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# Introductory Comment: A Historical Introduction to the Securities Act of 1933 and the Securities Exchange Act of 1934

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# Introductory Comment: A Historical Introduction to the Securities Act of 1933 and the Securities Exchange Act of 1934

## I. INTRODUCTION

On October 19, 1987, now referred to as Black Monday, the Dow Jones Industrial Average dropped a previously unimaginable 508 points. On that Monday, \$500 billion of paper wealth evaporated. For many, it inevitably brought to mind the collapse of the stock market in 1929<sup>1</sup> which preceded the Great Depression. The reaction of businessmen to the recent crisis, however, points to one of the many differences between these two historic events. "Unlike their predecessors in the 1920's, who did not think emergency Government measures could help, the . . . businessmen of the 1980's are calling for Washington to intervene to stabilize the markets."<sup>2</sup> In addition, a Presidential task force studied the October crash and strongly recommended tougher governmental regulation of financial markets and the establishment of one federal "superagency" to oversee intermarket issues.<sup>3</sup> Today, increased regulation is seen by many as a panacea for the ills of the market.

The economic crisis of the 1920s and '30s led to intensive efforts by the federal government to regulate business, ending years of a *laissez-faire* policy. Business historian Thomas K. McCraw of Harvard points out that the

underpinnings of the economy in 1929 were in some ways stronger than they are today: New industries were taking hold and growing and the government was running a surplus. The depression that followed the crash came because the institutional and regulatory safety net that exists today was not in place to avoid a panic.<sup>4</sup>

Key components of the regulatory safeguards put in place during the Depression were the Securities Act of 1933<sup>5</sup> (Securities Act) and the Securities Exchange Act of 1934<sup>6</sup> (Exchange Act), the legislation that had the greatest effect on the securities market. While much debate centers around the Securities Act and the Exchange Act (the Acts), one must realize that Congress enacted four additional statutes to regulate

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1. The stock market crash of 1929 was not as sudden nor as big a plunge as the 1987 crash.

Substantial losses occurred on Friday, October 18, [1929], Saturday, October 19, and Monday, October 21. The market advanced Tuesday, but on Wednesday, October 23, *The New York Times* Average lost . . . eighteen points. . . .

. . . .

. . . . Losses on Monday, October 28, far exceeded those previously recorded. The *Times* Average fell twenty-nine points; individual securities like General Electric lost as many as fifty points. . . . In the eight weeks after Labor Day, the average fell 111 points (36 percent), nearly as much as it had gained in the preceding eighteen months.

J. SELIGMAN, *THE TRANSFORMATION OF WALL STREET* 3 (1982).

2. Feinberg, *Financiers React to the Plunge—Then and Now*, N.Y. Times, Oct. 25, 1987, at F-6, col. 1.

3. Murrey, *Brady Study Finds Reagan Economics A Culprit in Crash*, Wall St. J., Jan. 11, 1988, at 14, col. 1 (summarizing the findings of the presidential task force, known as the Brady Commission).

4. *Collapse Shakes Core of Confidence in Economy*, Washington Post, Oct. 25, 1987, at A-18, col. 1.

5. Securities Act of 1933, Pub. L. No. 73-22, 48 Stat. 74 (1933) (codified as amended at 15 U.S.C. §§ 77a-77aa (1982 & Supp. IV 1986)) [hereinafter Securities Act].

6. Securities Exchange Act of 1934, Pub. L. No. 73-291, 48 Stat. 881 (1934) (codified as amended at 15 U.S.C. §§ 78a-78kk (1982 & Supp. IV 1986)) [hereinafter Exchange Act].

securities during this time. Although beyond the scope of this Article, it is important to mention the additional parameters Congress created to effectively regulate securities: the Public Utilities Holding Company Act of 1935;<sup>7</sup> the Trust Indenture Act of 1939;<sup>8</sup> the Investment Company Act of 1940;<sup>9</sup> and the Investment Advisors Act of 1940.<sup>10</sup> These six statutes administered by the Securities and Exchange Commission (Commission) complete an integral regulatory scheme designed to provide investors with certain minimal protections.<sup>11</sup> At the time of their enactment, the stock market and the national economy were in serious distress. There was a clear need to restore public confidence in the symbols and the basic currency of the industrial era, namely, investment securities.<sup>12</sup> These new securities laws were among the many Roosevelt administration efforts to stimulate the economy and restore confidence in the capitalist system.

The general purpose of the Securities Act is to regulate the initial distribution of securities by issuers to public investors. The Act compels the filing of a registration statement for securities sold through the instrumentalities of interstate commerce or the mails. The goal of registration is the full disclosure of truthful information regarding the character of the securities offered to the public. The Exchange Act provides for the regulation of the securities exchange markets and the operations of the corporations listed on the various national securities exchanges (such as the New York and American stock exchanges). The Exchange Act also created the federal agency in charge of securities regulation, the Securities and Exchange Commission.

This Article will first present the historic and economic background of these Acts and examine their original provisions. Part III of the Article will then set forth key provisions of the Acts. By examining the historical foundations and the language of these Acts, this Article will attempt to provide a basic understanding of the

7. Pub. L. No. 74-333, 49 Stat. 803 (1935) (codified as amended at 15 U.S.C. §§ 79-79z-6 (1982 & Supp. IV 1986)). The Act "pervasively regulates electric and gas holding companies and their subsidiaries in order to assure their compliance with the statutory standards of geographical integration and corporate simplification." L. LOSS, *FUNDAMENTALS OF SECURITIES REGULATION* 37 (1988).

8. Pub. L. No. 76-253, 53 Stat. 1149 (1939) (codified as amended at 15 U.S.C. §§ 77aaa-77bbb (1982)). The Act

requires that bonds, notes, debentures and similar securities publicly offered for sale, except as specifically exempted by the Act, be issued under the indenture which meets the requirements of the Act, and has been duly qualified with the Commission. . . . [T]he rights of holders of securities issued under such indentures may be protected and enforced [by the Act] . . . . [T]he Act . . . [also] imposes on the trustee, after default, the duty to use the same degree of care and skill . . . as a prudent man would use in the conduct of his own affairs.

H. BLOOMENTHAL, *CASES AND MATERIALS ON SECURITIES LAW* 2 (1966).

9. Pub. L. No. 76-768, 54 Stat. 789 (1940) (codified as amended at 15 U.S.C. §§ 80a-1-80a-64 (1982 & Supp. IV 1986)). This Act "provides for the registration and regulation of companies primarily engaged in the business of investing, reinvesting, owning, holding, or trading in securities." H. BLOOMENTHAL, *supra* note 8, at 3.

10. Pub. L. No. 76-768, 54 Stat. 847 (1940) (codified as amended at 15 U.S.C. §§ 80b-1-80b-21 (1982 & Supp. IV 1986)). This Act has regulations similar to those of broker-dealers in the Securities Act, with certain specific exemptions. The Act "requires persons engaged for compensation in the business of advising others with respect to securities to register with the Commission." H. BLOOMENTHAL, *supra* note 8, at 3.

11. H. BLOOMENTHAL, *supra* note 8, at 6. Bloomenthal notes that all of these statutes, except the Investment Advisors Act, are mostly concerned with practices employed in the sale of securities. *Id.* Although beyond the scope of this Article, it is also important to note that the Banking Act of 1933 also had significant impact on the securities industry. The relevant sections, better known as Glass-Steagall, divorced commercial and investment banking activities. For a general history of this Act, see generally Perkins, *The Divorce of Commercial and Investment Banking: A History*, 88 *BANKING L.J.* 483 (1971).

12. M. PARRISH, *SECURITIES REGULATION AND THE NEW DEAL* 3 (1970).

functions and purposes of the two Acts and with it a general understanding of modern securities regulation. While the Securities Act and the Exchange Act have been amended over the years, "the basic concepts and objectives of the original statutes have not been changed . . ." <sup>13</sup> With such long-standing legislation, there tends to be relatively little examination of the context and the controversies that attended their passage. In view of the recent crisis and the potential for new legislation, it is timely to examine the genesis of securities regulation.

## II. THE HISTORIC AND ECONOMIC BACKGROUND

### A. *Blue Sky Legislation*

State governments undertook the regulation of corporate securities over twenty years before the federal government enacted such legislation.<sup>14</sup> The number of stockholders of record in the United States increased from 4,400,000 to over 18,000,000 in the period between 1900 and 1928.<sup>15</sup> State securities statutes were known as "blue sky" laws, because some lawmakers believed that "if securities legislation was not passed, financial pirates would sell citizens everything in [the] state *but* the blue sky."<sup>16</sup> Legislators were reacting to both genuine and spurious complaints received from investors regarding fraudulent securities deals.<sup>17</sup> The lawmakers generally believed that the states must take the initiative against fraud and negligence and not wait for the outcry of the victimized public.<sup>18</sup>

Blue sky laws varied from state to state but can be classified into two broad categories: antifraud laws and licensing laws.<sup>19</sup> Antifraud laws did not take effect until evidence appeared that fraud had been or was about to be committed in the sale of securities. State authorities were empowered by statute to investigate suspected fraud and could enjoin such fraudulent activities and in some cases undertake criminal proceedings.<sup>20</sup> Licensing laws gave state officials control over traffic in securities by prohibiting sales until an application was filed and permission granted by the state. Officials of the state agency, charged with enforcement of this type of blue sky law, usually reviewed detailed information supplied by the issuer regarding the issuer's financial history and present status and passed judgment on the soundness of the

13. R. KARMEL, *REGULATION BY PROSECUTION* 44 (1982). There have been some significant changes in the Acts, e.g., the Williams Act, Exchange Act, 15 U.S.C. §§ 78b(d)-(e), 78n(d)-(f) (1982 & Supp. IV 1986). It is beyond this Article's scope to discuss any changes to the Acts since their enactment. Additionally, not all sections of the Acts are discussed. The specific sections discussed are chosen to provide a general understanding of the functions and purposes of the two Acts.

14. In 1911, the first state blue sky statute was enacted in Kansas. It was administered by the state bank commissioner. M. PARRISH, *supra* note 12, at 6.

15. A. BERLE & G. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* 56 (1939).

16. M. PARRISH, *supra* note 12, at 5 n.1. Variations of this famous quote can be found in many of the accounts of the history of the blue sky legislation, e.g., J. SELIGMAN, *supra* note 1, at 44.

17. M. PARRISH, *supra* note 12, at 5. "Moral fervor, not regulatory acuity, guided many of [the initial efforts at state regulation]." *Id.* at 6.

18. Note, *The Securities Act of 1933*, 20 VA. L. REV. 451, 456 (1934).

19. Comment, *The New Federal Securities Act*, 31 MICH. L. REV. 1117, 1118, 1119 (1933).

20. *Id.* at 1119. See also Note, *supra* note 18, at 456-57 (discussing the various approaches of securities regulation by the states prior to the federal legislation).

securities offering.<sup>21</sup> If the securities appeared to meet the statutory requirements, the issuer was permitted to sell the securities within the state.<sup>22</sup> In some instances, securities with no record of earnings could be sold by issuers only with the express label: "This is a speculative security."<sup>23</sup>

Many states boasted of great success with their blue sky legislation, but there was little documented proof as to their effectiveness.<sup>24</sup> In reality, the laws proved quite ineffective for several reasons.<sup>25</sup> First, responsibility for the enforcement of these laws was delegated to "unspecialized attorneys working for state officials as disparate as the railroad commission or the state auditor. When political administrations changed, responsibility for blue sky law enforcement frequently also was reassigned."<sup>26</sup> In addition to the lack of expertise among the enforcers, state funding was generally inadequate to support the fulltime manpower needed to investigate the securities and to take remedial or prosecutorial action.<sup>27</sup> Also, many states were deliberately lax in the regulation of securities traffic in order to attract outside industry and to prevent the exodus of industry to more lenient states.<sup>28</sup>

The victims of securities fraud were another factor in the inadequate enforcement of state security laws. Typically, promoters and dealers, facing prosecutorial investigation, would offer refunds to prosecution witnesses.<sup>29</sup> Often a witness would accept a refund and the case would fail for lack of sufficient evidence.<sup>30</sup> Insurance funds set up by fraudulent dealers would be used for "placating the more dangerous of the defrauded investors."<sup>31</sup> While this practice interfered with effective enforcement of the laws, the objectives of the blue sky laws were met in an indirect way by forcing dealers to return money to some investors.<sup>32</sup>

In 1917, the Supreme Court clearly established the constitutionality of the blue sky laws.<sup>33</sup> By that time the laws had already been analyzed by the securities industry, in particular, the Investment Banker's Association (IBA), an organization interested in resisting regulation.<sup>34</sup> In 1915, the IBA informed its members that the

21. Comment, *supra* note 19, at 1118.

22. *Id.*

23. *Id.* at 1123.

24. See J. SELIGMAN, *supra* note 1, at 44-45.

25. See Comment, *supra* note 19, at 1120. See generally M. PARRISH, *supra* note 12, at 5-41 (chronicling the tumultuous life of state regulation).

26. J. SELIGMAN, *supra* note 1, at 46; see also M. PARRISH, *supra* note 12, at 28-29.

27. J. SELIGMAN, *supra* note 1, at 46.

28. Federal Securities Act: Hearings before the House Interstate and Foreign Commerce Comm., 73d Cong., 1st Sess., on H.R. 4314, 99, 100 (1933) (Dept. of Commerce: A STUDY OF THE ECONOMIC AND LEGAL ASPECTS OF THE PROPOSED FEDERAL SECURITIES ACT), reprinted in 2 LEGISLATIVE HISTORY OF THE SECURITIES ACT OF 1933 AND SECURITIES EXCHANGE ACT OF 1934 item 20, at 100 (comp. by J.S. Ellenberger & E. Mahar 1973) [hereinafter *Congressional Hearings*].

29. *Id.* at 100. This practice was known as "compounding." *Id.*

30. *Id.*

31. *Id.* A New York City investigator said it was common for swindlers to put aside one-tenth to one-third of the money they received to reimburse persons who demanded an adjustment. *Id.*

32. *Id.*

33. See *Hall v. Geiger-Jones Co.*, 242 U.S. 539 (1917); *Caldwell v. Sioux Falls Stock Yards Co.*, 242 U.S. 559 (1917); *Merrick v. Halsey & Co.*, 242 U.S. 568 (1917). These cases were the result of attacks on the constitutionality of blue sky statutes of Ohio, Michigan, and South Dakota. The Supreme Court found the statutes to be constitutional, overruling lower court decisions to the contrary.

34. M. PARRISH, *supra* note 12, at 5.

blue sky laws could be evaded easily by operating across state lines.<sup>35</sup> Promoters could sell their securities through the mails in other states, as long as the sale was finalized through an acceptance from the seller's office by mail or telegram. Since a sale consists of an offer and acceptance, until the buyer accepts an offer there is no sale. Under the law of contracts, the sale is legally made at the place where the acceptance is given.<sup>36</sup> Sellers took great care to avoid the jurisdiction of states that had effective statutes.<sup>37</sup> Even with offers that were strictly intrastate, effective lobbying, principally by the IBA, riddled the statutes with exemptions.<sup>38</sup>

Securities listed on the New York Stock Exchange were exempted from regulation under most of the state laws, since the listing requirements of the exchange were more stringent than most states' requirements.<sup>39</sup> Legislatures began to provide exemptions for securities listed on other exchanges which had not developed listing requirements adequate to protect investors.<sup>40</sup> These exemptions provided a way for issuers with less than "sound" financial histories to escape the scrutiny of state examiners. Once these issuers were listed with one of the exempt minor exchanges, they could offer securities within the state, unaffected by the state regulation.<sup>41</sup>

The blue sky laws were not much of an obstacle for the fraudulent promoter. According to contemporary reports,<sup>42</sup> promoters used the devices noted above to continue their dealings. They selected ventures, such as mining, oil, or real estate, and set up companies with no legitimate prospects, in order to sell stock.<sup>43</sup> In 1922, a movement was begun to draft uniform blue sky legislation directed at eliminating some of the inherent problems that permitted evasion of the laws. At the time of the enactment of the federal securities laws, no state had adopted the uniform act that had been drafted between 1922 and 1930 by the National Conference of Commissioners on Uniform State Laws.<sup>44</sup> Without universal adoption of the uniform laws, the purposes of such legislation could still have been subverted.<sup>45</sup>

Because certain states were of greater importance to big business, the IBA targeted them for stronger lobbying efforts.<sup>46</sup> For instance, the IBA was active in keeping New York free of registration and licensing laws. New York, however, enacted the Martin Act, an antifraud law. The IBA supported such laws because it believed these laws would keep fraudulent dealers from competing with its members

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35. J. SELIGMAN, *supra* note 1, at 45.

36. *Congressional Hearings*, *supra* note 28, at 101.

37. *Id.* at 99. See also Note, *Securities as Subjects of Interstate Commerce*, 19 ST. LOUIS L. REV. 69 (1933).

38. J. SELIGMAN, *supra* note 1, at 45.

39. Comment, *supra* note 19, at 1120.

40. *Id.* Legislators may have added these other exchanges out of local pride. For example, the Illinois statute exempted not only the New York Stock Exchange but the Chicago Stock Exchange, the Chicago Curb Exchange, and the Chicago Board of Trade. *Id.* at 1120 n.8.

41. *Id.* at 1120.

42. *Congressional Hearings*, *supra* note 28, at 99. See also Note, *The Securities Act of 1933*, 33 COLUM. L. REV. 1220 (1933).

43. *Congressional Hearings*, *supra* note 28, at 99.

44. *Id.* at 100. In August 1930, the National Conference of Commissioners on Uniform State Laws adopted a fourth draft of a uniform act. One week later the American Bar Association approved the proposed uniform act. *Id.*

45. *Id.*

46. M. PARRISH, *supra* note 12, at 21-22.

for investors without burdening its members with disclosure responsibilities.<sup>47</sup> The Martin Act vested authority in the New York Attorney General to investigate fraudulent practices and seek injunctions against suspected individuals.<sup>48</sup> However, a basic defect in antifraud laws was recognized by those who were charged with enforcement. The Attorney General had difficulty in uncovering fraud in order to protect unsuspecting investors. Little information was available to those responsible for such enforcement.

In a state such as New York, where a large percentage of the securities sold in the nation originated, a more rigorous blue sky law could have had a profound deterrent effect on unethical practices in the sale of securities. However, there appeared to have been two major reasons why the state chose not to enact such legislation: (1) bankers and other businessmen feared that such legislation would weaken New York's position as a financial center; and (2) reformers feared that public officials in New York were so dishonest that the "licensing of the sale of securities would open the door to a tremendous amount of graft."<sup>49</sup>

There was, however, a regulatory system operating in New York for securities traded on the New York Stock Exchange. Regulation of listed securities was administered by the Exchange's stock-listing committee. "Before a security could be offered for sale on the Exchange, [a] corporate issuer had to file an application describing in detail the firm's capital structure, history, liabilities, properties, financial statements for the last five years, among other things."<sup>50</sup> The required disclosure was more demanding than the requirements of any of the blue sky laws.<sup>51</sup> These standards were closer to the requirements of the subsequent Securities Act than they are to the English Companies Act,<sup>52</sup> which was considered a model for the Securities Act. The Exchange's listing requirements, however, which appeared to be a leading force in adequate corporate disclosure, proved little more effective than the blue sky laws.<sup>53</sup> They were purely voluntary, were easily avoided, and were not rigorously enforced.<sup>54</sup>

### B. *The Federal Government's Response Before the Crash*

According to congressional reports, in the decade after World War I, approximately fifty billion dollars of new securities were floated in the United States, and half of them were worthless.<sup>55</sup> The general belief among legislators was that many underwriters and dealers in securities had not been operating in a fair, honest, and

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47. *Id.* at 22.

48. Martin Act, N.Y. GEN. BUS. LAW (Art. 23(A)) §§ 352-359(g) (McKinney 1928).

49. Comment, *supra* note 19, at 1119 n.6.

50. J. SELIGMAN, *supra* note 1, at 46.

51. *Id.*

52. See *infra* note 124 and accompanying text for a description of the English Companies Acts of 1908 and 1929.

53. J. SELIGMAN, *supra* note 1, at 47.

54. *Id.*

55. H.R. REP. NO. 85, 73d Cong., 1st Sess. 2 (1933), reprinted in 2 LEGISLATIVE HISTORY OF THE SECURITIES ACT OF 1933 AND SECURITIES EXCHANGE ACT OF 1934 item 18, at 2 (comp. by J.S. Ellenberger & E. Mahar 1973) [hereinafter H.R. REP. NO. 85].

prudent manner.<sup>56</sup> The irresponsible sale of securities resulted in "wastage" in industry and real estate. "Because of the deliberate overstimulation of the appetites of securities buyers, underwriters had to manufacture securities to meet the demand that they themselves had created."<sup>57</sup> The efficient functioning of many industries was compromised when investment bankers, promoters, and management encouraged corporations to accept new capital for expansion purposes so that new securities might be issued for public consumption.<sup>58</sup> Similar inefficiencies occurred when developers undertook needless real estate development solely for the purpose of issuing more securities to satisfy an artificially created market.<sup>59</sup>

While promises of "getting rich quick" were made to investors, the typical offering circular prior to 1933 contained little of the information needed to estimate the worth of a security.<sup>60</sup> A circular usually included "very little information as to the use of the proceeds, a rather brief description of the securities themselves, and very few if any material facts relating to the business of the issuer."<sup>61</sup> The public, however, was caught up in a current of optimistic speculation.<sup>62</sup> They wanted their savings invested in securities with the hope of getting rich overnight. Stocks of new industrials such as radio companies, airplane manufacturers, and transportation companies attracted many investors—"each company [was] assumed to be a potential Ford Motor Co."<sup>63</sup> Accounts of the swindles and fraudulent practices perpetrated on the public, including bankers and other businessmen, were numerous. For example, George Graham Rice defrauded investors of over \$200,000,000 through the sale of securities for bogus corporations. Rice "touted the stock of Idaho Copper, a corporation which he formed. He had its stock listed on the Boston Curb. Its property consisted of a water-filled, abandoned mine, the entrance to which was so overgrown that the federal investigators had difficulty locating it."<sup>64</sup> He later wrote a book entitled *My Adventures with Your Money*, dedicated "[t]o the American Damphool Speculator, surnamed the American Sucker, otherwise described herein as The Thinker, Who Thinks He knows But He Doesn't—Greetings!"<sup>65</sup>

56. *Id.*

57. *Id.*

58. *Id.* One 1930s commentator described the behavior of the management and promoters prior to the enactment of the federal securities legislation:

Promoters and managements inspired and profited by this buying extravaganza. In their conscious or unconscious desire to get a portion of this easy capital they issued securities for overvalued properties, pyramided and complicated corporate structures, over-expanded, over-borrowed. Not only the promoters and managements accepted the golden opportunity, but the bankers likewise too frequently forgot their duty of counselors; . . . they reaped a harvest on the popularity of management and fixed trusts.

James, *The Securities Act of 1933*, 32 MICH. L. REV. 624, 626 (1934).

59. H.R. REP. NO. 85, *supra* note 55, at 2.

60. Halleran & Calderwood, *Effect of Federal Regulation on Distribution of and Trading in Securities*, 28 GEO. WASH. L. REV. 86, 94 (1959).

61. *Id.* See also H.R. REP. NO. 85, *supra* note 55, at 2.

62. James, *supra* note 58, at 625-26.

63. *Id.* at 626-27.

64. *Id.* at 627.

65. *Id.*



Before 1929, there had been panics on the stock market in 1873, 1907, and 1921. These events were followed by government investigations. Yet no federal legislation resulted from these efforts; perhaps because the appearance of continuing prosperity and the prospects of gain lulled the nation into a belief that the economic system was fundamentally sound.<sup>66</sup> The subsequent federal regulation of the securities markets, however, should not be thought of as having been "dreamed up precipitously in the nightmare which followed the dramatic stock market collapse of 1929."<sup>67</sup> The minimal impact of the blue sky laws and the failure of the states to adopt uniform laws clearly led to a demand for federal legislation. After World War I, several bills were introduced in Congress that contained disclosure requirements, antifraud measures, and federal aid for the enforcement of state blue sky laws.<sup>68</sup> But the climate, which was predominantly optimistic, was not yet amenable to widespread support for these laws.

One of these bills, introduced in the U.S. House of Representatives by Edward Dennison of Illinois in 1922, would have eliminated the largest loophole in state blue sky laws. The bill would have made it illegal for any person to use the mails or any facilities of interstate commerce to sell securities in any state, unless there had been compliance with the state's blue sky laws.<sup>69</sup> Dennison stated that the "Federal Government ought to cooperate with the State to the extent of not permitting those agencies over which the Federal Government has exclusive control [the U.S. Post Office] to be used to nullify the State laws. . . ."<sup>70</sup> Questions arose as to the constitutionality of a statute, the sole purpose of which was to secure the enforcement of state laws. The bill was passed almost unanimously by the House, but never left the Senate Committee. Other bills introduced included an antifraud bill similar to the Martin Act and registration bills similar to many of the blue sky laws.<sup>71</sup>

Presidential inaction in this area during the 1920s may have been a factor in the failure of the various legislative efforts. President Coolidge was briefed by numerous experts who informed him of the troubles in the financial markets.<sup>72</sup> It has been suggested that Coolidge "connected [these] developments neither with the well-being of the country nor with his own responsibilities."<sup>73</sup> Coolidge believed regulation was the responsibility of the states, and perhaps more importantly, he clung to a faith in the *laissez-faire* philosophy—"the benign tendency of things that are left alone."<sup>74</sup> The Hoover Administration's reaction was not markedly different than that of its predecessor, even though the crisis had clearly unfolded.

66. Nussbaum, *Wall Street: From the Robber Barons to Regulation by the SEC in 95 Years*, 191 N.Y.L.J. 48 (Jan. 30, 1984).

67. Gadsby, *Historical Development of the S.E.C.—The Government View*, 28 GEO. WASH. L. REV. 6 (1959).

68. *Id.* See generally *Congressional Hearings*, *supra* note 28, at 101-03; James, *supra* note 58, at 625 (describing the Taylor bill, the Dennison bill, and the Volstead bill).

69. J. SELIGMAN, *supra* note 1, at 50.

70. *Congressional Hearings*, *supra* note 28, at 102.

71. *Id.* at 102-03.

72. Tyler, *The Coming of the SEC in SECURITIES, EXCHANGES AND THE SEC* 132, 145 (P. Tyler ed. 1965).

73. *Id.* at 144-45.

74. *Id.* at 146.

### C. After the Crash

While the country was reeling from the shock of the stock market collapse, President Hoover called for an investigation of stock exchange practices. While he insisted that hearings be undertaken "with a view to legislation," this outcome was doubtful.<sup>75</sup> There were several reasons why Hoover may have resisted legislative intervention. Hoover realized that an attack on the financial leaders, who were also major supporters of his party, carried with it considerable political risk.<sup>76</sup> He also felt that the constitutionality of the exercise of federal authority in the regulation of the sale of securities was doubtful. With regard to the New York Stock Exchange, Hoover felt that the responsibility for the initiation of regulatory action lay with Governor Franklin Roosevelt, as this was properly a state matter.<sup>77</sup> From his memoirs, it seems clear that Hoover understood the magnitude of the economic crisis and that the future of the nation was involved.<sup>78</sup> Yet, his insistence that this was a state matter does not adequately explain his actions. It appears that the primary purpose of Hoover's call for investigation was to put pressure on the directors of the stock exchange to institute effective measures and reforms so that federal intervention would not be necessary.<sup>79</sup>

Both Hoover and Coolidge may have used the questionable constitutionality of federal regulation of the securities market to avoid taking aggressive action. The federal government's power to enact legislation regulating the sale of securities arises from the constitutional grant of authority to regulate commerce and the mails.<sup>80</sup> At the time of enactment of the Acts, numerous law review articles addressed the constitutional issues.<sup>81</sup> Several Supreme Court cases regarding the scope of the commerce clause gave rise to potentially conflicting views as to whether securities were subject to interstate regulation.<sup>82</sup> This remained a debated issue before and after the passage of the Acts. In the 1936 case of *Jones v. SEC*,<sup>83</sup> the Supreme Court settled some of the constitutional objections to the Securities Act without addressing the issues by affirming a court of appeals decision holding the Securities Act to be constitutional.<sup>84</sup> The significance of the constitutional issue has less to do with constitutional law than it does with the history of securities reform. The unclear constitutional authority for this type of legislation enabled the federal government to appear legitimately to rely solely on the states for regulation.

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75. J. SELIGMAN, *supra* note 1, at 12-13.

76. *Id.* at 5.

77. *Id.*

78. Tyler, *supra* note 72, at 143.

79. See J. SELIGMAN, *supra* note 1, at 12.

80. U.S. CONST. art. I, § 8.

81. See, e.g., Burgess, *The Twilight Zone Between the Police Power and the Commerce Clause*, 15 IOWA L. REV. 162 (1930); Note, *supra* note 42; Comment, *Constitutional Law—Power to Enact Federal Securities Act of 1933*, 32 MICH. L. REV. 811 (1934); Note, *supra* note 37.

82. See Lottery Case, 188 U.S. 321 (1903) (the Supreme Court held that lottery tickets are subjects of commerce); Paul v. Virginia, 75 U.S. 168 (8 Wall.) (1868) (the Supreme Court held that insurance policies are not subjects of interstate commerce); Nathan v. Louisiana, 49 U.S. 73 (8 How.) (1850) (the Supreme Court held that bills of exchange are not subjects of interstate commerce).

83. 298 U.S. 1 (1936).

84. See *Jones v. SEC*, 79 F.2d 617 (2d Cir. 1935).

For President Roosevelt, the inaction of Coolidge and Hoover may have provided him with a valuable perspective. It was clear that the Coolidge-Hoover philosophy was ineffective. During the 1932 presidential campaign, Roosevelt charged that the Hoover "administration lined up with the stock market and attempted to minimize the crash . . . it delayed relief; . . . it forgot reform."<sup>85</sup> After Roosevelt's victory in the 1932 election, inquiry into the stock exchange practices was resumed. Ferdinand Pecora, who was credited with the prosecution of over 150 fraudulent securities salesmen in New York, was named counsel of the Senate Banking Committee. The Pecora hearings greatly influenced the character of the Securities Act and the Commission that was later created to enforce the securities laws.

The Banking Committee hearings engendered serious questioning of the widely held view that *laissez-faire* economic policies served the country well. The overall effect of the hearings was a diminution of the faith the country placed in its financial institutions, which were already being severely questioned in the wake of the stock market collapse.<sup>86</sup> Criticism was leveled at corporate directors, investment bankers, brokers, securities dealers, and accountants, among others. In the effort to galvanize public support for regulation, attention was drawn to corporate salary levels, income tax returns, and other data regarding those who appeared before the committee, even though such information had little relevance to the investigation of the causes of the stock market crash.<sup>87</sup> This strategy was successful in "transforming national political sentiment from a *laissez-faire* ideology symbolized by the views of President Coolidge to a regulatory-reform ideology associated with Roosevelt's New Deal."<sup>88</sup> It has been suggested that, in spite of the severity of the economic situation at that time, effective securities legislation might not have been enacted had the Pecora revelations not so captured the public sentiment.<sup>89</sup>

The opening gun in the campaign to enact securities regulation was sounded by President Roosevelt in his message to Congress in March 1933. He recommended "legislation for Federal supervision of traffic in investment securities in interstate commerce."<sup>90</sup> This legislation was not to be construed as a guarantee "that newly issued securities are sound in the sense that their value will be maintained or that the properties which they represent will earn profit."<sup>91</sup> The major safeguard was to be full disclosure of information to the potential buyer. The aim was to be "full publicity and information, and that no essentially important element attending the issue shall be concealed from the buying public."<sup>92</sup> Roosevelt asserted that "[t]his proposal

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85. J. SELIGMAN, *supra* note 1, at 19.

86. *Id.* at 2, 29.

87. *Id.* at 2.

88. *Id.*

89. *Id.*

90. Address to Congress by Franklin D. Roosevelt (March 1933), *reprinted in* M. PARRINO, *TRUTH IN SECURITIES* 23 (1968).

91. *Id.* at 24.

92. *Id.*

adds to the ancient rule of caveat emptor, the further doctrine 'let the seller beware.'"<sup>93</sup>

The principle underlying Roosevelt's regulatory philosophy had been expressed earlier by Brandeis in his book, *Other People's Money*.<sup>94</sup> He wrote, "[p]ublicity is justly commended as a remedy for social and industrial diseases. Sunlight is said to be the best of disinfectants; electric light the most efficient policeman . . . . [T]he potent force [of publicity] must . . . be utilized in many ways as a continuous remedial measure."<sup>95</sup> In addition, other writers in the 1920s documented the abuses of corporate management and bankers.<sup>96</sup> Although these authors may have emphasized and "magnified the undesirable practices to justify their theories,"<sup>97</sup> such publications paved the way for popular acceptance of the belief that investment bankers and corporate management were responsible for securities losses.<sup>98</sup> This attitude certainly guided the early congressional efforts to address the stock market crisis.

Roosevelt asked former Federal Trade Commission (FTC) Chairman Huston Thompson to prepare a draft of a securities regulation bill.<sup>99</sup> The resulting draft bill was based on the most severe blue sky laws.<sup>100</sup> The major provisions were: (1) issuers of securities were required to register with the FTC; (2) the FTC was empowered to revoke the registration of any security on the basis of inadequacies of the filing, misrepresentation, and fraud; (3) revocation was also called for when the issuer was found to be not solvent or "the business of the issuer, or person, or security [was] not based upon sound principles, and that the revocation [was] in the interest of the public welfare . . ."; (4) sales could commence immediately upon filing of the registration statement, unlike many of the blue sky laws that required prior approval; (5) no action of the FTC was to be construed as an approval or an endorsement of a security; (6) liability extended to "promoters, issuers, principal officers and directors who were required to sign the registration statement before the security could be offered for sale . . ."; and (7) the FTC was given unlimited power to investigate all sales of securities, including the securities otherwise exempted from the provisions of this bill.

A considerable amount of criticism of Thompson's draft surfaced during hearings on the bill. The harshest criticism was leveled at the FTC's power to revoke any security that it found not to be based upon sound principles. This provision seemed to be at odds with the principle of regulation through disclosure rather than through substantive intervention. Criticism was also directed against the provision providing immediate effectiveness upon registration: "This device operated not only to lock the barn door after the horse had been stolen, but at the same time it held an

93. *Id.*

94. L. BRANDEIS, *OTHER PEOPLE'S MONEY* (R. Abrams ed. 1967).

95. *Id.* at 62.

96. James, *supra* note 58, at 628-29 (citing as examples A. BERLE & G. MEANS, *supra* note 15; W. RIPLEY, *MADN STREET AND WALL STREET* (1927); T. VELBEN, *ABSENTEE OWNERSHIP AND BUSINESS ENTERPRISE* (1923)).

97. James, *supra* note 58, at 629.

98. *Id.*

99. J. SELIGMAN, *supra* note 1, at 52.

100. Landis, *The Legislative History of the Securities Act of 1933*, 28 GEO. WASH. L. REV. 29, 30-32 (1959).

incalculable threat over the seller of securities."<sup>101</sup> There was also concern that the FTC had too little experience with securities to effectively administer the legislation. The FTC's reputation in the Harding-Coolidge-Hoover era had not been the highest, but the Roosevelt administration planned to "restaff and re-invigorate it."<sup>102</sup>

Senator Sam Rayburn of the Commerce Committee of the House believed the Thompson bill was too severe. He sought and received Roosevelt's approval to have drastic changes made in the bill.<sup>103</sup> "Roosevelt brought in a drafting team that could produce a bill conservative enough to be rapidly enacted."<sup>104</sup>

At the request of a Roosevelt aide, Felix Frankfurter coordinated the effort to draft a new bill. Frankfurter was one of Roosevelt's close, lifelong friends and had served the President as an informal advisor.<sup>105</sup> Frankfurter shared Roosevelt's basic philosophy of the New Deal and he supported the principles underlying Roosevelt's proposed securities legislation.<sup>106</sup> Frankfurter spoke of the Depression and the strain on the American system:

The great and bouyant faith in capitalism, in the competitive system, is largely deflated, and . . . it is not only a question of whether the system is just, but whether it works. When you have a system which is questioned by the masses, that system cannot last unless it wins back the loyalty and allegiance of the doubters. . . .<sup>107</sup>

Frankfurter, however, did not adhere to the belief that all the nation's ailments could be cured in Washington.<sup>108</sup> He recognized the complexities of industry and finance and realized effective regulation could come only through governmental administration that was comprehensive, yet flexible.<sup>109</sup> Like Roosevelt, Frankfurter saw a need to preserve individual investment decisions and existing state regulation.<sup>110</sup>

Frankfurter assembled a team to draft, under his guidance, the new Securities Act.<sup>111</sup> James Landis, Benjamin Cohen, and Thomas Corcoran were the chosen draftsmen. Landis was a young law professor at Harvard, and a former clerk of Justice Brandeis. Landis, like his mentor Frankfurter, had a particular interest in administrative and public utilities law.<sup>112</sup> One of the reasons Frankfurter selected Landis for this project was that he had made a detailed investigation of state blue sky laws.<sup>113</sup> Landis had a great faith in the "fourth branch" of government, administrative agencies, which stemmed from his belief in the "inadequacy of a simple tripartite form of government to deal with modern problems."<sup>114</sup> Even before the Thompson

101. *Id.* at 32.

102. *Id.* at 34.

103. J. SELIGMAN, *supra* note 1, at 56.

104. *Id.*

105. M. PARRISH, *supra* note 12, at 58.

106. L. BAKER, FELIX FRANKFURTER 146-47 (1969).

107. *Id.* at 146 (taken from a Frankfurter speech delivered at Smith College, Feb. 22, 1933).

108. M. PARRISH, *supra* note 12, at 61.

109. *Id.* at 62.

110. *Id.*

111. The draft was characterized as "perfecting amendments" to the Thompson bill in deference to Huston Thompson. J. SELIGMAN, *supra* note 1, at 64; Landis, *supra* note 100, at 36.

112. J. SELIGMAN, *supra* note 1, at 61.

113. *Id.* at 61-62.

114. *Id.* at 62.

bill was introduced in Congress, Frankfurter and Landis had discussed the most suitable approach to legislative control of the financial markets.<sup>115</sup> They saw the need to avoid a statute containing excessive generalities, as well as one that, like many state regulatory statutes, contained excessive detail which unnecessarily narrowed the discretion of administrators.<sup>116</sup> The substance of Landis' approach was a combination of administrators with an expert knowledge of the securities industry and carefully drafted guidelines permitting flexible administration without an evasion of congressional mandates. After the Securities Act became the law, Landis was appointed to the Federal Trade Commission to administer the Act.

Benjamin Cohen was a former student of Frankfurter's at Harvard Law School and in 1933 an active practitioner. He was considered by Frankfurter and Landis to be a brilliant lawyer and knowledgeable in the field of securities.<sup>117</sup> While serving as a clerk to Federal Circuit Court Judge Julian W. Mack in New York, Cohen acquired skill at "unraveling the complicated legal and financial webs woven by some corporations."<sup>118</sup>

Thomas Corcoran, the third member of the drafting team, had also been one of Frankfurter's students at Harvard, where he had co-authored several articles with Frankfurter.<sup>119</sup> Corcoran had become an accomplished Wall Street attorney and, like Cohen, was adept at the legal intricacies of corporate reorganizations.<sup>120</sup> In 1933, Corcoran was working in Washington at the Reconstruction Finance Corporation. Frankfurter primarily wanted Corcoran to help lobby for the passage of the Act, while Cohen and Landis would be responsible for the drafting of the statute.<sup>121</sup> Landis, Cohen, and Corcoran brought to the new legislation a view of American business and the new governmental bureaucracies that Frankfurter clearly recognized as a necessary ingredient to the creation of an enduring statute.<sup>122</sup>

The new drafting team was not working without established models for this type of legislation. The British Companies Acts of 1908 and 1929 were often mentioned in the legal literature of the 1930s as an influence on the new federal legislation.<sup>123</sup> The British had rejected a substantive regulation approach similar to blue sky licensing laws in favor of a detailed disclosure requirement. Every new issue had to be accompanied by a prospectus signed by the directors and containing the information specified by schedules provided for in the Acts.<sup>124</sup> Those who authorized the issue were individually liable for damages to investors resulting from untrue statements unless they could show that they believed the statements were true and had

115. M. PARRISH, *supra* note 12, at 62.

116. *Id.*

117. Landis, *supra* note 100, at 33.

118. M. PARRISH, *supra* note 12, at 59.

119. J. SELIGMAN, *supra* note 1, at 63.

120. M. PARRISH, *supra* note 12, at 60.

121. J. SELIGMAN, *supra* note 1, at 63.

122. M. PARRISH, *supra* note 12, at 61-63.

123. *See, e.g.*, Note, *supra* note 18, at 458. Cohen was especially familiar with the Acts. Landis, *supra* note 100, at 34.

124. Note, *supra* note 18, at 454. The prospectus contains an exhaustive description of "the individual investor, the past history and the present structure and obligations of the appealing company, and the private interests involved in or contemplated by the present issue." *Id.*

reasonable grounds for their beliefs.<sup>125</sup> The British philosophy of disclosure was certainly a guiding principle for the federal legislation. But greater governmental initiative, called for in much of the blue sky legislation, was also contemplated by the Administration, as evidenced by the provisions of the Securities and Securities Exchange Acts.<sup>126</sup>

The core of the Securities Act could be found in the first draft by Cohen, Landis, and Corcoran.<sup>127</sup> However, there were four revisions of the draft before it was submitted to a House subcommittee for approval. According to Landis, the theoretical base of the first draft was drawn from the English Companies Act:

but to the sanctions of that act we added the right of the Commission to suspend the registration of any security if inadequate compliance with the stated requirements for disclosure or misrepresentation of fact were found to exist in its registration statement. We also provided for the passage of a period of time before a registration statement could become effective, giving the Commission power during that period to issue a stop order because of misrepresentation or inadequacy of disclosure.<sup>128</sup>

The draft remained true to Roosevelt's conception of the legislation which he had articulated in his speech before Congress in March 1933.<sup>129</sup>

### III. KEY PROVISIONS OF THE SECURITIES ACT OF 1933 AND THE SECURITIES EXCHANGE ACT OF 1934 AS ORIGINALLY ENACTED

#### A. *The Securities Act of 1933*

Despite various conflicting viewpoints, the drafters produced a bill with an underlying policy of disclosure through registration of securities<sup>130</sup> unless the securities or the transaction are exempt.<sup>131</sup> On May 27, 1933, the Securities Act became law. The underlying policy of the Securities Act had some glaring problems. William O. Douglas (later Justice Douglas), who wrote extensively on the Act and later became chairman of the Commission, questioned whether many investors would benefit from the Act's disclosure requirements.<sup>132</sup> The highly technical information provided in registration would be "small comfort" to those in need of investment guidance.<sup>133</sup> The average investor has difficulty assimilating the vast amounts of

125. *Id.*

126. *Id.* at 458. See also *supra* notes 90-93 and accompanying text.

127. Landis, *supra* note 100, at 34.

128. *Id.* See also M. PARRISH, *supra* note 12, at 63.

129. Landis, *supra* note 100, at 34. See also *supra* note 90.

130. The purpose of the Securities Act, as stated in its preamble, is "to provide full and fair disclosure of the character of securities sold in interstate commerce and foreign commerce and through the mails, and to prevent fraud in the sale thereof, and for other purposes." The Senate Committee on Banking and Commerce stated that the "purpose of the bill is to protect the investing public and honest business. The basic policy is that of informing the investors of the facts concerning securities to be offered for sale in interstate and foreign commerce and providing protection against fraud and misrepresentation." S. REP. NO. 47, 73d Cong., 1st Sess. 1 (1933), reprinted in 2 LEGISLATIVE HISTORY OF THE SECURITIES ACT OF 1933 AND SECURITIES EXCHANGE ACT OF 1934 item 17, at 1 (comp. by J.S. Ellenberger & E. Mahar 1973) [hereinafter S. REP. NO. 47].

131. Securities Act §§ 3,4, 15 U.S.C. §§ 77d, 77e (1982).

132. Douglas & Bates, *The Federal Securities Act of 1933*, 43 YALE L.J. 171, 172 (1933).

133. *Id.*

information to make an informed investment decision. President Roosevelt made it clear that the federal government should be careful not to give any appearance that the government either approved or guaranteed the newly issued securities; any supervision over the quality of the security was left to state law.<sup>134</sup> The drafters of the Act were concerned primarily with providing adequate information to potential purchasers and holding those filing the registration statement liable for any misstatements or omissions.<sup>135</sup>

The Securities Act is designed to regulate the new issuing of securities by any issuer. A corporation cannot use the mails or instruments of interstate and foreign commerce to sell or offer to sell a security before it files with the Commission<sup>136</sup> the appropriate registration statement, and includes the prospectus relating to the security to which a registration statement applies, unless it complies with the requirements of the Act.<sup>137</sup> The registration statement is only effective for the securities specified in the statement and the statement's purpose is to make information available to the public with regard to those securities.<sup>138</sup>

A part of the registration statement is the prospectus.<sup>139</sup> Section 10 of the Securities Act prescribes what shall be included in every prospectus used in the sale of securities over which the Commission has jurisdiction.<sup>140</sup> Again, the purpose of this section is to give potential buyers an effective means to understand the intricacies of the transaction in which they are asked to invest.<sup>141</sup> The disclosure requirements were justified by an unlikely ally, Arthur Dean, a member of the committee formed to study the proposed legislation. Dean, one of the more "persistent and articulate opponents"<sup>142</sup> of the Securities Act as originally enacted, later conceded: "An examination of some pre-Act prospectus will show how ludicrously inadequate some of them were."<sup>143</sup>

The informational requirements of the registration statement are set forth in section 7<sup>144</sup> of the Securities Act. Over thirty-two items concerning the corporation and its finances are required to be included in the statement. The registration statement provides information to the prospective buyer and supplies a foundation for

134. Landis, *supra* note 100, at 30. See *supra* text accompanying notes 90-95.

135. Ruder, *Civil Liability Under Rule 10b-5: Judicial Revision of Legislative Intent?*, 57 NW. U.L. REV. 627, 649 (1963). For a comment on the typical offering circular before the enactment of the Securities Act, see *supra* notes 60-61.

136. Securities Act § 6, 15 U.S.C. § 77f (1982). Originally, enforcement of the Act was the task of the Federal Trade Commission. The Exchange Act established the Securities and Exchange Commission (the Commission) as the authoritative regulatory body. See *infra* text accompanying notes 188-90.

137. Securities Act § 6(a), (d), 15 U.S.C. § 77f(a), (d) (1982).

138. Securities Act § 5, 15 U.S.C. § 77e (1982). Note, however, that the Securities Act does not require registration statements for all securities offered by companies; sections 3 and 4 specifically exempt some securities and transactions. See 15 U.S.C. §§ 77c, 77d (1982).

139. Securities Act § 2(10), 15 U.S.C. § 77b(10) (1982) (a prospectus is "any . . . notice, circular, advertisement, letter or communication, written or by radio or television, which offers any security for sale or confirms the sale of any security; except . . . [if a written prospectus is given to the buyer at the time or prior to an offer].").

140. Securities Act § 10, 15 U.S.C. § 77j (1982).

141. H.R. REP. NO. 85, *supra* note 55, at 8. The prospectus must contain the information contained in the registration statement, including names and addresses, the general character of the business transacted, purposes of the issue, balance sheets, profit and loss statements, etc.

142. J. SELIGMAN, *THE SEC AND THE FUTURE OF FINANCE* 226 (1985).

143. Dean, *The Lawyer's Problems in the Regulation of Securities*, 4 LAW & CONTEMP. PROBS. 154, 184 (1937).

144. Securities Act § 7, 15 U.S.C. § 77g (1982); See also Securities Act Schedule A, 15 U.S.C. § 77aa (1982).



civil liability for false or misleading information.<sup>145</sup> Section 7 of the Securities Act was not without its critics. Some argued that the expense of compliance would cause corporations to forgo issuing new securities and look to other sources to raise capital.<sup>146</sup> However, "the evidence was profound and widely accepted as proving a need for a general mandatory corporate disclosure scheme."<sup>147</sup>

The registration statement does not become effective until the twentieth day after it is filed, and any amendment to the statement will trigger another twenty day period.<sup>148</sup> The twenty day waiting period was not merely an administrative provision; the drafters were concerned with high pressure sales techniques inducing stock purchases before the purchaser could adequately review the securities' merit.<sup>149</sup> In addition to giving the Commission time to review the registration statement, the waiting period serves as a "cooling-off" period, allowing investors time to examine the statements and make informed decisions.<sup>150</sup> The Commission, although not making a merit review, can refuse to allow the statement to become effective until the proper amendments to cure any inaccuracies are completed.<sup>151</sup> Additionally, the Commission, at any time after filing, can suspend a registration statement if the statement contains "any untrue statement of a material fact required to be stated therein or necessary to make the statement therein not misleading."<sup>152</sup>

Although full and fair disclosure has been the cornerstone of the Securities Act, the drafters realized they needed additional weapons to ensure successful regulation. The Act imposes criminal liability on anyone who: (1) attempts to sell a security prior to filing a registration statement;<sup>153</sup> (2) transmits a prospectus related to a security that does not comply with the Act;<sup>154</sup> or (3) makes any misrepresentation to a prospective purchaser contrary to the provisions of the Act.<sup>155</sup> These criminal penalties are only partially effective because injured investors are not compensated and prosecution is difficult.<sup>156</sup>

Civil sanctions included in both the Acts effectively complete federal regulation, enabling injured investors to recover lost funds.<sup>157</sup> In adopting the federal securities

145. H.R. REP. No. 85, *supra* note 55, at 7. The requirements of the registration statement were designed to reach important items not revealed by the seller (*i.e.*, distribution of profits, watered values, and hidden interests). *Id.*

146. Donworth, *A Review of the Securities Act of 1933*, 8 WASH. L. REV. 61, 68-69 (1933) (quoting Arthur D. Dean of the law firm Sullivan & Cromwell, and a member of the committee formed to study the proposed legislation, who argued the Act would be detrimental to business and listed 16 prophecies as to the effect of the Securities Act).

147. J. SELIGMAN, *supra* note 142, at 224.

148. Securities Act § 8(a), 15 U.S.C. § 77h(a) (1982).

149. H.R. REP. No. 85, *supra* note 55, at 7-8.

150. *Id.*

151. Securities Act § 8(b), 15 U.S.C. § 77h(b) (1982).

152. *Id.* § 8(d), 15 U.S.C. § 77h(d) (1982). If such is the case, the Commission will issue a stop order. Of course, the issuing party has a right to have any order of the SEC reviewed in the courts. *See* Securities Act § 9, 15 U.S.C. § 77i (1982).

153. Securities Act § 5(c), 15 U.S.C. § 77e(c) (1982).

154. *Id.* § 5(b), 15 U.S.C. § 77e(b) (1982).

155. *Id.* § 23, 15 U.S.C. § 77w (1982). Section 24 of the Securities Act provides penalties for violators. *Id.* § 24, 15 U.S.C. § 77x (1982).

156. S. REP. No. 792, 73d Cong., 2d Sess. (1934). *See* Note, *Federal Regulation of Securities: Some Problems of Civil Liability*, 48 HARV. L. REV. 107, 108 (1934) (citing *Report of Senate Committee on Banking and Currency on S. 3420*).

157. Note, *supra* note 156, at 108. Additional protection is provided by the Security Act's antifraud provision making all schemes to defraud unlawful. *Id.* § 17, 15 U.S.C. § 77q (1982).

laws, Congress recognized that private actions for damages could play an important role in assuring compliance.<sup>158</sup> Although there was some opposition to the civil liability sections, the atmosphere in 1933 was not conducive to restraint. During floor debate the majority of the criticisms was that the Act did not go far enough in taking corrective action.<sup>159</sup>

The drafters used the securities laws to modify the common law notions of deceit. The provisions dealing with fraud were reactions to the common law obstacles to recovery. At common law, a remedy for an action in deceit was severely limited because the buyer had to prove that the seller knowingly made the false statement.<sup>160</sup> Additional problems of obtaining jurisdiction over the seller and varying common law elements in deceit further supported the need for a single standard to provide those defrauded in securities transactions an appropriate remedy.<sup>161</sup>

Liability arising out of the filing of a registration statement is predicated on an untrue statement of a material fact or on an omission of a material fact that was necessary in order to make other statements not misleading.<sup>162</sup> Various individuals, including every person who signs the registration statement, every director, every expert preparing the registration statement, and every underwriter, are jointly and severally liable.<sup>163</sup> Section 11 acts as an “*in terrorem*”<sup>164</sup> remedy to deter violations by encouraging careful preparations. Opponents were unsuccessful in convincing Congress in 1933 to limit section 11 liability to only those who actually sold the security, excepting directors and experts.<sup>165</sup> Section 11 is based on the legal principle that if one of two innocent persons must bear the loss, that person should bear it who has the opportunity to learn the truth and has allowed untruths to be published and relied upon.<sup>166</sup>

To recover, the purchaser need only establish that the assertion or assertions in the registration statement omitted material information required to be included.<sup>167</sup> At common law there is no duty to disclose all information in an arm’s length relationship; however, “a duty to speak may arise from partial disclosure, so that the speaker, although not under a duty to speak, has a duty to tell the whole truth if he does speak.”<sup>168</sup>

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158. H. BLOOMENTHAL, *SECURITIES LAW IN PERSPECTIVE* 64 (1977).

159. Nussbaum, *supra* note 66, at 48.

160. Shulman, *Civil Liability and the Securities Act*, 43 *YALE L.J.* 227, 235 (1933). Although the Securities Act changed the existing common law, some believed the courts would have reached the same conclusion over a period of time through case development. H. BLOOMENTHAL, *supra* note 8, at 402.

161. Shulman, *supra* note 160, at 238–39.

162. Securities Act § 11(a), 15 U.S.C. § 77k(a) (1982).

163. Securities Act § 11(f), 15 U.S.C. § 77k(f) (1982).

164. “Both in the extent of liability imposed—the variety of persons to whom the liability is attached, the bases of the liability, and the persons in whose favor it runs—and in the limitations of the amounts recoverable, the *in terrorem* function of the [Securities] Act is evidenced.” Shulman, *supra* note 160, at 227.

165. Ballantine, *Amending the Federal Securities Act*, 20 *A.B.A. J.* 85, 87 (Fall 1934).

166. S. REP. No. 47, *supra* note 130, at 4–5.

167. Securities Act § 11(a), 15 U.S.C. § 77k(a) (1982).

168. Ruder, *supra* note 135, at 661. Typically, a purchaser alleging fraud has a difficult burden. He must show the following elements: (1) false representation of a material fact; (2) knowledge of falsity; (3) intent to deceive; (4) action in reliance based on the false representation; and (5) damages. PROSSER & KEETON ON TORTS § 108 (W. Keeton ed. 1984 & Supp. 1988). See also Securities Act § 11(a), 15 U.S.C. § 77k(a) (1982).

The liability of the issuer for violations of section 11 of the Securities Act is almost absolute. The issuer's only two defenses available are that the purchaser knew the statement was not true at the time of the sale or that the statute of limitations has run.<sup>169</sup> Individual defendants are treated differently. In addition to the defenses available to the issuer, individual defendants are not liable if they can prove one or all of the following: (1) reliance on experts as to that section of the statement; (2) reasonable investigation and reasonable grounds for belief, and belief that the registration statement was true, complete, and not misleading; or (3) that the part of the registration statement sued on was allegedly made by an official person or is extracted from an official document and the defendant had reason to believe it was not misleading and fairly represented the statement made by the official.<sup>170</sup>

Section 11 of the Securities Act had involved much controversy and sharp differences of opinions in Congress as to the degree of responsibility of these persons to the purchaser of securities.<sup>171</sup> One side believed liability should be "absolute" since those who signed the registration statement were in the best position to know the truth of the statement.<sup>172</sup> Others argued this went too far and that section 11 should follow the English principle and merely place the burden of proof on the seller.<sup>173</sup> A compromise was struck; added to section 11 was a definition of "reasonable investigation."<sup>174</sup> The Exchange Act amended the Securities Act, changing the definition of reasonable investigation from that "required of a person occupying a fiduciary relationship,"<sup>175</sup> to that of "a prudent man in the management of his own property."<sup>176</sup>

Section 12<sup>177</sup> imposes liability on any person who sells a security in violation of section 5<sup>178</sup> or sells a security by means of "a prospectus or oral communication, which includes an untrue statement of material fact or omits to state a material fact necessary in order to make the statements, in light of the circumstances under which they were made, not misleading . . . ."<sup>179</sup> The burden is on the seller of the security to prove it did not know, and in the exercise of reasonable care, could not have known, of such untruth or omission.<sup>180</sup> The drafters knew they were changing the common law; however, the shift in the burden of proof was necessary because the buyer is not in a position to give convincing proof of an offense.<sup>181</sup> Additionally, the drafters did not want to limit purchasers' recovery, and specifically provided that all

169. Douglas & Bates, *supra* note 132, at 190.

170. Securities Act § 11(b)(3), 15 U.S.C. § 77k(b) (1982).

171. Chamberlain, *Securities Act*, 19 A.B.A. J. 643, 645 (1933).

172. *Id.*

173. *Id.*

174. *Id.*

175. "Measuring the defendant's reasonable investigation and reasonable ground for belief by that of a 'fiduciary' was one of the bogys of the original act." Comment, *Amendment to the Securities Act of 1933*, 32 MICH. L. REV. 1130, 1135 (1934).

176. Securities Act § 11(c), 15 U.S.C. § 77k(c) (1982).

177. *Id.* § 12, 15 U.S.C. § 77l (1982).

178. *Id.* § 5, 15 U.S.C. § 77e (1982).

179. *Id.* § 12(2), 15 U.S.C. § 77l(2) (1982).

180. *Id.*

181. H. REP. NO. 85, *supra* note 55, at 9-10.

other rights and remedies existing at law or equity would be preserved, although, double recovery under the federal securities and state common laws would be precluded.<sup>182</sup>

When a prospectus or registration statement is in violation of the Securities Act, anyone who purchases a security can rescind the transaction or sue to recover damages if the purchaser has sold the security.<sup>183</sup> The purchaser must bring an action within one year of discovery of the untrue statement or within one year of when the untrue statement should reasonably have been discovered.<sup>184</sup> In any event no suit may be brought under sections 11 or 12(2) of the Securities Act three years after the security was offered to the public.<sup>185</sup>

### B. *The Securities Exchange Act of 1934*

The many complexities and inadequacies of the Securities Act and the need for an independent administrative body to enforce the federal securities laws, regulate stock market practices, and curb the evils in the stock exchanges themselves led Congress to enact the Securities Exchange Act of 1934. Benjamin Cohen and Tom Corcoran<sup>186</sup> drafted a bill designed to establish the Securities and Exchange Commission to regulate the securities business; require the stock exchanges to adopt rules of fair dealing; apply the full disclosure requirements of new securities under the Securities Act to all securities traded on a national exchange; and instruct the Federal Reserve Board to regulate the use of borrowed money in the stock market.

Initially, Roosevelt and the House of Representatives wanted jurisdiction of the Acts to remain with the FTC. However, the Senate agreed with the drafters and lobbied for a new regulatory agency.<sup>187</sup> Eventually the Senate prevailed and the Securities and Exchange Commission was formed.<sup>188</sup> Roosevelt's first appointees to the five-member Commission were well-known: including Ferdinand Pecora, James Landis, Robert Healy, George Mathews, and Joseph Kennedy.<sup>189</sup> Kennedy was the

182. Exchange Act § 28(a), 15 U.S.C. § 78bb(a) (1982). Note also that common law will allow for punitive damages, unlike Federal securities laws.

183. Securities Act §§ 11(a), 12(2), 15 U.S.C. §§ 77k(a), 77l(2) (1982). Rescission is available under § 12 and damages under § 11. Note that § 12(a) liability under the Exchange Act covers all securities, not just those in registration statements. 15 U.S.C. § 78l(a) (1982). The buyer must show: (1) purchase of a security; (2) the use of jurisdictional means in connection with the sale; and (3) a false or misleading statement made in connection with the sale. The exemptions set forth in §§ 3 and 4 of the Securities Act are not applicable with respect to actions brought under the antifraud provisions of the Securities Act (*i.e.*, §§ 12(2) and 17). 15 U.S.C. § 77c (1982). A plaintiff establishes a *prima facie* case by merely proving the purchase of a security. *SEC v. Ralston Purina Co.*, 346 U.S. 119, 126 (1953).

184. Securities Act § 13, 15 U.S.C. § 77m (1982). Note that the original Act had a two year statute of limitations. See Comment, *supra* note 175, at 1136-37 (the Exchange Act amended the Securities Act to change the statute of limitations). Additionally, actions brought under § 12(1) must be brought within one year after the violation. 15 U.S.C. § 77m(1) (1982).

185. Securities Act § 13, 15 U.S.C. § 77m (1982). The original Act had a ten year statute of limitations.

186. These two individuals were the principal drafters. Providing assistance were James Landis, David Schenter, Ferdinand Pecora, Max Lowenthal, and John Flynn. R. DEBEDTS, *THE NEW DEAL'S SEC 60* (1964). For a discussion of the drafting of the Securities Act by some of these same individuals see *supra* notes 99-102 and accompanying text.

187. Tracy & MacChesney, *The Securities Exchange Act of 1934*, 32 MICH. L. REV. 1025, 1039 n.24 (1934).

188. Exchange Act § 4, 15 U.S.C. § 78d (1982).

189. J. SELIGMAN, *supra* note 1, at 106. Pecora and Landis have been mentioned earlier in this Article. See *supra* text accompanying notes 86-89 and 112-16, respectively. Healy was longtime chief counsel for the FTC; Mathews had considerable experience as administrator of Wisconsin's progressive securities laws; and Kennedy was a staunch Roosevelt supporter and highly successful businessman. *Id.* at 101-09.

only controversial appointment. Many questioned Kennedy's fitness because he had made his fortune in the 1920s through market manipulation and insider trading.<sup>190</sup> Kennedy had once remarked: "It's easy to make money in this market . . . [w]e'd better get in before they pass a law against it."<sup>191</sup> Roosevelt jokingly justified Kennedy's appointment claiming the motto "it-takes-a-thief-to-catch-a-thief."<sup>192</sup> Roosevelt's insight proved correct as Kennedy's Wall Street background enabled him to conciliate the financial community without compromising the principles of the Acts.

Of course, as with the Securities Act, there was opposition to the Exchange Act. James H. Rand, Jr. of Remington-Rand felt the Exchange Act would push the nation "along the road from Democracy to Communism."<sup>193</sup> Congressman Fred Britten concurred: "The real object of the bill is to Russianize everything worthwhile. . . ."<sup>194</sup> Despite such feelings of ill will, Florida Senator Duncan Fletcher and Speaker of the House Sam Rayburn took the lead in their respective houses, as they did for the Securities Act, to muster support for the bill. Their efforts were instrumental in getting the Exchange Act to pass by substantial majorities.<sup>195</sup>

The Exchange Act intended to reach various exchange abuses: notably speculation and market manipulation.<sup>196</sup> The most common forms of speculation are short selling and margin trading. A short sale "is made when a trader sells on the market shares of stock he does not . . . own, but . . . expects to acquire later when the market price shall reach a lower level."<sup>197</sup> In order to meet the delivery requirements, the seller "borrows through his broker the requisite number of shares from another broker."<sup>198</sup> The seller then "covers" by purchasing the shares in the market, hopefully at a lower price. Margin trading "involves the process by which a portion of the capital required by a customer in buying or in selling short any given number of shares of stock is supplied by loans made to him by the broker."<sup>199</sup> Although speculation in certain circumstances is acceptable,<sup>200</sup> the deliberate efforts of a dishonest trader to artificially raise or lower the price of a particular security to make profits at the expense of the investing public is not allowed.<sup>201</sup>

190. *Id.* at 103-04; D. KOSKAFF, *JOSEPH KENNEDY: A LIFE AND TIMES* 25-27 (1974). Before the 1929 crash and subsequent regulation, an operator could make a fortune through market manipulation. Although not everyone participated in such activities, those who did were considered shrewd, not immoral. *Id.* at 51.

191. J. SELIGMAN, *supra* note 1, at 25.

192. *Id.* at 56.

193. *Id.* at 55.

194. *Id.*

195. R. DEBEDTS, *supra* note 186, at 75-76. The Exchange Act passed the House of Representatives by a vote of 281 to 84 and the Senate, 62 to 13.

196. Tracy & MacChesney, *supra* note 187, at 1027.

197. *Id.*

198. *Id.* at 1028.

199. *Id.* at 1029.

200. Many testified that short selling was necessary to market trading and stabilization. See LETTER FROM THE COUNSEL FOR THE COMMITTEE ON BANKING AND CURRENCY, 72D CONG., 1ST SESS., REPORT ON STOCK EXCHANGE PRACTICES 5-6 (Comm. Print 1933).

201. Tracey & MacChesney, *supra* note 187, at 1031.

Section 10(a) of the Exchange Act addresses short sales, prohibiting such sales except those in accordance with such rules and regulations as the Commission may deem "necessary or appropriate in the public interest or for the protection of investors."<sup>202</sup> Similarly, margin trading is effectively regulated by section 7(a),<sup>203</sup> preventing "excessive use of credit in purchasing or carrying securities."<sup>204</sup> Speculation is further limited as capital requirements prevent brokers from extending "excessive amounts of credit for the purpose of speculation."<sup>205</sup> Those opposing margin and capital requirements had argued that any requirement was too inflexible,<sup>206</sup> but again the proponents of strict regulation carried the day.

Congress was quite concerned about market manipulation. Various sections of the Exchange Act prohibit manipulative devices,<sup>207</sup> prohibit manipulative pricing,<sup>208</sup> and regulate broker and dealer activities.<sup>209</sup> A proposed bill had severely limited the practices of brokers and dealers; however, heavy opposition convinced the drafters to merely empower the Commission to formulate rules on the regulation of floor activities, while the segregation of broker-dealer functions was relegated to future studies.<sup>210</sup> Despite the temporary reprieve, those favoring more extensive regulation eventually prevailed, as evidenced by the rules promulgated by the Commission.

In addition to Commission regulation, the Exchange Act provides individual purchasers the right to sue those who willfully violate its manipulative prohibitions.<sup>211</sup> Those who willfully violate any provision of the Exchange Act or any rule or regulation thereunder, or are responsible for making a statement false or misleading are subject to criminal liability.<sup>212</sup> By imposing liability, the Exchange Act attempts to ensure adequate publicity of corporate management and finances. Many opponents to the enactment of these provisions argued that the publicity requirements led to usurpation by the government of the proper functions of corporate management.<sup>213</sup> Congress was not persuaded that the registration requirements of the Securities Act or the listing requirements of the New York Stock Exchange

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202. Exchange Act § 10(a), 15 U.S.C. § 78j(a) (1982).

203. *Id.* § 7(a), 15 U.S.C. § 78g(a) (1982). Section 7 also directs the Federal Reserve Board to periodically revise margin requirements. *Id.* § 7(b), 15 U.S.C. § 78g(b) (1982).

204. Tracy & MacChesney, *supra* note 187, at 1040.

205. *Id.* at 1042; *see also* Exchange Act § 8(a), 15 U.S.C. § 78h(a) (1982).

206. Tracy & MacChesney, *supra* note 187, at 1043.

207. Exchange Act § 10, 15 U.S.C. § 78j (1982).

208. *Id.* § 9, 15 U.S.C. § 78i (1982).

209. *Id.* § 11, 15 U.S.C. § 78k (1982).

210. Tracy & MacChesney, *supra* note 187, at 1044-45. Thus the Commission was able to make exceptions for transactions necessary to maintain an efficient market (*i.e.*, arbitrage—"a system by which two markets on which the same security is traded in are brought into relationship with each other by buying on one market and selling on the other."). *Id.* at 1045 n.53.

211. Exchange Act § 9(e), 15 U.S.C. § 78i(e) (1982).

212. *Id.* § 32, 15 U.S.C. § 78ff (1982).

213. *See Hearings Before the Comm. on Banking & Currency, Part 15—Nat'l Sec. Exchange Act 1934*, 72d Cong., 2d Sess., and 73d Cong., 1st Sess., 1934, *reprinted* in 6 LEGISLATIVE HISTORY OF THE SECURITIES ACT OF 1933 AND SECURITIES EXCHANGE ACT OF 1934 item 22, at 6421 (comp. by J.S. Ellenberger & E. Mahar 1973) [hereinafter *Senate Hearings—Part 15*], where many criticisms of the first draft were made by corporate executives and exchange officials, especially, *id.* at 6624 (statement of Richard Whitney, President NYSE). *See also* 7 *id.* at 7485 (statement of Whitney on the revised bill). *See generally* Edwards, *Control of the Security Investment System*, 12 HARV. BUS. REV. 1 (1933); Comment, *Disclosure of Corporate Affairs*, 47 HARV. L. REV. 335 (1933).

adequately provided continuing information and addressed the problem in section 12 of the Exchange Act.<sup>214</sup>

Section 18(a) of the Exchange Act provides purchasers an express private right of action if they have been injured due to reliance on documents required to be filed under the Exchange Act.<sup>215</sup> Although section 18(a) of the Exchange Act parallels section 11 of the Securities Act,<sup>216</sup> it is less effective because, unlike sections 11 and 12, section 18(a) requires the buyer to prove that she read the statement, and actually relied on the material misrepresentation.<sup>217</sup>

The Exchange Act reached securities listed on the exchange by prohibiting trading unless registered pursuant to the Act.<sup>218</sup> Rather than specific regulations, the Commission was directed to make a study and report to Congress concerning unlisted securities traded on the exchange,<sup>219</sup> and over-the-counter securities were to be regulated by rules and regulations promulgated by the Commission.<sup>220</sup> In effect, section 12 of the Exchange Act requires securities listed on the national securities exchanges to be registered and to contain information similar to the information requirements of new issues under the Act.<sup>221</sup>

The Exchange Act also requires periodic reports necessary to keep reasonably current the information on material filed pursuant to section 12.<sup>222</sup> William O. Douglas had criticized the Securities Act because it failed to regulate securities once the securities were registered. He contended that the Securities Act was "superficial" because there was "no machinery for periodic reports."<sup>223</sup> An earlier draft of the section was quite stringent, requiring quarterly reports to be certified by public accountants.<sup>224</sup> However, testimony as to the extreme expense convinced Congress to require certified financials only once a year.<sup>225</sup> Proxies are similarly regulated, as they are prohibited unless they comply with the regulations of the Commission.<sup>226</sup>

From the outset, Congress was concerned with insider trading. Some argued insider trading was "among the most vicious practices unearthed . . . [and] was the flagrant betrayal of . . . [the] fiduciary duties [of] directors and officers of corporations who used their positions of trust and the confidential information which came to them in such positions, to aid them in their market activities."<sup>227</sup>

214. Tracy & MacChesney, *supra* note 187, at 1049.

215. Exchange Act § 18(a), 15 U.S.C. § 78r(a) (1982).

216. *See supra* text accompanying notes 162-85.

217. *Jacobsen v. Peat, Marwick, Mitchell & Co.*, 445 F. Supp. 518, 525 (S.D.N.Y. 1977).

218. Exchange Act § 12, 15 U.S.C. § 78l (1982).

219. Tracy & MacChesney, *supra* note 187, at 1051. The 1938 Maloney Act amendment to the Exchange Act "provided a measure of self-regulation of the business practices of the over-the-counter market securities industries under the general aegis of the SEC." Loss, *supra* note 7, at 31 n.16. *See also* Exchange Act § 15, 15 U.S.C. § 78o-3 (1982).

220. Tracy & MacChesney, *supra* note 187, at 1052.

221. *Id.* at 1053.

222. Exchange Act § 13(a), 15 U.S.C. § 78m(a) (1982).

223. Douglas, *Protecting the Investor*, 23 YALE REV. (n.s.) 521 (1934).

224. *See Senate Hearings—Part 15, supra* note 213, at 6624 (statement of Richard Whitney, President NYSE); *id.* at 6529 (testimony of Thomas Corcoran, counsel for the Reconstruction Finance Commission); *id.* at 6533 (testimony of Corcoran, reading testimony of Fred Y. Presley, manager of investment trust, before the House Committee).

225. *Id.* at 1175-83 (statement of George A. May, member of Price, Waterhouse & Co.).

226. Exchange Act § 14(a), 15 U.S.C. § 78n(a) (1982).

227. *Stock Exchange Practices: Report of Senate Comm. on Banking and Currency*, S. REP. NO. 1455, 73d Cong.,

Congressman Lea aptly noted: "We have had the ugly picture of corporation officials juggling with the stocks of their own companies, preying on their own stockholders through inside information they obtained as trustees of the trust they violated."<sup>228</sup> The insider trading section was highly controversial and various corporate executives testified against the section, claiming that

this section would prevent corporations from having directors; that the profits from dealing in their own stock served as compensation; that extending the prohibition to large stockholders would discourage investment by strong men who would be valuable to the corporation; that the great majority of officers and directors of . . . corporations have been actuated by a high sense of fiduciary obligation to stockholders.<sup>229</sup>

Congress was not convinced by the opponents' arguments. The drafters supplied section 16<sup>230</sup> of the Exchange Act with a three-fold attack on the problem. First, the Exchange Act requires reporting by certain insiders of their stock holdings and transactions in the company's securities.<sup>231</sup> Second, it makes it unlawful for the same insiders to engage in short sales of their company's equity securities.<sup>232</sup> Third, it permits the corporation or security holder bringing an action on behalf of the corporation to disgorge and recover for the benefit of the corporation any short-swing profits arising from the purchase and sale or sale and purchase by insiders within any six month period.<sup>233</sup> This section allows disgorgement within the six month period regardless of fault. The *in terrorem* approach is used because it is difficult for the corporation or shareholder to prove actual intent of the insider.<sup>234</sup> Beneficial owners of more than ten percent of a corporation's shares<sup>235</sup> are similarly regulated.

Of course the Exchange Act did not stop all unethical, fraudulent, and criminal acts perpetuated in the securities markets. Although the Exchange Act's critics were numerous, most of the opposition to the Commission's presence on Wall Street had subsided after the Exchange Act became law. Interestingly enough, Richard Whitney, former New York Stock Exchange president and key opponent of the Exchange Act throughout the Congressional hearings, was silenced when his own firm (Richard Whitney & Company) was suspended from membership on the New York Stock Exchange for "conduct inconsistent with just and equitable principles of trading."<sup>236</sup>

2d Sess., 55 (1934), reprinted in 5 LEGISLATIVE HISTORY OF THE SECURITIES ACT OF 1933 AND SECURITIES EXCHANGE ACT OF 1934 item 21, at 55 (comp. by J.S. Ellenberger & E. Mahar 1973).

228. 78 CONG. REC. 7861, 7862 (1934) (remarks of Congressman Lea).

229. Tracy & MacChesney, *supra* note 187, at 1056 n.93, (citing *Hearings before the Senate Comm. on Banking and Currency*, 72d Cong., 2d Sess., and 73d Cong., 1st & 2d Sess's. (1934)).

230. Exchange Act § 16, 15 U.S.C. § 78p (1982).

231. Section 16(a) of the Exchange Act provides in part: "Every person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity security. . . which is registered pursuant to section 12 of this title, or who is a director or officer of the issuer of such security . . ." 15 U.S.C. § 78p(a) (1982).

232. *Id.* § 16(e), 15 U.S.C. § 78p(e) (1982).

233. *Id.* § 16(b), 15 U.S.C. § 78p(b) (1982). Although the action must be brought by the corporation or a shareholder and recovery is for the benefit of the corporation, attorney fees may be awarded by the court out of the amounts recovered. *Smolowe v. Delendo Corp.*, 136 F.2d 231, 241 (2d Cir.), *cert. denied*, 320 U.S. 751 (1943).

234. *Smolowe v. Delendo Corp.*, 136 F.2d 231, 235 (2d Cir.), *cert. denied*, 320 U.S. 751 (1943) (citing *Hearings Before the Committee on Banking and Currency on S. 84*, 72d Cong., 2d Sess., and S. 56 and S. 97, 73d Cong., 1st & 2d Sess's. 6557 (1935)).

235. Exchange Act § 16, 15 U.S.C. 78p (1982).

236. F. CORMIER, WALL STREET'S SHADY SIDE 11 (1962).



Whitney had misappropriated over \$5.6 million in customer funds in a desperate effort to avoid personal bankruptcy. One of the most outspoken critics of the Commission on Wall Street ended up serving over three years at Sing Sing Prison.<sup>237</sup>

#### IV. CONCLUSION

The Securities Act of 1933 and the Securities Exchange Act of 1934 are much the same as they were when initially enacted. This is not to say that over the years there have been no substantive changes in these Acts, or that there have been no controversies. Subsequent amendments by Congress have been limited, leaving the bulk of discussion and development of securities law to the Commission and the courts. Among some of the controversies that remain today are the implied rights of action; the powerful Commission enforcement weapon under rule 10b-5; insider trading; and the regulation of takeovers and tender offers. This Article has reviewed the history of the federal securities laws to set the stage for the articles that follow.

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