THE REGULATORY PATTERN OF THE FEDERAL SECURITIES LAWS

ADDRESS BY

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As a former Chairman of the Legal Institute Committee of the State Bar Association of Connecticut, and more than mindful of the many problems involved in exciting lawyers to post-legal education, I want first to commend your Committee on Legal Education and Institutes and your Chairman of that Committee, Edwin E. Weiss, for the fine program which you have arranged here today.* It is both a privilege and a pleasure to join with you and my colleagues on this all-day institute to discuss the many problems, both legal and practical, that arise from day to day for the lawyer who is engaged in the practice of securities law as well as the lawyer about to face his first securities problem.

Just before I came to the Commission over three years ago, a law school classmate of mine suggested to me that perhaps I ought not accept the offer which had been tendered to me because as he said "all of the problems have been decided long ago--all of the legal precedents have been established and the fun of meeting new and challenging legal issues is a thing of the past." I wish he could sit in my chair and see how wrong he was. We are constantly confronted with new questions -- and while the precedents - both administrative and judicial are many and most helpful guideposts -- they must be and are being regularly revisited in light of the ever expanding financing and changes in our capital markets. Thus, it is that we at the Commission are always happy to join in institutes of this type where both representatives of Government and the bar practicing before agencies of it can participate in a give and take session. And before proceeding any further, I want to recognize one of the Commission's most distinguished officers, a fine lawyer, an excellent administrator, and a very real public servant, my friend Judge O. H. Allred -- who as our Regional Administrator is always willing to discuss problems with you whether you be expert or inexperienced in the Federal securities laws.

I have been asked to give you a summary of the provisions of the Federal statutes which are administered by the Securities and Exchange Commission. I need not add that in the time allotted to me I can do no more than touch on the highlights of this legislation, but I hope I can give you some indication of the purposes and the effects of our work. However, so that you do not leave here with only an oral recollection of one hour of me, I have brought along for each of you a copy of this talk and a supplement thereto consisting of a number of releases issued at various times by the Commission which are, in

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*/ The Securities and Exchange Commission, as a matter of policy, disclaims responsibility for any private publication by any of its employees. The views expressed herein are those of the author and do not necessarily reflect the views of the Commission or of the author's colleagues upon the staff of the Commission.

effect, exhibits of what we do, inter alia, in the administration of the several securities laws.

You have just heard an excellent description of the aims and provisions of your new Texas Securities Act. No doubt you were impressed, as I was, with its scope and extent. It would seem to be fully adequate to protect your citizens from unscrupulous promoters and salesmen.

Probably, therefore, the first question that comes to mind is this: "Why is there any necessity for regulation by the Federal Government? To answer that question, we must go back to 1933 to examine the situation as it existed at that time.

Perhaps the most important obstacle to effective securities regulation by a state was the boundary of that state. It was virtually impossible for a state to protect its citizens from selling campaigns conducted from a neighboring state by mail and long-distance telephone. Even extradition was no solution. If a criminal violated a state's laws from a distance and remained out of that state, he was not technically a fugitive and could carry on his swindle with impunity.

We are now faced with a new problem somewhat akin to that situation. In order to avoid the disclosure requirements of Federal law, persons in control of an issuer have transferred large blocks of its securities through foreign banks and trusts to brokers and dealers for resale to the public in boiler rooms, a type of activity I will discuss a bit later. The anonymous, numbered accounts of these institutions shield the identities of the controlling persons and make it more difficult for the Commission to detect those responsible for violations of the law.

Various proposals for some type of Federal securities regulation had been advanced for many years but it was not until the depression following the debacle of 1929 that matters came to a head. A Congressional committee reported that during the decade after the first World War some 50 billions of dollars of new securities were floated in this country and that by 1933 fully half of them were found to be worthless. 1/ This situation brought about the Federal Securities Act of 1933.

Before discussing the acts and their provisions individually, there are two aspects of the subject I should like to mention which are common to all of the statutes. The first is the matter of Federal jurisdiction. The lawyer whose practice is confined largely to local

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1/ House Report No. 85, 73rd Cong. 1st Sess. 1933, p. 2.

matters is likely to forget that the Federal government is not a sovereign in the sense that Texas is a sovereign. The United States is a government of limited powers and must find its source of authority in the Federal Constitution. All of the Federal securities laws, therefore, are based on the Congressional jurisdiction over the mails and the facilities of interstate commerce. Accordingly, before considering any action under our statutes, it is first necessary to find some use of the mails or of the means or instrumentalities of interstate commerce. This is so whether the action is civil or criminal, whether it is public or private. Of course, the jurisdictional factors need not be present in every step in a scheme if they are present somewhere along the line. 2/ Some criminals have endeavored to take advantage of these requirements to evade the sanctions of the Federal statutes but they have generally not been successful. A swindler may studiously avoid mailing letters only to find that he has overlooked a certain automobile trip to a nearby town in the neighboring state. Or he may carefully stay away from the mail box and the telephone, remain within the confines of a state, and then learn to his dismay that the bank in which he deposited the victim's check mailed the check to the victim's bank for collection. However, be that as it may, some jurisdictional basis must be present in any action under our statutes.

The second point I want to emphasize is that our statutes are not intended to supplant the regulatory power of the states. The statutes are intended to strengthen and reinforce the efforts of the states to protect the public interest. 3/ Indeed, one of the purposes of the Public Utility Holding Company Act of 1935, of which I will speak later, was to free the operating utility companies from absentee control which had prevented state authorities from exercising effective regulatory authority over them.

The cooperation between the several state securities commissions and our Commission has been particularly gratifying. There have been several instances in which we have made available to state authorities information we had developed when it appeared that the matter was of a local nature primarily a matter for state enforcement action. 4/

2/ Some provisions (e.g. Sections 7(c), 8, 9(c), and 14(b) of the Securities Exchange Act of 1934) are not themselves dependent on the use of the mails or facilities of interstate commerce, but they came into play by virtue of the status of the person regulated, e.g. a member of a securities exchange the regulation of which rests on such jurisdictional factors.

3/ See Securities Act of 1933, Section 18; Securities Exchange Act of 1934, Sections 2, 28(a); Public Utility Holding Company Act of 1935, Sections 1, 18(b), 19; Trust Indenture Act of 1939, Sections 302, 326(2); Investment Company Act of 1940, Sections 1, 50, 40(c).

4/ A liaison committee meets twice a year with a similar committee of the National Association of Securities Administrators to discuss mutual problems.

Similarly state officials have supplied us with their information when it appeared that a particular matter extended beyond their geographical reach.

I would like to stress the fact that the need for a vigorous enforcement program to combat fraudulent securities sales is more important today than it ever has been, and I urge you to lend the influence and prestige of your association in support of such program. We chuckle sometimes at the historic gullibility of those who were sold gold bricks or the Brooklyn bridge. But the huge sums of money swindled from our citizens at this moment are extracted on representations equally fantastic. Hardly a year passes that we do not have at least one case in our office of someone who represents that he has a doodlebug which tells him with certainty the precise spot where oil can be found. These doodlebugs range from a forked stick to complicated machines allegedly powered by atomic energy.

Right here in Texas a swindler went to prison who had extracted large sums from the public for stock in a company which he claimed had perfected a perpetual motion machine. He also had an atomic healing machine which was a panacea for about every disease known to man including cancer. This remarkable machine turned out to be a small kitchen cabinet containing a Mazda sun lamp. 5/

The old "boiler rooms" which I mentioned are in evidence again. You are probably accustomed to think of a stock broker's office as a reputable organization servicing the legitimate investment needs of their clientele, and I hasten to add that your impression is true of the vast majority of such firms. But there are the fringe outfits who operate in a way that is nothing less than fantastic. The typical boiler room is located in some shabby office building and consists of rows of small cubicles, each one just about large enough to hold one person. Frequently twenty-five or thirty salesmen are working at the same time. These salesmen are often recruited from ex-convicts, veteran fraud artists, and carnival and circus barkers. Each one has, in his cubicle, a number of telephones, a list of prospective victims, and a three-minute egg-timer. The clatter and din of these pitchmen, frequently stripped to the waist, makes the term "boiler room" an apt description. The egg-timer is used to limit the telephone calls unless the prospect shows particular promise. The representations made over these phones are almost unbelievable. The pitchmen work on a production basis. They must make a certain quota of sales proportionate to their phone calls or they are fired. The results are staggering. One boiler room we closed down had, in a few months, grossed commissions -- commissions mind you -- not sales -- of two million dollars. The long distance

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5/ Estep v. United States, 223 F. 2d 19 (C.A. 5, 1955).

telephone bill for the same period was $200,000. Although these outfits do not offer stock in non-existent companies, much of the securities peddled in the boiler rooms is virtually worthless.

We are doing all we can to eradicate these criminal activities, but we cannot do it alone. We must rely to a great extent on the efforts of state authorities like your own.

Turning now to the specific statutes, the first, as I said, was the Securities Act of 1933. 6/ The statute is not really a regulatory statute in any sense. It is purely and simply a disclosure and anti-fraud statute. It has two basic provisions:

(1) It prohibits the sale of securities unless an effective registration statement is filed with the Commission and a prospectus delivered; (2) It makes unlawful the sale of securities by fraud or by misleading statements or half-truths. I use the word "sale" as a shorthand term. The prohibitions include an offer as well. I think it is important to emphasize that the Commission does not "qualify" securities in the sense that term is often used. Indeed it is a criminal offense to represent that the Commission has in any way approved or passed upon the merits of any security. The statute has been termed a "truth in securities" act. Its basic philosophy is that anyone may sell any security to the public if he tells the truth, the whole truth, and nothing but the truth.

6/ 15 U.S.C. 77.

This is accomplished by means of a registration statement filed with the Commission which sets forth the information which Congress has determined is necessary in order to permit an investor to exercise an informed judgment in deciding whether to purchase a particular security. Once that registration statement has become effective, it is the investor who makes the ultimate decision. As one writer has expressed it, "Congress did not take away from the citizen his inalienable right to make a fool of himself. It simply attempted to prevent others from making a fool of him." 7/ The Commission's duties under this statute are, in a sense, merely those of the "policeman on the beat."

To enforce the requirements of the Act, Congress has decreed a full complement of remedies. If a registration statement appears to be incomplete or inaccurate the Commission can issue a stop order to prevent it from becoming effective. It can ask the Court to enjoin sales of securities in violation of the registration or fraud provisions, and it can refer to the Attorney General matters which warrant criminal action. There are also provisions which, in my judgment, result in an effective deterrent to violations of the Act, namely, those which enable investors to bring suit for the recovery of damages if sales to them were in violation of the Act. 8/

There are certain exemptions from these registration requirements. 9/ Private offerings and sales are exempt. Sales and offerings which do not involve an issuer, an underwriter, a broker, a dealer, or a person in control, are exempt. Certain types of securities are exempt such as those issued by federal, state, or municipal governments or banking institutions, and securities issued by certain non-profit corporations, savings and loan associations, and cooperatives. Another exemption that you may be particularly interested in is the intra-state exemption. 10/ As I mentioned a little while ago, Congress felt that the state should exercise its own regulation where it was possible for it to do so. Accordingly, exempted from registration is any security which is part of an issue sold only to persons resident in a single state where the issuer is incorporated in that state and does a substantial part of its business in that state. I think I should make it clear to you, however, if you should be consulted by a client who wishes to rely upon this exemption, that there are certain risks involved. First of all, the issuer must be certain that all of the purchasers intend to take the securities for investment. If,

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7/ Loss, Securities Regulation, 1951, p. 82.

8/ Sections 11 and 12, 15 U.S.C. 77k and 77l.

9/ Sections 3 and 4, 15 U.S.C. 77c and 77d.

10/ Section 3(a)(11), 15 U.S.C. 77c(a)(11).

within a short period, one or more of the purchasers should resell to a non-resident, the purchaser might be considered an underwriter within the definition of the Act and the exemption will be destroyed. Secondly, it should be noted that the exemption is available only if all of the issue is sold intra-state. If any part is sold to a non-resident the entire exemption is lost and all of the sales, even those to residents, become unlawful. This could be of serious import to your client. The sale to the non-resident might even be inadvertent, and even if it should not warrant criminal action, should the stock decline in value, all who participated in the sale would be subject to civil liability at the suit of all of the investors.

If your client's contemplated offering is to be under $300,000 in amount he would be well advised to take advantage of a special exemption Congress provided primarily as an aid to small business. 11/ I hasten to add that this exemption, unlike the others I have mentioned, is not an automatic one. It becomes operative only after certain information, including a notification and offering circular, is filed with the Commission and upon the performance of certain conditions imposed by the Commission's Regulation. 12/

I should mention here that the Commission is constantly on the alert to discover imperfections in our rules or statutes. If we discover loopholes which allow malefactors to act to the detriment of the common good, or, on the other hand, if we find that a regulation may be unfair or unduly restrictive to legitimate business, we do not hesitate to amend our rules after notice and opportunity for hearing, and public comments where required by the Administrative Procedure Act or, if necessary, to request Congress to enact appropriate legislation.

For example, the Commission is now giving serious consideration to what is known as the "no sale theory" which has been embodied in our Rule 133. 13/ That rule provides in effect that where a vote of stockholders is taken to authorize a statutory merger, consolidation, reclassification of securities, or a transfer of assets, such transaction is deemed not to involve a sale to the stockholders for the purposes of the registration provisions of the Act. In other words, if the requirements of the Rule have been complied with, new securities delivered to the stockholders in such situation need not be registered.

11/ Section 3(b), 15 U.S.C. 77c(b).

12/ Regulation A, 17 CFR 230.215.

13/ 17 CFR 230.133.

The rationale behind the rule is that since there is no volition by the individual stockholder to accept or reject the stock in his individual capacity, there is no sale to him.

This rule has been used as a subterfuge to avoid registration. Indeed many of the securities sold in the "boiler rooms" I mentioned are being sold in reliance on such devices.

For example, in one case X corporation exchanged 1,750,000 shares of its stock for all of the shares of Y Corporation. Y's sole asset was an oil field valued by the Y Corporation at about two million dollars. The X stock was not actually transferred to Y, but instead the deal included an arrangement for the stock to be turned over to the President of X with the understanding that Y was to be paid only two million dollars. The securities were sold at greatly inflated prices resulting in a net profit to the sellers of about five million dollars over and above the two million that Y received. 14/

The Commission and the courts, accordingly, have taken the position that where the merger is merely a device to effect a public distribution of securities without registration, the rule is not applicable.

In another case where the stockholders in the purchased corporation signed authorizations for an officer of the issuing corporation to sell their stock, the Commission sought an injunction to prevent the sale of the stock. The Court sustained the Commission's position that the rule had no application in the situation where the exchange "was but a step in the major activity of selling the stock." 15/

Consideration is now being given to proposals for modification of the rule.

There are certain other exemptive provisions in the Act which I have not mentioned but time will not permit a discussion of all of them. Before leaving the matter of exemptions, however, I wish to make one thing clear. All of the exemptions I have mentioned are from the registration provisions. There are no exemptions of any kind from the anti-fraud provisions. Any sale of a security which is effected by fraud, misrepresentation or half-truth is a violation of the statute.

14/ Great Sweet Grass Oils, Ltd., Securities Exchange Act Release No. 5483, April 8, 1957.

15/ S.E.C. v. Micro-Moisture Controls, 148 F. Supp. 558, 562 (S.D.N.Y. 1957).

Questions of exemption are not the only difficult problems we face under the Securities Act. Even after twenty-two years of Commission administration of the Act we are still confronted with novel questions as to what is or is not a security. We have now pending a case involving variable annuities. 16/ Not long ago we obtained a consent decree in connection with the sale of certain types of mortgage notes. 17/ Recently a group of food dealers associations submitted a brief to the Commission contending that trading stamps should be held to be securities.

As I have indicated, the registration and disclosure provisions of the Securities Act of 1933, were concerned with the distribution of securities. The following year Congress met the problem of trading in securities. There are two principal branches of the securities industry relating to trading in securities -- the stock exchange market and the so-called over-the-counter market. When Congress came to legislate in 1934, it thought primarily in terms of the stock exchange and passed the second of our statutes, the Securities Exchange Act of 1934. 18/ This statute required registration of the stock exchanges themselves and also registration of all companies the securities of which were listed for trading on an exchange.

In regulating trading, of course, it is none of our business whether the market goes up or down so long as there is no market manipulation. We have no power and no desire to interfere with the free interplay of the forces of supply and demand. But we are vitally concerned that all price movements result from the free judgment of buyers and sellers trading in fair, honest, and orderly markets.

This statute, incidentally, was the one that created the Securities and Exchange Commission. During the preceding year the Securities Act had been administered by the Federal Trade Commission. By this statute the governmental functions under both statutes were entrusted to the newly created SEC.

In addition to requiring registration of securities which are listed on exchanges, the Act also includes regulatory provisions relating to companies issuing such securities, which have become very important. One of these provisions requires the reporting of all purchases or sales by an officer, director, or 10% stockholder of his company's stock, and provides for the liability of such persons to the corporation for any profits that might be made on short swing transactions within a six-months period. 19/ While this provision is intended to prevent the improper use of inside information, no such use need be shown. The provision is a prophylactic one and subjects all such profits to being disgorged regardless of the circumstances.

16/ SEC v. Variable Annuity Life Insurance Co. of America, et al, District Court, District of Columbia, Civil Action No. 2549-56.

17/ SEC v. Mortgage Clubs, Inc., District Court, District of Massachusetts, Civil Action No. 57-385-W.

18/ 15 U.S.C. 78.

19/ Section 16, 15 U.S.C. 78p.

Another important provision is the one which makes it unlawful to solicit proxies in violation of the rules of the SEC. 20/ The Commission has adopted a comprehensive regulation which has been amended from time to time to correspond with our increased experience in administering it. 21/ The basic purpose of the regulation has been to afford shareholders the material facts important to any analysis of matters presented for their vote. One writer has said that this Congressional action "has probably had a more beneficial effect on corporate democracy in America than any other of the numerous weapons in the SEC arsenal." The Commission has designed its rules "so as to make the proxy device the closest practicable substitute for attendance at the meeting." 22/

Our proxy rules, like the provisions of the Securities Act, are basically disclosure and anti-fraud rules. They require disclosure of material facts pertaining to any matter which is to be voted upon and prohibit false statements or half-truths. I would like to emphasize the fact that in all proxy contests our position is an impartial one. We do not care, of course, which side in a proxy battle is the winner. That is a matter for the stockholders to decide. But we are concerned that whatever they decide should be on the basis of adequate and truthful information. Our rules provide for the submission to us of proxy material before it is disseminated. In most cases offensive material will be deleted or revised in accordance with our suggestions. However, if material goes to the stockholders in a misleading condition the courts have not hesitated to grant our requests for injunction to prevent the voting of proxies so obtained.

Of course, here also there are those who try to cut corners. Only recently an insurgent group waged a proxy battle against the management of a large industrial company. They did not make false statements. They just asked questions such as: "Where is the Pension Fund money?" "Why does the management withhold an accounting from its stockholders?" "Isn't it odd that the company wrote off $4,000,000 of assets that were 'no longer in existence'?" There was no basis for any of these insinuations. When we applied to the court for an injunction, the defendants piously said that they had no intention of charging the management with impropriety or misconduct. They were just asking questions. It is almost unnecessary to add that the courts had no difficulty in finding that these questions violated the prohibitions against false and misleading statements. 23/

20/ Section 14(a), 15 U.S.C. 78n(a).

21/ 17 CFR 240.14a. See Aranow and Einhorn, Proxy Contests for Corporate Control (1957), Introduction by J. Sinclair Armstrong, former chairman of the S.E.C.

22/ Loss, op. cit. supra pp. 523, 525.

23/ S.E.C. v. May, 134 F. Supp. 247 (S.D.N.Y. 1955) affirmed 229 F. 2d 123 (C.A. 2, 1956).

In another case an injunction was obtained where the identity of one of the participants in the solicitation was concealed. 24/

Two years after the passage of the Exchange Act, Congress enlarged the statute to provide more detailed regulation of the over-the-counter segment of the securities industry. It provided for registration of brokers and dealers, gave the Commission authority to deny or revoke registration in appropriate cases, and gave the Commission certain regulatory and visitatorial powers over them.

It might be noted that at this stage one vital difference between the two segments of the industry was that of self-dicipline. The exchanges, under the general aegis of the Commission, have powers to regulate and discipline their own members for conduct "inconsistent with just and equitable principles of trade." 25/ There was no comparable provision for members of the over-the-counter industry. Accordingly, in 1938 the Act was again amended to provide for the formation and registration of associations of securities brokers and dealers. 26/ To be registered an association must meet certain standards and its rules must be designed to provide for disciplining of members in order to "promote just and equitable principles of trade."27/ Only one association has ever been registered, the National Association of Securities Dealers, but that one comprises in its membership the large majority of all securities dealers. This association's efforts have been of great value in preventing unlawful practices by the over-the-counter industry.

Not long ago a broker-dealer who had been expelled from the Association, took an appeal to the SEC which has the power to review such disciplinary actions. The basis of that expulsion was what we colloquially call "churning." Two elderly ladies had placed with this firm their life's savings of about $50,000 for investment. The firm did nothing so crude as to convert or appropriate any of the funds. But the salesman, having obtained the trust and confidence of these uninformed customers, persuaded them repeatedly to sell certain securities and purchase others. All of the purchases were of legitimate worth-while securities. But each time a security was bought or sold the firm and the salesman made a commission. Over a six-year period, there were over 600 transactions in a total amount of over one million dollars. Several stocks were bought, sold, bought and sold, over and over. To make a long story short, the firm's commissions on this $50,000 account amounted to over $24,000 and the net capital in the account decreased by an equivalent amount. The Commission not only sustained the firm's expulsion from the association,but made a further investigation on the basis of which the firm's registration was revoked. 28/

24/ Ostergren v. Kirby, N.D. Ohio, No. 33, 393 (1957)

25/ Section 6(b), 15 U.S.C. 78f(b).

26/ Section 15A, 15 U.S.C. 78o-3.

27/ Section 15A(b)(7), 15 U.S.C. 78o-3(b)(7).

28/ Johnson & Co. v. S.E.C., 198 F. 2d 690 (C.A. 2, 1952); 231 F. 2d 523 (C.A. D.C. 1956).

In 1935 Congress passed the Public Utility Holding Company Act.[29] It was more than merely a disclosure and anti-fraud statute. Based upon an extensive investigation made by the Federal Trade Commission and by Congressional committees, the Act sought among other things to reorganize the corporate structure of the electric and gas utility industries. The investigation had shown an alarming degree of concentration of control, particularly in the electric industry. As an example of this, three holding company systems were found to exercise effective control over 45% of the total electric productive capacity in the country. Some 15 systems controlled 80%. [30]

This concentration of control was made worse by the fact that the holding company systems were assembled largely in helter-skelter fashion as opportunities arose without relation to sound operational principles. They were also financed by complex capital structures which bewildered security holders and made the systems, particularly the holding companies in the systems, dangerously susceptible to trouble upon a small decline in earnings of the underlying operating companies. To a large degree it was evident that these complexities were the result of the desire by management, and in several notable instances of one key personality in management, to exercise maximum control with minimum investment, and to sell securities to gullible members of the public by giving them deceptive labels.

The response of Congress to the facts disclosed by the studies was not simply to abolish holding companies, although there was strong support at the time for such a drastic solution. The method actually adopted was to require holding companies to reduce themselves to single integrated systems, plus certain other properties meeting rather strict standards, and to reorganize their capital structures so as to eliminate complexities and inequities.

Section 11 of the Act, which embodies these principles, early received the label of "death sentence" and, indeed, many of the most famous and infamous holding companies were unable to meet the requirements of Section 11 and so have passed out of existence. But "death sentence" is on the whole a misnomer. Many holding companies continue to exist. Dozens of them exist free from Holding Company Act regulation by virtue of exemptions granted by the Commission as provided for in the Act. But some 23 holding company systems, representing roughly 20% of the privately owned electric and gas utility industry in the country, remain registered under the Act and subject to its regulation. While some of these may qualify for exemption, we expect to be in the business of regulating electric and gas utility holding companies for the indefinite future.

29/ 15 U.S.C. 79.

30/ Federal Trade Commission, Utility Corporations, 70th Cong., 1st Sess. S. Doc. 92, Part 72A, pp. 37-44.

An example of a holding company system which has met the integration and simplification standards of Section 11 is the Central and South West system, which serves electricity to a large part of your State of Texas. It does this through two subsidiaries -- one of which is the West Texas Utilities Company, headquartered in Abilene, Texas, and the other is Central Power and Light Company, headquartered in Corpus Christi. These companies and their parent are subject to our regulation under the Act with respect to all of their financing and other strictly corporate activities. I should emphasize, what I assume you know, that we have no rate regulatory authority or responsibility. Rates are regulated either by the states or by the Federal Power Commission.

In addition to this registered holding company system, Texas has utility companies which are free from the Act's regulation by virtue of exemptive orders granted by the Commission. An example is Texas Utilities Company solely a holding company, which does business through three operating subsidiaries -- Dallas Power & Light, Texas Electric Service Co., and Texas Power & Light. We do not regulate any of the activities of such companies, but we do have a continuing duty to reexamine their entitlement to exemption if there should be any material change in their situations.

There is not time to describe in any detail the immense task accomplished by the Commission in this corporate and financial reorganization of our utility industry. The job was done with none of the loss of values to security holders which the opponents of the Act had gloomily forecast, and the experience has been that many an operating company, when finally separated from a parent corporation, has found new vigor to expand to meet our rapidly growing fuel and power needs. Those companies which remain subject to the Act appear to be in good health and progressing successfully.

The next major securities enactment by the Congress was the Trust Indenture Act of 1939. This is actually an amendment to the Securities Act of 1933 to provide additional investor protection in the case of bonds, debentures and other debt securities issued under certain trust indentures. It also requires that bonds be issued under an indenture if more than $250,000 is issued in any one year.

In 1940 there were two Congressional enactments -- the Investment Advisers Act 31/ and the Investment Company Act. 32/ The Investment Advisers Act was designed to give the Commission some measure of regulation over those persons who sell investment advice. Apart from general provisions to prevent fraud or deceit upon their customers, there are other particular provisions such as those requiring the

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31/ 15 U.S.C. 80b.

32/ 15 U.S.C. 80a.

adviser to disclose to his client any interest in the transactions recommended, prohibiting profit sharing arrangements, etc. Of course, as in any other area, there are various kinds of investment advisers. There are those who are expert investment analysts who make a careful study of corporate balance sheets, market trends, etc. There are also the other kind who have some very unusual methods of predicting the fluctuations of the market. One of the most intriguing to my mind was the investment adviser who had a very special and secret formula. Part of this formula was based -- and I quote directly from the Commission's opinion - "on the daily comic strips, in which he believed there existed a code which, when interpreted by him would reflect future movements of certain securities on the stock exchanges." 33/

As I pointed out a little while ago, the Holding Company Act brought under federal regulation a particular segment of American industry. The Investment Company Act brought another group of companies under federal regulation. However, the latter Act provides a somewhat different pattern. The Investment Company Act is intended to curb abuses found to exist within investment companies. One of the most flagrant of such abuses was the practice by those who controlled such companies to use them for their own purposes. These insiders often transferred to the companies for cash their own investments which had turned out to be unmarketable or of dubious value, used the companies to guarantee their personal undertakings, and borrowed from the companies without any collateral or adequate security. I would like to make it clear that the statute does not undertake to control the direction of investment. This remains the responsibility of the management. The Act is essentially preventive. Investment companies and trusts must register with the Commission and full disclosure must be made to their security holders of the financial condition and activities of the companies. Underwriters, bankers, and brokers are limited to a minority of the management. Management contracts must be submitted to security holders for approval. Transactions between the companies and the insiders are prohibited or strictly regulated. To enforce these provisions the Commission has a wide authority including the power to obtain from the federal courts decrees enjoining insiders from continuing to act as officers or directors if they have violated their fiduciary duties.

In one case the Commission had recourse to the courts to unseat a management which had obtained control of a large investment trust with a nominal investment. The management then proceeded to dispose of the marketable investment securities in its portfolio to acquire control of a speculative race-track enterprise. It is not insignificant that the management then elected themselves as officers of the race-track at high salaries. 34/

33/ Frederick N. Goldsmith, 30 S.E.C. 563, 564 (1949).

34/ Aldred Investment Trust v. S.E.C., 151 F. 2d 254 (C.A. 1, 1945).

In another case the Commission brought an action to remove the management of a tier of investment companies, alleging in its complaint that the defendants had been managing the portfolio of the companies for their personal interests and so as to yield no income to the publicly held preferred stocks. Prior to final disposition of the action the defendants proposed a plan of reorganization which the Commission regarded as fair and equitable whereby the publicly held stocks were exchanged for stock in another company not affiliated with the defendants which took over the assets of the defendant companies. This plan also required certain amendments to the charter of the new company to incorporate certain protective features for the benefit of the public investors. The plan was a voluntary one but virtually all of the public security holders availed themselves of the offer and received readily marketable securities which were substantially equivalent in value to their old preferred stocks and accrued dividends. 35/

This, then, is a summary of the six acts administered by the SEC. In addition the Commission has certain advisory duties relating to corporate reorganizations under the federal bankruptcy act but time will not permit a discussion of these important duties. I cannot resist the opportunity, however, to mention that the federal judges have expressed publicly -- in some instances in their formal opinions -- their appreciation of the assistance rendered to the courts by the SEC in these difficult and complex reorganizations.

In the early part of my talk, we went back to 1933 to a time when our people had lost confidence in the capital markets as a place to invest their savings. It might be of interest to compare those times with the situation today. At that time, new issues of corporate securities amounted to about $400 million dollars annually. Today it averages over $10 billion dollars. At that time, the value of all shares listed on the New York Stock Exchange was $34 billion dollars. Today it is about $200 billion dollars. In my opinion, this restored confidence in our capital markets is due in a large measure to the reliance by public investors on the vigorous enforcement of the securities laws, and that restored confidence, in turn, has resulted to a great degree in our present prosperity, employment, national income and national productivity.

35/ S.E.C. v. Home & Foreign Corp. et al., S.D. N.Y., C.A. No. 80-382, 1952.

The importance of maintaining confidence in our securities markets cannot be stressed too strongly. Few of us are unaffected by these markets. The ninety million Americans holding life insurance policies have an indirect interest in these markets through the great investment in the bonds and stocks of corporations held by insurance companies. Beneficiaries under pension funds and holders of investment company shares have a similar interest. And the families of eight and a half million citizens who directly own shares of corporations are vitally concerned. Our corporate wealth is very broadly held. The securities markets provide the mechanism by which business raises the capital required to serve the economic needs of the people. They provide a mechanism by which industry may be broadly shared by the people. Ownership of American industry has become, through the operation of the capital markets, freely transferable. Investors are willing to place their savings at the disposal of industry, and thus the capital so essential to the nation's economic progress is provided.

In conclusion, I wish to emphasize that we, at the Commission, are eager to assist the members of the bar with their problems. I wish you to feel free to write to us if you think we can be of service to you. We welcome your communications and try to give you a prompt and helpful reply. Or if you are in the vicinity of Washington or of any of our regional offices, we invite you to come in and discuss your problems with us personally.

Nearly twenty years ago the late Judge Jerome Frank, then Chairman of the Commission, spoke to another Bar Association 36/ and what he said then is true today. "We on SEC," he said, "try to approach business problems with informed understanding of business needs and ways. * * * We do not stand on false dignity. We recognize that, although we have official titles, we are still human beings and do not know it all. We do not wear frock coats, and we do not think frock coatedly. We and those with whom we confer think out loud and in the vernacular: we and they put our feet on the table and unbutton our vests. We want to understand and be understood. Ours is a practical problem, a problem to be worked out, under the requirements of the statute, with businessmen. We seek decisions which will carry out the law and yet be workable. We think that that is the best means of bringing about cooperation between Government and business."

36/ Association of the Bar of the City of New York, May 5, 1940.