

ADDRESS

of

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You all know that the broad legislative purpose of the Securities Act of 1933 is to bring about a fair disclosure of the facts essential to the appraisal of a security. The solution of the problem of compelling disclosure does not depend alone on the existence of legal remedies. Legal remedies do not operate automatically. The accomplishments of this legislation, as is true with all legislation, will in large part be determined by the caliber of the Commission's personnel and the methods by which their efforts are organized and directed. It is my purpose this afternoon to present to you a survey of the methods and principles developed and applied by the Commission, with particular reference to mining securities, in the course of its administration of the Securities Act.

The Commission has authority to prescribe the form or forms in which the information required by the Act shall be given, including the power to prescribe methods to be followed in accounting and appraisal matters, and to make rules defining accounting, technical and trade terms. Certain sanctions have been set up in the Act to assure the correctness and validity of the information submitted. A wilful misstatement or concealment of any material fact is made criminal. Likewise the Act provides to the purchaser of every registered security for an untrue or misleading statement in a registration statement a civil remedy against the issuer, the underwriter, certain of the officers, all the directors, and every expert who has, with his consent, been named as having prepared the part of the registration statement with respect to which part an untruth or omission is claimed.

Additional provisions in the Act authorizing the Commission to issue an order refusing to permit the registration statement to become effective if, on its face, it is inaccurate or incomplete in any material respect, or to issue a stop order suspending its effectiveness if it contains untrue statements of material facts or omits required information, or information without which that given is misleading, tend to give integrity and reliability to the information supplied by a registrant.

Descriptions of the forms of administration too often operate to obscure and blur the realities. The examination of a registration statement is more than a mechanical check of formal requirements. It is rather an analysis of the sharpness and distinctness of the picture presented against the background of formal requirements; the examination process converts procedural requirements into effective administrative devices.

Mining issues have been registered since the Act became effective on Form A-1, a general form for the use of all issuers for which another form is not specifically prescribed. Broadly speaking, this form calls for information concerning the nature of the business the issuer is engaged in, or intends to engage in, the type and amount of securities to be issued and the gross and net proceeds to be derived from their sale, all expenses chargeable against the proceeds including underwriting expense, payments to promoters, directors, officers and principal stockholders, and the nature of the consideration for such payments, the statement of any facts which might diminish confidence in any information furnished by an expert or subject such information to a closer scrutiny

and examination, and facts which reveal an interest of any person related to the corporation in a transaction consummated within a given time prior to the filing of the registration statement or to be executed by use of all or any portion of the proceeds from the sale of the securities registered. A survey of the facts presented in particular cases and the conclusions expressed by the Commission, either in a letter of deficiency or a formal opinion in a stop order proceeding, reveals the nature and extent of the information and the manner of presentation of such information deemed by the Commission to be essential as a basis for an informed judgment as to the securities of a person engaged in the business of mining.

The nature and character of the property of an issuer of mining securities, including that already possessed and that to be acquired out of the proceeds of the security registered, must be disclosed. Without minimizing the importance of other factors, it may be said that the nature and character of the mining property itself are of fundamental importance to the investor. There are no specific requirements as to the extent of the information which must be given; the degree of development of the particular property shapes the limits of the requirement. The extent of information available varies from property to property. The Commission insists that some information concerning the property be included in the registration statement and prospectus, the amount of information to be given necessarily being dependent upon the extent to which observation, sampling and measurement of the ore bodies are possible. The Commission in its opinion in the matter of Snow Point Mining Company, held that the statement of a construction and equipment program with no adequate description of the mining property itself left an investor who had read the prospectus with a misleading impression of the true nature of the enterprise. In stating the average value of the mineral content of a vein, the statement must rest upon a sampling program executed in accordance with accepted practices and methods of computing the average value of ore bodies. Consequently, an average obtained by methods which do not take cognizance of the quantities of material represented by each sample entering the average is held to be misleading and inaccurate.

Frequently in a mining venture the complete execution of a given program depends upon the outcome of the earlier stages of operations. For instance, an issuer seeking funds for exploration, development and equipment of the properties will carry out its development and a large part of its equipment program only if the exploration work indicates ore bodies of a size and quality suitable to profitable mining operations. The Commission takes the view that under such circumstances a statement of a mining program is faulty unless it recognizes the possibility of unfavorable results in the initial stages, which would, of course, assuming sincerity on the part of the management, cause the proceeds to be used for other purposes than those stated.

Frequently in mining ventures it is likewise true that a specific minimum amount will be required to set the enterprise in motion, and if anything less than that amount is raised through the financing, the stated objects cannot be carried out. The Commission requires in all

registrations of mining issues that the priority of application of the proceeds to each of the individual purposes be stated, together with a statement concerning the disposition of any balance remaining which, because of unfavorable exploratory results, will not be used for the purposes stated, and, in those instances where execution of the program outlined depends upon raising a certain minimum amount, that that fact be clearly stated so that an investor may realize that this is a hazard peculiar to the particular undertaking.

One issuer of mining securities proposed to raise \$750,000, of which \$150,000 was payable as underwriting commission. The balance, \$600,000, except for a small amount to be used in payment of certain expenses of the issue, was to be expended in exploration, development and equipment of the properties. An itemized statement was set forth in the registration statement and prospectus specifying in detail the uses to which the \$600,000 was to be put. The picture created showed in broad outline a cow pasture growing into a thriving mining operation. A hearing was held and evidence was adduced establishing that the issuer owned a quite extensive area in the Rice Lake District in Canada. Shallow test pits and shafts had been sunk at irregular intervals along the outcrop of several veins on the properties. The sampling of these exposures was irregular, and no attempt had been made, nor indeed could one have been successful, to correlate the data reflecting the assay results of this sampling. Nevertheless the issuer stated in minute detail each use to be made of the proceeds. The Commission took the view that no mining engineer could, in the unexplored and undeveloped state of the property, so perfectly and precisely allocate particular amounts to specific purposes. The treatment accorded this registration statement is an excellent illustration of the application of the requirements of fair disclosure. The Commission does not require the manufacture of facts, and if the registrant is seeking money from the public for which it has no present use, the truth of the situation demands that he say so. An investor's conduct may be guided by the knowledge that he is writing a blank check. This registration statement was subsequently amended to show that the issuer's purchasing program was based upon a favorable outcome of each of the steps, and, in the event that the results of any of the successive steps demonstrated that it was useless or unprofitable to go further with the venture, the issuer would call a stockholders meeting to determine the disposition of the remaining proceeds.

The Commission recognizes that uncertainty in the extensions of ore deposits is an inherent feature of the business of mining. It takes the position, however, that a distinction may be drawn between that basic, measurable worth of ore-bodies which have been developed to such an extent that their tonnages and metal contents can be estimated within reasonable limits and the possible extensions of those ore-bodies which are in an undeveloped state. To this end it has adopted the classification of ore-bodies as "proven", "probable" and "possible", terms familiar to mining engineers, agreeing that the ore reserves of a mine are to be considered as comprising its proven and probable ores, and that the possible ores are those to which no significant tonnages or values can be attached in numerical terms. If proven or probable ores are to be described in the registration statement, the Commission considers it to be its function to so criticize the data underlying those claims that, in the absence of direct fraud, adequate assurance will be had that those ore reserves may be reasonably supposed to exist.

Information is required concerning any purchases of property within two years by the issuer from officers, directors, underwriters and principal stockholders, in brief, those persons who could exercise an influence or control over the issuer not ordinarily exercisable by a vendor of property. Any colorable relationship of the vendor to the issuer induces the investor to a sharper and stricter scrutiny of the entire transaction. The Commission in these cases requires that the cost be segregated as to each item or portion of consideration given to the issuer. That amount which the promoters or persons related to the issuer are out of pocket, not reasonably attributable to the subject matter of the conveyance, may not be included in the statement of cost. In illustration of this point is the Commission's action with respect to the statement of cost appearing in a particular registration statement purporting to be the cost to the promoter of a lease and option subsequently assigned by him to the issuer. The cost was stated to be \$17,000. Evidence adduced at a stop order hearing in this matter disclosed that this statement of cost included amounts for travelling expenses incurred in trips around the country in search of an underwriter for the securities registered, and more than \$4,000 as a fee for the preparation of the registration statement. The Commission held that these amounts were not properly included in the statement of cost of the lease and option, pointing out in its opinion that the inclusion of these amounts operated to conceal the true disparity between the amount paid by the promoter and the amount for which he transferred the same property to the corporation.

The Act contemplates that certain of the information in the registration statement and prospectus may be furnished by an expert. In the case of mining companies, the expert is often a mining engineer. The various forms adopted under authority of the Act require that the interest of any expert upon whose authority a statement is made, or whose expert opinion is used in connection with a registration statement, be revealed, and a full explanation of the circumstances given. Although the existence of an interest does not of itself vitiate information based upon an expression of the interested expert, it is a fact which, taken together with other facts revealed in the registration statement, aids in a more accurate judgment of the venture.

It is patent that all the information in the registration statement cannot be based upon expert opinion or knowledge. The determination of what information may be given upon the authority of an expert and what information must be supplied by the issuer itself is a matter of a day-to-day routine of examination of registration statements. Assuming that the subject matter covered by the expert is of a type or kind properly susceptible of treatment by an expert, what are the standards set up by the Commission by which the validity and accuracy of the expert's conclusions will be tested, in so far as a test or standard has been created in the administration of mining statements? The Commission, in an early opinion, stated that valuations contained in an appraisal purporting to follow certain norms, are representations that these norms have been accurately and fairly followed. If the norms purported to be followed are not fairly observed, the valuations finally arrived at are in essence misrepresentations of facts because they untruthfully describe the basis upon which the valuations are made. In another opinion the Commission held that a mining engineer's report on ore bodies which neglected fundamental principles of scientific method and disregarded obvious and known facts and also disregarded the standards he expressly or impliedly purported to follow constituted a

misrepresentation of fact. Thus it becomes clear that the Commission will, in connection with any report prepared by an expert, insist that the conclusions expressed in the report be based upon an exercise of technique and procedure common among the class with which he identifies himself as expert. It will be noted that in both these cases the Commission criticized the report on the ground that the method impliedly followed in reaching conclusions had not, in actuality, been followed. The Commission's action in these two cases represented a challenge of both the method and result of the appraisals.

A variation of the Commission's action with respect to experts is represented by its opinion in the matter of the registration statement of La Luz Mining Corporation. The registration statement in that case included a report by one Professor Haas, described by registrant as a scientist and geologist of world-wide renown, and the inventor of the "mineral indicator". While no thorough-going description of the mineral indicator was set forth in the registration statement, it turned out at the hearing subsequently called that the mineral indicator was a cylinder suspended from a leather thong, by which the professor claimed to be able, with uncanny accuracy and precision, to estimate the length, depth, width and average value of mineral veins. It appeared that the professor had been a horticulturist until ten years before the date of the hearing, at which time he discovered and constructed his mineral indicator. Two expert witnesses produced by the Government testified that the professor's mineral indicator fell within the class of devices known as "doodle bugs", and both were quite positive that this method of prospecting for ore-bodies was ridiculous. The Commission, in its opinion, characterized the method as ludicrous, but did not pass upon the qualifications of Professor Haas in the matters in which he was held out as an expert. There was no room for criticism of Mr. Haas for deviation in application of recognized "mineral indicator" principles as Mr. Haas, being discoverer of this method of locating and evaluating ore bodies, unquestionably adhered to the standards of his own creation.

These three opinions taken together establish that the conclusions of value reached by an expert may be challenged by the Commission either because the method is unsound or because of failure to adhere to norms impliedly followed, or, aside from principle and method, because the result expressed is inaccurate. It is only inferentially that the Commission has, through these opinions, passed upon and expressed an opinion as to the qualifications required to be possessed by an individual before he may be held out as an expert. The whole opinion of the Commission in La Luz is to the effect that, regardless of the knowledge and abilities which Professor Haas might have applied in observing and reporting upon the issuer's properties, the principles which he applied and the methods which he followed in reaching conclusions as to value were ludicrous. It may be said that the Commission indirectly ruled in this opinion that one who holds himself out as an expert must demonstrate the possession of knowledge and skill similar to that possessed by experts of the class with which he associates himself, and exercise judgment upon the basis of the application of that knowledge and skill to the facts presented for consideration.

Where independence is not required, the Commission insists that the interest of any expert upon whose authority statements are made, or whose opinion or report is used in connection with the registration statement and prospectus, be disclosed and the circumstances of such interest fully revealed. The breadth which the Commission gives to this requirement is illustrated by its opinion in the matter of the registration statement of Plymouth Consolidated Gold Mines, Ltd. In that case the report of a particular mining engineer was filed with the registration statement. The material contained in the registration statement and the evidence adduced at a hearing held in this matter established that the engineer whose report was used had been, at the time the report was drawn up, an employee of the predecessor of the issuer, and it further appeared from the evidence that this engineer was hopeful of obtaining employment with the issuer when and if its properties were put into operation. The Commission ruled that disclosure of these facts was within the ambit of disclosure called for by the item.

In addition to the requirement that an engineer, in examining and reporting upon property, must adhere to norms impliedly followed, and the methods used be reasonably adapted to the matter presented, the Commission has set up an additional requirement that the expert after the formation of an opinion must present it in such form that the layman may be able to appreciate the nature of the undertaking, and the expert may be advised of the facts from which the soundness of the observations and the conclusions drawn therefrom may be judged.

The cumulative effect of all the transactions of the issuer, including those by which it has obtained its property and issued its stock, is reflected in the financial statements and supporting schedules. If the valuation of assets rests upon purported cost, the statement of cost may not include any stock issued and simultaneously donated back even though under the applicable state law the effect of such a transaction is to render the shares fully paid and non-assessable, and a surplus which owes its existence to a concurrent donation is deemed to be fictitious. Likewise, it is deemed to be misleading to state as cost of an asset, the aggregate par value of the stock issued in exchange for such asset when the stock was selling currently below par. If the figure at which such assets are shown rests upon a valuation, the valuation must have been conducted in accordance with accepted methods, and the resulting figure attributed to value be accurate within the limits of variation allowed for a reasonable difference of opinion among experts. A mining engineer's opinion as to "prospective value" affords no scientific basis for actual valuation of the property at the time of acquisition by the registrant, and may not be used to indicate the value of the consideration paid for the property and thus permit its entry as a cost figure.

The exact consideration received for stock issued or money paid must be stated on the balance sheet. Quite commonly the issuer on the basis of a resolution of its board of directors reflects as a single transaction on its balance sheet what in actuality is a result brought about by reasons, motives and considerations entirely outside the scope of any recitations contained in the resolution. The Commission refuses to permit a resolution of the board to obscure or distort the truth of what has transpired and what is transpiring. A resolution of the board of directors

of the issuer establishes only that the board of directors has acted in a particular manner and to a particular end, but is not conclusive of the truth of its contents. In its opinion in two cases the Commission has pointed out a discrepancy which existed between the action purported to have been taken by the issuer's board of directors and the description of the board's action contained in the financial statements. The Commission found that neither of these representations was accurate concerning the subject matter covered in view of the evidence that in both cases the shares of stock involved were issued, not in exchange for any particular assets or services, but in execution of a pre-incorporation agreement between the promoters as to the division of such stock.

Although the existence of a colorable relationship does not of itself establish that the issuer did not receive fair value in the execution of such transactions, its existence is a material element to be considered in exercising judgment as to the validity of the whole. As a first step in compelling disclosure of relationship the Commission required that there be shown, on the face of the balance sheet, the relationship of the various individuals to the corporation, which, in many instances, resulted in revealing that vendor and purchaser were, in actuality, the same persons; that is, the promoters or officers by whom the particular asset had been transferred likewise constituted a majority of the board of directors of the issuer.

It is a common practice of registrants to represent that a certain number of shares has been issued to promoters solely in exchange for identifiable, tangible assets. Frequently it appeared to the Commission that there was included in such a transaction payment not only for the tangible assets but for a variety of things for which the promoter might or might not legitimately claim compensation. Thus, shares given in exchange for promotional services, or in execution of a contractual arrangement between the promoters prior to the organization of a corporation, must be identified as such and carried on the balance sheet under the appropriate designation. As a consequence the investor is enabled to determine the amount the corporation is out of pocket for its physical assets and promotional services, and the amount out of pocket as gifts to the promoters.

The Commission has been engaged for some time in the preparation of a form specifically adapted to the registration of securities to be issued by a person engaged in the exploitation of a mineral deposit. The proposed form, known as A-0-1, consolidates the experience of the Commission in three years of administration of the Act, supplemented by the criticism and suggestions of various mining engineers and persons engaged in the mining business. The information called for is of such a character that the investor will have a reasonable chance of distinguishing between those issuers who are engaged principally in stock selling and those who are interested in developing and exploiting a mineral deposit. This form also calls for information from which the investor will be able to perceive the familiarity or lack of familiarity of the issuer with its own property, and be able further to appraise, to a reasonable extent, the competence of the management and the prudence of its proposed operating program. In general, it may be said that the information called for does not exceed in

extent or character information which will be available to the ordinary competent mine management. The descriptive data required is nothing more than a reasonably competent management collects from day to day and has available for its own guidance in conducting operations. The extent of information required concerning the property depends on the claims of the issuer as to the existence of proven or probable ore. If proven or probable ore is claimed, the registrant must furnish adequate data to support that claim. Similarly, if special value is claimed for a property due to its proximity to some other property, adequate data setting forth the basis of that claim is required.

The dual purpose of protection to sincere enterprises and protection to investors is the aim of the Commission, and it hopes that a great step in those directions will be accomplished by the new form.