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CORPORATE LIQUIDATION AND SECURITIES LAW—PROBLEMS IN THE DISTRIBUTION OF PORTFOLIO SECURITIES

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A. INTRODUCTION

Lawyers are generally aware of the impact of securities laws on corporate organization, reorganization and financing. Little attention has been given, however, to the effect of these laws on corporate liquidation or dissolution.¹

Securities law has nothing to do with the liquidation of a corporation which owns no securities. Cash or tangible property is distributed to the shareholders, usually on surrender of their certificates of stock in the corporation and with a termination of the legal existence of the corporation. But if the liquidating corporation owns portfolio securities,² there may be problems.

Lest the reader become unduly alarmed, he is assured that most liquidations raise no securities law questions even if portfolios are distributed. This article attempts to show why. Direct authority is scanty and the argument is in terms of analogies and general principles. Doubtful regions are mapped with suggestions for safe passage.

This consideration is limited to voluntary dissolution (since the other kind rarely witnesses distribution of portfolio securities to shareholders) and to complete liquidation (since the other kind raises fewer

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¹ In this article, "liquidation" and "dissolution" are used almost interchangeably. The former emphasizes the process of winding up and distribution, the latter the technical extinction of the corporation.

² This term embraces general investments and securities of subsidiaries. It does not include securities issued by other companies in a merger, consolidation or purchase of assets to which the liquidation is incidental. The latter situation is covered by SEC Rule 133, 17 C.F.R. § 230.133 (Supp. 1961), and is reached only tangentially in this article; see text para. C(2) & note 55 infra.

questions). In general, the discussion is confined to ordinary business corporations not subject to special regulatory statutes.³ Although closely held corporations are not excluded, their problems are easily solved;⁴ consequently, the analysis is directed mainly at publicly held companies. Finally, dissolutions incident to mergers and similar reorganizations are ignored except insofar as their special features help analyze the one-corporation situation.⁵

B. BACKGROUND

A corporation holding portfolio securities and contemplating liquidation has two basic alternatives: (1) sell the securities to third persons and distribute the proceeds, or (2) distribute the securities pro rata to its shareholders. Corporate law generally exercises no influence on this decision. At dissolution, the net assets are held for the stockholders and may be distributed (except probably for liquidation preferences of preferred stock⁶) in cash or in kind.⁷

Other factors may influence the choice between sale to strangers and distribution to shareholders. For example:

- (1) Buyers may not be readily available.
- (2) Distribution may be preferable for tax reasons.⁸

³ Thus, public utility holding companies are excluded except for occasional references, notes 19, 24. So are corporations registered under the Investment Company Act of 1940, 54 Stat. 789 (1954), 15 USC §§ 80a-1 et seq. (1958). Section 25, 54 Stat. 826 (1940), 15 USC § 80a-25 (1958) [hereinafter cited by sections of the act], gives the SEC certain powers over their reorganizations which are defined by § 2(a)(32)(E), 54 Stat. 790 (1940), 15 USC § 2 (1958), to include dissolution or liquidation. On the other hand, an investment company which for any reason is unregistered is (by virtue of § 7(a)(5), 54 Stat. 802(1940), 15 USC § 80a-7 (1958)) not required to register because of transactions incidental to its dissolution. It would therefore appear to be covered by the treatment in the text.

⁴ See discussion of Securities Act of 1933 § 4(1), 48 Stat. 77 (1933), as amended, 15 USC 77d (1958), 1st clause, *infra* note 16.

⁵ See note 2 *supra*.

⁶ Cf. text accompanying note 33 *infra*.

⁷ See, in general, Ballantine, *Corporations* 725, 734-35 (1946); authorities are collected in 16 Fletcher, *Private Corporations* § 8134 nn. 87-88 (perm. ed. rev. repl. 1942). Representative statutes are: Del. Code Ann. tit. 8 § 281 (1953); Ill. Ann. Stat. ch. 32, § 157.79b (1954); N.Y. Bus. Corp. Law § 1004a (effective Apr. 1, 1963). It is a corollary that stockholders take corporate assets subject to corporate debts; see, e.g., Okla. Stat. Ann. tit. 8 § 1.194 (1953). Cf. *Schrage v. Bridgeport Oil Co.*, 31 Del. Ch. 305, 71 A.2d 882 (1950) (plan for liquidating distribution of small fractional interests in numerous oil properties held unfair to small shareholders).

⁸ Int. Rev. Code of 1954, § 337 eliminates most of this advantage. Prior to the enactment of § 337, if upon liquidation the corporation distributed the assets in kind to the shareholders, it was not liable for a capital gains tax, even though the shareholders disposed of the assets upon receipt. This was diluted somewhat by *Court Holding Co. v. Commissioner*, 324 U.S. 331 (1945), where a capital gains tax was imposed upon the corporation as it had negotiated for the sale of the assets prior to the distribution to the shareholders, who, upon receipt of the assets, sold them to the same party.

(3) Time limits imposed by tax aspirations may be insufficient to find buyers.⁹

(4) Continuity of control may be desired, e.g., where a subsidiary is spun off, a new corporation endowed with part of the business is split off, or a holding company passes out of existence (for reasons of simplification or otherwise) and distributes the stock of various subsidiaries.

Whatever the reason, care should be exercised to comply with the securities laws. For example, a violation of the federal provision creates civil liability enforceable against the liquidating corporation¹⁰ and, quite possibly (by virtue of local law), against its shareholders as transferees¹¹ and against its directors.¹² Moreover, if the corporation is liable, so are the persons who control it.¹³ There is no reason to suppose that this liability terminates with dissolution of the corporation, especially where state statutes preserve the corporate existence after dissolution for purposes of enforcing liabilities.¹⁴

C. THE "SALE" REQUIREMENT OF THE SECURITIES ACT

One of the most important questions with which the liquidating corporation and its advisors are faced, is whether the distribution of portfolio securities to the shareholders constitutes a sale within the provisions of the Securities Act of 1933.¹⁵ Of the numerous features of the Securities Act, the most important for the purposes here considered is the registration of securities. This is required whenever there is a "sale" or "offer" of a security.¹⁶ "Sale" is defined to "include every

⁹ Int. Rev. Code of 1954, § 337 requires distribution within 12 months of the adoption of the plan of liquidation in order to avoid recognition of gain on sales made in the course of the liquidation. The shareholder's gain on liquidation which is recognized for tax purposes may be limited in accordance with Int. Rev. Code of 1954, § 333, if all the corporate property is transferred within one calendar month. For analysis of these provisions, see Bittker, *Federal Income Taxation of Corporations and Shareholders* 263-72, 282-98 (1959). There may simply be a rush to liquidate before another year's franchise tax becomes due or in order to give stockholders their gain or loss in the current income tax year rather than the next one.

¹⁰ Securities Act of 1933 § 12, 48 Stat. 84 (1933), 15 USC § 77e (1958).

¹¹ Cf. text accompanying note 7 *supra*.

¹² See Ballantine, *Corporations* 732-33 (rev. ed. 1946). Authorities on directors' liability are collected 2 Model Bus. Corp. Act Ann. 13 (1960).

¹³ Securities Act of 1933 § 15, 48 Stat. 84 (1933), as amended, 15 USC § 770 (1958). For definition of control see note 52 *infra*.

¹⁴ See, e.g., Del. Code Ann. tit. 8 § 278 (1953); Ill. Ann. Stat. ch. 32, § 157.95 (1954); N.Y. Bus. Corp. Law § 1005 (Effective Apr. 1, 1963). Cf. *Melrose Distillers, Inc. v. U.S.*, 359 U.S. 721 (1959) (state continuity statute prevents abatement of federal anti-trust liability; indictment preceded dissolution).

¹⁵ 48 Stat. 74 (1933), as amended, 15 USC §§ 77a-77aa (1958) [hereinafter cited by sections of the act].

¹⁶ Securities Act § 5. "Sale" or "offer" is also essential to civil liability under § 12.

contract of sale or disposition . . . for value."¹⁷ "Offer" is defined to "include every attempt or offer to dispose of, or solicitation of an offer to buy . . . for value."¹⁸ Because of the word "include," these cannot be regarded as exclusive definitions. However, no others are given, and it is hard to imagine any reasonable one without the concept of "value," which term is prominent in both parts of the statute.¹⁹

In the context of these provisions, three theories tend to negate a "sale" in a liquidation distribution to shareholders.

1. *No Value Given by Shareholders in Liquidation.* The most obvious of the theories is geared to the dependence of "sale" on "value." To be sure, it has been suggested that a shareholder gives value when he relinquishes in dissolution the rights evidenced by his certificate.²⁰ Realistically, though, there is no "value" since the transaction itself dissipates all the assets of the corporation and terminates its existence, thus making the stock and stockholder status totally worthless. Even if it be thought that the shareholder gives "value," it can hardly be true that the corporation receives "value"; it gets only a piece of engraved paper to be buried in a transfer agent's or an attorney's file.²¹ Moreover, civil relief under the federal law would be a mockery since it enables the purchaser "to recover the consideration paid,"²² which would be the surrendered certificate or stockholder status in the defunct entity.

Certain exemptions from registration are provided by §§ 3-4. The only one with wide applicability to corporate liquidations is § 4(1) 1st clause ("transactions by any person other than an issuer, underwriter or dealer"). This will ordinarily cover closely-held corporations. But it may not operate when the number of distributee shareholders is large and the portfolio securities are control-related. See the text para. D(5) *infra*. Narrower in scope are the \$300,000 qualified exemption (§ 3(b) and Regulation A, 17 C.F.R. § 230.254(a) (Supp. 1961)) and the intrastate exemption (§ 3(a)(11)). (The use of the latter by a non-issuer is not altogether clear; see 1 Loss, Securities Regulation 594 (2d ed. 1961).) Other exemptions are even more limited:

- (a) Particular types of securities (e.g., §§ 3(a)(2)-(8), 3(c));
- (b) Transfer by issuers (as distinct from owners) (§§ 3(a)(9), 4(1) 2d clause) or dealers (§ 4(1) 3d clause) or brokers (§ 4(2));
- (c) Particular transactions (e.g., § 3(a)(10)). For general discussion of exemptions, see 1 Loss, Securities Regulations 559-715 (2d ed. 1961). It should be noted that an exemption lifts the registration requirement but not the civil and criminal liabilities of §§ 12(2) and 17.

¹⁷ Securities Act § 2(3).

¹⁸ *Ibid*.

¹⁹ But see Public Utility Holding Company Act of 1935 § 2(a)(23), 49 Stat. 804 (1935), 15 USC § 79b (1958), which defines sale without reference to value. The latter demonstrates that Congress is capable of a broader definition if it so desires. For its effect, see note 24 *infra*. For a general analysis of "value" in the definition of "sale," see 1 Loss, Securities Regulation 513-18 (2d ed. 1961).

²⁰ *Greyhound Corp. v. U.S.*, 53-1 USTC ¶ 9326 (N.D. Ill. 1953) discussed at note 28 *infra* (dictum in deed tax case).

²¹ See note 34 *infra* (no transfer tax on certificates surrendered).

²² Securities Act § 12.

Supporting analogy is found in the treatment afforded stock dividends. The issuance of stock dividends is generally believed not to involve a "sale" by the issuing corporation.²³ Congress clearly thought so. It deleted, as unnecessary, a House-passed exemption for stock dividends with the explanation that "they do not constitute a sale, not being given for value."²⁴ To the same effect is a rule stating that no purchase or sale occurs when there is a pro rata distribution in cash or in kind.²⁵

Further confirmation is found in the more distant realm of taxation. It has been held, for example, that a distribution of securities and cash upon liquidation is subject to state income tax as a "dividend" rather than as a "sale."²⁶ The stamp tax on each "deed . . . by which any . . . realty sold shall be . . . conveyed to the purchaser"²⁷ need not be paid on assets distributed upon liquidation, if there are no corporate debts.²⁸ On the other hand, if there are debts expressly

²³ This is implicit in *Opin. of Gen. Coun., Sec. Act Rel. 929*, (1936) discussed at notes 36, 50 *infra*.

²⁴ H.R. Rep. No. 152, 73rd Cong., 1st Sess. 25 (1933). See also 1 Loss, *Securities Regulation* 517 n. 182 (2d ed. 1961) citing *Sec. Act Rel. 3728* (1956), and his discussion at 2 *id.* 1077 n. 176, 1082 n. 197 to the effect that stock dividends are not "purchases" within the insider trading provisions of Securities Exchange Act of 1934 § 16(b), 48 Stat. 896 (1934), 15 USC § 78p (1958). Compare the definition of "sale" in the Public Utility Holding Company Act of 1935 § 2(a)(23), *supra* note 19, which makes both stock dividends and liquidating distributions subject to SEC regulation. Similarly, stock dividends of railroad carriers must be approved by the ICC pursuant to the Interstate Commerce Act, 41 Stat. 494 (1920), as amended, 49 USC § 20a (1958), because the provision expressly governs issuance and is not limited to sale. For further analysis see 1 Loss, *Securities Regulation* 378 n. 20 (2d ed. 1961).

²⁵ Investment Company Act Rule 17a-5, 17 C.F.R. § 270.17a5 (Supp. 1961). The interpretation is limited to the terms as they appear in Investment Company Act § 17(a) prohibiting certain transactions between investment companies and designated affiliates, promoters and underwriters. It does not extend to the general definition of "sale" in Investment Company Act § 2(a)(33) which is substantially the same as Securities Act § (3). The rule operates only if the stockholder has no election as to the specific assets which he will receive.

²⁶ *U.S. Trust Co. v. Commissioner of Corporations and Taxation*, 299 Mass. 296, 13 N.E.2d 6 (1938) (gains from sales taxable at lower rates than dividends). But see *S. Rep. No. 398*, 68th Cong., 1st Sess. 11 (1924), reprinted 1939-1 (Part 2) Cum. Bull. 266, 274 accompanying the first federal income tax provision treating a liquidating distribution as a sale. The Report regards the transaction as a sale "in effect" and notes that this is the only administratively feasible method of taxing it. It was also a concession to the stockholder since it gave him the benefit of capital gains.

²⁷ Int. Rev. Code of 1954, § 4361 (emphasis added).

²⁸ U.S. Treas. Regs. § 43.4361-2(a)(8) (1959); Rev. Rul. 58-50, 1958-1 Cum. Bull. 461. Contrary dictum appears in the district court opinion in *Greyhound Corp. v. U.S.*, 208 F.2d 858 (7th Cir. 1954), aff'g, 53-1 USTC ¶ 9326 (N.D. Ill. 1953), which states that any liquidating distribution is for valuable consideration in the form of the stockholders' rights evidenced by the stock surrendered. This ignores the extinction of the rights in the dissolution process; see text para. C(1) *supra*. See also *Deer Park Pine Industry, Inc. v. County of Stevens*, 46 Wash.2d 852, 286 P.2d 98 (1955) (surrender of certificates is form not substance; stockholder neither gains nor loses thereby).

assumed, the stamp tax applies.²⁹ The result seems to be the same if the debts are merely taken "subject to."³⁰ The prevailing theory in the deed tax domain is that any assets in excess of liabilities are transferred without consideration, while the remainder are purchased by the shareholders from the corporation (or from its creditors who have paramount rights in the assets to the extent of their claims).³¹ By contrast, the stamp tax on stock,³² which applies to a "transfer" as well as to a "sale," is imposed on portfolio securities distributed in liquidation.³³ However, even this tax is not imposed on shares surrendered to the dissolving corporation since these are not considered transferred.³⁴

2. *No Individual Action.* A second theory has roots in securities law (or at least in securities administration). It is the principle of Rule 133³⁵ that "no sale" occurs for Securities Act purposes when

²⁹ *Greyhound Corp. v. U. S.*, *ibid*; *R. H. Macy & Co. v. U.S.*, 107 F. Supp. 883 (S.D.N.Y. 1952); U.S. Treas. Regs. § 43.4361-2(a)(8) (1959); Rev. Rul. 54-363, 1954-2 Cum. Bull. 428. Earlier cases to the contrary, *Tide Water Associated Oil Co. v. Jones*, 57 F. Supp. 482 (W. D. Okla. 1944) and *Socony-Vacuum Oil Co. v. Sheehan*, 50 F. Supp. 1010 (E. D. Mo. 1943) apparently are no longer law. Both involved debts and, at least in the latter, the debts were expressly assumed. The theory of the last-cited case is that the stockholder (parent corporation) was the equitable owner of the assets and that the deed did not transfer title but merely showed the transfer on the public records. It further states that the conveyances were not in consideration of the assumption of debts since the assets exceeded the debts; hence, the transfer was without valuable consideration. All four cases were indiscriminately cited as "persuasive" in holding no tax under an almost identical state statute, *State v. Green*, 88 So. 2d 493 (Fla. 1956) (partial liquidation). See also *Deer Park Pine Industry, Inc. v. County of Stevens*, *supra* note 28, (where debts were assumed, there was a "conveyance . . . for a valuable consideration" within language of ordinance taxing real estate sales).

³⁰ U.S. Treas. Regs. § 43.4361-2(a)(8) (1959); Rev. Rul. 58-50, 1958-1 Cum. Bull. 461.

³¹ *Greyhound Corp. v. U.S.*, *supra* note 28. See Special Ruling, Oct. 23, 1942, CCH 1942 Stand. Fed. Tax. Rep. ¶ 6566, CCH Fed. Excise Tax Rep. ¶ 3319.16 for method of allocating consideration (debts) between realty and other property distributed.

³² Int. Rev. Code of 1954, § 4321.

³³ Apparently nothing squarely so holds, but it is established practice among the corporate bar. Cf. U.S. Treas. Regs. § 4321-2(a)(10) and (11) (1959) (stock dividends subject to tax); *Transamerica Corp. v. Lewis*, 126 F.2d 402 (9th Cir. 1942) (non-liquidating distribution of portfolio securities; parties admitted tax due; dispute over computation). See also *North American Co. v. Green*, 120 So. 2d 603 (Fla. 1960) (spin-off after 100-for-1 split taxable under state statute virtually identical to Int. Rev. Code of 1954, § 4321). Certain transfers by operation of law are exempt from this stamp tax, Int. Rev. Code of 1954, § 4343(a), but they do not include dividends in shares of another corporation; the designated exemptions are exclusive, Int. Rev. Code of 1954, § 4343(b).

³⁴ U.S. Treas. Regs. § 43.4321-2(b)(3) (1959). *Glenn L. Martin Co. v. U.S.*, 21 F.Supp. 562 (D. Md. 1937) (surrender to going concern, without consideration, to facilitate refinancing); *Transamerica Corp. v. Lewis*, 28 F.Supp. 765 (N. D. Cal. 1939), appeal dismissed by stipulation, 108 F.2d 1016 (9th Cir. 1940) (cash purchase by going concern for retirement).

³⁵ Securities Act Rule 133, 17 C.F.R. § 230.133 (Supp. 1961).

stockholders take corporate (rather than individual) action by voting in a prescribed majority for certain mergers or other reorganizations.³⁶ Although the rule is not primarily concerned with liquidations, the rationale would seem equally applicable, since the stockholder vote for dissolution in most jurisdictions resembles the one for merger. Indeed, Rule 133(c)³⁷ specifically allows a constituent corporation (e.g., one which has sold its assets for securities of another company, or has acquired securities of another company in a merger or consolidation) to distribute in complete or partial liquidation the securities received.³⁸ A fortiori, securities already held by a corporation should be exempt from registration when distributed pursuant to a liquidation plan voted upon by the shareholders.

3. *Stockholders Already Owners.* Since the stockholders are the equitable owners of the net corporate assets at dissolution,³⁹ one may plausibly argue that no "sale" to them has taken place when the assets are formally transferred. The transfer is merely to perfect an existing title.⁴⁰

D. AREAS OF POSSIBLE APPLICABILITY OF SECURITIES LAWS

The foregoing analysis should indicate that ordinary liquidating distributions of portfolio securities involve no sale and are not subject to the registration or other provisions of the Securities Act of 1933. One reason for the elaborate argument is to generate ideas which may be helpful in variant situations where the law is less clear. Some of these are sketched below, with the *caveat* that most conclusions must be tentative in the present undeveloped state of affairs. In specific situ-

³⁶ For a full discussion of the rationale, see 1 Loss, Securities Regulation 521-24 (2d ed. 1961). The same idea probably underlies Investment Company Act Rule 17a-5, discussed *supra* note 25, which is conditioned on the absence of any election by the individual shareholder. But see Opin. of Gen. Coun., Sec. Act Rel. 929, 11 F.R. 10957, CCH Fed. Sec. Law Rep. ¶ 2125.21 (1936), stating that there is no Securities Act "sale" where each stockholder is given in advance an election to take either a cash dividend or a stock dividend; the Opinion is to the contrary, if, after a cash dividend is declared, a stock dividend is offered as an alternative. The Opinion is concerned not so much with individual action as with release of accrued money rights. See also the SEC's dictum that Rule 133, *supra* note 35, is inapplicable where control is so concentrated that stockholder approval is "a mere formality," *Great Sweet Grass Oils, Ltd.*, 37 SEC 683, 691 (1957), *aff'd* without opinion, 256 F.2d 893 (D.C. Cir. 1958).

³⁷ *Supra* note 35.

³⁸ This statement first appeared in the Rule in 1959 but the idea was accepted by the SEC much earlier; see 1 Loss, Securities Regulation 520 n. 195 (2d ed. 1961); Letter from Chief Coun., Div. of Corp. Fin., SEC, CCH Fed. Sec. Law Rep. ¶ 2128.03 (Feb. 10, 1948).

³⁹ *Supra* note 7.

⁴⁰ This theory was used to support one of the earlier deed tax decisions, *Socony-Vacuum Oil Co. v. Sheehan*, *supra* note 29 (and see the accompanying discussion).

ations it may be possible and prudent to obtain opinions or "no-action" letters from the SEC.⁴¹

1. *Satisfaction of Creditors' Claims.* Although the concern here is mainly with transfers to shareholders, it is worth noting that transfers in liquidation are sometimes made to creditors in satisfaction of their claims. Such transfers are undoubtedly sales. Value is present; so is individual action on the part of the creditor (since he is foregoing a claim to be paid in money). Registration will be required unless the transaction is otherwise exempt.⁴²

2. *Satisfaction of Liquidation Preferences.* A preferred shareholder, like a creditor but inferior to him in rank, is ordinarily entitled to be paid in cash.⁴³ If he individually agrees to be paid in portfolio securities, there may well be a "sale" within the Securities Act. On the other hand, if a valid plan of dissolution adopted by the shareholders specifies distribution of portfolio securities in satisfaction of liquidation preferences, the absence of individual (as opposed to corporate) action may preclude a "sale."⁴⁴ Moreover, the adoption of the plan simultaneously eliminates his money claim and solidifies his status as equitable owner of the designated portfolio assets. Accordingly, the theories that stockholders give no value in liquidation and that they are already owners should operate.

3. *Assumption of Debts.* It is well established that shareholders take the corporate assets subject to corporate debts,⁴⁵ and they may expressly assume them in order to expedite the liquidation or continue an advantageous credit arrangement. It already has been observed that assumption, and probably taking "subject to," amounts to a "sale" under the stamp tax on deeds.⁴⁶ There, however, the "sale" is only to the extent of the debts; the rest of the distribution is gratuitous. Such a distinction is hardly workable in deciding whether the securities must be registered. If *any* value is given, there is presumably a "sale" compelling registration.⁴⁷ This all-or-nothing rule argues against extend-

⁴¹ See Thomas, Federal Securities Act Handbook 45-46 (1959).

⁴² Cf. note 16 *supra*.

⁴³ Ballantine, Corporations 734-35 (rev. ed. 1946). Cf. *Bowman v. Armour & Co.*, 17 Ill.2d 43, 160 N.E.2d 753 (1959) (invalidating recapitalization plan for redemption of preferred by payment in debentures).

⁴⁴ See para. C(2) *supra*.

⁴⁵ *Supra* note 7.

⁴⁶ Cf. text accompanying notes 29, 30 *supra*.

⁴⁷ Securities Act § 2(3). The section also states that a bonus given with a purchased security is "conclusively presumed" to have been purchased "for value." Segregating the consideration and limiting it to the amount of the debts makes sense in Securities Act § 12 where the measure of damages for a sale in violation of the registration requirement is "the consideration paid."

ing the deed tax precedents to securities law. But there can be no assurance that this would not be done, particularly in a flagrant case.⁴⁸

Since few liquidating corporations are so fortunate as to be debt-free, this problem can arise quite frequently. Some gradations are discernible. *Express* assumption of *known* debts looks much more like "value" and entails far more individual action than taking *subject to unknown* debts. The latter almost certainly cannot precipitate a "sale."⁴⁹ The consequences of less pronounced situations are not clear. In all instances, caution suggests the discharge of debts with corporate assets before distribution of portfolio securities.

4. *Stockholder's Choice*. Ordinarily, pro rata distribution is the only kind that is practical. But there may be instances where the shareholders are given a choice among various securities (e.g., in a split-up) or between securities and cash. In either case, there is individual action and perhaps "value" in the release of one alternative.⁵⁰ A considerable (but not unthinkable) extension of this concept would be necessary to turn this into a "sale"; the risk cannot be altogether ignored.

A similar problem may arise where the corporation arranges facilities for disposition of the portfolio securities for the account of shareholders after distribution.⁵¹

5. *Control-Related Securities*. Problems involving control arise in two general ways. The portfolio securities may themselves represent control (e.g., securities of a subsidiary). Or, they may have been acquired from the issuer or someone in a "control relation" with the issuer.⁵² In either case, the liquidating corporation will be a statutory

⁴⁸ Consider, for example, a block of securities purchased on credit shortly prior to dissolution and distributed subject to the purchase money debt. Cf. text, para. D(5) *infra*, concerning distribution of control-related securities.

⁴⁹ Such a rule would seem to make every liquidation a sale or, equally intolerable, leave the question to be answered by future events, i.e., the assertion of claims. One way out of the dilemma might be the often used escrow or retention fund to meet contingencies. But too large a fund would deprive the shareholders of the use of the assets; too small a one might leave them "subject to" debts not satisfied out of it.

⁵⁰ Cf. Opin. of Gen. Coun., Sec. Act Rel. 929 (1936) discussed *supra* note 36 (no "value," hence no "sale" where each stockholder in a going concern is offered the choice between a cash dividend and a stock dividend). The Opinion states that a waiver or surrender of a right or claim ordinarily constitutes "value" and that a "sale" would occur if a stockholder were offered stock in lieu of an already declared cash dividend.

⁵¹ See discussion at the end of para. D(5) of the text. There should be no question about acquisition or disposition to round out fractional shares; these are *de minimis*; cf. Securities Act Rule 133(b), *supra* note 35, last sentence; 1 Loss, Securities Regulation 651-52 (2d ed. 1961).

⁵² The phrase is shorthand for "any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer" in Securities Act § 2(11). "Control" is defined as "the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a

"underwriter"⁵³ if it took with a view to "distribution."⁵⁴ "Distribution" in the statutory sense just mentioned is the antonym of "investment," but not necessarily the synonym of distribution to shareholders in liquidation. The statutory concept is roughly equivalent to "public offering."⁵⁵ If the dissolving corporation is publicly held, its liquidating distribution looks very much like a public offering. But there is one crucial difference: the absence of "value." Apparently, no court has ever had occasion to say that a "distribution" occurs only if the distributees give "value," but this is almost surely a correct statement. Since it already has been concluded that "value" is not given by shareholders in corporate liquidation,⁵⁶ it follows that a dissolving corporation is not an "underwriter." Even if "value" were not essential to "distribution," the consequences would be slight: the unavailability of an exemption⁵⁷ from the registration requirement.⁵⁸ Registration is not required at all if, as argued earlier, no "sale" takes place because of the absence of "value."

The foregoing analysis presumes that the essential "value" must pass to the dissolving corporation as the putative distributor. But "distribution" *vel non* is a complex question to be determined by examination of the total environment. Conceivably there might be a statutory distribution because of "value" going to (a) the issuer or controlling person from whom the liquidating corporation obtained the stock, or to (b) the controlling stockholders of the liquidating corporation.⁵⁹ Or, a distribution might be discerned in the subsequent sale of the portfolio securities by the liquidating corporation's stockholders (who would thereby receive "value"). It is at least theoretically pos-

person, whether through the ownership of voting securities, by contract, or otherwise," Securities Act Rule 405, 17 C.F.R. § 230.405 (1949). For a full discussion of control concepts under the SEC statutes, see 2 Loss, Securities Regulation 764-83 (2d ed. 1961). For a general discussion of secondary distributions, see Gilchrist & Hanna, Secondary Distributions of Corporate Securities, 13 SW.L.J. 1 (1959).

⁵³ Securities Act § 2(11).

⁵⁴ We ignore the other "underwriter" definition in Securities Act § 2(11) (one who sells for an issuer in connection with a distribution) since it will rarely arise in a bona fide corporate dissolution.

⁵⁵ 1 Loss, Securities Regulation 551 (2d ed. 1961); Oklahoma-Texas Trust, 2 SEC 764, 769 (1937), *aff'd sub nom. Oklahoma-Texas Trust v. SEC*, 100 F.2d 888, (10th Cir. 1939); Ira Haupt & Co., 23 SEC 589, 597 (1946); Gilligan, Will & Co. v. SEC, 267 F.2d 461, 466-68 (2d Cir. 1959), *cert. den.*, 361 U.S. 896 (1959).

⁵⁶ Text para. C(1) *supra*.

⁵⁷ Securities Act § 4(1) 1st clause: "Transactions by any person other than an issuer, underwriter, or dealer."

⁵⁸ Securities Act § 5.

⁵⁹ An example might be the enhancement in value of their individual securities through the creation of a market for similar securities distributed from the corporate portfolio.

sible that the liquidating corporation would be party to a statutory distribution, though unwitting or unwilling.

Principles of vicarious responsibility are familiar in securities law. Areas come readily to mind where transfers by transferees affect the status of the first transferor.⁶⁰ While all of these are dependent on particular provisions not applicable to liquidations, they could easily provide precedent.

How, then, will it be possible to distinguish the legitimate from the illegitimate? The spin-off of a newly created subsidiary and the formation of a new corporation in the process of a split-up both seem to fall within the literal language requiring registration. In each case securities come from the issuer (the subsidiary, which receives "value" in the form of assets transferred) to the parent who takes with a "view" to (and in fact accomplishes) distribution to its shareholders. Rule 133⁶¹ probably shields the latter arrangement (assuming a proper plan and stockholder vote) but not the former. By contrast, a liquidating corporation might be an attractive vehicle to scatter worthless securities (paid for from corporate assets prior to dissolution).⁶² A mechanical test, such as the time the securities are held in portfolio, is hardly sufficient. The "good faith" criterion, though recently vitiated,⁶³ is bound to remain significant. The ultimate resolution perhaps lies in

⁶⁰ (a) Private Offerings. A private sale by one person is not exempt if his purchasers take with a view to (and do effect) public distribution. *Gilligan, Will & Co. v. SEC*, 267 F.2d 461 (2d Cir. 1959), cert. den., 361 U.S. 896 (1959); *Crowell-Collier Publishing Co., Sec. Act Rel. 3825* (1957). See 1 Loss, *Securities Regulation* 665-73 (2d ed. 1961).

(b) Intrastate Offerings. An intrastate sale by one person is not exempt if his purchasers take with a view to (and do effect) sales outside the state. *Brooklyn Manhattan Transit Corp.*, 1 SEC 147 (1935); *Sec. Act Rel. 4386* (1961); *Opin. of Gen. Coun., Sec. Act Rel. 1459* (1937). See 1 Loss, *Securities Regulation* 595-97 (2d ed. 1961).

(c) Rule 133 Transactions. The "no sale" theory for mergers and other reorganizations may be destroyed for the constituent corporations because their shareholders participate in or permit further distribution. *Great Sweet Grass Oils, Ltd.*, 37 SEC 683 (1957), aff'd without opinion, 256 F.2d 893 (D.C. Cir. 1958); *SEC v. Micro-Moisture Controls, Inc.*, 148 F.Supp. 558 (S.D.N.Y. 1957) (preliminary injunction), 167 F.Supp. 716 (S.D.N.Y. 1958) (final injunction), aff'd sub nom. *SEC v. Culpepper*, 270 F.2d 241 (2d Cir. 1959). Cf. *Securities Act Rule 133(b)*, supra note 35 (purchaser from stockholders for distribution is an underwriter). By *Rule 133(c)*, supra note 35, a constituent corporation is an underwriter if it takes with a view to distribution, but (as noted in the text at note 38 supra) a transfer to shareholders in complete or partial liquidation is not a distribution in this sense. Sometimes the corporation is within the Rule but its shareholders are not, *Sec. Act Rel. 3846* (1957).

⁶¹ Supra note 35.

⁶² For examples, see cases cited in note 60 supra.

⁶³ *SEC v. Guild Films, Inc.*, 279 F.2d 485 (2d Cir. 1960) ("distribution" by pledgee).

a "business purpose" test of the kind used in gauging income tax consequences of corporate reorganizations.⁶⁴

In the current embryonic stage of the law, there is not much the liquidating corporation can do with absolute confidence. It can, of course, try to avoid involvement in a "dumping" scheme. It may want to take "investment letters"⁶⁵ from some of the larger shareholders as a means of minimizing market activity in the portfolio securities. To the same end, it should probably refrain from encouraging dealers to trade in the portfolio securities after distribution, although this might frustrate a natural desire to aid the stockholders.

E. THE BLUE SKY LAWS

The multiplicity and diversity of state "blue sky" laws⁶⁶ makes it difficult to generalize about them. The trouble is compounded by the paucity of published interpretation,⁶⁷ vagueness as to persons civilly liable⁶⁸ and obliviousness to such points as secondary distributions.⁶⁹ However, the "blue sky" laws are relatively harmonious and clear in the aspect most basic to this article. Virtually all those which require some sort of securities registration condition the requirement on "sale."⁷⁰ Their definitions of sale fall into several classes:

(1) Approximately seventy *per cent* define "sale" in terms of "value." The argument that stockholders give no value in liquidation should suffice for them.

(2) Another ten *per cent* define "sale" in terms of "consideration."⁷¹ Probably these should be regarded as substantially like the "value" states.⁷²

(3) The remainder define "sale" in terms of any disposition or transfer,⁷³ or in some other manner,⁷⁴ or not at all.⁷⁵

⁶⁴ E.g., Bittker, *Federal Income Taxation of Corporations and Shareholders* 15, 323-25, 392-93 (1959); *Gregory v. Helvering*, 293 U.S. 465, 469-70 (1935).

⁶⁵ For content of investment letters, see *Israels, Some Commercial Overtones of Private Placement*, 45 *Va. L. Rev.* 851, 861 (1959); *Victor & Bedrick, Private Offering: Hazards for the Unwary*, 45 *Va. L. Rev.* 869, 873-75 (1959).

⁶⁶ Cf. *Loss & Cowett, Blue Sky Law* 17-42 (1958).

⁶⁷ Cf. *id.* at 62-86.

⁶⁸ Cf. *id.* at 135-36.

⁶⁹ Cf. *id.* at 316-17.

⁷⁰ An exception, which may be more apparent than real, is Nebraska, *Neb. Rev. Stat.* § 81-314 (1958) (sale or exchange).

⁷¹ *Conn. Gen. Stat. Ann.* § 36-265(E) (1960); *Neb. Rev. Stat.* § 81-304(2) (1958); *Ore. Rev. Stat.* § 59.030(1) (1959); *R.I. Gen. Ann.* § 7-11-1(d) (1956).

⁷² Cf. 1 *Loss, Securities Regulation* 513 (2d ed. 1961).

⁷³ *Mass. Gen. Laws Ann. ch. 110 A, § 2(d)* (1958); *Ohio Rev. Code Ann. (Baldwin 1958) § 1707.01(C)(1)*.

⁷⁴ *Mich. Comp. Laws* § 451.102(d) (1948); *Mo. Rev. Stat.* § 409.020(10) (1949) ("value" implied).

⁷⁵ *Ida., N.Y., N.H., Wyo.*

The situation in these states is cloudy. However some have exemptions which cover liquidating distributions⁷⁶ or which might be stretched to do so.⁷⁷

As a practical matter, the state problem is probably much smaller in dimension than the federal.

F. CONCLUSION

A routine liquidating distribution of portfolio securities is almost certainly not intended to require registration with the SEC or approval by the blue sky administrators, and they (or the courts) would probably so rule if faced with the problem. The potential for abuse and need for information (at which the statutes are aimed) is just not significant in dissolutions.

Nonetheless, the laws were apparently drafted with no thought for this problem. Their inapplicability can be established only indirectly. The principal reason is that they operate only if there is a sale for "value," and shareholders give none in liquidation. Two other theories are that the requisite individual action is lacking and that the transfer is only a formality recognizing the stockholders' equitable ownership of the corporate assets at dissolution.

Areas of considerable doubt remain. Distributions in satisfaction of debt have the magic "value"; so may distributions in satisfaction of liquidation preferences, although this should depend on how the distribution plan was determined. Assumption of debt by stockholders may trigger the statutes, but taking assets subject to debts seems less likely to do so. Legislative or administrative exclusion or exemption here is desirable, particularly in view of the relative frequency of debts. The most difficult questions center around "control-related" securities where the danger of abuse is greatest. This is the respect in which guidance from statutes or regulations would be most welcome. Yet it is the one for which objective tests are hardest to fashion.

⁷⁶ Mass. Gen. Laws Ann. ch. 110 A, § 3(E) (1958).

⁷⁷ E.g., isolated transactions, Mich. Comp. Laws § 451.105(c) (1948); Mo. Rev. Stat. § 409.050(3) (1949); Ohio Rev. Code Ann. (Baldwin 1958) § 1707.03(B); distributions to stockholders, Mich. Comp. Laws § 451.105(d) (1948); Ohio Rev. Code Ann. (Baldwin 1958) § 1707.03(K)(1); certain securities outstanding five years or more, Mo. Rev. Stat. § 409.050(11) (Supp. 1960).