Comments and Notes

THE DELAWARE RESPONSE TO
FEDERAL REGULATION OF SMALL
BUSINESS SECURITIES OFFERINGS

INTRODUCTION

The federal securities laws are designed to advance two main goals: first, the laws are designed to protect investors from fraudulent securities offerings; second, the laws seek to establish an orderly and equitable marketplace for capital accumulation. The Securities and Exchange Commission balances these goals when it adopts new rules and regulations which pertain to certain areas of the securities industry. Because the Securities Act of 1933 and the Securities Exchange Act of 1934 specifically reserve joint regulatory powers with the states, such a balancing of goals occurs on a state level, as well as on the federal level. In many instances, however, the states' balancing of investor protection-capital accumulation goals differ from the federal approach; moreover, the states frequently differ among themselves on the methods used to achieve these goals. A prospective issuer must therefore consider federal law as well as the law of every state in which an offer will be made; the result is a maze of rules, regulations, statutes, and other compliance standards which lead to higher costs for the issuer.

Although these costs are incurred by all issuers, the expense can be especially burdensome for small businesses which do not have the

1. "An Act to provide full and fair disclosure of the character of securities sold in interstate and foreign commerce and through the mails, and to prevent frauds in the sale thereof." Preamble to the Securities Act of 1933, 15 U.S.C. §§ 77(a)-77(aa) (1979) [hereinafter cited as Securities Act of 1933].
3. "Nothing in this subchapter shall affect the jurisdiction of the securities commission (or any agency or office performing like functions) of any State or Territory of the United States, or the District of Columbia, over any security or any person." Securities Act of 1933 § 77(r).
4. "[N]othing in this title shall affect the jurisdiction of the securities commission (or any agency or office performing like functions) of any State over any security or any person insofar as it does not conflict with the provisions of this title or the rules and regulations thereunder." Securities Exchange Act of 1934 § 78(bb).
5. This depends upon whether a state is a "full disclosure" or a "fair, just and equitable" jurisdiction. See note 69 infra.
legal talent or financial resources necessary to interpret the inconsistent federal and state compliance standards. In response to the small business problem, the SEC has attempted to reduce the costs associated with federal regulation which small businesses incur. The states, however, have been reluctant to follow the federal initiatives; consistency with respect to regulatory standards for small businesses has therefore not been established. Unless the states adopt compatible small business provisions, the effect of the federal provisions will be minimal and the costs associated with small business offerings may remain prohibitively high.

This comment will examine two of the more important federal small business provisions, Rules 240 \(^6\) and 242,\(^7\) and the subsequent response of the Delaware Division of Securities \(^8\) to the federal rules. The analysis will be presented in two major sections. First, in order to gain an understanding of the events which led to the Delaware response, we will examine the development of Rules 240 and 242. The evolution of federal small offering provisions from the SEC v. Ralston Purina Co.,\(^9\) standards, through the adoption of the federal private offering exemption provided by Rule 146,\(^10\) and the subsequent adoption of rules dealing specifically with small business offerings (Rules 240 and 242) will be examined. In the second section, we will turn to the Delaware reaction to federal Rules 240 and 242, and trace the development of the Delaware action from the enactment of the Delaware Securities Act \(^11\) through the most recent rule change.\(^12\) By use of this case study, it is hoped that the reader will be

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8. As enacted in 1973, the Delaware Division of Securities [hereinafter the Division] is established as part of the Department of Justice under the authority of the Attorney General. As the Delaware Securities Act indicates, Del. Code Ann. tit. 6, § 7323 (1975), the Securities Commissioner shall have the qualifications of a deputy attorney general. Since the enactment of the Act, there have been three Securities Commissioners. The current Commissioner is Donald L. Brutow.

10. 17 C.F.R. § 230.146 (1975) [hereinafter cited as Rule 146].
better able to understand the complex procedures which underlie a seemingly simple rule adoption. It is also hoped that the reader will be made aware of the regulatory problems which face small businesses in obtaining needed capital.

I. Federal Rules

A. Background

The basic intention of the registration provisions of the Securities Act of 1933 is to provide investors with the necessary information for making intelligent investment decisions. The philosophy of registration is not to pass on the value or desirability of a particular offering; rather, the federal laws are based upon the concept that if an investor is adequately informed, his investment decision is more likely to be realistic and successful. With respect to protecting the issuers of securities, requiring disclosure of material information serves to remove the possibility that a purchaser has been defrauded: if the purchaser is properly informed, and the securities subsequently decline in value, the investor has no one but himself to blame for his loss.

Registration under the federal statute thus serves to protect the investor from fraudulent information and the issuer from unfair accusations of misrepresentation. Such a system is most effective when the size of an offering is large or the number of prospective purchasers is considerable, since the orderly management of the securities industry is, along with investor protection, one of the prime responsibilities of the SEC. However, as the legislative history of the 1933 Act indicates, Congress recognized that there may be some circumstances wherein full registration under the Act would serve to offer little in-

13. SEC v. Ralston Purina Co., 346 U.S. 119, 124 (1953). In the Ralston Purina case, the decision turned on whether the employee offerees would have the necessary information without registration by the company. The Court made note of the vocational positions included among the offerees such as "artist, clerical assistant, electrician, stock clerk, stenographer." Employee Stock Offerings Under the Securities Act—The Ralston Purina Case, 21 U. Cn. L. Rev. 113, 116 (1953). "The basic purpose of the Securities Act was to protect investors by requiring full disclosure of all facts necessary for informed investment decisions." Non-Public Offerings Under the Securities Act, 48 Nw. U. L. Rsv. 771 (1954).

14. Id.

15. Civil and criminal liability are imposed for material misstatements. There is also a general antifraud provision which is enforceable by injunctive relief and criminal sanctions. L. Loss, Securities Regulation 84 (1951). The issuer is likewise protected from unfair accusations of misrepresentation by registering under the Act.

16. The Securities and Exchange Commission would hold that an offering to a substantial number of persons would rarely be exempt. The Ralston Purina Court further stated that nothing would prevent the Commission from using some kind of numerical test when determining exemptions. 346 U.S. at 125.
vestor protection while increasing the costs associated with issuing securities. In a series of securities and transactional exemptions, Congress created statutory provisions whereby certain issuers could offer securities on an interstate basis without registration under the Act. It is these exemptions which have provided the bulk of small business provisions under the federal securities laws.

Under section 4(2) of the 1933 Act, a transaction in an issue not involving a public offering would be exempt from the registration provisions of the Act. On its face, the section could apply to any issuer transaction offered to a limited number of offerees. The statute provides no definitions for the terms "transaction" or "not involving any public offering," nor does the statute give any guidance as to the steps which are necessary to ensure compliance. Based upon the broad language of the statute, almost any offering could fall within the meaning of section 4(2) so long as the issuer did not advertise the offering to the general public and the offering was an initial, as opposed to secondary, transaction. The intent of Congress in enacting these broad provisions, however, was not to permit such a universal application of the section. It has been the role of the SEC and the courts to interpret the provisions and limit the scope of the statutory exemption provided by section 4(2).

Prior to any Commission action with respect to the section 4(2) exemption, the United States Supreme Court interpreted the exemption in response to what had been an almost unguided path of compliance. In the landmark SEC v. Ralston Purina Co. decision, the Court set forth the guidelines whereby an issuer who wishes to rely upon the section 4(2) exemption can base his offering. The standards established in the Ralston Purina decision formed the basis for what would eventually become the federal private placement Rule 146. Ralston Purina involved an offering of stock by a corporation

17. H.R. Rep. No. 85, 73d Cong., 1st Sess. 5 (1953). Congress recognized that certain types of securities transactions have no practical need for the application of registration. In other situations the public benefits would be too remote to mandate registration.
19. All brokers are included within the definition of a dealer in section 2(12) of the 1933 Act. This exemption would seem to be available to a firm selling securities as an auctioneer. L. Loss, Securities Regulation 404 (1951).
20. H.R. Rep. No. 85, 73d Cong., 1st Sess. 16 (1933). The purpose was to exempt the ordinary brokerage transaction and provide an open market for securities at all times.
21. SEC v. Blazon Corp., 609 F.2d 960, 968 (9th Cir. 1979). "Exemptions from the registration requirements of the Securities Act are construed narrowly."
22. 346 U.S. at 119.
23. "The focus of inquiry should be on the need of the offerees for the protections afforded by registration." Id. at 127.
to certain members of its staff. The Court maintained that the limited number of purchasers did not alone warrant the availability of the section 4(2) exemption. Instead, the Court indicated that the important feature of the exemption was the nature of the offerees and their knowledge of information concerning the offering. Since the employees in Ralston Purina were "not shown to have access to the kind of information which registration would disclose," the exemption was deemed to be unavailable and registration would be required. The concept of access to information was thus established as a major factor of the federal private offering exemption.

The impact of Ralston Purina was significant but inconclusive. The criteria set forth in that decision and subsequent interpretations resulted in more confusion and uncertainty for issuers contemplating a section 4(2) exemption. For example, although the Ralston Purina employees were deemed to be "public" in terms of information resources, the Court indicated that offerings to executive personnel or narrowly defined classes of employees might qualify as offers to private individuals for purposes of the exemption. The decision also cast a doubt over the specific number limitation feature of such offerings; no longer would the limited number of purchaser factor ensure the availability of the exemption. As a result of this uncertainty, the federal private offering remained a dangerous area for most issuers seeking to utilize that provision.

B. Rule 146

The SEC recognized this problem when it enacted Rule 146 in 1973, which provides a "safe harbor" exemption under which total

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24. "[T]he statute would seem to apply to a "public offering" whether too few or many." Id. at 125.
25. "But once it is seen that the exemption question turns on the knowledge of the offerees, the issuer's motives, laudable though they may be, fade into irrelevance." Id. at 126-27.
26. Id. at 127.
27. Adato v. Kagan, 599 F.2d 1111, 1116 (2d Cir. 1979). Byrnes v. Faulkner, Dawkins and Sullivan, 550 F.2d 1305, 1311 (2d Cir. 1977). Section 4(2) was ruled inapplicable on its face since it exempts only "transactions by an issuer not involving any public offering."
28. 346 U.S. at 125. The applicability of public protection, the Court maintained, should "turn on whether the particular class of persons affected needs the protection of the Act." Thus, those able to take care of themselves do not need its protection.
29. For an offering to be public, it need not be open to the "whole world." Id. at 123.
30. Id. at 125.
31. Rule 146(b) provides that "Transactions by an issuer involving the offer, offer to sell, offer for sale or sale of securities of the issuer that are part of an
compliance with the Rule's provisions ensures the availability of an exemption from regulation under section 4(2). There is no limit on the amount of securities which may be offered under Rule 146, but there is a prohibition against any general advertisement or solicitation of general investors. There are also stringent restrictions upon the nature of offerees and purchasers including the "offeree representative," an individual who advises a prospective purchaser who might lack the requisite knowledge to evaluate the merits and risks of the offering without assistance. The Rule further provides that before an offer is made and before a sale is effected, the issuer must take reasonable steps to ensure that the purchaser is sufficiently informed to

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offering that is made in accordance with all the conditions of this rule shall be deemed to be transactions not involving any public offering within the meaning of Section 4(2) of the Act." The "safe harbor" is provided by the Rule and the provision of Section 19(a) of the Act, 15 U.S.C. § 77s(a) (1970) which states that "No provision of this title imposing any liability shall apply to any act done or omitted in good faith in conformity with any rule or regulation of the Commission, notwithstanding that such rule or regulation may, after such act or omission, be amended or rescinded or be determined by judicial or other authority to be invalid for any reason."


32. Rule 146.

33. Rule 146(c) provides in pertinent part:

Limitation of Manner of Offering. Neither the issuer nor any person acting on its behalf shall offer to sell, offer for sale, or sell the securities by means of any form of general solicitation or advertising, including but not limited to, the following:

(1) Any advertisement, article, notice or other communication published in any newspaper, magazine or similar medium or broadcast over television or radio.

(2) Any seminar or meeting, except that if paragraph (d)(1) of this section is satisfied as to each person invited to or attending such seminar or meeting, and, as to persons qualifying only under paragraph (d)(1)(ii) of this section, such persons are accompanied by their offeree representative(s), then such seminar or meeting shall be deemed not to be a form of general solicitation or general advertising;

(3) Any letter, circular, notice or other written communication, except that if paragraph (d)(1) of this section is satisfied as to each person to whom the communication is directed, such communication shall be deemed not to be a form of general solicitation or general advertising.

34. The appropriate section, Rule 146(d), states:

Nature of offerees. The issuer and any person acting on its behalf who offer, offer to sell, offer for sale or sell the securities shall have reasonable grounds to believe and shall believe:

(1) Immediately prior to making any offer, either:

(i) That the offeree has such knowledge and experience in financial and business matters that he is capable of evaluating the merits and risks of the prospective investment, or

(ii) That the offeree is a person who is able to bear the economic risk of the investment; and

(2) Immediately prior to making any sale, after making reasonable inquiry, either:
make an intelligent investment decision. There is no limit placed on the number of offerees, although the Rule limits the number of purchasers to thirty-five, and the exemption is available to any

(i) That the offeree has such knowledge and experience in financial and business matters that he is capable of evaluating the merits and risks of the prospective investment, or

(ii) That the offeree and his offeree representative(s) together have such knowledge and experience in financial and business matters that they are capable of evaluating the merits and risks of the prospective investment and that the offeree is able to bear the economic risk of the investment.

35. Rule 146(a) defines "offeree representative" as:

(a) Definitions. The following definitions shall apply for purposes of this rule.

(1) Offeree representative. The term "offeree representative" shall mean any person or persons, each of whom the issuer and any person acting on its behalf, after making reasonable inquiry, have reasonable grounds to believe and believe satisfies all of the following conditions:

(i) Is not an affiliate, director, officer or other employee of the issuer, or beneficial owner of 10 percent or more of any class of the equity securities or 10 percent or more of the equity interest in the issuer, except where the offeree is:

(a) Related to such person by blood, marriage or adoption, no more remotely than as first cousin;

(b) Any trust or estate in which such person or any persons related to him as specified in paragraph (a)(1)(i)(a) or (c) of this section collectively have 100 percent of the beneficial interest (excluding contingent interests) or of which any such person serves as trustee, executor, or in any similar capacity; or

(c) Any corporation or other organization in which such person or any persons related to him as specified in paragraph (a)(1)(i)(a) or (b) of this section collectively are the beneficial owners of 100 percent of the equity securities (excluding directors' qualifying shares) or equity interest;

(ii) Has such knowledge and experience in financial and business matters that he, either alone, or together with other offeree representatives or the offeree, is capable of evaluating the merits and risks of the prospective investment;

(iii) is acknowledged by the offeree, in writing, during the course of the transaction, to be his offeree representative in connection with evaluating the merits and risks of the prospective investment; and

(iv) discloses to the offeree, in writing, prior to the acknowledgement specified in paragraph (a)(1)(iii) of this section, any material relationship between such person or its affiliates and the issuer or its affiliates, which then exists or is mutually understood to be contemplated or which has existed at any time during the previous two years, and any compensation received or to be received as a result of such relationship.

36. Rule 146(g) states:

(g) Number of purchasers. (1) The issuer shall have reasonable grounds to believe, and after making reasonable inquiry, shall believe, that there are no more than thirty-five purchasers of the securities of the issuer from the issuer to any offering pursuant to the Rule.

NOTE: See paragraph (b)(1) of this section, the note thereto and the Preliminary Notes as to what may or may not constitute an offering pursuant to the rule.

(2) For purposes of computing the number of purchasers for paragraph (g)(1) of this section only:

(i) The following purchasers shall be excluded:

(a) Any relative or spouse of a purchaser and any relative of such spouse, who has the same home as such purchaser; and
issuer.\textsuperscript{37} However, the issuer must provide information which would be required to be filed with the SEC, unless the offeree is able to readily obtain the information.\textsuperscript{38} Also, a sales report on Form 146 must be filed with the issuer’s regional SEC office within six months after the date of the first sale.\textsuperscript{39} In addition, the securities may not be resold unless such resale is made in accordance with other applicable provisions of the federal securities laws.\textsuperscript{40}

\(\text{(b)}\) Any trust or estate in which a purchaser or any of the persons related to him as specified in paragraph \((g)(2)(i)(a)\) or \((c)\) of this section collectively have 100 percent of the beneficial interest (excluding contingent interests);

\(\text{(c)}\) Any corporation or other organization of which a purchaser or any of the persons related to him as specified in paragraph \((g)(2)(i)(a)\) or \(\text{(b)}\) of this section collectively are the beneficial owners of all the equity securities (excluding directors’ qualifying shares) or equity interest; and

\(\text{(d)}\) Any person who purchases or agrees in writing to purchase for cash in a single payment or installments, securities of the issuer in the aggregate amount of $150,000 or more.

\textit{NOTE:} The issuer has to satisfy all the provisions of the rule with respect to all purchasers whether or not they are included in computing the number of purchasers under paragraph \((g)(2)(i)\).

\(\text{(i)}\) There shall be counted as one purchaser any corporation, partnership, association, joint stock company, trust or unincorporated organization, except that if such entity was organized for the specific purpose of acquiring the securities offered, each beneficial owner of equity interests or equity securities in such entity shall count as a separate purchaser.

\textit{NOTE:} See Preliminary Note 5 as to other persons who are considered to be purchasers.

\textsuperscript{37} Rule 146.

\textsuperscript{38} Rule 146(e).

\textsuperscript{39} Subsection (i) of Rule 146 states:

\textit{Report of offering.} At the time of the first sale of securities in any offering effect in reliance on this rule the issuer shall file three copies of a report on Form 146 with the Commission at the Commission’s Regional Office for the region in which the issuer’s physical business operations are conducted or proposed [sic] to be conducted in the United States. The copies of such report with respect to an issuer having or proposing to have its principal business operations outside the United States shall be filed with the Regional Office for the region in which the offering is primarily conducted or proposed to be conducted. No report need be filed for any offering or offerings in reliance on Rule 146 the proceeds of which total, cumulatively, less than $50,000 during any twelve-month period. If any material change occurs in the facts set forth on the report on Form 146 filed with the Commission, the person who filed the statement shall promptly file with the Commission, at the Regional Office of the Commission in which the original report on Form 146 was filed, three copies of an amended Form 146 disclosing such change.

\textsuperscript{40} Rule 146(h) states:

\(\text{(h)}\) \textit{Limitations on disposition.} The issuer and any person acting on its behalf shall exercise reasonable care to assure that the purchasers of the securities in the offering are not underwriters within the meaning of section 2(11) of the Act. Such reasonable care shall include, but not necessarily be limited to, the following:

\(\text{(1)}\) Making reasonable inquiry to determine if the purchaser is acquiring the securities for his own account or on behalf of other persons;

\(\text{(2)}\) Placing a legend on the certificate or other document evidencing the securities stating that the securities have not been registered under the
The provisions of Rule 146 provide important guidelines for private issues. Indeed, many small businesses could rely upon the Rule in eliminating a significant amount of the costs associated with a securities transaction. However, as capital formulation became an even more complex problem in the later part of the 1960s and the early 1970s, it became increasingly clear that the provisions of Rule 146 did not fulfill all of the needs of small business issuers. For example, a small issue sold to more than thirty-five purchasers, not offerees, automatically prevented reliance upon the Rule. Such an issuer would need to rely upon the vague and uncertain statutory exemption of section 4(2) should it wish to avoid registration. In addition, any small business issue which was directed to unsophisticated or wealthy offerees, despite a small dollar amount, could not raise the necessary capital without registration. In this regard, the SEC sought alternative measures whereby small business issuers could offer their securities without registration. Two of the more significant results were Rules 240 and 242 adopted under section 3 of the 1933 Act.

C. Rules 240 and 242

Rule 240 was adopted by the SEC on January 24, 1975. It is important to note that the Rule was based not upon the transactional exemptions provided by section 4(2) of the Securities Act of 1933, but rather upon the securities exemptions of section 3 of the Act. The purpose of the Rule is to provide an exemption from registration for

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42. Id. at 514, 567–69.
43. Id.
44. Rule 146(g).
47. Section 4(2) provides that the registration requirements of section 5 shall not apply to transactions by an issuer not involving any public offering.
48. Section 3(b) provides:
The Commission may from time to time by its rules and regulations, and subject to such terms and conditions as may be prescribed therein, add any class of securities to the securities exempted as provided in this section, if it finds that the enforcement of this title with respect to such securities is not
securities, as opposed to offerings, of issuers who, because of the small size and limited character of the offering, do not warrant full registration.49

Rule 240 established another safe harbor exemption and required that:

1) Offerings be limited to a total of $100,000 by an issuer within the twelve months preceding the offering. Excluded from this dollar amount are all securities sold by an issuer, either exempt or registered, which were sold in reliance upon an exemption other than Rule 240 which met certain conditions.

2) No general advertisement or solicitation may be made in connection with an offer or sale. In addition, no commission may be paid in connection with any sale.

3) There is no limitation upon the nature of the offerees or purchasers; unlike Rule 146, the issuer need not determine the relative wealth of the offerees nor analyze their knowledge regarding securities matters.

4) There may be no more than 100 beneficial owners of the securities of the issuer, although there is no express limitation regarding the number of purchasers.

5) There is no requirement concerning the information which must be made available to purchasers of the securities, other than the prohibition of fraudulent or misleading materials.

6) The limitations on resale are identical to the private offering provided by section 4(2) of the Act.

7) For any securities sold by an issuer which exceeds the initial $100,000 limit, a report on Form 240 must be filed with the Commission.

An examination of the provisions of Rule 240 discloses the relaxed requirements for qualifying issuers in comparison with Rule 146. Unlike Rule 146 offerors, the issuer which relies on a Rule 240 exemption need not be concerned with the nature of the persons

necessary in the public interest and for the protection of investors by reason of the small amount involved or the limited character of the public offering; but no issue of securities shall be exempted under this subsection where the aggregate amount at which such issue is offered to the public exceeds $5,000,000.

Because the basis for the exemption is section 3(b) rather than section 4(2), public offerings are possible under Rule 240. If section 4(2) was the basis, no public offering would be permitted.

49. Section 3(b) provides that section 5 compliance is not required because “enforcement of this title with respect to such securities is not necessary in the public interest and for the protection of investors by reason of the small amount involved or the limited character of the public offering.”
towards whom the offering will be directed. This was intended to provide meaningful assistance for issuers offering small amounts of securities to a wide variety of offerees. In this regard, Rule 240 was expected to reduce the costs and risks associated with the determination of the nature of each offeree as experienced under Rule 146. In addition, unlike Rule 146, a violation with respect to one offeree would not disallow the exemption with respect to other purchasers, thus further reducing the risk of losing an exemption based upon one sale of the offering.

Despite its attractive qualities, Rule 240 did not present an ideal solution to the small business capital problem. First, the Rule covered only offerings which were less than $100,000; offerings which exceeded this amount were subject to registration if the private offering exemptions provided by section 4(2) or Rule 146 promulgated thereunder were not available. Second, the prohibition of commissions for the sale of securities presented a difficult situation for issuers who sought to retain commissioned brokers with sufficient expertise to effect the transactions. Third, inasmuch as Rule 240 was available only to issuers with less than 100 beneficial owners, the ex-

50. Rule 240 does not have a provision like Rule 146(d) where there is a burden on the offeror to determine the nature of the offeree. Rule 146(d) provides: The issuer and any person acting on its behalf who offer, offer to sell, offer for sale or sell the securities shall have reasonable grounds to believe and shall believe:

(1) Immediately prior to making any offer either:

(i) That the offeree has such knowledge and experience in financial and business matters that he is capable of evaluating the merits and risks of the prospective investment, or

(ii) That the offeree is a person who is able to bear the economic risk of the investment; and

(2) Immediately prior to making any sale, after making reasonable inquiry, either:

(i) That the offeree has such knowledge and experience in financial and business matters that he is capable of evaluating the merits and risks of the prospective investment, or

(ii) That the offeree and his offeree representative(s) together have such knowledge and experience in financial and business matters that they are capable of evaluating the merits and risks of the prospective investment and that the offeree is able to bear the economic risk of the investment.


53. Rule 240(b) n.1 provides: "Each individual transaction effected in reliance on the rule must meet all the terms and conditions of the rule; the availability of the rule will not be affected by other transactions effected in reliance upon the rule but which do not meet all its terms and conditions."


emptions available under the Rule would be of no value to an issuer who sought to maintain a broader base of security holders.

In response to the apparent deficiencies of Rule 240 with respect to many small businesses, the SEC held a series of public hearings during 1978 to study proposals which would allow small businesses greater freedom in soliciting capital while maintaining sufficient investor protection. The hearings, which were held upon the recommendation of the House Committee on Interstate and Foreign Commerce, examined most of the problems confronting small business with respect to capital formulation, with the goal of alleviating some of those problems. To be sure, many of the problems which hindered capital accumulation by small businesses were outside the scope of SEC activity. Nevertheless, it was thought that with SEC initiative, less restrictive capital accumulation rules would assist small businesses in their efforts to increase plant production and compete with increasingly sophisticated foreign products. Rule 240, it was thought, dealt with small offerings; a new rule was needed to deal with small businesses. The result of the SEC study was the adoption of Rule 242 on January 27, 1980.

57. A summary of these hearings is available from the SEC for public inspection at the Commission's Public Reference Center in Washington, D.C. Refer to file number S7-784. SEC Securities Act Release No. 6121 (September 11, 1979).

58. The hearings were recommended by the Advisory Committee on Corporate Disclosure to the SEC, Committee Print 95-29. SEC Securities Act Release No. 6121 n.1 (September 11, 1979).


60. Some of the problems which hinder capital accumulation by small businesses include:

   a) inconsistent state policies which do not reflect the position of the SEC. Id. at E-2.

   b) economic factors such as high interest rates and inflation which limit the abilities of small businesses to compete with larger companies for limited capital. Small Business Investment: Hearings on H.R. 13032 Before the Subcomm. on Consumer Protection and Finance of the House Comm. on Interstate and Foreign Commerce, 95th Cong., 2d Sess. 8 (Sept. 27, 28, 1978) (comments of Harold Williams, Chairman SEC) [hereinafter cited as 1978 Hearings].

   c) inefficient plant machinery and soaring labor costs which cut into small business profit margins. 1978 Hearings, id. at 14 (Memorandum of SEC on H.R. 13032).


63. 1. The Rule permits, pursuant to the statutory limit of section 3(b) of the Securities Act of 1933, sales of up to $5,000,000 worth of securities, the total dollar amount including all sales made pursuant to section 3(b) within six months of the offer. 17 C.F.R. § 230.242(c) (1981).
Rule 242 was adopted as an experimental provision subject to additional review by the Commission pending the results of use.64 However, statistics compiled by the Commission indicate that during the first six months of experimental use, sixty-four issuers filed the required notices with the Commission for a total of $38,058,704.65 Moreover, with respect to the expected lower cost of Rule 242, the statistics derived from these sixty-four issuers indicated that the average distribution expense of Rule 242 issues was 2.5% of the intended aggregate sales, as opposed to a 13.9% figure reported by small public offerings.66 Based upon these favorable findings, it is likely that the SEC will make Rule 242 a permanent part of its effort to facilitate small business capital accumulation. Inasmuch as the impact of Rules 240 and 242 will be minimal unless the states adopt similar provisions, the reaction by the states in coming months will perhaps be the most significant factor in the ultimate success of the Rules.

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64. On October 23, 1980, the Commission amended Rule 242(c) to specify a $2,000,000 maximum dollar amount for Rule 242 offerings. Subsequently, the Commission has revised the figure to coincide with the $5,000,000 maximum which section 5(b) of the 1933 Act permits.

2. The exemption is available only if the issuer does not advertise the securities or generally solicit purchasers. There is no limit upon the commissions which may be paid in relation to the offer. 17 C.F.R. § 230.242(d)(1981).

3. There are no requirements concerning the nature of the offerees or purchasers. In this respect, Rule 242 abandons the nature of the offeree provision of Rule 146 which was reiterated in Rule 240. SEC Securities Act Release No. 6180 (January 17, 1980).

4. There is no limit on the number of offerees, although there is a purchaser limit of 39, but this figure does not include "accredited" investors as defined by Rule 242(a)(1). 17 C.F.R. § 230.242(c) (1981).

5. The exemption is available only to corporations. Partnerships and limited partnerships are excluded from the provisions of the rule. 17 C.F.R. § 230.242(a) (1981).

6. If the company is subject to the reporting requirements of the federal securities laws, the issuer is required to provide each offeree with a copy of the most recent report filed with the SEC. If the issuer is a non-reporting company, the information which would be required if the issuer prepared an S-18 registration statement, Part I, must be provided for each offeree. Accredited purchasers need not be supplied with any of the information indicated in this section. 17 C.F.R. § 230.242(f) (1981).

7. The resale restrictions of section 4(2) of the Act are applicable to the exemption. 17 C.F.R. § 230.242(g) (1981).

8. The issuer is required to file a report of sales, along with a copy of Form 242, with the regional office of the SEC within six months of the initiation of the offering. 17 C.F.R. § 230.242(h) (1981).


66. Id. at iii.
II. DELAWARE RULE 9 (b)(9)(I)(A)

A. Background

Delaware enacted its securities statute in 1973,67 the last state to adopt a comprehensive securities registration law. When the legislative process was completed, Delaware adopted an act which contained many of the familiar provisions of the Uniform Securities Act.68

As a full disclosure state,69 Delaware does not require merit review for most securities offered within the state. The Act provides three general means by which securities may be offered. The first and least used method is the registration of securities by qualification.70 Registration by qualification is the Delaware registration provision which allows merit review by the Delaware Division of Securities. The registration by qualification provision is designed for offerings which are fully exempt from federal registration but fail to qualify for an exemption under Delaware law.71 Few offerings are registered by qualification in Delaware; in the period from July 1, 1980, to June 30, 1981, the Division of Securities registered only two such offerings.72 To effect a registration under this section, an issuer must submit a detailed registration statement 73 with the Division and pay a rather high filing fee.74

The other registration provision, and the second method of compliance, is registration of securities by coordination.75 This method is by far the most frequently used mechanism for public offerings in

68. Uniform Securities Act §§ 101–419.
69. State securities regulation encompasses a wide range of philosophic approaches. Some jurisdictions, termed "merit" or "fair, just and equitable" states, examine proposed offerings for many items, and may deny registration for any offering on the basis of excessive underwriting expenses, poor business reputation, unsound practices or other deficiencies. See, e.g., Mich. Comp. Laws § 451.706 (1970).
70. Delaware Securities Act, § 7306.
71. The Delaware Securities Act § 7309 contains the possible exemptions from registration.
72. See Land of Lincoln, effective October 16, 1979 and Sunrise Savings and Loan Association, effective September 12, 1980. These files are located in the Division's public files; they represent two of the three offerings registered by qualification over the past 24 months.
73. Delaware Securities Act § 7306(b), Rules Pursuant to Delaware Securities Act, Rule 6(A) (1981).
74. "Fees for registration by qualification shall be 1/2 of 1% of the maximum aggregate offering price of securities to be offered in Delaware but not less than $100 or more than $1,000." Rules Pursuant to Delaware Securities Act, Rule 6(e) (1981).
75. Delaware Securities Act § 7305.
Delaware.76 "Any security for which a registration statement has been filed under the Securities Act of 1933 in connection with the same offering may be registered by Coordination" in Delaware.77 As interpreted by the Division,79 this means that Delaware will impose no additional requirements with respect to the content of federal registration statements; if the statement is acceptable to the SEC in terms of disclosure and other respects, it is automatically acceptable in Delaware. To effect a registration of securities by coordination, an issuer need file only a minimum number of documents and pay a flat $100 filing fee.79 The Division merely inspects the documents for mechanical accuracy and full disclosure is achieved by federal review. Assuming the papers are in order and have been on file with the Division for ten days,80 an offering may become effective in Delaware simultaneously upon SEC effectiveness.81 Registration by coordination is available to any federally registered security; the provision has also been applied to Regulation A offerings,82 although this appears to be a policy matter and has not been established by statute or rule.83

76. The Division registered 1,169 offerings by coordination in fiscal year 1981. Division ledger record (1981). It should be noted that most securities registered by coordination are traded over-the-counter; most exchange listed securities are exempt from registration under section 7309(a)(8) of the Delaware Securities Act. All open-end investment companies, including money market funds, register by coordination in Delaware. Delaware Securities Act § 7305(a).

77. Delaware Securities Act § 7305; Rules Pursuant to Delaware Securities Act, Rule 7(f) (1981).

78. Delaware is following the “full disclosure” philosophy. Its administrative policy is to accept federal disclosure review for all securities registered by coordination; this policy has not been modified or memorialized by rule or regulation.

79. To register securities by coordination the Commissioner requires the use of Form U-1 (omitting 8(c) through 8(g) and (i) and (k) and also (j) if an investment company under the Investment Company Act of 1940), and Form U-2 (omitting U-2A), three copies of the final prospectus and a filing fee of $100, provided, however, that no instruction, undertaking or other matter appearing in said forms shall be deemed to modify or in any way affect the application of the requirements of the Delaware Securities Act and of the rules and regulations thereunder to such registration. Rules Pursuant to Delaware Securities Act, Rule 5 (1981).

80. Delaware Securities Act § 7305(c).

81. Id.

82. Regulation A is a limited form of registration under the Securities Act of 1933 which, although technically an exemption under the Act, requires the filing of an offering circular and the use of the circular in offering securities. 15 C.F.R. § 230.251-230.263 (1972). See also H. Bloomenthal, Securities and Federal Corporate Law § 5 (1st ed. 1972).

83. Technically, Regulation A offerings are not registered with the SEC but are rather exempt securities which must nevertheless follow certain filing procedures. See note 82 supra. It could be maintained that the provisions of section 7305 of the Delaware Securities Act might not apply to Regulation A offerings since these offerings do not file a “registration statement” with the SEC as mandated in section 7305(a). Delaware’s current policy placing Regulation A offerings in section 7305 has not been memorialized by rule or regulation.
The third general area for compliance in Delaware is the collection of securities and transactional exemptions contained in the Act. In terms of cost and efficiency, these provisions are the most attractive methods of compliance. With some exceptions, the exemptions are self-executing and require no affirmative act on the part of the issuer before an offer or sale may be made. Of course, the burden of proving the availability of an exemption lies with the claimant, and in some cases proving the technical requirements for an exemption would indeed be a costly and difficult task. In this regard, some issuers obtain exemption approval or "no-action" letters prior to making an offering within the state. History indicates, however, that those relying upon an exemption without such an option from the Division are not taking an excessive risk: since the enactment of the Securities Act, there has not been a single conviction under the Act which disallowed a claimed exemption after the offering had been completed.

As enacted in 1973, the statutory private placement exemption contained in the Delaware Securities Act suggests as many uncer-

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84. Delaware Securities Act § 7309(a).
85. Delaware Securities Act § 7309(b).
86. Delaware Securities Act §§ 7309(a)(11), (b)(11)-(12).
87. "In any proceeding under this act, the burden of proving an exemption or an exception from a definition is upon the person claiming it." Delaware Securities Act § 7309(d).
88. E.g., [A]ny offer or sale of a security by or through a registered broker-dealer if such offer or sale is not directly or indirectly for the benefit of the issuer or a person who is known or should reasonably be known to such broker-dealer to be the record or beneficial owner of ten percent or more of the outstanding voting securities of the issuer; the security is not part of an unsold allotment or subscription taken by a participant in a distribution directly or indirectly for the benefit of the issuer or a person who is known or should reasonably be known by such broker-dealer to be the record or beneficial owner of ten percent or more of the outstanding voting securities of the issuer; and no administrative stop-order or similar order or permanent or temporary injunction of any court of competent jurisdiction is in effect under this subtitle or under any federal or state act against the offering or sale of the security or any security of the same class. Delaware Securities Act § 7309(b)(13).
89. "Requests for rulings by the Commissioner are to be accompanied by a fee in the amount of $20." Rules Pursuant to Delaware Securities Act, Rule 6(c)(A) (1981).
90. There are no records of any convictions in the public files of the Division.
91. A]ny transaction pursuant to an offer directed by the offerer to not more than twenty-five persons [other than those designated in paragraph (8)] in this State during any period of twelve consecutive months, whether or not the offeror or any of the offerees is then present in this State, if the seller reasonably believes that all the buyers in this State, other than those designated in paragraph (8), are purchasing for investment; but the Commissioner may by rule or order, as to any security or transaction or any type of security or transaction, withdraw or further condition this exemption, or in-
tainties in compliance as does section 4(2) of the corresponding federal provision. The exemption also contains many of the provisions found in the Uniform Securities Act with an important deletion. Unlike the Uniform Act, the Delaware statute does not prohibit commissions or other compensation for solicitation. Although the Uniform Act provides for a waiver of this condition, the lack of similar language in the Delaware Act seems to suggest that compensation should have no bearing upon the availability of an exemption for the issuer. In this regard, Delaware's statutes seem more favorable to small business offerings, in that the issuer can feel free to retain competent assistance in selling his securities, instead of relying upon frequently inexperienced in-house management personnel. Ideally, of course, the private offering statute should provide sufficiently specific standards in order to permit the prospective issuer the opportunity to determine the general availability of the exemption with respect to its particular transaction, yet flexible enough to allow the Securities Commissioner the discretion to modify the provisions as conditions warrant. In Delaware, the statute provides such flexibility, as set forth in the rule and waiver clause, but it fails to specify adequate compliance standards.

Just as section 4(2) of the Securities Act of 1933 failed to provide an acceptable standard for federal private offerings, Delaware's statutory exemption did not set forth standards whereby an issuer

crease or decrease the number of offer[ees] permitted, or waive the condition relating to their investment intent.

Delaware Securities Act § 7309(b)(9) as amended.

92. [A]ny transaction pursuant to an offer directed by the offeror to not more than ten persons (other than those designated in paragraph (B) ) in this state during any period of twelve consecutive months, whether or not the offeror or any of the offerees is then present in this state, if (A) the seller reasonably believes that all the buyers are purchasing for investment, and (B) no commission or other remuneration is paid or given directly or indirectly for soliciting any prospective buyer; but the Administrator may by rule or order, as to any security or transaction or any type of security or transaction, withdraw or further condition this exemption, or increase or decrease the number of offerees permitted, or waive the conditions in Clauses (A) and (B) with or without the substitution of a limitation on remuneration.


93. Id.

94. Under section 7302(a)(2) of the Delaware Securities Act, an individual who transacts business in securities on behalf of an issuer whose securities are exempt under section 7309(b)(9) is not within the definition of an "agent" and thus need not register under section 7313. Compare this provision to the Maryland Securities Act, which requires broker-dealer registration for such an individual if three or more such offerings are sold by an individual within 12 months. Md. Sec. Act, Release No. 19, 1A Blue Sky Rep. (CCH) ¶ 30,560 (May 10, 1974).

95. "[T]he Commissioner may, by rule or order . . . withdraw or further condition this exemption . . . ." Delaware Securities Act § 7309(b)(9).

96. See p. 99 supra.
could feel certain that an exemption would be available. In recognition of the problem, Delaware adopted its first safe harbor private offering rule on the effective date of the statute. Rule 9(b)(9) was the state's first attempt to address some of the problems which arose as a result of the decision in SEC v. Ralston Purina. Since the rule was replaced in 1974, full discussion of its provisions will not be undertaken. Rule 9(b)(9) was, however, a collection of concepts from which the current private offering exemption, Rule 9(b)(9)(I), was created.

B. Rule 9(b)(9)(I)

Rule 9(b)(9) was replaced by Rule 9(b)(9)(I) on December 12, 1974. Rule 9(b)(9)(I) was clearly the product of state examination of federal Rule 146, adopted by the SEC just five months earlier. The rule contains two separate and distinct safe harbor private offering exemptions. Just as Delaware law provided for the registration of securities by coordination, Rule 9(b)(9)(I) permitted an exemption by coordination for all federal Rule 146 offerings. To qualify in Delaware, a Rule 146 offeror need merely file a state Form D-1 within a certain time period. No merit review of the offering is conducted, and the division does not become aware of the offering until it is completed. Rule 146 offerings are thus easily accom-

97. Delaware Securities Act § 7509(b)(9).
98. See note 31 supra.
100. Rules Pursuant to Delaware Securities Act.
101. See p. 99 supra.
103. Rule 9(b)(9) contained some items which served to confuse, rather than clarify, the vague private offering concept. For example, the Rule defined "securities of the issuer" to "include securities issued by any predecessor of the issuer." This term is crucial in determining whether an exemption is available in terms of the limitation on the number of purchasers as set forth in the Rule. The Rule failed to define or comment upon the possibility that an issuer might issue more than one offering of securities during the described 12 month period. To provide suitable guidance, the Rule should have distinguished between separate offerings made by the same issuers over a certain time period.
107. "[F]orm D-1 shall be filed with the Delaware Department of Justice not later than twenty days after the completion of the offering, or within six months of the commencement of the offering, whichever shall occur first ...." Rules Pursuant to Delaware Securities Act, Rule 9(b)(9)(I)(g). The Rule also states that the Form is required only when the offering exceeds $50,000. Rule 9(b)(9)(I)(g). Although the Division has not adopted a rule or regulation which defines this figure, it has been the policy of the Division that the $50,000 represents the total offering, not merely the offering which is made in Delaware. Thus, an offer of $1,000 made in Delaware which is part of an overall $60,000 offering would require a filing.
plished in Delaware, and within the context of the investor protection-capital accumulaton balance of regulatory responsibilities, it is apparent that the Delaware Securities Division believes that minimal investor protection is necessary with respect to federal Rule 146 offerings.

In the second safe harbor provided by Rule 9(b)(9)(I), an exemption is allowed for offerings which for some reason fail to meet all Rule 146 requirements. This section of the rule contains most of its text, and consists of a set of merit provisions which are substantially identical to the Rule 146 standards. However, in an effort to facilitate local private offerings, the division made some significant changes to the Rule 146 guidelines. These changes were the inclusion of a "related persons" concept with respect to the total number of purchasers allowed under the rule, and the deletion of the "access to or furnishing of information" provision for each offeree.

With respect to the "related persons" concept, it is Delaware's position that officers, directors, partners, and their families should not be counted when the number of purchasers are calculated in connection with the rule's thirty-five purchaser limitation. This provision could conceivably allow a private placement exemption for offerings which, based upon the number of purchasers, could technically be deemed public. Inasmuch as the rule contains no provision for disclosing the identity of such "related persons," there is no way of determining the extent to which the provision is used.

The second major difference in the merit provisions of Rule 9(b)(9)(I), the information access deletion, presents a more important policy decision by Delaware. It is a generally accepted principle that investors must have access to sufficient information to enable them to make intelligent investment decisions. It was with this principle in mind that the SEC included the "access" or "furnishing information" provisions in its private offering rule. Apparently, the Delaware Commissioner believes that such access is not crucial to intelligent investment decisions in terms of private offerings.

111. Id.
112. Id.
113. This possibility is diminished under the standards set forth under SEC v. Ralston Purina, 346 U.S. 119 (1933), supra note 24, where the number of purchasers, as a strict determining factor for private offerings, is reduced.
115. This is the "full disclosure" standard of the SEC. See note 1 supra.
Delaware law, an issuer must provide information which constitutes a disclosure document only when the offeree requests the information.\textsuperscript{117} The significance Delaware places in information access is perhaps best illustrated by the placement of the appropriate provision in the rule: the only reference to disclosure documents is contained in the paragraph which indicates that the documents, when provided "upon request," would be excluded from the prohibited advertising materials as set forth in the rule.\textsuperscript{118} It could be argued that the nature of offerees' requirements contain sufficient safeguards for offeree screening, and that a separate disclosure material provision would contribute no substantial additional investor protection. In addition, it could also be stated that when the access to or furnishing of information requirement is imposed upon local or intrastate offerings, the materials merely serve to add additional costs to the offering, since in most cases the purchasers have a personal relationship with or knowledge of the issuer and its business.\textsuperscript{119} But regardless of the theoretical analysis of the Delaware revisions to Rule 146 within its private offering safe harbor, the actual effect of these changes with respect to investor protection and capital formulation is difficult to determine. As a member of the Delaware Bar Association noted in retrospect, the rule changes may not have been successful, but at least they reflect attempts to facilitate local-capital accumulation within the Commissioner's rulemaking authority.\textsuperscript{120}

Thus, prior to the adoption of federal Rules 240 and 242 by the SEC, there were five means whereby small businesses could offer securities in Delaware. If the securities were registered with the SEC, registration by coordination was available.\textsuperscript{121} If these securities were exempt from federal registration, but were not within any of the exemptions contained in the Delaware provisions, registration by qualification could be utilized.\textsuperscript{122} Finally, the issuer could form the offering within the safe harbors of Rule 146\textsuperscript{123} or Delaware Rule 9(b)(9)(l).\textsuperscript{124}

\begin{footnotes}
\textsuperscript{117} Rules Pursuant to Delaware Securities Act, Rule 9(b)(9)(l)(C)(3).
\textsuperscript{118} Id.
\textsuperscript{119} It should be noted that very few offerings are made in reliance upon the merit provisions of Rule 9(b)(9)(l). During the first six months of 1981, the Division received no D-1 Forms for any offering made in reliance upon the merit provisions; all forms were received pursuant to Rule 146 offerings. It thus seems that the more lenient merit provisions were designed for use by issuers which might never report on Form D-1, these usually being small local businesses with parties who are familiar with each other. See L. Loss, Securities Regulation 84 (1951).
\textsuperscript{120} Subcommittee to Draft Regulations Under Delaware Securities Act file letter dated March 12, 1980.
\textsuperscript{121} See pp. 108-109 supra.
\textsuperscript{122} See p. 108 supra.
\textsuperscript{123} See pp. 99-108 supra.
\textsuperscript{124} See pp. 112-115 supra.
\end{footnotes}
or choose to rely upon the uncertain statutory exemption for a private offering.\textsuperscript{125} In 1974, it was believed that these options would provide sufficient flexibility for any small business issue which might be anticipated in Delaware. As we have seen in our federal analysis, however, the standard choices which were available to small businesses became insufficient.\textsuperscript{126}

The SEC responded to this problem in adopting provisions such as Rules 240 and 242. Now, with an understanding of the compliance provisions of the Delaware law and the attempts by Delaware to maintain standards which are at least as favorable towards issuers as are federal standards, we turn to the actions which were taken by Delaware after the adoption of Rules 240 and 242 by the SEC.

\textbf{C. Proposals by the Delaware Corporations Law Subcommittee}

On February 12, 1980, the Corporation Law Subcommittee to Draft Regulations Under the Delaware Securities Act, formally came into existence.\textsuperscript{127} The Committee consisted of eight Delaware attorneys from Wilmington-based law firms.\textsuperscript{128} As originally structured, the Subcommittee's task was to prepare appropriate statutory or regulation provisions concerning Rule 242 offerings in Delaware.\textsuperscript{129} The initial function of the Subcommittee did not include Rule 240; rather, it was formed only to deal with problems which Rule 242 issuers would experience in offering securities in Delaware.

As noted in the federal discussion,\textsuperscript{130} offerings which eventually fell within the guidelines of Rule 242 would not, in most instances, qualify for the private offering exemption. With respect to federal regulation, offers directed to unsophisticated investors would automatically eliminate the possibility of a Rule 146 exemption,\textsuperscript{131} and without the safe harbor of Rule 242, such issuers might have been forced to rely upon the uncertain provisions of section 4(2) of the Securities Act of 1933 \textsuperscript{132} in order to avoid registration under section 5. In Delaware, a small issuer which sought to offer securities with-

\textsuperscript{125} See pp. 110–112 \textsuperscript{supra}.
\textsuperscript{126} See pp. 105–107 \textsuperscript{supra}.
\textsuperscript{127} Subcommittee file letter dated February 12, 1980.
\textsuperscript{129} Subcommittee file letter dated February 12, 1980.
\textsuperscript{130} See pp. 105–107 \textsuperscript{supra}.
\textsuperscript{131} See note 34 \textsuperscript{supra}.
\textsuperscript{132} See pp. 98–99 \textsuperscript{supra}.
out costly registration was faced with an additional problem: after the adoption of Rule 242 by the SEC, the issuer would still have to find an exemption from registration in Delaware should it intend to make an offer in the state. An examination of Delaware law at the time Rule 242 was adopted made this compliance problem clear.\textsuperscript{133} For Rule 242 issuers whose number of purchasers, including accredited purchasers, exceeded thirty-five, the only option for compliance in Delaware was the costly registration of securities by qualification.\textsuperscript{134} Registration by coordination was unavailable because no registration statement was filed with the SEC; Rule 9(b)(9)(I) merit review could not be used because Rule 242 requires no determination of the nature of the offerees; \textsuperscript{135} Rule 146 exemption by coordination was not possible because all of the conditions of Rule 146 are usually not met by Rule 242 issuers.\textsuperscript{136} A review of other exemptions discloses no other reliable alternative.\textsuperscript{137} It was within this climate that the Subcommittee began its analysis of the Delaware provisions in an effort to maintain the state’s federal coordination policy with respect to securities regulation.\textsuperscript{138}

Initially, there was some confusion as to the proper section of the statute upon which the Subcommittee should base its rule change proposals. With respect to exemptions, the Subcommittee at first considered the provisions of sections 7309(b)(8) and (9)\textsuperscript{139} as possible areas of the statutes upon which the Commissioner could adopt an appropriate rule. At this early stage, the Subcommittee also examined the possibility that the provision of the statute which permits the Commissioner to omit certain items of a registration statement\textsuperscript{140} could allow another document to constitute a prospectus.\textsuperscript{141} The general rulemaking power of the Commissioner\textsuperscript{142} was also mentioned as a possible source for adding a Rule 242 provision to the Delaware law. Shortly after considering these possible sources, the Subcom-

\textsuperscript{133} See pp. 114-115 \textit{supra}.

\textsuperscript{134} See p. 108 \textit{supra}.

\textsuperscript{135} See note 63 \textit{supra}.

\textsuperscript{136} See note 63 \textit{supra}.

\textsuperscript{137} None of the other exemptions contained in sections 7309(a) and (b) seem particularly suited to small businesses. The exemption provided for preorganization certificates might apply in narrow circumstances, but the exemption would not be available for existing businesses seeking to raise additional capital. \textit{See Delaware Securities Act} § 7309(b)(10).

\textsuperscript{138} See p. 109 \textit{supra}.

\textsuperscript{139} Subcommittee file letter dated February 20, 1980.

\textsuperscript{140} Delaware Securities Act § 7307(c).

\textsuperscript{141} Offerors registering either by coordination or qualification must file three copies of a prospectus with the Division. \textit{Delaware Securities Act}, §§ 7305(b)(1) and 7306(b)(12).

\textsuperscript{142} Delaware Securities Act § 7325.
mittee agreed that the proper basis would be the private offering exemption, section 7309(b)(9). 143

The issue of statutory authority for a Rule 242 rule in Delaware was a legitimate concern of the Subcommittee which was not fully resolved until an amendment to section 9(b)(9) was enacted on June 30, 1981. 144 Based upon the twenty-five offeree provision of the statute, it would seem difficult for the Commissioner to adopt a rule under that section which could, in theory, allow an unlimited number of purchasers, taking into account the accredited purchaser exclusion of Rule 242. Although the statute does provide a large area of discretion for the Commissioner with respect to conditioning an exemption for certain types of securities, 145 it would be a cumbersome and unintended interpretation of the private offering statutory exemption that would allow unlimited applicability towards Rule 242 offerings. 146 Given the provisions of the alternative basis for authority, section 7209 seemed the best choice of the Subcommittee. However, the Subcommittee noted the uncertainty of this approach at an early stage; even though the Subcommittee would proceed under section 7309(b)(9) for a regulation to allow Rule 242 offerings to be made in Delaware without registration, it determined that such a rule would be a "stop-gap" measure which would govern only until appropriate legislation which specifically dealt with such offerings was passed by the legislature. 147

At the same time section 7309(b)(9) was chosen as the statutory basis for a proposed rule, the Subcommittee decided to expand the scope of its work to include federal Rules 146 and 240. 148 The inclusion of Rule 240 is logical, in that the same problems which made Rule 242 offerings difficult to effect in Delaware were also applicable to Rule 240 offerings. In addition, since Rule 240 permitted an unlimited number of purchasers, 149 regardless of sophistication, wealth, and amount purchased, any accommodation under existing Delaware law outside of registration by qualification was unavailable. The inclusion of Rule 146 offerings in the project was less clear. As noted earlier, any offering which meets the standards of Rule 146 is deemed

144. "Amend § 7309(b)(9), Chapter 73, Title 6, Delaware Code, by adding the following: 'provided, however, the Commissioner may by Rule or Order exempt transactions that are exempt under Federal Securities Laws or Regulations.'" H.B. 257, 131st G.A., 2d Sess. (1981) [hereinafter cited as H.B. 257].
145. See note 95 supra.
147. H.B. 257.
149. See p. 104 supra.
to be exempt by coordination in Delaware.\textsuperscript{150} Perhaps the Subcommittee felt that a complete review of the Delaware private placement exemption was appropriate in view of the complexity of the Rule 240 and 242 problem. In any event, the adoption of a state provision analogous to Rule 146 continued to appear as an issue throughout the period of work by the Subcommittee.

At this point, the Subcommittee was concerned with three primary issues: a stop-gap regulation to allow immediate offers of Rule 146, 240, and 242 securities; a statutory amendment which would confirm the availability of these and similar SEC exemptions in Delaware; and the rulemaking authority of the Securities Commissioner to incorporate federal rules into Delaware provisions and require notice to effect such exemptions.\textsuperscript{151} At this stage in the Subcommittee's analysis, certain Subcommittee members offered proposals which addressed these issues. One proposal \textsuperscript{152} explored the possibility of amending the statute, to include all of the provisions which were desired by the Subcommittee. This proposal recommended the addition of four subsections to the exempt transactions section of the statute.\textsuperscript{153}

The first amendment would provide an exemption for any transaction for which an SEC rule under section 4(2) of the Securities Act of 1933 had been adopted.\textsuperscript{154} As the comment which accompanied the proposal indicates, such an amendment would provide an exemption for any federal private placement offering, whether or not the offering was relying upon the safe harbor of Rule 146, and would in effect make Rule 9(b)(9)(I)(h)\textsuperscript{155} unnecessary.

The second proposed amendment would exempt section 3(b)\textsuperscript{156} securities only if the securities were deemed to be nonpublic within the

\textsuperscript{150} Rules Pursuant to Delaware Securities Act, Rule 9(b)(9)(I)(h).

\textsuperscript{151} Only three exemptions contained in the Delaware Securities Act require notice to the Securities Commissioner. See Delaware Securities Act §§ 7309(a)(11), (b)(11), (b)(12). The statutory basis for Rule 9(b)(9)(I) required no notice to the Commissioner; such notice under paragraph (l) of Rule 9(b)(9)(I) in Form D-1 apparently was the outcome of the discretion of the Commissioner's provision. See note 95 supra.

\textsuperscript{152} Subcommittee file letter dated March 12, 1980.

\textsuperscript{153} Id.

\textsuperscript{154} This proposal exempted any offering "[n]ot involving a public offering within the meaning of Section 4(2) of the Securities Act of 1933, as amended, or of any rule or regulation of the Securities and Exchange Commission under Section 4(2) of that Act in effect at the time of the transaction.\textsuperscript{8}" Subcommittee file letter dated March 12, 1980.

\textsuperscript{155} The merit provisions of Rule 9(b)(9)(I) would continue to be needed if an intrastate safe harbor were to be retained. See p. 113 supra.

\textsuperscript{156} This proposal exempted [s]ecurities in which Section 5 of the Securities Act of 1933 does not apply by reason of any Rule or regulation of the Securities and Exchange Commission pursuant to Section 3(b) of the Act in effect at the time of the transaction if
resale provisions of section 4(2) of the Securities Act of 1933. The proposal, as written, would thus permit exemptions for all Rule 240 and 242 exemptions without specifying the federal rules in the text of the statute. Other section 3(b) offers, such as offers made pursuant to Regulation A, would not be within the coverage of the statute and would thus require registration under the registration by coordination provisions.

The third proposed amendment to the statute provided an exemption for a large category of securities transactions. The broad scope of an available definition would considerably expand the rule-making power of the Securities Commissioner with respect to exempt transactions. Under this amendment, the Commissioner would, in effect, be able to determine without legislative review what provisions are necessary to protect the investors of the state in terms of exempt transactions. In addition, such a provision would have allowed the Commissioner to adopt any federal regulation which exempts a certain type of securities transaction through administrative, rather than legislative, law-making processes. Such an amendment would give the Commissioner almost unlimited power with respect to exemptions under the Delaware Securities Act.

The final proposed section would confirm the general rule-making power of the Commissioner with respect to the notice requirement of any transactional exemption. Previously, the filing requirement under section 7309(b)(9), in the Form D-1 provision of

under such rule or regulation the securities are deemed for purposes of any resale to have had the same status as if the securities had been acquired in a transaction pursuant to Section 4(2) of the Act.


This provision deals with securities which are not subject to resale and are exempt under section 3(b).

See notes 82–83 supra.

See p. 109 supra.

This proposed amendment exempted from registration any security "[w]hich the Commissioner by rule or regulation exempts as not being comprehended within the purposes of this Act or as to which registration under this Act is not necessary for the protection of investors." Subcommittee file letter dated March 12, 1980.

This provision would suggest possible problems in terms of excessive granting of legislative powers to an administrative body. For a discussion of this matter in terms of the federal laws, see L. Loss, Securities Regulation 797 (1961).

This provision seems to suggest that only certain types of securities, as opposed to specific transactions, would be subject to exemption by the Commissioner, Id. at 799 n.45.

Id.

This proposed amendment would "[r]equire that notification in the form specified by the Commissioner be filed with the Commissioner in connection with any transaction exempt from registration under subsection (b) of the section." Subcommittee file letter dated March 12, 1980.
Rule 9(b)(9)(I),\textsuperscript{165} was based upon the section of the statute which allowed the Commissioner to make and publish whatever rules and forms were necessary to carry out the provisions of the statute.\textsuperscript{166} It could be argued that since the specific statutory provision under which Rule 9(b)(9)(I) was adopted did not require notice, the Commissioner could not require such notice without express approval from the legislature.\textsuperscript{167} Nevertheless, the proposed amendment would specifically allow such notice requirements outside of the more generalized rule-making provision of the statute.

Thus, the first proposal provided for broad statutory amendments which not only allowed Rule 240 and 242 offerings, but also greatly expanded the power of the Commissioner to determine what conditions, with respect to investor protection and notice, could be imposed upon an issuer seeking to reduce registration costs. If adopted by the General Assembly, such amendments would enable the Commissioner to exempt virtually all small business offerings from registration in Delaware based upon an administrative finding of unnecessary investor protection.

A second proposal was introduced as Rule 9(b)(9)(II).\textsuperscript{168} The proposed rule provided safe harbor protection for all federal Rule

\textsuperscript{165} Rules Pursuant to Delaware Securities Act, Rule 9(b)(9)(I)(9).

\textsuperscript{166} “The Commissioner may from time to time make, amend and rescind rules, regulations, forms and orders to carry out and define the provisions of this act.” Delaware Securities Act § 7325(b).

\textsuperscript{167} See note 161 supra.

\textsuperscript{168} Rule 9(b)(9)(II): Exemption of Limited Offers And Sales

A. The provisions of § 7304 and § 7312 of Title 6 of the Delaware Code shall not apply to any—

1. transaction not involving a public offering. A transaction shall be deemed to be one “not involving a public offering” if that transaction is exempt from the provisions of § 5 of the Securities Act of 1933 (“1933 Act”) by virtue of, and if there has been compliance with, (a) Rule 146 (17 C.F.R. § 230.146), as amended from time to time, or any successor rule or regulation of the Securities and Exchange Commission (“SEC”), or (b) any rule or regulation, as amended from time to time, promulgated by the SEC pursuant to § 4(2) of the 1933 Act.

2. security or transaction that is exempt from the provisions of § 5 of the 1935 Act by virtue of (a) Rule 240 (17 C.F.R. § 230.240), as amended from time to time, or any successor rule or regulation of the SEC, or (b) rule 242 (17 C.F.R. § 230.242), as amended from time to time, or any successor rule or regulation of the SEC, or (c) any rule or regulation, as amended from time to time, promulgated by the SEC pursuant to § 9(b) of the 1935 Act.

B. A transaction or security shall not be exempt from the provisions of § 7304 and § 7312 of Title 6 of the Delaware Code by virtue of this Rule unless the Commissioner shall have received the following items with respect to each offering no later than three (3) business days after each notice referred to in subsection (1) below is filed with the SEC, or, if no such notice is required to be filed with the SEC, no later than five (5) business days prior to the date the offering is to commence:
146, 240, and 242 offerings, and any successor rule which might be adopted by the SEC. Notice was required by either simultaneous federal document filings,\textsuperscript{169} or, if no federal document was required, a statement which indicated that no federal form was necessary.\textsuperscript{170} The proposed rule also imposed a $100\textsuperscript{171} filing fee for the exemption and required the claimant to consent to service of process.\textsuperscript{172} The proposed rule, in effect, treated federal Rule 146, 240, and 242 offerings as securities to be registered by coordination: \textsuperscript{173} the filing fee was identical to coordination registration, both required the consent to service of process, and the registration requirement of the registration statement was replaced by the federal exemption document filing requirement.\textsuperscript{174}

Two comments \textsuperscript{175} from Subcommittee members were submitted in response to the statutory amendment \textsuperscript{176} and rule adoption \textsuperscript{177} proposals. The commentators agreed that the portions of both proposals which automatically adopted all SEC rules should be reconsidered.\textsuperscript{178} In this regard, one commentator noted the limitation of

\begin{itemize}
\item [(1)] A copy of the original and each subsequent notice required to be filed with the SEC, or, if no such notice is required to be filed with the SEC, a statement saying that no notice to the SEC is required;
\item [(2)] A written representation that the issuer has complied with the rule or regulation of the SEC upon which it is relying;
\item [(3)] A consent to service of process as provided for in \textsection 7327 of Title 6 of the Delaware Code; and
\item [(4)] A filing fee of $100.00.
\end{itemize}


169. Subcommittee proposed Rule 9(b)(9)(II)(B)(1). \textit{Id.}

170. \textit{See} note 168 \textit{supra.}


173. \textit{Compare} p. 109 \textit{supra} with note 169 \textit{supra.} It could be argued that in some cases the exemption as proposed by this rule would be more burdensome than the registration of securities by coordination, inasmuch as under the registration by coordination provisions, no merit review whatsoever is conducted by the Division. Under this proposal, however, when the exemption is claimed, much more specific filing requirements are imposed, \textit{i.e.}, the forms must be filed within three business days after notice is filed with the SEC. No such deadlines are set forth in the registration of securities by coordination under section 7305 of the Delaware Securities Act.

174. \textit{See} note 169 \textit{supra.}


176. \textit{See} pp. 118–120 \textit{supra.}

177. \textit{See} pp. 120–121 \textit{supra.}

178. "I would not want the statute to automatically adopt SEC rules. I believe our Commissioner should have discretionary authority to mold the various SEC rules to our local situation." Subcommittee file letter dated March 12, 1980.

"I do not believe that we should adopt statutory language which would automatically incorporate rules adopted by the SEC." Subcommittee file letter dated March 20, 1980.
Rule 242 to corporate issuers, and suggested that real estate limited partnerships should be included in a Delaware provision. The comments also suggested that distinctions regarding SEC rule-making power under sections 3(b) and 4(2) were unnecessary in terms of the Delaware situation, and suggested that instead a more general statutory rule-making provision should be included in the Delaware statute. Finally, the comments mentioned the notice requirements and suggested that extensive filings outside of those forms which were specifically required by the federal rules would serve no useful state purpose.

A third proposal offered by a member of the Subcommittee offered the simplest and most narrow regulatory approach to Rules 240 and 242. While suggesting a basic statutory amendment which would permit further action by the Commissioner as necessary to carry out the provisions of the private offering subsection, the major por-

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180. "I believe the principal need for an exemption is in the area of limited partnership real estate offerings." Subcommittee file letter dated March 12, 1980.

181. I would prefer not to get hung up on the distinction between the rule making power of the SEC under section 3 (b) in adopting Rules 240 and 242 and its powers under section 19 (a) which forms the basis for the promulgation of Rule 146 under section 4 (2). I have some vague recollection that the legislative history of the '33 Act suggests that section 3 (b) was mistakenly placed under the "exemptive securities" section and should have been placed under the "exemptive transactions" section. In any event, I believe it only serves to cause confusion and complexity.

Subcommittee file letter dated March 12, 1980. This comment concerned the distinctions suggested in paragraphs (1) and (2) of proposed Rule 9 (b) (9) (II), note 168 supra.

182. "Why not simply add a proviso which states that: 'The Commissioner shall have authority from time to time to make, amend, and rescind such rules and regulations as may be necessary to carry out the provisions of this subsection.' " Subcommittee file letter dated March 12, 1980.


184. Because Rule 240 and 242 have been adopted by the SEC pursuant to Section 3 (b) of the '33 Act while Rule 146 has been adopted pursuant to Section 4 (2) of the '33 Act, I have some conceptual difficulties in incorporating the three rules as definitional exemptions under Section 7309 (b) (9) of the Delaware Act. The rules adopted by the SEC pursuant to Section 3 (b) of the '33 Act are really special rules applicable to a "public offering" which is the antithesis of the Section 4 (2) exemption. Section 7309 (b) (9) of the Delaware Act is conceptually a private offering exemption and it seems to me anomalous to say that SEC Rules 240 and 242, which exempts certain "public offerings" from Section 5, are private offering exemptions within the intent of Section 7309 (b) (9) of the Delaware Act. At this point I don't know how to solve this problem other than to rewrite the statute or write a state rule which customizes the essential features of Rules 240 and 242. In any event, I believe that this is a problem which requires a more extended consideration and I am proposing the enclosed rule as an interim measure.

tion of the third proposal was a rule governing Rule 240 and 242 exemptions. This proposed rule was designed to eliminate Rule 9(b)(9)(I) and replace it with an entirely new rule, also named Rule 9(b)(9)(I).

The most striking feature of the third proposal was the apparent elimination of any safe harbor private offering from the Delaware securities laws which does not rely upon federal Rule 146. As we have seen, Rule 9(b)(9)(I), as adopted in 1974, contained a safe harbor protection for intrastate offerings and offerings which, for whatever reason, were unable to meet all Rule 146 standards. This proposed rule provided no standards for such a safe harbor rule; rather, the commentator created an exemption by coordination for federal Rule 146, 240, and 242 offerings. In this sense, this rule, if adopted by the Commissioner, would solve one problem at the expense of another: if the intrastate safe harbor was eliminated, any issuer which sought to rely upon the statute as written, as opposed to federal Rule 146, would be required to follow the uncertain standards which statutory private offerings suggest. The commentator recognized the availability of

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185. Rule 9(b)(9)(I):
   (a) Transactions by an issuer involving the offer, offer to sell, offer for sale or sale of securities of the issuer shall be deemed to be transactions exempt under § 7309(b)(9) of the Act if the transactions are exempt from the provisions of § 5 of the Securities Act of 1933 by virtue of Rule 146, Rule 240, or Rule 242 of the Securities and Exchange Commission and provided that the issuer files with the commissioner, at the same time as it files with the Securities and Exchange Commission, a copy of each notice, or any amendments thereto, required to be filed with the Securities and Exchange Commission pursuant to Rules 146, 240, or 242, together with a consent to service of process as provided for in § 7327 of the Act.
   (b) The term "corporation" as used in the definition of "qualified issuer" in Rule 242(a)(5) shall be deemed to include any partnership or limited partnership constituting an "issuer" as that term is defined in § 7302(l)(g) of the Act and an issuer otherwise meeting the conditions of Rule 242, other than filing a notice with the Securities and Exchange Commission, will be deemed to meet the conditions of paragraph (a) of this Rule 9(b)(9)(l) provided that it files with the Commissioner the form of notice required to be filed by Rule 242.
   (c) Transactions by an issuer made in reliance upon Section 7309(b)(9) of the Act but which are exempt from the provisions of § 5 of the Securities Act of 1933 by reason of Section 3(a)(11) thereof, shall be deemed to meet the conditions of paragraph (a) of this Rule 9(b)(9)(I) if the issuer complies with the conditions of Rule 146, 240, or 242 except that any notice filing required by these Rules shall be deemed notice filing requirements with the Commissioner.

186. Id.


189. See pp. 98–99 supra.
a private offering outside of the rule in his proposal, but he failed to address the compliance uncertainty which would result if Rule 9(b)(9)(I), as written in 1974, was completely discarded.

Despite this significant problem regarding this proposal, the commentator provided some clear and effective language with respect to the Rule 240 and 242 matter. First, in connection with the original task of the Subcommittee to produce a compatible Delaware rule, the proposal contained a provision which would fully coordinate the Delaware rule with present and future SEC small business offering exemptions. This provision dealt specifically with the Rule 240 and 242 problem and did not concern the rather complex issue of the nature of SEC rule-making power. The proposal dealt only with Rules 146, 240, and 242 and their amendments, thus taking into account the criticism regarding the extent of Delaware's acceptance of all SEC rules. The third Subcommittee proposal also suggested that the Delaware rule be designed to include limited partnerships within its safe harbor protection, again being consistent with the prior criticism of the previous proposals.

On April 21, 1980, the Subcommittee considered the three proposals and prepared a draft of a rule for submission to the Corpor-
ate Law Committee Chairman. The draft, also entitled Rule 9(b)(9)(I), contained many of the provisions which were set forth in the third proposal.\textsuperscript{197} There were, however, two significant differences from the third proposal. First, the Subcommittee decided that Delaware should not create any exemption which the SEC, for whatever reason, declined to adopt.\textsuperscript{198} Specifically, the Subcommittee chose to exclude the limited partnership provisions\textsuperscript{199} from the rule and instead included the federal definitions of Rules 146, 240, and 242. Second, unlike the third proposal,\textsuperscript{200} the draft included a state filing requirement even for those offerings which might not require a document under federal law.\textsuperscript{201} The draft provided a safe harbor exemption for federal statutory private offerings under section 3(a)(11) of the Securities Act of 1933,\textsuperscript{202} if the offering did comply with Rule 146, 240, or 242 when the issuer filed with the Securities Division a state Form D-1.\textsuperscript{203}

\begin{verbatim}
          pursuant to Rules 146, 240, or 242, together with a consent to service of process as provided for in Section 7327 of the Act.
          (b) Transactions by an issuer made in reliance upon Section 7309(b)(9) of the Act but which are exempt from the provisions of Section 5 of the Securities Act of 1933 by reason of Section 3(a)(11) thereof, shall be deemed to meet the conditions of subparagraph (a) of this Rule 9(b)(9)(I) if the issuer complies with the conditions of Rules 146, 240, or 242 of the Securities and Exchange Commission as those Rules may be amended from time to time; except as to the notice required to be filed with the Securities and Exchange Commission pursuant to those Rules, provided that the issuer shall file with the Commissioner a notice on form D-1.
          (c) Any filing pursuant to this Rule shall be accompanied by a filing fee of $100 before it shall become effective.
197. See pp. 122–124 supra.
198. "We also determined not to expand the exemption (by way of proposed Regulation) to include partnerships or limited partnerships. The reasons were: (i) a desire not to create an exemption at the state level which the S.E.C. itself declined to create, without some good reason; and (ii) the absence of any substantial economic reason, because limited partnerships may now avail themselves of an exemption under Rule 146, as to which the costs of compliance would not be significantly reduced by creating other exemption options under Rules 240 and 242."


203. This provision, in an indirect manner, suggested that the intrastate exemption provided by section 3(a)(11), note 202 supra, would be available only if the issuer could meet the exemptions provided by Rule 146, 240, or 242, but was not required to do so for federal purposes. Of course, under this rule, the several provisions of the statutory exemption, section 7309(b)(9) of the Delaware Securities Act, would appear to be available as well. See p. 112 supra.
\end{verbatim}
The notice provision contained the investor protection aspect of the draft. It was contended that the information which was required to be filed with the SEC in connection with the filing of a Rule 146, 240, or 242 exemption would be suitable for any potential enforcement action in Delaware.\[^{204}\] With respect to those offerings which are exempt in Delaware, not on the basis of their actual compliance with an applicable federal rule, but which qualify for the proposed rule on the basis of their potential compliance with the conditions of the federal rule,\[^{205}\] Form D-1 would serve to provide adequate information to the Commissioner for enforcement purposes.\[^{206}\] The accuracy of the draft with respect to the notice function is unclear. That is, with respect to the protection of Delaware investors, the utility of federal forms in enforcement has not been established in Delaware securities regulations. However, inasmuch as the federal forms do not contain information regarding purchaser identification, the use of the federal counterpart to Form D-1 may not provide adequate protection.

This draft \[^{207}\] was submitted to the Corporation Law Committee Chairman on May 19, 1980.\[^{208}\] The Chairman made grammatical changes in the draft and clarified the Form D-1 requirement. When the corrected draft was returned to the Subcommittee for final review, a problem arose concerning the language of the draft and the commentary which was prepared to accompany the draft.\[^{209}\] Some members of the Subcommittee were concerned that the draft, as written,

\[^{204}\] The Form D-1 is a much more useful tool for Delaware enforcement than is a federal document. See letter to Subcommittee from Donald L. Bruton, Securities Commissioner, dated September 4, 1980.

\[^{205}\] See note 203 supra.

\[^{206}\] Form D-1 contains the names of all Delaware purchasers. It is the most detailed report which is received by the Division regarding a securities transaction.

\[^{207}\] One Subcommittee member disagreed with the language in the draft which would exempt the securities issued under SEC rules as they are amended. "It should be the task of the Delaware Commissioner to review all amendments prior to their adoption and then make the determination as to whether the exemption should continue." Subcommittee file letter dated April 28, 1980.

\[^{208}\] Subcommittee file letter dated May 19, 1980.

\[^{209}\] 1. This proposed Rule is intended to replace existing Rule 9(b)(9)(I). The present Rule is, in substance, analogous to Rule 146 of the Securities and Exchange Commission ("SEC"). Because it was felt that the Delaware Securities Act should not impose registration requirements upon certain other types of transactions which the SEC has determined should be exempt, the proposed new Rule would broaden the exemptions presently allowed, by including within its coverage those transactions which would merit exemption under SEC Rules 240 and 242 as well as those exempted under Rule 146. SEC Rules 240 and 242 exempt from registration, under certain prescribed conditions, sales of securities not exceeding $2 million and $100,000, respectively.

Thus, any transaction of securities which would be exempt under SEC rules 146, 240 or 242, would likewise be exempt under the proposed
did not provide adequate opportunity for an exemption outside of the federal rules.\(^{210}\) One Subcommittee member suggested a clarifying addition to paragraph (a) of the draft. A second member proposed a shorter phrase which confirmed that a Form D-1 would be required for all offerings which did not involve a federal notification.\(^{211}\) Another member pointed out that the draft did not specify the time for the filing of either the federal forms or the Form D-1.\(^{212}\) The exchange of opinions between subcommittee members involved the crea-

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rule. The only Delaware filing requirement would be the filing of a notice on Form D-1.

2. It should be noted that while the Proposed Rule is believed to fit comfortably within the scope of the Commissioner's exemptive power under 6 Del. C. § 7309(b)(9), the conceptual focus of the § 7309(b)(9) exemption (i.e., offers to not more than 25 persons) differs from the focus of Rules 240 and 242, which concern themselves with the size of the offering, not the number of offerees. Moreover, the notion implicit in 6 Del. C. § 7309(b)(9)—that an offer restricted to 25 persons is "private" and does not for that reason, require registration protection—is now generally regarded as an outmoded concept of securities regulation. Accordingly, it is recommended that 6 Del. C. § 7309(b)(9) be amended at some future date to eliminate any suggestion that the Commissioner's exemptive powers are somehow restricted by that concept.

3. The proposed Rule has been drafted as an interim measure, pending the anticipated promulgation (by a subcommittee of the Corporation Banking and Business Law Committee of the American Bar Association) of a uniform "Blue Sky" exemption which is expected to accomplish the objectives of the proposed Rule. If and when such a uniform exemption is proposed, at that time both the proposed Rule and § 7309(b)(9) should be reexamined for possible revision in light of the proposed uniform exemption.

Commentary to Proposed Rule 9(b)(9)(I), Subcommittee file.

210. [I]t should be m[ade] clear that the rule is not intended to be exclusive, but that issuers may still rely on the private offering exemption. I suggest that the commentary . . . be amended by deleting the parenthetical in the next to the last sentence of Section 1 and by adding the following sentence to that section: 'Like SEC Rule 146, this rule is not intended to be the exclusive basis for determining whether a transaction is exempt from the registration provisions of the Delaware Securities Act.'


211. [P]rovided, however, if the issuer does not file a notice with the Securities and Exchange Commission by reason of a reliance upon the § 3(a)(11) intrastate offering exemption of the Securities Act of 1933 but the issuer otherwise complies with the conditions of Rules 146, 240, or 242, then the transaction shall be deemed exempt if the issuer shall file with the Commissioner a notice on Form D-1 in place of the notice required by those Rules.


212. One Subcommittee member noted that the draft, note 196 supra, and the commentary, note 209 supra, contained inconsistent clauses. Compare the draft with the commentary provision:

[The commentary does contemplate that where no filing with the SEC is required a D-1 is required to be filed with the Commissioner, but the rule, as drafted, does not contain this requirement, since it seems to assume that filings are required in every instance when Rules 146, 240 and 242 are relied upon.

tion of several revisions to the original draft over a period of six weeks. 213 Finally, on July 18, 1980, the proposal as approved by the Committee was formally submitted, with commentary, to the Securities Commissioner for consideration. 214


(a) Transactions by an issuer involving the offer, offer to sell, offer for sale or sale of securities of the issuer shall be deemed to be transactions exempt under Section 77Q9(b)(9) of the Act if the transactions are exempt from the provisions of Section 5 of the Securities Act of 1933 by virtue of Rule 146, Rule 240 or Rule 242 of the Securities and Exchange Commission as those Rules may be amended from time to time; provided that the issuer files with the Commissioner, at the same time as it files with the Securities and Exchange Commission, a copy of any notice, or any amendments thereto, required to be filed with the Securities and Exchange Commission pursuant to Rules 146, 240 or 242. For purposes of the preceding sentence, if the transaction is exempt from § 5 of the Securities Act of 1933 by reason of the intrastate offering exemption of § 3(a)(11) of that Act, then the transaction shall be exempt hereunder if the issuer meets all of the requirements of Rules 146, 240 or 242, except for the filing of a notice with the Securities and Exchange Commission. In such case, and in cases where an issuer relies on an exemption under Rules 146, 240 or 242, but by the terms of any of such rules no notice is required to be filed with the Securities and Exchange Commission, the issuer shall file with the commissioner a notice on Form D-1. Such notice shall be filed no later than ten (10) days after the first sale of securities in this State effected without registration under Section 5 of the Securities Act of 1933 in reliance on Section 3(a)(11) thereof, or at the time that any notice under Rules 146, 240 or 242 would have to be filed with the Securities and Exchange Commission, except for an exemption under any such rule for filings thereunder. In all cases, the issuer shall simultaneously file with the Commissioner the consent to service of process provided for in § 7327 of the Act.

(b) Any filing pursuant to this Rule shall be accompanied by a filing fee of $100 before any exemption hereunder shall become effective.

**COMMENTARY TO PROPOSED RULE 9(b)(9)(I)**

1. This proposed Rule is intended to replace and to supplement existing Rule 9(b)(9)(I). The present Rule is, in substance, analogous to Rule 146 of the Securities and Exchange Commission ("SEC"). Because it was felt that the Delaware Securities Act should not impose registration requirements upon the types of transactions which the SEC has determined should be exempt, the proposed new Delaware Rule would broaden the exemptions presently allowed under the Delaware Act. This would be done by exempting those transactions which are exempt under SEC Rules 240 and 242, as well as those which are exempt from Rule 146. SEC Rules 240 and 242 exempt from registration, under certain prescribed conditions, sales of securities not exceeding $2 million and $100,000, respectively.

Thus, under the proposed Rule any securities transaction which would be exempt under SEC Rules 146, 240 or 242, would likewise be exempt under the Delaware Act. The Delaware filing requirement would be the filing of either a counterpart of the required filing with the SEC or, in cases where no filing with the SEC is required, a notice on Form D-1. In all cases, the issuer must also file with the Commissioner a consent to service of process as provided for in § 7327 of the Act. Like SEC Rule 146, this Rule is not intended to be the exclusive basis for determining whether a transac-
The commentary which accompanied the proposal explained the various provisions which have been examined in this comment.\textsuperscript{215} Again, it was noted that the proposed rule contains no safe harbor for an exemption outside of the standards of Rules 146, 240, and 242.\textsuperscript{216} With the merit provisions of the previous Rule 9(b)(9)(I) revoked, it would seem that the Subcommittee was suggesting that the Securities Commissioner narrow one aspect of the Delaware private placement exemption while expanding its applicability towards federally exempt offerings. This concept is clearly within the federal coordination policy of the Delaware Securities Division;\textsuperscript{217} it is not, however, designed to facilitate the capital growth of local issuers which, based upon the proposed rule, would in every case be required to examine the provisions of federal securities exemptions.

The commentary also deals with the rulemaking powers of the Commissioner under section 7309 and concludes that the section provides adequate authority as written.\textsuperscript{218} However, in order to deal with the twenty-five purchaser limitation, the commentary suggested that appropriate clarifying legislation be submitted in connection with the rule change.\textsuperscript{219}

\textsuperscript{215} Id.

\textsuperscript{216} "This proposed Rule is intended to replace and to supplement existing Rule 9(b)(9)(I)." Commentary to Proposed Rule, para. 1. As we have seen, pp. 112-115 supra, Rule 9(b)(9)(I) contains a safe harbor distinct and separate from Rule 146 offerings.

\textsuperscript{217} See p. 108 supra.

\textsuperscript{218} Commentary to Proposed Rule 9(b)(9)(I), note 214 supra. \textit{See also} discussion of Rules 146, 240 and 242, pp. 116-117 supra.

\textsuperscript{219} "It is recommended that 6 Del. C. § 7309(b)(9) be amended in the future to eliminate any question that the Commissioner's exemptive powers are somehow restricted." Commentary to Proposed Rule 9(b)(9)(I), note 214 supra.
D. The Response by the Delaware Division of Securities

On September 4, 1980, the Commissioner responded to the initial Subcommittee proposal. The Commissioner agreed with the general intention of the proposal, the inclusion of small business exemptions by coordination in Delaware, but he noted that two of the procedural approaches taken by the Subcommittee would serve no function other than to confuse or burden issuers in attempting to comply with the rule. The Commissioner first noted the relative unimportance of the Form 240 and 242 requirements, as it was believed that the federal forms would offer less valuable information than the Delaware D-1 Form and, accordingly, the Commissioner recommended that the Delaware form be adopted for all offerings made pursuant to section 7309(b)(9) of the statute. With respect to the filing fee, the Commissioner noted that the fee would be a new element of exemption qualification in Delaware and thus concluded that such an addition would be unnecessary.

On October 22, 1980, following additional review by the Subcommittee, the Commissioner offered his proposed version of the rule to accommodate a Delaware exemption for Rule 240 and 242 offerings. Instead of creating an entire replacement for Rule 9(b)(9)(I), the Commissioner's proposal merely added a new paragraph which, in effect, created an exemption by coordination for such offerings as the rule provides for Rule 146 offerings. The Commissioner's proposal is simple and direct, and it covers most of the major concepts which were previously considered by the Subcommittee.

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221. Id.
222. Id.
223. "This Office has little need for contemporaneous copies of the Rule 240 and 242 Federal forms." Id.
224. "We would be better served by a form D-1 as now required for Rule 146 offerings." Id.
225. Id.
227. RULE 9(b)(9)(I)(A)

SEC. RULE 240 or 242—Exemption by Coordination

Transactions by an issuer involving the offer, offer to sell, offer for sale or sale of securities of the issuer shall be deemed to be transactions exempt under Section 7309(b)(9) of the Act if the transactions are exempt from the provisions of Section 5 of the Securities Act of 1933 by virtue of Rule 240 or Rule 242 of the Securities and Exchange Commission as those Rules may be amended from time to time; provided that the issuer files with the Commissioner, the information required by Form D-1, along with a true copy of the Federal Form 240 or 242 Notice, not later than twenty days after completion of the offering or within six months of the commencement of the offering, whichever shall occur first.

Id.
tee. First, as the proposal specifically sets forth, the paragraph would provide a safe harbor for Rule 240 and 242 offerings under the private offering statutory provisions.\textsuperscript{228} The proposal also provides flexibility in its allowance for amended Rule 240 and 242 provisions.\textsuperscript{229} Second, the proposal provides investor protection by extending the Form D-1 requirements to such exemptions in accordance with the established procedures of Rule 9(b)(9)(I).\textsuperscript{230} The Commissioner's proposal contains no fee provision, nor does it contain any language which in any way modifies the rulemaking authority of the Commissioner. But perhaps most importantly, the Commissioner's proposal provides for continued merit private placement exemptions under Rule 9(b)(9)(I)\textsuperscript{231} instead of relying entirely upon federal exemption rule standards. Thus, the Commissioner's proposal added a new safe harbor rule to the Delaware provisions without eliminating any other possible exemptions under the private offering exemption.

In accordance with Subcommittee procedure, the Commissioner's proposal was submitted to all Subcommittee members for review and comment. Upon review, it was decided that the Commissioner's proposal, with one change, should be submitted as the formal and final version of the recommended provision. The one change\textsuperscript{232} to the Commissioner's proposal concerned the filing of SEC information with the Delaware Division of Securities by the issuer. As stated in the Commissioner's draft, a copy of an offering memorandum would be required to be filed with the Division within six months of the commencement of the offering or twenty days after the completion of the offering, whichever occurred first.\textsuperscript{233} The commentator felt that this provision was inadequate for two reasons. First, it was contended that the rule would be too restrictive in terms of required filings if such language was adopted. Should Rules 240 or 242 be amended, it was contended the Delaware rule would not be sufficiently flexible as to allow the filing of a suitable replacement document.

\textsuperscript{228} \textit{Id.}

\textsuperscript{229} \textit{Id.}

\textsuperscript{230} \textit{Id.}

\textsuperscript{231} See note 214 \textit{supra.}

\textsuperscript{232} It was suggested that all of the language following "Form D-1" on the Commissioner's proposal, note 214 \textit{supra}, be replaced by the following language: "[A] copy of each Notice Form as and when filed with the Securities and Exchange Commission pursuant to Rule 240 or Rule 242 together with a consent to service of process as provided for in Section 7327 of the Act." Subcommittee file letter dated November 13, 1980.

\textsuperscript{233} See note 214 \textit{supra}. The memoranda are the disclosure documents required by Rules 240 and 242.
which was required by the SEC. Second, the commentator noted that the time frame item with respect to federal forms was not functional; that is, inasmuch as some federal offerings pursuant to Rule 240 or 242 would exceed six months in length, the commentator felt that a date restriction, as suggested by the Commissioner, would result in incomplete filings which would provide inaccurate enforcement material to the Division. The Subcommittee adopted the Commissioner's draft as its final proposal with the modifications suggested above. The final draft by the Commissioner, as amended by the Subcommittee, was adopted as an addition to Rule 9(b)(9)(I) in a public hearing conducted by the Securities Commissioner on January 26, 1981.

As may be observed, the final product in the rule revision process was quite short and direct. Nevertheless, by noting the extent of the

234. The Subcommittee member contended that the language of the proposed change, note 232 supra, "[w]ould not need to be changed should the SEC decide to consolidate forms or adopt new ones." Subcommittee file letter dated November 13, 1980.

235. The Subcommittee member believed that the new rule should track SEC requirements with respect to federal forms. Subcommittee file letter dated November 13, 1980.

236. RULE 9(b) (9) (I) (A)

Transactions by an issuer involving the offer, offer to sell, offer for sale or sale of securities of the issuer shall be deemed to be transactions exempt under Section 7309(b)(9) of the Act if the transactions are exempt from the provisions of Section 5 of the Securities Act of 1933 by virtue of Rule 240 or Rule 242 of the Securities and Exchange Commission as those rules may be amended from time to time; provided that the issuer files with the Commissioner, the information required by Form D-1, and a copy of each Notice Form as and when filed with the Securities and Exchange Commission pursuant to Rule 240 or Rule 242 together with a consent to service of process as provided for in Section 7327 of the Act.

COMMENTARY TO RULE 9(b) (9) (I) (A)

This new Rule is designed to supplement and broaden the exemptions conferred by present Rule 9(b)(9)(I).

The present Rule exempts from registration offers to sell securities which, in essence, would be exempt under the "private offering" exemption conferred by Rule 146 of the Securities and Exchange Commission ("SEC"). The new Rule is designed to create additional exemptions from registration under the Delaware Securities Act under circumstances where the offers to sell securities would be exempt under the (recently adopted) Rules 240 and 242 of the SEC, as those Rules may be amended from time to time. Those new SEC Rules exempt from registration, under certain prescribed conditions, sales of securities not exceeding $100,000 and $5 million, respectively. That result reflects a policy decision by the Securities Commissioner that no useful purpose would be served by requiring registration at the State level in certain cases where the SEC has determined that no registration at the Federal level is necessary to protect the interest of investors.

Under Rule 9(b)(9)(I)(A), the only State filing requirements would consist of (a) a copy of each Notice form as and when filed with the SEC pursuant to SEC Rule 240 or 242, (b) the information filed by Form D-1 and (c) a consent to service of process as provided for in Section 7327 of the Act.
work performed by the Subcommittee, the issues which accompany even the simplest rule changes in securities regulation must be carefully considered. With respect to this matter, the final step in providing a Delaware provision which was compatible with the federal rules was not completed until June 30, 1981, when the General Assembly passed an amendment to the securities statute which confirmed the rule-making authority of the Commissioner under section 7309(b)(9).237 This statutory amendment provided the Commissioner with the authority to exempt any transactions which are exempt under any federal exemption. By securing this statutory power, the Commissioner in essence removed the possibility that future SEC rules with respect to small business offerings would be subject to the extensive treatment which surrounded Rules 240 and 242.

III. CONCLUSION

It is obvious that the adoption of even a simple rule which deals with securities regulation requires extensive study. The most innocent aspect of a proposed rule, such as the time in which a document is to be filed, can affect the entire operation of a securities administrative office; moreover, if such a form was unavailable to an enforcement agency, the impact upon the ability of the agency to offer adequate investor protection would be severely reduced. On the other hand, regulations which add unnecessary filing and other compliance requirements serve only to burden potential issuers. Thus, those who consider new securities regulations must consider the impact of their decisions upon all interested parties in the securities industry.

It is too early to speculate whether Delaware has in fact considered all of the implications of its recent activity with respect to federal Rules 240 and 242. However, based upon the lengthy process which created the new Delaware rule, it can be said with some degree of accuracy that all of the issues which could affect subsequent filings with respect to the federal rules in Delaware have at least been mentioned at some time during the adoption process. When one multiplies the Delaware activity by the number of states which must act upon the federal rules, it is easy to see why securities regulation remains such a difficult field for attorneys and their clients.

Michael D. Kelsey

237. See note 144 supra.