Michigan Law Review

Volume 62 | Issue 4

1964

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Recommended Citation

Jack M. Whitney II, *Rule 10b-6: The Special Study's Rediscovered Rule*, 62 MICH. L. REV. 567 (1964).

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RULE 10b-6: THE SPECIAL STUDY'S REDISCOVERED RULE†

Jack M. Whitney II*

I. INTRODUCTION

THE Special Study of Securities Markets of the Securities and Exchange Commission, in its recently released *Report*,¹ provided an unprecedented critical analysis of issues and problem areas existing in the securities markets today. That analysis produced numerous recommendations for substantive changes in regulatory and self-regulatory laws, rules, and policies. One of the areas which, although discussed by the Special Study, was distinctive because not the subject of such a recommendation,² was that involving the regulation of trading activities during a distribution.³ The

† This article carries a date of authorship of November 1, 1963. The Securities and Exchange Commission, as a matter of policy, disclaims responsibility for any private publication by any of its members or employees. Therefore, the views expressed here are the author's own and do not necessarily reflect the views of the Commission or its staff. The author wishes to acknowledge the substantial contribution made by Mark K. Kessler, attorney in the Commission's Division of Corporation Finance, to the organization and content of this article, as well as the helpful comments and editorial assistance of Richard H. Brill, the author's legal assistant.

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¹ *Report of Special Study of Securities Markets of the Securities and Exchange Commission*, H.R. Doc. No. 95, 88th Cong., 1st Sess. (1963) [hereinafter cited as *Special Study*]. In the interest of brevity, this article assumes some degree of familiarity on the part of the reader with the pertinent characteristics of over-the-counter ("OTC") trading markets. The requisite background material may be found principally in Chapters IV, VII and VIII of parts 1 and 2 of the *Special Study*.

² It is noted, however, that certain affirmative recommendations are set forth which would flow from a Commission clarification of the applicability of Rule 10b-6. See note 57 *infra*; *Special Study* pt. 1, at 568-70.

³ The term "distribution" is used in this article almost exclusively in the context of Rule 10b-6 and of the Exchange Act anti-manipulative provisions generally. It is not necessary (nor even necessarily easy) to reconcile completely the substantive content of the term, as so used, with that of the same term as used in the context of the Securities Act of 1933. (See note 23 *infra*.) In Rule 10b-6, the term "distribution" is employed to fix the setting in which, for the protection of investors, restrictions must be imposed upon the actors in that setting, in order to prevent distortion of the market price and trading activity of the securities involved. In the 1933 Act (*e.g.*, in § 2(11) and Rules 133 and 154, thereunder), on the other hand, the term is used to facilitate a determination of whether circumstances exist such as to require the registration of securities in order to provide fair and adequate disclosure of factual and financial information on which an intelligent investment decision may be based. This accounts for the common assumption that the term, as used in the 1933 Act, is substantially synonymous with the term "public offering" which appears in § 4(1) of that act. Such, indeed, is the import of the *House Report's* statement, with respect to the 1933 act, that ". . . the Act is, in the main, concerned with the problem of distribution as distinguished from trading." H.R. REP. No. 85, 73d Cong., 1st Sess. 15 (1933). In any event, the prudent "rule of thumb" assumes that a registered 1933 Act "distribution" normally will be subject to Rule 10b-6 but that an exemption from 1933 Act registration is not determinative of the inapplicability of the rule. See discussion in text at Part II(B)(2) *infra*.

Special Study concluded that the Commission's principal rule in this area, Rule 10b-6⁴ under the Securities Exchange Act of 1934,⁵ was subject to widespread misunderstanding or uncertainty in the industry and urged the Commission to take appropriate steps to clarify the application of the rule in various enumerated situations.⁶

The rule, together with its siblings, Rules 10b-7 and 10b-8,⁷ was adopted on July 5, 1955.⁸ The body of the rule prohibits an underwriter, prospective underwriter, or other participant in a distribution, or any person on whose behalf such distribution is being made, from directly or indirectly bidding for or purchasing the securities being distributed or any other securities of the same class and series, or any right to purchase any such security, or from attempting to induce anyone else to bid for or purchase such securities, prior to or during a distribution. This is followed by eleven exceptions and several exemptive provisions as well as definitions for certain of the rule's more critical terms.⁹ Thus, the rule takes the form of a sweeping prohibition from which are carved certain categories of activities and transactions which are necessary adjuncts of the mechanics of distribution and either do not contain manipulative potential, or are insulated sufficiently to render the manipulative potential *de minimis*. It is the exceptions and the exemptions which give the rule viability and feasibility.¹⁰

Rule 10b-6 evolved from a history of regulation of practices designed to maintain artificially the market price of a security in preparation for or during a distribution of that security to the public. Congress, in 1934, was concerned about such practices as speculative pooling operations, "wash sales," and "matched orders," all of which, if employed effectively, served to exploit the public by permitting dispositions of securities at artificial prices.¹¹ These practices, of course, were to be distinguished from

⁴ 17 C.F.R. § 240.10b-6 (Cum. Supp. 1963).

⁵ 48 Stat. 881, 15 U.S.C. § 78 (1958 & Supp. IV, 1963) [hereinafter cited as Exchange Act].

⁶ See text accompanying note 30 *infra*.

⁷ 17 C.F.R. §§ 240.10b-7, .10b-8 (Cum. Supp. 1963). These rules deal, respectively, with stabilizing activities during a distribution and offerings of securities by means of rights. Although the general provisions of Rule 10b-6 would prohibit certain of these activities, the rule, in exceptions (8) and (9), specifically permits activities carried out in accordance with Rules 10b-7 and 10b-8. See 3 LOSS, SECURITIES REGULATION 1596 (2d ed. 1961).

⁸ SEC Securities Exchange Act Release No. 5194, July 5, 1955, amended, SEC Securities Exchange Act Release No. 5208, August 15, 1955.

⁹ See Appendix.

¹⁰ For a thorough discussion of the genesis and language of the rule, see 3 LOSS, *op. cit. supra* note 7, at 1595-1604; Foshay, *Market Activities of Participants in Securities Distributions*, 45 VA. L. REV. 907 (1959).

¹¹ Staff of Senate Committee on Banking and Currency, *Report Relative to Stock Ex-*

the commonly accepted "distribution pool or syndicate,"¹² which performed a stabilizing function such as we know today. Section 9 of the Exchange Act¹³ emerged from this atmosphere as the statutory prohibition against manipulation of prices of securities listed on a national securities exchange. Paragraph (a)(2) of that section was intended to curb most of the evils described above, while the regulation of stabilization practices was left to the Commission through the exercise of the rule-making power delegated to it by paragraph (a)(6). Section 10(b),¹⁴ which generally makes it unlawful to employ any manipulative or deceptive device in connection with the purchase or sale of any listed or unlisted security, is not self-executing and, with the exceptions of one abortive Commission attempt to legislate in this area¹⁵ and Rule 10b-2 with respect to distributions on a national securities exchange,¹⁶ no rule comparable to Rule 10b-6 was adopted thereunder until 1955. The heart of that portion of the Exchange Act dedicated to the OTC market, however, appeared in the broad and general terms of the original section 15,¹⁷ which was a sweeping delegation of regulatory powers to the Commission in this area.

All of this merely reflects the separate and different treatment which Congress in 1934 accorded to the exchange markets and the OTC market. While the statute was self-executing and reasonably specific with respect to the former, it was broad and delegatory in the latter in recognition of the then unexplored character of the OTC market.¹⁸

change Regulation, 73d Cong., 2d Sess. 13-15 (Comm. Print 1934); see also S. REP. No. 792, 73d Cong., 2d Sess. 7-10 (1934).

¹² *Report Relative to Stock Exchange Regulation*, *supra* note 11, at 13.

¹³ 48 Stat. 889 (1934), 15 U.S.C. § 78i (1958).

¹⁴ 48 Stat. 889 (1934), 15 U.S.C. § 78j(b) (1958).

¹⁵ The Commission, in *Barrett & Co.*, 9 S.E.C. 319, 329-31 (1941), repealed Rule X-10B-4, a rule which had been intended to carry over the prohibitions of § 9(a) of the Exchange Act to the OTC market but which never became effective. See also text accompanying note 21 *infra*.

¹⁶ Since Rule 10b-2 [17 C.F.R. § 240.10b-2 (Cum. Supp. 1963)] involves distributions using the facilities of an exchange, the subsequent adoption of Rule 10b-6 makes it plain that the latter is directed primarily at problems arising from distributions in the OTC market. For a discussion of Rule 10b-2, see 3 Loss, *op. cit. supra* note 7, at 1236-39, 1427 n.19. See also note 74 *infra*.

¹⁷ 48 Stat. 892 (1934), 15 U.S.C. § 78o (1958); see note 18 *infra*.

¹⁸ *Special Study* pt. 4, at 604. In the *Tenth Annual Report of Securities and Exchange Commission*, the Commission stated:

"In contrast to other areas in which the Commission commenced its administrative duties in June 1934, there were little or no reliable data concerning the scope or nature of the abuses to which the directives of Section 15 of the Securities Exchange Act of 1934 were intended to apply. . . . [A]s to over-the-counter markets, the legislative history of the Securities Exchange Act yields little information and sheds little light on the directives of Section 15 relating to over-the-counter regulation, beyond the obvious

Pursuant to statutory amendments in 1936 and 1938, section 15(c) emerged as the general anti-manipulative section of the Exchange Act concerning the OTC market.¹⁹ The *Report* states:

"Working first with this broad grant of power [the original section 15] and, a few years later, with an amended statute, the Commission provided for registration of broker-dealers engaging in over-the-counter transactions, the prohibition of various fraudulent practices, and the adoption of standards for recordkeeping and financial responsibility. [Footnote omitted.] With the passage of the Maloney Act in 1938 [52 Stat. 1070, 15 U.S.C. § 78o-3 (1938)], the principle of self-regulation was applied to the over-the-counter markets, and the NASD [National Association of Securities Dealers, Inc.] was formed to supervise the business conduct of over-the-counter broker-dealers. [Footnote omitted.]"²⁰

The Commission, in 1941, held that the prohibitions of section 15(c)(1) of the Exchange Act afford "to the over-the-counter market at least as great a degree of protection against manipulation or attempted control as is afforded to the exchange market by Section 9(a)."²¹ And, as is further indicated below,²² prior to 1955, those cases involving situations which presently fall within the prohibitions of Rule 10b-6 were decided on the basis of the aforementioned sections and the anti-fraud provisions of the Securities Act of 1933²³ and the Exchange Act.

It is important also to note that Rules 10b-6, 10b-7, and 10b-8 did not emerge from an atmosphere of practices calling for urgent promulgation of corrective measures. Rather, they were the result of years of Commission and industry experience with the anti-manipulative sections of the Exchange Act,²⁴ and the fraud pro-

facts that unique opportunities for abuse existed in that market and that regulation of exchange markets made necessary the regulation of counter markets, since business tends to flow from regulated to unregulated areas." 10 SEC ANN. REP. 69 (1944).

¹⁹ For a discussion of the evolution of § 15 of the Exchange Act, see *Tenth Annual Report of Securities and Exchange Commission*, *supra* note 18, at 68-72.

²⁰ *Special Study* pt. 2, at 541.

²¹ *Barrett & Co.*, 9 S.E.C. 319, 328 (1941).

²² See note 24 *infra*.

²³ 48 Stat. 74, 15 U.S.C. § 77 (1958 & Supp. IV, 1963) [hereinafter cited as Securities Act]. The basic anti-fraud provisions of this act are contained in § 17 (15 U.S.C. § 77q) thereof.

²⁴ Prior to 1955, the Commission, in situations which now would fall within Rule 10b-6, relied on such general anti-manipulative sections of the Exchange Act as § 9(a)(2), with respect to listed securities, § 15(c)(1), with respect to unlisted securities, and on anti-fraud provisions of both the Exchange Act and the Securities Act. *Adams & Co.*, 33 S.E.C. 444 (1952); *Halsey, Stuart & Co.*, 30 S.E.C. 106 (1949); *Barrett & Co.*, 9 S.E.C. 319 (1941);

visions of both the 1933 Act and the Exchange Act. They were, in large part, a codification and synthesis arrived at only after many months of consultation with industry representatives. Through this process, "the differences between the Commission's staff and industry were greatly reduced."²⁵ Whatever reservations might then have persisted in anyone else's mind, the Commission's conclusion was succinct:

"The Commission believes that these rules, which represent *a formulation of principles which have been generally followed*, will not impede the orderly distribution of securities and will afford investors protection against manipulative and deceptive devices in *situations in which the rules are applicable*."²⁶

The Commission further stated in the public release announcing the adoption of the above rules:

"The Rules adopted do not purport to cover every possible type of manipulative or deceptive activity. The fact that a particular activity is not specifically dealt with or prohibited in such rules does not necessarily mean that it is not unlawful under the Act or the Commission's other rules."²⁷

There is nothing to indicate that the Commission's position is different today. The codification of administrative policy which has been formulated on an *ad hoc* basis inevitably entails some measure of change from prior administrative practice.²⁸ Nevertheless, comparison of Commission and federal court opinions arising before and after adoption of the rule demonstrates that it was in fact "a formulation of principles which have been generally followed."²⁹ Likewise, the Commission, in its informal administrative

S. T. Jackson & Co., SEC Securities Act Release No. 4459 at 30, n. 51, June 23, 1950; SEC Securities Exchange Act Release No. 3505, Nov. 16, 1943; SEC Securities Exchange Act Release No. 3056, Oct. 27, 1941; SEC Securities Exchange Act Release No. 605, April 17, 1936. See generally, Foshay, *supra* note 10, at 910-13, and cases cited therein. The Commission, since passage of the rule, continues to consider such situations in light of other anti-manipulative provisions of the Exchange Act and the rules thereunder. See, e.g., Landau Co., 40 S.E.C. 1119 (1962) (§ 15(c) and Rules 15c1-2, 15c1-8); C. A. Benson & Co., SEC Securities Exchange Act Release No. 7044, March 26, 1963 (§ 15(c)(1) and Rule 15c1-2).

²⁵ Foshay, *supra* note 10, at 919. Such is indeed the typical result of the informal and formal processes observed by the Commission in the exercise of its rule-making powers.

²⁶ SEC Securities Exchange Act Release No. 5194 at 3, July 5, 1955. (Emphasis added.)

²⁷ *Ibid.*

²⁸ See generally 3 Loss, *op. cit. supra* note 7.

²⁹ Compare *Koepp v. SEC*, 95 F.2d 550 (7th Cir. 1938), and *Kidder Peabody & Co.*, 18 S.E.C. 559 (1945), and *Russell Maguire & Co.*, 10 S.E.C. 332 (1941), and *Barrett & Co.*, 9

interpretations since 1955, has attempted to apply principles consistent with those employed prior to the passage of the rule. If the Commission or the industry were of the view in 1954 and early 1955, while the proposed rule was being discussed among all parties expressing interest, that there was a substantial awareness and understanding of the "situations in which the rules are applicable," the basis for the Special Study's concern can only be the conclusion that such a view is not now tenable. To the extent the broker-dealer community, which must live under and with the rule—sweeping prohibition and all—is confused or ill-informed, the rule has not served its intended functions in that the protections for the interest of investors, so painstakingly developed, are not achieved, and the goal of reasonable certitude in the "rules of the game" is not within reach of the players.

An attempt either to assign responsibility for the breakdown in communication or to secure a quantitative measure of the consequences of that breakdown would be bootless. I attempt here only to pinpoint some of the areas of seeming ambiguity within the rule, and to consider them in light of a variety of situations wherein, it is hoped, the problems will become clearer and more precise, thus facilitating the consideration of whether solutions are needed and what form they should take.

II. PROBLEMS CONCERNING APPLICABILITY OF THE RULE

The *Report* identifies four situations where it has found industry "misunderstandings and uncertainties" with respect to the application of Rule 10b-6: "(a) during a period when stock is being held 'for investment' by a broker-dealer, (b) in connection with various forms of 'shelf' registration, (c) in connection with a planned reduction of inventory or 'workout,' and (d) in connection with unregistered distributions generally."³⁰

Pivotal to any question of the applicability of the rule is the question of whether a particular person is either a participant in or the beneficiary of a "distribution." This question, in turn, must be considered in the context of the variety of situations listed

S.E.C. 319 (1941), and *SEC v. Saphier*, 1 SEC Jud. Dec. 291 (S.D.N.Y. 1936), with *SEC v. Electronics Security Corp.*, 217 F. Supp. 831 (D. Minn. 1963), and *SEC v. Scott Taylor*, 183 F. Supp. 907 (S.D.N.Y. 1959), and *Landau Co.*, 40 S.E.C. 1119 (1962), and *Bruns, Nordeman & Co.*, 40 S.E.C. 652 (1961), and *Gob Shops of Am.*, 39 S.E.C. 92 (1959), and *Sutro Bros.*, SEC Securities Exchange Act Release No. 7053, April 10, 1963; *C. A. Benson & Co.*, SEC Securities Exchange Act Release No. 7044, March 26, 1963.

³⁰ *Special Study* pt. 1, at 559.

above, *i.e.*, those which involve a registered offering pursuant to the 1933 Act as well as those which do not.

A. *Situations Involving Registered Distributions*

There is no question that a "distribution" is contemplated in an underwritten offering to the public of previously unregistered securities pursuant to registration under the 1933 Act, or that there are persons "participating" or about to "participate" in that "distribution." There may be some misunderstanding, however, as to why this is so. Some persons, recognized by the rule and administrative practice as being engaged in a distribution, notwithstanding the existence of an exemption from registration under the 1933 Act for the securities which are the subject of that distribution, conduct their business as though such exempt status were a conclusive indication that a distribution is not involved for Rule 10b-6 purposes.³¹ This position has been rejected by both the courts and the Commission, which have made it clear that 1933 Act interpretations or implications are not determinative of what constitutes a distribution under Rule 10b-6.³² It is enough at this point to conclude that use of the obvious example for illustrative purposes should *not* convey any notion of exclusivity.

1. *Stock Acquired by an Underwriter in Connection With a Distribution*

It is the policy of the Commission to require that securities acquired by underwriters in connection with a public offering of securities must be included in the registration statement covering the offering, notwithstanding the underwriter's avowal of an intention to acquire the securities for investment.³³ Subsequently, should the underwriter decide to dispose of such stock in the mar-

³¹ See *id.* at 568 & n.216.

³² "It is enough if the broker or dealer is engaged in a distribution in the sense of a major selling effort in his own behalf." *Gob Shops of Am.*, 39 S.E.C. 92, 103 n.25 (1959), cited favorably in *SEC v. Scott Taylor*, 183 F. Supp. 907, 908 n.8 (S.D.N.Y. 1959).

In *Bruns, Nordeman & Co.*, 40 S.E.C. 652, 660 (1961), the Commission said that "rule 10b-6 is applicable to all distributions whether or not subject to registration under the Securities Act and whether or not the conventional procedure of utilizing an underwriter or selling group is employed. [Citing *SEC v. Scott Taylor*.] The term 'distribution' as used in Rule 10b-6 is to be interpreted in the light of the rule's purposes as covering offerings of such a nature or magnitude as to require restrictions upon open market purchases by participants in order to prevent manipulative practices. [Footnote omitted.] For these purposes a distribution is to be distinguished from ordinary trading transactions and other normal conduct of a securities business upon the basis of the magnitude of the offering and particularly upon the basis of the selling efforts and selling methods utilized."

³³ SEC Securities Act Release No. 3210, April 9, 1947.

ket, a post-effective amendment disclosing the terms of the offering is required.³⁴ Assuming that the original distribution has been successfully completed pursuant to the provisions of paragraph (c)(3)-(B)³⁵ of the rule, the question arises as to the permissible scope of activities in which the underwriter may engage during the interim period between completion of the original offering and the ultimate disposition of its stock.³⁶ There are two principal questions with which the underwriter must contend during this period:³⁷ First, may it buy and sell as principal for its own account and, second, may it solicit agency transactions in the usual conduct of its retail activities.³⁸

The rule provides a clear answer to the first question. In the case of buying as principal, exception (11) permits the underwriter, during the interim period, to conduct normal trading activities in the OTC market as principal up to and including the tenth business day prior to the proposed date of distribution, at which time it must terminate purchasing or bidding for any security of the same class. It may make unsolicited principal purchases, however, up to and including five business days preceding the distribution.³⁹ It should be noted that exception (11) does not restrict the permitted purchases and bids to the "inside" dealer market. In the case of selling as principal, exception (6) permits the underwriter to solicit retail purchase orders to be effected on a principal basis from inventory or, in the rare case, by incurring a short position.^{39a}

To place sole reliance upon this exception, however, is to assume that the prohibition of the rule has been appropriately invoked in the first place. In seeking the answer to the second question, the validity of the assumption must be faced squarely, since it must be determined whether the rule's prohibition

³⁴ It has been the practice of the Commission staff to require an undertaking that prior to any offering of such stock occurring after ninety days following the effective date of the registration statement, a post-effective amendment will be filed disclosing such current information as would be required in a new registration statement.

³⁵ See Appendix.

³⁶ The Study found that managing underwriters receiving stock or options in connection with the underwriting or in interim financing generally did not dispose of such holdings during or shortly after the original offering, perhaps because of tax considerations. *Special Study* pt. 1, at 508, 541.

³⁷ This discussion assumes (realistically, I believe) that the disposition of the stock will take the form of a public offering constituting a "distribution" under Rule 10b-6. See note 32 *supra*.

³⁸ Administrative practice construes solicitations of agency transactions to include any solicitations, by way of market letter or otherwise, not directly related to sales by a dealer for its own account.

³⁹ 17 C.F.R. § 240.10b-6, exception (11) (Cum. Supp. 1963).

^{39a} 17 C.F.R. § 240.10b-6, exception (6) (Cum. Supp. 1963).

against the solicitation of purchases on an agency basis comes into play. A matter of time is at once involved; if the underwriter has no intention of holding his stock for investment there is no problem, since the original offering and the disposition of the stock are merged in time and in fact, as well as conceptually. Consequently, no basis exists for asserting that more than one distribution is involved. Where, however, the underwriter has an express, bona fide intention to "shelve" his stock, a basis for argument arises. Underwriters claim that the requirement that such stock be registered along with the principal offering is based upon considerations arising out of the 1933 Act which are not necessarily relevant in the resolution of questions arising under Rule 10b-6. Accordingly, they argue that the rule contemplates two distributions and that solicitation of agency purchases should not be prohibited during the interim period until there is a manifest intention to dispose of such stock. They argue, further, that in those situations in which they intend to make a market for the stock, especially where the underwriter intends to hold his stock for long-term investment, it is unrealistic to differentiate between principal and agency transactions, so far as "solicitation" is concerned. Parenthetically, it goes without saying that market-making is dependent upon the existence somewhere of retail activity, which, in turn, involves some measure of merchandising or retail selling.⁴⁰ Finally, they assert that any manipulative practice would be curbed by the other anti-manipulative provisions of the Exchange Act, and the rules and regulations thereunder.⁴¹

The Special Study refers to a situation in which an underwriter, whose partners in advance had acquired investment stock in connection with an underwriting, was informed by the Commission that, during the interim period between the completion of the principal offering and the distribution of their stock, the firm could not engage in activities involving the solicitation of agency transactions but that it could engage in trading activities for its principal account to the extent permitted by exception (11). The Special Study's analysis is that the basis for this result was that

⁴⁰ As to non-integrated firms the *Report* states: "There are several possible motives for making a market. Probably of greatest significance, particularly for nonintegrated firms, is the desire of the dealer simply to profit from expected activity of broker-dealers engaged in executing buy or sell orders for public customers A trader for such a wholesale dealer expects activity to come from retail houses; when that activity falls off, he may lose interest and discontinue trading." *Special Study* pt. 2, at 563. The same basic considerations obtain, perhaps to a lesser degree, in the integrated firm.

⁴¹ For a discussion on how some firms actually do conduct operations during the investment period, especially as to soliciting agency purchases, see *id.* pt. 1, at 542-44.

there were in fact two separate distributions involved,⁴² but that the second was contemplated from the time of the original offering. It would appear to follow that the basis for the Commission's position was that the underwriter was also a "prospective underwriter" (as defined in paragraph (c)(2) of the rule), despite his assertion of investment intent, with respect to the subsequent disposition of his own stock,⁴³ and that he was to be considered as such from the time of the original offering. That basis, in turn, would appear to be dependent upon the usual prospectus disclosure that the underwriter in the original offering may be deemed to be an underwriter, for 1933 Act purposes, in the distribution of his own stock.

Ordinarily, where two distributions occur separately in time, Rule 10b-6 is considered as applying to each independently of the other, and the rule is not invoked as to the second distribution until the intention to effectuate it is manifest. If the result is different in the situation involving registration of an underwriter's stock, *i.e.*, the dispositive intention is assumed to exist at the time of the original offering rather than being dependent on a later expression of a change of intention on the part of the underwriter, there can be little question but that registration under the 1933 Act and the representations required in connection therewith tend to deprecate the underwriter's expressed intention to hold his stock for investment.

Setting aside any question concerning the merits of applying 1933 Act interpretations to a rule under the Exchange Act, the Special Study's analysis does not have smooth sailing within the rule itself. Paragraph (c)(3) of the rule defines the bases for determining when a person under the rule may be deemed to have completed his participation in a particular distribution. An underwriter, for example, completes his participation and is released from the rule's

⁴² A contrary assumption, *i.e.*, that the result was based on the belief that the entire sequence of events, including both the principal offering and the disposition of the underwriter's stock, constituted one offering, is untenable in light of the fact that the Commission, by permitting trading to resume in the interim period subject to exception (11) of the rule, implicitly recognized the existence of two distributions.

⁴³ *Special Study* pt. 1, at 545. The rule, on the surface, offers some resistance to this interpretation. For purposes of Rule 10b-6, it would be difficult to label the holder of stock acquired in connection with underwriting activities as an "underwriter" or "prospective underwriter" with respect to the distribution of such stock after it had been held for a substantial period and where other pertinent circumstances are consistent with an intention to hold for investment. Thus, if he is considered to be an "issuer," "other person on whose behalf such a distribution is being made," "broker," "dealer," or "other person" pursuant to Rule 10b-6(a)(2) and (3), the rule does not apply to such persons until the actual distribution is commenced. Administrative practice, however, has been that the rule may be applicable to an issuer or the vendor *about* to distribute securities. See Foshay, *supra* note 10, at 920-21.

application “when he has distributed his participation, and any stabilization arrangements and trading restrictions with respect to such distribution to which he is a party have been terminated.” The last sentence of paragraph (c)(3) states, “A person, including an underwriter or dealer, shall be deemed for purposes of this paragraph (c)(3) to have distributed securities acquired by him for investment.” The rule, therefore, contemplates the possibility that two distributions may occur even in the underwriter’s stock situation and pays no heed to whether such stock has been registered under the 1933 Act. To the extent that the last sentence of paragraph (c)(3) fixes only the point in time when the primary offering is completed (indeed, this was the only purpose for including in the rule the language just quoted), and does not refer to the point in time when the rule begins to apply to the subsequent distribution of the retained block of stock, there is no conflict with the Study’s analysis. The two positions, however, are anchored to opposite poles of departure in that the rule, on its face, reflects an intention to consider the two dispositions of stock as separate distributions, whereas the alleged Commission reasoning, which would hold that the firm is a “prospective underwriter” of the stock which they purport to take for investment, rests on 1933 Act considerations which tend to bridge the separation of the two distributions. Of course, as is discussed below,⁴⁴ even though the “two separate distributions” analysis might take an underwriter out from under the rule, it would not give him a *carte blanche* to engage in manipulative activity intended to benefit a disposition of his stock at some indefinite future time.

The ultimate effect of the analysis set forth by the Special Study is that the underwriter is prohibited from soliciting agency purchases throughout the period of time spanning the two distributions but that exception (11) is available for each distribution so as to permit principal transactions. This result, as suggested above, does not comply with a literal reading of the rule, and may result in inequitable treatment.

In light of the proviso to exception (11)—“[I]f none of such purchases or bids are for the purpose of creating actual, or apparent, active trading in or raising the price of such security”—it has been the administrative practice, in cases where trading activity appears to have been excessive, to extend the ten-day prohibition of the exception in order to provide a “cooling-off” period prior to the distribution. Such a procedure, of necessity, would

⁴⁴ See text accompanying notes 60, 61 *infra*.

invoke the rule as of the date such action is taken and would thus prohibit the solicitation of agency purchases for a period sufficient to insulate the market from the possible manipulative effect of such solicitation.⁴⁵ Since the Commission would be informed as to the intended date of distribution by the filing of a post-effective amendment,⁴⁶ these precautions could be taken and the rule's purposes enforced without resorting to the more harsh strictures of the position taken by the Commission in the instance cited by the Special Study.

2. *The "Sticky" Issue*

Where an underwriter in a firm commitment offering fails to distribute to the public the entire amount of shares being offered, it may choose to "eat" the unsold shares by placing them on the "shelf" for investment, terminating stabilization and trading restrictions, and then commencing trading in the security in reliance upon paragraph (c)(3) of the rule. Under these circumstances the Commission's administrative practice contemplates resumption of trading activities subject to the obvious further proviso that the unsold shares not be fed to the public through such trading operations.⁴⁷

Any activities conducted during the interim period which constitute solicitation of agency transactions would most likely be considered as being in violation of Rule 10b-6, since the same basic considerations apply in this situation as in the underwriter's stock situation cited above, with the exception that in the former instance the underwriter is more or less forced into taking an investment position with respect to the "shelved" stock, whereas in the latter it is presumed that the underwriter had entertained, *ab initio*, a bona fide investment intent as to the stock acquired by him. Although the circumstances might tend to cast doubt on the *bona fides* of the investment intent in connection with "shelving" a sticky issue, and thus provide greater support for the application of the rule than in the case involving underwriter's stock, this interpretation nevertheless is subject to the very same legal and practical difficulties.

3. *Interim Financing*

It is not unusual for investment banking firms to provide risk capital to companies well in advance of a public offering. Although an underwritten public offering for permanent financing may be something more than a gleam in the banker's eye, the shares are

⁴⁵ See text accompanying note 26 *supra*.

⁴⁶ See note 34 *supra*.

⁴⁷ See Halsey, Stuart & Co., 30 S.E.C. 106 (1949).

placed in long-term investment accounts of principals (and their associates) in the firm or in such an account of the firm itself.⁴⁸ Frequently, these shares are not registered when the time arrives for the issuer to make a public offering on the ground that such securities do not constitute stock acquired by the underwriter in connection with the public offering.⁴⁹ The Special Study found that these underwriters did not tend to distribute their investment position in the issuer during the period immediately following the completion of the public offering.⁵⁰

The obvious question, as far as Rule 10b-6 is concerned, is when the rule initially applies to the underwriter with respect to the unregistered investment stock obtained through interim financing. In those cases where no registration is required, the interim financing situation is distinguishable from the underwriter's stock situation for Rule 10b-6 purposes, in that there would be no basis for applying the rule in the former instance until an intention to distribute the investment stock is manifest. Thus, there would be no prohibition against the solicitation of agency purchases until an intention to distribute the investment stock is manifested by the registration of those shares, if required by 1933 Act concepts, or by an affirmative expression of such intention. If this result suggests some degree of inconsistency with the result in the underwriter's stock situation where, despite the registration of that stock, the underwriter's investment intention may be as bona fide as it is with respect to his interim financing holding, the answer, from the industry's point of view, may be simply that half a loaf is better than none.

In any event, if the benefits of the dichotomy are to be secured, the transaction providing the interim financing must exhibit the indicia of investment intent. An interim investment arrangement where absence of risk is evident may well be questioned.

B. *Situations Involving Unregistered Distributions*

1. *The Nature of the Problem*

A thornier problem arises when a broker-dealer accumulates a position in a particular security, as a market-maker or otherwise,

⁴⁸ The *Special Study* suggests that tax considerations play a significant part in this procedure. "[I]t can be said that it is generally to the advantage of an underwriter to establish that any stock or options received from issuers do not constitute compensation for risks assumed or services performed as underwriters, but rather are an investment undertaken by the firm or its principals, unconnected with its underwriting business" *Special Study* pt. 1, at 508.

⁴⁹ *Id.* at 542.

⁵⁰ *Id.* at 541.

and plans to dispose of such stock at some time in the near future, or when a dealer participates in a block sale or in a selling program on behalf of an institutional investor. Assuming the stock is "free stock" for 1933 Act purposes, there, nevertheless, may be a distribution involved for Rule 10b-6 purposes in the disposition of the stock.⁵¹

With respect to the inventory workout situation the *Report* states:

"Interviews with trading firms in the course of the study of the over-the-counter markets disclosed that firms frequently sold large inventory positions by means of selling effort and at the same time continued to maintain a trading market for the issues involved. One such firm indicated to the study that it had never even considered the possibility of Rule 10b-6 applying to such a situation."⁵²

On the subject of block sales, including sales on behalf of institutional investors, the *Report* states:

"In the absence of a formal underwriting agreement, however, many firms appear to regard the disposition of a block, no matter how large, as subject to no greater controls than normal trading transactions despite the fact that the disposition may have all the characteristics of a 'distribution.'"⁵³

Notwithstanding the fact that many inventory workout programs and block sales involve stock positions of the magnitude of distributions which are registered pursuant to the 1933 Act,⁵⁴ and the fact that both the courts and the Commission have interpreted the word in general terms,⁵⁵ an industry version of what constitutes a distribution for purposes of Rule 10b-6 is provided in the response of a large member firm of the New York Stock Exchange to a Special Study inquiry:

"'[A] point which in our view needs clarification under (rule 10b-6) is the meaning of the term 'distribution' as used in the rule. We believe that most members of the investment

⁵¹ Most of these distributions requiring a strong selling effort, even those involving listed stocks, are effected in the over-the-counter market, where regulatory controls by the exchange over the distribution do not apply. *Id.* at 560-64. See also note 74 *infra*.

⁵² *Special Study* pt. 1, at 546-47. The Study then refers to one firm whose practice it is to withdraw completely from the market and terminate all advisory activities and the solicitation of agency purchases six months prior to its disposition of stock acquired in connection with an underwriting, but to disregard such policy with respect to dispositions of stock positions acquired in the market. *Ibid.*

⁵³ *Id.* pt. 2, at 591.

⁵⁴ *Id.* pt. 1, at 559-60.

⁵⁵ See note 32 *supra*.

community construe this term to mean an offering registered under the Securities Act of 1933 or an "unregistered secondary," i.e., an offering which because of its size must be syndicated by the dealer handling it or handled in some other way as an organized distribution. We believe that it would be helpful if the SEC were to announce a definition of the term so that a dealer would know for certain when the restrictions of the rule are to be applied. To be helpful, the definition should be precise as to the size of the offering, number of shares, etc., and not phrased in general terms.'"⁵⁶

The quoted firm would appear to have had in mind a "rule of thumb" definition such as the Commission gave to the term "distribution" in Rule 154⁵⁷ under the 1933 Act. Of course, it must be borne in mind that one of the circumstances that permitted such certainty in Rule 154 was that other provisions of that rule effectively prevent manipulative activity in connection with the sales permitted by the rule. It would be surprising if the industry would, as the price of certainty of application of Rule 10b-6, agree that the latter rule should take on the "strait jacket" characteristics of Rule 154.

A further limitation, however, on the benefits to flow from a response to the particular industry plea quoted above arises from two related assumptions implicit in it: first, that a more specific definition of the term "distribution" will provide the certainty needed for comprehension of and compliance with the rule, and second (erroneously), that the rule does, and was intended by its framers to, contain all of the anti-manipulative regulation of trading activities at or near the time of a disposition of securities by persons interested or participating in such disposition, to the exclusion of any other applicable section of the securities laws or of the rules and regulations thereunder. Indeed, sections 10(b) and 9(a)(2) of the Exchange Act, on which this anti-manipulative rule is based,⁵⁸ can reach any "purchase or sale" rather than only the

⁵⁶ *Special Study* pt. 1, at 568.

⁵⁷ "[T]he term 'distribution' shall not be deemed to include a sale or series of sales of securities which, together with all other sales of securities of the same class by or on behalf of the same person within the preceding period of six months, will not exceed [in the case of an OTC security] . . . approximately one percent of the shares or units of such security outstanding. . . ." 17 C.F.R. § 230.154 (Cum. Supp. 1963).

For purposes of one of its recommendations, the Special Study defined "unregistered distribution" "to include the sale by any broker-dealer, as principal (including any planned reduction of inventory or 'workout') or as agent, of any block of securities of such size as to require an underwriting or selling group and/or receipt or payment of compensation exceeding normal compensation for routine (nonblock) transactions in similar securities, unless the block is sold to fewer than 25 purchasers and/or at an aggregate price of (say) \$300,000 or less." *Special Study* pt. 1, at 570.

⁵⁸ See SEC Securities Exchange Act Release No. 5194 at 3, July, 5, 1955.

situation involving a distribution. Prior to the adoption of Rule 10b-6, trading activities which the industry may believe to be outside the scope of the rule were being considered and even prohibited on the basis of other sections of the Exchange Act and the 1933 Act.⁵⁹ As Professor Loss states, "[E]xcept to the extent that the doctrine was refined with the adoption of Rule 10b-6 as a complement to the stabilization rule in 1955, all this is still true."⁶⁰

The Commission has stated the proposition forcefully: "[O]ver-the-counter manipulation of unregistered securities will continue to be—as it always has been—a violation of the common law, of Section 17(a) of the Securities Act, and of Section 15(c)(1) of the Securities Exchange Act and Rule [15c1-2] thereunder."⁶¹ Every retailing dealer must, therefore, be continuously aware of the standards by which he must test his acts and representations, whether or not he is engaged in a "distribution," however defined: Is his sales "pitch" fair, honest, and well founded? Are his activities in "the market"—the indispensable backdrop for his retailing effort—of a character consistent with the requirement that that market, too, be "fair and honest"?⁶² Both the responsibility for and the experience requisite to arrive at compliance with these standards are, first if not last, in the hands of the professional participant in the securities markets.

2. *Current Cases and Practices*

The Commission has characterized the word "distribution," as it appears in Rule 10b-6, in terms of "a major selling effort" on behalf of a broker or dealer,⁶³ and has identified as two basic factors to be considered in distinguishing a distribution from ordinary trading transactions "the magnitude of the offering" and "particularly . . . the selling efforts and selling methods utilized."⁶⁴ Nevertheless, with respect to the first factor, a federal district court has recently held that a distribution was involved where only 6,692 shares out of 150,000 outstanding shares (at least 93,308 of which were free floating shares on an intrastate Blue Sky basis) were involved in the offering.⁶⁵

⁵⁹ See note 24 *supra*.

⁶⁰ 3 LOSS, SECURITIES REGULATION 1596 (2d ed. 1961). See also note 24 *supra*.

⁶¹ Barrett & Co., 9 S.E.C. 319, 331 (1941).

⁶² Exchange Act § 2.

⁶³ Gob Shops of Am., 39 S.E.C. 92 (1959).

⁶⁴ Bruns, Nordeman & Co., 40 S.E.C. 652 (1961). See also note 67 *infra* for an application of this double standard.

⁶⁵ SEC v. Electronics Security Corp., 217 F. Supp. 831 (D. Minn. 1963). The case involved a publicly owned broker-dealer which engaged in purchasing for its own account 5,185 shares of its own stock at \$2.00 to \$2.50 per share while selling 6,692 shares,

The Commission recently held that a disposition of 860,000 shares, of a total of 10,000,000 "penny" shares outstanding, constituted a distribution for Rule 10b-6 purposes.⁶⁶ Although the number of shares involved was not insignificant, the Commission was at least equally concerned with the selling methods employed by the firm, and the publishing of daily bids in the National Daily Quotation Sheets during the distribution of the shares in 328 separate retail transactions.⁶⁷

The Special Study, in its treatment of this subject, also tended to emphasize the nature of the selling campaign that accompanied a disposition of a block of securities or an inventory workout program rather than relying on the actual number of shares being distributed. In one case cited by the Study, an integrated firm, *i.e.*, one having both retail and trading facilities, managed an underwriting of an offering which had all the earmarks of a "hot issue."⁶⁸ Immediately after the completion of the distribution, but prior to the termination of trading restrictions, the price jumped ten points. There was, however, little actual trading being done in the immediate after-market, most transactions arising from agency execution of customers' buy and sell orders. Subsequently, as the buying pressure fell off, the price began to fall and the underwriter began to make a market in the stock. Eventually, the underwriter became the only market-maker in the stock, retail buying pressure fell to a low ebb, and the underwriter was the "bucket" for all shares coming into the market. He thus acquired a long position of 13,000 shares representing an investment of over \$300,000 (the

which it had acquired at \$1.15 per share from the wife of a controlling stockholder, in 67 transactions at \$2.00 to \$3.00 per share.

⁶⁶ C. A. Benson & Co., SEC Securities Exchange Act Release No. 7044, March 26, 1963.

⁶⁷ Although the National Daily Quotation Sheets are circulated almost solely among brokers and dealers, they serve to provide a supporting basis for retail prices. The Special Study states, "The insertion of quotations may also be used to qualify a security for retail quotation on one of the NASD lists and to provide a basis for a fictitious retail price to be used in a selling campaign." *Special Study* pt. 2, at 608-09. See also *SEC v. Scott Taylor*, 183 F. Supp. 907 (S.D.N.Y. 1959); *Landau Co.*, 40 S.E.C. 1119, 1123-27 (1962); *Gob Shops of Am.*, 39 S.E.C. 92, 101-02 (1959); *Halsey, Stuart & Co.*, 30 S.E.C. 106, 126-28 (1949).

Although an application of both factors may be implicit in every case, one or the other may be emphasized in a Commission opinion. For a clear-cut application of the "dual test," see *Sutro Bros.*, SEC Securities Exchange Act Release No. 7053 at 8, April 10, 1963, where the Commission stated, "Having found that registrant was an underwriter participating in a distribution of AGR stock, it follows that the placing of bids for the stock in the pink sheets was a violation of Rule 17 CFR 240.10b-6 under Section 10(b) of the Exchange Act. [Footnote omitted.] It is clear that the offers and sales of the AGR stock were made for or on behalf of the issuer or persons in control of the issuer and the sales were the result not of unsolicited orders, but of an aggressive selling campaign of a substantial number of shares."

⁶⁸ *Special Study* pt. 2, at 583-85.

original offering involved a distribution of 436,086 shares). The firm then began a selling program and, as stated in the *Report*:

"Representatives of [the firm] testified that at this point, when the security was selling at or about the offering price, they were concerned about their long position and salesmen were told that they would be paid a larger than normal profit for sale of [the stock] to retail customers. [Footnote omitted.]"⁶⁹

The firm continued to buy shares coming into the market during this sales campaign. The selling effort produced a 10,000 share short position which was covered after the special selling effort had ended.⁷⁰

The nature of the problem in the context of the OTC market is illuminated by a comparison with the facts presented by an "exchange distribution" described in the *Report* as follows:

"In an exchange distribution member firms solicit orders with respect to the block and the offsetting buy orders are then 'crossed' on the floor of the Exchange with the block sale order. The selling price is within the prevailing bid and offer for the security in the regular auction market. The purchaser usually pays a net price and the seller pays at least the equivalent of a double commission. No public announcement is made of the distribution until it is completed, at which time the transaction appears on the tape preceded by the term 'Dist.' Salesmen receive a higher rate of compensation in making sales of the security involved in an exchange distribution than would be paid with respect to normal trading transactions. [Footnote omitted.]

"An exchange distribution often takes place through a syndicate with a manager. This is not an invariable practice and large blocks have been distributed entirely through one member firm. Thus, in 1961, Merrill Lynch, Pierce, Fenner, & Smith, Inc. (Merrill Lynch) disposed of a block of 167,174 shares of General Electric Co. for an aggregate selling price of \$12,078,359 through an exchange distribution utilizing only its own organization. A firm like Merrill Lynch, with its many branch offices, has sufficient distribution facilities that the assistance of a selling group may not be required. [Footnote omitted.]"⁷¹

⁶⁹ *Id.* at 584.

⁷⁰ This discussion, and that which follows, is not intended to treat or comment on the activities of the underwriter, and the applicability of rules other than Rule 10b-6 under the Exchange Act, in connection with the assumption of the short position and the methods by which such short position was eliminated.

⁷¹ *Special Study* pt. 1, at 562.

It is interesting to note the features common to the OTC and exchange distributions just described. Both involved (1) a substantial block (in the light of the market for the particular security), (2) an organized selling effort by a single firm, and (3) extra compensation for the sales force. Both also would fall within the definition of "distribution" provided elsewhere in the *Report*.⁷² The feature conspicuously *not* common to the two offerings is the nature of the markets "away" from the offerings. The auction market, buttressed by specialist participation, provided by the New York Stock Exchange for General Electric (which—and this is a significant addition—is one of those stocks which in some measure "sells itself"), contrasts sharply with that provided for the OTC issue. In the latter case the managing underwriter, not surprisingly, had become the principal market-maker, if not the only one. The only counterpart for the auction market-specialist combination to be found was located at his trading desk. Furthermore, absent his continuing merchandising effort at retail, the trading market could be expected to shrivel in depth and breadth.⁷³ The relevance is this: the independence of the market serving as the backdrop (more accurately, the backstop) for the General Electric exchange distribution meant that Rule 10b-6, were it applicable,⁷⁴ could have been meticulously observed.⁷⁵ The lack of independence of the trading market provided by the principal underwriter-market-maker is one of the primary targets of the prohibitions of the rule. It is not difficult to conclude that the rule, in its present form, applies literally with all its rigor to the OTC example. It is more difficult to conclude, in the light of the need for—and the needs of—the OTC market, that this result is altogether in the public interest. The Special Study offers no resolution of the

⁷² See note 57 *supra*.

⁷³ See note 40 *supra*.

⁷⁴ Rule 10b-6 contains an exemption (Exemption 10) for "[exchange] transactions effected . . . in accordance with the provisions of a plan filed by such exchange under Rule 10b-2(d) and declared effective by the Commission." Rule 10b-2 generally prohibits the payment of compensation for the solicitation of purchases in the effectuation of a distribution on an exchange but contains an exemption for transactions pursuant to a plan filed by a national securities exchange and declared effective by the Commission.

Since 1942, several exchanges, including the New York and American Stock Exchanges, have filed such plans for distributions (such as the "special offering" and "exchange distribution" plans) and such filings have been declared effective by the Commission. Each such plan, however, contains a prohibition against bids and purchases (except lawful stabilizing purchases under the special offering plan) by the parties to the arrangement.

⁷⁵ The analysis, as it applies to the General Electric example, would also apply to any distribution of a highly liquid security whether or not the prohibitions of Rule 10b-6 apply. It is in the situation where there is *not* a broad and deep market in a particular security that a distinction is made and the ensuing problems arise.

dilemma and, at this writing, the Commission has not developed one, other than in the area of stabilization.⁷⁶

The provisions of Rule 10b-6 are equally applicable, although perhaps less obviously, to the wholesale dealer who effects a distribution in the OTC market. The Special Study indicates that block sales or inventory workouts of unlisted securities⁷⁷ by a wholesale dealer, unless syndicated pursuant to a formal underwriting agreement, as stated previously, are regarded by many firms as not falling within the definition of a distribution.⁷⁸ Instances are cited wherein block sales were made either on an informal syndicated basis or by gradual workout while the wholesaler continued to quote bids and offers and to make purchases, especially when the market appeared to weaken.⁷⁹

It is apparent that, with respect to unregistered distributions, the determination as to when a distribution is being made, for purposes of Rule 10b-6, is, in the first instance, to be made by the broker-dealer himself. Since the Commission's rules require disclosure to the Commission of an unregistered offering (other than offerings pursuant to the exemption provided by Regulation A) only where stabilizing purchases are to be effected and where the aggregate offering price exceeds \$300,000,⁸⁰ it is often very difficult for anyone other than such broker-dealer to be apprised of the fact of the distribution. He must, therefore, be alert to the possibilities of the rule's application. This determination may be most difficult in the situation where trading activities result in a long position materially larger than normal. However, in most other cases, he is usually aware of the fact that the disposition is out of the regular course of events. In such

⁷⁶ 17 C.F.R. §§ 240.10b-7, .10b-8 (Cum. Supp. 1963).

⁷⁷ Block sales and other distributions of securities on the exchange are closely regulated by the provisions of the "exchange distribution" plan or "special offering" plan, whichever controls. See note 74 *supra*. Such distributions of listed securities made off the exchange but which involve the participation of stock exchange member firms are not subject to any regulation by the exchange although the permission of the exchange must be secured by such participating member firms. See New York Stock Exchange Rules 393-395. Rule 10b-6, however, still applies. Note also that exception (11) applies only to OTC transactions. The activities of the specialists likewise are regulated by the exchange and the prohibition of Rule 10b-6. See generally *Special Study* pt. 1, at 560-63; *id.* pt. 2, at 292.

⁷⁸ See text accompanying notes 39, 53 *supra*. With respect to block sales by institutional investors through the primary market-makers and the possible disregard of Rule 10b-6, see *Special Study* pt. 1, at 568 n.216. See generally *id.* pt. 2, ch. VIII-C.

⁷⁹ *Id.* pt. 2, at 591-92.

⁸⁰ Exchange Act Rule 17a-2(a), 17 C.F.R. § 240.17a-2(a) (Cum. Supp. 1963). See also Exchange Act Rules 15c1-4, 15c1-6, 17 C.F.R. §§ 240.15c1-4, .15c1-6 (1949) for other related requirements.

situations where extra commissions or other incentives are employed, or a dealer selling group is formed while trading activities continue, the broker-dealer would appear to have taken himself out of the realm of normal trading activities. As a matter of prudence, he can resolve his doubts by assuming that the rule applies. He can then observe the provisions of exception (11) by discontinuing bids and purchases, in addition to his discontinuance of solicitations, for the requisite ten-day period before proceeding with his selling effort. The "unexpected" block distribution situation must be distinguished. Since the dealer cannot anticipate the occasion for the special selling effort, he is clearly not a participant in a distribution until the business is presented to him. By reason of the circumstances, the block seller may proceed at once to his selling effort without any requirement that he observe the ten-day "cooling-off" period.

APPENDIX

Rule 10b-6

Prohibitions Against Trading by Persons Interested in a Distribution.

(a) It shall constitute a "manipulative or deceptive device or contrivance" as used in section 10(b) of the act for any person,

(1) Who is an underwriter or prospective underwriter in a particular distribution of securities, or

(2) Who is the issuer or other person on whose behalf such a distribution is being made, or

(3) Who is a broker, dealer, or other person who has agreed to participate or is participating in such a distribution,

directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange, either alone or with one or more other persons, to bid for or purchase for any account in which he has a beneficial interest, any security which is the subject of such distribution, or any security of the same class and series, or any right to purchase any such security, or to attempt to induce any person to purchase any such security or right, until after he has completed his participation in such distribution: *Provided, however,* That this rule shall not prohibit (1) transactions in connection with the distribution effected otherwise than on a securities exchange with the issuer or other person or persons on whose behalf such distribution is being made or among underwriters, prospective underwriters or other persons who have agreed to participate or are participating in such distribution; (2) unsolicited privately negotiated purchases, each involving a substantial amount of such security, effected neither on a securities exchange nor from or through a broker or dealer; or (3) purchases by an issuer effected more than forty days after the commencement of the distribution for the purpose of satisfying a sinking fund or similar obligation to which it is subject; or (4) odd-lot transactions (and the off-setting round-lot transactions hereinafter referred to) by a person registered as an odd-lot dealer in such security on a national securities exchange who offsets such odd-lot transactions in such security by round-lot transactions as promptly as possible; or (5) brokerage transactions not involving solicitation of the customer's order; or (6) offers to sell or the solicitation of offers to buy the securities being distributed (including securities or rights acquired in stabilizing) or securities or rights offered as principal by the person making such offer to sell or solicitation; or (7) the exercise of any right or conversion privilege to acquire any security; or (8) stabilizing transactions not in violation of Rule 10b-7; or (9) bids for or purchases of rights not in violation of Rule 10b-8; or (10) transactions effected on a national securities exchange in accordance with the provisions of a plan filed by such exchange under Rule 10b-2 (d)

and declared effective by the Commission; or (11) purchases or bids by an underwriter, prospective underwriter or dealer otherwise than on a securities exchange, 10 or more business days prior to the proposed commencement of such distribution (or 5 or more business days in the case of unsolicited purchases), if none of such purchases or bids are for the purpose of creating actual, or apparent, active trading in or raising the price of such security. In the case of securities offered pursuant to an effective registration statement under the Securities Act of 1933 the distribution shall not be deemed to commence for purposes of this clause (11) prior to the effective date of the registration statement.

(b) The distribution of a security (1) which is immediately exchangeable for or convertible into another security, or (2) which entitles the holder thereof immediately to acquire another security, shall be deemed to include a distribution of such other security within the meaning of this rule.

(c) The following shall be applicable for the purposes of this rule:

(1) The term "underwriter" means a person who has agreed with an issuer or other person on whose behalf a distribution is to be made (A) to purchase securities for distribution or (B) to distribute securities for or on behalf of such issuer or other person or (C) to manage or supervise a distribution of securities for or on behalf of such issuer or other person.

(2) The term "prospective underwriter" means a person (A) who has agreed to submit or has submitted a bid to become an underwriter of securities as to which the issuer, or other person on whose behalf the distribution is to be made, has issued a public invitation for bids, or (B) who has reached an understanding, with the issuer or other person on whose behalf a distribution is to be made, that he will become an underwriter, whether or not the terms and conditions of the underwriting have been agreed upon.

(3) A person shall be deemed to have completed his participation in a particular distribution as follows: (A) The issuer or other person on whose behalf such distribution is being made, when such distribution is completed; (B) an underwriter, when he has distributed his participation, including all other securities of the same class acquired in connection with the distribution, and any stabilization arrangements and trading restrictions with respect to such distribution to which he is a party have been terminated; (C) any other person, when he has distributed his participation. A person, including an underwriter or dealer, shall be deemed for purposes of this paragraph (c) (3) to have distributed securities acquired by him for investment.

(d) The provisions of this rule shall not apply to any of the following securities: (1) "Exempted securities" as defined in section 3(a)(12) of the act, including securities issued, or guaranteed both as to principal and interest, by the International Bank for Reconstruction and Development; or (2) face-amount certificates issued by a face-amount certificate company, or redeemable securities issued by an open-end management company or a unit investment trust. Any terms used in clause (2) of this paragraph (d) which are defined in the Investment Company Act of 1940 shall have the meanings specified in such act.

(e) The provisions of this section shall not apply to any distribution of securities by an issuer to its employees, or to employees of its subsidiaries, or to a trustee or other person acquiring such securities for the account of such employees, pursuant to (1) a stock option plan involving only "restricted stock options" as defined in section 421 of the Internal Revenue Code; or (2) a savings, investment or stock purchase plan providing for both (A) periodic payments (or payroll deductions) for acquisition of securities by participating employees and (B) periodic purchases of the securities by participating employees, or the person acquiring them for the account of such employees.

(f) This rule shall not prohibit any transaction or transactions if the Commission, upon written request or upon its own motion, exempts such transaction or transactions, either unconditionally or on specified terms and conditions, as not constituting a manipulative or deceptive device or contrivance comprehended within the purpose of this rule. 17 C.F.R. § 240.10b-6 (Cum. Supp. 1963).