# THE EIGHTY-FIFTH CONGRESS AND THE FEDERAL SECURITIES LAWS

Address of

THOMAS G. MEEKER

General Counsel

Securities and Exchange Commission

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# THE EIGHTY-FIFTH CONGRESS AND THE FEDERAL SECURITIES LAWS *

Thank you Commissioner Sargent. Mr. President, members of the Chicago Chapter of the American Society of Corporate Secretaries, and guests, it is indeed a pleasure to have this opportunity to outline for you some of the proposed securities legislation now pending in the Eighty-Fifth Congress. You will, of course, appreciate that in view of time limitations, my remarks must necessarily be general and directed toward the more significant proposals.

Under the federal securities laws, the Commission is obligated to the Congress to make such legislative recommendations as the Commission may from time to time deem desirable in the public interest. 1/ Last summer, the Commission submitted to the Senate Committee on Banking and Currency and the House Committee on Interstate and Foreign Commerce, which have the duty of exercising watchfulness over the execution of the federal securities laws 2/,

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1/ Sec. 28, Securities Act of 1933; Sec. 21(a), Securities Exchange Act of 1934; Sec. 23, Public Utility Holding Company Act of 1935; Sec. 46(a), Investment Company Act of 1940; Sec. 216, Investment Advisers Act of 1940.

2/ Pursuant to Sec. 136 of the Legislative Reorganization Act of 1946.

proposals to amend an aggregate of 87 provisions of the Securities Act of 1933, the Securities Exchange Act of 1934, the Trust Indenture Act of 1939, the Investment Company Act of 1940, and the Investment Advisers Act of 1940. These proposals were introduced in the Senate by Senator Frank J. Lausche, Chairman of the Subcommittee on Securities of the Committee on Banking and Currency, [3] and in the House by Representative Oren Harris, Chairman of the Committee on Interstate and Foreign Commerce. [4] The Senate bills were referred to the Committee on Banking and Currency and the House bills to the Committee on Interstate and Foreign Commerce. Although the press of other business prevented either Committee from considering the Commission's proposals during the remainder of the first session of the Congress, I am hopeful that hearings will be scheduled early in the second session.

These proposals are the culmination of an extensive analysis of the Commission's experience in administering the federal securities laws. They are designed to strengthen the safeguards and protections afforded the public by tightening jurisdictional provisions, by correcting inadequacies in the securities laws revealed in their administration, by facilitating criminal prosecutions and other enforcement activities, and by clarifying ambiguities to make it easier for those subject to the securities laws to know precisely their rights and obligations thereunder.

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3/ The Securities Act proposals are embodied in S. 2544; the Exchange Act proposals in S. 2545; the Trust Indenture Act proposals in S. 2546; the Investment Company Act proposals in S. 2796; and the Investment Advisers Act proposals in S. 2547.

4/ As H. R. 9326; H. R. 9327; H. R. 9328; H. R. 9329; and H. R. 9330.

While the Commission was formulating its legislative program, the Senate Committee on Banking and Currency and the House Committee on Interstate and Foreign Commerce authorized it to discuss its proposals with representatives of the securities industry and other interested members of the public. Accordingly, one public and several informal conferences were held at which interested persons were heard. Thereafter, the Commission reexamined its program in the light of the comments received at and as a result of these conferences. The Commission's proposals thus reflect many ideas of the regulated as well as those of the regulators.

The amendments in which I think you will be primarily interested are embodied in the proposals under the Securities Act. 5/

Section 3(b) of the Securities Act is now and was during the 84th Congress the subject of considerable congressional interest. As you know, this provision supplies a conditional exemption from registration for securities offerings not in excess of $300,000. The Commission's program contains a proposal to amend this exemptive provision to increase the maximum limit to $500,000. 6/ The Commission believes that this is necessary in order to facilitate access to the public capital markets by more small and medium-sized businesses.

Substantially similar proposals have also been made by Senator Edward Thye 7/ and Senator John J. Sparkman. 8/ After conducting hearings on the Thye and Sparkman bills, at which the Commission appeared in their support,

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5/ S. 2544; H. R. 9326.
6/ Sec. 3 of H. R. 9326.
7/ S. 810.
8/ S. 843.

the Senate Committee on Banking and Currency favorably reported its own bill, [9] which is essentially identical with the Thye, Sparkman and Commission proposals. The Senate passed this bill [10] and sent it to the House where it is now under consideration by the Committee on Interstate and Foreign Commerce.

A further proposal which would affect Section 3(b) offerings is the Commission's suggested amendment to Section 12 of the Act. [11] This proposal would add a new subsection providing for clear civil liability on the part of those responsible for untrue statements of, or omissions to state, material facts in any document filed with the Commission in connection with a Section 3(b) exempt offering.

Section 11 of the Act now provides civil liability in the event of material misstatements or omissions in a registration statement, and Section 12(2) contains civil liability provisions which are applicable to the sale of securities generally, regardless of whether they are registered. Section 12(2) provides that "any person who * * * offers or sells" a security by false or misleading statements is liable "to the person purchasing such security from him." However, under this provision, where an issuer sells to a dealer and the dealer in turn sells to an investor, it is not clear that the investor can go beyond his immediate seller (the dealer) and recover from the issuer -- who may be the person actually responsible for the misleading information used in the sale.

The Commission believes that persons who sign documents filed with it containing untrue statements or omissions, persons who make or cause to be made

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9/ S. 2299. See S. Rpt. 438, dated June 14, 1957.
10/ June 26, 1957.
11/ Sec. 7 of S. 2544; Sec. 8 of H.R. 9326.

untrue statements or omissions, controlling persons and the issuer should all be civilly liable to any person (not knowing of such untruths or omissions) who receives or is shown copies of such documents in connection with his purchase of securities, or who relies on such untrue statements or omissions in connection with his purchases.

As to the issuer, there should be no defense of lack of knowledge of any untruth or omission in a document filed with the Commission. On the other hand, the Commission is of the opinion that liability for misleading statements or omissions in an exempt offering should not be imposed on any officer, director or other individual associated with the offering if he can sustain the burden of proof that he acted in good faith and did not know of the untruth or omission on which the action is based. Thus under the Commission's proposal, officers, directors and other individuals would be liable only for actual misconduct or bad faith, whereas the issuing corporation would be absolutely liable. The Commission firmly believes that enactment of this proposal will furnish investors with needed additional protection in Section 3(b) exempt offerings.

Incidentally, Representative Leonard Farbstein has introduced a bill [12/] which embodies the provisions of this proposal.

Another bill, [13/] introduced by Representative John B. Bennett, would make applicable to Section 3(b) offerings the same strict civil liabilities now pertaining solely to registered offerings. The Commission opposed this bill in the 84th Congress, and has continued to oppose it in the Eighty-fifth, because the Commission believes its enactment would result in the equivalent of registration for small issues of securities and thus have the

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12/ H. R. 173.
13/ H. R. 4744.

indirect effect of repealing the Section 3(b) exemption. The Bennett bill, unlike the Commission and the Farbstein proposals, would apply liability -- virtually of a fiduciary nature -- to all persons associated with a Section 3(b) offering despite any lack of knowledge of, or responsibility for, the untrue statements or omissions.

The Commission has also recommended [14/] that Section 24 of the Act be amended to provide for the same criminal responsibility for filing false or misleading offering circulars and other documents in connection with Section 3(b) offerings as now exists in the case of registered offerings.

The Commission's amendment program under the Securities Act contains a proposal which would make explicit a registrant's right to withdraw its registration statement unless the statement is subject to a stop-order or a stop-order proceeding. [15/] In Jones v. S.E.C. [16/] the Supreme Court held that under the circumstances of that case where no securities had been sold, the registrant could withdraw its registration statement prior to effectiveness as a matter of right. This holding has been given a limited construction in subsequent decisions. [17/] In order to clarify the matter, the Commission would add an amendment to Section 6(c), which recognizes a registrant's right to withdraw in all cases except where a proceeding or examination by the Commission is pending or is commenced within fifteen days after application for withdrawal is filed, or where the registration statement is subject

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14/ Sec. 12 of S. 2544; Sec. 13 of H.R. 9326.
15/ Sec. 3 of S. 2544; Sec. 4 of H.R. 9326.
16/ 298 U.S. 1 (1936).
17/ Cf. Resources Corporation International v. SEC, 103 F. 2d 929 (C.A.D.C. 1939); Oklahoma-Texas Trust v. SEC, 100 F. 2d 88 (C.A. 10, 1939); SEC v. Hoover, 25 F. Supp. 484 (N.D. Ill. 1938).

to an order of the Commission. An effective registration statement could not be withdrawn after any of the securities covered by it have been sold.[18]

An important purpose of the proposed amendment to Section 6(c) is to prevent unscrupulous persons from filing a misleading registration statement and then withdrawing it when the Commission either institutes or deems it necessary to institute proceedings to ascertain and disclose the misleading character of the statement, and to prevent withdrawal after the Commission has issued an order under Section 8 unless the statement is first amended to make adequate disclosure of the facts. The purpose of prohibiting withdrawal of an effective registration statement where part or all of the securities have been sold is, of course, to safeguard the rights of the purchasers of the securities.

The Commission has recommended a number of other amendments to the Securities Act, as well as ~~complete~~ amendment programs with respect to the Exchange Act[19], the Trust Indenture Act[20], the Investment Company Act[21], and the Investment Advisers Act,[22] However, in view of the fact that you as officials of issuing corporations would probably have no more than a passing interest in these proposals (which are either technical in their nature, apply only to the securities industry, or affect principally investment companies and investment advisers), I shall not impose on your time in any discussion of them.

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18/ This provision, however, would not foreclose the filing of an amendment to the registration statement, in accordance with the existing practice, to reduce the number of shares registered to those which have been sold.

19/ S. 2545; H. R. 9327.

20/ S. 2547; H. R. 9328.

21/ S. 2796; H. R. 9329.

22/ S. 2546; H. R. 9330.

Instead, I shall briefly describe several other proposals before the Congress in which you may have an interest. Although these bills did not originate with the Commission, their enactment would amend the federal securities laws.

The Fulbright Bill of the Eighty-fourth Congress was re-introduced early in the Eighty-fifth Congress.[23] This proposal of Senator J. W. Fulbright[24] was designed to amend the Exchange Act to extend the financial reporting, proxy and insider reporting and trading provisions of the Act[25] to large corporations whose securities are publicly held but not listed and registered on a national securities exchange. As originally introduced, the bill applied to corporations having more than 750 stockholders or debt securities of more than $1,000,000 outstanding in the hands of the public, and $2,000,000 dollars of assets. In addition to requiring these corporations to register with the Commission and file with it annual and other periodic reports now required only of corporations with listed and registered securities, the bill would also have subjected them to the Commission's proxy rules and the insider trading provisions of the Act.

After a careful study, the Commission endorsed the financial reporting, proxy and insider reporting provisions of the bill, but recommended deferral of any action on the application of the insider short-swing trading recovery provisions to unlisted securities pending further study. The Commission also objected to a provision of the bill which would have repealed Section 15(d) of the Act and thus relieved 246 corporations now required to file financial reports from that obligation.[26]

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23/ S. 1168.
24/ Chairman of the Committee on Banking and Currency.
25/ See Secs. 12, 13 14 and 16 of the Act.
26/ Hearings before a Subcommittee of the Committee on Banking and Currency, U. S. Senate, 85th Cong., 1st Sess., on S. 594, S. 1168 and S. 1601, May 21-29, p. 61 et seq.

The Committee reported the bill out to the Senate with amendments reducing its application to companies having $10,000,000 of assets and more than 1,000 stockholders of record and deleting the debt security test.[27/] An exemption for insurance companies was added, and the Commission's two suggested amendments were adopted by the Committee. As reported out by the Committee, the bill covers 650 companies, approximately one-half of the number which would have been covered by the original bill.

S. 594, introduced by Senator Homer E. Capehart, would amend Section 16(a) of the Exchange Act to require beneficial owners of more than five percent (instead of the present ten percent) of any class of any security registered on a national securities exchange to file with the Commission reports of their holdings and transactions. The reporting requirements now apply, and would continue to apply, to officers and directors, irrespective of the size of their holdings. The application of Section 16(b), which provides for the recovery of short-swing profits realized by insiders, would not be changed by the bill, so that five percent stockholders would be subject to the reporting requirements of Section 16(a) but not to the short-swing recovery provisions.

In written comments and in hearings before the Subcommittee on

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27/ S. Rpt. 700, dated July 24, 1957.

Securities of the Senate Committee on Banking and Currency, [28] the Commission expressed its view that disclosure of five percent ownership might assist management or any other group in determining whether substantial beneficial holdings are being accumulated and the identities of the persons so accumulating them. Presently it is possible for very substantial accumulations to be made by groups without any public disclosure because single individuals may accumulate up to ten percent of the outstanding securities of a corporation without disclosing their activities. As a result, instances have occurred in which groups possessing thirty to fifty percent of the outstanding stock of their companies have appeared at corporate meetings and revealed for the first time such concentrations of ownership merely because each member of the groups could, without prior public disclosure, accumulate within the present ten percent limitation. To the extent that this percentage is reduced, additional light might be thrown upon such activities.

S. 1601, another bill introduced by Senator Capehart, is directed toward identifying beneficial owners in proxy contests. This bill would amend Section 14 of the Exchange Act, which deals with solicitation of proxies in connection with securities registered on a national securities exchange. It would add a provision making it unlawful for any person to give a proxy relating to such a security for the election or removal of directors, where there is a contest, unless (1) such person is the bene-

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28/ Hearings before a Subcommittee of the Committee on Banking and Currency, U.S. Senate, 85th Cong., 1st Sess., on S. 594, S. 1168 and S. 1601, May 21-29, pp. 11-12.

ficial owner of the security or (2) the name and last known address of the beneficial owner appear on the proxy. In addition, the bill would make it unlawful for any person knowingly to exercise any proxy in violation of the foregoing provision. The Commission both in written comments and hearings before the Subcommittee on Securities 30/ expressed the following views. First, that there is a substantial question as to whether the bill would actually facilitate disclosure of beneficial ownership because the record holder may not know the beneficial owner, particularly where the owner seeks to conceal his identity. In addition, the record holder may not be in a position to conduct the necessary investigation to discover the beneficial owner even if he suspects the person so named is not in fact the beneficial owner. Second, that since the purpose of proxy regulation is to provide stockholders with the necessary information to exercise an informed judgment in casting their votes, the information required by the bill would be of no help to the rank and file stockholders because it would not be available to them at the time they execute their proxies. Finally, the Commission felt that enactment of the bill might impede the conduct of corporate meetings. Beneficial owners might refrain from giving their proxy rather than have their identity revealed, and record owners, fearful of any possible implication in a violation, might prefer not to execute any proxy. These conditions might result in the lack of a quorum so that no meeting could be held.

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30/ Hearings before a Subcommittee of the Committee on Banking and Currency U.S. Senate 85th Cong., 1st Sess., on S. 594, S. 1168 and S. 1601, May 21-29, p. 12 et seq.

Although hearings have been held on S. 1601, the bill has not been reported out by the Senate Banking and Currency Committee. We expect that this is one of the proposals to amend the federal securities laws which will be receiving further consideration in the second session of the 85th Congress which convened yesterday.

I regret that time has not permitted me to go into detail on all of the aspects of the Commission's program and the other securities legislative proposals before the Congress. However, I appreciate the opportunity you have afforded me to discuss briefly with you some of the legislative matters pending in the Congress and which you may wish to follow during the ensuing months of the second session of the Eighty-fifth Congress.