

EXAM No. _____

SECURITIES REGULATION

Professor Wells

Fall 1993

Final Examination

This examination is in three parts. Parts One and Two are short-answer questions; Part Three comprises two essay questions. The exam is designed to be completed in two and one-half hours. You will have three hours to complete it, which should allow you plenty of time to consider your answers. With respect to the essays especially, concise precision will reap more rewards than expansive vagueness. Please take care to address the specific question(s) posed at the end of each essay fact pattern.

Write your answers to the short-answer questions on the exam paper itself. Use separate bluebooks to respond to each of the two essay questions, placing your exam number on the examination sheet and on all bluebooks you care to have graded.

During the examination, you may refer to your statutory supplement, as annotated by you. Please remember that you are taking this examination under the Honor Code of the Mercer Law School.

Good luck on the examination. Have a happy and safe holiday.

PART I: MATCHING (Match Column A with items listed on Column B. You may use Column A entries as many times as you need.)

COLUMN A

COLUMN B

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|--------------------------------------|---|
| A. Pre-filing period | ___ 1. Underwriter commences offers to retail dealers. |
| B. Waiting (or pre-effective) Period | ___ 2. Underwriter commences sales to retail dealers. |
| C. Post-effective period | ___ 3. Issuer delivers securities to underwriter. |
| D. Pre-Columbian period | ___ 4. Underwriter delivers securities to retail dealer. |
| | ___ 5. Retail dealer delivers securities to investors. |
| | ___ 6. Issuer files amendment to registration statement, if needed. |
| | ___ 7. Letter of intent signed between issuer and underwriter. |
| | ___ 8. Issuer files "red herrings." |
| | ___ 9. Underwriter delivers final prospectuses to dealers. |
| | ___ 10. SEC conducts review of registration statement. |

Bonus question:

- ___ 11. Teotihuacan Stock and Commodities Exchange founded.

Part II: True (T) or False (F). Place T or F in space preceding numbered statement. If statement is false, briefly explain why in space following. If you think a true statement warrants additional comment, use the space allotted.

- _____ 1. It is technically illegal for prospective securities issuers to negotiate with investment bankers regarding the offering price prior to filing the registration statement.

- _____ 2. In a firm-commitment underwriting, an underwriter must sell all of the issuer's offered stock to broker/dealers or the public before it receives any of the spread.

- _____ 3. A prospectus has but one important function: to make the security offered sound attractive to investors.

- _____ 4. Unfortunately for issuers, offerings of securities similar to or the same as those previously offered by the issuer will depress the prices of all such securities, a problem for which the issuer is without remedy.

- _____ 5. The SEC receives cooperation from issuers with respect to suggested amendments to registration statements because it has the power both to enjoin sales and to accelerate the effective date.

- _____ 6. "Gun-jumping" can be avoided by making sure that pre-filing publicity is limited to oral statements at press conferences and to regular 1934 Act periodic reports.

- _____ 7. The securities laws may require registration of offers by public companies to their own employees.

- _____ 8. Even if a securities purchaser in a public offering has already received a "red herring" prospectus prior to buying the securities, that purchaser is still entitled to receive a final prospectus upon the purchase.

- _____ 9. The function of Regulation S-K is to identify, and to ensure that companies disclose, every fact likely to be material to an investor or shareholder; thus, good-faith compliance with S-K ensures full disclosure under the securities laws.

- _____ 10. A registration statement, absent amendment or issuer withdrawal, always becomes effective on the 20th day after filing.

- _____ 11. A price amendment to the registration statement is the one amendment that will not, under the statute, delay the effective date.

_____ 12. Proving privity between plaintiff and defendant is not one of the several principal hurdles in a litigation under Section 11 of the '33 Act.

_____ 13. Fortunately for the SEC, the United States Supreme Court has remedied a Congressional oversight that resulted in the various securities acts' failure to include a definition of "security."

_____ 14. General partnership interests and limited partnership interests are both "securities" under federal case law.

_____ 15. "Stock" is always a security.

Essay Question 1 (60 points)

It is December 1989. For the past thirty years Randy Smith-Wesson has owned a gun shop in Pasadena, California. Over those years she has amassed a valuable collection of "vintage" and new-old-stock weapons. Wanting to turn this collection into cash, she realizes that she needs an inexpensive way to advertise her collection to potential buyers across the country. Existing "national" gun dealers charge high commissions, and the current gun magazines just cost too much to advertise in regularly.

Smith-Wesson intends to start her own newsletter, the "National Gun Exchange Newsletter" ("NGEN"), which would offer to its readers not only a current list and description of guns for sale but also the opportunity to advertise their own guns for sale to other readers. This approach would give Smith-Wesson potential market for her guns and preemptive access to other "collectible" guns.

The costs of starting NGEN would be an estimated \$5000. Smith-Wesson will fund the initial operating costs from subscriptions to NGEN. She intends to offer two types of subscriptions: "Shooter" and "Collector." A "Shooter" subscription would cost \$12 per year, entitling the Shooter only to receive the newsletter. A "Collector" subscription would cost \$100 per year. Collectors would be entitled to five free gun advertisements (usually costing \$20 each) for the period of the subscription. In addition, the first 50 Collectors would be deemed "Charter Collectors" and would receive a certificate entitled "Discount Gun Stock."

NGEN would also provide a transaction service for subscribers who sell instruments. This service would include negotiating with prospective buyers on behalf of the seller (to avoid the hassle) and receiving and holding the seller's weapon for shipment until the buyer's check had cleared the bank. Ordinarily the commission for the transaction service would be 15% of the sale price. The "Gun Discount Stock" certificates would say that "Owners of these certificates may use the NGEN transaction service for a commission fee of only 5%."

Smith-Wesson has described this plan to you and seeks your legal counsel. She has already received advice of counsel that her plan, surprisingly, can be carried out quite legally insofar as federal and state gun laws are concerned.

She comes to you, her business counsel, to address other potential issues. Are there any securities law implications inherent in her plan? If so, please identify and discuss them. If not, spell out how you came to that conclusion.

Essay Question 2 (40 points)

(A) (20 points) Beginning in December 1989, Randy Smith-Wesson carried through with her plan, only to discover shortly thereafter that the Gun Discount Stock certificates were sold by the Charter Collectors to large national dealers who then began using NGEN as a cheap vehicle for selling large volumes of guns. The certificates changed hands often, always going to those who were willing to pay the holder dearly for the right to the cheap transaction service. It so happened that, given her business costs of running the transaction service, Smith-Wesson lost money on each 5% commission transaction. Desperate to keep NGEN afloat, in January 1990 she secretly instituted a regular practice of understating the true sales prices in each 5% transaction service sale only enough so that she could pocket an amount that would cover her actual costs. On average for such transactions, she raised the effective commission to 7%, still a bargain in her mind. Owing to her ability to keep very good, false records, the users of the transaction service were kept in the dark.

Does this behavior have any securities law implications? As before, please discuss why or why not.

(B) (5 points) Smith-Wesson's transaction commission "enhancement" program remained a secret from January 1990 until December 1993, when she discontinued the practice, owing to efficiencies she developed in the service. Would this fact have any bearing on your answer in (A) above? Why or why not?

(C) (15 points) If Smith-Wesson were to incorporate NGEN, INC., and take it public in January 1995 (with your legal assistance) would the underwriter's failure to discover the above facts and disclose them in the registration statement result in underwriter liability to the NGEN public stock purchasers? Why or why not?