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Securities—Withdrawal of Registration by Applicant Under Section 15 (a) of the Securities Exchange Act of 1934.—Peoples Securities Company v. S.E.C.

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the traditional repair-reconstruction principles of the dissent, but found reconstruction a reviewable mixed question of law and fact and on application of the principles found repair.[53]

The opinion of the majority of the Court doubtlessly reflects the general attitude of the Court to the patent system. In recent years the Court has been more sympathetic to the policy of the antitrust laws than tolerant of the inherent monopoly of the patent system. The doctrine of contributory infringement has been gradually weakened[54] until *Mercoid v. Mid-Continent* ostensibly declared that it no longer existed.[55] The undermining of the *General Electric* rule that allowed a patentee to control his licensee's resale price,[56] by *Cummer-Graham Co. v. Straight Side Basket Corp.*,[57] and *United States v. Line Material Co.*[58] and the intimations that abuse of the patent right is per se violative of the antitrust laws,[59] are indicative of the Court's narrow view of the patent grant.[60]

Thus the rationale of the present Court is but a further step in a continuing judicial attitude on the part of the Supreme Court.

NEAL E. MILLERT

Securities—Withdrawal of Registration by Applicant Under Section 15(a) of the Securities Exchange Act of 1934.—*Peoples Securities Company v. S.E.C.*[1]—Peoples Securities was incorporated under the laws of Texas for the purpose of underwriting a proposed $100,000,000 offering of shares of American Provident Investors Corporation. Pursuant to section 15(a) of the Securities Exchange Act of 1934[2] petitioner applied for registration as a broker and dealer in securities. After several postponements of the effective date of registration by the Commission with the consent of Peoples, the Commission, in accordance with section 15(b) of the Exchange Act,[3] issued notice of public administrative proceedings to determine whether the application should be denied because of alleged violations of the act.

In an effort to quash the inquiry, Peoples made several motions to cancel

[53] Supra note 1, at 362.

[54] Henry v. A.B. Dick Co., 224 U.S. 502 (1912); Motion Picture Patents Co. v. Universal Film Co., 243 U.S. 502 (1916); Carbice Corp. v. American Patents Development Corp., 283 U.S. 27 (1931); Morton Salt Co. v. G. S. Suppiger Co., 314 U.S. 488 (1942).

[55] Supra note 44, at 669.

[56] United States v. General Electric Co., 272 U.S. 476 (1926).

[57] 142 F.2d 646 (5th Cir. 1944), cert. denied, 323 U.S. 726 (1944).

[58] 333 U.S. 287 (1948).

[59] See Schueller, The New Antitrust Illegality Per Se: Forestalling and Patent Misuse, 50 Colum. L. Rev. 170, 184-95 (1950); Note, 64 Harv. L. Rev. 626 (1951).

[60] This conclusion is a paraphrase of the concluding paragraphs of Note, Contributory Infringement & Misuse—The Effect of Section 271 of the Patent Act of 1952, 66 Harv. L. Rev. 909-18 (1953). It seemed singularly appropriate.

[1] 289 F.2d 268 (5th Cir. 1961).

[2] 48 Stat. 895 (1934), as amended, 15 U.S.C. § 780(a) (1958).

[3] 48 Stat. 895 (1934), as amended, 15 U.S.C. § 780(b) (1958).

or withdraw its application for registration, one of which was based upon the fact that Peoples had since become legally dissolved as a corporation. Each was denied by the Commission. The Commission continued the hearings and found that Peoples should be denied an application for registration because of willful violations of the statute[4] in that there were false and misleading statements of material facts in petitioner's application and in two additional amendments thereto. These findings are not contested. There were no outstanding holders of American Provident Investors Corporation's stock. Petitioners sought review of the Commission's order. HELD: Petitioner's motion for withdrawal of its registration for application and dismissal of the inquiry was correctly denied.

There are serious disadvantages that accompany an order disallowing an application for registration as a broker and dealer. Section 15A of the Exchange Act[5] includes provisions for a limited amount of self-regulation of dealers and brokers engaged in over-the-counter sales of securities. This section provides for the formation of national associations of dealers with a purpose of supervising the conduct of their members under Commission scrutiny. At present the National Association of Securities Dealers, Inc., (N.A.S.D.) is the only association registered with the Commission under the aforementioned section. The section also provides that the association may stipulate that its members are precluded from dealing with non-members on the same basis as they deal with each other, but, rather, must trade with such non-members as with the general public.[6] The N.A.S.D. adopted this provision. It is obvious that membership in the Association has strong economic advantages since the members may sell at reduced rates and on different terms among themselves whereas they are not allowed to do so with the public generally. A further provision of section 15A[7] prohibits the admission into a national association of any dealers or brokers who are the subject of an order denying registration as a broker under section 15(b) of the Exchange Act.[8] If, therefore, a registrant were able to halt the proceedings on the question of the acceptance of its application prior to a final determination by the S.E.C., it would still be eligible for membership in the N.A.S.D. and be able to reap the advantages such membership brings.

The Court was faced with two major problems. Initially, it had to contend with a 1936 decision by the Supreme Court seemingly *contra* and, secondly, with the proper interpretation of certain sections of the Exchange

[4] Ibid. The section empowers the Commission, after appropriate notice, to deny registration to any dealer or broker if such denial is found to be in the public interest. The basis for denial depends upon whether the broker, dealer, or any controlling person therein has (1) issued or caused to be issued any false or misleading statements in the application itself or in supplemental documents, (2) has been convicted of a crime involving securities transactions within the past ten years, (3) is presently, permanently or temporarily enjoined from engaging in securities transactions, (4) has wilfully violated any provisions of the Exchange Act or the Securities Act of 1933.

[5] 52 Stat. 1070 (1938), 15 U.S.C. § 78o-3 (1958).

[6] Id. at (i).

[7] Id. at (b) 4.

[8] Supra note 3.

Act. In *Jones v. S.E.C.*[9] involving the registration procedure under the Securities Act of 1933,[10] the majority of the Supreme Court, speaking through Mr. Chief Justice Sutherland, emotionally denounced the administrative process,[11] holding that an applicant's right to withdraw is absolute when conditions are such that no interests will be affected other than his own.[12] Petitioner there had filed an application for registration but, when the Commission ordered an investigation before the effective date of said application, moved to withdraw it. The Court, analogizing the petitioner to a plaintiff in equity, stated that he had the unqualified right to dismiss his complaint unless some plain legal prejudice would result to the defendant other than the mere prospect of a second suit upon the same subject matter.[13] As in the principal case, there were no holders of outstanding shares of the class of stock involved in the registration statement. The *Jones* case received its share of unfavorable criticism,[14] but, nonetheless was often cited as precedent for an absolute right of withdrawal of a registration application or for a cancellation of an already effective registration statement.[15]

However, the *Jones* case has been sufficiently encroached upon by both Commission ruling and court opinions to leave its continued validity as a precedent seriously in doubt. Whenever there were outstanding shares of the securities under consideration sufficient public interest was found to preclude an absolute right of withdrawal.[16] For example, in *Columbia General Investment Corp. v. S.E.C.*,[17] the court had an opportunity to deal with this

[9] 298 U.S. 1 (1936).

[10] 48 Stat. 78 (1933), 15 U.S.C. § 77f (1958).

[11] Supra note 9, at 23-25.

[12] Id. at 22-23. Therein the Court states:

"In this proceeding, there being no adversary parties, the filing of the registration statement is in effect an ex parte application for a license to use the mails and the facilities of interstate commerce for the purposes recognized by the act. We are unable to see how any right of the general public can be affected by the withdrawal of such an application before it has gone into effect. Petitioner emphatically says that no steps had been taken looking to the issue of securities, and this is not denied. So far as the record shows there were no investors, existing or potential to be affected. The conclusion seems inevitable that an abandonment of the application was of no concern to anyone except the registrant. The possibility of any other interest in the matter is so shadowy, indefinite and equivocal that it must be put out of consideration as altogether unreal. Under these circumstances the right of any person to withdraw an application for any other form of privilege in respect of which he is at the time alone concerned."

[13] Id. at 19.

[14] 49 Harv. L. Rev. 1369 (1936); 34 Mich. L. Rev. 1031 (1936); 84 U. Pa. L. Rev. 1019 (1936).

[15] Columbia General Investment Corporation v. S.E.C., 265 F.2d 559 (5th Cir. 1959); Guaranty Underwriters, Inc., v. Johnson, 133 F.2d 54 (5th Cir. 1943); Resources Corporation International v. S.E.C., 103 F.2d 929 (D.C. Cir. 1939); Oklahoma-Texas Trust v. S.E.C., 100 F.2d 888 (10th Cir. 1939); S.E.C. v. Hoover, 25 F. Supp. 484 (E.D. Ill. 1938).

[16] *Colum. Gen. Invest. v. S.E.C.* supra note 15; *Guar. Under. v. S.E.C.*, supra note 15.

[17] *Colum. Gen. Invest. v. S.E.C.*, supra note 15.

precise issue. Rather than attempt to overrule *Jones* the court distinguished the two cases on the ground that in *Columbia* there were 1800 shares of stock already held by investors. Thus, there were other persons who had a sufficient interest to preclude any absolute right of withdrawal. In addition, the court pointed out that since the *Jones* decision there has been at least one significant change in the law making an application for registration of immediate concern to the investing public. At the time of the *Jones* case the Securities Act of 1933, section 5,[18] prohibited the offer for sale of the securities involved in the registration statement until said statement was effective. Under the 1954 amendments to this act[19] a registrant may make such offers to sell prior to the effective date of registration. As the court in the instant case points out,[20] a registrant may make such offers to sell prior to the effective date of registration, postpone the effective date several times, issue a prospectus with misleading statements and then, if there were an absolute right of withdrawal, simply withdraw his application before any investigation could become final. Sales could then be made without utilizing the mails or the facilities of interstate commerce. The registrant would have derived his profits by the use of the very channels of the S.E.C.

Further, under Regulation A,[21] a sale of up to $300,000 of securities can be made without the requirement of registration with the Commission. In an attempt to safeguard this exemption the Commission has ruled that the exemption is not available to one who has been the subject of a stop order by the Commission within the immediately preceding five year period.[22] If the power to issue a stop order and complete an investigation is lacking by reason of an absolute right of withdrawal the result is obvious. A registrant might fully exploit the channels of the S.E.C. in his attempt to bilk the public under the Regulation A exemption. However, despite this cogent reasoning, the court in *Columbia* declined specifically to overrule *Jones*, but, rather, used judicial restraint and distinguished the two cases on the basis of the outstanding shares held by investors in the *Columbia* case.[23]

In a further departure from *Jones*, subsequent courts have held that if the Commission's stop order proceeding was instituted after the registration became effective the registrant had no absolute right of withdrawal despite the fact that there were no outstanding shares of the securities in question. The vital distinction providing public interest was said to be the fact of effective registration.[24]

Thus, after a consideration of precedent, including the *Jones* case, the *Columbia* case which distinguished *Jones*, and other cases which either dis-

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18 48 Stat. 77 (1933).

19 68 Stat. 906 (1954), 15 U.S.C. § 77e(a)(1)(2) (1958).

20 Supra note 1, at 274.

21 S.E.C. Reg. A, 17 C.F.R. § 230.254(a) (Supp. 1961).

22 Id. at § 230.252(c).

23 265 F.2d at 562.

24 *Okla.-Tex. Trust v. S.E.C.* supra note 15; *Resources Corp. Int. v. S.E.C.*, supra note 15.

tinguished or limited it, together with subsequent legislation, the court concluded that an applicant has no absolute right to withdraw his registration statement, whether or not there are existing investors.[25]

Finally, the court had to interpret the Securities Exchange Act and its application to the instant case. While *Jones* and *Columbia* arose under the Securities Act of 1933, this case comes under the provisions of the Exchange Act of 1934. Section 15(b) of the Exchange Act provides that when the Commission finds that a registered dealer or applicant for registration has ceased doing business as such, the Commission "shall by order cancel the registration of such broker or dealer."[26] The petitioner argued that it is mandatory, by the explicit language of the section, for the Commission to cancel the registrant's application. It contended that by the use of the word "shall", the Commission is precluded from the use of any discretion in cancelling applications for registration when the registrant has ceased doing business. The court recognized that "shall" often imposes a mandatory duty but held that when applied to government action "shall" is sometimes the equivalent of "may."[27] In view of the fact that "shall" is also used in another part of section 15(b),[28] and, further, that the cancellation provision appears at the end of the section, the court decided that the word is used as a provision for clearing the Commission's files of applicants and dealers no longer in existence as such and is in no way a mandatory directive.

The purpose of the Exchange Act is to regulate the exchange of securities involved in over-the-counter transactions, to safeguard the public from misleading statements, and to prevent unfair practices by dealers and brokers generally. As mentioned earlier the act provides for some self-regulation of the dealers and brokers in over-the-counter trading.[29] It is clear that if the petitioner's contention that the cancellation provision of section 15(b) were to be considered mandatory upon the Commission the purpose and regulatory scheme of Exchange Act would be severely disrupted.

While unreversed decisions of the Supreme Court are binding upon lower courts, they are "but evidences of the law and not the law itself."[30] Their value as evidence may have been so eroded by subsequent judicial decision and legislation as to make them valueless to someone urging their acceptance as precedent. It appears that the *Jones* decision has reached this point in its ill-fated history. The court properly held that today public interest is affected immediately upon the filing of a registration statement, thus precluding withdrawal without the Commission's consent, and further, that the use of the

[25] Supra note 1, at 274.

[26] Supra note 3.

[27] Ibid. See also Richbourg Motor Co. v. U.S., 281 U.S. 528 (1930); Railroad Company v. Hecht, 95 U.S. 168 (1877); West Wisconsin Railway Company v. Foley, 94 U.S. 100 (1876).

[28] Section 15(b), supra note 3, also provides that the Commission "shall" deny an application for registration if in the public interest and if the applicant is subject to one of the disqualifications as set out in note 4 supra.

[29] Supra note 5.

[30] Browder v. Gayle, 142 F. Supp. 707 (1956).

word "shall" in the cancellation provision of section 15(b) imposes no mandatory duty, but rather, allows discretionary policing action by the Commission.

PAUL L. BARRETT

Taxation—Deferral of Prepaid Receipts by Accrual Basis Taxpayer.—***American Automobile Association v. United States.***[1]—The taxpayer, a non-stock membership corporation, kept its books on an accrual basis and paid taxes on a calendar year basis. Its receipts consisted mainly of prepaid annual membership dues, payment of which entitled a member to the availability of certain automobile services. Under customary accounting procedure the taxpayer reported as gross income in the year of receipt only that portion of the total prepaid dues actually received which ratably corresponded with the number of membership months covered by the dues occuring within the same taxable calendar year. In auditing the taxpayer's returns for the years 1952 through 1954 the Commissioner of the Internal Revenue, in the exercise of his discretion under section 41 of the Internal Revenue Code of 1939,[2] rejected the taxpayer's system of accounting as not clearly reflecting income. The Commissioner adjusted the gross income for the years in question so as to recognize receipt of dues as income in the years actually received. Consequently, a net operating loss claim for 1954 and corresponding carryback reductions were greatly reduced, and tax deficiencies were assessed for 1952 and 1953. In a suit to recover the deficiencies paid, the Court of Claims sustained the Commissioner[3] in the face of detailed "expert testimony" to the effect that the taxpayer's treatment of prepaid receipts comported with sound commercial accounting practices. By reason of a conflict between the decision below and that in *Bressner Radio Inc. v. the Commissioner,*[4] the United States Supreme Court granted certiorari. HELD (5-4): The Commissioner was not wrong in requiring the prepaid annual membership dues received by such a club to be included as income in the calendar year of its actual receipt.

The Court concluded that even assuming petitioner's treatment of prepaid dues to be in accord with sound accounting practice, the case of *Automobile Club of Michigan v. Commissioner*[5] is still persuasive authority for

[1] 367 U.S. 687 (1961).

[2] A taxpayer's "net income shall be computed . . . in accordance with the method of accounting regularly employed in keeping the books . . . but . . . if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income . . ." Int. Rev. Code of 1939, ch. 1, § 41, 53 Stat. 24, 26 U.S.C. § 41 (1952). See similar provision in Int. Rev. Code of 1954, § 446.

[3] 181 F. Supp. 255 (Ct. Cl. 1960).

[4] 267 F.2d 520 (2d Cir. 1959). In this case the taxpayer, a retail television dealer, long employing the accrual method of accounting, was permitted to defer inclusion of income of prepaid revenue on twelve month television servicing contracts over a twelve month period subsequent to date of receipt, since the method employed was not shown to misrepresent income.

[5] 353 U.S. 180 (1957).