesis

2. Defenses
   a. P knew about the misstatement
   b. §12(b) Loss causation - P’s loss from depreciation in stock price was due to factors other than the misstatement in the RS
   c. Reasonable care defense – D didn’t not know and could not have known the truth through the exercise of reasonable care
   i. Similar to DD defense but no affirmative duty to make an investigation in non-expertised portions like w/ §11.

3. Damages
   a. Rescission if still have, damages if sold – like §12(a)(1)
   
F. See Master Cause of Action Chart at end of Outline for Summary
VIII. 34 Act Registration/Disclosure

A. Mandatory Disclosure

1. Generally
   a. Registration under the ’34 act (becoming an exchange act reporting company) means mandatory periodic disclosure
      i. High degree of delegation to SEC
      ii. Note the difference b/t whether the SEC makes it mandatory to disclose something is distinct from whether it is material.
   b. Rationale: Coordination, Agency Costs, Allocates Efficiency (see expansion on these issues in Section I)
      i. When ownership in company is broadly dispersed, we want to make sure owners have access to the info they need
   c. Analysis Framework: When its required, what is required, to whom need to disclose?

2. When is it required to register (to become “public”):
   a. §12(a) – Unlawful for broker dealer to engage in a transaction with a security unless it is registered
      i. Means companies that want their shares traded by broker dealers have to register
      ii. §12(b)/Form 10 – process for registration
      iii. How to get out of this status (going dark)
         a. delist from being traded
   b. §15(d) – Issuers doing a public offering (including debt) must comply w/ disclosure requirements of the 34 Act until at least the next fiscal year after the effective registration date
      i. How to get out of this status (going dark)
         a. less than 300 shareholders any time greater than 1 yr. after the offering
   c. §12(g) – Issuers effecting interstate commerce (if have a stock trading on nat’l mkt including OTC) must register if (R. 12g-1):
      i. at least $10mil. total assets AND
      ii. at least 500 shareholders
         a. R.12g5-1: must count all beneficial owners (can’t combine multiple ownership interests into one trust to circumvent rule)
         iii. as measured by last day of fiscal year
         iv. companies can also voluntary register if don’t meet minimums
         v. How to get out of this status (going dark)
            a. R.12g-4: fewer than 300 shareholders OR
            b. §12(g) – less than 500 shareholders AND less than $10mil. in assets on the last day of 3 prior fiscal yrs.

d. Summary Chart

<table>
<thead>
<tr>
<th>Section</th>
<th>Trigger</th>
<th>Discl. Requirements</th>
<th>Termination</th>
</tr>
</thead>
<tbody>
<tr>
<td>§12(a)</td>
<td>Registering a security on an exchange (securities traded by a broker/dealer) e.g. - listing</td>
<td>Periodic Filings, Proxy Rules/Annual Report, Tender Offer Rules, Insider Stock Transactions (§16)</td>
<td>Delisting and either: &lt;300 Shareholders OR &lt; 500 Shareholders AND &lt;$10mil in assets for 3 years</td>
</tr>
<tr>
<td>§12(g)</td>
<td>Securities traded interstate and</td>
<td>Periodic Filings</td>
<td>Either:</td>
</tr>
<tr>
<td>--------</td>
<td>---------------------------------</td>
<td>-----------------</td>
<td>--------</td>
</tr>
<tr>
<td>&gt; 500 Shareholders and</td>
<td>Proxy Rules/Annual Report</td>
<td>&lt; 300 Shareholders OR</td>
<td></td>
</tr>
<tr>
<td>&gt; $10mil. total assets</td>
<td>Tender Offer Rules</td>
<td>&lt; 500 Shareholders AND</td>
<td></td>
</tr>
<tr>
<td>e.g. – size</td>
<td>Insider Stock Transactions (§16)</td>
<td>&lt; $10mil. in assets for 3 years</td>
<td></td>
</tr>
<tr>
<td>§15(d)</td>
<td>Registered public offering</td>
<td>Periodic Filings</td>
<td>No earlier than next fiscal year after the offering</td>
</tr>
<tr>
<td>e.g. – public offering</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

e. Note – if required to register pursuant to more than one of the above sections, must meet going dark qualification for each section b/f can go dark.

3. Why would company want to stay private rather than registering?
   a. Get out of having to make mandatory period disclosures
      i. Avoid transaction and compliance costs (lawyers, accountant, ect.)
   b. Avoid sanctioning except 10b-5 b/c that applies to unregistered securities too
   c. Avoid public scrutiny

4. What is required
   a. §13(a) – gives SEC authority to require all §12 registered issuers to file disclosure documents (3 kinds)
   b. Form 10-K – filed annually, most detailed disclosure
      i. Draws requirements from Reg. S-K (Items 101-103, 201, 301-305, 401-404, 601 and 701)
         a. Most is info investors would deem impt. when making invest. dec.
            i. Includes info on registrant’s:
               a. Business,
               b. Properties,
               c. Legal Proceedings,
               d. Market for Common Stock,
               e. Management Discussion and Analysis of Financial Condition (MD&A)
                  i. see discussion in next section
               f. Directors/Officers, Executive Compensation,
               g. Security Ownership of Certain Beneficial Owners & Management,
               h. Certain Relationships and Related Transactions,
               i. Principal Accounting Fees and Services
               j. Outcome of Shareholder votes
      ii. Financial Info (audited v. unaudited)
         a. Reg. S-X sets out requirements for financial statements that must be certified by outside auditor
            i. R. 13b-2 – officers/directors can’t mislead auditors
         b. Reg. S-K Item 303 supplements w/ unaudited MD&A narrative
            i. requires forward looking info – “known trends or uncertainties” “reasonably likely” to have an material impact on financial condition of registrant

37
ii. (c) – safe harbor from private liability for forward looking info
iii. (a)(4) – discl. of off-balance sheet arrangements

c. Form 10-Q – filed quarterly
   i. No requirement for audited financial info

d. 10-K and 10-Q must be certified by CEO and CFO
   i. SOX §302 sets out what officers are certifying to by signing the Forms
   ii. Purpose of officer certification
       a. holds officers accountable for ensuring accuracy of fin. numbers
       b. reduces officers ability to claim ignorance for mistakes
       c. more difficult to evade personal liability in private suits
       d. increases penalties b/c crime to sign false financial statement
   iii. Argument whether this is imposing strict liability (liability w/out
       inquiry into fault) on officers or neg’l (imposing a duty and liability for
       failing to fulfill the duty)

e. Form 8-K – filed w/in 4 days of the occurrence of specified events

<table>
<thead>
<tr>
<th>Section of the Form</th>
<th>Type of event</th>
</tr>
</thead>
<tbody>
<tr>
<td>§1. Registrant’s Biz. &amp; Operations</td>
<td>Entry into, a material amendment to, or termination of a material definitive agreement (contracts outside the ordinary course of business). Includes ltr of intent of merger only if imposes binding obligations</td>
</tr>
<tr>
<td></td>
<td>Filing of bankruptcy or receivership</td>
</tr>
<tr>
<td>§2. Financial Information</td>
<td>Completion of the acquisition/disposition of assets that make up &gt; 10% total assets</td>
</tr>
<tr>
<td></td>
<td>Results of operations and financial condition if they are disclosed by press release before the filing of a 10-Q or 10-K</td>
</tr>
<tr>
<td></td>
<td>Creation or triggering of an off-balance sheet arrangement (in response to Enron)</td>
</tr>
<tr>
<td></td>
<td>Costs associated w/ exist or disposal activities – including employee termination benefits, contract terminations, etc.</td>
</tr>
<tr>
<td></td>
<td>Material impairments to assets such as goodwill (intangible value of biz. reputation on the books)</td>
</tr>
<tr>
<td>§3. Securities &amp; Trading Markets – related directly to interests of shareholders</td>
<td>Receipt of notice of delisting or a transfer of listing (of stock)</td>
</tr>
<tr>
<td></td>
<td>Unregistered sale of equity securities (dilutes stock value)</td>
</tr>
<tr>
<td></td>
<td>Material Modifications to the rights to security holders (usually in a negative way)</td>
</tr>
<tr>
<td>§4. Matters Related to Accountants &amp; Financial Statements</td>
<td>Changes in the company’s outside auditor (and reasons for change)</td>
</tr>
<tr>
<td></td>
<td>Notice that previously issued financial statements/audit reports should no longer be relied on</td>
</tr>
<tr>
<td>§5. Corporate Governance &amp; Management</td>
<td>A change in control of the registrant</td>
</tr>
<tr>
<td></td>
<td>Departure/appointment of directors and principal officers</td>
</tr>
<tr>
<td></td>
<td>Amendments to the articles of incorporation or bylaws</td>
</tr>
<tr>
<td></td>
<td>Changes is company’s fiscal year</td>
</tr>
<tr>
<td></td>
<td>Temporary suspension of trading under employee benefits plan</td>
</tr>
<tr>
<td></td>
<td>Amendment to the registrant’s code of ethics or waiver of requirements of the code, or if there is no code required must explain why</td>
</tr>
<tr>
<td>§7. Regulation FD</td>
<td>Any disclosures required to comply with Reg. FD</td>
</tr>
<tr>
<td>§8. Other Events</td>
<td>Anything the issuer thinks would be of interest to its security holders (no time req.)</td>
</tr>
<tr>
<td>§9. Financial Statements &amp; Exhibits</td>
<td>For businesses acquired by the registrant</td>
</tr>
</tbody>
</table>
Note: see actual § for detailed disclosure requirement (some §§ require description of circumstance surrounding the event – e.g. §5 director departures)

f. Integrated disclosure – the disclosure forms above (and public offering disclosure forms) refer to specific disclosure requirements contained in:
   i. Reg. S-K – for non-financial statement info
   ii. Reg. S-X – for financial statement info
   iii. benefits
      a. allows ppl. to learn only 1 set of disclosure requirements
      b. allows integrated disclosure

5. Other Disclosure Venues
   a. There are numerous other ways that companies voluntarily disclose info to investors other than through filings
      i. ex. press releases, roadshows, analyst conversations, ect.
      ii. this is usually how financial earnings are first released
   b. Need for Regulation?
      i. Fairness – selective discl. gives some ppl. and advantage over others which flies in face of evenhandedness goal of securities reg.
      ii. Corruption - company may selectively disclose to certain analysts to curry favor

6. Solution: Reg FD prohibitions against selective disclosure
   a. R. 100 – Whenever an issuer discloses material non-public info to a covered group, the issuer must make that info public
      i. Applies only ‘34 Act reporting companies (registered companies)
      ii. “Covered” groups include:
         a. broker dealers
         b. investment advisors/investment companies
         c. any investor in the issuer that is reasonably expected to trade on the info
      iii. Not covered groups include:
         a. rating agencies
         b. doesn’t apply during public offering process
   b. If discl. intentional → must make simultaneous discl. to public
   c. If discl. unintentional → must discl. to public w/in 24 hrs. or by time trading commences on NYSE, whichever is sooner
   d. R. 102 – No private cause of action

B. Accuracy of Disclosure

1. Books and Records Violations
   a. §13(b)(2)(A) – Registered companies must make and keep books/records that accurately reflect, in reasonable detail, the transactions/dispositions of the assets of the company.
   b. §13(b)(2)(B) – Registered companies must devise and maintain internal accounting controls to provide reasonable assurances of proper execution of transactions and accuracy of books/records
      i. Tonka – SEC brought suit against Tonaka b/c CFO set up shell corp. that did biz. w/ Tonka and Tonka had no controls to detect this fraud.
c. These provisions are incredibly broad – SEC can interpret it to mean whatever they want
   i. the two provisions act as a belt and suspenders approach
   ii. any mistake in company’s internal records can be a violation
   iii. treated as fallback when they really want to get somebody

d. Strict liability and no materiality requirement!!!
   i. But §13(b)(4) - criminal if “knowingly” falsified a document

e. SOX
   i. §302 – this is one of the things CEO and CFO must certify to
   ii. §304 – CEO & CFO must return bonuses received for period that financial statements must be restated b/c of “misconduct”
      a. misconduct not defined nor limited to activ. by CEO & CFO
   iii. §404 – mngrs must include statement in annual report on mngr responsibility for internal controls and outside auditor must certify

2. Gatekeepers
   a. Generally
      i. Def – Gatekeepers are any 3d pty w/out whom the transaction couldn’t take place
      ii. How to create
         a. By mandate (ex. 10-Ks must be audited)
         b. Mkt forces (ex. econ. incentive to have reputable firms auditing)
            i. arg. for relying solely on mkt forces – all auditor has to sell is their reputation → great econ. incentive not to hurt reputation
            ii. counter arg. – only finite number of audits can be done, but sky is the limit for other services → strong incentive to keep client happy (we have seem examples of this)
      iii. Why sanction gatekeepers instead of penalizing primary pty for not relying on a gatekeeper?
         a. W/out a sanction, gatekeeper has econ. incentive to appease issuer
            i. by penalizing it realigns econ. interests to represent public too
         b. Reduces gov’t enforcement costs
         c. Gatekeeping raises probability of catching violations
            i. Economic formula for devising sanctions
               a. expected sanction (ES) must be > benefit from violation
               b. ES = probability of getting caught X sanction
      iv. Problems w/ Gatekeeper sanctions
         a. Even w/ sanctions remains large incentive for gatekeeper to keep client happy b/c gatekeeper dependent on client fees.
         b. Difficult to have firm represents a client yet also act as a cop
            i. May keep gatekeeper from having access to client info that needs to put the gate down
            ii. Clients may stop asking gate keeper about ex ante transactions

b. Outside Auditors
   i. How are they gatekeepers
      a. R. 13a-1 – 10-K financial statements must be audited
      b. Mkt force – crazy to keep track of finances w/out auditor
ii. **Tasks/Duties**
   a. abide by GAAP (gen’l accepted acct. prin.) – how do calculate #s
   b. abide by GAAS (gen’l accepted acct. stand.) – how conduct audit
   c. abide by PCAOB (pub. co. acct. oversight brd.) – sets standards of audits and supervises/disciplines public accountants
   d. §10A – sets out other duties auditors have:
      i. (a) procedures to find criminal activity
      ii. (b) when auditors need to rat out clients
         a. this is the only provision that wasn’t new w/ SOX
      iii. (g) restricts auditor’s ability to sell client non-audit services
      iv. (j) auditor must rotate partner in charge of audit every 5 yrs.
      v. (l) can’t work as outside auditor then go to work for issuer
      vi. (m) audit committee has detailed responsibility for supervising outside auditors

iii. **Liability/Sanctions**
   a. primary violations (See list of D’s for 33 & 34 Act violations)
   b. aiding and abetting (SEC and DOJ only)
   c. SEC Rule of Practice 102(c) – Accountants censured/barred from practicing b/f SEC if:
      i. lacking proper qualifications
      ii. engaged in unethical or improper professional conduct
         a. improper prof. conduct defined as:
            i. intentional/reckless that violates professional standards
            ii. neg’l conduct in form of unreasonable conduct
      iii. willfully violated/aided and abetted violation of any sec. laws
   d. 18 USC §1520 – criminal offense to destroy audit records

c. **Lawyers**
   i. How are they gatekeepers
      a. Lawyer’s client is the corp. (shareholders) → must check mngt.
         behavior that diverges from interests of shareholders
      i. but not as easy as to police mngt as auditors → only applies
         when mngt behavior grossly departs from legal standard
      b. Lawyers bound by ethical rules that align interests more w/ public
      c. NO MANDATE BY STATUTE like auditors
         i. but sec. reg. is complex and need lawyers to understand
         ii. ex ante incentive - relying on lawyer could be affirmative def.

ii. **Tasks/Duties**
   a. SEC Rule of practice 205 – requires lawyers to report material violations of sec. laws/breaches of fid. duty to issuer’s gen’l counsel, then audit committee if response insufficient
      i. permissive to reveal to SEC if preventing fraud/perjury

iii. **Sanctions**
   a. Same as accountants (above)
   b. Lawyers can be found to be a cause of a §13(a) violation (the statute that requires filing of 10-K, 10-Q, 8-K)

iv. How differ from accountants
a. Don’t have to certify financial statements (no sticking neck out)
b. Have ex ante and ex post role (accountants only have ex ante role)
IX. Agency Enforcement

A. SEC Enforcement of Disclosure/Accuracy Regime

1. The process
   a. Company irregularities are reported to SEC Enforcement Div. from:
      i. Articles in WSJ or other tips
      ii. Irregularities in periodic filings w/ SEC
      iii. Self regulating organizations (SRO’s – NADAQ, ect.) give referral
      iv. Other gov’t agencies give referral
   b. Informal investigation to determine how serious
      i. Usually starts as invest. against indiv. then decision to get comp. too
   c. Most cases settle at this point
      i. Why?
         a. Allows comp. to move on from uncertain situation/bad reputation
         b. Saves company $ of expensive litigation
         c. Adverts adverse ruling thus collateral estoppel in private lit.
         d. Money in the bank and good press for fed. gov’t
   ii. What are they settling to?
      a. Consent Order (for §21C or §15(c)(4) proceedings) or Consent decree for injunctive proceedings in fed. ct. AND
      b. Neither admit nor deny
         i. Companies won’t settle w/out it b/c collateral estoppel
         ii. But arg. that SEC’s message gets diluted and prevents development of case law
         iii. Note: company/employees can’t later deny wrongdoing
   iii. SEC criteria for giving leniency to company
      a. Accidental or willful violation
      b. Circumstances leading up to violation
         i. where there compliance procedures in place?
      c. How pervasive was the misconduct (how high up chain did it go?)
      d. How long did the misconduct last
      e. What was the harm
      f. How was the harm detected/who uncovered
      g. Response time of company
      h. How did the company respond
         i. internally and w/ regard to regulators and investors
      i. What process did company use to resolve problem
         i. Were the audit committee and/or directors informed?
      j. Commitment to learning the truth
      k. Did the company turn investigation over to outside firm?
      l. Company and employee cooperation in the investigation?
         i. Why Relevant
            a. Saves SEC resources/allows investigation of more cases
            b. Reduces likelihood company will be viewed as obstructive
         ii. Waiver of A/C privilege?
            a. May want SEC to know what lawyer said to use as defense
               i. must show atty advice given w/ knowledge of the facts
iii. Indemnification
   a. Arg. indemnification for sanctions undoes deterrent effect
   b. Arg. re: atty fees indemnification
      i. if not have then nobody will want to work there, have to raise salaries to compete
      ii. if do have reduces incentive for employees to ex ante refrain from questionable conduct
m. Measure company is taking to prevent future violations
n. Has the company changed hands since misconduct occurred?
d. If informal investigation shows serious violation and no settlement → seek approval from Commission to start formal investigation
   i. §21(a) SEC has power to investigation/report any pot’l sec. violations
      a. power very broad – can investigate an entire industry if want
   ii. §21(b) gives SEC power to issue subpoenas
      a. also very broad – just has to be new info (not reported in filings)
         i. can investigate an entire industry if they want
         ii. don’t want to make SEC run to ct. every time wants subpoena
e. Commission delegates investigation/subpoena power to Enforcement Div.
   i. §21(c) – if subpoena not complied w/ need to go to fed. ct. to get order to comply. If still not comply → contempt of ct.
      a. Ct. will enforce if SEC says investigation in progress (no proof of violation need) Why?
         i. Can’t submit proof if investigation just beginning
         ii. Ct. doesn’t have time to do fact finding on every subpoena
         iii. Reduced expectation of privacy w/ public co.’s
      b. Can only overcome if issued in bad faith (no legit. purpose) or unduly burdensome (SEC already has the info or can easily get)
f. SEC begins Administrative proceeding against company
   i. This is civil authority which can also be used in Fed. Dist. Ct.
   ii. Can refer criminal violations to DOJ
2. Administrative Proceedings
a. §21C Cease and Desist Order proceedings (§8A in 33 Act)
   i. Generally
      a. This is SEC’s primary means of enforcement b/c cheaper, faster, and easier than going to fed. ct. and sets up for serious sanctions if violate again
      b. FRCP don’t apply, governed by SEC Rules of Practice
   ii. Cause for the proceeding
      a. Violation of any securities laws
   iii. Potential Defendants
      a. Any broker, dealer, investment advisor, or accountant who violates any securities law
      b. Any of the same who “is, was, or could be” the cause of a violation due to an act or omission person should’ve known would contribute to violation
i. Especially useful for sanctioning accountants as an alternative to Rule of Practice 102(e) b/c that requires showing willful ethical violation whereas this only requires neg’l

ii. Can this draw in issuers or their employees?

iv. Sanctions
a. SEC administrative judge cease and desist order to stop current violation or prohibit future violations of same kind
   i. If violate the order – seek civil penalties and/or injunction in fed. ct.

b. Temporary cease and desist order – must stop the violation and prevent dissipation of assets pending the outcome of the proceeding
   i. SEC must show violation likely to result in significant dissipation of assets, harm to investors, or pub. interest
   ii. Requires notice to issuer and a hearing unless notice hearing prior to issuing order would harm pub. interest

c. Disgorgement of funds resulting from violation

d. Auditor can get civil penalties for violating whistle blowing duty of §10(A)(b) (see §21B for range of civil penalties)

e. Officer/Director bar from serving public companies
   i. must violate §10(b) and be “unfit” under §12(C)(f)

f. Need to seek judicial enforcement to enforce any of these remedies and if so, is sanction contempt of ct. or is sanction to comply with the remedy (as if suit was brought directly under §21(d) (see below)?)

b. §15(c)(4) Disclosure Violation Proceedings
i. Cause for the proceeding
   a. Violations of 34 Act §§ 12, 13, 14, 15(d) covering periodic disclosure requirement and proxy solicitations

ii. Potential Defendants
   a. Any person subject to the above disclosure requirements who violated them
      i. Gives SEC advantage b/c employees may want to settle to prevent being named

   b. Person was the cause of the failure to comply
      i. includes accountants and lawyers

iii. Sanctions
   a. Admin. judge order to stop disclosure violations
      i. If don’t comply, get order compelling obedience from fed. ct.
      ii. If break that order, sanction is contempt of ct.

c. §21(a) Report of Investigation
i. Cause for SEC to issue report
   a. Results of investigation of any person who may have or is about to violate ’34 Act or any SRO rules
   b. Serve as a basis for recommending future legislation

ii. Sanctions
a. Public scolding by publishing of report
b. This is SEC’s lease stringent sanction
d. §12(j) & (k) Trading Suspensions
   i. Cause for suspension
      a. suspension required to protect investor and public interest
   ii. Potential Defendants
      a. any security can be suspended from trading
   iii. Sanctions
      a. (k) - suspend for up to 10
         i. S. Ct. held can’t do repeated 10 day suspension
         ii. But R. 15c2-11 – broker dealers can’t resume trading until info
             on company is current (requires current periodic filings)
      b. (j) – indefinitely suspension
         i. must provide notice and hearing to issuer first
e. Summary Chart

<table>
<thead>
<tr>
<th>Authority</th>
<th>Proceeding</th>
<th>Cause</th>
<th>Defendants</th>
<th>Sanctions</th>
<th>Advantage</th>
</tr>
</thead>
</table>
| 21C and 33 Act §8A | Cease and desist | - Current violations of sec. laws
- Future violations of sec. laws | - Broker, dealers, accountants who violated sec. laws
- Any of the same who caused the violation | - Temporary Restraining Order
- Cease and desist order from violating sec. laws
- Disgorgement
- Officer/Director bar from public companies (if violated §10(b) and unfit under §12(C)(f)) | - Cheaper, faster, easier than going to fed. ct. (neg’l standard)
- Sets up for serious sanctions
- Home field advantage |
| 15(c)(4) | Disclosure Violations | Violations of §§12, 13, 14, 14(d) | - Persons subject to discl. requirements
- Persons who caused the violation | - Order to stop disclosure violations
- If violate order, get ct. order compelling obedience
- If violate ct. order, sanction is contempt of court | - Seek sanctions against indiv. employee as tool to encourage settlement w/ company |
| 21(a) | Report of investigation | - Investigate persons who may have or are about to violate ’34 Act or SRO rules | - Any potential violators | Public announcement of violation of securities laws | - Public Scolding |
| 12(j) & (k) | Trading Suspensions | Suspension required to protect investors and public interest | - Any security | Halt trading for 10 days or indefinitely | |

3. Judicial Review of Administrative Proceedings
   a. §25(a)(1) Orders from SEC admin. proceedings are subject to review by Circuit Ct. in which person seeking review resides or D.C. Circuit Ct.
b. Standard of Review
   i. §25(a)(4) SEC entitled to presumption of correct:
      a. factual findings unless if supported by substantial evid.
      b. interpretation of law unless unwarranted interpretation
         i. if interpretation of law is novel, SEC must give notice of
            interpretation to satisfy due process requirements
   ii. SEC’s choice of sanctions not overturned unless “arbitrary, capricious,
        abuse of discretion, or unwarranted in law”
      a. Review for Cease and Desist order is that must have “reasonable
         relation” to prior violations (i.e., prohibits acts w/ same goals)
         i. If Order prevents future violations of same kind, need to show
            likelihood that they will occur
4. SEC Civil Remedies (other than administrative proceedings)
   a. Generally – for more serious violations, SEC skips administrative
      proceedings and heads straight to fed. ct. to seek sanctions
   b. Possible Sanctions
      i. Injunctions
         a. 34 Act §21(d)(1), 33 Act § 20(b) – authorizes SEC to file civil suit
            to enjoin violations of securities laws, regs., and SRO rules
            i. No need to show inadequacy of other remedies
         b. What SEC must show:
            i. If seeking injunction for current violation
               a. Must show same elements as would need to prove for the
                  underlying violation
                  i. if statute requires showing of scienter, must prove
                  ii. if no scienter requirement in statute, no need to prove
            ii. If seeking injunction for future violations
               a. Must show future violation likely
         b. Factors (from Sargent and First Pac.):
            i. Nature and seriousness of the violation
            ii. Repetition of Violations
            iii. What does this show about D’s past or future badness
            iv. Is D in a position to violate again
            v. Was D culpable in the offenses (scienter)
      c. Fact intensive inquiry b/c is sitting equity
      c. Problematic for issuers b/c must discl. injunctions (and cease and
         desist orders) in periodic filings for 5 yrs. (Reg. S-K Item 401)
      ii. Disgorgement, Fines, Bar from begin officer/director
         a. §21(d)(2), (3) gives SEC authority so sue in Fed. Dist. ct. for
            Disgorgement, fines, and bar from serving as officer/director
         b. Unlike §21C – can bring action against any violator, including
            issuer and employees
         c. Factors to consider in deciding whether to assess civil
            penalties/disgorgement
            i. Same as injunction (above) plus:
               a. D’s financial worth
b. What other penalties is D subject to

c. Whether D attempted to conceal his conduct

d. Disgorged funds go to the investors or U.S. Treasury if not possible to identify victims

e. Why fine a company for the activities of their employees?
   i. Deterrence – it incentivizes company to closely watch behavior of employees and install compliance programs

iii. Other remedies
   a. §21(d)(5) – SEC can seek and Fed. Ct. grant any other equitable remedies appropriate for benefit of investors

B. Criminal Enforcement

1. Parallel SEC/DOJ Proceedings – Company being investigated by SEC and DOJ at same time
   a. Problems:
      i. Testimony from SEC investigation can be used against witness in criminal case and private litigation
         a. §21(g) – private pts can’t consolidate their claims w/ SEC injunctive action w/out permission (permission rarely granted)
      ii. B/c SEC admin. proceeding is civil, rights given to criminal D’s don’t apply
         a. But SEC Rules of Practice allows witness to be accompanied by atty and
         b. Witness can invoke 5th A. against self incriminating statements
            i. But adverse inference can be drawn against him in SEC proceeding only
            ii. 5th A. right doesn’t attach to block subpoena of incriminating company docs (no 5th A. right in paper).
      iii. Civil discovery is broader than criminal discovery
      iv. Defenses asserted in civil case could tip off prosecutors and give them an advantage

b. Notwithstanding problems civil proceeding are only stayed where:
   i. Gov’t acting in bad faith by bringing dual proceeding to disadvantage D OR
   ii. Interests of justice require a stay of civil proceeding b/c substantial prejudice to the rights of D
      a. D must have substantial rights harmed and no way around it
         i. ex. indicted for same charge as SEC investigation AND all of the above concerns come into play (even then still only discretionary)
   iii. Rationale
      a. SOL may run if a proceeding is stayed
      b. SEC often needs fast civil remedies to protect investors
      c. Evidence may become stale (e.g. witness forget)
      d. Congress encourages sharing of info b/t agencies
iv. Reality – SEC usually stays its proceeding b/c if DOJ wins collateral estoppel helps and if DOJ looses SEC gets another bite at the apple w/ lower preponderance standard

2. Criminal Sanctions
a. §21(d) – SEC refers criminal violations of sec. laws to USAO
b. §32(a) – criminal to:
   i. willfully violate any provision, reg., or rule of 34 Act
      a. especially willful violations of §10(b)
   ii. willfully and knowingly make or cause to be made a false or misleading material statement in a 34 Act filing
c. SOX
   i. 18 USC § 1348 – crime to “knowingly” commit sec. fraud
   ii. 18 USC § 1350 – crime if CEO/CFO “knowingly” certify a false financial statement
d. Defense – no knowledge of the regulation that was violated
   i. But imputed knowledge for fraud b/c everybody knows its wrong
   ii. “Conscious Wrongdoing” Standard (Dixon case):
      a. Even if don’t know what rule violating a willful decision to do a wrong act satisfies §32(a) willful requirement
         i. This standard tries to find a middle ground b/t the lack of knowledge defense and thimbleriggers (those who consciously try to loophole around the law)
         ii. Thus proving a “willful” act is less onerous a burden than proving knowledge (b/c D’s burden to prove lack of knowledge)
      b. Thimblerigging is common problem w/ rules based law b/c always new ways to get around the rule that causes same harm
         i. Look to form over substance – technical compliance can still be violation if causes same harm rule enacted to prevent (ex. Worldcom arg. that complied w/ GAAP)

3. Why have criminal sanctions?
   a. Sanction formula
      i. Expected sanction (ES) must be > expected benefit
      ii. $ES = \text{probability of getting caught} \times \text{sanction}$
      iii. Since probability of getting caught is low, need to have high sanction for actor to choose avoidance over benefit.
   b. Fines is often not enough to raise expected sanction over expected benefit b/c
      i. D’s wealth is capped
      ii. Money paying fines w/ is fruits of the fraud so it doesn’t take anything away from D.
      iii. Need criminal sanction to raise ES above monetary wealth
   iv. Retribution – ppl. angry at big execs. who stole other’s money
   c. Why not criminalize everything
      i. Discourage desirable social behavior (big risk/big reward)
ii. High sanctions for everything provides perverse incentive to commit big crime instead of staying small
X. Private Enforcement - Rule 10b-5

A. Purpose

1. Private pts can seek sanctions for secondary mkt transactions for fraud only (not all the nuanced violation of sec. laws that SEC/DOJ can enforce)
2. Why allow these additional sanctions? To increase deterrence to prevent:
   a. The lemon problem (see discussion on 1st pg.)
   b. Agency costs (see discussion on 1st pg.)
   c. Investor sophistication – Investors should be able to prevent harm from fraud by diversifying, but that depends on assumption of sophistication, which a lot of investors aren’t.

B. Plain language of the Rule

1. §10(b) – promulgating statute
   a. Crime to engage in any device to defraud in contrivance of any Rules passed under the statute
      i. Broad delegation of policing power to SEC
      ii. SEC could have adopted many specific rules, but instead adopted a very broad Rule: 10b-5

2. Rule 10b-5 language – Crime to:
   a. Directly or Indirectly
   b. Through interstate commerce, mail, or exchange
   c. (a) Employ a device, scheme, or artifice to defraud OR
   d. (b) Make untrue statement of material fact OR
   e. (c) Omit material fact necessary to make statement not misleading OR
   f. (d) Engage in act, practice, course of business which would operate or operates as fraud or deceit
   g. In connection with a purchase or sale of security
   h. EFFECT – this basically grants court common law authority to sanction securities fraud.

C. Overlap Issues

1. Can bring suit under 10b-5 and other 33/34 Act sections (Huddleson)
   a. Because private cause of action is judicially implied must look to policy of the rule (rather than plain language) to make the determination

2. Policy behind the Rule
   a. 10b-5 provides remedy for broad class of P’s (purchasers and sellers)
      i. Wouldn’t make sense to bar broader remedy if narrow remedy allowed
   b. 10b-5 address different acts than other statutes (fraud in purchase OR sale)
   c. Needed to give effect to purpose of added protection to purchasers

3. Why bring 10b-5 if can sue under another provision?
   a. 10b-5 has longer SOL
   b. Class of potential defendants is broader than most other sections
   c. May be able to get more damages under 10b-5

4. Other provisions that may overlap
   a. 33 Act §11: Strict liability for false/misleading statement in offering
      i. Huddleson case – see above policy rationale why may bring both
   b. 34 Act §9: Prohibits manipulative acts on nat’l security exchanges
i. Traders can’t create false appearance of active trading or false demand in a security

ii. Explicitly provides for a provide cause of action but limited to those who bought/sold on nat’l exchange at price affected by manipulation

c. 33 Act §17(a):

D. Class Actions

1. Why allow them?

a. Adds to deterrence

i. Adding private police eliminates a ceiling on probability of getting caught (see formula on pg. ?)

ii. Gov’t has limited resources but class action att’y only limited by how much money they can collect

a. But if allow SEC to be self funding by taking piece of settlement this arg. would be eliminated

b. Long history of class actions in other legal regimes

c. Collective action problem (see pg. 1)

2. Problems class actions cause

a. Waste – cost to society for bringing frivolous suits even greater here b/c large litigation expense to even determine if suit is frivolous

i. Gives Ps bargaining chip to settle even frivolous suits

b. Less deterrence – if chance of having frivolous suit brought against is high regardless of whether commit fraud, less incentive not to commit fraud

c. Judicial economy – takes a lot of time/money to sort out frivolous v. merit

d. Lots of potential victims – lots of ppl. own stock an harm is more tangible diffuse than other torts

e. Point – must be some limits on class of Ps. Finding a balance b/t meeting remedial purpose and limiting class of P’s is a main theme b/c

i. Private remedy is judicially implied to don’t want to overextend

ii. Societal harm from frivolous suits is great in this context

3. PLSRA – Congress’ Solution under 34 Act §§ 21D, E

a. Lead P will be the shareholder w/ largest financial interest

i. Rebuttable presumption that person w/ most harm is in best position to determine whether case should be brought/settle/go to trail

b. Must plead w/ particularity facts that make strong inference of scienter

i. Weeds out cases early that won’t survive b/c can’t prove an element

c. Discovery stayed until after motion to dismiss state

i. Saves costs of frivolous suit, reduces friv. P’s bargaining chip

d. Safe harbor for forward looking statements

e. Proportionate liability for D’s not acting intentionally

a. Rather than joint and several liability

f. Point – reduces incentive to bring frivolous suits

4. Results

a. Number of class suits being brought hasn’t decreased

b. But amount of fraud may be increasing/kinds of fraud may be changing

E. Who Can Sue under 10b-5: Two limiting rules

1. “In connection with” requirement
a. P must be a purchaser or seller of a sec. (Blue Chip Stamps: P discouraged from the purchase through overly pessimistic statement had no standing)
   i. 3 classes of P’s who have no standing
      a. Potential purchaser who didn’t buy
      b. Potential seller who didn’t sell
      c. Shareholder/creditors who suffered harm b/c of fraudulent purchase/sales of insiders (insider trading)
         i. But shareholders of the issuer can bring a derivative suit if the issuer was a purchaser or seller.
   ii. Rationale
      a. Limits class of P’s to only those that can show actual harm
         i. Problematic for ct’s to have to speculate about what P would have done and what harm they would have suffered
      b. Potential for abuse b/c of great power wielded by P
      c. Private cause of action is judicially implied so don’t want to over extend (too easy for P to claim “I would have bought/sold)
         i. Judicial oak grown from legislative acorn
   b. P’s purchase or sale must be a necessary component of D’s fraud
      i. Ex. Stealing money then using that money to purchase security not covered (This is a hypo given in Zanford)
      ii. But no contractual privity b/t D and P required (relationship b/t P and D is not determinative)

2. Selecting lead P under PLSRA Develop this issue more if have time – see flagged pg in notes (may be policy issue on test)
   a. Problems in selecting a lead P
      i. Division in interest b/t P’s who have sold their stock and those that still have shares in the D
         a. Those w/out stock may be okay w/ settlement that bankrupts D
      ii. Division in interests b/t individual investors and institutional investors
         a. Instit. investors may wind up controlling b/t smaller investors don’t have the economic incentive to stay active in the litigation
      iii. Lead P may be corrupt – getting kickbacks from lead counsel
         a. Causes fraud on rest of class b/c instead of controlling atty fees, lead P is actually promoting higher atty fees
         b. PLSRA prohibits lead P from getting more than pro rata share or serving as lead P in no more than 5 suits w/in 3 yrs.
      iv. Lead P may not have enough interest in claim to control lead att’y
         a. PLSRA counteracts by presumption lead P has most interest
         b. Ct.’s try to control att’y fees through diff. approaches (below)
   b. Solutions – PLSRA standard on selecting lead P
      i. Rebuttable presumption that most adequate P to be lead P is P w/ largest financial interest in the litigation
         a. Can be a group of P’s (should be less than 5) but can’t be group created by an att’y
         b. Ct’s still use their judgment in determining adequacy
i. May not est. presumption if: not enough incentive, diff. claims, unsophisticated, unreasonable fee arrangement

ii. May be rebutted by a member of the class showing:
   a. Presumptive P will not fairly protect interests of the class OR
      i. ex. Lead att’y paying offing lead P,
   b. Is subject to unique defenses → incapable of rep. interests of class

iii. Presumption that lead P’s choice of counsel is adequate
   a. overcome by showing: lead P unsophisticated, poor process of choosing counsel, counsel chosen not experienced, didn’t negotiate properly for atty fees

iv. Presumption of reasonableness of att’y fees negotiated by lead P
   a. overcome by showing: unusual change in circumstances since fee negotiations, fees clearly excessive
      i. Diff methods of determining excessiveness of fees
         a. Loadstar Approach
            i. calculate base atty fees based on # of hrs. atty expected to work and mkt rate for atty w/ similar experience
            ii. then apply a “multiplier” accounting for riskiness and complexity of case and atty’s performance
         b. Percentage of Recovery Approach
            i. fees not allowed to exceed “reasonable amount” of class settlement and prejudgment interest
   ii. Either method, reasonableness usually = 20 – 30% of recovery.

F. Defendants under 10b-5
   1. Lang. of rule: “any person” who violates “directly or indirectly” is liable
   2. Who is a secondary violator?
      a. No aiding and abetting liability in private cause of action (Central Bank)
         i. Aiding and abetting not covered by plain lang. (congressional intent)
            a. None of the other private actions cover aiding and abetting
         ii. Worry about providing too much deterrence
            a. aiding and abetting is broader than indirect violations
            b. discourage 3d pts from providing advice
      b. Central Bank essentially eliminates secondary violators
   3. Who is primary violator – “ANY person” who:
      a. Employs an agent to commit the fraud/misrep. (e.g., business entities)
      b. Otherwise, two different tests used by court
         i. Bright Line (2d Cir Ernst & Young)
            a. Statement must be directly attributable to D to be primary violator
               i. D friendly test – no matter how strong D’s scienter is, if didn’t directly make the statement then no liability
            ii. Substantial Participant (9th Cir.)
               a. 3d pty may be primarily liable for statements made by others if “significant participation” in making the statement
                  i. similar to a “but for” inquiry
                  ii. ex. accountant who helped draft a ltr. sent to SEC
            iii. Third test created by Enron judge
a. If 3rd pty was involved in creating the fraudulent transaction AND has scienter → primary violator

iv. This entire inquiry is trying to find a balance b/t compensation goal (deep pocket D’s help P), deterrence goal (want to deter but don’t want to discourage some socially desirable activity), and limiting friv. suits

4. Split liability for multiple D’s
a. Traditional rule - §10(b) D’s are jointly and severally liable
b. PSLRA §21D(f) – D’s who are only recklessly involved pay only proportionate share found by jury. Except when:
   i. Joint/several liability if P’s net worth is less than $200K and damages exceed 10% of net worth
   ii. Must pay shortfall of Co-D, if Co-D goes insolvent and shortfall is up to 50% of other D’s proportionate share

G. Elements of 10b-5 cause of action

1. Conduct by D – two choices
   a. manipulative or deceptive (lang. for §10(b)) AND
      i. scheme or device to defraud (language of (a)) OR
      ii. act, practice, or course of biz which operates to defraud (lang. of (d)).
      iii. Sante Fe Industries – breach of fid. duty not enough w/out it being manipulative or deceptive b/c plain breach of fid. duty is state law claim – don’t want to expand into state law (primary concern).
         a. Point – the scheme/act must be manipulative or deceptive!!!
   b. materially false statement, misstatement, or omissions (lang of (b) and (c))
      i. Must be material
      ii. Duty to correct?
         a. Yes, if statement incorrect when made
            i. no scienter inquiry into why original statement incorrect
         b. Split if correct when made then later becomes incorrect (updating)
            i. 7th Cir – no duty to update at least until next periodic disclosure
               a. not update isn’t manipulation, it’s neg’l
               b. requiring continuous disclosure infringes on periodic disclosure rules
               c. can’t correct a statement that wasn’t incorrect when made
            ii. 2nd Cir – maybe if prior statement “alive”/forward looking
         c. No, if statement made by a 3rd pty unless D becomes “entangled”
   iii. PSLRA Safe Harbor for forward looking statements - §21E
      a. Forward looking statement is not material if include cautionary warning not to rely (codification of Bespeaks doctrine)
      i. Must be a written statement (Asher case)
      ii. §21E(c) - statement must be “meaningful”/identify factors that are “important”/“could cause actual result to differ materially”
      iii. Asher ct. interpretation
          a. Must be tailored to the risks (not boiler plate)
             i. factual and tailored to biz, but not include every factor
             ii. balance b/t “get out of jail free card” and so cautionary that negates all positive predictions (Asher case)
      b. Why have safe harbor?
i. This is often the most valuable info to investors
ii. Issuers especially susceptible to lawsuits for forward looking info → reduce frivolous lawsuits

2. Scienter
   a. Must be an intent to deceive (Ernst & Ernst v. Hochfelder)
   b. Why?
      i. Lang. of §10(b) – “manipulative or deceptive” is a mental state
      ii. Other stat. where neg’l is enough are express, have due diligence defense, and narrow class of Ds – ex. 33 Act §11
   c. What mental state is enough?
      i. Intent – Yes, conscious object
      ii. Knowledge – Yes, awareness
      iii. Recklessness – Yes in most ct.’s, conscious disregard
         a. Problem b/c some ct.’s articulate as “gross neg’l”
         b. This is basically just asking how easy ct. will make it for P to plead
   d. How to plead – PSLRA req. pleading facts w/ particularity giving rise to strong inference of scienter
      i. Must plead unusual/heightened motive and opportunity
         a. can’t use blanket accusations
         b. factors that if plead make the motive unusual/particular
            i. insider trading, timing of the act, magnitude of the mistake, D’s incentive to commit the fraud,
      ii. P not entitled to have inferences drawn in his favor
      iii. Without this it would be too easy for P to get past pleading stage

3. Reliance (only private P’s have to prove, not the SEC)
   a. Omissions - where there is a duty to disclose, and D makes an omission, P’s reliance is PRESUMED (don’t have to prove)
      a. ex. Affiliate Ute – Held P’s reliance was on brokers duty to disclose, where broker didn’t tell P selling theirs shares for profit.
   b. Misrepresentations – P does not have to have been a recipient of the misrepresentation to rely on it (can also prove face to face reliance).
      i. Rat. - Fraud on Mkt theory: in efficient mkt stock price reflects all info, including D’s misrepresentation and investor relies on mkt price
         a. But problem w/ efficient mkt – mkt price also reflects behavioral biases and noise trading.
      ii. Must show: material misrepresentation, efficient mkt, P traded during relevant time
      iii. D can rebut presumption by showing misrep didn’t affect:
         a. price paid by P (mkt knew the truth) OR
         b. P’s decision to purchase (P bought for reasons other than mkt price)

4. Loss Causation
   a. §21D(b)(4) – in any 34 Act violation P had burden of proving D’s act/omission caused the loss
      i. This is proximate cause inquiry – P must show price inflated b/c misrepresentation AND price dropped b/c truth leaked to mkt
      ii. Proving price was artificially inflated alone is not enough b/c:
a. If P sells b/f price drops (truth disseminated) then no loss
b. Price may drop, not b/c truth of misstatement leaked, but b/c of other economic or mkt factors

5. Damages
   a. Factually similar to loss causation, but quantitative focus
   b. Two diff. goals being accomplished
      i. Deterrence – make sanction just greater than D’s benefit/social harm
         a. sanction must be greater than benefit b/c prob. of getting caught is less than 100% (Sanct’n X Prob. must be > Expected benefit/harm)
      ii. Compensation – pay P back for out of pocket expenses
   c. Remedies/damage calculation possibilities
      i. Out of pocket expenses: Price sold at – actual value at time of sale
         a. When applicable
            i. FOM – some misstatement which causes stock price to artificially rise then drop when truth is disseminated
            ii. Face to face transactions
            iii. This is the typical rule
      
   b. Problems
      i. No aggregate harm to investors – for every investor that purchased at inflated price, another sold
      ii. If transaction was FOM
         a. No benefit to D if D is a corp. b/c FOM doesn’t raise funds
         b. Compensation vastly outweighs benefit to D if D was officer b/c expenses of class huge
      iii. Tough to determine “actual value” – battle of experts
         a. PSLRA §21D(e) caps factors to be considered in det. value
      
   ii. Disgorgement – D gives D’s profits to P
      a. When applicable
         i. When D’s profits are greater than P’s losses
         ii. Face to face and Open mkt
         iii. Do not take away D’s profits attributable to any “unusual” efforts by D (Pidock v. Sunnyland)
            a. ex. efforts D performed that were above and beyond his compensated mgt duties (aggressive mngt. activ.)
      b. Problems
         i. Serves deterrence by way overcompensates P
      iii. Rescission – put P back in position would have been if no fraud
         a. Can be return of security, return of purchase price, or purchase price – sale price (until P found out about the fraud)
         b. When applicable
            i. Fraud in the inducement (including lie about risks involved)
            ii. Face to face transactions only
      iv. Benefit of the bargain: Value promised – value received
         a. When applicable
            i. Must show “value promised” with certainty (rare)
               a. unusually only to prevent unjust enrichment
            ii. Face to face transactions only
<table>
<thead>
<tr>
<th>§ Violated</th>
<th>Conduct</th>
<th>Standing</th>
<th>Defendants</th>
<th>Elements</th>
<th>Defenses</th>
<th>Remedy</th>
</tr>
</thead>
<tbody>
<tr>
<td>§33 §12(a)(1)</td>
<td>Violation of §5</td>
<td>Any person who bought a security from a D</td>
<td>Any person who violated §5</td>
<td>Violation of §5 (strict liability)</td>
<td>Strict Liability</td>
<td>Rescission or damages if P sold already</td>
</tr>
<tr>
<td>§33 §11</td>
<td>Fraud in RS</td>
<td>Strict Tracing of sec. purchased to offering w/ fraudulent RS</td>
<td>Statutory Ds</td>
<td>- Material misstatement in RS (as of effective date)</td>
<td>- P had actual knowledge of fraud - D blew whistle - Loss causation - DD for all but issuers - SOL</td>
<td>Differs depending on if P sold b/f suit, after suit filed, or still owns</td>
</tr>
<tr>
<td>§33 §12(a)(2)</td>
<td>Fraud in prospectus</td>
<td>Any person who bought a security w/ a fraudulent prospectus</td>
<td>Offeror/Seller of a security w/ a fraudulent prospectus</td>
<td>- Public offering w/ §5 delivery obligation - Material misstatement in prospectus</td>
<td>- SOL - Reasonable Care for sellers</td>
<td>Rescission or damages if P sold already</td>
</tr>
<tr>
<td>§34 R. 10b-5</td>
<td>Fraud in connection w/ purchase or sale</td>
<td>- “In connection with” (must be a defrauded purchaser or seller)</td>
<td>- Primary violators (aiders and abettors in SEC action)</td>
<td>- a material misstatement/omission OR a manipulative/deceptive act - scienter - reliance (but see exceptions) - loss causation</td>
<td>- Out of pocket expenses (typical remedy) - Disgorgement - Rescission - Benefit of the bargain</td>
<td>- Out of pocket expenses (typical remedy) - Disgorgement - Rescission - Benefit of the bargain</td>
</tr>
<tr>
<td>§33 §17(a)</td>
<td>Fraud in offer or sale</td>
<td>- SEC only</td>
<td>Any offeror or seller</td>
<td>- Neg’l is enough</td>
<td>Administrative, judicial</td>
<td>Administrative, judicial</td>
</tr>
<tr>
<td>§34 §9(a)</td>
<td>Fraudulent trading a on nat’l exchange</td>
<td>- Bought/sold on nat’l exchange at price effected by fraud</td>
<td>- Any person who engages in fraudulent trading</td>
<td>- Engaging in trading that creates the appearance of active trading or demand - Scienter (trading for the purpose of creating the false appearance) - loss causation</td>
<td>- Rebut one of the elements</td>
<td>- ?</td>
</tr>
<tr>
<td>§34 §13</td>
<td>Books &amp; Records Violation</td>
<td>- SEC only (if they really want to get somebody bring this) - DOJ if going criminal</td>
<td>Any 34 Act reporting co.</td>
<td>- Not keep accurate books/records - Not devise/maintain internal accounting controls - Criminal offense if “knowingly” falsified</td>
<td>Strict Liability</td>
<td>Administrative, judicial, criminal</td>
</tr>
</tbody>
</table>

Note: SEC can bring suit for the violation of any securities law. But they bring suit under §20(b) and §21(d) for ’33 and ’34 Act violations respectively. They are afforded the remedies provided under those sections.