Denver Law Review

Volume 11 | Issue 1 Article 4

January 1933

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Recommended Citation
Horace N. Hawkins, Jr., Outline of the Securities Act of 1933, 11 Dicta 4 (1933).

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OUTLINE OF THE SECURITIES ACT OF 1933

By HORACE N. HAWKINS, JR., *of the Denver Bar*

THE Securities Act of 1933, so entitled in Section 1 of act itself, is Title I of Public Statute No. 22 of the 73rd Congress of the United States, and was approved by the President of the United States and became effective on May 27, 1933. It may be said to have two general purposes, first, to regulate the sale of securities which it is proposed to offer to the general public through the channels of interstate commerce, and second, to close the mails and the means of interstate transportation and communication to sales of securities involving certain condemned practices and methods. In its broad aspects this legislation would seem to have clear constitutional sanction, whatever may be thought of the validity of some of its details.

Insofar as the first purpose of the act is concerned, the regulation of the interstate sale of securities, it has been called —with entire aptness—a National Blue Sky Law, and is intended to cover and does cover with respect to interstate commerce the same general phases of the business of finance that typify the subject matter of the modern blue sky law.

The first question that naturally suggests itself is as to what securities are included within the scope of the regulatory provisions of the act. The answer is a problem in subtraction, or perhaps more accurately in elimination, because the statutory definition of security is intended to be and is so all-inclusive as to cover any instrument which through commercial usage is known as a security, and it is necessary to examine Section 3, which deals with exempted securities, and if any given security is not therein described, it is subject to the terms of the Securities Act.

Those securities privileged by exemption are as follows:

(1) Any security which, prior to or within 60 days after the date of the Act (the date of the Act being May 27, 1933) has been sold or disposed of by the issuer (and who is an "issuer" will be hereinafter discussed) or within such time bona fide offered to the public; but no new offering thereof is exempt.

(2) Domestic Governmental and Municipal securities and those of domestic governmental instrumentalities and agencies.

(3) Securities issued by National Banks, Federal Reserve Banks, and State Banks the businesses of which are substantially confined to banking and which are under state supervision.

(4) Drafts, notes, bills of exchange, and bankers' acceptances which arise out of or the proceeds of which are to be used in current transactions, provided they mature in not exceeding 90 days from the date of issue, or if renewed, are not renewed for more than that period of time.

(5) Securities of certain charitable corporations, using that word in the broad sense, which are not operated for profit.

(6) Securities of building and loan associations and similar institutions, substantially all the business of which is confined to making loans to members, provided the issuer does not deduct more than 3 per cent of the face value of the security from the total amount paid by a purchaser.

(7) Securities issued by a farmer's cooperative association as defined in the Revenue Act of 1932.

(8) Securities issued by a receiver or a trustee in bankruptcy.

(9) Securities issued by a common carrier subject to the Interstate Commerce Act.

(10) Any insurance, endowment, or annuity policy or contract issued by a corporation subject to state supervision.

(11) Such other classes of securities, where the amount offered to the public does not exceed $100,000, as the Federal Trade Commission shall declare exempt by reason of the small amount involved or the limited character of the offering. No additional class of security has as yet been declared exempt by the Federal Trade Commission.

Any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting trust certificate, certificate of interest in property, tangible or intangible, or any other instru-

ment commonly known as a security, or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing, which is not also described in the foregoing eleven exempt classes, is a security within the meaning of the Securities Act of 1933.

Every transaction concerning a security embraced within the meaning of that term as used in the Act, does not, however, call for compliance with the regulatory requirements thereof. Certain classifications of entities, actual and fictional, are recognized. The Act defines a "person" as that term is used therein as including individuals, corporations, partnerships, associations, joint stock companies, unincorporated associations, governments and political subdivisions thereof, and trusts the beneficial interests wherein are evidenced by a security.

"Persons" in turn, are, unless the context of the Act otherwise requires, divided into and considered as belonging to the following classes: (1) issuers, (2) underwriters, (3) dealers, and (4) persons other than issuers, underwriters and dealers.

An "issuer" is any person who issues or proposes to issue any security or who guarantees the same either as to principal or income; except that with respect to certificates of deposit, voting trust certificates, collateral trust certificates, or certificates of interest or shares in an unincorporated investment trust not having a board of directors or persons performing similar functions or of the fixed, restricted management or unit type, "issuer" means the person performing the duties of depositor or manager; and except that with respect to such securities as equipment-trust certificates "issuer" means the person by whom the property is to be used.

An "underwriter" is any person who has purchased from an issuer or from any person controlling or controlled by or under common control with the issuer, a security with a view to the distribution thereof, or who sells a security for an issuer or for any person controlling or controlled by or under common control with the issuer, in connection with the distribution thereof, or who participates in or in the underwriting of either of such undertakings, but the term "under-

writer" does not include one whose interest is limited to the receipt from an underwriter or dealer of the usual and customary distributors' or sellers' commission.

A "dealer" is any person engaged in the business of dealing in securities issued by another person.

Having in mind the foregoing classifications of persons, there are seven classes of transactions with respect to securities of the kind otherwise included within the regulatory features of the Securities Act, which are not governed by such regulations solely on account of the nature of such transactions, and they are as follows:

(1) transactions by any person other than an issuer, underwriter or dealer,

(2) transactions by an issuer not through or with an underwriter and not involving a public offering,

(3) transactions by a dealer subsequent to one year after the last date on which the security was offered to the public by the issuer or through an underwriter, provided such transactions are not with reference to securities constituting any part of an unsold allotment to or subscription by such dealer as a participant in the distribution thereof by the issuer or by or through an underwriter,

(4) brokers' transactions executed on customers' orders on any exchange or in the open or counter market,

(5) the issuance of a security of a person which is exchanged, without remuneration, to existing security holders exclusively,

(6) the issuance of securities to existing security holders or creditors of a corporation in the process of reorganization under court supervision, and

(7) preliminary negotiations and agreements between issuer and underwriter.

If any given security comes within the broad statutory definition of "security" and does not come within any of the hereinbefore mentioned eleven classes of exempted securities, certain acts are forbidden and made unlawful except in the negotiation or consummation of the seven types of transactions just mentioned, unless the registration provisions of the Act hereinafter discussed are complied with. These acts, so

forbidden in the absence of effective registration, are as follows:

(1) To use any means of transportation or communication in interstate commerce to sell or to offer to buy (and note this restriction on a purchaser) such security.

(2) To carry or cause to be carried in interstate commerce any such security for the purpose of sale or for delivery after sale.

(3) To use the mails to sell or offer to buy (again the restriction on the purchaser) such security or as a carrier of or for such security for the purpose of sale or delivery after sale, except where the issue of which such security is a part is sold only to residents of a single state and where the issuer is a resident of and doing business within, or, if a corporation, incorporated and doing business within, such state.

In order to use the mails and other means of transportation and communication in the interstate sale of non-exempt securities, if such sales do not come within the exempted classes of transactions hereinbefore noted, a registration statement must be in effect with regard to such securities.

Registration is accomplished by filing a registration statement in triplicate with the Federal Trade Commission, and at least one of such copies must be signed by each issuer, its principal executive officers, its principal financial officer, its principal accounting officer, and the majority of its board of directors or persons performing similar functions, or if neither board of directors nor similar functionaries exist, by the majority of the persons or board having the power of management of the issuer, and if the issuer is a foreign or territorial person the statement must also be signed by its United States representative; however, if the issuer is a foreign government or political subdivision thereof, the statement need only be signed by the underwriter of the security. When the statement is filed, a fee of one one-hundredth of one per cent of the aggregate price at which the securities are to be offered must be paid, with a minimum fee fixed at $25.00.

The Act prescribes thirty-two items which must appear in a registration statement or in documents accompanying the same when relating to a security other than one issued by a foreign government or political subdivision thereof, and

fourteen items are so required when the statement relates to a security issued by a foreign government or political subdivision thereof. The Federal Trade Commission is given the power to provide that any such information or document need not be furnished in respect to any class of issuers or securities if it considers the same inapplicable to that class and that disclosures adequate to the protection of investors are elsewhere required in the statement.

If the statement names any accountant, engineer, or appraiser, or any person whose profession gives authority to his statement, as having prepared or certified any part of the registration statement, or as having prepared a report or valuation for use in connection therewith, such person's written consent must be filed with the registration statement. If any such person is named as having prepared or certified a report or valuation (other than a public official document or statement) used in connection with the registration statement, but is not named as having prepared or certified the same for use in connection therewith, the written consent of such person must be filed with the registration statement unless the Federal Trade Commission dispenses with such filing as impracticable or an undue hardship on the registration applicant.

The Commission is also given authority to by rule or regulation require other information and documents to be incorporated in or filed with the registration statement.

A registration statement becomes effective on the twentieth day after it is filed, except in the case of a foreign public authority which is not in default in its obligations in the United States, which becomes effective seven days after it is filed, but if an amendment thereto is filed prior to the effective date the statement is considered filed when such amendment is filed, with a consequent postponement of effective date. However, if the amendment is filed with the consent or pursuant to an order of the Commission, it is treated as part of the registration statement and does not delay the effective date thereof.

If the Federal Trade Commission considers a registration statement incomplete or inaccurate, it may after notice not later than ten days after the filing thereof and after opportunity for a hearing not later than ten days from such notice, issue an order prior to the effective registration date refusing

to permit the statement to become effective until amended. When the statement is amended in accordance with the order the Commission shall so declare, and the registration shall become effective on the twentieth day following the original filing or on the date of such declaration, whichever is later.

Amendments filed after the effective registration date become effective on such dates as the Commission may determine.

The Commission is given authority, at any time it appears to it that a registration statement includes any untrue statement of fact or omits to state any fact required to be stated or necessary to make the statements therein not misleading, after notice and opportunity for hearing within fifteen days after such notice, to issue a stop order suspending the effectiveness of the registration statement. When the statement is amended in accordance with the stop order the Commission shall so declare and the stop order shall thereupon cease to be effective.

The Federal Trade Commission is empowered to make an examination in any case to determine whether a stop order should issue.

The notices required to be given by the Commission are to be given to the issuer, or in case of a foreign government or political subdivision thereof, to the underwriter, or in case of a foreign or territorial person, to its United States Representative, and such notices may be effected either by personal service or by telegraphic notice directed to the address given in the registration statement.

Orders of the Commission may be reviewed at the instance of any person aggrieved thereby, by filing a petition to set aside or modify any such order in the Circuit Court of Appeals of any circuit wherein the petitioner resides or has his principal place of business, or in the Court of Appeals of the District of Columbia, within sixty days after the date of the order. The petition is served upon the Commission and that body files in response a transcript of the record upon which the order was entered. The Court of Appeals in such review may consider only such objections as were urged before the Commission, and that body's findings of fact, if supported by the evidence are conclusive. Provision is made for the taking of additional material evidence if reasonable

grounds for failure to introduce the same at the hearing before the Commission exist, and for modification of its findings by the Commission itself on the basis of such additional evidence. The judgment or decree of the Court of Appeals is final, subject, however, to review by the Supreme Court on certiorari or certification under sections 239 and 240 of the Judicial Code. Commencement of a proceeding for review does not operate as a stay of the order complained of unless the court so orders.

After effective registration of a security is accomplished, contracts for the sale and disposition thereof, attempts and offers to dispose of and the solicitation of offers to buy the same or any interest therein, must be negotiated and carried on in compliance with the terms of the Act unless such transactions are within the exempted classes of transactions hereinbefore discussed or are wholly intrastate to the extent that no registration is required to engage therein. The terms of the Act with respect to these matters forbid the use of the mails or of any other means of transportation or communication in interstate commerce to carry any communication offering a registered security for sale, unless such communication meets the requirements of a statutory prospectus as prescribed by section 10 of the Act. This provision, however, does not apply if prior to such communication the person to whom it is made has received a statutory prospectus from the person making the communication or his principal, and does not apply to a communication which states from whom a statutory prospectus may be obtained and does no more than identify the security and state the price thereof and by whom orders will be executed. The Act also forbids any person, in the same circumstances under which the last mentioned prohibition obtains, to carry or cause to be carried through the mails or in interstate commerce any registered security for the purpose of sale or for delivery after sale unless it is accompanied or preceded by a statutory prospectus.

The statutory prospectus prescribed by section 10 of the Securities Act is required to contain the same statements made in the registration statement, with certain exceptions. However, if the prospectus is used more than thirteen months after the effective registration date of the statement, the information therein contained must be of a date not more than

twelve months prior to such use. Such other matters required to be in the registration statement may also be omitted from the prospectus as the Commission by rule or regulation so permits, and, conversely, the Commission may require by regulation the inclusion in the prospectus of information in addition to that required by the terms of the statute. If a prospectus consists of a radio broadcast, copies thereof must be filed with the Commission. The Commission is given broad powers to classify and prescribe the forms of prospectuses, and to require the filing with it of specimens or forms thereof.

The teeth in the Securities Act of 1933 consist, apart from the penalties prescribed for its violation, in the provisions imposing civil liabilities on account of false or misleading registration statements, prospectuses and communications.

If any part of a registration statement at the time it becomes effective contains an untrue statement of material fact, or omits to state a material fact which is required to make such statements as are made not misleading, any person acquiring the security to which the registration relates, unless he knew of such untrue statement or omission (and the burden of so proving is on defendants), may sue every person who signed the registration statement; every person who was a director or similar functionary of, or partner in the issuer at the time such part of the registration statement was filed; every person who with his consent is named in the registration statement as about to become a director or similar functionary, or about to become a partner; every underwriter of such security; and every accountant, engineer or appraiser, or person whose profession gives authority to his statements, provided he has with his consent been named in the registration statement as having certified or prepared any part thereof, or as having prepared or certified any report or valuation used in connection therewith—this last class of potential defendants, however, are liable only if the untruth or omission occurs in the part of the statement, report, or valuation which purports to have been prepared or certified by them. All who may be so sued are jointly and severally liable, and any person who by stock ownership, agency, agreement with those who have stock ownership or agency, or otherwise, con-

trols any person who may be so sued as aforesaid, is also liable jointly and severally with and to the same extent as such controlled person.

In such suit no statutory affirmative defense is available to the issuer other than that the person acquiring the security knew at the time he acquired the same of the untruth or omission complained of.

If liability is asserted against one, other than the issuer, by virtue of his having with his consent been named in some part of the registration statement as acting or agreeing to act in some office, capacity or relationship, he may plead as a defense that before the effective date of that part of the statement he had resigned from or refused to act in every such office, capacity or relationship and had advised the issuer and the Commission of such action and that he would not be responsible for that part of the statement, and he may also plead as a defense that such part of the statement became effective without his knowledge and that upon becoming aware of such fact he forthwith resigned or refused to act and advised the Commission as aforesaid, and that he also gave reasonable public notice that such part of the statement had become effective without his knowledge.

When liability is asserted against one other than an issuer with regard to part of a registration statement not purporting to be made on the authority of an expert, nor to be a copy of or extract from an expert's report or valuation, nor to be made on the authority of a public official document, such person may allege and prove as a defense that after reasonable investigation he had reasonable ground to and did believe at the time that part of the statement became effective, that the statements therein were true and that there was no omission to state a material fact required therein or necessary to make the same not misleading.

A person other than an issuer sued on account of an alleged untruth or omission in part of a registration statement purporting to be made upon his authority as an expert or to be a copy of or extract from a report or valuation of himself as an expert has two affirmative defenses, first, that after reasonable investigation he had reasonable grounds to and did believe, at the time such part of the statement became effective, that the statements therein were true and that there was no

omission to state any fact required therein or necessary to make the same not misleading, and, second, that such part of the registration statement did not fairly represent his statement as an expert or was not a fair copy of or extract from his report or valuation.

A defendant, other than an issuer, from whom recovery is sought on the ground of an untruth or omission in any part of a registration statement purporting to be made on the authority of an expert (other than himself) or to be a copy of or extract from a report or valuation of an expert (other than himself), may avoid liability by showing that he had reasonable grounds to and did believe, at the time such part of the statement became effective, that the statements therein were true and that there was no omission to state a material fact required therein or necessary to make the same not misleading, and that such part of the registration statement fairly represented the statement of the expert or was a fair copy of or extract from his report or valuation.

Where the asserted liability is against one other than an issuer, and is based on an untruth or omission in any part of a registration statement purporting to be a statement made by a public official or to be a copy of or extract from a public official document, the defendant may exculpate himself by showing that he had reasonable ground to and did believe at the time such part of the statement became effective, that the statements therein were true and that there was no omission to state a material fact required therein or necessary to make the same not misleading, and that such part of the registration statement fairly represented the public officer's statement or was a fair copy of or extract from the public official document.

In determining what constitutes reasonable investigation and reasonable grounds for belief, the statute prescribes the standard of reasonableness required of a person occupying a fiduciary relationship.

If a person becomes an underwriter of a security after the part of the registration statement with respect to which his liability is asserted has become effective, that part of the statement is considered effective as to him as of the date he became such underwriter, insofar as it affects his affirmative defenses based on any grounds other than his resignation from any

and all offices, capacities, and relationships in which he is in the registration statement stated to be acting or to have agreed to act in.

The suit which may be so brought on account of any such untruth or omission in the registration statement may be to recover the consideration paid for the security, plus interest thereon, less any income therefrom, upon tender of the security, or it may be for damages if the plaintiff no longer owns the security; but in no case may the recovery exceed the price at which the security was offered to the public. The action must be instituted within two years after the discovery of the untrue statement or omission or after such discovery should by the exercise of reasonable diligence have been made, but in no event may it be brought more than ten years after the security was offered to the public.

In addition to the foregoing liability for untruth or omission in the registration statement, liability is also incurred to the purchaser of a security by the seller thereof, to the extent of the consideration paid therefor plus interest thereon, less any income thereon, upon the tender of such security, or for damages if the purchaser no longer owns the security, by selling such security by methods or means or in circumstances under which it is required to be registered when the same is not registered, by selling the same in violation of the provisions of the act relative to the required use of a statutory prospectus, and by selling the same by the use of any means of transportation or interstate commerce or of the mails, by means of a prospectus or communication which includes an untrue material statement or omits to state a material fact necessary in order to make the same not misleading, if the purchaser did not know of such untruth or omission. It is a defense to such a suit brought on account of untruth or omission in a prospectus or communication to prove that defendant did not know and in the exercise of reasonable care could not have known of the untruth or omission. If the action is based on a forbidden transaction with an unregistered security which should have been registered, or on a failure to comply with the requirements of the Act relative to the required use of a statutory prospectus, it must be commenced within two years from the date of the violation of the Act. If the suit is brought on account of untruth or omission in the prospectus

or communication by which the sale was effected, it must be brought within two years from the discovery thereof or from the date when such discovery should have been made by the exercise of reasonable diligence, and in any event within ten years from the date the security was offered to the public.

Any agreement or stipulation by any person acquiring any security to waive any of the provisions of the Act or of the rules and regulations of the Federal Trade Commission is declared void by the Act, and the rights and remedies created or conferred by its terms are declared to be in addition to all other existing rights and remedies.

United States District Courts and State Courts are given concurrent jurisdiction to enforce duties and liabilities created by the Act, and no suit brought under the Securities Act in any State Court may be removed to the Federal Court. In suits in the Federal District Courts service of process may be had out of the district where the action is pending. The Act expressly provides that nothing therein shall affect the jurisdiction of the Securities Commission, or any agency or officer performing like functions, of any state or territory, or the District of Columbia, over any security or person.

The enforcement of the Securities Act of 1933 is committed entirely to the Federal Trade Commission which, incidentally, has established a securities division as part of the mechanism of carrying out its statutory duties. The Commission is given broad and extensive power to enact rules and regulations to effectuate the purpose of the Act, and it and its members are authorized to administer oaths, subpoena witnesses and, generally, to conduct any investigation which it believes proper and in the public interest and desirable in securing compliance with the terms of the Act. The Commission is given authority to apply for and obtain permanent and temporary injunctions or restraining orders without bond, and the United States District Courts are expressly given jurisdiction to issue writs of mandamus upon application therefor by the Commission commanding any person to comply with the Securities Act, or with any order of the Commission. All hearings before the Commission are public and records thereof are required to be kept. In case any person refuses to obey a subpoena issued by the Commission, that body may apply to any United States District Court for

an order requiring such person to appear before the Commission, or one of its Examiners, and a failure to obey such court order may be punished as contempt. The privilege of refusing to testify before the Commission on the ground that the testimony required may tend to incriminate the witness is abrogated by the statute which provides, however, that no individual shall be prosecuted or subjected to any penalty or forfeiture for or on account of any matter concerning which he is compelled to testify after having claimed his privilege against self-incrimination. It is made unlawful to make or cause to be made to any prospective purchaser of a security any representation that the registration of a security or the non-issuance of a stop order is a finding by the Commission that the registration's statement is true and accurate on its face, or that it does not contain an untrue statement of fact, or omit to state a material fact, or that the Commission has in any way passed upon the merits of, or given approval to, such security.

The second purpose of the Securities Act is effectuated by Section 17 thereof. Under this section, it is unlawful for any person in the sale of any securities, and securities as used in this section include the eleven types of security exempt from the registration features of the Act, by the use of any means of transportation or communication in interstate commerce, or by the use of the mails directly or indirectly, (1) to employ any device, scheme or artifice to defraud, or, (2) to obtain money or property by means of any untrue statement of a material fact, or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or, (3) to engage in any transaction, practice or course of business which operates or would operate as a fraud or deceit upon the purchaser. The same section of the Act also declares it to be unlawful for any person, by transportation or communication in interstate commerce, or by the use of the mails, to publish or circulate any communication which, though not purporting to offer a security for sale, describes such security for a consideration from an issuer, underwriter or dealer, without disclosing the receipt, past or prospective, of such consideration, and the amount thereof.

Any person who wilfully violates any provision of the Act, or the rules or regulations of the Commission, or who wilfully in a registration statement makes any untrue statement of a material fact, or omits to state any material fact required to be stated therein, or necessary to make the statements therein not misleading, upon conviction, is to be fined not more than Five Thousand Dollars, or imprisoned not more than five years, or both.

Acting under the authority of the Securities Act, the Federal Trade Commission, on July 6, 1933, promulgated its initial rules and regulations. These regulations provide the details for the conduct of business with the Commission by applicants for registration, and other parties, and prescribe a form of registration statement. They also set forth certain requirements as to the contents of a prospectus, and forbid the use of any prospectus until five copies of the form thereof have been filed with the Commission. If the prospectus is a radio broadcast, it must be reduced to writing, and five copies filed with the Commission at least five days before the same is broadcast. The Commission has not as yet prescribed all the forms which will eventually be required to administer the Securities Act, and the official statement accompanying the rules and regulations announces that the Commission realizes that the rules, regulations and forms published on July 6, as aforesaid, are experimental only, pending actual working experience with the Act, and will be subject to revision from time to time, as experience proves the advisability of changes.

UNAUTHORIZED PRACTICE

The Detroit Bar Association during the past year has been extremely active in its attempt to curb the unauthorized practice of law. It has instituted suits to enjoin the American Life Insurance Company, Detroit Trust Company, Reliance Legal Agency, a collection agency, and others from practicing law. The Detroit Bar Quarterly for October, 1933, contains a half page notice requesting all members of the bar to report to the members of the Unauthorized Practice of the Law Committee, all evidence of ambulance chasing, practice by laymen before Circuit Court Commissioners and the Industrial Accident Board, by notaries public, by collection agencies, by automobile clubs, etc., and as to attorneys rendering legal services in connection with advertisements and newspapers, etc., including so-called "Legal Advice" columns.