The Impact of the SEC's Rule 415 on Individual Investors

The Securities Act of 1933[1] (Securities Act) was enacted to protect individual investors in the securities market by requiring issuers to furnish current financial and other material information concerning new issues of securities to the public:

> The aim [of the Securities Act] is to prevent further exploitation of the public by sale of unsound, fraudulent, and worthless securities through misrepresentation; to place adequate and true information before the investors; to protect honest enterprise, seeking capital by honest presentation, against the competition afforded by questionable securities offered to the public through crooked promotion; to restore confidence of the prospective investor in sound securities.[2]

In order to provide investors with such information, an issuer is required to file a registration statement with the Securities and Exchange Commission (SEC) for all issuances of securities unless a statutory exemption from the registration requirement is available.[3] The registration statement is filed on forms prepared by the SEC that require disclosure of current financial and other material information regarding the registrant and the particular issue of equity or debt security.[4]

Section 6(a) of the Securities Act provides that a filed registration statement is effective only for the specific securities proposed to be offered for sale in the registration statement.[5] Although no legislative history clearly helps interpret section 6(a), the SEC historically has required an issuer to register only the specific securities it intends to offer for sale once the registration statement becomes effective. In *Shawnee Chiles Syndicate*,[6] the SEC obtained a stop order suspending the effectiveness of a registration statement and held that "[i]t is misleading to include in a registration statement more securities than are presently intended to be offered, and thus give securities offered at some remote future date at least the appearance of a registered status."[7] The prohibition against registering securities that are to be offered at some unspecified future time protects private investors because it ensures that the information disclosed to investors by the registrant is current and reliable at the time the securities are offered for sale.

Despite the seemingly clear language of section 6(a), the SEC has created various exceptions to the *Shawnee* rule and has permitted securities to be shelf

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1. 15 U.S.C. §§ 77a–77aa (1982).
2. 77 CONG. REC. 2983 (1933), *reprinted in* 1 J. ELLENBERGER & E. MAHAR, LEGISLATIVE HISTORY OF THE SECURITIES ACT OF 1933, item 8 (1973).
3. 15 U.S.C. § 77e (1982) prohibits any person to sell or offer a security in interstate commerce unless a registration statement is in effect as to the security. Certain specific classes and transactions of securities are exempt from the registration requirement. *See id.* §§ 77c, 77d.
4. *See id.* § 77aa; *see also* 17 C.F.R. § 239.11–.13 (1984).
5. 15 U.S.C. § 77f(a) (1982).
6. 10 S.E.C. 109 (1941).
7. *Id.* at 113.

registered.[8] Shelf registration, or registration for the shelf, is the practice of filing a registration statement covering securities that the issuer does not intend to offer for sale immediately after the registration statement becomes effective.[9] The SEC created the concept of shelf registration because a strict application of section 6(a) to the issuance of convertible securities such as warrants and options presents several practical problems. By permitting issuers to shelf register convertible securities, the SEC treats the issuance of convertible securities as the issuance of both the convertible security itself[10] and the issuance of the underlying security that is borne by the exercise of the conversion right.[11] Without shelf registration, an issuer would be required to file a registration statement each time a purchaser of the convertible security exercised his or her option or conversion right.

The SEC began to relax the requirements of section 6(a) of the Securities Act by permitting shelf registration for securities which the registrant expected to sell within a reasonable time after the effectiveness of the registration statement.[12] The registrant was required, prior to the sale of shelf securities, to file a post-effective amendment to the registration statement. The amendment contained certain material information related to the shelf securities, including the amount of securities to be offered and the price and terms at which they would be offered.[13] Each post-effective amendment was deemed to be a new registration statement for the sale of the specified number of securities.[14]

In March 1982 the SEC temporarily adopted Rule 415 and thereby expanded the concept of shelf registration.[15] Rule 415 provides for the delayed or continuous offer and sale of securities for a period of up to two years.[16] It codifies the traditionally permitted shelf registrations and, for the first time, permits shelf registration of equity and debt securities by issuers qualified to use the short form for the registration of securities.[17]

Between March 1982 and September 1983 approximately 4600 shelf registration statements were filed under temporary Rule 415.[18] Of this number, eighty-five per-

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8. The Securities and Exchange Commission (SEC) first published its description of appropriate shelf registration situations in 1968. Securities Act Release No. 33–4936, Guide 4, 33 Fed. Reg. 18,617, 18,618–619 (1968) [hereinafter cited as Securities Act Release No. 33–4936 (Dec. 9, 1968)]. *See generally* Hodes, *Shelf Registration: The Dilemma of the Securities and Exchange Commission*, 49 VA. L. REV. 1104 (1963).

9. Hodes, *supra* note 8, at 1107.

10. Section 2(1) of the Securities Act of 1933 (Securities Act) defines the term security to include warrants and options. 15 U.S.C. § 77b(1) (1982). Thus, the Act requires a registration statement to be filed for issuances of convertible securities.

11. Securities Act Release No. 33–4936 (Dec. 9, 1968).

12. *See* Hodes, *supra* note 8.

13. *Id.* at 1107.

14. *Id.* at 1108.

15. Securities Act Release No. 33–6383, 47 Fed. Reg. 11,380 (1982) [hereinafter cited as Securities Act Release No. 33–6383 (Mar. 3, 1982)]. Rule 415 was adopted on a temporary, experimental basis and was to be effective until December 31, 1982. A revised version of the Rule was permanently adopted by the SEC in Securities Act Release No. 33–6499, 48 Fed. Reg. 52,889 (1983), *reprinted in* [1983–1984 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 83,449 (Nov. 17, 1983) (codified at 17 C.F.R. § 230.415 (1984)).

16. 17 C.F.R. § 230.415(a)(2) (1984).

17. *Id.* § 230.415(a)(1)(x). The qualifications of issuers to use the various registration forms are codified at 17 C.F.R. §§ 239.11–.13 (1984).

18. Securities Act Release No. 33–6499, 48 Fed. Reg. 52,889 (1983), *reprinted in* [1983–1984 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 83,449, at 86,337 (Nov. 17, 1983).

cent of the offerings were traditional shelf filings representing $47 billion in value.[19] Twelve percent of the shelf filings were for debt securities representing nearly $70 billion in value,[20] and three percent of the shelf filings were for the registration of equity securities representing nearly $13 billion in value.[21]

Initially, Rule 415 was adopted on an experimental basis. During its experimental period, the impact of Rule 415 on the securities market was studied by both the SEC and the securities industry. On November 17, 1983, the SEC announced the final adoption of Rule 415 as a permanent and exclusive rule governing shelf registration of securities.[22]

This Note analyzes the impact that the expansion of shelf registration under Rule 415 has on individual investors. The analysis illustrates that while issuers may benefit from Rule 415, individual investors may be unable to obtain adequate information about shelf registrations and may be unable to purchase securities sold pursuant to Rule 415.[23]

I. THE MECHANICS OF RULE 415

A. *Background*

The SEC announced both the temporary adoption of Rule 415 and the permanent adoption of the integrated disclosure system in March 1982. The integrated disclosure system permits an issuer to incorporate by reference in the registration statement information from documents it has filed pursuant to the periodic reporting requirements of the Securities Exchange Act of 1934 (Exchange Act).[24] The purpose of the system is to avoid duplication of information filed pursuant to the essentially similar disclosure requirements of the Securities and Exchange Acts.[25] An understanding of the integrated disclosure system is vital to understanding the impact of Rule 415 on individual investors.

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19. *Id.*

20. *Id.*

21. *Id.*

22. Securities Act Release No. 33-6499, 48 Fed Reg. 52,889 (1983), *reprinted in* [1983–1984 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 83,449, at 86,335 (Nov. 17, 1983) (codified at 17 C.F.R. § 230.415 (1984)); *see also* Rowe, *SEC Filings Update*, 17 REV. SEC. REG. 929 (1984); *Shelf Registration Modified and Made Permanent*, [Jan.–June] SEC. REG. & L. REP. (BNA) No. 6 (1984).

23. The scope of this Note is limited to the shelf registration of debt and equity securities—the main controversy surrounding Rule 415.

24. Securities Act Release No. 33–6383, 47 Fed. Reg. 11,380 (1982), *reprinted in* [1937–1982 Accounting Series Releases Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 72,328 (Mar. 3, 1982). The Securities Exchange Act of 1934 is codified at 15 U.S.C. §§ 78a–78kk (1982).

25. Companies subject to the registration and reporting requirements of the Securities Exchange Act of 1934 (Exchange Act) include (1) issuers who sell their securities on any of the national exchanges, (2) companies with a class of equity security held by 500 or more persons and with assets exceeding $3 million, and (3) issuers who have filed a registration statement pursuant to the Securities Act if the number of shareholders has not fallen below 300. *See* 15 U.S.C. § 77*l*(g) (1982). Section 13 of the Exchange Act requires issuers to file Form 10-K, an annual report to the SEC that covers substantially all the information required in the Securities Act registration statement filed on Form S-1. In addition, the issuer must file Form 10-Q, a quarterly report of financial information and material, nonrecurring events that have taken place during the quarter. An issuer must file Form 8-K if a reportable event occurs. Finally, Form SR must be filed within ten days after the end of the first three month period following the effective date of a registration statement. Form SR contains information regarding the use of proceeds from the sale of the securities and the expenses incurred in the registration process. For a discussion of registration and periodic reporting requirements under the Exchange Act, see generally Schneider & Shargel, "*Now That You are Publically Owned . . .*", 36 BUS. LAW. 1631 (1981).

The amount of information that may be incorporated into a registration statement from Exchange Act documents is governed by the requirements of the particular registration form a corporation is qualified to use for the purpose of registering an offering. The SEC has developed three major registration forms for the contemplated issue and sale of securities: Forms S-1, S-2, and S-3.[26] Form S-1, the longest form, requires the registrant to provide the most information. Form S-1 is used almost exclusively by corporations that either are not subject to the Exchange Act requirements or have been subject to the Exchange Act requirements for less than thirty-six months prior to filing the registration statement.[27] Form S-1 does not permit any information which may have been provided in reports filed subject to Exchange Act requirements to be incorporated by reference into the registration statement. Form S-2 permits a limited amount of information from the periodic reports filed with the SEC to be incorporated by reference. In order to use Form S-2, a registrant must have been subject to the reporting requirements for thirty-six months immediately preceding the filing of the shelf registration.[28] Form S-3, the short registration form, allows the maximum amount of information from the periodic reports filed with the SEC to be incorporated by reference into the registration statement. In order to be eligible to use Form S-3, a registrant must have (1) been subject to the reporting requirements for thirty-six months preceding registration,[29] (2) timely filed all required reports in the past twelve months,[30] and (3) made timely installment payments on preferred stock and paid rent on long-term leases.[31] In addition, to qualify for Form S-3 registration, either: (1) $150 million of the issuer's voting stock must be held by nonaffiliates of the issuer, or (2) $100 million of the issuer's voting stock must be held by nonaffiliates and the trading volume of the stock must exceed three million shares annually.[32]

B. *Eligible Security Offerings*

Rule 415, as adopted by the SEC, permits all issuers to shelf register securities that have traditionally been held amenable to shelf registration.[33] Rule 415 also permits issuers qualified to register an issue on Form S-3 to shelf register both debt and equity securities.[34] The registrant is required to shelf register only those securities that it reasonably expects to offer for sale within two years of the registration statement's effective date.[35] Shelf registered securities may be offered for sale on a continuous basis for the two year period. Alternatively, the issuer may sell shelf registered securities on a deferred basis within the two year period whenever market conditions are favorable. The dollar amount of shelf registered equity securities that

26. *See* 17 C.F.R. §§ 239.11–.13 (1984) for the eligibility requirements of each form.
27. Form S-1 must be used by corporations who are ineligible to use Forms S-2 and S-3.
28. 17 C.F.R. § 239.12 (1984).
29. *Id.* § 239.13(a)(3).
30. *Id.*
31. *Id.* § 239.13(a)(4).
32. *Id.* § 239.13(b).
33. *See* 17 C.F.R. § 230.415(a)(1)(i)-(viii) (1984).
34. *Id.* § 230.415(a)(1)(x).
35. *Id.* § 230.415(a)(2).

may be sold in an existing trading market at the market price cannot exceed ten percent of the aggregate market value of the registrant's outstanding stock.[36] Rule 415 refers to offerings of equity securities at the market price as "at the market" offerings.[37] A security issued in an at the market offering must be sold through an underwriter who is named in the prospectus portion of the registration statement.[38] The registrant must file a post-effective amendment to the shelf registration statement that updates information in the registration statement at the time securities are sold off the shelf.[39] The integrated disclosure system, however, provides a modified exception to the post-effective amendment requirement for short-form registrants; a registrant using Form S-3 is not required to update information in a post-effective amendment prior to the sale of shelf registered securities if a periodic report previously filed with the SEC pursuant to the Exchange Act contains the current information.[40] Information contained in Exchange Act reports instead may be incorporated by reference into an abbreviated form of a post-effective amendment.[41]

II. The Impact of Rule 415 on the Individual Investor

A. *Benefits to the Issuer*

Issuers can potentially save money by shelf registering securities as provided in Rule 415. Studies suggest that securities sold pursuant to Rule 415 cost less to issue than securities sold under the traditional registration requirements.[42] The flexibility in timing the sale of shelf registered securities attributes to the decreased cost.[43]

Prior to the adoption of Rule 415, an issuer filed a registration statement that registered only those securities it planned to sell immediately upon the effectiveness of the registration statement. Thus, a registration statement had to be filed prior to the sale of any security (unless an exemption from the registration requirement was available) each time a security was sold. Even if a short form registration were used, a registration statement had to be prepared and filed with the SEC. Consequently, there was a delay from the time the issuer decided to issue new securities to the time the issuer could initiate sales of the registered securities.[44]

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36. *Id.* § 230.415(a)(4)(ii).

37. *Id.* § 230.415(a)(4).

38. *Id.* § 230.415(a)(4)(iii)-(iv).

39. *Id.* § 230.415(a)(3). The registrant must comply with Item 512(a) of Regulation S-K, 17 C.F.R. § 229.512(a) (1984). Item 512(a) sets forth the prospectus requirements for shelf registration.

40. 17 C.F.R. § 229.512(a) (1984). However, a post-effective amendment containing information as to the number of securities being sold, the price of the securities, and any material changes in the method by which the securities will be distributed must always be filed. Material changes not involving the plan of distribution which can be reported accurately by sticker amendments do not need to be reported in a post-effective amendment. *See* Ferrara & Sweeney, *Shelf Registration Under SEC Temporary Rule 415*, 5 Corp. L. Rev. 308, 310–11 (1982).

41. 17 C.F.R. § 229.512(a) (1984).

42. Securities Act Release No. 33–6499, 48 Fed. Reg. 52,889, 52,891 (1983), *reprinted in* [1983–1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,449, at 86,338 (Nov. 17, 1983).

43. *Id.* The study cited by the SEC suggested that the cost of issuing equity securities registered on the shelf was 29% less than that of comparable securities sold through the traditional registration process.

44. Historically, the offering process began several months prior to the proposed date of sale. The issuer used this period to prepare and file the registration statement. During the waiting period, the time between the date of filing and the

Under Rule 415, once a shelf registration statement is deemed effective the issuer may sell a security off the shelf any time within two years. Prior to selling off the shelf, the issuer needs only to file a post-effective amendment which, under Form S-3, is effective upon filing.[45] The flexibility afforded by the ability to defer sales over a period of two years provides the issuer with the opportunity to enter a market when the interest rate and other market factors are favorable. The cost of registering shelf securities is also decreased because the issuer is not forced to pay additional fees for preparing a separate registration statement prior to each sale of securities during the two year period. In addition, the sale of securities at any time during the two year effective period increases competition among underwriters who submit bids for the distribution of the issuer's securities.[46] The competition is especially acute when investors perceive the risk of purchasing the securities to be minimal, such as when the issuer selling the security is a blue-chip, established company. This competition results in lower underwriter spreads and contributes to the cost savings experienced by issuers of shelf securities under Rule 415.

Cost savings enjoyed by issuers, however, does not necessarily translate into cost savings enjoyed by individual investors. An individual investor benefits from an issuer's cost savings only if the issuer passes the savings to an investor by decreasing the price of the securities, increasing the dividend payment, or increasing the interest rates of debt securities. No studies have been conducted to research and document the impact of the decreased cost of issuing securities sold under Rule 415 on the individual investor. However, there is no indication that issuers have passed their savings to individual investors. Moreover, the underlying assumption that the shelf registered securities are sold to individual investors is not sound. Commentators have expressed concern that securities sold pursuant to Rule 415 may not be readily accessible to individual investors.[47]

B. *Adequacy of Information*

One of the major concerns about the registered securities issued under Rule 415 is that investors will not have adequate information on which to base investment decisions.[48] This inadequacy is a result of the integrated disclosure system. The

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date the registration statement became effective, the SEC staff reviewed and commented on the registration statement. Today, however, the integrated disclosure system considerably reduces the length of the offering period; the issuer prepares a registration statement with considerably less information than was required to be included in the registration statement prior to the adoption of the integrated disclosure system. Section 8(a) of the Securities Act provides that a registration statement is deemed effective upon the twentieth day after filing unless the SEC determines otherwise. 15 U.S.C. § 77h(a) (1982). This 20-day period can be and usually is accelerated, at the discretion of the SEC, for short form registrations. *See generally* Greene, *Determining the Responsibilities of Underwriters Distributing Securities Within an Integrated Disclosure System*, 56 NOTRE DAME LAW. 755, 787–90 (1981). For a comparison of a securities offering prior to the adoption of the integrated disclosure system and a securities offering under the current system, see Pryor & Smith, *Significant Changes in Primary Stock Distributions Over the Last 25 Years*, Nat'l L.J., Aug. 9, 1982, at 21.

45. *See* 17 C.F.R. § 230.464(a) (1984).

46. Securities Act Release No. 33–6499, 48 Fed. Reg. 52,889, 52,891 (1983), *reprinted in* [1983–1984 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 83,449, at 86,338 (Nov. 17, 1983).

47. *See infra* text accompanying notes 120–35.

48. *See* Securities Act Release No. 33–6499, 48 Fed. Reg. 52,889, 52,892 (1983), *reprinted in* [1983–1984 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 83,449, at 86,338 (Nov. 17, 1983); *see also* Commissioner Thomas' dissent in the

issuer's ability under Rule 415 to sell securities off the shelf at momentary notice compounds the problem.

Form S-3 permits the registrant to incorporate by reference into the registration statement the maximum amount of information from periodic reports filed pursuant to Exchange Act requirements. Consequently, financial and other material information needed by individual investors is contained in files maintained by the SEC and by professionals in the investment business, such as underwriters, broker/dealers, and sophisticated investors. Complete information will not be contained in either the Form S-3 registration statement or the prospectus that is delivered with the security. Although an investor can gain access to information in the files of the SEC or a broker/dealer, the investor now bears the burden of obtaining information about the issuer.[49] Placing such a burden on the individual investor is contrary to the congressional mandate of the Securities Act. Congress intended to place the burden of providing the public with current, material information on the issuer.[50] "There is . . . an obligation upon us to insist that every issue of new securities to be sold in interstate commerce shall be accompanied by full publicity and information, and that no essentially important element attending the issue shall be concealed from the buying public."[51]

The SEC addressed the question whether an investor purchasing securities in a Rule 415 offering would have adequate information on which to base an investment decision when it permanently adopted Rule 415.[52] The SEC believes that the existence of timely and accurate periodic reports filed by issuers under Exchange Act requirements will provide adequate information to individual investors.[53] The SEC has also stated that it will rely on investment advisors to disseminate information regarding Rule 415 issuances to the public.[54] However, this reliance directly undercuts the goals of the Securities Act. The Securities Act clearly places the responsibility of providing information on the issuer: section 5 of the Securities Act requires issuers to register all securities sold in interstate commerce unless it can come within a statutory exemption;[55] section 7 of the Securities Act provides that a prospectus must be delivered to a purchaser either prior to or contemporaneously with the certificate representing the purchased security.[56] Congress placed this burden on the issuer to enable individuals to reach an independent investment decision. The ability of an investor to reach an investment decision independently will be enhanced

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Release which extended the date of effectiveness of Temporary Rule 415 from December 31, 1982 to December 31, 1983. Securities Act Release No. 33-6423, 47 Fed. Reg. 39,799 (1982), *reprinted in* [1982 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 83,250, at 85,279-290 (Sept. 2, 1982).

49. Exchange Act reports are on file with the SEC and are open to public inspection. 15 U.S.C. § 77f(d) (1982).

50. *See generally* R. JENNINGS & H. MARSH, JR., SECURITIES REGULATION: CASES AND MATERIALS 23-32 (5th ed. 1982) for a discussion of the objectives and operation of the Securities Act of 1933 and the Exchange Act of 1934.

51. H.R. DOC. NO. 12, 73d Cong., 1st Sess. 1 (1933), *reprinted in* 1 J. ELLENBERGER & E. MAHAR, *supra* note 2, at item 15.

52. Securities Act Release No. 33-6499, 48 Fed. Reg. 52,889, 52,892-893 (1983), *reprinted in* [1983-1984 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 83,449, at 86,339 (Nov. 17, 1983).

53. *Id.*

54. *Id.*; *see* Gutfreund, *The SEC's Rule 415*, TR. & EST., Aug. 1982, at 11.

55. 15 U.S.C. § 77e (1982).

56. *Id.* § 77e(b)(2).

if the issuer, rather than a broker/dealer, provides information material to investment analysis; in a broker/dealer relationship the investor is more vulnerable to high pressure sales tactics.[57]

Rule 415 compounds the problem of individuals receiving inadequate information by allowing sales off the shelf at momentary notice. In a non-Rule 415 offering, a preliminary prospectus is widely disseminated during the time between the filing of the registration statement and its date of effectiveness. The purpose of the preliminary prospectus is to provide potential investors with information regarding the upcoming offering.[58] In a Rule 415 offering, once the shelf registration statement is effective, the issuer decides to sell the securities on momentary notice during a period of favorable market conditions. Consequently, in connection with deferred or delayed securities off the shelf, prospectuses are not distributed immediately prior to the sale of securities to either investment advisors or public investors. In order to comply with section 5, which prohibits the issuer from selling a security unless accompanied or preceded by a statutory prospectus,[59] the issuer is required only to send a purchaser the final prospectus with the confirmation of the sale.[60] The failure to provide a preliminary prospectus containing current material information regarding a delayed offering exacerbates the lack of information available to an individual investor upon which to base an investment decision. The investor is forced to make an investment decision based on the information provided by the broker/dealer, who also does not possess a prospectus containing current information regarding a delayed offering. Decisionmaking based on less than full disclosure of current and relevant information is contrary to the principle that investment decisions should be informed and deliberative.

In addition to the inadequate information about the offeror and the securities in Rule 415 offerings, the lack of time in which an investor can investigate an issue magnifies the problem of uninformed decisionmaking. An issuer must file a post-effective amendment to the shelf registration statement that contains information regarding the amount of securities being sold and the plan of distribution.[61] In an "at the market" offering, the post-effective amendment is effective upon filing and, thus,

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57. *See generally* Landis, *The Legislative History of the Securities Act of 1933*, 28 GEO. WASH. L. REV. 29 (1959). The Securities Act was a reaction to the market's failure to impose fiduciary standards that should govern persons who handle other people's money. The high financing of the era and the 1929 market crash preceding the enactment of the Securities Act had eroded the public's trust in investment bankers, broker/dealers, and officers and directors of corporations. *Id.* at 30.

58. The preliminary prospectus is used during the waiting period to notify potential investors about the upcoming offering. The prospectus must conform to the disclosure requirements of section 10(b) of the Securities Act, 15 U.S.C. § 77j(b) (1982). For background information on prospectus requirements during the waiting and post-effective periods, see generally R. JENNINGS & H. MARSH, JR., *supra* note 50, at 62–74. The preliminary prospectus is used by investment bankers to solicit interest in the issue from broker/dealers, institutional investors, and individual investors.

59. 15 U.S.C. § 77e(b) (1982). A statutory prospectus is one that complies with the requirements of section 10(a) of the Securities Act, 15 U.S.C. § 77j(a) (1982).

60. The SEC encourages the distribution of preliminary prospectuses so that the issuer and underwriter can determine the interest in the market for the issuance. In non-Rule 415 offerings, the SEC will not accelerate the registration statement's effective date if the issuer fails to distribute a requisite number of preliminary prospectuses. In Rule 415 offerings, however, the post-effective amendment is effective on filing, and the SEC cannot exercise power over acceleration when preliminary prospectuses are not distributed.

61. 17 C.F.R. § 512(a) (1984).

the issuer may commence selling the securities immediately upon filing the amendment.[62] Because Rule 415 does not impose a waiting period or a cooling off period[63] prior to the effectiveness of the post-effective amendment, investors do not have sufficient time to review any readily available information regarding the issuance. The investor not only lacks sufficient information regarding the issuance, but, since the decision to purchase the security must be made immediately upon the issuance of the security, also lacks the necessary time in which to make an informed investment decision.

C. *Underwriters' Due Diligence Investigations*

Both the Securities and Exchange Acts prohibit issuers from employing false information, misrepresentations, and material omissions in registration and reporting statements.[64] Section 11 of the Securities Act casts liability upon the issuer or other seller whenever any part of a registration statement contains false information, misrepresentations, or material omissions.[65] Persons subject to section 11 liability include the issuer, every person who signed the registration statement, accountants who certified any part of the statement, and underwriters of the issue.[66] Section 11 defendants, except issuers, who do not have a statutory defense, primarily rely on the due diligence defense to absolve themselves of liability.[67] Generally, in order for a due diligence defense to succeed, the defendant must demonstrate that (1) an independent, reasonable investigation of the information contained within the registration statement was conducted and (2) the defendant had no reasonable ground to believe that the information contained within the registration statement was false, misleading, or contained an omission of a material fact.[68] The legislative history of the Securities Act indicates that Congress intended to place the burden of establishing the due diligence defense upon the defendant: "[a] director or other responsible party must prove that his statement was made in good faith and that he acted with due care in order to escape liability."[69] The burden is placed on the defendant because the information contained within a registration statement is "peculiarly within the knowledge of the corporation, its managers, its underwriters, and its technical advisors."[70]

In *Escott v. BarChris Construction Corp.*[71] the court interpreted section 11 and set forth standards by which a reasonable investigation can be measured. In 1961,

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62. *Id.*

63. A cooling off period is the period between the time a registration statement is deemed effective and the time sales of securities may be initiated. The cooling off period enables investors and other interested parties to investigate the issue and gather the financial resources necessary to participate in the sale of the issue.

64. *See* 15 U.S.C. §§ 77*l*, 77q, 78j(b) (1982).

65. *Id.* § 77k.

66. *Id.*

67. *Id.* § 77k(b)(3). The issuer is not permitted to use the due diligence affirmative defense and, except in a few limited exceptions, is absolutely liable for the inclusion of false or misleading information in a registration statement. *Id.* § 77k(b).

68. *Id.* § 77k(b)(3).

69. 77 CONG. REC. 2934 (1933), *reprinted in* 1 J. ELLENBERGER & E. MAHAR, *supra* note 2, at item 7.

70. *Id.*

71. 283 F. Supp. 643 (S.D.N.Y. 1968). For a discussion of underwriters' section 11 liability, see generally Greene, *supra* note 44, at 764–81.

BarChris, a company in the business of constructing and equipping bowling alleys, filed a registration statement for the sale of $3.5 million of subordinated convertible debt securities.[72] The following year, BarChris filed a petition in bankruptcy. The purchasers of the debentures initiated a class action under section 11.[73] The complaint named the issuer and its officers, directors, accountants, and underwriters as defendants.[74] The underwriters had conducted an investigation that included questioning the officers of BarChris about a number of issues relevant to the financial condition of the company.[75] The underwriters also had made an effort at documenting the representations made by the officers of BarChris in the registration statement. The underwriters, however, failed to examine the minutes of executive level meetings during the course of their investigation. An examination of the minutes would have revealed that some of the representations made in the registration statement were either false or misleading.[76]

The United States District Court for the Southern District of New York refused to accept that the underwriters' inquiry constituted a reasonable investigation.[77] The court held that section 11 due diligence requires an independent investigation by an underwriter of all material representations and facts[78] contained within the registration statement.[79]

An investigation by an underwriter is crucial to ensure the accuracy of information presented in a registration statement. The SEC historically has regarded an underwriter's investigation as a device to protect investors from false statements or overly optimistic representations by issuers attempting to raise capital.[80] The following case illustrates the importance of an underwriter's due diligence investigation.[81] During a due diligence investigation and while preparing an offering circular for the sale of Penn Central stock, underwriters discovered new facts that unveiled the precarious financial condition of the company.[82] The discovery may have prevented individual investors from purchasing securities of a financially troubled company, which filed bankruptcy proceedings soon after the issuance, and thus may have protected the investors from losing a substantial amount of money.[83]

A major concern expressed in connection with the integrated disclosure system is that underwriters will no longer have the time necessary to conduct adequate due

72. Escott v. BarChris Constr. Corp., 283 F. Supp. 643, 654 (S.D.N.Y. 1968).

73. *Id.*

74. *Id.* at 652.

75. *Id.* at 694.

76. *Id.* at 695.

77. *Id.* at 696.

78. In TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438 (1976), the Court defined a material fact as one which a reasonable investor is substantially likely to consider important in making an investment decision. *Id.* at 448.

79. Escott v. BarChris Constr. Corp., 283 F. Supp. 643, 696 (S.D.N.Y. 1968).

80. *See id.* at 697 (The court required the underwriters to independently verify the information submitted to them by the issuer.). In a stop order proceeding suspending the effectiveness of a registration statement, the SEC commented on the importance it attached to the underwriter's investigation: "By associating himself with a proposed offering, an underwriter impliedly represents that he has made such an investigation in accordance with professional standards. Investors properly rely on this added protection which has a direct bearing on their appraisal of the reliability of the representation made in the prospectus." *In re* Richmond Corp., 41 S.E.C. 398, 406 (1963).

81. The case is described in Gutfreund, *supra* note 54.

82. Gutfreund, *supra* note 54, at 12.

83. *Id.*

diligence investigations of representations made by issuers in the course of issuing and selling securities.[84] The concern is magnified by the ability of issuers to sell securities registered on the shelf at momentary notice. Rule 415 does require issuers of at the market offerings to sell the securities through an underwriter.[85] The issuer must name in the registration statement the underwriters it may potentially use for distributing the securities.[86] The issuer only needs to name in the post-effective amendment the underwriter who will actually distribute the securities.[87] In a traditional, non-Rule 415 offering, even in a short form registration that incorporates information from Exchange Act reports, the underwriter has a cooling off period of forty-eight hours in which to conduct a due diligence investigation into the facts and representations contained within the registration statement.[88] Under Rule 415, by contrast, underwriters may be given only momentary notice in which to decide whether to participate in the distribution of an issue.

An example of the fast wheeling of securities afforded by Rule 415 is the process by which the stock of Multinstint Corp. (Multinstint) was issued and sold.[89] Multinstint, a Form S-3 registrant, filed two Rule 415 registration statements covering an issuance of up to $200 million of debt securities and/or an at the market offering of 500 thousand shares of common stock at market price.[90] The shelf registration statements named twenty potential underwriters.[91] The SEC ruled the statements effective on June 28, 1982, one week after they were filed.[92] Multinstint did not commence selling the securities until October 1982. On October 6, 1982, Multinstint called six of the twenty named underwriters and informed them of its intent to sell, on the following day, 300 thousand shares of common stock at market price.[93] Consequently, the underwriters had only twenty-four hours in which to decide whether to participate in the distribution. They had virtually no time to conduct an independent investigation into the representations contained within either the registration statement or the periodic reports that had been incorporated by reference into the registration statement. Failure to conduct an independent due diligence investigation removes a layer of protection provided by the Securities Act to assure an investor access to full disclosure of information concerning an issue and subjects the underwriter to section 11 liability.

When the SEC permanently adopted Rule 415, it addressed the concern of inadequate due diligence investigations and stated it will rely on two factors to combat this problem. First, the SEC believes that investors may rely on information

84. *Id.*; *see also* Securities Act Release No. 33-6499, 48 Fed. Reg. 52,889, 52,892-893 (1983), *reprinted in* [1983-1984 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 83,449, at 86,339-341 (Nov. 17, 1983).

85. 17 C.F.R. § 230.415(a)(4)(iii)-(iv) (1984).

86. *Id.; see also id.* § 229.512(a).

87. *See* 17 C.F.R. § 229.512(a) (1984).

88. Prior to May 1982, Form S-16 was used for short form registration. Form S-16 imposed a 48 hour cooling off period. Form S-3 replaced Form S-16 and imposes no cooling off period. As a result the issuer may sell securities immediately after the document becomes effective. *See generally* Johnson & Cote, *The New Shelf Registration Rule*, 15 REV. SEC. REG. 925 (1982).

89. The offering procedure of Multinstint Corp. is described in Pryor & Smith, *supra* note 44, at 39-40.

90. *Id.* at 39.

91. *Id.*

92. *Id.*

93. *Id.*

available in periodic reports filed by companies required to register under the Exchange Act.[94] The SEC's confidence in the disclosure provided by periodic reports results from its belief that the integrated disclosure system in fact has enhanced the level of disclosure to investors.[95] The SEC's belief is premised on the assumption that registrants constantly upgrade the disclosure of information provided in periodic reports, thereby ensuring that complete and current information regarding the issuer is available in the market.[96] However, in the two year experimental period of Rule 415, no evidence to test the validity of the SEC's assumption was produced. Furthermore, even if the information regarding an issuer were current and complete, the conclusion that the information regarding the current issuance of securities is current and complete does not necessarily follow. Congress intended that issuers should directly provide current, material information to investors. An issuer is not exempt from the disclosure requirements simply because the securities to be issued are blue-chip securities. Moreover, periodic reports are usually assembled without the assistance of underwriters and are generally prepared with less diligence than registration statements filed under the Securities Act.[97] The reason for this less diligent preparation is that the Exchange Act imposes liability on issuers whose Exchange Act documents contain false information, misrepresentations, and material omissions only upon a showing that an issuer either *knowingly* used false or misleading information or demonstrated *reckless disregard* for the accuracy of the information.[98] Under section 11 of the Securities Act, by contrast, defendants are liable for *negligent* inclusion of false or misleading information in the registration documents.[99] By incorporating information from Exchange Act reports into the shelf registration statement, the reports become subject to the more stringent liability standard imposed by section 11 of the Securities Act but investors who rely on registration statements to make investment decisions suffer because of the less accurate information incorporated from Exchange Act documents.

The Penn Central example discussed above demonstrates both the need for an adequate investigation of the information incorporated into a registration statement and the interplay of Rule 415 with the integrated disclosure system.[100] Under current SEC rules, Penn Central would have filed a registration statement on Form S-3 for the

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94. Securities Act Release No. 33-6499, 48 Fed. Reg. 52,889, 52,892-893 (1983), *reprinted in* [1983-1984 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 83,449, at 86,339 (Nov. 17, 1983); *see also* Gutfreund, *supra* note 54, at 11-12. *See supra* note 25 for a discussion of the Exchange Act's registration and reporting requirements.

95. *See* Securities Act Release No. 33-6499, 48 Fed. Reg. 52,889, 52,892-893 (1983), *reprinted in* [1983-1984 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 83,449, at 86,339-340 (Nov. 17, 1983).

96. *Id.*

97. *See generally* Greene, *supra* note 44; *see also* Fox, *Shelf Registration, Integrated Disclosure and Underwriter Due Diligence: An Economic Analysis*, 70 VA. L. REV. 1005, 1027 (1984).

98. In Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976), the Supreme Court held that the defendants could be liable under section 10(b) of the Exchange Act of 1934 only when they had an intent to deceive, manipulate, or defraud. In *Hochfelder*, the defendant, a certified public accountant, had audited the financial statements of a company whose president had perpetrated a fraudulent securities scheme. It was conceded that the defendant's failure to detect the fraudulent scheme was not a result of intentional misconduct. The Court held that a defendant who acted out of negligence and without scienter could not be liable under section 10(b).

99. The issuer, except in a few limited exceptions provided in section 11, is absolutely liable for the inclusion of false or misleading information in the registration statement or prospectus. *See supra* text accompanying notes 71-79.

100. *See supra* text accompanying notes 73-75.

sale of its securities. Penn Central would have included very little information regarding its business and financial condition either in the registration statement or the prospectus.[101] This information would have been incorporated into the registration statement only by reference to periodic reports filed by Penn Central pursuant to Exchange Act requirements. Since periodic reports are prepared with less diligence than registration statements, it is doubtful that the periodic reports would have revealed the precarious financial condition of Penn Central. Furthermore, an underwriter may not have had the time to conduct an independent investigation into the information disclosed in Penn Central's registration statement if Penn Central had sold its securities to the underwriter under Rule 415 on momentary notice.

The SEC also anticipates that issuers and underwriters will develop innovative investigative procedures that will enable underwriters to adapt their investigations to the integrated disclosure system and shelf registration process.[102] The SEC has proposed two alternatives. First, the SEC suggests that the underwriters perform a continuous investigation during the two year period in which the Rule 415 registration statement is effective.[103] Second, the SEC suggests that the issuer and underwriter hold quarterly due diligence sessions in which the underwriters and the issuer's managers would discuss the information contained in the issuer's most recent periodic reports and any material developments that might have occurred in the period after the most current report was filed.[104]

It is unlikely that underwriters will adopt either procedure. Rule 415 issuers are bound only to sell shelf securities through an underwriter named in the registration statement. There is no limit on the number of prospective underwriters an issuer may name in the registration statement. Few underwriters have the resources or inclination to perform a costly due diligence investigation without any commitment from the issuer that the underwriter will actually participate in distributing the shelf registered securities. Not every prospective underwriter should be expected to perform continuous due diligence investigations for the two year period in which a shelf registration statement is effective. In fact, it is inefficient to require each underwriter to duplicate the others' efforts in updating the information. In the Multinstint Rule 415 offering discussed above,[105] Multinstint had named twenty potential underwriters in its shelf registration statement.[106] Ultimately, only one of the named underwriters participated in the distribution.[107] One underwriter, Formerwidedistrib & Co. (Formerwidedistrib), in October 1982, accepted 225,000 shares of common stock of Multinstint for distribution.[108] Formerwidedistrib did not conduct any investigation subsequent to being named a prospective underwriter in the registration statement

101. *See* Gutfreund, *supra* note 54, at 12.

102. *See* Securities Act Release No. 33-6499, 48 Fed. Reg. 52,889, 52,893 (1983), *reprinted in* [1983-1984 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 83,449, at 86,340 (Nov. 17, 1983).

103. *Id.*

104. *Id.*

105. *See supra* text accompanying notes 89-93.

106. Pryor & Smith, *supra* note 44, at 39.

107. *Id.* at 39-40.

108. *Id.* at 40.

filed with the SEC in June 1982.[109] Formerwidedistrib, however, had maintained an up-to-date file of the periodic reports that Multinstint had filed with the SEC.[110] In the twenty-four hour period between the time Multinstint informed Formerwidedistrib of its decision to take common stock off the shelf and the time Formerwidedistrib accepted the shares, analysts at Formerwidedistrib quickly reviewed the Form S-3 registration statement.[111] No other investigation was undertaken. A quick review of a registration statement is not an adequate due diligence investigation and does not ensure that investors will be protected against the inclusion of false or misleading information in the registration statement.

It is also impractical to expect potential underwriters who have been named in a registration statement to meet with an issuer periodically over a two year time span. If the management of an issuer consented to meet with the numerous prospective underwriters for quarterly due diligence sessions, the management would have less time to conduct the issuer's business and the issuer would incur other increased costs. Consequently, it is unlikely that the investigative techniques suggested by the SEC will be widely utilized. Therefore, under the present scheme, individual investors will be forced to rely on inadequate and possibly defective information to make investment decisions.

Commissioner Shad commented that the techniques suggested by the SEC to underwriters conducting due diligence investigations are of little practical value when the issuer has the ability under Rule 415 to solicit competitive bids from underwriters and effect distribution of the shelf registered securities on the same day.[112] A possible modification to Rule 415 not adopted by the SEC would be to require the registrant to name, in the registration statement filed pursuant to Rule 415, the underwriter with whom it has a firm commitment to distribute the shelf registered securities. Once an underwriter has made a commitment to participate in a distribution, its incentive to perform a continuous investigation as well as to conduct due diligence meetings over a period of two years significantly increases. The issuer, under a rule with this suggested modification, could continue to sell securities off the shelf on momentary notice. The modification, however, would better protect investors because an underwriter would have had an opportunity to investigate the representations made by the issuer in both the Rule 415 registration statement and the periodic reports incorporated therein.

An alternative to a firm underwriter commitment requirement would be to require a forty-eight hour cooling off period between the effective date of the Rule 415 registration statement (or the effective date of the post-effective amendment) and the time the issuer could initiate sales of the registered securities.[113] The cooling off period would enable the underwriter to submit a bid for distribution of the shelf

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109. *Id.*

110. *Id.*

111. *Id.*

112. Securities Act Release No. 33-6499, 48 Fed. Reg. 52,889, 52,896-897 (1983), *reprinted in* [1983-1984 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 83,449, at 86,346 (Nov. 17, 1983).

113. A 48 hour cooling off period was suggested by Commissioner Thomas in Securities Act Release No. 33-6423, 47 Fed. Reg. 39,799 (1982), *reprinted in* [1982 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 83,250 (Sept. 8, 1982).

registered securities and to conduct an underwriter's due diligence investigation. Either alternative would protect individual investors better than the present version of Rule 415, the provisions of which result in little time for underwriters to investigate the issuer.

D. *Rule 415 Revisions*

Rule 415, as permanently adopted in November 1983, was a significantly revised version of the Rule as originally proposed. Under temporary Rule 415, securities eligible for shelf registration included debt securities issued by Form S-1 and Form S-2 corporations as well as debt and equity securities issued by Form S-3 corporations.[114] Unlike Form S-3 corporations, Form S-1 and Form S-2 corporations are not usually well established, blue-chip companies. Consequently, there is less information available in the market concerning the Form S-1 and S-2 corporations. In order to mitigate the dangers presented by the inadequate information about Forms S-1 and S-2 registrants and the lack of time necessary in order for the underwriter to conduct an adequate investigation, the SEC limited shelf registration to the traditional shelf offerings by all corporations and to the issuance of equity and debt securities by Form S-3 corporations.[115] Rule 415, as permanently adopted, also requires an underwriter named in the prospectus to participate in at the market offerings, although, as demonstrated by the Multinstint example, the underwriter who distributes the shelf securities may be one of many prospective, named underwriters.[116]

Ironically, the modifications to Rule 415 do not address the major concerns that have been expressed about shelf registration. The greatest concern commentators have expressed over Rule 415 has been its provision permitting shelf registration of equity securities. Commissioner Thomas suggested a modification in her partial dissent to the adoption of Rule 415 which would have limited non-traditional shelf offerings to debt securities only.[117] Individual investors more often purchase equity securities than debt securities. Debt securities are purchased more often by sophisticated investors.[118] There is a greater need for full and fair disclosure of information in connection with issuances of equity securities so that individual investors have ready access to information needed in investment decisionmaking. Form S-1 permits no incorporation by reference of information from periodic reports. Thus, the information in the registration statement and post-effective amendments is current and readily available for the use of individual investors. Form S-2 companies are permitted to incorporate only a limited amount of information by reference. Registration statements filed on Forms S-1 and S-2 contain much more information than Form S-3

114. *See* Securities Act Release No. 33–6383, 47 Fed. Reg. 11,380 (1982), *reprinted in* [1937–1982 Accounting Series Releases Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 72,328 (Mar. 3, 1982).

115. 17 C.F.R. § 230.415(a) (1984).

116. *Id.* In traditional shelf offerings and offerings of debt securities, the underwriter may be named in a sticker post-effective amendment. *See* Rowe, *supra* note 22.

117. *See* Commissioner Thomas' dissent in Securities Act Release No. 33–6423, 47 Fed. Reg. 39,799 (1982), *reprinted in* [1982 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 83,250 (Sept. 8, 1982).

118. *Id.* One's level of sophistication is a function of one's knowledge of the market, economic position in life, and tax situation in terms of capital gains and losses. Continental Research Inc. v. Cruttenden, Podesta & Miller, 222 F. Supp. 190, 193 (D. Minn. 1963).

registration statements. The adequacy of information about the issuer is much less a concern when information is readily available in the registration statement, prospectus, and post-effective amendments. Thus, there is more concern to provide information to investors who purchase securities registered on Form S-3.

The concern for a due diligence investigation assumes greater proportion in the case of Form S-1 and S-2 companies. Companies which use Forms S-1 and S-2 are smaller and less established than issuers who are eligible to use Form S-3. Investing in Form S-1 and Form S-2 companies is more speculative than investing in blue-chip companies, who are often eligible to use short form registration. Although the information in the Form S-1 and Form S-2 registration statements and prospectuses is more complete than information in a Form S-3 statement, there is a greater need to conduct an independent underwriter investigation of Form S-1 and Form S-2 issuers. While it does not follow that an underwriter investigation of blue-chip issues is unneeded, the enhanced risk of investments in nonblue-chip companies magnifies the need for an independent investigation by an underwriter in order to protect individual investors in those cases. Even though Forms S-1 and S-2 contain more complete information, the information may not be accurate. Underwriters may, understandably, be more reluctant to submit bids for nonblue-chip securities on the momentary notice they receive from issuers preparing to offer securities off the shelf.

Forms S-1 and S-2 companies need not be absolutely prohibited from the shelf registration of debt and equity securities in order to mitigate the dangers of Rule 415. Inadequate disclosure of information cannot justify total exclusion from the shelf registration process. Both Form S-1 and Form S-2 registration statements contain more information than Form S-3 registration statements. In addition, a less severe modification of Rule 415 can be adopted[119] which would allow the underwriter more time to conduct an adequate due diligence investigation. A modification requiring the issuer to select an underwriter through which the securities will be sold and to disclose the underwriter in the registration statement, or a modification creating a cooling off period after the issuer announces a sale off the shelf, would substantially decrease the concern that Rule 415 due diligence investigations are substandard. Thus, a modification to Rule 415 would support the inclusion of Form S-1 and S-2 securities in the potential class of shelf registered securities.

E. *Institutionalization of the Securities Market*

Institutionalization of the securities market is the process by which securities are purchased and held in large blocks by institutions rather than by individual investors. In its release that permanently adopted Rule 415, the SEC failed to address adequately the concern that shelf registration will accelerate institutionalization of the securities market. The release merely stated that Rule 415 is a procedural rule and does not mandate any particular method of distribution.[120] The SEC believes that concern over institutionalization reflects current economic and other factors that promote in-

119. *See supra* text accompanying notes 112–13.

120. Securities Act Release No. 33–6499, 48 Fed. Reg. 52,889 (1983), *reprinted in* [1983–1984 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 83,449, at 86,343–344 (Nov. 17, 1983).

stitutionalization of the securities market. It is the SEC's view that institutionalization is a phenomenon which transcends Rule 415.[121]

Institutionalization of the securities market has been increasing in recent times. The proportion of stock listed on the New York Stock Exchange (NYSE) that is held by institutions increased from 16% in 1957 to approximately 50% in 1980.[122] Large-block transactions increased from 29% of the NYSE trading volume in 1980 to approximately 39% in the first five months of 1982.[123] Securities held by pension funds account for nearly one-half of the securities held by institutions.[124]

Commentators believe that Rule 415 will accelerate institutionalization of the securities market because it allows and fosters rapid selling.[125] Rule 415 was enacted to give the registrant rapid access to the market when market conditions are favorable.[126] A Rule 415 distribution will generally unfold in the following sequence: An issuer will decide to sell securities off the shelf; it then will solicit bids from underwriters giving them only momentary notice of its decision. Consequently, the underwriter will have no time in which to form a syndicate with other underwriters and will have to accept the issuance of the securities either in its entirety or in large blocks. The underwriter, also looking to reduce its market risk, will dispose of the securities as quickly as possible.[127] The most rapid way to sell the securities is in large blocks. Thus, only institutional investors capable of financing purchases of large blocks of securities will participate in the distribution. The procedural advantages afforded by Rule 415 which enable issuers rapidly to gain access to the market, directly accelerate institutionalization of the securities market.

The Multinstint offering discussed above[128] provides an illustration of Rule 415's impact on institutionalization. The Form S-3 shelf registration that Multinstint filed with the SEC became effective on June 28, 1982.[129] At that time, the news of the filing caused the market price of the Multinstint stock to drop slightly.[130] On October 6, 1982, the treasurer of Multinstint called six of the twenty underwriters named in the prospectus filed with the registration statement to inform them of Multinstint's intent to sell 300,000 shares of common stock on the following day. Formerwidedistrib was the most aggressive underwriter in price bidding and urged Multinstint to sell more than the 300,000 shares it had originally intended to sell.[131] The following morning, the treasurer informed Formerwidedistrib that it was prepared to distribute 325,000 shares of common stock. Multinstint printed a prospectus

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121. *Id.* at 86,341–342.

122. *See* Pryor & Smith, *supra* note 44, at 40.

123. *Id.*

124. *Id.*

125. *See* Commissioner Thomas' dissent in Securities Act Release No. 33–6423, 47 Fed. Reg. 39,799 (1982), *reprinted in* [1982 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 83,250 (Sept. 8, 1982). *See generally*, Committee of Publicly Owned Companies, *Shelf Registration* (Mar. 7, 1983).

126. Securities Act Release No. 33–6499, 48 Fed. Reg. 52,889 (1983), *reprinted in* [1983–1984 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 83,449, at 86,338 (Nov. 17, 1983).

127. *See* Note, *SEC Rule 415: Resolving the Dilemma of Shelf Registrations Creates Problems of Its Own*, 3 PACE L. REV. 275, 295–300 (1982).

128. *See supra* text accompanying notes 89–93.

129. *See* Pryor & Smith, *supra* note 44, at 39.

130. *Id.*

131. *Id.*

supplement overnight deleting the other nineteen underwriters named in the prospectus filed with the shelf registration statement and adding the names of the two underwriters in Formerwidedistrib's syndicate. Of the 325,000 shares which were taken off the shelf, Formerwidedistrib accepted 225,000 shares for distribution and the two other investment bankers each accepted 50,000 shares for distribution.[132] At the time of the sale, the price of the stock in the securities market was generally rising.[133] Quick to take advantage of the favorable market conditions, each of the two investment bankers, within two days of accepting shares for distribution, placed their holdings of 50,000 shares of common stock with institutions. Formerwidedistrib also placed 75,000 shares of its holding directly with institutions within twenty-four hours of striking the deal with Multinstint. On October 13, 1982, Formerwidedistrib placed the balance of its holding of 150,000 shares with a single institution.[134] A month after the close of the Multinstint deal, Multinstint stock was selling for $59.50 on the NYSE. Multinstint had sold the shares for approximately $61.00.[135] By taking advantage of the rising market, Multinstint and the participating underwriters had sold their stock for a premium price.

The 325,000 share distribution of Multinstint securities did not result in 325,000 shares of newly issued stock reaching the open market. The 325,000 shares of common stock were all placed with institutions before they could reach the market. Consequently, individual investors were closed out of participating in a distribution of blue-chip securities. Blue-chip securities are the most favored investment by individual investors because they are the least speculative investment in the market. Rule 415, by accelerating the institutionalization of the securities market, decreases the opportunity for individual investors to participate in distributions of the safest and most favored type of security in the market.

III. CONCLUSION

The Securities Act was enacted by Congress for the purpose of protecting individual investors from high financing practices which prevailed in the Twenties and caused the crash of the securities market in 1929.[136] The legislative history of the Securities Act explains Congress' desire to protect individual investors:

> The wealth of the individual is represented by securities subject to the great swings in the appraisal by society of its own immediate future. . . . Only through sale in the market can the owner obtain direct use of his wealth. . . . It is for the protection of these 18 million owners of symbols that this bill has been drawn.[137]

The SEC is guided in its regulatory function by its principal charge of regulating the securities industry for the protection of the individual investor. In adopting Rule 415, the SEC attempted to balance the values of speed and efficiency in the capital

132. *Id.* at 40.
133. *Id.*
134. *Id.*
135. *Id.*
136. *See generally* Landis, *supra* note 57, at 30.
137. 77 CONG. REC. 2917–18 (1933), *reprinted in* 1 J. ELLENBERGER & E. MAHAR, *supra* note 2, at item 7.

raising process favoring issuers and full disclosure of information and fair treatment of investors.[138] The tension between these values is long standing and is illustrated by the controversy surrounding the passage of Rule 415. The procedural benefits of Rule 415 enable issuers to rapidly gain access to the securities market, resulting in cost savings to the issuer. The individual investor, however, is injured as a result of the procedural advantages given to the registrant.

Short form registration enables the issuer to incorporate by reference from periodic reports into the registration statement much of the current, material information needed to enable the investor to make independent investment decisions. Consequently, the information is not readily available to the investor. In addition, an independent due diligence investigation of information in the registration statement conducted by an underwriter may not be undertaken; the quick access to the market may foreclose a thorough underwriter investigation. Finally, the individual investor may be completely prevented from participating in shelf distributions because institutions will purchase the securities before they reach the open market.

The SEC has permanently adopted Rule 415. The SEC, however, remains obligated to closely monitor the impact of Rule 415 on the securities market. If experience under Rule 415 proves that individual investors are being injured as a result of inadequate information about shelf securities or an inability to participate in shelf offerings, the SEC must rescind or modify Rule 415 to comply with the congressional mandate: the individual investor must be protected.

Smeeta S. Rishi

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138. Pryor & Smith, *supra* note 44, at 41.