
David J. Newburger

Follow this and additional works at: https://scholarlycommons.law.case.edu/caselrev

Part of the Law Commons

Recommended Citation

This Recent Decisions is brought to you for free and open access by the Student Journals at Case Western Reserve University School of Law Scholarly Commons. It has been accepted for inclusion in Case Western Reserve Law Review by an authorized administrator of Case Western Reserve University School of Law Scholarly Commons.
Recent Legislation

SECURITIES ACT OF 1933 — RULE MODIFICATION — THE NO-SALE RULE AND THE PRIVILEGE TO AVOID REGISTRATION


The Securities and Exchange Commission (SEC) has again modified the once controversial “no-sale” rule.1 The changes operate to relieve some previously existing restrictions in two ways.2

1 Securities Act Release No. 4892, 33 Fed. Reg. 566 (1968), amending SEC Rule 133(a), 17 C.F.R. § 230.133(a) (1968) [hereinafter referred to as rule 133]. This rule, first adopted in 1951, SEC Securities Act Release No. 3420, 16 Fed. Reg. 8577 (1951), was a formal statement of a long standing administrative interpretation of the terms “sale,” “sell,” “offer to sell,” “offer for sale,” and “offer” under the Securities Act of 1933, § 2(3), 15 U.S.C. § 77(b)(3) (1964) [hereinafter cited as Securities Act]. The rule provided that, solely for the purposes of the registration requirements under Securities Act § 5, 15 U.S.C. § 77(e) (1964), no sale shall be deemed to have occurred, so far as the shareholders in a corporation are concerned, where a less than unanimous shareholder vote has the power, under the applicable State statute or the articles of incorporation, to cause a statutory merger or a transfer of one corporation’s assets to a second corporation in exchange for securities in the second corporation. The theory that this is not a sale rests on the fact that some of the shareholders in the transferor corporation may have opposed the transfer but are bound by it except to the extent that such shareholders have a statutory right to appraisal of their holdings. A transfer binding a shareholder without his consent involves no meeting of the minds, so it is reasoned, and therefore, no contract or “sale” results. Some have argued that while this rule may be very useful, practically speaking, the theory lacks logical rigor. See, e.g., 1 L. Loss, SECURITIES REGULATION 521-23 (2d ed. 1961) [hereinafter cited as L. Loss].

The no-sale fiction was extensively abused as early as the 1940’s. See Hearings on H.R. 4344 Before the House Comm. on Interstate and Foreign Commerce, 77th Cong., 1st Sess., pt. 3, at 845 (1941). See also 1 L. Loss 522 n.201. In 1956 the Securities and Exchange Commission proposed to repeal rule 133 altogether, SEC Securities Act Release No. 3698, 21 Fed. Reg. 7807 (1956), but after much public clamour, the SEC adopted amendments to the rule, making old rule 133 new rule 133(a) and adding subsections (b) through (f) which limited the possibility of abusing the rule. Securities Act Release No. 4115, 24 Fed. Reg. 5900 (1959). For an historical discussion of the development of the no-sale theory, see 1 L. Loss 518-42. See also Sargent, A Review of the “No-Sale” Theory of Rule 133, 13 BUS. LAW. 78 (1957); Note, The SEC’s No-Sale Rule and Exchanges Pursuant to Voluntary Reorganization, 67 HARV. L. REV. 1237 (1954).

That the new rule relieves restrictions was noted in a letter from Edmund H. Worthy, Director, Division of Corporate Finance, SEC, to Case Western Reserve Law Review, February 23, 1968. For this reason, according to Mr. Worthy, the Commission neither published notice of the proposed rule change nor held hearings thereon.

Rule 133(a) now provides, with deleted words in brackets and added words in italics:

(a) For purposes only of section 5 of the Act, no “sale,” “offer,” “offer to sell,” or “offer for sale” shall be deemed to be involved so far as the stockholders of a
First, the old rule allowed a corporation to transfer its assets to another corporation in exchange for securities in the transferee corporation or voting stock in the transferee's parent corporation. The new rule allows the assets to be exchanged for securities of the transferee or for securities of the transferee's parent. Second, under the old rule, a parent corporation was one which was in control of the corporation receiving the assets. "Control" was defined by reference to the definition of control in section 368(c) of the Internal Revenue Code of 1954. In amending the rule, the Commission eliminated reference to the Internal Revenue Code and, instead, inserted the exact wording used in section 368(c) to define control.

The provision that assets could be exchanged for voting stock in the parent of a transferee corporation was not within the rule as originally promulgated. That provision was added in 1954 because "[t]he Commission wished to bring Rule 133 in line with the then newly adopted section 368(a)(1)(C) of the Internal Revenue Code of 1954 . . ." Since the SEC did not follow the precise wording of the Internal Revenue Code section defining control, thus making rule 133 narrower than the Code in some aspects and broader in others, this rationale is at best curious.

corporation are concerned where, pursuant to statutory provisions in the state of incorporation, there is submitted to the vote of such stockholders a plan or agreement for a statutory merger or consolidation or reclassification of securities, or a proposal for the transfer of assets of such corporation to another person in consideration of the issuance of securities of such other person or [voting stock] securities of a corporation [which is in control, as defined in section 368(c) of the Internal Revenue Code of 1954] which owns stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of such other person, under such circumstances that the vote of a required favorable majority (1) will operate to authorize the proposed transaction so far as concerns the corporation whose stockholders are voting (except for the taking of action by the directors of the corporation involved and for compliance with such statutory provisions as the filing of the plan or agreement with the appropriate State Authority), and (2) will bind all stockholders of such corporation except to the extent that dissenting stockholders may be entitled, under statutory provisions or provisions contained in the certificate of incorporation, to receive the appraised or fair value of their holdings.

3 This form of assets-for-securities transaction is called a "C" reorganization.


5 Sargent, supra note 1, at 84. The author was then a member of the Securities and Exchange Commission. "The SEC supported Mr. Sargent's assertion by implication when it said, "[t]he amendment . . . arises from the fact that section 368(a)(1)(C) of the Internal Revenue Code, which defines tax-free reorganizations, has just been amended in a somewhat similar manner." SEC Securities Act Release No. 3522, 19 Fed. Reg. 7128 (1954).

6 For example, rule 133 does not include "B" or "F" transactions which are included in the Code. INTERNAL REVENUE CODE OF 1954, §§ 368(a)(1)(B),(F) [hereinafter cited as CODE]. On the other hand, rule 133 includes within its definition of
The current modifications mark the end of attempts to make rule 133 reorganizations conform with nonrecognition transactions of the Code.\textsuperscript{8} This is apparent from the fact that the new rule has no reference to voting stock requirements, which are essential elements of section 368 transactions. Further, by deleting the allusion to the Code definition of "control," the SEC has eliminated from rule 133 all reference to the Code. Because of the old rule's reference to the Code, courts could reasonably restrict the rule according to the judicial and administrative limitations which have been imposed on section 368 transactions.\textsuperscript{9} Therefore, deletion of the Code reference has made these limitations irrelevant to court or SEC interpretation of the no-sale rule.

An immediately apparent problem with the rule modification stems from the elimination of the reference to the Code. At one time, the relation of section 368 to rule 133 caused great confusion type-C transactions the exchange of the transferor's assets for any securities of the transferee or voting stock of the transferee's parent, whereas CODE § 368(a)(1)(C) requires the exchange to be solely for voting stock in either the transferee or its parent.

\textsuperscript{7} Accord, 1 L. Loss 528 n.229. The rationale is particularly obscure for the requirement in the 1954 version of rule 133 which allowed for the exchange of the corporate assets for any securities of the transferee corporation, but permitted the exchange of corporate assets only for voting stock of that corporation's parent. One author addressing himself to this distinction said, "There seems to be no valid reason for this distinction and the writer suspects that careless, borrowed-language drafting of the 1954 amendment of Rule 133 is to blame for this restriction." Purcell, \textit{A Consideration of the No-Sale Theory under the Securities Act of 1933}, 24 BROOKLYN L. REV. 254, 274 (1958). However valid that author's guess may be, in one context it is irrelevant. Regardless of the Commission's motive for making the distinction, it has been made. Indeed, the distinction has had the effect of fostering the connection to nonrecognition theory under the \textit{Internal Revenue Code}, subsequently requiring affirmative action by the SEC to change that effect.

\textsuperscript{8} CODE § 368(a) defines all the nonrecognition transaction forms.

\textsuperscript{9} Judicial and administrative interpretations have limited CODE § 368 in two ways which are relevant in the present context. First, certain restrictions have been placed upon section 368 transactions which must be satisfied before gain or loss will be ignored, even though the transaction conforms technically with the requirements of the section. These restrictions, which relate to the basic policy assumptions of the nonrecognition rule, are discussed in notes 14-16 infra and accompanying text. Second, the actual words defining "control" in CODE § 368(c) have been very strictly interpreted by the Internal Revenue Service. Section 368(c) requires that "at least 80 percent of the total number of shares of all other [i.e., nonvoting] classes of stock of the [subsidiary] corporation . . . ." be held by the parent. The IRS has ruled that this means the parent corporation must own "at least 80 percent of the total number of shares of each class of outstanding non-voting stock." Rev. Rul. 59-259, 1959-2 CUM. BULL. 115, 116. In considering another requirement of section 368(c), that the parent corporation must also own "at least 80 percent of the total combined voting power of all classes of stock entitled to vote . . . .," the Service ruled that voting power means the power to elect directors. Rev. Rul. 63-234, 1963-2 CUM. BULL. 148. Under this reasoning, if a corporation has 80 percent of the votes in the subsidiary, but because of stock classifications it can only elect three of the four directors of the subsidiary, the parent is not in control within the meaning of CODE § 368(c).
and led people to believe that gain need not be recognized for any reorganization which met the rule 133 standards. The recent modification can only aggravate whatever confusion may remain, because by eliminating reference to section 368 in rule 133, the Commission has destroyed a "warning flag" for those not highly sophisticated in the tax as well as the securities aspects of "C" reorganizations. The Commission tacitly recognized this problem in its release accompanying the amended rule, which warned that even though specific reference to section 368 has been deleted from rule 133, parties considering a reorganization under the no-sale theory should be made aware that the requirements of section 368 must also be met if gain is not to be recognized in the reorganization.

It is submitted that attorneys or other parties concerned with fitting reorganizations into the no-sale rule will generally read Securities Act rules, but not Securities Act releases. Once the rule modification has been incorporated in the Code of Federal Regulations, the warning may be lost in the collection of old, rarely referred to Federal Register volumes. While this is unquestionably a real problem, deletion of the "warning flag" is probably not a sufficient reason to conclude that the rule 133 amendment was a mistake by the Commission.

To evaluate other aspects of the rule 133 modifications, the policy assumptions behind the nonrecognition and the no-sale theories must be explored. The Treasury regulations state the general rule that gain or loss must be recognized if one piece of property is exchanged for another and if there is a material difference between the two pieces of property. The regulations then continue:

The purpose of the reorganization provisions of the Code is to except from the general rule certain specifically described exchanges incident to such readjustments of corporate structures made in one of the particular ways specified in the Code, as are required by business exigencies and which effect only a readjustment of continuing interest in property under modified corporate forms.

To implement this purpose the Internal Revenue Service and the courts have articulated three requirements, not explicitly stated in section 368, which must be fulfilled for the gain or loss in a trans-

10 See Purcell, supra note 7, at 254.
11 The Commission said, "The taxable nature of the transaction should, of course, be fully disclosed to stockholders whose proxies or consents are solicited to the approval of the transaction." SEC Securities Act Release No. 4892, 33 Fed. Reg. 566 (1968).
13 Id.
action not to be recognized. The transaction must have been for a “business purpose,” and there must be a “continuity of interest” and a “continuity of enterprise” following the transaction.

Under the Securities Act, the SEC has no interest in gain or loss recognition. The purpose of the Securities Act is to “provide full and fair disclosure of the character of the securities sold in interstate and foreign commerce and through the mails, and to prevent frauds in the sale thereof . . . .” The scope of the Act is generally limited to “initial [and secondary] distribution of securities rather than subsequent trading.” Thus, one policy assumption underlying rule 133 is that the requirement for registration of securities issued in a “no-sale” transaction will not further the purpose of guaranteeing shareholders full and fair disclosure. Although perhaps beyond its express authority, at times the Commission has used registration requirements to regulate corporations. Hence, a sec-

---

14 The transaction must not have been a mere ploy to avoid taxes. See, e.g., Gregory v. Helvering, 293 U.S. 465 (1935).

15 “[T]he transferor corporation or its shareholders [must retain] . . . a substantial proprietary stake in the enterprise represented by a material interest in the affairs of the transferee corporation, and . . . such retained interest [must represent] . . . a substantial part of the value of the property transferred.” Southwest Natural Gas Co. v. Commissioner, 189 F.2d 332, 334 (5th Cir.), cert. denied, 342 U.S. 860 (1951). This requirement is actually built into Code “C” reorganizations by the stipulation that the assets must be exchanged almost exclusively for voting stock in the transferee or in the parent, which in turn must be in very close control of the transferee.

16 “Such transactions and such acts must be an ordinary and necessary incident of the conduct of the enterprise and must provide for the continuation of the enterprise.” Treas. Reg. § 1.368-1(c) (1955).


18 Accord, letter from Edmund H. Worthy, supra note 2. Mr. Worthy said:

When the most recent amendment to this provision [rule 133] was adopted, many more companies had become subject to the proxy rules and the scope of the antifraud provisions of the securities laws had developed to the point where failure to disclose the tax consequences would be more clearly actionable. Id.

19 The Commission has used its power to accelerate the effective date of registration-statement amendments in order to regulate corporations in some ways. The Commission established a general rule that amendment effective dates would normally be accelerated and identified certain types of situations in which acceleration would be refused. Failure to have amendments accelerated indicates to the public that the SEC does not approve of an issuer’s conduct. Thus, the public is likely to react negatively to the issuance when it finally goes on the market. This process serves as an effective deterrent which keeps issuers from attempting to issue securities under a disfavored situation as specified by the SEC. See 1 L. Loss 277-83. This administrative practice was made more formal in a note added to Securities Act Rule 460. 17 C.F.R. § 230.460 (1968). Yet, it is important not to infer from this procedure that the SEC willingly regulates corporations in all areas of the law. The Commission, with certain exceptions, limits its use of this device to the regulation of corporate disclosure. 1 L. Loss 282.
ond policy assumption must be either that there is no need to attempt to regulate companies engaged in rule 133 transactions or that, even if regulation were needed, requiring registration would not adequately perform the regulatory function.

Whether the Code nonrecognition rule and the SEC no-sale rule successfully implement their underlying policies can best be analyzed in a factual context. Therefore, the following is a hypothetical situation in which the benefits of the rule modifications have been exploited.21

Sale of Assets by BCA, Inc. to 231, Inc. BCA, Inc. was a publicly held corporation with assets worth $1,500,000 and 600 shareholders of its over-the-counter stock. The president and a major shareholder of BCA, Stephen Strait, planned to retire and completely relinquish management of the corporation. He hoped to continue to participate in BCA profits, but wanted his securities investment to have a preferred status which would guarantee him a regular income. Because management of BCA requires a working knowledge of nuclear physics, Mr. Strait found no one within the organization capable of assuming management. For the same reason very few corporations were competent to merge with BCA and properly manage it.

Mr. Strait did discover one corporation able to take over and continue BCA’s management, 231, Inc., a recently formed subsidiary of Octopus, Inc. The managements of 231 and Octopus and Mr. Strait quietly discussed a sale of BCA’s assets. They concluded (1) that a sale of assets would be ideal; (2) that it would be impractical for 231 to acquire BCA’s assets for securities in 231, because 231’s newness to the field involved too much risk for Mr. Strait and the other BCA shareholders; and (3) that 231 did not yet have the capital which would be necessary to purchase BCA’s assets outright. The parties finally agreed to a plan whereby BCA would transfer its assets to 231 in exchange for preferred nonvoting stock in Octopus, Inc. This would give Mr. Strait the security he needed in his investment and would avoid disrupting the voting power balance in the Octopus management.

21 No actual cases have been found in which the no-sale rule has been examined, with the possible exception of National Supply Co. v. Leland Stanford Jr. Univ., 134 F.2d 689 (9th Cir.), cert. denied, 320 U.S. 773 (1943). The issues and facts of that case are not relevant here. Further, “[i]t is a most difficult stretch of legal reasoning to conclude that the ‘no-sale’ theory was the basis for the court’s decision in such case.” Sargent, supra note 1, at 86.

Attorneys recognize that it is in the best interest of clients to file a registration
The proposal was submitted to a vote of the BCA shareholders. The vote was by proxy and, pursuant to section 14(a) of the Securities Exchange Act of 1934 and rules promulgated thereunder, a complete disclosure of the arrangement was made available to the public and given to the shareholders of record. The proposal was adopted. Octopus issued the securities to BCA which in liquidating exchanged them with its shareholders for their outstanding BCA stock. Since this reorganization was effected after the recent Securities Act rule 133 modifications had been promulgated, the shares were issued without Octopus having the burden and expense of registering the securities pursuant to section 5 of the Securities Act.

This was not a nonrecognition transaction for tax purposes, because it did not meet the requirements of section 368(a)(1)(C) of the Internal Revenue Code. Each shareholder was required to recognize his gain or loss from the transaction.

As readily seen from this hypothetical situation, more options are now open to parties negotiating a "C" reorganization who wish to keep the transaction within the aegis of rule 133. BCA shareholders are not restricted to taking voting stock in Octopus. They may choose to relinquish control in favor of guaranteeing income from their assets. Octopus can execute the "C" transaction without diluting the voting power of its current voting shareholders if it is able to convince BCA shareholders to accept a guaranteed income in lieu of a controlling voice in Octopus. Further, more corporations are eligible to engage in the no-sale transaction. For example, Octopus may own 80 percent of all nonvoting shares in 231, but not 80 percent of all nonvoting shares in each class of 231 stock and still be a "controlling" corporation within the meaning of rule 133. Although Octopus may engage in the transaction with the intent of having its subsidiary, 231, immediately sell or terminate statement or to design a reorganization so that it is clearly within rule 133. Perhaps this explains the dearth of cases testing the application of the rule.


25 See CODE § 1002.

26 If the Internal Revenue Service interpretations of CODE § 368(c) were applicable to section 368(c) as referred to in old rule 133, which they very likely would have been, Octopus would not have been in "control" of 231. See note 9 supra.
the BCA business, unregistered securities still may be issued in the transaction.\footnote{The "continuity of enterprise" requirement of the CODE, see note 16 supra, would probably have made this impossible under the old rule, assuming that rule was affected by section 368 limitations.}

Although the potential for abusing minority shareholders' interests seems minimal under the new rule, the possibility is present. Assume in the hypothetical that Octopus had used the new rule to expand its operations by buying a controlling interest in BCA and by using that interest to instigate a "C" reorganization with 231. Under these circumstances, no one negotiating the reorganization will protect the interests of the minority shareholders as did Mr. Strait in the hypothetical. The minority shareholders will have a right of redress under the securities laws if Octopus uses any misrepresentation or nondisclosure to bring about the reorganization agreement.\footnote{As Mr. Worthy indicated, the civil liabilities for fraud and nondisclosure have been greatly expanded in the last several years. Note 19 supra. Liability for misstatements or nondisclosure in proxy statements pursuant to Exchange Act § 14(a), 15 U.S.C. § 78(n)(a) (1964) or other statements by the management of a corporation or its controlling shareholders may be found in various sections of the securities laws. See, e.g., Securities Act § 12(2), 15 U.S.C. § 77l(2) (1964); Exchange Act § 18(a), 15 U.S.C. § 78l(a) (1964); Exchange Act Rule 10b-5, 17 C.F.R. § 240.10b-5 (1968), pursuant to Exchange Act § 10(b), 15 U.S.C. § 78(j)(b) (1964).}

If the consideration to the minority shareholders is clearly unfair, Octopus' position as a majority shareholder may make it liable for breach of a fiduciary responsibility.\footnote{The liability can be very strict. For example, Exchange Act Rule 10b-5, 17 C.F.R. § 240.10b-5 (1968), provides in part:

\begin{quote}
It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentalities of interstate commerce, or of the mails, or of any facility of any national securities exchange, . . . to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, . . . in connection with the purchase or sale of any security.
\end{quote}

Further, the federal class action procedure now makes it easier for minority shareholders to sustain the cost of actions against a large corporation.\footnote{"All powers granted to a corporation and its directors and majority shareholders are impliedly to be exercised by the directors or the shareholders or by both concurrently only in good faith and for legitimate purposes. They should be regarded in some sense as fiduciaries." H. BALLANTINE, CORPORATIONS § 278, at 655 (rev. ed. 1946); see 19 CASE W. RES. L. REV. 1130, 1137 n.37 (1968).} Practically speaking, however, the difficulty and expense of rapidly organizing a class action may be such as to deter many minority shareholders from suing for remedies which they justly deserve.

This possibility of minority shareholders being injured without
compensation is not a function of the rule change. Even if the old rule were still in effect, Octopus could instigate the same transaction. The only difference would be that the securities issued to the BCA shareholders would have to be voting stock or registered nonvoting securities. If Octopus were large enough and if the voting stock were placed in a class with limited voting power, the transaction could easily be effected without endangering the domination of Octopus management by the currently controlling Octopus shareholders. If securities other than voting stock were given and registered, the minority shareholders would have no greater opportunity to redress their grievances than they would have if the securities were not registered. Misrepresentation or nondisclosure remedies are much the same if the untruthful statements are made in registration of securities or in proxy statements. A proxy statement would have been required when the BCA shareholders were asked to vote on the reorganization plan.

In one way requiring registration might be used to avoid this abuse. If the Commission were to require registration and selectively employ delaying tactics to defeat a registration, it could indirectly regulate those corporations which unfairly treated transferor corporation minority shareholders. Transferee corporations could easily circumvent this regulation by issuing voting stock. Thus, the Commission would have to abolish much of the no-sale rule in order to effectively use registration to regulate "C" reorganizations. No evidence is available to make a convincing case that such regulation is needed. Further, it is highly doubtful that the Commission should take such drastic action to perform a purpose which is not in its statutory mandate.

The hypothetical use of new rule 133 and the analysis of its advantages and problems points to a vindication of both the Code nonrecognition concept and the SEC no-sale rule even though they now permit significantly different transactions. The nonrecognition rule is applied to corporate reorganizations "which effect only a readjustment of continuing interest in property under modified corporate forms." The situation where Mr. Strait and the BCA share-

---

33 See text accompanying notes 22 and 23 supra.
34 The use of registration requirements to regulate corporations is not foreign to the Commission. See note 20 supra.
36 Treas. Reg. § 1.368-1(b) (1955). For a more thorough discussion of the nonrecognition policies, see text accompanying notes 12-16 supra.
holders are relinquishing all management control of their corporate assets in exchange for preferred nonvoting securities is not within the purpose of the Code nonrecognition rule. Gain should be recognized. In this same situation, virtually all information which can be used to protect shareholders from misrepresentation or nondisclosure is already required. No useful purpose would be served by requiring registration of the securities issued pursuant to the transaction. If there is a need to regulate corporations involved in these transactions, it is doubtful that a mere registration requirement would help perform that function.

The rule modification has not gone too far. The next question is whether it goes far enough. While reference to section 368(c) of the Internal Revenue Code has been deleted, the requirements of that subsection are still imposed upon rule 133.\(^7\) One demand of the Code nonrecognition rule is that the transferor corporation or its shareholders have a continuing interest in the assets which are transferred.\(^8\) This continuity cannot occur where the transferor receives voting stock in the parent corporation of the transferee unless the parent has a close control over its subsidiary-transferee. The section 368(c) requirements are integral elements in the chain of continuity. But, “continuity of interest” is unnecessary to the Securities Act. The transferor's having a continuing interest in its assets is irrelevant to whether full and fair disclosure of facts relating to the securities issued in a “C” transaction has been achieved.\(^9\) The SEC impliedly recognizes this by not requiring that the exchange of assets be for voting stock. Unless the transferor has voting stock in the transferee or its parent, the transferor has no managerial power over its assets and the continuity of interest chain is broken.

Absent a continuity of interest requirement, no reason for the 80 percent requirement appears. Returning to the hypothetical, if Octopus, Inc. had had no control over 231, no less information would be available to the BCA shareholders than was available un-

\(^7\) For the precise wording of that requirement, see note 2 supra.

\(^8\) See note 15 supra.

\(^9\) Rule 133(b)-(f) is a form of continuity of interest requirement. The transferor cannot take securities from the transferee with the intent of selling them publicly. Allowing such a transaction would make it possible to sell the securities to a public which has no access to full information about the issuance, since no proxy statement would be involved. This "continuity of interest" requirement is the inverse of the requirement in Code § 368. The Code requires that the transferor have voting stock control over its assets. The transferor may at any time sell that stock and will then have to recognize gain. Under rule 133(b)-(f) it is irrelevant that the transferor may not have voting stock control over its assets, but the transferor must hold whatever securities it does receive as an investment.
der the other circumstances. If Octopus did not substantially own 231, Octopus could not properly issue shares to BCA shareholders unless Octopus' assets were increased by adequate consideration, probably from 231. To do so would be a breach of the trust relation with Octopus shareholders. However, this does not involve full and fair disclosure problems, and the problems which are created are adequately solved by the general law of corporations. Requiring registration would have the same result as it did when Octopus was in control of 231. No significant additional protection from fraud and nondisclosure would be added. Therefore, since the 80 percent requirement is a restriction which does nothing to promote full and fair disclosure, the SEC should eliminate control requirements from rule 133.

DAVID J. NEWBURGER

40 Corporate management generally has a statutory obligation to issue par shares for at least par value and no-par shares for at least some valuable consideration. See, e.g., ABA-ALI MODEL BUS. CORP. ACT ANN. § 17 (1960). A further management duty to issue the shares for a reasonable consideration can be inferred from the duty to exercise reasonable care, see H. HENN, CORPORATIONS § 235 (1961); N. LATTIN, CORPORATIONS 241 (1959), the duty to be loyal to the interests of the corporation, see H. HENN, supra § 239, and the duty not to oppress minority shareholders, see id. § 241.