The Interface between Securities Act 3(a)(10) and Ohio Revised Code 1707.04: Utilitarian Considerations for Ohio Mergers and Corporate Reorganization Transactions

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THE INTERFACE BETWEEN SECURITIES ACT § 3(a)(10) AND OHIO REVISED CODE § 1707.04: UTILITARIAN CONSIDERATIONS FOR OHIO MERCERS AND CORPORATE REORGANIZATION TRANSACTIONS

ROBERT N. RAPP

THE NEED FOR AVAILABILITY of an exemption from the registration and prospectus delivery requirements of Section 5 of the Securities Act of 1933 for corporate merger and reorganization transactions involving exchanges of securities was of little concern prior to October, 1972 and the adoption of SEC Rule 145. That Rule reversed SEC Rule 133 and corresponding interpretive views of the Commission which had deemed the distribution of securities involved in a merger or reorganization transaction submitted to and approved by a vote of the security holders not to involve an "offer" or "sale" of the securities within the purview of Section 5. But with the adoption of Rule 145 came the recognition that absent an exemption, corporate action involving reclassification of securities, mergers and other forms of business combinations, and transfers of corporate assets in exchange for securities which are subject to shareholder approval, must comply with the provisions of Section 5 as to registration and prospectus delivery prior to the vote by shareholders.

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1 15 U.S.C. §77(e) (1976). The requirements of a filed and effective registration statement are respectively set forth in sections 5(c) and 5(a) of the Securities Act, 15 U.S.C. §§ 77(e)(c), 77(a) (1976), while the prospectus delivery requirements are set forth in section 5(b), 15 U.S.C. §77(e)(b) (1976), in conjunction with section 10, 15 U.S.C. § 77j (1976), which prescribes the form and content of permissible communications to potential purchasers during a distribution of securities.


3 17 C.F.R. § 230.133 (1977). Rule 133 represented the so-called "no sale theory" for issuances of securities in mergers and other business combination transactions upon grounds that no individual decision by a security holder was involved, but rather only a corporate act and, hence, no "sale" occurred within the ambit of the registration provisions of the Act. The old Rule is discussed in further detail infra, at pp. 5-6.

4 Rule 145 provides in pertinent part:

An "offer," "offer to sell," "offer for sale" or "sale" shall be deemed to be involved within the meaning of Section 2(3) of the Act, so far as the security holders of a corporation or other person are concerned where, pursuant to statutory provisions of the jurisdiction under which such corporation or other person is organized, or pursuant to provisions contained in its certificate of incorporation or similar controlling instruments, or otherwise, there is submitted for the vote or consent of such security holders a plan or agreement for—

(1) Reclassifications. A reclassification of securities of such corporation or other person, other than a stock split, reverse stock split, or change in par value, which involves the substitution of a security for another security;

(2) Mergers of Consolidations. A statutory merger or consolidation or similar plan of acquisition in which securities of such corporation or other person held by
The scheme of exemptions available under the Securities Act, while relatively comprehensive from the perspective of the company which is itself closely held or which is acquiring a relatively closely held company, is nevertheless problematic in the reorganization and acquisition context. Limitations and restrictions on available exemptions from Section 5 compliance leave them of uncertain utility and cast unacceptable doubts in many instances upon the consummation of reorganization and acquisition transactions for those who are unable to either undertake or economically justify the undertaking of Rule 145's prescribed registration procedures.

It is this uncertainty which has raised Section 3(a)(10) of the Securities Act\(^5\) to new and desired prominence in certain states such as Ohio. That provision, which exempts from Section 5 compliance any security issued in specified corporate transactions which are submitted for "fairness" determinations by authorized judicial or administrative bodies, is significantly enhanced in Ohio by the existence of the correlative provision of the Ohio Securities Law\(^6\) which specifically authorizes an application to the Ohio Division of Securities for a determination of the fairness of certain types of reorganization or acquisition transactions. Indeed, Section 1707.04 of the Ohio Revised Code provides in pertinent part:

The Division of Securities may consider and conduct hearings upon any plan of reorganization, recapitalization, or refinancing of a corporation organized under the laws of the state, or having its principal place of business within this state, when such plan is proposed by such corporation or by any of its shareholders or creditors and contains a proposal to issue securities in exchange for one or more bona fide outstanding securities, claims, or property interests, or partly in such exchange or partly for cash. The division may also approve the terms of such issuance and exchange and the fairness of such terms, after a hearing upon such fairness at which all persons to whom it is proposed to issue securities have the right to appear, if application for such a hearing is made by such corporation, by the holders of a majority amount of its debts, or by the

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holders of a majority amount of any outstanding class of securities issued by it. . . .

"Reorganization," as used in § 1707.04, is further defined in the statute to include, among other things, the exchange of securities by an issuer for securities of another issuer, and a merger or consolidation.

The mechanism for a "fairness" determination by the Ohio Division of Securities for covered transactions represents a clear interface with the Securities Act § 3(a)(10) exemption at the federal level. Thus, for transactions now within the ambit of SEC Rule 145, the combination of § 3(a)(10) and Ohio Rev. Code § 1707.04 represents a meaningful alternative to the procedural burdens of the federal registration processes, as well as to the uncertainties of reliance upon other exemptive provisions in covered transactions. The state law provision for a fairness determination, and the ability to obtain it, provides assurance of the federal exemption, and it is the availability of this mechanism in a handful of states, including Ohio, which has thrust the generally overlooked Section 3(a)(10) exemption to the forefront of consideration.

Against this backdrop, it is the purpose of this article to examine the interface between Securities Act § 3(a)(10) and Ohio Rev. Code § 1707.04, and to highlight the utility of the combination for Ohio corporate transactions. Subpart II below analyzes the significant background considerations which underlie the new-found importance of § 3(a)(10). It is followed in Subpart III by in-depth consideration of the interface itself. And finally, the application and utilization of the Ohio provision are analyzed in Subpart IV.

I. BACKGROUND CONSIDERATIONS

The adoption of SEC Rule 145 in October, 1972, and the concomitant repeal by the Commission of the prior controlling "no sale" theory of Rule 133 as applied to corporate reorganization or business combinations involving shareholder approval, brought with it new burdens of compliance with the registration and prospectus delivery requirements of the Securities Act of 1933. In contrast to the administrative principles codified previously in

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8 § 1707.04(B) provides:
"Reorganization," "recapitalization," and "refinancing," as used in this section, include the following:
(1) A readjustment by modification of the terms of securities by agreement;
(2) A readjustment by the exchange of securities by the issuer for others of its securities;
(3) The exchange of securities by the issuer for securities of another issuer;
(4) The acquisition of assets of a person, directly or indirectly, partly or wholly in consideration for securities distributed or to be distributed as part of the same transaction, directly or indirectly, to holders of securities issued by such person or secured by assets of such person;
(5) A merger or consolidation.
9 See note 4, supra, and accompanying text.
10 See note 3, supra, and accompanying text.
11 For transactions within the ambit of Rule 145, compliance with Securities Act registration requirements is to be effected through the use of Form S-14, and its incorporation of the informational requirements of Regulation 14A or 14C under Section 14 of the Securities Exchange Act of 1934, 15 U.S.C. § 78n(a) (1970). The registration statement and prospectus, then, take on the character of a proxy statement rather than the more detailed prospectus involved in a Form S-
Rule 133, Rule 145 now declares that the definitions of "offer," "offer to sell," "offer for sale," or "sale" as contained in Section 2(3) of the Securities Act, and which trigger the requirement for Section 5 compliance, are deemed to include three categories of corporate transactions, the consummation of which, by state law, corporate charter or otherwise, are subject to shareholder approval. As Rule 145 sets forth, those categories of transactions are as follows:

(1) **Reclassifications.** A reclassification of securities of such corporation or other person, other than a stock split, reverse stock split, or change in par value, which involves the substitution of a security for another security;

(2) **Mergers or Consolidations.** A statutory merger or consolidation or similar plan of acquisition in which securities of such corporation or other person held by such security holders will become or be exchanged for securities of any other person, except where the sole purpose of the transaction is to change an issuer's domicile; or

(3) **Transfers of Assets.** A transfer of assets of such corporation or other person, to another in consideration of the issuance of securities of such other person or any of its affiliates, if:
   (i) such plan or agreement provides for dissolution of the corporation or other person whose security holders are voting or consenting; or
   (ii) such plan or agreement provides for a pro rata or similar distribution of such securities to the security holders voting or consenting; or
   (iii) the board of directors or similar representatives of such corporation or other person, adopts resolutions relative to subdivision (i) or (ii) of this subparagraph within one year after the taking of such vote or consent; or
   (iv) the transfer of assets is a part of a pre-existing plan for distribution of such securities, notwithstanding subdivision (i), (ii), or (iii) of this subparagraph.

The Rule is thus comprehensive in its coverage of virtually all of the most common types of corporate business combinations, such as statutory mergers or consolidations, or sales of assets of an acquired company in exchange for securities of the acquiring company, as well as reorganizations involving the distribution of securities to shareholders in which there is submission of the transaction for shareholder approval. The latter point is, of course, the key to the operation of Rule 145.

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1 registration statement. In providing for the Form S-14 procedure, the SEC specifically sought to minimize the burdens of registration in Rule 145 covered transactions for small businesses to the extent feasible. See "Preliminary Note to Rule 145," Securities Act Rel. No. 5316, supra, note 2.

12 See note 4, supra.

13 The SEC has determined, however, that Rule 145 is not applicable to "B" type corporate reorganizations, in which an acquiring company makes an independent offer to the shareholders of a company proposed for acquisition to exchange their shares for shares of the acquiring company.
Prior to the adoption of Rule 145, SEC Rule 133 had declared that for purposes of Section 5 of the Securities Act, the submission to a vote of stockholders of a corporation of a proposal for certain mergers, consolidations, reclassifications of securities or transfers of assets was not deemed to involve an "offer," "sale" or "offer to sell" or "offer for sale" of the securities of the new or surviving corporation to the security holders of the disappearing corporation. The effect of the provision was to exclude the distributions of securities involved in such transactions from coverage of Section 5 and its registration and prospectus delivery requirements. As noted above, the operation of Section 5 is tied directly by definitional provisions to the disposition or attempted disposition of securities for value, i.e., an offer or sale. The so-called "no sale" theory codified in Rule 133 neatly excised such corporate transactions as were subjected to shareholder approval from the key definitions of offer or sale and thus removed such transactions from the ambit of Section 5.14

The "no-sale" theory of Rule 133 was based upon the notion that the exchange or alteration in the rights of a security holder in a reorganization or reclassification transaction, or the receipt of new securities of a new company in exchange for old securities in a merger situation, occurred not because of any individual volition or consent but rather by corporate action authorized by a specified majority of the interests affected. The individual volition involved in casting a vote in favor of the transaction was ignored, and it is that element of the theory which contributed to the rocky tenure of the Rule. Indeed, as early as 1956 the Commission proposed that the Rule be reversed because it overlooked the practical substance of the transactions and ignored the fundamental nature of the relationship between the stockholders and corporation.15 Likewise in 1969, the influential Wheat Report16 urged that Rule 133 left a "decided disclosure gap" in acquisition situations, and that there should be recognized as a matter of policy:

...the fact that when a shareholder is asked to vote on the question of whether or not his company should be acquired by another and,
accordingly, whether or not he wishes to exchange his shares for the securities of the acquired company, an offer of a security within the meaning of the '33 Act is made to him.\textsuperscript{17}

The Commission response in 1972 was, of course, the complete elimination of Rule 133 and the "no-sale" theory which it embodied. In doing so, the Commission recognized:

The corporate action in these [covered] circumstances . . . is not some type of independent fiat, but is only the aggregate effect of the voluntary decisions made by individual stockholders to accept or reject the exchange. Formalism should no longer deprive investors of the disclosure to which they are entitled.\textsuperscript{18}

Rule 145 now recognizes that business combinations or reclassifications which are submitted to shareholder vote do involve an "offer" or "sale" of securities and, hence, are subject to the provisions of Section 5, unless an exemption from such compliance is available.\textsuperscript{19}

Since the mechanics of Rule 145 specify that the registration of securities involved in a covered transaction may be effected on Form S-14, and the "prospectus" utilized will be essentially the same as disclosure documents specified under the proxy rules,\textsuperscript{20} the additional regulatory burden imposed by Rule 145 on most large, publicly-held companies may not be great. The likelihood is that most of these companies would be subjected to compliance with the proxy rules under the Securities Exchange Act of 1934\textsuperscript{21} in any event.

The real burden of Rule 145 falls upon those smaller companies who are not required to comply with the Exchange Act proxy rules, and for whom the preparation of a Form S-14 registration statement and prospectus represents a major undertaking.\textsuperscript{22} Thus, it is important to note the Commission's express

\textsuperscript{17} Id. at 272.
\textsuperscript{18} Securities Act Rel. No. 5316, supra, note 2, at 82,198.
\textsuperscript{19} See text accompanying note 23, infra.
\textsuperscript{21} Compliance with the proxy rules promulgated under Section 14(a) of the Securities Exchange Act is triggered where a company has a class of securities registered under Section 12 of the Exchange Act, 15 U.S.C. § 78l(1978). Registration under the Exchange Act is required for all securities listed on a national securities exchange and for securities traded in the over-the-counter market where the issuer meets certain tests regarding assets and numbers of shareholders. The principal impact of Exchange Act registration is the triggering of further responsibilities such as proxy rule compliance, periodic reporting requirements and others.
\textsuperscript{22} While the Commission sought in the adoption of Rule 145 to lessen the burden "to the extent feasible" by providing for the Form S-14 registration procedure, the burden of compliance for the smaller company remains substantial. The requirement for certified financial statements may, in and of itself, be prohibitive. Form S-14 makes no concession in regard to required information for the prospectus in cases where the company is not subject to Exchange Act proxy regulation. Indeed, as Instruction (b) to Item 1 of Form S-14 declares:

If neither the registrant nor any other person which is a party to the transaction in which the securities to be registered are to be issued is required to solicit proxies pursuant to Section 14(a), or to furnish information to security holders pursuant to Section 14(c), of the Securities Exchange Act of 1934 in regard to the transaction, then the prospectus shall contain the information which would be required to be included in a proxy or information statement of the registrant if it were subject to Section 14(a) or 14(c) and may be in form of such a proxy or information statement.
preservation of the right of those involved in Rule 145 covered transactions to rely on available statutory exemption from Section 5 compliance. As the Commission stated in its “Preliminary Note” to Rule 145: “Transactions for which statutory exemptions under the Act, including those contained in Sections 3(a)(9), 3(a)(10), 3(a)(11) and 4(2) are otherwise available are not affected by Rule 145.”

What emerges, then, is the express recognition that despite the fact that a Rule 145 covered transaction occurs, compliance with Section 5 via the prescribed Form S-14 registration, may be avoided by reliance upon any of the statutory exemptions from Section 5 coverage. Sections 3 and 4 of the Securities Act specify numerous exemptions from Section 5 compliance under the heading of either “Exempted Securities” or “Exempted Transactions.” Underlying the entire exemptive scheme is the basic premise that in certain circumstances the need for the protections of Section 5 is either substantially lessened or non-existent. As referenced in the Commission’s “Preliminary Note” to Rule 145, principal exemptions under the Act available for Rule 145-type transactions are those specified in Section 3(a)(9), covering securities exchanged by an issuer with its existing security holders; Section 3(a)(10), covering securities issued in exchange for outstanding securities or property of any person after a fairness determination, and which is the subject of detailed analysis below; Section 3(a)(11), the so-called “intrastate offering” exemption; and Section 4(2), covering transactions by an issuer “not involving any public offering.”

A. Exemptions Available Under Sections 3 and 4
of the Securities Act

Given the costs and procedural burdens involved in compliance with the S-14 registration process in a Rule 145 covered transaction, the availability of a statutory exemption from Section 5 compliance takes on great significance.


23 “Preliminary Note to Rule 145,” note 11, supra.


Any security exchanged by the issuer with its existing security holders exclusively where no commission or other remuneration is paid or given directly or indirectly for soliciting such exchange.


Any security which is a part of an issue offered and sold only to persons resident within a single State or Territory, where the issuer of such security is a person resident and doing business within or, if a corporation, incorporated by and doing business within, such State or Territory.

Pertinent considerations attendant to Section 3(a)(11) analysis in the instant setting appear at text pp. 9-10, infra.

27 15 U.S.C. § 77d(2)(1970). Section 4(2) declares that the provisions of Section 5 shall not apply to:

. . . transactions by an issuer not involving any public offering.

See discussion at text pp. 8-9, infra.

28 See note 22, supra.
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Whereas prior Rule 133 and the "no-sale" theory of corporate transactions eliminated any concern for Securities Act compliance (short of the anti-fraud provisions, the efficacy of which is expressly continued) by carving out these transactions from the purview of the statute, the demise of Rule 133 thrust the importance of statutory exemptions into critical perspective.

1. The Section 4(2) Exemption

In the main, the exemption provided by Section 4(2) of the Act has been relied upon in situations involving mergers and acquisition of relatively small, closely-held companies. Section 4(2) provides an exemption for transactions undertaken by an issuer not involving a "public offering." Availability of the exemption, as a matter of administrative interpretation and case law, is conditioned upon offerees' access to information and relative ability to fend for themselves in a particular transaction, as measured by such qualities as business sophistication and financial ability to bear the risk of an investment.

In recent years, however, the availability of the Section 4(2) exemption has been subjected to no small amount of uncertainty. While the adoption of the "safe harbor" provision of SEC Rule 146 has ameliorated some of that uncertainty, one commentator has nevertheless aptly observed: "... the entrance to the harbor is narrow, particularly in the business combination context." Effective compliance with Rule 146 in the business combination context may not be much less a procedural burden than an S-14 registration itself, a fact which has prompted generalized criticism of the substantive

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29 Id. It should be noted that under a recent amendment to the Ohio Revised Code, Section 1707.03Q, a distributor of securities meeting the requirements of the Section 4(2) private offering exemption and carried out pursuant to certain further procedures will also be exempted from compliance with the Ohio securities registration provisions, Sections 1707.08 through 1707.11, inclusive.


31 Most of the uncertainty has been a function of the general requirement that an offeree/purchaser in a Section 4(2) exempt transaction have access to, or be furnished with, information that the registration process would afford, and further that such persons be in a position vis-a-vis the issuer so as to be able to "fend" for themselves. See, e.g., SEC v. Universal Major Investors Corp., supra; see also Henderson v. Hayden, Stone, Inc., 461 F.2d 1069 (5th Cir. 1972); Haber v. Bordas [1975-1976] Fed. Sec. L. Rep. (CCH) ¶ 95,330, at 98,656 (S.D.N.Y. 1975). In the business combination setting, many of the controls that an issuer might undertake in a § 4(2) offering may be impossible or impracticable, thus adding significantly to the peril of reliance on that exemption.


33 Mann, The Section 3(a) (10) Exemption: Recent Interpretations, 22 UCLA L. Rev. 1247, 1249 (1975) [hereinafter cited as Mann]. Mann also notes that "the conditions for attaining protection under rule 146 are strict in the business combination context." A practical consideration, of course, is the 33 purchaser limitation. Rule 146(g). Additionally the Rule specifically imposes the burden upon the issuer in a "business combination" transaction (defined to be a Rule 145 covered transaction, or an exchange offer):

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provisions of the Rule and cast some doubts upon its continued vitality.\textsuperscript{34} Moreover, in those Rule 145 covered transactions involving shareholders numbering greater than 35, or in which the securities being distributed may by reason of time considerations specified in the Rule be integrated with prior or subsequent transactions so as to exceed the numerical limitation or destroy the qualification of offerees in the Rule 145 transaction,\textsuperscript{35} Rule 146 is not available.

The attractiveness of Section 4(2) in the business combination context is thus vitiated by numerous uncertainties. These uncertainties arise due to the complex procedures and specific substantive requirements of Rule 146, or they are caused by reliance on the Section 4(a) exemption without the benefit of Rule 146. Use of the Section 4(2) exemption outside the "safe harbor" of Rule 146 involves the genuine risk of relying on administrative and judicial interpretations of the exemption's availability outside of the Rule.

2. The Section 3(a)(11) Exemption

The "intra-state offering" exemption contained in Section 3(a)(11) of the Act,\textsuperscript{36} and its corresponding "safe harbor" provision, Rule 147, present problems similar to those encountered in the Section 4(2) exemption.\textsuperscript{37} Section 3(a)(11), and Rule 147, exempt from Section 5 coverage any security "... which is part of an issue offered and sold only to persons resident within a single state ..." where the issuer qualifies as to residence and "doing business" requirements. The availability of the exemption is conditioned upon compliance with all of the requirements of Section 3(a)(11), as established by administrative and judicial decisions, or Rule 147. Prominent among these requirements are those relating to issuer's residence and "doing business" considerations, as well as the residence of each offeree. The latter, although seemingly an objective consideration, has come to include the

\ldots [T]he issuer and any person acting on its behalf, after making reasonable inquiry shall have reasonable grounds to believe, and shall believe, at the time that any plan for a business combination is submitted to security holders for their approval, or in the case of an exchange, immediately prior to the sale, that each offeree either alone or with his offeree representative(s) has such knowledge and experience in financial and business matters that he is or they are capable of evaluating the merits and risks of the prospective investment.


\textsuperscript{35} The 35 purchaser limitation has previously been noted. With respect to "integration" of the offering with any other transaction by the issuer, Rule 146(b)(1) provides that offers and sales of securities made pursuant to exemptions more than six months prior to the Rule 146 transaction and after the six months following that transaction will not be integrated. To the extent a "business combination" transaction carried out in reliance upon the rule was integrated within another prior or subsequent transaction within the six month periods, the impact could be to (1) cause the issuer to exceed the 35 purchaser limitation, or (2) destroy the qualification of the Rule 146 transaction in terms of the "nature" of the offerees and purchasers. In either case, its effect would be preclusion of Rule 146 for the transaction.


subjective element of an offeree/purchaser's state of mind in taking the security, i.e., the view or intention of that individual respecting resales to non-residents. Moreover, the problem of integration with other transactions is generally more pronounced in intra-state offering situations, although use of the exemption in a business combination transaction may avoid integration under established criteria\(^{38}\) where there is no pattern of such transactions by the issuer involved.

The principal difficulty with the Section 3(a)(11) exemption, either by itself or under the Rule 147 "safe harbor," in a business combination transaction is compliance on both sides with the residence requirements. Not uncommonly, the parties to business combinations are situated, or doing business, in different states, or the recipient shareholders are not domiciled within the issuer's state.\(^{39}\) In any event, like § 4(2) the utility of the § 3(a)(11) exemption is substantially diminished by reason of the practical and mechanical limitations imposed upon its availability and the inflexibility of its application in the business combination setting.

3. The Section 3(a)(9) Exemption

The section 3(a)(9) exemption\(^{40}\) is aimed at corporate reclassifications, and where such a reclassification requires shareholder approval, Section 3(a)(9) has clear efficacy inasmuch as Rule 145 would deem the transaction to involve an offer and sale of the securities involved. Yet Section 3(a)(9) likewise contains within it certain restrictions on availability which can materially affect its utility in a Rule 145 covered transaction.

One of the reasons for this limited utility is that the exemption applies only to exchanges of securities by an issuer with its existing security holders and has no application in the case of a business combination in which a given element is the exchange of securities by an issuer with shareholders of another corporation. Additional limitations are imposed since the exemption is restricted to exchanges of securities between a corporation and its existing shareholders "exclusively." Thus, to the extent that a security holder is

\(^{38}\) The determinative consideration in any integration question is whether different offers or sales of securities are regarded as part of the same issue. In making that inquiry the SEC has identified certain factors to be generally applied. These are:

1. are the offerings part of a single plan of financing;
2. do the offerings involve issuance of the same class of securities;
3. are the offerings made at or about the same time;
4. is the same type of consideration to be received; and
5. are the offerings made for the same general purpose.


The major concern over integration in the intra-state offering context is the preclusion of the exemption for a qualifying offering by integration with other offers or sales not qualifying, even where those other transactions were effected in reliance upon another exemption.

\(^{39}\) The SEC has emphasized that mere presence within a particular state will not suffice to meet the residence requirement for a valid intra-state offering. See Securities Act Rel. No. 4434, id. The operative notion, rather, is domicile, with its attendant connotation of a permanent home to which the person intends to return after periods of absence, and from which he or she has no present intention of moving.

required to pay something as well as surrendering his or her securities for the security received in the transaction, or to the extent that an exchange is made between the issuer and anyone other than an existing shareholder, the exemption is lost.\(^{41}\) The prohibition against payment by a security holder may produce an unanticipated bar to the exemption in situations involving the surrender by shareholders of some accrued rights or preferences in connection with giving up their securities for different ones. Additionally, the Section 3(a)(9) prohibition of the payment of any commission or remuneration for solicitation of security holders eliminates the option of engaging solicitors to obtain shareholder votes or consents in favor of the reclassification plan.\(^{42}\)

In sum, the Rule 145 express preservation of the Sections 3(a)(9), 3(a)(11) and 4(2) statutory exemptions from Section 5 compliance falls short of assuring an exemption for mergers and reorganization transactions in those situations where either the time or expense of registration is not justifiable. In Ohio, however, such assurance is available through the Section 3(a)(10) exemption as applied in conjunction with Section 1707.04 of the Ohio Blue Sky Law.\(^{43}\)

II. THE Rediscovery of Section 3(a)(10)

Section 3(a)(10) of the Securities Act was designed to exempt judicially or administratively approved reorganization or recapitalization transactions. Where such transactions are submitted to independent "fairness" determinations the exemption simply presumes no need for further regulation via Section 5.\(^ {44}\) With the advent of Rule 145, Section 3(a)(10) has taken on new significance in those states, like Ohio, which provide the mechanisms for such administrative evaluation of these transactions.

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\(^{41}\) The restriction on no other consideration as remuneration in connection with the exchange is ameliorated only to the extent provided by Rule 149 under the Securities Act, 17 C.F.R. § 230.149 (1977), which permits the payment of cash by the security holder to the extent necessary to effect "an equitable adjustment" in respect of dividends or interest paid or payable on the securities involved.

\(^{42}\) "Commission or other remuneration," as used in the Rule, does not include any payments made by the issuer to security holders in connection with the exchange where such payments are part of the terms of the offer. See 17 C.F.R. § 230.150 (1977) (Rule 150).


\(^{44}\) As the SEC declared through its General Counsel in 1935:

'[T]he whole justification for the exemption afforded by Section 3(a)(10) is that the examination and approval by the body in question of the fairness of the issue in question is a substitute for the protection afforded to the investor by the information which would otherwise be made available to him through registration.'


In considering this "substitute" it would be kept in mind that the registration and prospectus delivery requirements contained in Section 5 of the Securities Act do not have "fairness" as their object. That is, and has always been, the fundamental conceptual difference between state and federal securities regulation. Disclosure, the object of the federal regulatory scheme, is viewed wholly apart from fairness or merit, which is the touchstone of blue sky regulations. Thus, it is worthy of considerable note that in Section 3(a)(10) analysis disclosure and merit evaluation are viewed interchangably.
Section 3(a)(10) exempts from the registration provisions of the Securities Act:

[any] security which is issued in exchange for one or more bona fide outstanding securities, claims or property interests, or partly in such exchange and partly for cash, where the terms and conditions of such issuance and exchange are approved, after a hearing upon the fairness of such terms and conditions at which all persons to whom it is proposed to issue securities in such exchange shall have the right to appear, by any court, or by any official or agency of the United States, or by any state or Territorial banking or insurance commission or other governmental authority expressly authorized by law to grant such approval . . . . 45

Therefore, the § 3(a)(10) exemption has achieved prominence only in the area of court-approved reorganizations — particularly in the bankruptcy setting. Court-approved distributions or reclassifications of securities as part of a plan of arrangement under Chapter XI of the Bankruptcy Act, 46 for example, are relatively common. But outside of these applications, Section 3(a)(10) has caused little stir.

The availability of Section 3(a)(10) in any situation is conditioned upon a determination of the fairness of the particular transaction by an authority empowered to make that determination. Early in the history of the statute the General Counsel of the Securities and Exchange Commission articulated that body’s view of the requisite “authorizations” vis-a-vis state governmental authorities as meaning that the state governmental body must possess “express authority of law to approve the fairness of the securities in question.” 47 He added: “[t]he requisite express authorization of law to approve the fairness of such terms and conditions, however, probably need not necessarily be in haec verba but, to give effect to the words ‘express’ and ‘by law’, must be granted clearly and explicitly.”48

Where, however, a state agency has such express legal authority, causes

47 See Securities Act Rel. No. 312, supra note 44; see also Institutional Corp. of America [1970-1971] Fed. Sec. L. Rep. (CCH) ¶ 78,133, at 80,448 (1971) (§ 3(a)(10) exemption not available where state authority (North Dakota) was not expressly authorized to approve fairness of an exchange from the standpoint of the investors). Professor Loss has noted that while the syntax of Section 3(a)(10) requires the construction that a state governmental authority must be expressly authorized by law to approve fairness, that requirement is not provided for review by a federal official or agency. 1 L. Loss, SECURITIES REGULATION 586 (2d Ed. 1961) [hereinafter cited as Loss]. The difference in treatment has no significance in the instant analysis which focuses only upon the availability of the Section 1707.04 procedure except to the extent that it underscores the policy significance in specifically providing the “express authority.” Certain questions exist relating to the discretion of the Ohio Division of Securities to refuse a proper application under Section 1707.04 for a hearing on fairness of a covered transaction, see pp. 17-20 infra. The fact that the legislature has acted to specifically provide the “express authority” which Section 3(a)(10) requires for state agency review is indicative of the intent to assure the availability of the procedure on proper application.
48 Securities Act Rel. No. 312, supra note 44.
adequate notice of the proceedings to be issued to those persons to whom it is proposed to issue securities, and makes the requisite fairness determination pursuant to the hearing, the transaction in which the securities are issued is exempt in its entirety from Section 5 compliance. This is so irrespective of the number of recipients, their level of business sophistication, wealth, domiciles or the like. And in reclassification situations, the utility of the procedure is particularly evident. Indeed, as Professor Loss notes:

Section 3(a)(10) embodies none of the restrictions which surround the 3(a)(9) exemption. There is no requirement of identity of the issuers. . . . Not only may the new securities be issued in exchange for claims or property interests as well as outstanding securities, but the consideration may in part be cash. . . . Finally, the § 3(a)(10) exemption is not destroyed by the payment of remuneration for soliciting exchanges. 50

There are, of course, some limiting factors attendant to the exemption. For example, not unlike other exemptive provisions, reliance upon § 3(a)(10) may carry with it adverse consequences for resales of securities so distributed. Limitations such as these are considered in greater detail below. 51 It is clear, however, that where state law provides the requisite grant of authority, Section 3(a)(10) represents a meaningful alternative to the uncertainties of reliance upon other exemptions in a Rule 145 covered transaction. The utility of the exemption is particularly apparent in acquisition situations in which, for example, a relatively large corporation acquires a relatively small one, when neither is subject to the proxy rules and the acquired company is too large for the transaction to fall safely within the parameters of Rule 146.

Rule 145 has literally compelled the rediscovery of Section 3(a)(10) in those few states which provide for this requisite mechanism. 52 The Ohio provision, Section 1707.04, and its fairness determination, has been specifically recognized by the SEC as supporting reliance upon the Section 3(a)(10) exemption. Indeed, in American Financial Leasing and Services Co. 53 the exemption was applied to a proposed exchange offer by a corporation holding a majority of a company's common stock to outstanding minority shareholders, and that application was endorsed by the Commission. The offer provided proposed recipients with the alternative of receiving either cash or securities or a mixture of both in exchange for their securities and was expressly conditioned upon the approval of the Ohio Division of Securities pursuant to Section 1707.04.

49 Speaking for the Commission, the General Counsel did not opine on the question of what constitutes "adequate" notice. Rather, he merely observed:
To give substance to this express requirement, some adequate form of notice seems necessary. The usual practice of giving notice to persons who will receive securities in reorganizations, mergers and consolidations supports this view. Of course, the question of what mode of notice is adequate cannot be answered in the abstract but may vary with the facts and circumstances in each case. Id. ¶ 2182.

50 Loss, supra, note 47, at 585.
51 See text accompanying notes 93-118, infra.
52 E.g., CAL. CORP. CODE § 25142 (West); OR. REV. STAT. § 59-095 (1953).
III. Operation of § 1707.04; Ohio Fairness Hearings

A. Statutory Authority

Section 1707.04 of the Ohio Securities Law, which expressly authorizes the Division of Securities to conduct hearings upon the fairness of covered transactions, and to make required findings in respect thereof, precisely tracks the language of Section 3(a)(10) of the Securities Act. Upon application by the corporation, by a dollar majority of debtholders, or by a majority of shareholders, a fairness hearing may be held upon satisfaction of these mechanical conditions:

—all persons to whom it is proposed to issue securities in the transaction must have the right to appear;
—notice, in person or by mail, of the time and place of such hearing is provided to all such persons;
—that satisfactory evidence of such notice is presented to the Division; and
—the payment of a filing fee of $50.00 and the deposit of a sum determined by the division (but not exceeding $500.00) for the purpose of defraying costs of the hearing and any investigation undertaken in connection therewith.

The express authorization to the state agency to conduct fairness hearings, and the prescription of notice requirements respecting “all persons to whom it is proposed to issue securities,” unquestionably satisfy the guidelines established by the Securities and Exchange Commission as being necessary in order for the Section 3(a)(10) exemption to be available at the federal level, as the American Financial Leasing and Services Co., determination well evidences.

It should also be noted at this juncture that while principal focus is upon the availability of the Section 3(a)(10) exemption from compliance with federal securities registration and prospectus delivery requirements, compliance in Ohio with the procedure authorized by Section 1707.04 of the Revised Code likewise eliminates the need for further compliance with registration or qualification provisions of the state securities law as well. Indeed, the section declares: “[s]ecurities issued in accordance with a plan so approved by the division are exempt from Sections 1707.01 to 1707.45, inclusive, of the Ohio Revised Code, relating to registration or qualification of securities or the registration of transactions therein.”

While the Ohio Division of Securities has not promulgated guidelines or rules concerning the procedures for the statutory fairness hearings, the statute itself prescribes that notice of the time and place thereof must be given to

54 See note 49, supra, and accompanying text.
55 Supra note 53. The Commission noted that the proposed offering would be made only if the Ohio Division of Securities approved the fairness of the terms of the exchange “after a public hearing at which stockholders . . . are given notice of and the opportunity to appear at the hearing.”
proposed recipients of securities. There is no publication requirement, although it is quite conceivable that publication of notice undertaken in conjunction with a mailing could be persuasive in the presentation of "evidence" of notice to the Division, as required by the statute, in those situations where a mailing may be incomplete. There is no time limit on notice provided in the statute, but an administrative rule operative under the analogous California statute calling for a minimum period of 10 days notice, subject to shortening "for good cause shown," appears reasonable for the Ohio provision as well.

On the face of the statute, the hearing procedure may operate with respect to "any plan of reorganization, recapitalization or refinancing ...." These terms are expressly defined to include the following:

1. A readjustment by modification of the terms of securities by agreement;
2. A readjustment by the exchange of securities by the issuer for others of its securities;
3. The exchange of securities by the issuer for securities of another issuer;
4. The acquisition of assets of a person, directly or indirectly, partly or wholly in consideration for securities distributed or to be distributed as part of the same transaction, directly or indirectly, to holders of securities issued by such persons or secured by assets of such person;
5. A merger or consolidation.

Reference to SEC Rule 145 at this point demonstrates that while covered transactions under that Rule, i.e., reclassifications, mergers, consolidations or transfers of assets, would in the main be susceptible of being characterized as "any plan of reorganization, recapitalization or refinancing" for purposes of the general category of Section 1707.04 covered transactions, it is also clear that specific coverage is provided via the express inclusions in the Ohio statute. Thus, a Rule 145 covered reclassification would qualify as a "readjustment by the exchange of securities by the issuer for others of its securities." Mergers and consolidations within the purview of Rule 145 are also expressly included in Section 1707.04, as are stock-for-assets transactions.

Obviously, there is no requirement in the Ohio statute that transactions in any of these categories be submitted to the fairness determination procedure. The essence of Section 1707.04 is the creation of a voluntary right to seek and obtain that determination which, in the narrow perspective of the Ohio Blue Sky Law, represents an alternative to such registration and qualification procedures that might otherwise be required in the context of the particular

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57 See Rules 250.17 through 250.25 under the California Corporation Code. Under the California rules the notice must be served either personally or by mail upon all of the shareholders to whom it is proposed to offer the exchange of securities not later than 10 days prior to the hearing. Additionally, the Corporation Commissioner is empowered to provide for notice by publication in his discretion in a particular case.


transaction. Indeed it should be kept in mind that the definition of “sale” in the Ohio Blue Sky Law\(^{60}\) is as broad as its federal definitional counterparts of “offer” and “sale,” and by specific statutory recognition of an exemption from compliance with blue sky procedures for transactions submitted to the fairness determination procedure of Section 1707.04, the indication is rather clear that such transactions are clearly within the purview of the blue sky law.

Beyond the narrow perspective of the Ohio statute, however, it is also important to note that the administrative mechanism of Section 1707.04 does not represent simply an alternative to other registration and qualification procedures under the blue sky law. Rather, it operates independently, and is available in situations involving transactions otherwise exempt from blue sky compliance. Thus, for example, the issuer of securities listed for trading over a national securities exchange which proposed to offer listed securities to shareholders of another corporation in a merger transaction, in which case an exemption from the blue sky law would be available pursuant to Section 1707.02(E),\(^{61}\) may nevertheless seek an administrative fairness determination under Section 1707.04 for the purpose of assuring the availability of Section 3(a)(10) at the federal level. Despite the fact that the transaction is exempt from Ohio Blue Sky regulation, the “voluntary user” of Section 1707.04 may still be assured of the federal exemption. In this situation the Securities and Exchange Commission has taken the position that such voluntary usage of a state fairness determination procedure will not adversely affect the availability of the federal Section 3(a)(10) exemption.\(^{62}\)

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\(^{60}\) **Ohio Rev. Code Ann. § 1707.01(C)(1) (Page 1978)** provides:

“Sale” has the full meaning of “sale” as applied by or accepted in courts of law or equity, and includes every disposition, or attempt to dispose, of a security or of an interest in a security. “Sale” also includes a contract to sell, an exchange, an attempt to sell, an option of sale, a solicitation of a sale, a solicitation of an offer to buy, a subscription, or an offer to sell, directly or indirectly, by agent, circular, pamphlet, advertisement or otherwise.

Section 2(3) of the Securities Act, 15 U.S.C. § 77b(3) (1978) correspondingly addresses the pertinent terms thusly:

The term “sale” or “sell” shall include every contract of sale or disposition of a security or interest in a security, for value. The term “offer to sell,” “offer for sale,” or “offer” shall include every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value.

\(^{61}\) **Ohio Rev. Code Ann. § 1707.02(E)(1) (Page 1978)**. Section 1707.02(E)(1) provides in pertinent part:

Any security . . . is exempt, which, at the time of sale within this state, is listed, or listed upon notice of issuance, on the Cincinnati Stock Exchange, the Midwest Stock Exchange, the New York Stock Exchange, the American Stock Exchange, or any other stock exchange approved by the division as having listing requirements substantially equivalent to those of any one of said exchanges, and any security senior to any security so listed is also exempt . . .

Other potential exemptions under the Ohio Act include securities outstanding for a period of five years on which there has been no default in payment of principal, interest or dividends, Ohio Rev. Code Ann. § 1707.02(f) (Page 1978), and so-called “manualized” securities sold by licensed dealers as principal or agent, Ohio Rev. Code Ann. § 1707.03(M)(3) (Page 1978). (Publication in a “recognized securities manual” of certain organizational and financial information concerning an issuer.)

\(^{62}\) See Sinton & Brown Co. [July 1, 1974] No Action Letter (CCH Microfilm) R. 7, Fr. 9392. That conclusion is likewise supported in the reasoning of the Commission as expressed by its General Counsel in Securities Act Rel. No. 312, supra, note 44. For a discussion of this reasoning see Glickman, *The State Administrative Fairness Hearing and Section 3(a)(10) of the Securities*
B. Threshold Agency Discretion.

In considering the operation of Section 1707.04, a difficult question arises concerning whether or not the Division of Securities must provide the hearing mechanism upon application, or whether provision of the hearing is discretionary. The statute is not entirely clear on this point, but is susceptible of an interpretation that there is no such discretion. The statute declares, of course, that the Division “may consider and conduct hearings upon any plan of reorganization, recapitalization or refinancing of a corporation…” when such a plan is proposed. But this language does not expressly relate to the provision for fairness determinations upon proper application of a party involved in such a transaction. As to the actual fairness determinations, the statute declares that the Division “… may also approve the terms of such issuance and exchange and the fairness of such terms, after a hearing … if application for such a hearing is made by such [specified persons involved].” The first sentence of the statute, then, quite clearly empowers the Division to act in its discretion to conduct hearings — a power which it could presumably invoke sua sponte as part of its normal evaluative and regulatory function. But the second element, that dealing specifically with fairness determinations, clearly contemplates a hearing undertaken upon the application of an involved party — a separate and distinct function. Embracing the independent significance of the second sentence of Section 1707.04 supports the conclusion that while the Division may exercise discretion in the commencement of its own proceedings, it may not decline to hold a hearing upon proper application of an appropriate party — assuming, of course, applicable jurisdictional grounds.63

To be sure, the creation of the power to conduct hearings cannot be viewed as a naked, objectless power. For the Division to consider and conduct hearings upon a covered transaction, presumptively the object of that consideration is the determination of fairness and approval of terms on which the securities are proposed to be distributed. And thus, one cannot realistically separate the first and second sentences of the statute in terms of end result. But it is clearly possible to separate the two in scope, and in doing so conclude that the fairness determination authority contemplates that a hearing will be held upon appropriate application. This conclusion is buttressed by the language of Section 1707.04(C) relating to a filing fee and security for costs. Subsection (C) declares:

Upon filing an application with the division under this section, the applicant shall pay to the division a filing fee of fifty dollars and shall deposit with the division such sum, not in excess of five hundred dollars, as the division requires for the purpose of defraying the costs of the hearing provided for in this section and of any investigation which the division may make in connection therewith.64

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63 See discussion of “Jurisdictional Nexus” at pp. 20-21 infra.

64 OHIO REV. CODE ANN. § 1707.04(C) (Page 1978).
There is no suggestion here that if such a hearing is provided, the necessary deposit must be made; nor is there any suggestion that "the hearing provided for . . ." is subject to any administrative discretion.

Regulations under the analogous California statute leave no doubt as to the mandatory character of the hearing provision in that statute. Indeed, it is provided that with respect to an application for a fairness determination, "[a] hearing will be ordered by the Commissioner in connection with any transaction described in Section 251.42 of the Code upon the request of the applicant."\(^6\) The California statute, however, does not contain any of the language found in the first sentence of the Ohio provision,\(^6\) and one might argue that the inclusion of this language was meant to create a general threshold discretion in the Division of Securities to accept or reject a request for a hearing.

With no legislative history to supply guidance and no available administrative or interpretative analysis, the question of threshold discretion is not susceptible of easy resolution. Provision for the fairness determination procedure is the obvious object of the statute, and just as clearly the "application" involved is directed to that determination and not simply for a hearing. Given this unquestionable overall object, it is not a strained reading of Section 1707.04 to conclude that the Division may in its discretion commence and conduct its own hearings respecting a covered transaction, but must conduct a hearing upon proper application therefore by an appropriate party.

The statutory scheme lends some support to this conclusion. As noted previously, the corporate transactions which are the subject of Section 1707.04 (and indeed Rule 145 at the federal level) involve distributions of securities which, absent some other available exemption, would be subject to blue sky regulation. That regulatory process would involve Division review and merit analysis with an ultimate determination that it may be either carried out in the state or not. Whatever determination is made is the result of the Division applying standards or guidelines consistent with statutory authority.\(^6\) Granting the Division the power to "consider and conduct hearings" upon such transactions, as the first sentence of Section 1707.04 does, merely adds a

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\(^6\) 10 CAL. ADMIN. CODE 260.142.

\(^6\) The California provision, CAL. CORP. CODE 25142, states in pertinent part:

When application is made for a permit to issue securities (whether or not the security or transaction is exempt from qualification) in exchange for one or more bona fide outstanding securities, claims, or property interests, or partly in such exchange and partly for cash, the Commissioner is expressly authorized to approve the terms and conditions of such issuance and exchange and the fairness of such terms and conditions, and is expressly authorized to hold a hearing upon the fairness of such terms and conditions, at which all persons to whom it is proposed to issue securities in such exchange have the right to appear.

\(^6\) The standard of review for "qualification," of securities in Ohio is set forth in OHIO REV. CODE ANN. § 1707.09(K) (Page 1978), which provides for, among other things, the determination by the Division "that the business of the issuer is not fraudulently conducted, that the proposed offer or disposal of securities is not on grossly unfair terms, and that the plan of issuance and sale of the securities . . . would not defraud or deceive, or tend to defraud or deceive, purchasers . . . ."
further mechanism to the Division's basic authority to approve or disapprove of the distribution of securities involved. The provision then that the Division may also approve terms after a specific hearing on fairness brought about by the application of a proper party, suggests a procedure wholly apart from the Division's normal merit regulation processes, even as supplemented by the power to hold hearings for particular kinds of transactions.

Section 1707.04 in its present form is the result of a 1963 Amendment to the original provision adopted in 1938. A comparison of the present statute with the original provision offers some additional insight into this interpretive inquiry. As originally enacted, General Code Section 8624-4a, entitled "Power on Reorganization," provided in pertinent part:

The division is authorized and empowered to consider and to conduct or hold hearings upon any plan of reorganization, recapitalization or refinancing of a corporation organized under the laws of this state, or having its principal place of business within this state, proposed by such corporation or by any of its shareholders or creditors, under which plan it is proposed to issue securities in exchange for one or more bona fide outstanding securities, claims or property interests or partly in such exchange or partly for cash, to approve the terms and conditions of such issuance and exchange and the fairness of such terms and conditions, after a hearing upon the fairness of such terms and conditions, at which all persons to whom it is proposed to issue securities in such exchange shall have the right to appear, provided that application for such a hearing is made by such corporation or by the holders of a majority amount of its debts or by the holders of a majority in amount of any outstanding class of securities issued by it...

It can be seen that the original provision did not contain the bifurcation of authority which is a part of the current version. That is to say that by the original statute the Division was authorized and empowered to conduct hearings for the purpose of approving terms and conditions, along with the fairness thereof, provided that application for the hearing was made by a proper party. The statutory mechanism was thus triggered by, and only by, an application. Now, however, current Section 1707.04 confers upon the Division the authority to act sua sponte with respect to consideration of reorganization plans and the conduct of hearings in respect thereof; and in addition to that separate power, undertake a fairness determination upon application therefor. The current provision could be read, then, as generally expanding the authority of the Division to act on its own while not diminishing in any way the right of an appropriate party to a hearing for purposes of a fairness determination. On the other hand, including the "may" in the first sentence of post-1963 Section 1707.04, could be deemed indicative of the intention of the legislature to provide overall threshold discretion. And irrespective of the language in subsection (C) of the provision, it must be

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remembered that the "application" which is the focus of the section is not an application for a fairness determination, but rather *for a hearing* on fairness. The implication attendant to the provision for an application is that it may be denied.

As a matter of policy, Section 1707.04 should be interpreted to require the Division to provide a hearing on fairness upon a proper application. The fact that the statute precisely tracks the elements of the Section 3(a)(10) federal exemption, and the interpretive views of the SEC concerning its elements and requisite authority, can only be interpreted as a recognition on the part of the legislature that Section 1707.04 was meant to implement Section 3(a)(10) at the federal level. There is simply no room for surmise in considering the intent of the Ohio provision. That being the case, all questions regarding the power of the Division to refuse to undertake the hearing procedure on a proper application should be resolved in the negative so as to carry out the clearly intended federal/state complimentary scheme. At the very least, if any discretion is to be permitted, the exercise of it should be permitted only upon the establishment of appropriate standards and subject to the normal avenues of administrative and judicial review. Apart from any question regarding threshold discretion in granting or denying an application for hearing under Section 1707.04, and whatever standards might be employed in connection therewith, there is one clear statutory requirement that must be satisfied and that is the existence of a jurisdictional nexus between the state, the transaction and the parties.

### C. Jurisdictional Nexus

Section 1707.04 contains within it the prescription that the power of the Division to conduct fairness hearings extends to covered transactions involving "... a corporation organized under the laws of the state, or having its principal place of business within that state. ..." The requirement that the issuing corporation be an Ohio corporation or have its principal place of business in Ohio assures that the state has a substantial interest in the transaction and has the power to assert jurisdiction over it. This is of particular significance in the case of the so-called "voluntary user" who seeks a fairness determination for the purpose of relying upon Section 3(a)(10) at the federal level. Satisfying jurisdictional prerequisites is the key to the interface between the Ohio statute and Section 3(a)(10), whose basic purpose is to permit issuers to avoid federal compliance where there is adequate state protection available.

Section 3(a)(10) necessarily presumes the availability of a sufficient jurisdictional nexus between the reviewing authority and the covered transaction. The essence of the federal exemption is the availability of adequate investor protection found in state review procedures and, a fortiori, that protection is assured only when the reviewing state has a substantial interest in the transaction. As Mann has suggested, the concern for jurisdictional nexus

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70 See note 44 and accompanying text, *supra*.

71 *Id.*
is really a function of the desire to assure that the hearing officer will adequately perform his statutory duty, a motivation which he quite properly criticizes as unrealistic. But one cannot ignore the fact that just as Section 3(a)(11) of the Securities Act, and SEC Rule 147 thereunder — the “intrastate offering” exemption — turn upon the local character of a transaction and the consequent assurance of adequate investor protection by state regulators in the distribution of securities in that setting, jurisdictional nexus for state fairness determinations at least outwardly assures that review will be undertaken within a meaningful and involved regulatory framework.

The presence of an express jurisdictional requirement in the Ohio statute, of course, obviates the necessity for scholarly analysis of the pros and cons of any general jurisdictional nexus requirement in Section 3(a)(10) considerations. Ohio is clear in its requirement that the subject corporation either be incorporated in Ohio or have its principal place of business within the state. While neither the courts nor the Commission have expressed any view as to the adequacy of these express jurisdictional ties in determining the availability of Section 3(a)(10), the Commission, in *Fluor Corporation*, took a “no-action” position acknowledging the availability of the exemption based upon a California fairness determination involving an acquired corporation whose shareholders were not California residents and which was organized under the laws of another state, but which did, however, have its principal place of business in California.

D. Notice of Hearing

A fundamental element of the Securities and Exchange Commission’s 1935 analysis of the parameters of the Section 3(a)(10) exemption is the requirement of notice of the hearing at which the fairness determination will be undertaken. Addressing that mandate, the Ohio provision thus declares: “[n]otice in person or by mail of the time and place of such hearing shall be given to all persons to whom it is proposed to issue such securities, and evidence satisfactory to the division that such notice has been given shall be filed with the division.” The burden of notification is squarely placed upon one seeking the fairness determination, with the adequacy of the undertaking being subject to the discretion of the Division. In that the statute prescribes notification “in person or by mail” the Division’s “satisfaction” presumptively relates to the extent of the effort made to get such notice to all those entitled rather than the manner of notification or the specific substance thereof. This presumption, however, gives rise to certain further concerns.

No guidance is available either at the SEC or Ohio Division levels concerning the comprehensiveness of notice disseminated in a Section 3(a)(10) setting. A particularly acute problem arises at the federal level on

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72 Mann, supra, note 33 at 1254-1256.
76 Sec. Act Rel. No. 312, supra note 44.
the question of comprehensiveness in view of the prohibition of Section 5 of the Securities Act from any "offer," i.e., attempt to dispose, of a security until such time as a registration statement covering the security is filed with the SEC, and the further prohibition that without regard to a registration statement, no "prospectus" may be utilized unless it meets specified requirements of the Act. A "prospectus" is broadly defined in the Act to include any written or broadcast material which is deemed to represent an attempt to dispose of a security. The state regulatory scheme, although not keying on the notion of "prospectus" which is so fundamental to the federal scheme, absent an exemption prohibits every "attempt to dispose" of a security except upon registration under the Ohio Blue Sky Law.

At once it is apparent that a notice disseminated "to all persons to whom it is proposed to issue" securities in a covered transaction may be deemed to be a prospectus under federal law and/or an unlawful attempt to dispose of the securities under state law. Such a result could occur, of course, because neither the Section 3(a)(10) exemption nor the exemption from the blue sky statute (assuming no other state exemption ab initio) is operative until the terms and conditions of the transaction in which securities will be issued have been approved by the reviewing body. Actions undertaken prior to that determination, including the issuance of notice, have no independent exemption and, thus, may well violate one or both regulatory schemes.

The prospect that a notice of hearing on an application for a fairness determination may itself violate state and federal securities laws is obviously inconsistent with the provision for an exemption based on the fairness determination and its express notice requirement. The clear contemplation is that the proposed recipients of the securities to be issued in the transaction be aware of what is proposed. Only then would a notice of hearing giving them the right to appear and provide input be meaningful. The question, then, is the degree of comprehensiveness with which the transaction is presented in that notice. While one would expect that a notice of hearing contemplated by Section 1707.04 (and through it Section 3(a)(10) at the federal level) would necessarily describe the proposed transaction, it is clear that a comprehensive description could transform the notice into an "attempt to dispose" of the securities and, hence, be deemed violative of at least Section 5 of the Securities Act if not the Ohio Blue Sky Law as well.

79 See 15 U.S.C. § 77e(b)(1) (1976). The basic requirement is that a "prospectus" must meet the requirements of Section 10 of the Securities Act, 15 U.S.C. § 77j (1976), which provides, with exceptions for certain summary or preliminary forms, for inclusion of the extensive information specified in "Schedule A" to the Act.
80 15 U.S.C. § 77b(10) (1976). Section 2(10) defines "prospectus" as follows:

The term "prospectus" means any prospectus, notice, circular, advertisement, letter, or communication, written or by radio or television, which offers any security for sale or confirms the sale of any security.

As noted previously, "offer" is defined to include "every attempt or offer to dispose of, or solicitation of an offer to buy" a security. 15 U.S.C. § 77b(3) (1976).
81 Ohio REV. CODE ANN. § 1707.07 (Page 1978). As noted previously, "sale" in Ohio includes any "attempt to dispose" of a security. Ohio REV. CODE ANN. § 1707.01(c)(1) (Page 1978). The text of the Ohio definition of "sale" is set forth in note 60, supra.
82 Contemplating the necessity for issuing notice of a meeting to security holders in a Rule 145
Although neither federal nor state authorities have publicly addressed the issue in the context of Section 3(a)(10), the previously noted provision for notice in the context of Rule 145 is helpful, and so too is the general provision for “Notice Of Certain Proposed Offerings” contained in Rule 135 under the Securities Act. Rule 135 excepts from the definition of “offer” communications in the nature of an announcement of a forthcoming offering of securities to be registered under the Act where the announcement contains only information of a specified nature. The impact of the Rule is to negate any conclusion that a communication in conformity with it is an attempt to dispose of the securities. Although the Rule applies on its face only to offerings which will be registered under the Securities Act, the parameters which it sets forth would appear to have general applicability to any communication designed to notify individuals of an intended or upcoming offering of securities. And as can be seen, its prescription fits well into the concept of notice of hearing on a fairness determination.

As related to the substance of a notice of hearing on an application for a fairness determination, Rule 135 addresses these elements:

(1) the name of the issuer;
(2) the title, amount and basic terms of the securities proposed to be offered, the amount of the offering, if any, to be made by selling security holders, the anticipated time of the offering and a brief covered transaction, and the fact that such a notice would constitute a “prospectus,” Rule 145(b) provides the following:

(b) Communications not deemed to be a “Prospectus” or “Offer to Sell.” For the purposes of this section, the term “prospectus” as defined in section 2(10) of the Act and the term “offer to sell” in section 5 of the Act shall not be deemed to include the following:

(1) Any written communication or other published statement which contains no more than the following information: the name of the issuer of the securities to be offered, or the person whose assets are to be sold in exchange for the securities to be offered, and the names of other parties to any [covered] transaction . . . ; a brief description of the business of the parties to such transaction; the date, time, and place of the meeting of security holders to vote on or consent to any such [covered] transaction . . . ; a brief description of the transaction to be acted upon and the basis upon which such transaction will be made; and any legend or similar statement required by State or Federal law or administrative authority . . . .

Securities Act compliance in a Rule 145 covered transaction, of course, involves the dissemination of a structured disclosure document (the prospectus made a part of the issuer’s Form S-14 registration statement) prior to the vote of security holders. No such prospectus is involved in Section 3(a)(10) exempt transactions, nor is the object of the notice of a hearing on fairness in such a transaction the meeting and vote of security holders. But it would seem logical that the Rule 145(b)(1) parameters for notice of a meeting at which security holders would vote on approval or disapproval of a proposed reorganization or reclassification transaction would be relevant in determining the extent of a permissible notice of hearing on fairness under § 3(a)(10) and Section 1707.04. While not an “exemption” per se, this kind of communication is definitionally excepted from the key terminology in Rule 145 transactions. The same reasoning which mandates such an exception under Rule 145 would permit notice to the same extent in a Section 3(a)(10)/Section 1707.04 transaction in which the fairness determination is a “substitute” for the structured disclosure otherwise required by the Securities Act.

83 See note 82, supra.
statement of the manner and purpose of the offering without naming the underwriters

(4) in the case of an offering of securities in exchange for other securities of the issuer or of another issuer, the name of the issuer and the title of the securities to be surrendered in exchange for the securities to be offered, the basis upon which the exchange may be made, or any of the foregoing.85

The Rule further provides that any notice contemplated under it "may take the form of a news release or written communication directed to security holders . . . or other published statement.86

Inasmuch as Rule 135 expressly contemplates statements concerning such things as "the basic terms of the securities proposed to be offered" and "the basis upon which the exchange may be made" and "a brief statement of the manner and purpose of the offering," — the same kinds of things that would likewise be permitted in a notice of meeting under Rule 14587 — it seems clear that a fair and complete statement of the proposed transaction, absent any embellishment or expression of merit or value, should not be deemed violative of either Section 5 or the Ohio Blue Sky Law. What must be kept in mind is that the notice is not meant to be a "selling" document or a disclosure document in the nature of a prospectus or proxy statement. The object of disclosure in this setting is not the security holders who will receive securities, but rather the regulators who will make the fairness determination, and the notice is merely the means of alerting those persons who will receive the securities of their right to provide input in that determination.88

IV. The Voluntary User

Other than as to jurisdictional nexus, Section 1707.04 is unqualified in its creation of the right to seek a fairness determination in a covered transaction. And with the focus of the statute upon any plan of reorganization, recapitalization or refinancing of a corporation, it is clear that an application for a hearing may be filed irrespective of whether or not the securities involved would be subjected to qualification under the blue sky law. Thus, as noted earlier, even though particular securities or transactions may be exempt from

85 Id.
86 Id.
87 See note 82, supra.
88 For example, rules applicable under the analogous California fairness determination statute specify that notice with respect to any hearing before the Commissioner of Corporations: . . . shall set forth the matters to be considered at the hearing in sufficient detail to permit the respondent or other interested parties to prepare and present their allegations, and evidence in support thereof, at the hearing and shall contain the following:
(a) A brief statement of the facts which give rise to the hearing.
(b) A statement of the issues to be considered at the hearing, together with a reference to the relevant statutes and rules.
(c) The time and place of the hearing.
the qualification requirements of the state law, the fairness determination procedure may still be voluntarily invoked to obtain the benefit of the § 3(a)(10) exemption at the federal level.89

Without regard to the exempt character of a security or transaction under the blue sky law, Section 1707.04, absent any other considerations, creates a voluntary right to seek a fairness determination. Conversely, the Division of Securities in such situations is permitted but not required to engage in merit evaluation of the proposed offering.

As noted earlier, the availability of the § 3(a)(10) exemption on the basis of a fairness hearing by a state "commission" or "authority" is limited only by the requirement that such commission or authority be "expressly authorized by law to grant such approval." In his 1935 consideration of the exemption the General Counsel of the SEC looked upon this qualification only as providing assurance that state authorities have the power to undertake requisite consideration. As he observed:

This interpretation seems necessary to give meaning to the express requirement of a hearing upon the fairness of such terms and conditions [of the exchange], which must subsume authority in the supervisory body to pass upon the fairness from the standpoint of the investor, as well as the issuer and consumer, and to disapprove terms and conditions because unfair either to those who are to receive the securities or to other security holders of the issuer, or to the public. This requirement seems the more essential in that the whole justification for the exemption afforded by section 3(a)(10) is that the examination and approval by the body in question of the fairness of the issue in question is a substitute for the protection afforded to the investor by the information which would otherwise be made available to him through registration.90

Thus, there is no suggestion that the "express authorization" proviso was meant to be read as mandating that the state reviewing body also be required to engage in a merit evaluation irrespective of the invocation of the fairness hearing process. And in response to the specific question whether the § 3(a)(10) exemption was available where a fairness hearing procedure was available but not required, the General Counsel added:

[I]f state law expressly authorizes the approving authority to hold a hearing on the fairness of the terms and conditions of the issuance and exchange of securities, and such a hearing is in fact held, [the express authorization] requirement . . . is satisfied.91

The availability of an exemption from qualification under the blue sky law, then, should not preclude reliance on Section 3(a)(10) at the federal level by one who voluntarily invoked the state procedure, a conclusion which the Staff of the SEC subsequently endorsed in "no-action" letters.92

89 See note 61, supra, and accompanying text.
90 Securities Act Rel. No. 312, supra, at note 44.
91 Id. at ¶2184.
92 See note 62, supra.
Perhaps the greatest utility of Section 1707.04 lies in its voluntary usage. The issuer of securities exempt under the blue sky law who invokes the fairness determination procedure in a transaction covered by SEC Rule 145 at the federal level, or otherwise subject to federal registration requirements absent an exemption, benefits substantially in the savings of time and money that would otherwise be expended in the compliance process. Similarly, apart from Rule 145 covered transactions, voluntary usage of the fairness determination procedure has utility in avoiding restrictions that might otherwise preclude the availability of exemptions for other types of adjustments or modifications of outstanding securities which are relatively common. The fact that Section 3(a)(10) is not bound by a “single issuer” limitation, and permits exchanges involving other claims or property interests and cash, signals clear advantage and flexibility in the structuring of most all types of reorganization and reclassification transactions.

To be sure, the Division of Securities might be reluctant to undertake a fairness determination where the express purpose of the application is to provide a basis for reliance on Section 3(a)(10) at the federal level, but the complete interface between the Ohio and federal provisions leaves little room for doubt that the voluntary user was not meant to be excluded. The willingness or unwillingness of the Division to undertake a fairness determination upon such application must be viewed in the light normally attendant to abuse of discretion considerations and further tested by the clear statutory scheme. That scheme suggests that whatever discretion is vested with the Commission to deny a hearing application under Section 1707.04 as a matter of administrative law, the factors must weigh decisively on the side of the Division if a denial is to be made.

V. The Scope of the Exemption Provided

From the preceding discussion one may fairly generalize that to the extent the Ohio Division of Securities approves covered transactions after appropriate notice and hearing procedures as provided in Section 1707.04, Section 3(a)(10) of the Securities Act of 1933 will exempt the issuance of the securities at the federal level. This is so irrespective of the form of the transaction involved, or any voluntary or mandatory feature of it vis-a-vis the person to whom the securities would be issued. To what extent, however, does the Section 3(a)(10) exemption apply to any subsequent resales of the securities so acquired? The answer to that question, and consideration of its consequences, necessitates an understanding of the “security” versus “transaction” exemption problem.

The scheme of exemptions contained in the 1933 Act is divided into two categories, Sections 3 and 4 respectively. Section 3 speaks of “Exempted Securities” while Section 4 addresses “Exempted Transactions.” As a theoretical and practical matter, the scope of the two categories of exemptions is vastly different. Viewing a security as exempt would be to conclude that once demonstrated as applicable, the exemption continues through all subsequent transactions. A transactional exemption on the other hand applies only to the transaction in question and is not extended to subsequent transactions, which must have an independent exemption available for any
resale. The uncertainty of the availability of an exemption for resale by recipients of the securities may be no less than the uncertainty which motivated invocation of the Section 3(a)(10)/Section 1707.04 procedure by the issuer in the first place.

Despite the fact that § 3(a)(10) appears under the heading of “exempted securities” it, like the § 3(a)(9) exemption for certain exchanges and reclassifications between an issuer and its existing security holders, has been consistently viewed as a transactional exemption, and specifically so in the context of Rule 145 covered transactions. Resales by recipients, then, must be made pursuant to some other exemption, and it is this problem that has prompted the Staff of the SEC to suggest that compliance with the registration procedures for Rule 145-type transactions is preferable to the uncertainty of the status of resales by those persons who receive them in the transaction.

Uncertainty over an independent exemption for resales of securities acquired in a § 3(a)(10) transaction is attributable to the concept of “statutory underwriter” which plays such an important role in Securities Act analysis. In the vast majority of instances resales of securities acquired in exempt transactions are undertaken in reliance on a claim that the selling holder is not an “underwriter” as defined in Section 2(11) of the Act. That is to say, that the seller is neither engaging in nor participating in a “distribution” of the securities and his or her resale is, therefore, exempt by virtue of Section 4(1) of the Act as a transaction by a “person other than an issuer, underwriter or dealer.” The difficulty arises in view of the fact that the resale itself may constitute a distribution, or at least be determinative as to the “view to

93 Recently, for example, the Staff has made this observation directly on point:

While the exemption provided by Section 3(a)(10) of the Act may be available for shares issued in settlement of a claim where the fairness has been approved by a court, it is our view that the transactional exemption provided by that section does not extend to subsequent resales of the securities acquired. Such resales can only be effectuated pursuant to registration under the Act or a suitable exemption. Weatherford International, Inc. (August 13, 1976).

94 Securities Act Rel. No. 5463 (Feb. 28, 1974), supra note 13, ¶ 3058 at 3067-4. In response to the specific question of whether a company may rely upon the exemption afforded by Section 3(a)(10) of the Securities Act notwithstanding that the transaction is one covered by Rule 145, the Staff answered:

Yes. Rule 145 does not affect the availability of any exemption which is otherwise available so that an issuer may rely upon the exemption afforded by Section 3(a)(10) of the Act if all of the conditions of that exemption are met. Inasmuch as Section 3(a)(10) provides an exemption for the initial issuance of securities but not for the resale of such securities, it should be noted that an issuer may choose to register the securities to be issued in the transaction on Form S-14 or S-1 in order to be more certain of the status under the Act of public resales by underwriters of securities received in the transaction. (Emphasis added).


95 Id.


The term “underwriter” means any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in the direct or indirect underwriting of any such underwriting of any such undertaking. . . .

97 15 U.S.C. § 77d(1) (1976); see note 27, supra, and accompanying text.
distribution” with which the securities were taken. Being deemed to be an underwriter in the resale of the securities without compliance with the registration and prospectus delivery requirements thus carries with it the consequent violation of Section 5, and the basis for both civil and criminal liability in connection therewith.98

In most instances determination of the availability of the Section 4(1) exemption for resale transactions has turned upon identification of factors which negate the finding of a “distribution” or “view to distribution” in any given circumstances. While over-generalization must be avoided, determinative factors which have emerged over the years, and which in varying degrees continue to have significance, include (a) the relationship of the selling security holder to the issuer, i.e., “affiliate” / “non-affiliate” status;99 (b) the length of time which the seller has held the securities; (c) the amount of securities proposed to be resold; and (d) the particular circumstances under which resale is proposed to be undertaken and potential impact on any existing public market. Most of these considerations relate to the “investment intent” of the recipient of securities in a prior exempt transaction. Demonstrating that one took securities in that prior transaction with requisite intent negates the determination that in the resale of those securities he or she is acting as an underwriter. Application of the criteria has been analytical in some cases and presumptive in others,100 but in all cases the end result is a determination that a resale of securities may or may not be undertaken without compliance with the registration and prospectus delivery requirements of the Securities Act.

There are few published SEC Staff considerations of the resale problem strictly within the Section 3(a)(10) framework. In Kasper Instruments, Inc.,101 the Staff considered a Section 3(a)(10) transaction in which shares of stock were acquired by security holders in exchange for “restricted securities,” i.e., securities acquired from an issuer or affiliate in a transaction or chain of transactions not involving any public offering (a Section 4(2) exempt transaction), and determined that the newly acquired shares would continue

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98 Section 12(1) of the Securities Act, 15 U.S.C. § 77(1) (1970), creates an express right of recovery in favor of a buyer of securities against the seller in a transaction violative of Section 5 “to recover the consideration paid for such security with interest thereon, less the amount of income received thereon, upon the tender of such security, or . . . damages if he no longer owns the security. “In the latter case, the formula provided by the statute results in the substantial equivalent of recession. For analysis of the scope of civil liability under Section 12 of the Securities Act, see Rapp, Expanded Liability under Section 12 of the Securities Act: When Is a Seller Not a Seller?, 27 Case W. Res. L. Rev. 445 (1977). Criminal liability is imposed for any “willful” violation of Section 5, or any provision of the Act, under 15 U.S.C. § 77x (1976).

99 The definition of “affiliate” operative in resale analysis is that contained in SEC Rule 144 under the Securities Act, 17 C.F.R. 230.144 (1977). As set forth in Rule 144(a)(1): “An ‘affiliate’ of an issuer is a person that directly or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, such issuer.”

100 E.g., the so-called “Presumptive Underwriter Doctrine” under which certain recipients of securities in a public offering may presumptively be considered underwriters by reason of acquiring relatively large amounts of securities and without regard to any affiliate status vis-a-vis the issuer, or any other consideration that has traditionally marked analysis of statutory underwriter status. See Nathan, Presumptive Underwriters, 8 Rev. Sec. Reg. 881 (1975).

to be restricted. Noting the past position generally taken regarding shares acquired in exchange for "restricted securities" in a Section 3(a)(10) exempt transaction, the Staff went on to declare: "Accordingly, the Division is of the view that all persons who held securities of a predecessor subject to investment restrictions at the time of the merger, would hold similarly restricted securities of the successor subsequent thereof." The same result was obtained in Tymshare, Inc. Neither matter, however, focused upon the resale problem outside the context of a pre-existing restriction on securities received.

In a more broad ranging consideration the Staff did address proposed resales of securities acquired in a Section 3(a)(10) transaction in American Commonwealth Financial Corp. in this manner:

With respect to any public resales of ACFC securities received in the reorganization, it is our view that persons who do not receive an amount of securities which is substantial in relation to the amount of securities issued in the reorganization and who are not affiliated with ACFC or the Prior Companies may resell their shares in reliance upon the exemption provided by Section 4(1) of the Act. With respect to public resales of ACFC securities by any such persons who do receive a substantial amount of securities, the Staff is unable to express any view as to the applicability of the registration requirements of the Act without knowing the particular facts and circumstances of each case.

The Staff did note, however, that as to "affiliates" of the company, resales could be undertaken in conformity with SEC Rule 144, but without regard to the two year holding period.

Emphasis in American Commonwealth Financial on the amount of securities received in a Section 3(a)(10) transaction is entirely consistent with the view expressed by one commentator that:

[T]hose receiving an insubstantial amount of securities in [a § 104 The definition of "restricted securities" as such is set forth in Rule 144(b)(3) under the Securities Act, 17 C.F.R. § 230.144(a)(3) (1977). The specific focus of Rule 144 is the resale of securities acquired in such a transaction, the issuance of which securities is exempt pursuant to Section 4(2) of the Act. Securities received in a section 3(a)(10) exempt transaction are not, definitionally, "restricted securities." The issue in Kasper, supra, note 101, turned, however, on the fact that the securities distributed in the Section 3(a)(10) transaction were "restricted securities" by reason of their prior issuance in a Section 4(2) exempt transaction. Thus, the Staff was confronted with the question whether a Section 3(a)(10) transaction would extinguish the prior character of the securities involved. The Staff determined that it did not.


106 Id.

107 The Staff indicated that since the securities involved were not "restricted securities" within the definition of Rule 144, supra, the two year holding period contained in that provision would not be required. But see Kasper Instruments, Inc., supra; Tymshare, Inc., supra, for treatment of "restricted securities".

Although compliance with the two year holding period is deemed unnecessary, other elements of Rule 144 continue to operate, and principal among them is the volume limitation. See notes 99-102 supra, and accompanying text.
3(a)(10) transaction] should not be deemed underwriters or engaged in a distribution, even if the purchase with the intent to resell . . . [to hold otherwise would virtually read 3(a)(10) out of the act since no issuer could ever be certain of the investment intent of all such purchasers.\textsuperscript{108}

It appears, then, that one who is not an affiliate of the issuer and who receives an insubstantial amount of securities in a Section 3(a)(10) exempt transaction may resell those shares without registration. What is “insubstantial,” however, is not entirely clear. In \textit{American Commonwealth Financial} the Staff merely refused to take a “no-action” position as to non-affiliates who received a substantial amount of the securities being issued, but offered no parameters for defining the boundary. What has emerged more recently, however, is the apparent position of the Staff that the focal point may be whether a recipient acquires an amount of securities greater than the applicable volume limitation of Rule 144 (basically one percent of the outstanding securities of that class)\textsuperscript{109} in which case the presumptive underwriter doctrine will be applied. Nathan has cogently summarized the emergent position thusly:

[T]he Staff has now seemingly moved to the position that any person who acquires securities in excess of the rule 144 volume limitations in a section 3(a)(10) transaction may be considered a presumptive underwriter unless his resales comply with the volume limitations (but not the holding period, manner of sale or other provisions) of rule 144. In other words the Staff has apparently adopted a stringent numerical test . . . to determine presumptive underwriter status in most section 3(a)(10) transactions. Any person receiving less than this amount can resell without restriction; any person receiving more can avoid presumptive underwriter status only if his sales comply with the volume limitations of rule 144(e).\textsuperscript{110}

For the affiliate of the issuer in a Section 3(a)(10) transaction, the “insubstantial amount” analysis is of no help. For those persons the objective standard of Rule 144 as to volume represents the only viable means of resale short of Section 5 compliance. For covered transactions, Rule 145 has since its inception provided that resales of the issued securities by affiliates of a “party” to the transaction\textsuperscript{111} must be carried out in accordance with the


\textsuperscript{109}See 17 C.F.R. § 230.144(e)(3) (1977). The rule establishes a numerical limitation based upon 1% of the outstanding shares of the issuer, or, in the case of listed securities, the average trading volume over a four week period if less than 1% of the outstanding shares.


\textsuperscript{111}Rule 145(c), 17 C.F.R. § 230.145(c) (1977), declares that for purposes of imposing underwriter status in a covered transaction the term “party” means: “the corporations, business entities, or other persons, other than the issuer, whose assets or capital structure are affected by the [covered] transaction . . . .” The Rule further provides that any party to a covered transaction, or any person who is an affiliate of a party at the time the transaction is submitted to security holders, who publicly offers or sells securities of the issuer acquired in the transaction shall be deemed to be engaged in a distribution and, therefore, constitute an underwriter.
limitations of Rule 144, excepting the two year holding period.\textsuperscript{112} Recent
amendments to Rule 145\textsuperscript{113} have ameliorated the restrictions for affiliates of
parties to the transaction, other than the issuer, to the extent that after the
securities are held for a period of two years, they may be resold without
restriction providing the issuer meets certain requirements for periodic
reporting.\textsuperscript{114} Thus, after two years, only affiliates of the issuer will be bound
by the Rule 144 restrictions on resales.\textsuperscript{115} Logic dictates that the same
approach embodied in the amendments to Rule 145 should be embraced in
the Section 3(a)(10) setting so as to permit unrestricted non-issuer affiliate
resales after two years. Certainly the criticism which prompted the
amendment of the Rule is equally applicable.\textsuperscript{116} The difference, of course, is
that in the Section 3(a)(10) setting, there is no ongoing guarantee of adequate
public information concerning the issuer and on which the investing public
could rely in making decisions to purchase the securities being resold. This
difference is of no small consequence when the federal regulatory scheme and
the function of Section 5 of the Securities Act are taken into full account. The
concern for availability of adequate public information cannot be over-
estimated.\textsuperscript{117}

\textsuperscript{112} Rule 145(d), 17 C.F.R. § 230.145(d) (1977).


\textsuperscript{114} Rule 145(d), as amended, now permits unrestricted resales after two years by non-issuer
affiliates, provided that:


\textsuperscript{116} Id. The Commission identified the motivating criticisms of the Rule (and the requests that
the "indefinite underwriter" status imposed by it be reviewed) as follows:

These requests have focused on the fact that in many instances the persons who are
deemed underwriters by the rule do not become affiliated with the acquiring entity and
have no relationship to that entity other than that of a security holder. In such
circumstances, particularly where these persons hold an amount of securities which is
not large in relation to the total number of outstanding securities of the class, it has been
urged that they are unlikely to engage in transactions that are tantamount to
public distributions. Moreover, it has been asserted that Rule 145 is unduly harsh in its
treatment of former affiliates of acquired entities, since it forever deems such persons to
have acquired their Rule 145 securities with a view to distribution, when in fact they may
clearly have demonstrated by having held their securities for several years that such
securities were acquired for investment reasons and not for distribution purposes.

\textsuperscript{117} The concern has been recently manifested in Rule 148 under the Securities Act relating to
resales of securities acquired in bankruptcy proceedings. 17 C.F.R. § 230.148 (1978); see
Although not designed to focus on Section 3(a)(10) transactions generally, the Commission
proposed the Rule covering securities issued by a debtor in bankruptcy proceedings with the
express observation that such situations involve "public, non-registered offerings in reliance upon
some exemption from registration, such as that provided by Section 3(a)(10) of the 1933 Act."
(CCH) ¶ 81,304 at 88,493. As adopted, Rule 148 permits resales based upon modified Rule 144
restrictions, including the requirement that the issuer be subject to the periodic reporting
provisions and subsequent to issuing the securities be in compliance with them.
Perhaps indicative of this fundamental concern and the regulatory response it may engender, the staff of the SEC Division of Corporate Finance has recently observed in a proposed business combination setting that the two year cut-off date for resale restrictions on securities held by affiliates of acquired companies has not been extended to affiliates of companies acquired in Section 3(a)(10) exempt transactions. In Wells Fargo & Co., the staff determined that affiliates of a company proposed to be acquired, who would not continue their affiliate status as a result of the merger transaction in which securities were distributed pursuant to Section 3(a)(10) may resell those securities only in conformity with Rule 144 restrictions.

Despite the staff pronouncement in Wells Fargo & Co., the Commission's earlier recognition of the criticisms of prior Rule 145 restrictions should operate to assure flexibility in the assessment of statutory underwriter status for a non-issuer affiliate in a Section 3(a)(10)/Ohio Rev. Code Section 1707.04 transaction. Wells Fargo & Co. is indicative of concern, but it is unsupportive of differential treatment, even where ongoing, adequate public information concerning the issuer of the securities is available. The non-issuer affiliate in a Section 3(a)(10) exempt transaction should be entitled to the same flexibility in resales as his or her counterpart in a transaction carried out in compliance with Rule 145 where the same assurances of public information are present. For the issuer affiliate on the other hand, Rule 144 volume restrictions will apply indefinitely.

VI. CONCLUSION

The availability of Ohio Rev. Code Section 1707.04 and its specific interface with Section 3(a)(10) of the Securities Act of 1933 offers significant utility to practitioners in mergers, acquisitions and other forms of corporate reorganization or reclassification transactions. The provision in Ohio for submission of such transactions to an administrative fairness determination is a unique advantage shared by few other states and represents an opportunity to realize significant savings in the administrative burden and expense associated with federal securities registration procedures, or, just as importantly, the uncertainties attendant to reliance upon other exemptions from

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119 Where the securities issued in a Section 3(a)(10) transaction are in exchange for previously "restricted securities," see note 102, supra, the Staff of the SEC, as noted earlier, had determined that restrictions will continue for the new securities. Kasper Instruments, Inc., [1975-1976] Fed. Sec. L. Rep. (CCH) ¶ 50,431 at 86,137. Continuing restrictions would mean that in addition to being bound by volume limitations of Rule 144, the issuer affiliate would also face the two year holding period of that provision. As Mann has well pointed out in this situation, however, the Staff has indicated that "tacking" of the period for which previously restricted securities were held will be permitted. The recipient's holding period would in that event be calculated not from the time of the Section 3(a)(10) issuance but rather the original issuance of its exchanged securities. See Mann, supra note 33, at 1261; see also Sinton & Brown Co., [July 1, 1974] No Action Letter (CCH Microf.) R. 7, Fr. 9392.

Whether or not securities issued in a section 3(a)(10) transaction are deemed to be "restricted securities," and this subject to further restrictions of Rule 144, supra, on resale is entirely a function of the character of the exchanged and the manner of their original issuance. Where original issuance was effected via Section 4(2) of the Securities Act, the subsequent Section 3(a)(10) exchange will not extinguish restrictions imposed as a result of that original offering.
those procedures. To be sure, Section 1707.04 is not, and should not be viewed as, a device to avoid federal securities law responsibilities in the creation and execution of covered transactions. To the contrary, the interface between it and Section 3(a)(10) at the federal level is designed to ensure that the goals of investor protection lying at the foundation of both state and federal regulatory schemes will be furthered, through an alternative mechanism based upon traditional blue sky merit regulation and the evidentiary hearing process, rather than the cumbersome and often economically prohibitive registration procedures. Operating as intended in state fairness determination procedure is wholly consistent with the goals of both the federal securities laws and the Ohio Blue Sky Law.

Ohio practitioners are fortunate that their state is among the handful which have taken the specific initiative from Section 3(a)(10) to provide for a state fairness determination mechanism in corporate merger and reorganization transactions. The Section 1707.04 procedure is viable and workable, entailing a minimum of uncertainty. There remain for resolution certain questions concerning the application of the provision which may affect its ultimate utility. For example, to what extent, if any, may the Division of Securities refuse to accept an application for a fairness determination, and what standards should govern such an exercise of threshold discretion? Clearly an element of utility is lost if an applicant proposing a covered transaction cannot face with any degree of certainty the likelihood of a hearing being undertaken after proper request under the statute. But these are matters which can be explored informally during the planning stages of a covered transaction, and pending some resolution of the right to a fairness hearing, considerable uncertainty could likely be resolved through those informal means. Irrespective of these kinds of questions, the legitimacy and utility of the Section 1707.04/Section 3(a)(10) interface is manifest and its employment should be encouraged.