American Landmark Legislation

PRIMARY MATERIALS

Compiled and Edited by
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To Donald K. Stone,
friend, and expert
on this subject.

SPECIAL NOTE ON THIS VOLUME

This volume includes material on both the Securities Act of 1933 and the Securities Exchange Act of 1934. The two are so closely related in topic and in time that it seemed appropriate to include them in one volume. More often than not, they are popularly considered as a single piece of landmark legislation and they are so offered here.

The Editor

INTRODUCTION TO THE SERIES

The legislative background of our country reflects its past, its critical events, conflicts, and problems. More than this, legislation has a central place in America's governmental system. Acts of Congress increasingly control every citizen's political, social, and economic life. In selecting the laws for this series of *Landmark Legislation,* the editor used two criteria. The first of these was the important national significance they had at the time Congress passed them. Secondly, these laws carry principles that continue to be of great import to one dimension or another of American life. Even when particular laws are no longer in effect, either because they accomplished their purpose (*viz.,* the Homestead Act of 1862) or were declared unconstitutional at a later point by the judiciary (*viz.,* the Civil Rights Act of 1875), their legislative history helps us deal with contemporary issues. Thus public land use and civil rights have something of their genesis in the Homestead and Civil Rights Acts of the nineteenth century.

This series will provide general readers and students, as well as professional workers, with primary legislative materials not now readily available except in the largest library systems. And even there, the task of sifting out and distilling the specific and relevant materials takes skills, time, and energy a very limited number of people have. Hopefully, the *Landmark Legislation* series will make a study or investigation of these important pieces of legislation a pleasurable as well as a viable pursuit.

Reproducing as we have the actual legislative and judicially-related materials will give readers a sense of authenticity as well as "flavor" that cannot be conveyed with ordinary narrative texts.

The full, unabridged, and unedited primary sources are offered for each of the statutes covered. Editing or abridging would have resulted in selection, which in turn reflects an editor's point of view. While unedited accounts require the reader to wade through more than he may be looking for or wants to know, they have the advantage to alerting him to information he did not know existed and should have! In any case, the full reproduction of the congressional debates during the session of the Congress that passed the law is a feature of this series that distinguishes it from anything presently available.

Each "landmark" statute is preceded by a detailed narrative legislative history prepared either by the editor or adapted from an authoritative source. Following the statute are a variety of pertinent documentary sources.. In addition to the complete congressional debates already mentioned, there are committee reports, presidential messages, contemporary news or editorial accounts, and finally, judicial decisions that either interpret the legislation or some part of it or deal with its constitutionality. Together, such a set of materials relating to America's leading legislative enactments will fulfill a great variety of needs and purposes among our citizenry.

Irving J. Sloan
Scarsdale, New York

TABLE OF CONTENTS

THE SECURITIES ACT OF 1933

SOURCE NOTES

Legislative History of the Act

"THE LEGISLATIVE HISTORY OF THE SECURITIES ACT of 1933" by James M. Landis, 32 *The George Washington Law Review 29 (1933).*

The Statute, 1933

Securities Act of 1933, 73d Congress, Session I, Ch. 38

The Congressional Debates, 1933

Congressional Record, 73d Cong. 1st Sess., 1018-1022; 2910-2955; 2978-2984; 2986-3000; 3223-3233; 3879-3888; 3891-3902; 4088

Constitutional Law, "Power to Enact Federal Securities Act of 1933", 32 *Michigan Law Review* 811 (1933).

The Statute, 1934

Securities Exchange Act of 1934, 73d Congress, Session II, Ch. 404

The Congressional Debates, 1934

Congressional Record, 73d Cong. 2d Sess., 2087-2088; 2264-2272; 2827-2828; 3058-3059; 7689-7717; 7861-7869; 7920-7962; 8007-8021; 8023-8040; 8048; 8086-8117; 8160-8203; 8270-8287; 8295-8301; 8386-8396; 8488-8507; 8510; 8563-8587; 8588-8604; 8666-8670; 8699-8717; 8766; 8788; 9930-9941; 10,110-10,112; 10,181-10,184; 10,185-10,186; 10,248-10,269; 10,847

Wright v. *Securities and Exchange Commission,* 112 F.d. 89

THE LEGISLATIVE HISTORY OF THE SECURITIES ACT OF 1933 *

James M. Landis
Landis, Feldman, Reilly and Akers, New York

Personal reminiscences are a source of both profit and danger to the historian. Like oral testimony they can round out an arid story of documentation. But like oral testimony they can reflect not only an honest prejudice stemming from an incomplete view of the events to which they relate, but also facts that never occurred, simply because barnacles of desire have during the years for one reason or another covered the buried hulk of truth.

Naturally a sense of trepidation must therefore attach to anyone who draws upon recollections, now more than a quarter of a century old, to write the legislative history of the Securities Act of 1933. But documentation of this history is scanty[1] and the act as such in its interpretation and administration may benefit from a better knowledge of its origins. To have had a part—and not an insignificant

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[1] Some years after the passage of the Securities Act of 1933, I collected the various drafts and memoranda in my possession relating to its legislative history. They are by no means complete, although all the various drafts, usually containing my corrections and interlineations, seem to be there. However, I can no longer identify the source of some of the typewritten memoranda, which unfortunately were not marked at the time. I had all this material bound, and some years later gave the volume to the Harvard Law School Library, where it can now be found. Incomplete though this collection may be, it is the most extensive collection of these materials of which I am aware. It may be that a diligent search of the United States Archives may turn up some other material.

Various popular articles written by reporters and others dealing with the passage of the Securities Act have been published in contemporary magazines. None of them are strictly reliable. They suffer from the tendency either to aggrandize or to belittle some of the chief actors in this episode. Legislative drafting is rarely exciting. It reminds one of the story attributed to Oscar Wilde, who had accepted an inviation to spend a week-end in the country. His hostess, knowing his penchant for work, made a secluded study available to him. After breakfast on Saturday morning he repaired to the study. He reappeared at lunch time. His hostess dutifully asked him whether he had accomplished any work that morning. Getting an affirmative reply from him, she asked: "And what did you do this morning, Mr. Wilde?" He replied: "I put a comma into a sentence." After luncheon he again secluded himself in the study and reappeared for dinner. Once more his hostess asked him: "And what did you do this afternoon, Mr. Wilde?" He replied: "I took that comma out of that sentence."

* *32 The George Washington Law Review 29 (1933), with permission.*

one—in its creation and in its later administration thus imposes a responsibility that, I hope, can be decently and humbly discharged.

The act naturally had its beginnings in the high financing of the Twenties that was followed by the market crash of 1929. Even before the inauguration of Franklin D. Roosevelt as President of the United States, a spectacularly illuminating investigation of the nature of this financing was being undertaken by the Senate Banking and Currency Committee under the direction of its able counsel, Ferdinand D. Pecora. That Committee spread on the record more than the peccadillos of groups of men involved in the issuance and marketing of securities. It indicted a system as a whole that had failed miserably in imposing those essential fiduciary standards that should govern persons whose function it was to handle other people's money. Investment bankers, brokers and dealers, corporate directors, accountants, all found themselves the object of criticism so severe that the American public lost much of its faith in professions that had theretofore been regarded with a respect that had approached awe. As the criticism mounted, doubts as to the value of the very system of private enterprise were generated, and a wide demand was prevalent for the institution of procedures of governmental control that would in essence have created a capital issues bureaucracy to control not only the manner in which securities could be issued but the very right of any enterprise to tap the capital market.

It is of interest to note that Mr. Roosevelt declined to endorse this demand. His message to the Congress on March 29, 1933, contains these two paragraphs:

> Of course, the Federal Government cannot and should not take any action which might be construed as approving or guaranteeing 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.
>
> There is, however, an obligation upon us to insist that every issue of new securities to be sold in interstate commerce shall be accompanied by full publicity and information, and that no essentially important element attending the issue shall be concealed from the buying public.[2]

Meanwhile the task of drafting the legislation to carry out this message had been assigned to Huston Thompson, a former member

[2] See H.R. Rep. No. 85, 73d Cong., 1st Sess. 2 (1933).

of the Federal Trade Commission, whose draft bill introduced on that very day was totally inconsistent with the President's expressed desires. That bill, which sought to institute a system of registration of securities proposed to be offered, provided "that the Commission [the Federal Trade Commission] may revoke the registration of any security by entering an order to that effect, if upon examination . . . it shall appear . . . (e) that its [sic] or their affairs are in unsound condition or insolvent; or (f) that the enterprise or business of the issuer, or person, or the security is not based upon sound principles, and that the revocation is in the interest of the public welfare." [3]

The Thompson bill introduced by Mr. Rayburn in the House of Representatives and by Senator Robinson (for Senator Ashurst) in the Senate[4] was referred respectively to the House Committee on Interstate and Foreign Commerce and the Senate Committee on Banking and Currency.[5] Mr. Sam Rayburn was Chairman of the former and Senator Duncan U. Fletcher of Florida of the latter. The committees thereupon proceeded to hearings upon the bill.

The hearings before the House committee were brief but sufficient to disclose the unworkability of the Thompson bill. Its draftsmanship was of decidedly inferior quality. It had based itself in large measure on the blue sky legislation of the states, but went beyond the most severe of these state statutes in lodging extensive powers to control the issuance and sale of securities in the federal government. It did not exempt sales of outstanding securities from its provisions, a factor that would have frozen dealing in securities inasmuch as registration was required regardless of whether other than a public offering of these securities was being made, exemption from the registration requirements being accorded only to

> isolated transactions in which any security is sold, offered for sale, subscription, or delivery by the owner thereof, or by his representative solely for the owner's account, such sale or offer for sale, subscription, or delivery not being made in the course of repeated and

[3] H.R. 4314, 73d Cong., 1st Sess. § 6 (1933).

[4] S. 875, 73d Cong., 1st Sess. (1933).

[5] S. 875 was originally referred to the Senate Committee on the Judiciary but was moved over to the Committee on Banking and Currency, which had been conducting currently the investigation of investment banking and security trading.

> successive transactions of a like character by such owner for the purpose of engaging in the purchase and sale of securities as a business, and such owner or representative not being the underwriter of such security.[6]

The Thompson bill also, following the theory of the older liquor and child labor legislation, made it a federal offense, despite registration with the Commission, to offer for sale a security in a state in violation of that state's blue sky laws.

The Thompson bill also had an essential weakness in its registration requirements in that registration took effect immediately on the filing of the statement, with a power in the Commission to revoke registration on the basis of inadequacy of the filing, misrepresentation, fraud or "the unsoundness" of the security.[7] This device operated only to lock the barn door after the horse had been stolen, but at the same time it held an incalculable threat over the sellers of securities, so dire and yet so unpredictable that it is doubtful whether responsible investment bankers would have willingly chosen to subject themselves to the possibility of its exercise.

Integral to the deficiencies of the Thompson bill was that, like all state blue sky legislation of that time, it sought its controls through the requirement for the registration of securities rather than through the requirement for the registration of offerings of securities under circumstances when the public interest might deem it wise to institute a system of controls—controls that have to be moulded to the ability of the various types of sellers of securities to comply with their requirements. Issuers of securities, for example, can meet certain conditions that non-controlling holders who desire to market their holdings obviously cannot meet. This distinction, so important to any understanding of the scope of the Securities Act of 1933, had never therefore been recognized by the state blue sky laws.[8] Many of these laws still fail to draw this differentiation.

The hearings before the House committee on the Thompson bill convinced Mr. Rayburn and his committee that that bill provided no

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[6] H.R. 4314, § 12(c), *supra* note 3.

[7] H.R. 4314, § 6, *supra* note 3.

[8] In this respect registration under the Securities Act of 1933 differs materially from registration under the Securities Exchange Act of 1934. The latter calls for the registration of securities in order to maintain their eligibility to be traded on the various stock exchanges.

basis for sound federal securities legislation. His deep concern over this matter was communicated to the White House and the White House in turn went to other sources for help.

Professor Felix Frankfurter, now Mr. Justice Frankfurter, had been in close touch with the Roosevelt campaign of 1932. His associations with the President-Elect and particularly the reputed head of his "Brain Trust," Professor Raymond S. Moley, became even more frequent after the election. His wide knowledge of public law, his fertile mind, and his intimacy with the younger generation of lawyers upon whose help he could always count, made him invaluable to the new administration. I happened to have had the good fortune of being closely associated with him both as a student and later as his colleague, having cooperated with him in the production of a book and several articles, none of which, however, dealt with securities legislation. As a recently appointed Professor of Legislation at the Harvard Law School, I had spent considerable of my time and that of my small class in an attempt to explore the nature and variety of the sanctions available to government to bring about conformance with its statutory mandates and in dealing with the nature of standards capable of reasonable enforcement. An understanding of both problems seemed to me essential in order to grasp the elements of legislative draftsmanship. A particularly illuminating field, filled with challenge, had been state blue sky legislation. For the last years my seminar, as well as I, had been exploring this field. Little in the way of scholarly research had characterized that field and it had precipitated few judicial decisions of any consequence. Consequently, when in response to Rayburn's concern, Moley turned to Frankfurter for assistance, he, in turn, asked me to assist him. I can recall well the morning of that request. It was a Thursday in early April and my next classes were scheduled for the following Monday. Frankfurter, however, thought that the job could be done over that week-end. We consequently left on the night train for Washington.

The next morning in Washington we met with Benjamin V. Cohen and Thomas G. Corcoran. Cohen had been summoned by Frankfurter from the ranks of active practitioners. I was told he was a most brilliant man, knowledgeable in the field of securities, and that he possessed a gentle personality. My information was correct. Corcoran I had known intimately since law school days. I knew of his

experience with the law firm of Cotton & Franklin in New York City and of his work with that firm in the securities field. Considerably disillusioned after 1929, Corcoran had come to Washington abetted by Frankfurter and was then serving as counsel to the Reconstruction Finance Corporation. It was a strange team—Corcoran ebullient, moving easily with the new forces in the administration; Cohen reserved and almost shy; but both brilliant and indefatigable workers.

After a brief session with Frankfurter, where we determined to take as the base of our work the English Companies Act[9] with which Cohen was very familiar, Cohen, Corcoran and I set to work. Frankfurter had other political duties to attend to. By late Saturday night we had a draft of the bill in reasonable shape. We had to work under certain limitations imposed upon us by the fact of the Thompson bill. Tactically it seemed wise to shape our proposals as "perfecting" amendments to that bill, with the result that our original bill embodied a number of proposals contained in the Thompson bill that were subsequently happily discarded.[10] The core of the Securities Act of 1933 is, however, to be found in that hurried draft of ours.

Our draft remained true to the conception voiced by the President in his message of March 29, 1933 to the Congress, namely that its requirements should be limited to full and fair disclosure of the nature of the security being offered and that there should be no authority to pass upon the investment quality of the security. This, of course, is the theory of 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 misrepresentations of fact were found to exist in its registration statement. We also provided for the pas-

[9] The Companies Act, 1929, 19 & 20 Geo. 5, c. 23.

[10] Among these was the section making it a federal crime to sell a security in interstate commerce whose sale, had it occurred wholly within the borders of the state of the buyer, would have violated that state's law. On the other hand, the die had been cast in favor of the Federal Trade Commission as the agency to administer the act. Its reputation as an effective regulatory agency during the Harding-Coolidge-Hoover era had admittedly not been of the highest, but we understood that the administration intended to restaff and re-invigorate it. Under its General Counsel, Robert E. Healey, it had been conducting a remarkably thorough and penetrating study of the utility holding company industry, laying bare the crazy quilt pattern of holding companies that had developed in order to centralize control of these vast systems through relatively small investments. Apart from this investigation and a negligible study in blue sky legislation, neither the members nor the staff of the Federal Trade Commission had had experience with securities, especially the manner of their flotation.

sage 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. To avoid the delays of bureaucracy we insisted that time should run in favor of the registrant in the absence of any affirmative action by the Commission. This device of a waiting period, then completely novel, in our opinion would accomplish several things. It would slow up the procedure of selling securities and the consequent pressures that the underwriters could exert upon their selling group or other dealers to take sight unseen an allotment of the issue. It would give an opportunity for the financial world to acquaint itself with the basic data underlying a security issue and through that acquaintance to circulate among the buying public as well as independent dealers some intimation of its quality.[11] It also gave the Commission a preventive power to keep issues off the market, the filed data on which were inadequate or false. Finally, through such a device, underwriters and dealers would have some assurance, although never conclusive, that no precipitate action of the Commission would leave them in the midst of an offering with bundles of legally unsalable securities on their shelves.

The registration requirements with respect to the scope and extent of disclosure, which as amended now comprise Schedules A and B of the Securities Act, were both tightened and expanded—a task in which Cohen was a particular help. The civil liabilities of the registrant, its officers, directors and experts, drawn generally from the English Companies Act, were carefully revised. We were particularly anxious through the imposition of adequate civil liabilities to assure the performance by corporate directors and officers of their fiduciary obligations and to impress upon accountants the necessity for independence and a thorough professional approach.[12]

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[11] The device of the "red herring" prospectus, which developed later, was in accord with this concept. Admittedly we were not aware of a difficult problem that bedevilled the Securities and Exchange Commission until 1954: drawing a differentiation between the pre-sale circulation of information relating to a forthcoming security issue and the use of this information as a basis for soliciting clandestine offers to buy prior to the effective date of a pending registration statement. See § 5(c) of the Securities Act of 1933, as amended, 68 Stat. 684 (1954), 15 U.S.C. § 77e (1958).

[12] Despite the fact now generally recognized that the registration requirements of the Securities Act have introduced into the accounting profession ethical and professional standards comparable to those of other recognized professions, the then dean of the accounting profession, George O. May, of Price, Waterhouse & Co., was strangely opposed to our proposed requirements for independent accountants. See his undated memorandum on H.R. 4314, found in bound volume of memoranda, *supra* note 1.

The bill also came close to accurately carving out a differentiation between the registration of securities and the registration of offerings of securities. Throughout, its patent concern was primarily with the flow of securities from the issuer through underwriters to the public rather than with the subsequent buying and selling of these securities by the public.[13] It was, however, far from perfect on this point as well as in many of its other provisions.

On Sunday, Frankfurter informed us that Rayburn had called a special meeting of his Committee for Monday to consider our draft. I arranged to put off my classes for a day, trusting to be able to take Monday's night train back to Cambridge. Meanwhile both Cohen and I were disturbed that, although Frankfurter was familiar with the general outlines of our bill, he had not had the time to know it in all its details. Our disturbance was unnecessary. Monday morning we breakfasted with Thompson, who obviously knew his draft was unsatisfactory, explaining to him our mission as being one of suggesting "perfecting" amendments. Frankfurter, who had not joined us at breakfast due to his preoccupation with other political matters, met us on our way to the Committee room. He had the copy of the bill that we had given him the night before, but whether he had read it, and, if so, how carefully, none of us knew.

In addition to the members of the House Committee, there were present at this private hearing Frankfurter, Thompson, Cohen, Beaman, Perley and myself. Middleton Beaman had been for many years the chief legislative draftsman for the House of Representatives. Members of both political parties trusted him, and rightly so, for his complete impartiality and his competence. His function, as he always saw it, was to put into effective statutory language the ideas, whatever they might be, of the sponsors of such legislation as might be referred to him. Allan H. Perley, who later succeeded him, was only slightly less able than Beaman.

Frankfurter took the lead in the exposition of our draft. It was a brilliant performance. Questions of detail were referred by him to Cohen and to me, but he handled the main structure of the bill magnificently as well as the relationship of this bill in the nature of a "perfecting" amendment to the Thompson bill. The session, punctuated by questioning from members of the Committee, con-

[13] The bill thus exempted all securities issued prior to its enactment provided that they had been genuinely offered for sale as a medium of investment.