HARD COPY

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

Administrative Proceeding
File No. 3-17674

In the Matter of **ALEXANDER KON,** **Respondent.**	**DIVISION OF ENFORCEMENT'S RESPONSE TO RESPONDENT'S MOTION FOR A RULING ON THE PLEADINGS AND SUPPORTING MEMORANDUM OF LAW**

The Division of Enforcement ("Division"), pursuant to the Administrative Law Judge's Order Regarding Respondent's Motion for Judgment on the Pleadings and Motion for Withdrawal (Rel. No. 4501, January 5, 2017), hereby responds to Respondent's argument that this matter should be dismissed for failure to state a claim under Section 17(b) of the Securities Act of 1933 ("Securities Act"). Contrary to Respondent's argument and the district court's opinion in *SEC v. Recycle Tech Inc., et al.*, Case No. 12-21656-CV-LENARD (S.D. Fla. Sep. 26, 2013) (attached hereto as Exhibit A), the charge under Section 17(b) is properly brought as it is entirely consistent with the language and purpose of the statute.

Section 17(b) requires full disclosure of the consideration received from an "issuer, underwriter, or dealer." Thus, what needs to be disclosed is the existence and amount of consideration received from one of these three sources. There is no requirement in Section 17(b) to disclose consideration from any other source. Respondent's argument and the holding in *Recycle Tech* ignore this statutory language. This is impermissible, as it reads out the critical language of the source of the consideration. There cannot be truthful disclosure if the promoter of a stock is not accurately telling the public the source of the consideration received: an

HARD COPY

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

Administrative Proceeding
File No. 3-17674

In the Matter of

ALEXANDER KON,

Respondent.

DIVISION OF ENFORCEMENT'S RESPONSE TO RESPONDENT'S MOTION FOR A RULING ON THE PLEADINGS AND SUPPORTING MEMORANDUM OF LAW

The Division of Enforcement ("Division"), pursuant to the Administrative Law Judge's Order Regarding Respondent's Motion for Judgment on the Pleadings and Motion for Withdrawal (Rel. No. 4501, January 5, 2017), hereby responds to Respondent's argument that this matter should be dismissed for failure to state a claim under Section 17(b) of the Securities Act of 1933 ("Securities Act"). Contrary to Respondent's argument and the district court's opinion in *SEC v. Recycle Tech Inc., et al.,* Case No. 12-21656-CV-LENARD (S.D. Fla. Sep. 26, 2013) (attached hereto as Exhibit A), the charge under Section 17(b) is properly brought as it is entirely consistent with the language and purpose of the statute.

Section 17(b) requires full disclosure of the consideration received from an "issuer, underwriter, or dealer." Thus, what needs to be disclosed is the existence and amount of consideration received from one of these three sources. There is no requirement in Section 17(b) to disclose consideration from any other source. Respondent's argument and the holding in *Recycle Tech* ignore this statutory language. This is impermissible, as it reads out the critical language of the source of the consideration. There cannot be truthful disclosure if the promoter of a stock is not accurately telling the public the source of the consideration received: an

investor who knows the promoter is being paid by the issuer will take the promoter's opinion with a much larger grain of salt that an investor who thinks the promoter's compensation is coming from an independent third-party. Respondent's motion should thus be denied.

I. FACTUAL BACKGROUND

In early 2014, as part of an effort to increase his company's ("Issuer A") stock price, Issuer A's former CEO (the "Former CEO") retained Alexander Kon to disseminate information about Issuer A.[1] (OIP at II.B. ¶1). Kon, now 38, residing in Overland Park Kansas, was the sole member of 007Stockchat LLC, which also operated as Stockchat LLC, an entity through which Kon promoted microcap stocks. (OIP at II.A). Kon possessed an email list and various websites through which he touted microcap stocks. (OIP at II.B. ¶2).

After various email exchanges and phone calls between the Former CEO and Kon, they agreed that for $25,000, Kon would run a marketing campaign on Issuer A stock on April 14, 2014 via four websites that Kon operated: 1) 007stockchat.com; 2) awesomestocktips.com; 3) otcfire.com; and 4) pennystockspy.com. (*Id.* ¶3). Kon and the Former CEO interacted exclusively with each other to both organize and make payment arrangements for the promotional campaign. (*Id.* ¶4). The $25,000 payment to Kon was effected via wire transfer by the Former CEO and was in response to an invoice Kon sent directly to the Former CEO. (*Id.* ¶4).

However, despite Kon interacting exclusively with the Former CEO, sending the invoice directly to the Former CEO, and receiving payment from a transaction effected by the Former CEO, Kon determined, in concert with the Former CEO, that the disclaimer for each of the touts

[1] The Former CEO was recently deceased at the time of the institution of this action, hence "former." However, at all relevant times, he was the CEO and was the sole person to interact with Respondent as it pertained to the promotion of Issuer A.

on the four websites would note that Kon received money from "third party Casey Cummings." (*Id.* ¶4). Thus, each of the touts indicated that Kon's entity had "received twenty-five thousand dlrs for the awareness of CBGI from a third party Casey Cummings." (Composite Exhibit B).[2] Moreover, Kon was aware that Casey Cummings was the Former CEO's son, yet did not disclose this in the touts either. (OIP at II.B. ¶5). Issuer A's press releases and other public disclosures along with Kon's internet campaign coincided with stock sales by various individuals and entities, as Issuer A's trading volume and share price increased significantly concurrently with Issuer A's press releases, disclosures, and touts. (*Id.* ¶5).

II. STANDARDS FOR SUMMARY DISPOSITION

Rule 250(a) of the Commission's Rules of Practice provides that no later than 14 days after a respondent's answer has been filed, any party may move for a ruling on the pleadings on one or more claims or defenses, asserting that, even accepting all of the non-movant's factual allegations as true and drawing all reasonable inferences in the non-movant's favor, the movant is entitled to a ruling as a matter of law. The hearing officer shall promptly grant or deny the motion.

This is akin to a motion to dismiss under the Rule 12(b)(6) of the Federal Rules of Civil Procedure where a party may move to dismiss a complaint when the plaintiff has failed "to state a claim upon which relief can be granted." Fed.R.Civ.P. 12(b)(6). Under Rule 12(b)(6), the

---

[2] These documents are included to assist the ALJ under the "incorporation by reference" doctrine where "a court may look beyond the pleadings without converting the [Fed. R. Civ. P.] 12(b)(6) motion into one for summary judgment." *Van Buskirk v. Cable News Network, Inc.*, 284 F.3d 977, 980 (9th Cir. 2002). Specifically, courts may take into account "documents whose contents are alleged in a complaint and whose authenticity no party questions, but which are not physically attached to the [plaintiff's] pleading." *Knievel v. ESPN*, 393 F.3d 1068, 1076 (9th Cir. 2005).

court's inquiry is whether the complaint contains "enough facts to state a claim to relief that is plausible on its face." *Bell Atlantic Corp. v. Twombly,* 550 U.S. 544, 570 (2007). When analyzing a 12(b)(6) motion, "all well-pleaded factual allegations ... are accepted as true and viewed in the light most favorable to the nonmoving party." *Sutton v. Utah State School for Deaf and Blind,* 173 F.3d 1226, 1236 (10th Cir. 1999).[3]

III. SECTION 17(b) OF THE SECURITIES ACT

Section 17(b) of the Securities Act reads as follows:

> **(b) Use of interstate commerce for purpose of offering for sale**
> It shall be unlawful for any person, by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, to publish, give publicity to, or circulate any notice, circular, advertisement, newspaper, article, letter, investment service, or communication which, though not purporting to offer a security for sale, describes such security for a consideration received or to be received, directly or indirectly, from an issuer, underwriter, or dealer, without fully disclosing the receipt, whether past or prospective, of such consideration and the amount thereof.

15 U.S.C.. § 77q(b).

The legislative history of Section 17(b) is found in H.R. Rep. 73-85, 1st Sess. 1933, 1933 WL 983 (Leg.Hist.) (attached hereto as Exhibit C). In first discussing the purpose of what would become the Securities Act, the emphasis was "full and fair disclosure of the character of securities sold." (*Id.* at *1).

President Roosevelt's March 29, 1933 message to Congress stated:

To the Congress:

---

[3] While Respondent references Rule 9(b) of the Federal Rules of Civil Procedure (relating to pleading fraud with particularity), he makes no specific argument pertaining to it and concedes that it does not apply (Motion at 6, n.2), and thus the Division need not address it. Furthermore, Section 17(b) is not a fraud-based charge, and thus Rule 9(b)'s applicability is dubious even if this matter had been brought in federal district court. And in any event, the OIP clearly pleads with sufficient particularity the precise misconduct Respondent is charged with, providing the date of the touts, who made them, and the deficient disclosure that forms the basis for the Section 17(b) claim.

> I recommend to the Congress legislation for Federal supervision of traffic in investment securities in interstate commerce...
>
> 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.

Id. at *2.

Then later, specifically as to Section 17(b), the legislature stated:

> This subsection is particularly designed to meet the evils of the 'tipster sheet' as well as articles in newspaper or periodicals that purport to give an unbiased opinion but which opinions in reality are bought and paid for.

Id. at *24 (Section 16(b)).

IV. ARGUMENT

The well-pleaded facts are not in dispute. Kon, through his four internet touts, disclosed that he was being paid $25,000 for his touts of Issuer A. However, as alleged, and thus deemed true at this stage, Kon did *not* disclose that he was paid this $25,000 directly by the Former CEO of Issuer A, the sole person Kon interacted with in regards to these touts. Instead, per the Former CEO's instruction, Kon misrepresented that he received payment from "third party Casey Cummings," who Kon knew was the son of the Former CEO. Kon did not disclose that the compensation he received came from the Issuer, nor did he disclose the relationship between Casey Cummings and the Former CEO. As shown below, Kon's failure to disclose that the compensation he received came from the issuer violates Section 17(b).

A. Under the Plain Language of the Statute, Kon Was Required to Disclose that the Compensation He Received Came from the Issuer

As Kon notes in his motion, the question of whether his conduct violated Section 17(b) is a matter of first impression in an administrative proceeding. (Motion at 8). Here, Section

17(b)'s plain language shows that Kon was required to disclose not only the existence of and amount of compensation, but the fact that his compensation came, directly or indirectly, from the issuer.

Courts must presume that a legislature says in a statute what it means and means in a statute what it says there. *See, e.g., United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 241–242 (1989); *United States v. Goldenberg,* 168 U.S. 95, 102–103 (1897). When the words of a statute are unambiguous, then, this first canon is also the last: "judicial inquiry is complete." *Rubin v. United States,* 449 U.S. 424, 430 (1981). Further, it is a well-known canon of statutory construction that courts should construe statutory language to avoid interpretations that would render any phrase superfluous. *TRW Inc. v. Andrews,* 534 U.S. 19, 31 (2001) ("It is a cardinal principle of statutory construction that a statute ought, upon the whole, to be so construed that, if it can be prevented, no clause, sentence, or word shall be superfluous, void, or insignificant").

Applying these principles, it is readily apparent that disclosing the actual source of the compensation is a requirement of Section 17(b). Section 17(b) requires full disclosure of the receipt of "*such* consideration," i.e. the consideration received from an "issuer, underwriter, or dealer." Hence, the statute itself clearly indicates that the disclosure of the consideration and the amount is only required if the consideration is received from an issuer, underwriter, or dealer. Thus, it follows logically that if the compensation is not received from one of these entities, i.e. from a third party, then disclosure of the compensation is not required. However here, the OIP specifically alleges that Kon received compensation directly from the issuer.

Operating under the premise that all words in the statute must be construed so as not to be superfluous, it is impossible to construe Section 17(b) otherwise. Eliminating the requirement that the source be disclosed would render the entire phrase "describes such security for a

consideration received or to be received, directly or indirectly, from an issuer, underwriter or dealer," completely superfluous. This cannot be the proper result.

The cases Kon relies upon do not require a different result. The district court in *Recycle Tech* relied on three cases as the underpinnings to reach its conclusion that the issuer need not be properly disclosed.[4] However, none of those three cases addressed the issue raised here, and therefore *Recycle Tech* should not be deemed persuasive. In *United States v. Wenger*, 427 F. 3d 840 (10th Cir. 2005), the district court, in rejecting various First Amendment challenges to Section 17(b), found that because Section 17(b) required anyone who publicizes a stock to disclose the receipt of compensation and amount thereof, Section 17(b) was not unconstitutionally vague. *See id.* at 851-52 Thus, because Wegner did not disclose *anything* required under Section 17(b), the failure to disclose the *source* of his payment was never an issue the court needed to address.

In *SEC v. Gorsek*, 222 F. Supp. 2d 1099 (C.D. Ill. 2001), again the issue of whether disclosure of the source of the consideration is required was not addressed. The district court granted the Commission's motion for summary judgment, stating that two of the defendant's disclosures at issue, "[F]ail...to list the amount of compensation; both also fail to disclose the type of consideration (e.g. stock, cash, or combination of cash and stock)." *Id.* at 1107. Thus, again, the specific issue of failing to disclose who was providing the compensation, even if the actual compensation was disclosed, was not addressed.

Finally, in *United States v. Amick*, 439 F.2d 351 (7th Cir. 1971), the court's holding rested on the fact that the receipt of compensation was not disclosed at all. *See id.* at 364-65. The defendant challenged Section 17(b) on a First Amendment basis, and the court rejected the

[4] Respondent's argument is a mirror image of the district court's analysis in *Recycle Tech.*

challenge. *See id.* at 365. Again, the issue of the promoter disclosing the amount of payment but not the identity of the payor was not before the court.

In *Recycle Tech,* defendants Thompson and Fung each received more than two million shares of Recycle Tech stock from Recycle Tech itself (through its attorney) as compensation for the newsletter touting efforts of the stock, but only disclosed it had received such shares from a non-affiliated third party." (Exhibit A at 19-20). The district court, in noting it was a matter of first impression, applied the four part test in *Gorsek* to establish a 17(b) violation. The only prong at issue was the last, "full disclosure of the compensation received and the amount." The district court relied on *Gorsek, Wenger,* and *Amick* to conclude that the defendants' disclosure of the existence of the compensation and amount thereof was sufficient. *Id.* at 21-22. However, in concluding, "this is all the statute requires," (*Id.* at 21), the district court relied on inapplicable precedent and did not properly focus on the statutory language which makes the source of the consideration a defined prerequisite to the disclosure of the compensation and the amount. Therefore, since none of the cases cited by the district court in *Recycle Tech* support its conclusion, and the court's conclusion is inconsistent with the statutory language, *Recycle Tech* should not be followed by the Administrative Law Judge.

B. The Legislative History and Intent Dictates that the Source of Compensation Must be Accurately Disclosed

Furthermore, to the extent there is ambiguity, the legislative history, embodied in the highly persuasive committee report is determinative. Resort to authoritative legislative history may be justified where there is an open question as to the meaning of a word or phrase in a statute, or where a statute is silent on an issue of fundamental importance to its correct application. As a general matter, courts may consider reliable legislative history where, as here, the statute is susceptible to divergent understandings and, equally important, where there exists

authoritative legislative history that assists in discerning what Congress actually meant. *United States v. Gayle,* 342 F.3d 89, 94 (2d Cir. 2003). The Commission has previously consulted legislative history and other tools of statutory construction to discern Congress's meaning. *See, e.g., In the Matter of Larry C. Grossman,* S.E.C. Rel. No. 4543, 2016 WL 5571616, *16 (Sep. 30, 2016); *In the Matter of Salvatore F. Sodano,* S.E.C. Rel. No. 59141, 2008 WL 5328801, *4-7 (Dec. 22, 2008).

The most enlightening source of legislative history is generally a committee report, particularly a conference committee report, which has been identified as among "the most authoritative and reliable materials of legislative history." *Disabled in Action of Metropolitan New York v. Hammons,* 202 F.3d 110, 124 (2d Cir. 2000). In the words of one former legislator and judge, a committee report is "the most useful document in the legislative history." Abner Mikva, quoted in Robert A. Katzmann, "Summary of Proceedings," *in Judges and Legislators* 171 (R. Katzmann, ed.) (1988) (as quoted in *Gayle,* 342 F.3d at 94). Another former legislator and United States Circuit Judge has explained: "[M]y understanding of most of the legislation I voted on was based entirely on my reading of its language and, where necessary, on explanations contained in the accompanying [committee] report." James L. Buckley, *Statutory Interpretation and the Uses of Legislative History,* Hearing before the Subcommittee on Courts, Intellectual Property, and the Administration of Justice of the House Committee on the Judiciary, 101 Cong.2d Sess., Serial No. 107, at 21 (Apr. 19, 1990) (as quoted in *Gayle,* 342 F.3d at 94).

For starters, the framing of why the law was being passed is unequivocal. The introduction stresses that the Committee on Interstate and Foreign Commerce was seeking "full and fair disclosure." The President's message stresses all securities sold "be accompanied by full publicity and information and that *no essentially important element* attending the issue shall

be concealed from the buying public." (emphasis added). It strains credulity to assert that disclosure of the source of consideration is not "essential" to "full and fair disclosure."

In looking at the specific section in the legislative history pertaining to Section 17(b), its clear message is that the *entire* statute is designed to cure the evils of precisely what we have here – a tipster sheet for the modern era in the form of several internet touts. When the issuer is paying the stock touter, the opinion is not "unbiased." The full information which the statute's underlying premise was founded on would dictate that disclosure that the issuer is the source of the consideration is required.

V. CONCLUSION

A promoter of stock should be required to disclose the source of the consideration received. Section 17(b) of the Securities Act requires it. A plain reading of the statute dictates as much. And, if necessary to inspect, the legislative intent behind the statue indicates full and complete disclosure were the underpinnings of the law. Congress was specifically concerned with disclosing who was paying the consideration and thus did not require disclosure of consideration unless that consideration is paid for directly or indirectly by an issuer, underwriter, or dealer. It is only consideration from such sources that Congress deemed necessary to disclose in Section 17(b). Not holding tipsters and promoters to this standard is a disservice to the investors for whose protection the Securities Act exists. It is clear that an issuer, underwriter, or dealer has a financial interest in seeing positive opinions published about its security. It is not clear that an unaffiliated third party would have such an interest. Investors should not have to speculate as to the existence of bias. The statute's clear language and the legislature who created it demand no other conclusion. Respondent's motion should therefore be denied.

January 19, 2017

Respectfully submitted,

Russell Koonin
Senior Trial Counsel
Direct Line: (305) 982-6385
kooninr@sec.gov

DIVISION OF ENFORCEMENT
SECURITIES AND EXCHANGE COMMISSION
801 Brickell Avenue, Suite 1800
Miami, FL 33131
Phone: (305) 982-6300
Fax: (305) 536-4154

CERTIFICATE OF SERVICE

I hereby certify that an original and three copies of the foregoing were filed with the Securities and Exchange Commission, Office of the Secretary, 100 F Street, N.E., Washington, D.C. 20549-9303, and that a true and correct copy of the foregoing has been served by U.S. Mail and email as indicated below this 19th day of January 2017, on the following persons entitled to notice:

Honorable Cameron Elliot
Administrative Law Judge
Securities and Exchange Commission
100 F Street, N.E.
Room 2557
Washington, D.C. 20549
(also via email to alj@sec.gov)

Todd Feinstein, Esq.
111 Madrona Way
Sequim, WA 98382-9621
(Counsel for Alexander Kon)
(also via email to Todd@Feinsteinlawfirm.com)

Russell Koonin

EXHIBIT
A

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA

CASE NO. 12-21656-CIV-LENARD/O'SULLIVAN

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

RECYCLE TECH, INC., et al.,

Defendants.
_____/

ORDER GRANTING IN PART AND DENYING IN PART DEFENDANTS' MOTIONS TO DISMISS (D.E. 52, 55)

THIS CAUSE is before the Court on Defendants Pudong, LLC and Jay Fung's Motion to Dismiss (D.E. 52), filed on August 31, 2012. On October 1, 2012, Plaintiff Securities and Exchange Commission filed its response (D.E. 65), and Defendants filed their reply (D.E. 76) on October 19, 2012. Also before the Court is Defendants Anthony Thompson and OTC Solutions, LLC's Motion to Dismiss (D.E. 55), filed on September 4, 2012. On October 1, 2012, Plaintiff filed its response (D.E. 64), and Defendants filed their reply (D.E. 74) on October 12, 2012. Upon review of the Amended Complaint (D.E. 46), Motions, Responses, Replies, and the record, the Court finds as follows.

I. Background[1]

Plaintiff Securities and Exchange Commission ("SEC" or "the Commission") alleges that from "no later than January through March 2010, Defendants Recycle Tech, Inc.[,] Ryan Gonzalez, and Kevin Sepe orchestrated, coordinated, and funded a 'pump-and-dump' scheme involving the sale of unregistered shares of Recycle Tech stock." (Am. Compl. ¶ 1.) "Sepe concocted the scheme in an effort to capitalize on anticipated, increased demand for temporary housing because of the Haitian earthquake disaster of January 12, 2010." (Id. ¶ 2.) "Gonzalez organized the conversion of Recycle Tech into a publicly-traded company and drafted seven false and misleading press releases, which he then issued through the company." (Id.) Sepe and Gonzalez contacted Defendant Ronnie Halperin to help them implement their "'pump-and-dump' scheme." (Id. ¶ 1.) Halperin retained Defendant David Rees, a securities attorney, "to convert Recycle Tech's debt into more than 25 million purportedly free trading shares," and Recycle Tech issued the shares to various individuals and entities, including Defendants OTC Solutions, LLC ("OTC") and Pudong, LLC ("Pudong"). (Id. ¶ 3.)

The SEC alleges that OTC and Pudong and their respective owners, Defendants Anthony Thompson and Jay Fung, "actively participated in the scheme through their promotion of Recycle Tech stock." (Id. ¶ 4.) Specifically, the SEC alleges as follows against Defendants OTC, Pudong, Thompson, and Fung:

---

[1] The following facts are gleaned from Plaintiff's Amended Complaint and are deemed to be true for purposes of Defendants' Motions.

> In January and February 2010, OTC Solutions and Pudong, both stock promotion companies, collectively issued five e-mail newsletters touting Recycle Tech. Thompson and Fung each received more than two million shares of Recycle Tech stock as compensation for their touting efforts. Their newsletters, however, did not adequately disclose their stock compensation or Thom[p]son and Fung's stock sales.
>
> Halperin, OTC Solutions, Pudong, and Rees each took advantage of the inflated price and trade volume created by the misleading press releases and newsletter campaign. From February to early March 2010, they collectively sold more than five million Recycle Tech shares into an inflated market and realized proceeds of more than $1.1 million.

(Id. ¶¶ 4-5.)

On May 2, 2012, the SEC filed its eleven-count Complaint against nine Defendants and a Relief Defendant. (See D.E. 1.) Three Defendants (Sepe, Rees, and Halperin) and the Relief Defendant (Charter Consulting Group, Inc.) settled with the SEC, and the Court entered final judgments against them. (See D.E. 8, 9, 10, 11.)

On August 17, 2012, the SEC filed its Amended Complaint against the remaining Defendants. (See D.E. 46.) Among other things, the Amended Complaint alleges that Fung, Pudong, Thompson, and OTC violated federal securities laws by selling unregistered securities (Count I against all Defendants), committing fraud in the offer or sale of securities (Counts II, IV, and VI against Thompson and OTC; Counts III, V, and VII against Fung and Pudong), and committing fraud in connection with the purchase or sale of securities (Count X against Thompson and OTC; Count XI against Fung and Pudong). The SEC specifies that "[t]hrough their conduct, each Defendant violated Sections 5(a) and 5(c) of the Securities Act of 1933, 15 U.S.C. §§ 77e(a) and 77e(c)," as

well as "Section 10(b) of the [Securities] Exchange Act [of 1934], Exchange Act Rule 10b-5, and Sections 17(a) and 17(b) of the Securities Act, 15 U.S.C. §§ 77q(a) and 77q(b)." (Am. Compl. ¶ 7.) The SEC asserts that Fung, Pudong, Thompson, and OTC committed fraud by "scalping" (i.e., touting Recycle Tech's stock without adequately disclosing ownership and their intention to sell it and then doing so) and by failing to adequately disclose their compensation for circulating communications regarding a stock. (See Response, D.E. 64, at 2; Response, D.E. 65, at 2.)

On August 31, 2012, Defendants Fung and Pudong filed their Motion to Dismiss (D.E. 52), wherein they moved to dismiss the fraud claims (Counts III, V, VII, and XI).[2] Fung and Pudong argue that the Amended Complaint fails to state a claim for violations of the anti-fraud provisions of the federal securities laws for the following three reasons: (1) the SEC "fails to allege the existence of a relationship, fiduciary or otherwise, which would give rise to the existence of a duty;" (2) the Amended Complaint's allegation that Fung and Pudong "did, in fact, disclose that Pennypic.com 'may sell part or all of any shares during the period in which Pennypic.com is performing advertising and marketing services,' . . . eviscerates any 'scalping' claim that the Commission could advance based upon a material omission;" and (3) the Amended Complaint fails to meet the pleading standards of Rule 9(b) of the Federal Rules of Civil Procedure because the fraud counts merely incorporate by reference the factual allegations made earlier in the pleading.

[2] Defendants Fung and Pudong did not move to dismiss the claim regarding the sale of unregistered securities (Count I). (See Motion, D.E. 52, at 4 n.2.)

(Motion, D.E. 52, at 8 (quoting Am. Compl. ¶ 75).) Fung and Pudong also argue that the "anti-touting claims" must be dismissed because they "fully disclosed their compensation" and because "there is no requirement" to "disclose[] the identity of the third party who compensated them for their services." (Id. at 14-15.)

On September 4, 2012, Defendants Thompson and OTC filed their Motion to Dismiss (D.E. 55), wherein they moved to dismiss the fraud claims (Counts II, IV, VI, and X) for the same reasons argued by Fung and Pudong in their Motion.[3] (See Motion, D.E. 55, at 7-10.) Thompson and OTC also argue that the "Court does not need to accept the SEC's conclusory or internally inconsistent allegations as true" in ruling on the Motions to Dismiss. (Id. at 10; see also id. at 10-13.) In addition, Thompson and OTC move to dismiss the Amended Complaint for "fail[ing] to allege facts sufficient to establish that venue for the SEC's claims against Thompson and OTC is proper in the Southern District of Florida." (Id. at 5; see also id. at 13-17.)

II. Legal Standards

A. Motion to Dismiss for Failure to State a Claim

The Federal Rules of Civil Procedure generally require a plaintiff to set forth in its complaint a "short and plain statement of his claim showing that the pleader is entitled to relief" in order to "give the defendant fair notice of what the . . . claim is and the grounds upon which it rests." Bell Atl. Corp. v. Twombly, 550 U.S. 544, 555 (2007) (citing

[3] Defendants Thompson and OTC did not make any arguments regarding the sale of unregistered securities (Count I).

Conley v. Gibson, 355 U.S. 41, 47 (1957); FED. R. CIV. P. 8(a)(2)). However, "[a]llegations of security fraud are subject to the heightened pleading standards of Federal Rule of Civil Procedure 9(b)." SEC v. BIH Corp., No. 2:10-cv-577-FtM-29DNF, 2011 WL 3862530, at *4 (M.D. Fla. Aug. 31, 2011). In claims involving fraud, "a party must state with particularity the circumstances constituting fraud." Fed. R. Civ. P. 9(b). "Rule 9(b) is satisfied if the complaint sets forth (1) precisely what statements were made in what documents or oral representations or what omissions were made, and (2) the time and place of each such statement and the person responsible for making (or, in the case of omissions, not making) same, and (3) the content of such statements and the manner in which they misled the plaintiff, and (4) what the defendants obtained as a consequence of the fraud."[4] Ziemba v. Cascade Intern., Inc., 256 F.3d 1194, 1202 (11th Cir. 2001).

In evaluating a motion to dismiss under Rule 12(b)(6) of the Federal Rules of Civil Procedure, courts adopt a "two-pronged approach" whereby they first (1) eliminate any allegations in the complaint that are merely legal conclusions and then (2) where there are well-pleaded factual allegations, "assume their veracity and then determine whether they plausibly give rise to an entitlement to relief." Am. Dental Ass'n v. Cigna Corp., 605 F.3d 1283, 1290 (11th Cir. 2010) (citing Ashcroft v. Iqbal, 129 S. Ct. 1937, 1950 (2009)).

[4] However, the Court notes that "[u]nlike private litigants seeking damages, the Commission is not required to prove that any investor actually relied on the misrepresentations or that the misrepresentations caused any investor to lose money." SEC v. Blavin, 760 F.2d 706, 711 (6th Cir. 1985) (citing SEC v. Lum's, Inc., 365 F. Supp. 1046, 1059 (S.D.N.Y. 1973); SEC v. N. Am. Research & Dev. Corp., 424 F.2d 63, 84 (2d Cir. 1970); Berko v. SEC, 316 F.2d 137, 143 (2d Cir. 1963)). Accordingly, the SEC is not required to allege reliance in its complaint.

B. Motion to Dismiss for Improper Venue

A motion to dismiss for improper venue may be brought pursuant to Federal Rule of Civil Procedure 12(b)(3). "The plaintiff must show that venue in the chosen forum is proper." Belik v. Carlson Travel Grp., Inc., No. 11-21136-CIV, 2013 WL 308869, *3 (S.D. Fla. Jan. 25, 2013) (citing Wai v. Rainbow Holdings, 315 F. Supp. 2d 1261, 1268 (S.D. Fla. 2004). "Although 'the court may consider matters outside the pleadings, particularly when the motion is predicated upon key issues of fact,' it 'must draw all reasonable inferences and resolve all factual conflicts in favor of the plaintiff.'" Id. (quoting Webster v. Royal Caribbean Cruises, Ltd., 124 F. Supp. 2d 1317, 1320 (S.D. Fla. 2000); Wai, 315 F. Supp. 2d at 1268).

III. Discussion

A. Anti-fraud Violations: Section 17(a) of the Securities Act of 1933 and Section 10(b) and Rule 10b-5 of the Securities Exchange Act of 1934

The Amended Complaint alleges that Defendants Thompson, OTC, Fung, and Pudong violated Section 17(a)(1) of the Securities Act of 1933 (Counts II and III) and Section 10(b) and Rule 10b-5 of the Securities Exchange Act of 1934 (Counts X and XI). "Section 17(a) of the Securities Act, which proscribes fraudulent conduct in the offer or sale of securities, and Section 10(b) of the Exchange Act and Rule 10b-5, which proscribe fraudulent conduct in connection with the purchase or sale of securities, prohibit essentially the same type of sales practices." SEC v. Chem. Trust, No. 00-8015-CIV, 2000 WL 33231600, at *9 (S.D. Fla. Dec. 19, 2000) (citing United States v.

Naftalin, 441 U.S. 768, 773 n.4 (1979)); see also SEC v. Gane, No. 03-61553-CIV-SEITZ, 2005 WL 90154, at *11 (S.D. Fla. Jan. 4, 2005) (citing 15 U.S.C. § 77q(a); 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5). "To show a violation of Section 17(a)(1), the SEC must prove (1) material misrepresentations or materially misleading omissions, (2) in the offer or sale of securities, (3) made with scienter."[5] SEC v. Merch. Capital, LLC, 483 F.3d 747, 766 (11th Cir. 2007) (citing Aaron v. SEC, 446 U.S. 680, 697 (1980)); see also Gane, 2005 WL 90154, at *11 (noting that the SEC must also show "the involvement of interstate commerce, the mails, or a national securities exchange" (citing 15 U.S.C. § 77q(a)(1))). Similarly, "[t]o prove a 10(b) violation, the SEC must show (1) material misrepresentations or materially misleading omissions, (2) in connection with the purchase or sale of securities, (3) made with scienter."[6] Merch. Capital, 483 F.3d at

---

[5] Section 17(a)(1) of the Securities Act provides that it is "unlawful for any person in the offer or sale of any securities . . . by the use of any means or instruments of transportation or communication in interstate commerce or by use of the mails, directly or indirectly . . . to employ any device, scheme, or artifice to defraud." 15 U.S.C. § 77q(a)(1).

[6] "The scope of liability under Section 10(b) and Rule 10b-5 is the same." Merch. Capital, 483 F.3d at 766 (citing SEC v. Zandford, 535 U.S. 813, 816 n.1 (2002)).

> Section 10(b) of the Exchange Act makes it unlawful:
>
> for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange –
>
> . . .
>
> (b) To use or employ, in connection with the purchase or sale of any security . . . , any manipulative or deceptive device or contrivance in contravention of such

766 (citing Aaron, 446 U.S. at 695); see also Gane, 2005 WL 90154, at *11 (noting that the SEC must also show "the involvement of interstate commerce, the mails, or a national securities exchange" (citing 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5)).

The SEC also alleges that Defendants Thompson, OTC, Fung, and Pudong violated Section 17(a)(2) and 17(a)(3) of the Securities Act (Counts IV and V). "'The principal difference between § 17(a) and § 10(b) lies in the element of scienter, which the SEC must establish under § 17(a)(1), but not under § 17(a)(2) or § 17(a)(3).'" BIH Corp., 2011 WL 3862530, at *5 (quoting SEC v. Wolfson, 539 F.3d 1249, 1256 (10th Cir. 2008)). Accordingly, "to show that the defendants violated Section 17(a)(2) or 17(a)(3), the SEC need only show (1) material misrepresentations or materially

---

rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. § 78j(b). Rule 10b-5, promulgated thereunder, states as follows:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit 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
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,
>
> in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b-5.

misleading omissions, (2) in the offer or sale of securities, (3) made with negligence."[7] Merch. Capital, 483 F.3d at 766 (citing Aaron, 446 U.S. at 702); see also Gane, 2005 WL 90154, at *11 (stating that "[n]egligence, rather than scienter, may shown [sic] to prove violations of Sections 17(a)(2) and (a)(3) of the Securities Act" (citing 15 U.S.C. §§ 77q(a)(2), (a)(3)).

The Amended Complaint has sufficiently pled the elements for the fraud claims against Defendants Thompson, OTC, Fung, and Pudong (Counts II, III, IV, V, X, and XI). First, the Amended Complaint identifies "precisely what statements were made in what documents [and] what omissions were made," as well as the "time and place of each such statement and the person responsible for making (or, in the case of omissions, not making) same," Ziemba, 256 F.3d at 1202, and sufficiently alleges the materiality of Defendants' misrepresentations and omissions. "The test for materiality in the securities fraud context is 'whether a reasonable man would attach importance to the fact misrepresented or omitted in determining his course of action.'" Merch. Capital, 483

---

[7] Sections 17(a)(2) and 17(a)(3) of the Securities Act provides that it is

> unlawful for any person in the offer or sale of any securities . . . by the use of any means or instruments of transportation or communication in interstate commerce or by use of the mails, directly or indirectly . . . (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 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.

15 U.S.C. §§ 77q(a)(2), (3).

F.3d at 766 (quoting SEC v. Carriba Air, 681 F.2d 1318, 1323 (11th Cir. 1982)); see also SEC v. Morgan Keegan & Co., 678 F.3d 1233, 1245 (11th Cir. 2012) (a statement is material "if there is a 'substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available'") (quoting TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976))). Materiality "is a question of fact that may rarely be resolved at the motion to dismiss stage." BIH Corp., 2011 WL 3862530, at *5 (citing In re Unicapital Corp. Secs. Litig., 149 F. Supp. 2d 1353, 1364 (S.D. Fla. 2001)). "'Only if the alleged misrepresentations or omissions are so obviously unimportant to an investor that reasonable minds cannot differ on the question of materiality is it appropriate for the district court to rule that the allegations are inactionable as a matter of law.'" Id. (quoting In re Unicapital Corp. Secs. Litig., 149 F. Supp. 2d at 1364).

The Amended Complaint alleges that from January through March 2010, Thompson was the sole member of OTC, and during this same time period, OTC was "a marketing and advertising company" that was "associated with 'Explicit Picks' and 'Ox of Wall Street,' both stock promotional newsletters." (Am. Compl. ¶¶ 10, 11.) In exchange for touting Recycle Tech stock in OTC's newsletters, Sepe agreed to provide Thompson with 2.325 million shares of Recycle Tech stock. (Id. ¶¶ 65, 66.) After receiving the 2.325 million shares of Recycle Tech stock, between February 22 and February 24, 2010, OTC issued four newsletters touting Recycle Tech stock. (Id. ¶ 70.) The newsletters "reprinted portions of Recycle Tech's false and misleading press

releases, which Sepe had provided to Thompson," and each newsletter also "included its own language hyping the stock." (Id. ¶¶ 67, 68.) At the same time, on February 22, 2010, OTC "started selling its Recycle Tech shares," and "[i]t sold all 2.325 million shares by February 25" for $441,722.00. (Id. ¶¶ 71, 83.) These sales "contradicted the recommendations OTC Solutions made regarding Recycle Tech" in its newsletters. (Id.) The SEC asserts that some of OTC's newsletters had the following disclaimer:

> When [OxofWallstreet.com/ExplicitPicks.com] receives free trading shares as compensation for a profiled company, [OxofWallstreet.com/ExplicitPicks.com] may sell part or all of any such shares during the period in which [OxofWallstreet.com/ExplicitPicks.com] is performing such services. [OxofWallstreet.com/ExplicitPicks.com] has received two million three hundred and twenty-five thousand free trading shares from a non-affiliated third party for a one month profile of RCYT as compensation.

(Id. ¶ 72.) However, although some of the four newsletters contained this general disclaimer, the SEC asserts that "in some cases, the newsletters appeared on penny stock websites without any such disclosure at all." (Id.) The SEC further asserts that "[n]one of the newsletters disclosed the newsletter owner's intent to sell shares, or named the source of the stock the newsletter had received." (Id. ¶ 68.)

Similarly, the Amended Complaint alleges that from January through March 2010, Fung was the sole member of Pudong, and during this same time period, Pudong was "a marketing and advertising company associated with 'Penny Pic,' a stock promotional newsletter." (Id. ¶¶ 12, 13.) In exchange for touting Recycle Tech stock in Pudong's newsletters, Sepe agreed to provide Fung with 2.325 million shares of Recycle Tech

stock. (Id. ¶¶ 65, 66.) After receiving the 2.325 million shares of Recycle Tech stock, on February 23, 2010, Pudong issued a newsletter touting Recycle Tech stock. (Id. ¶ 74.) The newsletter "reprinted portions of Recycle Tech's false and misleading press releases, which Sepe had provided to . . . Fung," and also "included its own language hyping the stock." (Id. ¶¶ 67, 68.) On that same day, February 23, 2010, Pudong "sold all 2.325 million of its Recycle Tech shares" for $456,457.00, which "contradicted the recommendations Pudong made regarding Recycle Tech" in the "Penny Pic" newsletter. (Id. ¶¶ 74, 84.) The SEC asserts that the newsletter contained the following "general disclaimer":

> When Pennypic.com receives free trading shares as compensation for a profiled company, Pennypic.com may sell part or all of any such shares during the period in which Pennypic.com is performing such services.

(Id. ¶ 75.) The SEC further alleges that the newsletter disclosed that Pudong "has received from a third party non affiliate 2.325 million free trading shares of [Recycle Tech] for advertising and marketing," but asserts that the newsletter did not "disclose the third party's identity or Fung's Recycle Tech stock sales." (Id. ¶ 76.)

The Court finds that the Amended Complaint sufficiently identifies misrepresentations and omissions by stating that Defendants Thompson, OTC, Fung, and Pudong all recommended that investors purchase Recycle Tech stock in their newsletters while failing to disclose their intention to sell that stock on that same day. (See Am. Compl. ¶¶ 68, 70, 71, 74.) While the newsletters stated that Defendants "may sell part or all" of its Recycle Tech stock, they failed to disclose that they were definitively selling

Recycle Tech shares immediately after issuing the newsletters promoting the stock. (See id. ¶¶ 71, 72, 74, 75.) Indeed, courts have held that "a disclaimer that the investment advisor 'may' trade in recommended securities for its own account is itself a material misstatement." SEC v. Blavin, 760 F.2d 706, 711 (6th Cir. 1985); see also Gane, 2005 WL 90154, at *1 (noting the Court's previous Summary Judgment Order held that defendants' "written statements that they 'may' buy or sell Dicom stock did not provide adequate disclosure to investors"). Defendants' newsletters also stated that Defendants received Recycle Tech stock from "a non-affiliated third party" or "a third party non affiliate," but the newsletters failed to disclose that the shares came from Recycle Tech. (See Am. Compl. ¶¶ 72, 76.) The Court concludes that reasonable minds could differ as to the materiality of that misrepresentation/omission. BIH Corp., 2011 WL 3862530, at *5. Thus, the Amended Complaint sufficiently alleges material misrepresentations or materially misleading omissions. See Merch. Capital, 483 F.3d at 766.

Second, the Amended Complaint alleges that the misrepresentations and omissions were made in connection with the offer, sale, or purchase of securities. "The 'in connection with' requirement of Rule 10b–5 is '[t]he most imprecise, and consequently the most flexible, element' of a 10b–5 claim." Buffo v. Graddick, 742 F.2d 592, 596 (11th Cir. 1984) (quoting Note, The Pendulum Swings Farther: The "In Connection With" Requirement and Pretrial Dismissals of Rule 10b–5 Private Claims for Damages, 56 Tex.L.Rev. 62, 63 (1977)). "The phrase requires a certain relationship between the defendant's actions and a securities transaction." Id. In Superintendent of Insurance v.

Bankers Life & Casualty Co., 404 U.S. 6, 12-13 (1971), the U.S. Supreme Court characterized the material misrepresentation/"in connection with" nexus broadly as a "deceptive practice[ ] touching [the] sale of securities." The Amended Complaint alleges that (1) the Defendants distributed newsletters promoting the purchase of certain securities (2) which Defendants Thompson, OTC, Fung, and Pudong owned considerable shares of, (3) thereby inflating the price of those securities, (4) without sufficiently disclosing their intent to sell their shares or naming the source of the stock. The Court concludes that these allegations sufficiently establish that the material misrepresentations/omissions were made "in connection with" the offer, sale, or purchase of securities. See Buffo, 742 F.2d at 596-97.

Defendants argue, however, that the Amended Complaint fails to allege that they owed a duty of disclosure to their newsletter subscribers. With respect to the alleged omissions,[8] the Amended Complaint has sufficiently alleged facts establishing a duty to disclose. "[A] person who intends to engage in scalping assumes a duty to disclose his interest in the targeted stock." SEC v. Park, 99 F. Supp. 2d 889, 900 (C.D. Ill. 2000); see also Zweig v. Hearst Corp., 594 F.2d 1261, 1268 (9th Cir. 1979) (holding that newspaper columnist who scalped stocks he promoted in his columns was under a duty to disclose under Section 10(b) and Rule 10b-5 "when, with knowledge of the stock's market and an intent to gain personally, he encouraged purchases of the securities in the market").

[8] Affirmative misrepresentations (as opposed to omissions) are fraudulent, even absent a duty, if they were made for the purpose of inducing reliance thereon. Chiarella v. United States, 445 U.S. 222, 227 (1980).

Here, as in Park, the SEC is alleging that Defendants engaged in scalping. As such, "the alleged facts may show that Defendants . . . may have assumed a duty to disclose their scalping, [and] the SEC has [therefore] properly alleged its claims based on Defendants omission." Park, 99 F. Supp. 2d at 900.

Accordingly, the Court finds that the Amended Complaint sufficiently alleges that the material misrepresentations or omission were made in connection with the purchase or sale of securities. See Merch. Capital, 483 F.3d at 766.

Third, the Amended Complaint alleges facts sufficient to establish scienter. "Scienter is established when it is shown the defendant had the 'intent to deceive, manipulate, or defraud.'" SEC v. Risher, No. 6:11-cv-1440-Orl-18GJK, 2013 WL 1912719, at *7 (M.D. Fla. Apr. 25, 2013) (quoting Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 n.2 (1976)); see also SEC v. Betta, No. 09-80803-Civ, 2011 WL 4369012, at *9 (S.D. Fla. Sept. 19, 2011) (stating that "[a] plaintiff cannot recover without proving that a defendant made a material misstatement, not merely innocently or negligently, but with an intent to deceive" (citing Merck & Co. v. Reynolds, 130 S.Ct. 1784, 1796 (2010))). In addition, "[s]cienter may be established by a showing of knowing misconduct or severe recklessness." SEC v. Carriba Air, Inc., 681 F.2d at 1324. "'Severe recklessness is limited to those highly unreasonable omissions or misrepresentations that involve not merely simple or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and that present a danger of misleading buyers or sellers which is either known to the defendant or is so obvious that the defendant must have been

aware of it.'" SEC v. Monterosso, 768 F. Supp. 2d 1244, 1266 (S.D. Fla. 2011) (quoting McDonald v. Alan Bush Brokerage Co., 863 F.2d 809, 814 (11th Cir. 1989)). Defendants' newsletters hyped Recycle Tech stock and urged investors to purchase the stock without sufficiently disclosing their intent to immediately sell their shares. (See Am. Compl. ¶ 71, 74.) Defendants' acts of selling their Recycle Tech stock directly contradicted their recommendation to investors to purchase Recycle Tech stock. This establishes scienter. See Blavin, 760 F.2d at 712 ("At a minimum, Blavin recklessly failed to disclose that he was trading in stocks that his newsletter recommended . . . .).

Fourth, the Amended Complaint alleges the involvement of interstate commerce, the mails, or a national securities exchange. The alleged misrepresentations in this case were communicated through Defendants' internet websites. "[T]he Eleventh Circuit has held in other contexts that the internet is an instrumentality of interstate commerce." SEC v. GMC Holding Corp., No. 6:08-cv-275-Orl-28KRS, 2009 WL 506872, at *4 (M.D. Fla. Feb. 27, 2009) (citing U.S. v. Hornaday, 392 F.3d 1306, 1311 (11th Cir 2004)). Additionally, "[a]t least one district court within the circuit has found that use of an internet web site to sell securities constituted use of the instrumentalities of interstate commerce." Id. (citing SEC v. Phoenix Telecom, L.L.C., 239 F. Supp. 2d 1292, 1298 (N.D. Ga. 2000)); see also. SEC v. Levin, No. 12-21917-CIV, 2013 WL 594736, at *12 (holding that "the Internet, which necessarily includes email, is an 'instrumentality of interstate commerce'"). Accordingly, the Court finds that the Amended Complaint sufficiently alleges the involvement of interstate commerce.

Finally, the Amended Complaint does not constitute a "shotgun pleading" and satisfies the particularity requirement of Federal Rule of Civil Procedure 9(b).[9] "Shotgun pleadings are those that incorporate every antecedent allegation by reference into each subsequent claim for relief or affirmative defense." Wagner v. First Horizon Pharm. Corp., 464 F.3d 1273, 1279 (11th Cir. 2001) (citing Magluta v. Samples, 256 F.3d 1282, 1284 (11th Cir. 2001) (per curiam)). Shotgun pleadings do not satisfy Rule 9(b)'s pleading standards. See id. at 1280. However, the Amended Complaint does not constitute a "shotgun pleading"; the claims incorporate only the paragraphs applicable to the legal claims of the respective parties. For example, Counts X and XI—the Section 10(b)/Rule 10b-5 claims against Thompson/OTC and Fung/Pudong, respectively—each incorporate Paragraphs 1-21, 27-29, 31-32, 65-68, and 77-86. However, Count X additionally incorporates Paragraphs 69-72, which contain facts specific to Thompson/OTC, whereas Count XI incorporates 73-76, which contain facts specific to Fung/Pudong. (Am. Compl. ¶¶120, 123.) In any event, they do not "incorporate every antecedent allegation by reference." Wagner, 464 F.3d at 1279. Thus, the Amended Complaint satisfies the pleading standards of Federal Rule of Civil Procedure 9(b).

In sum, the facts alleged are sufficient to survive Defendants' respective Motions to Dismiss Counts II, III, IV, V, X, and XI of the Amended Complaint.

---

[9] "In alleging fraud or mistake, a party must state with particularity the circumstances constituting fraud or mistake. Malice, intent, knowledge, and other conditions of a person's mind may be alleged generally." Fed. R. Civ. P. 9(b).

B. Section 17(b) of the Securities Act

The Amended Complaint alleges that Defendants Thompson, OTC, Fung, and Pudong violated Section 17(b) of the Securities Act of 1933 (Counts VI and VII).

Section 17(b) of the Securities Act makes it

> unlawful for any person, by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, to publish, give publicity to, or circulate any notice, circular, advertisement, newspaper, article, letter, investment service, or communication which, though not purporting to offer a security for sale, describes such security for a consideration received or to be received, directly or indirectly, from an issuer, underwriter, or dealer, without fully disclosing the receipt, whether past or prospective, of such consideration and the amount thereof.

15 U.S.C. § 77q(b). Thus, "[i]n order to violate Section 17(b), a person must (1) publish or otherwise circulate (using a means of interstate commerce), (2) a notice or type of communication (which describes a security), (3) for consideration received (past, currently, or prospectively, directly or indirectly), (4) without full disclosure of the consideration received and the amount." SEC v. Gorsek, 222 F. Supp. 2d 1099, 1105 (C.D. Ill. 2001).

The first three elements do not appear to be at issue. With respect to the fourth element—the requirement of full disclosure—Plaintiff argues that the source of the Recycle Tech stock was misidentified as a "non-affiliated third party" when in fact the source was Recycle Tech itself (acting through Halperin). (Am. Compl. ¶ 66, 107, 111.) Thus, the Amended Complaint alleges that Defendants did not "fully disclos[e] the receipt . . . of such consideration . . . ." 15 U.S.C. § 77q(b) (emphasis added).

Defendants, however, argue that they complied with the mandates of Section 17(b) by fully disclosing the "consideration received and the amount." Gorsek, 222 F. Supp. 2d at 1105. Specifically, OTC's newsletter contained the following language: "[OxofWallstreet.com/ExplicitPicks.com] has received two million three hundred and twenty-five thousand free trading shares from a non-affiliated third party for a one month profile of RCYT as compensation." (Am. Compl. ¶ 72.) Pudong's disclaimer disclosed that it "has received from a third party non affiliate 2.325 million free trading shares of [Recycle Tech] for advertising and marketing." (Id. at ¶ 76.)

The specific issue here—i.e, whether misidentifying the source of the consideration received violates Section 17(b)'s requirement of "fully disclosing the receipt . . . of such consideration and the amount thereof"—appears to be one of first impression. By its plain language, Section 17(b) does not require affirmative disclosure of the source of the consideration received. "Section 17(b) contains two forms of disclosure: (1) that a promoter disclose his status as such, and (2) that a promoter disclose how much he is paid for his promotions." U.S. v. Wenger, 427 F.3d 840, 849-50 (10th Cir. 2005); see also Gorsek, 222 F. Supp. 2d at 1106 ("Section 17(b) calls for the disclosure of the receipt of compensation *and* the amount."). This Court has identified no authority, and has been cited to none, for the proposition that the source of the consideration must be identified. (Am. Compl. ¶ 72.)

The Court finds that despite allegedly misidentifying the source of the stock, the Defendants' respective newsletter disclaimers complied with the plain language of

Section 17(b) and honored its intent. "Section 17(b) was designed to protect the public from publications that 'purport to give an unbiased opinion but which opinions in reality are bought and paid for.'" Gorsek, 222 F. Supp. 2d at 1105 (quoting U.S. v. Amick, 439 F.2d 351, 365 (7th Cir. 1971) (citing Committee on Interstate and Foreign Commerce. H.R.Rep. No. 85, at 24 (1933))). OTC/Thompson's disclaimer leaves no doubt that they received 2.325 million shares of Recycle Tech stock "as compensation" for "a one month profile." Likewise, Fung/Pudong's disclaimer specifically provides that they "received . . . 2.325 million free trading shares of [Recycle Tech] for advertising and marketing." In short, both disclaimers "fully disclos[e] the receipt . . . of such consideration and the amount thereof." 15 U.S.C. § 77q(b). That is all the statute requires. Additionally, the Court can say with fair assurance that the at-issue disclaimers fully advise the readership that Defendants' opinions were "bought and paid for," Amick, 439 F.2d at 365 (citing Committee on Interstate and Foreign Commerce. H.R.Rep. No. 85, at 24 (1933)), i.e., that they were not unbiased.

The Court acknowledges that the Amended Complaint alleges that Defendants intentionally misstated the source of the Recycle Tech stock as part of a larger scheme to defraud consumers. However, even if that allegation is true, it is not a claim upon which relief can be granted under Section 17(b). Whereas "material misrepresentations or materially misleading omissions" are necessary elements of a Section 17(a) violation, Merch. Capital, 483 F.3d at 766, they are not elements of a Section 17(b) violation. As noted, Section 17(b) "calls for the disclosure of the receipt of compensation *and* the

amount," Gorsek, 222 F. Supp. 2d at 1106, and aims to ensure that consumers are fully advised when a promoter's opinion is "bought and paid for," and therefore not unbiased. Amick, 439 F.2d at 365 (citing Committee on Interstate and Foreign Commerce. H.R.Rep. No. 85, at 24 (1933)). Defendants' disclaimers did so.

Accordingly, Defendants' Motions to Dismiss Counts VI and VII, respectively, of the Amended Complaint are granted.

C. Venue

Finally, Defendants Thompson and OTC Solutions claim the Amended Complaint fails to allege facts sufficient to establish venue in this District is proper as to the claims against them. (Motion, D.E. 55 at 13.) Thus, they urge the Court to dismiss the Amended Complaint for improper venue.

In securities actions, venue is proper "in any district where the defendant 'is found or is an inhabitant or transacts business,' or where 'any act or transaction constituting the violation occurred.'" SEC v. Carroll, 835 F. Supp. 2d 281, 284 (W.D. Ky. 2011). "Courts have construed the 'act or transaction' requirement liberally—the venue-conferring act need not 'form the core of the claim' or 'itself constitute a violation of the [SEA].'" Id. (quoting Prettner v. Aston, 339 F. Supp. 273, 280 (D. Del. 1972). "Rather, any act in a forum district constituting an important step in the fraudulent scheme will suffice, even if the act is not itself fraudulent or illegal." Id. (citing Mariash v. Morrill, 496 F.2d 1138, 1144 (2d Cir. 1974) (citing Hooper v. Mountain States Sec. Corp., 282 F. 2d 195, 204 (5th Cir. 1960), Int'l Controls Corp. v. Vesco, 490 F.2d 1334, 1347 (2d Cir.

1974)). "This broad construction reflects one of the statute's 'plain objectives, namely avoiding having related counts adjudicated in piecemeal fashion across several venues.'" Id. (citing U.S. v. Johnson, 510 F.3d 521, 528 (4th Cir. 2007)).

The Amended Complaint sufficiently alleges facts establishing that venue in this District is proper with respect to the claims against OTC Solutions and Thompson. To begin with, it alleges that "Sepe, while he was in the District, contacted OTC Solutions and Thompson to hire them to promote Recycle Tech, and Halperin sent them their compensation from the District. During the fraud, Thompson also sent e-mails to Halperin, who was in the District, concerning the execution of the fraud." (Am. Compl. ¶ 20.) These communications, which originated from or were sent to this District, involved:

> (1) Sepe engaging "OTC Solutions . . . to tout Recycle Tech stock, (Am. Compl ¶ 32.);
>
> (2) Sepe "promis[ing] [OTC Solutions] more than two million free-trading shares of Recycle Tech stock as compensation," (Id.);
>
> (3) "OTC Solutions . . . issu[ing] . . . newsletters promoting Recycle Tech," which "reprinted portions of Recycle Tech's false and misleading press releases, which Sepe had provided to Thompson . . . ," (Am. Compl. ¶ 67); and
>
> (4) "Four days after the February 18 press release, OTC Solutions and Pudong[10] started touting Recycle Tech stock in their newsletters[, and] Thompson and Fung . . . had previously agreed to coordinate their touting with each other and with Sepe," (Am. Compl. ¶ 65).

[10] Fung operates Pudong from the Southern District of Florida.

Thus, through their contact with the District, OTC and Thompson allegedly planned their touting with Sepe, coordinated their touting with another promoter, and received their compensation from another alleged member of the scheme. Each of these events can fairly be described as "an important step in the fraudulent scheme." SEC v. Carroll, 835 F. Supp. 2d at 284 (citing Mariash, 496 F.2d at 1144 (citing Hooper, 282 F. 2d at 204, Int'l Controls Corp., 490 F.2d at 1347 (2d Cir. 1974))).

In light of the foregoing, the Court concludes that venue is proper, and therefore denies OTC Solutions and Thompson's Motion to Dismiss for Improper Venue.

IV. Conclusion

Accordingly, it is **ORDERED AND ADJUDGED** that:

1. Defendants Pudong, LLC and Jay Fung's Motion to Dismiss (D.E. 52), filed on August 31, 2012, is **GRANTED IN PART AND DENIED AND PART**;
2. Defendants Anthony Thompson and OTC Solutions, LLC's Motion to Dismiss (D.E. 55), filed on September 4, 2012, is **GRANTED IN PART AND DENIED IN PART**; and

3. Counts VI and VII of the Amended Complaint (D.E. 46) are **DISMISSED WITH PREJUDICE**.

DONE AND ORDERED in Chambers at Miami, Florida, this 26th day of September, 2013.

JOAN A. LENARD
UNITED STATES DISTRICT JUDGE

EXHIBIT B

007 STOCKCHAT
PROFITS MADE SIMPLE

Alert: CBGI

Good Morning,

Its Monday, its early and you should be excited as we kick off a short trading week with CBGI an MJ play that stands to benefit from national MJ growth.

CBGI fundamentals are through the roof:

- CBGI is **liquid**, trading on average over 5 mill shares per day
- CBGI went from .003 to .48 in a matter of 5 weeks
- CBGI has made multiple business acquisitions
- CBGI has acquired land for MJ cultivation
- CBGI moved their head quarters to be better positioned in the MJ industry
- CBGI plans to become fully transparent with SEC and OTCmarkets.
- CBGI made key Executive Hires
- CBGI is in the midst of a 506 Capital raise of $5 Mill
  [read more]

How is that for one company?

"We get to participate at support level prices on a bullish chart."

CBGI has a double bottom formation, at three times its average price from January shows us that this is it not another MJ dilution pig that we have become familiar to seing over the past few weeks.

When CBGI touched down on these levels last week, it bounce back up over 70pct.

Now back to those same levels, the double bottom formation is stronger then ever as the RSI and MACD are both screaming bounce. IMO

"CBGI is an impressive formula of technical and fundamental development not to be missed out on. IMO"

Continue here for CBGI full report and enjoy this beautiful swing trade.

Sincerely,

007

Join Us In Chat Now and let the profits roll in

DISCLAIMER

Stockchat LLC has received twenty five thousand dlrs for the awareness of CBGI from a third party Casey Cummings.

Disclaimer – By reading our newsletter, website, twitter, Facebook and chat you agree to the terms of our disclaimer, which are subject to change at any time. 007stockchat LLC, its owners and affiliates are not registered or licensed in any jurisdiction whatsoever to provide financial advice or anything of an advisory nature. Always do your own research and/or consult with an investment professional before investing. Low priced stocks are speculative and carry a high degree of risk, so only invest what you can afford to lose. By using 007stockchat LLC service you agree not to hold 007stockchat LLC, its editors, owners, or staff liable for any damages, financial or otherwise, that may occur due to any action you may take based on the information contained within our newsletters, website, twitter, Facebook and chat. We do not advise any reader take any specific action. Our website, newsletter, twitter, Facebook and chat are for informational and educational purposes only. Never invest purely based on our alerts. Gains mentioned in our newsletter, twitter, Facebook and on our website may be based on EOD or intraday data. **007stockchat LLC may be compensated for the production, release and awareness of this newsletter.** This publication and their owners and affiliates may hold positions in the securities mentioned in our alerts, which we may sell at any time without notice to our subscribers, which may have a negative impact on share prices. Our emails may contain Forward Looking Statements, which are not guaranteed to materialize due to a variety of factors. We do not guarantee the timeliness, accuracy, or completeness of the information on our site or in our newsletters. The information in our email newsletters, twitter, Facebook our website and chat is believed to be accurate and correct, but has not been independently verified. The information in our disclaimers is subject to change at any time without notice. See full disclaimer at 007stockchat.com.

Stockchat LLC is not held liable or responsible for the information in press releases issued by the companies discussed in these email's. Please do your own due diligence.

AwesomeStockTips.com

Good Morning,

Its Monday, its early and you should be excited as we kick off a short trading week with CBGI an MJ play that stands to benefit from national MJ growth.

CBGI fundamentals are through the roof:

- CBGI is **liquid**, trading on average over 5 mill shares per day
- CBGI went from .003 to .48 in a matter of 5 weeks
- CBGI has made multiple business acquisitions
- CBGI has acquired land for MJ cultivation
- CBGI moved their head quarters to be better positioned in the MJ industry
- CBGI plans to become fully transparent with SEC and OTCmarkets.
- CBGI made key Executive Hires
- CBGI is in the midst of a 506 Capital raise of $5 Mill
  [read more]

How is that for one company?

"We get to participate at support level prices on a bullish chart."

CBGI has a double bottom formation, at three times its average price from January shows us that this is it not another MJ dilution pig that we have become familiar to seing over the past few weeks.

When CBGI touched down on these levels last week, it bounce back up over 70pct.

Now back to those same levels, the double bottom formation is stronger then ever as the RSI and MACD are both screaming bounce. IMO

"CBGI is an impressive formula of technical and fundamental development not to be missed out on. IMO"

Continue here for CBGI full report and enjoy this beautiful swing trade.

Sincerely,

AwesomeStockTips

Disclaimer:

Stockchat LLC has received twenty five thousand dlrs for the awareness of CBGI from a third party Casey Cummings.

Disclaimer – By reading our newsletter, website, twitter, Facebook and chat you agree to the terms of our disclaimer, which are subject to change at any time. Stockchat LLC, its owners and affiliates are not registered or licensed in any jurisdiction whatsoever to provide financial advice or anything of an advisory nature. Always do your own research and/or consult with an investment professional before investing. Low priced stocks are speculative and carry a high degree of risk, so only invest what you can afford to lose. By using Stockchat LLC service you agree not to hold Stockchat LLC, its editor's, owners, or staff liable for any damages, financial or otherwise, that may occur due to any action you may take based on the information contained within our newsletters, website, twitter, Facebook and chat. We do not advise any reader take any specific action. Our website, newsletter, twitter, Facebook and chat are for informational and educational purposes only. Never invest purely based on our alerts. Gains mentioned in our newsletter, twitter, Facebook and on our website may be based on EOD or intraday data. Stockchat LLC may be compensated for the production, release and awareness of this newsletter. This publication and their owners and affiliates may hold positions in the securities mentioned in our alerts, which we may sell at any time without notice to our subscribers, which may have a negative impact on share prices. Our emails may contain Forward Looking Statements, which are not guaranteed to materialize due to a variety of factors. We do not guarantee the timeliness, accuracy, or completeness of the information on our site or in our newsletters. The information in our email newsletters, twitter, Facebook our website and chat is believed to be accurate and correct, but has not been independently verified. The information in our disclaimers is subject to change at any time without notice. See full disclaimer at www.007stockchat.com.

Stockchat LLC is not held liable or responsible for the information in press releases issued by the companies discussed
in these email's. Please do your own due diligence.

OTC FIRE

Alert: CBGI

Good Morning,

Its Monday, its early and you should be excited as we kick off a short trading week with CBGI an MJ play that stands to benefit from national MJ growth.

CBGI fundamentals are through the roof:

- CBGI is liquid, trading on average over 5 mill shares per day
- CBGI went from .003 to .48 in a matter of 5 weeks
- CBGI has made multiple business acquisitions
- CBGI has acquired land for MJ cultivation
- CBGI moved their head quarters to be better positioned in the MJ industry
- CBGI plans to become fully transparent with SEC and OTCmarkets.
- CBGI made key Executive Hires
- CBGI is in the midst of a 506 Capital raise of $5 Mill
  [read more]

How is that for one company?

"We get to participate at support level prices on a bullish chart."

CBGI has a double bottom formation, at three times its average price from January shows us that this is it not another MJ dilution pig that we have become familiar to seing over the past few weeks.

When CBGI touched down on these levels last week, it bounce back up over 70pct.

Now back to those same levels, the double bottom formation is stronger then ever as the RSI and MACD are both screaming bounce. IMO

"CBGI is an impressive formula of technical and fundamental development not to be missed out on. IMO"

Continue here for CBGI full report and enjoy this beautiful swing trade.

OTC Fire

Disclaimer

Stockchat LLC has received twenty five thousand dlrs for the awareness of CBGI from a third party Casey Cummings.

PENNYSTOCKSPY
BE THE FIRST TO KNOW...

Mega Alert:
CBGI

Good Morning,

Its Monday, its early and you should be excited as we kick off a short trading week with CBGI an MJ play that stands to benefit from national MJ growth.

CBGI fundamentals are through the roof:

- CBGI is liquid, trading on average over 5 mill shares per day
- CBGI went from .003 to .48 in a matter of 5 weeks
- CBGI has made multiple business acquisitions
- CBGI has acquired land for MJ cultivation
- CBGI moved their head quarters to be better positioned in the MJ industry
- CBGI plans to become fully transparent with SEC and OTCmarkets.
- CBGI made key Executive Hires
- CBGI is in the midst of a 506 Capital raise of $5 Mill
  [read more]

How is that for one company?

"We get to participate at support level prices on a bullish chart."

CBGI has a double bottom formation, at three times its average price from January shows us that this is it not another MJ dilution pig that we have become familiar to seing over the past few weeks.

When CBGI touched down on these levels last week, it bounce back up over 70pct.

Now back to those same levels, the double bottom formation is stronger then ever as the RSI and MACD are both screaming bounce. IMO

"CBGI is an impressive formula of technical and fundamental development not to be missed out on. IMO"

Continue here for CBGI full report and enjoy this beautiful swing trade.

Spy Hard, Profit Easy

Disclaimer

Stockchat LLC has received twenty five thousand dlrs for the awareness of CBGI from a third party Casey Cummings.

EXHIBIT C

H.R. REP. 73-85, H.R. Rep. No. 85, 73RD Cong., 1ST Sess. 1933, 1933 WL 983 (Leg.Hist.)

FEDERAL SUPERVISION OF TRAFFIC IN INVESTMENT SECURITIES IN INTERSTATE COMMERCE

May 4, 1933 (To accompany H.R. 5480)

Committed to the Committee of the Whole House on the state of the Union and ordered to be printed

Mr. RAYBURN, from the Committee on Interstate and Foreign Commerce, submitted the following

(CONSULT NOTE FOLLOWING TEXT FOR INFORMATION ABOUT OMITTED MATERIAL. EACH COMMITTEE REPORT IS A SEPARATE DOCUMENT ON WESTLAW.)

HOUSE REPORT NO. 73-85

May 4, 1933

The Committee on Interstate and Foreign Commerce, to whom was referred the bill (H.R. 5480) to provide full and fair disclosure of the character of securities sold in interstate and foreign commerce and through the mails, and to prevent frauds in the sale thereof, and for other purposes, report favorably thereon and recommend that the bill do pass with the following amendments:

Page 6, line 18, strike out 'or any political'.

Page 6, line 19, strike out 'subdivision thereof' and insert 'or by any political subdivision of a State or Territory, or by any public instrumentality of one or more States or Territories exercising an essential governmental function'.

Page 6, line 23, after the words 'national bank,' insert 'or by any banking institution organized under the laws of any State or Territory, the business of which is substantially confined to banking and is supervised by the State or territorial banking commission or similar official;'.

Page 8, line 19, after the word 'underwriter' insert 'and not involving any public offering'.

I. INTRODUCTORY STATEMENT

1. THE PRESIDENT'S MESSAGE

On March 29, 1933, the President sent the following message to Congress:

To the Congress:

I recommend to the Congress legislation for Federal supervision of traffic in investment securities in interstate commerce.

In spite of many State statutes the public in the past has sustained severe losses through practices neither ethical nor honest on the part of many persons and corporations selling securities.

*2 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.

This proposal adds to the ancient rule of caveat emptor, the further doctrine 'let the seller also beware.' It puts the burden of telling the whole truth on the seller. It should give impetus to honest dealing in securities and thereby bring back public confidence.

The purpose of the legislation I suggest is to protect the public with the least possible interference to honest business.

This is but one step in our broad purpose of protecting investors and depositors. It should be followed by legislation relating to the better supervision of the purchase and sale of all property dealt in on exchanges, and by legislation to correct unethical and unsafe practices on the part of officers and directors of banks and other corporations.

What we seek is a return to a clearer understanding of the ancient truth that those who manage banks, corporations, and other agencies handling or using other people's money are trustees acting for others.

FRANKLIN D. ROOSEVELT.

2. THE SITUATION THAT DEMANDS ACTION

The background of the President's message is only too familiar to everyone. During the post-war decade some 50 billions of new securities were floated in the United States. Fully half or $25,000,000,000 worth of securities floated during this period have been proved to be worthless. These cold figures spell tragedy in the lives of thousands of individuals who invested their life savings, accumulated after years of effort, in these worthless securities. The flotation of such a mass of essentially fraudulent securities was made possible because of the complete abandonment by many underwriters and dealers in securities of those standards of fair, honest, and prudent dealing that should be basic to the encouragement of investment in any enterprise. Alluring promises of easy wealth were freely made with little or no attempt to bring to the investor's attention those facts essential to estimating the wroth of any security. High-pressure salesmanship rather than careful counsel was the rule in this most dangerous of enterprises.

Equally significant with these countless individual tragedies is the wastage that this irresponsible selling of securities has caused to industry. Because of the deliberate overstimulation of the appetites of security buyers, underwriters had to manufacture securities to meet the demand that they themselves had created. The result has been that investment bankers with no regard for the efficient functioning of industry forced corporations to accept new capital for expansion purposes in order that new securities might be issued for public consumption. Similarly, real-estate developments would be undertaken, not on the basis of caring for calculated needs but merely as an excuse for the issuance of more securities to satisfy an artificially created market. Such conduct has resulted both in the imposition of unnecessary fixed charges upon industry and in the creation of false and unbalanced values for properties whose earnings cannot conceivably support them. Whatever may be the full catalogue of the forces that brought to pass the present depression, not least *3 among these has been this wanton misdirection of the capital resources of the Nation.

The irresponsibility which fostered this tragic distribution of securities derived in the main from the abnormal profits possible from the business of selling securities. Despite the fact that that business demands the assumption of responsibilities of a character fully equivalent to those of trusteeship, compelling full and fair disclosure not only of the character of the security but of the charges made in connection with its distribution, the literature on the faith of which the public was urged to invest its savings was too often deliberately misleading and illusive. Even dealers through the exertion of high-pressure tactics by underwriters were forced to take allotments of securities of an essentially unsound character and without opportunity to scrutinize their nature. These then would be worked off upon the unsuspecting public. One would have to turn the pages of history back to the days of the South Sea bubble to find an equivalent fantasy of security selling. It is these facts that have led the President, speaking for the Nation, rightly to demand that such a situation can no longer be tolerated.

3. PRINCIPLES OF THE PRESIDENT'S MESSAGE

Because only the dishonest man could object to the principles of the legislation outlined in the President's message, these principles have met with wide approval from the public, investment bankers, dealers, and industry alike. In brief, the aims set forth by the President are:

(1) An insistence that there should be full disclosure of every essentially important element attending the issue of a new security.

(2) A requirement that whatever action taken by the Federal Government for such disclosure should be limited to that purpose and should be so devised as not to be capable of being construed as an approval or guarantee of a security issue.

(3) A demand that the persons, whether they be directors, experts, or underwriters, who sponsor the investment of other people's money should be held up to the high standards of trusteeship.

The achievement of these ends is the principal purpose of this bill.

4. DISCLOSURES REQUIRED

Resting upon the power of Congress under the Constitution over interstate and foreign commerce the bill closes the channels of such commerce to security issues unless and until a full disclosure of the character of such securities has been made. The items required to be disclosed, set forth in detailed form, are items indispensable to any accurate judgment upon the value of the security. But to require a disclosure of these items by the filing of a registration statement with the Federal Trade Commission would be insufficient, if by the mere act of such filing a privilege immediately to sell these securities was granted. High-pressure salesmanship with all its demonstrated evil effects would not even be scotched. Instead, heightened pressure would be exerted to effect the distribution of an issue before the investing public could digest the information demanded. For this reason and because some check should be exercised as to whether *4 or not the disclosures demanded have been made, a period of 30 days intervenes between the act of disclosure by the filing of the registration statement and the date upon which that statement becomes effective so as to permit the sales of the securities registered under it. The type of information required to be disclosed is of a character comparable to that demanded by competent bankers from their borrowers, and has been worked out in the light of these and other requirements. They are, in the judgment of your committee, adequate to bring into the full glare of publicity those elements of real and unreal values which may lie behind a security. To require anything else would permit evasions; but to require these disclosures fulfills the President's demand that 'there is an obligation upon us to insist * * * that no essentially important element attending the issue shall be concealed from the buying public.'

5. THE NONASSUMPTION BY THE FEDERAL GOVERNMENT OF ANY GUARANTEE

The mechanism devised by your committee for compelling disclosures and for insisting that disclosures shall be both adequate and true has been carefully framed, so that neither action nor nonaction by the Federal Trade Commission can be interpreted as a guarantee or approval of any particular security issued. The right to sell a security follows automatically upon the termination of the stipulated period after the filing of the registration statement. Nonaction by the Commission has no effect to disturb the acquisition of this right to sell the security in interstate commerce. Such functions as are given the Commission, with reference to the initial filing of the registration statement, are limited merely to determining whether the information so filed is complete and accurate on its face. The Commission may inquire to see whether the questions that should have been answered have been answered. But with the truth or falsity of the answers the Commission has no initial concern. If the statement is incomplete and inaccurate on its face, the Commission may require that these gaps shall be filled in before the statement is to become effective.

If, in an unusual case, the Commission is of the opinion that the statements made are materially untrue or materially inadequate, the Commission may institute an investigation and after giving an opportunity for a hearing, if convinced that the statements are untrue or inadequate, issue a stop order that will prevent further distribution of the security. The power so to suspend the right of underwriters and dealers to continue selling the security to the public, after proof that the statements upon the face of which the security is sold are false, is essential for the protection of the investing public.

Thus the grant of control to the Federal Trade Commission conveys with it no right to pass upon the merits of any security, but simply to insist that whatever its merits, facts essential to its character are to be disclosed. An additional safeguard against the construction that the Government in any way approves a security registered with the Commission, is the provision of the bill expressly prohibiting any statement that registration of a security with the Commission is evidence either that the requirements of the act have been met or that the Commission has in any way approved the security.

*5 6. THE IMPOSITION OF STANDARDS OF TRUSTEESHIP

The character of civil liabilities imposed by this bill are described in detail elsewhere. Their essential characteristic consists of a requirement that all those responsible for statements upon the face of which the public is solicited to invest its money shall be held to standards like those imposed by law upon a fiduciary. Honesty, care, and competence are the demands of trusteeship. These demands are made by the bill on the directors of the issues, its experts, and the underwriters who sponsor the issue. If it be said that the imposition of such responsibilities upon these persons will be to alter corporate organization and corporate practice in this country, such a result is only what your committee expects. The picture of persons, assumed to be responsible for the direction of industrial enterprises, occupying 50 or more directorships of corporations is the best proof that some change is demanded. Directors should assume the responsibility of directing and if their manifold activities make real directing impossible, they should be held responsible to the unsuspecting public for their neglect. But to require them to guarantee the absolute accuracy of every statement that they are called upon to make, would be to gain nothing in the way of an effective remedy and to fall afoul of the President's injunction that the protection of the public should be achieved with the least possible interference to honest business. Whereas to insist upon the assumption of duties of trusteeship is to return to the ancient truths of fair dealing. The demands of their bill call for the assumption of no impossible burden, nor do they involve any leap into the dark. Similar requirements have for years attended the business of issuing securities in other industrialized nations. They have already been readily assumed in this country by honest and conservative issuers and investment bankers. Instead of impeding honest business, the imposition of liabilities of this character carries over into the general field of security selling, ethical standards of honesty and fair dealing common to every fiduciary undertaking.

II. GENERAL ANALYSIS OF THE BILL

1. ITS SCOPE

The bill affects only new offerings of securities sold through the use of the mails or of instrumentalities of interstate or foreign transportation or communication. It does not affect the ordinary redistribution of securities unless such redistribution takes on the characteristics of a new offering by reason of the control of the issuer possessed by those responsible for the offering. It carefully exempts from its application certain types of securities and securities transactions where there is no practical need for its application or where the public benefits are too remote.

In respect of unexempted security offerings it provides in substance that:

(1) Any such offering is unlawful until-

(a) A registration statement setting forth prescribed information has been filed with the Federal Trade Commission; and

(b) Such 'registration statement' has remained on file for not less than 30 days, subject to public inspection, thereby giving adequate *6 opportunity for appropriate scrutiny by State securities commissions and independent securities services and advisers.

(2) After such waiting period, such securities may be sold through the mails, or through the use of any instrumentalities of interstate or foreign communication or transportation only if the buyer is given a substantial replica of the information included in the 'registration statement'; and if sales are made without giving the buyer such information, or if even after the waiting period the Commission discovers that the 'registration statement' is or has become false, inadequate, or misleading, because it includes an untrue statement of a material fact or omits to state a material fact, the Commission may be stop order, subject to court reviw, temporarily or permanently stop the further sale of such securities.

(3) Newspaper articles, 'tipster's sheets', and other descriptions of or comments upon securities not purporting to offer such securities for sale must disclose any financial interest of the writer or publisher in their sale.

(4) The directors and officers of the issuers, the accountants, appraisers, and other experts authorizing and furnishing the information included in the 'registration statement,' and the underwriters of the offering, are jointly and severally liable to any buyer for rescission of any sale or for damages, if the registration statement or the information given to the buyer in the course of a sale is false or misleading and the defendant cannot prove both that he did not know and by the exercise of due care could not have known of such false or misleading character.

(5) The Commission may apply to the courts to enjoin any device, scheme, or artifice to defraud, employed in connection with the sale in interstate or foreign commerce of any securities, whether new or already outstanding.

2. EXEMPTED SECURITIES AND TRANSACTIONS

The exemption sections, 3 and 4, exempt, among other transactions in securities, transactions by individuals; the execution by brokers of customer's orders in open market; transactions by a dealer in securities not connected by time or circumstance with distribution of a new offering; securities issued in a reorganization subject to the approval of a court; certificates issued by a receivedr or by a trustee in bankruptcy, with the approval of a court; short-term commercial paper; general obligations of the Federal Government and its corporate instrumentalities, of national banks, of the Federal Reserve banks, of State banks (as suggested by a committee amendment), and the States and their political subdivisions; railroad securities subject to the jurisdiction of the Interstate Commerce Commission; insurance policies subject to the supervision of a State insurance commissioner; and the securities of a nonprofit corporation and of certain building and loan associations. The Commission is given a further discretionary power carefully limited to exempt additional transactions and securities where the aggregate amount of the offering does not exeed $100,000. This power is deemed necessary for the effective administration of the bill, but is expected to be used only in a sparing manner, which keeps in mind the prima facie requirement that every security and transaction not specifically exempted by the *7 terms of the bill should be kept within its scope. Section 5(c) also exempts sales within a State of entire issues of local issuers. In view of these exemptions and the restriction of the bill's application to new offerings, the bill does not affect transactions beyond the need of public protection in order to prevent recurrences of demonstrated abuses.

3. THE CHARACTER OF REGISTRATION AND THE CONDITIONS TO ITS EFFECTIVENESS

Sections 5, 6, 7, 8, and 9 include the provisions for the filing of the 'registration statement' with the Commission, the required lapse of an inspection period between the first availability of such information to the public through the

'registration statement' and the time when selling of securities therein described may lawfully commerce, and the power in the Commission to stop the further improper distribution of securities. It should be noted that the Commission is not empowered to affect at any time the validity, as such, of sales already lawfully made.

The information required to be filed in and with the 'registration statement' is set forth in the schedules annexed to the bill. Because of the basic importance of this 'registration statement', both as a source of information to the prospective buyer and as a foundation for civil liability if the information therein given is false or misleading, the requirements of this 'registration statement' have, of course, been designed to reach items of distribution profits, watered values, and hidden interests that usually have not been revealed to the buyer despite their indispensable importance in appraising the soundness of a security. A balance sheet that gives an intelligent idea of the assets and liabilities of the issuer and a profit and loss statement that gives a fair picture of its operations for the preceding 3 years, must be certified by an independent public accountant. The requirements in respect of securities of foreign governments have been worked out with particular care. To assure the necessary knowledge for judgment, the bill requires enumerated definite statements. Mere general power to require such information as the Commission might deem advisable would lead to evasions, laxities, and powerful demands for administrative discriminations. No honestly conceived and intelligently worked out offering, floated at a fair but not exorbitant profit, will be injured by the revelation of the whole truth which these requirements seek to elicit. The requirement of comparable information, at the time of the offering, of many of the most fraudulent issues, in which the public has suffered the greatest losses in late years, would have prevented their flotation. A compulsory revelation of the whole truth will give impetus to honest dealing in securities and help to bring back public confidence.

4. THE WAITING PERIOD

The compulsory 30-day inspection period before securities can be sold is deliberately intended to interfere with the reckless traditions of the last few years of the securities business. It contemplates a change from methods of distribution lately in vogue which attempted complete sale of an issue sometimes within 1 day or at most a few *8 days. Such methods practically compelled minor distributors, dealers, and even salesmen, as the price of practicipation in future issues of the underwriting house involved, to make commitments blindly. This has resulted in the demoralization of ethical standards as between these ultimate sales outlets and the securities-buying public to whom they had to look to take such commitments off their hands. This high-pressure technique has assumed an undue importance in the eyes of the present generation of securities distributors, with its reliance upon delicate calculations of day-to-day fluctuations in market opportunities and its implicit temptations to market manipulation, and must be discarded because the resulting injury to an underinformed public demonstrably hurts the Nation. It is furthermore the considered judgment of this committee that any issue which cannot stand the test of a waiting inspection over a month's average of economic conditions, but must be floated within a few days upon the crest of a possibly manipulated market fluctuation, is not a security which deserves protection at the cost of the public as compared with other issues which can meet this test. There is no more appropriate function of government than that it should encourage reasonable saving by protecting the fruits of that saving.

5. PROSPECTUSES

Section 10 of the bill requires that any 'prospectus' used in connection with the sale of any securities, if it is more than a mere announcement of the name and price of the issue offered and an offer of full details upon request, must include a substantial portion of the information required in the 'registration statement.' The Commission is given power to classify prospectuses according to the nature and circumstance of their use and to prescribe the form and contents appropriate to each class. While a leeway is given to the Commission to meet the varying exigencies of business transactions, fundamental safeguards necessary to insure a fair disclosure are to be preserved.

'Prospectus' is defined in section 2(1) to include 'any prospectus, notice, circular, advertisement, letter, or other communication offering any security for sale.'

The purpose of these sections is to secure for potential buyers the means of understanding the intricacies of the transaction into which they are invited. The full revelations required in the filed 'registration statement' should not be lost in the actual selling process. This requirement will undoubtedly limit the selling arguments hitherto employed. That is its purpose. But even in respect of certain types of listed issues, reputable stock exchanges have already, on their own initiative, recognized the danger of abbreviated selling literature and insisted upon supervising the selling of literature distributed in connection with such issues, to make certain that such literature includes the same information concerning the issue required in a formal circular filed with and approved by such exchanges. Any objection that the compulsory incorporation in selling literature and sales argument of substantially all information concerning the issue, will frighten the buyer with the intricacy of the transaction, states one of the best arguments for the provision. The rank and file of securities buyers who have hitherto bought blindly should be made aware that securities are intricate merchandise.

*9 6. CIVIL LIABILITIES

Section 11 and 12 create and define the civil liabilities imposed by the act and the machinery for their enforcement which renders them practically valuable. Fundamentally, these sections entitle the buyer of securities sold upon a registration statement including an untrue statement or omission of material fact, to sue for recovery of his purchase price, or for danages not exceeding such price, those who have participated in such distribution either knowing of such untrue statement or omission or having failed to take due care in discovering it. The duty of care to discover varies in its demands upon participants in security distribution with the importance of their place in the scheme of distribution and with the degree of protection that the public has a right to expect. The committee is fortified in these sections by similar safeguards in the English Companies Act of 1929. What is deemed necessary for sound financing in conservative England ought not be unnecessary for the more feverish pace which American finance has developed.

The Committee emphasizes that these liabilities attach only when there has been an untrue statement of material fact or an omission to state a material fact in the registration statement or the prospectus-the basis information by which the public is solicited. All who sell securities with such a flaw, who cannot prove that they did not know-or who in the exercise of due care could not have known-of such misstatement or omission, are liable under sections 11 and 12. For those whose moral responsibility to the public is particularly heavy, there is a correspondingly heavier legal liability-the persons signing the registration statement, the underwriters, the directors of the issuer, the accountants, engineers, appraisers, and other professionals preparing and giving authority to the prospectus-all these are liable to the buyer not only if they cannot prove they did not know of the flaw in the information offered the public but also if they cannot prove that they could not have found that flaw 'after reasonable investigation' and that they 'had reasonable ground to believe and did believe * * * that such statement was true or that there was no such omission.' This throws upon originators of securities a duty of competence as well as innocence which the history of recent spectacular failures overwhelmingly justifies. As a proper safeguard, anyone who has been given an apparent responsibility by the terms of the registration statement can avoid subsequent liability only by disclaiming such responsibility in a public way prior to the effective date of the registration statement or at the first opportunity.

The provisions throwing upon the defendant in suits under sections 11 and 12 the burden of proof to exempt himself are indispensable to make the buyer's remedies under these sections practically effective. Every lawyer knows that with all the facts in the control of the defendant it is practically impossible for a buyer to prove a state of knowledge or a failure to exercise due care on the part of defendant. Unless responsibility is to involve merely paper liability it is necessary to throw the burden of disproving responsibility for reprehensible acts of omission or commission on those who purport to issue statements for the public's reliance. The responsibility imposed is no more nor less than that of a trust. It is a responsibility that no honest banker *10 and no honest business man should seek to avoid or fear. To impose a lesser responsibility would nullify the purposes of this legislation. To impose a greater responsibility, apart from constitutional

doubts, would necessarily restrain the conscientious administration of honest business with no compensating advantage to the public.

The constitutionality of the imposition of liabilities of the character provided by the bill raises no serious question. Even though the activities of the particular persons concerned may be actually intrastate in character, they are, nevertheless, an integral part of a process calling for the interstate distribution of securities. Liability is imposed upon them as a condition of the acquisition of the privilege to do business through the channels of interstate or foreign commerce. The statements for which they are responsible, although they may never actually have been seen by the prospective purchaser, because of their wide dissemination, determine the market price of the security, which in the last analysis reflects those manifold causes that are the impelling motive of the particular purchase. The connection between the statements made and the purchase of the security is clear, and, for this reason, it is the essence of fairness to insist upon the assumption of responsibility for the making of these statements.

7. STATE SECURITY LAWS

The bill carefully preserves the jurisdiction of State security commissions to regulate transactions within their own borders. It goes further and makes that control more effective by preventing evasion of State security legislation by the device of selling in interstate or foreign commerce from outside the State. The fact that security dealers who wish to evade State laws have so frequently resorted to methods of selling securities without entering the State and thus never subjecting themselves to State control makes the elimination of this evil imperative.

The bill thus withdraws securities sold in violation of State laws from the protection that the method of selling them in interstate commerce would otherwise give them. It also makes it unlawful to use the instruments of interstate or foreign commerce in an effort to evade protective State legislation. In this aspect the bill builds itself upon existing precedents. Congress, by the Reed amendment of 1917, forbade sellers of intoxicating liquor from shielding their distribution of liquor in violation of State law behind the cloak of interstate commerce. The same principle was approved by this House, with reference to the sale of securities, by the passage of the Denison bill which sought in this respect to effectuate the same end. In the light of these precedents, together with the upholding of the Webb-Kenyon Act by the Supreme Court of the United States in *Clark Distilling Company* v. *Western Maryland Railway Company* (242 U.S. 311) there can be slight doubt as to the existence of a power in the Nation to prevent the use of means, such as interstate commerce, over which it has control, being employed to evade the settled policies of the States, whether these policies concern securities or intoxicating liquor. The right to withdraw protection of the interstate commerce clause from a commodity, because otherwise it would be sold in violation of State law (upheld by the Supreme Court in the Clark Distilling case), implies of necessity a power in the Nation ***11** to punish an attempt to use interstate commerce in defiance of the very purpose for which the protection of the interstate commerce clause was withdrawn. The wisdom of such an exertion of congressional power bases itself upon the uncontested fact that dealers in securities have cleverly organized their means of distributing securities so as to evade State blue-sky legislation by never entering the State. Such a policy does not interfere with legitimate business, but only by a resort to such a policy can interstate commerce be closed to illegitimate business.

III. SUMMARY OF THE BILL BY SECTIONS

SECTION 1. TITLE

This section provides a short title for the bill.

SECTION 2. DEFINITIONS

Paragraph (1) defines the term 'security' in sufficiently broad and general terms so as to include within that definition the many types of instruments that in our commercial world fall within the ordinary concept of a security. The definition is broad enough to include as securities, for example, certificates of interest in oil, gas, or mining leases or royalties. The definition is again comprehensive enough to bring within its terms certificates of deposit issued by protective committees. It also includes warrants or rights to subscribe to a security, so that the control exerted by this bill commences with the initiation of any scheme to sell securities to the public.

Paragraph (2) defines 'person' in terms sufficiently broad to include within that conception not only an individual but also every form of commercial organization that may issue securities. It includes within the concept of 'person' a government or a political subdivision thereof, although later sections of the bill exempt from its provisions securities issued by the United States, a State, or a Territory, or a political subdivision of any of these governmental units. The term 'trust' is defined to exclude the ordinary noncommercial trust but to include that type of organization, commonly known as a 'business trust' or a 'Massachusetts trust', which, without resort to the device of incorporation, is used to achieve many of the purposes of the ordinary business corporation.

Paragraph (3) defines the term 'sale' or 'sell' broadly to include every attempt or offer to dispose of a security for value. It includes within the definition of 'sale' an offer to buy, thereby preventing dealers from making offers to buy between the period of the filing of the registration statement and the date upon which such a statement becomes effective. Otherwise, the underwriter, although only entitled to accept such offers to buy, after the effective date of the registration statement, could accept them in the order of their priority and thus bring pressure upon dealers, who wish to avail themselves of a particular security offering, to rush their orders to buy without adequate consideration of the nature of the security being offered. From the definition of sale, however, is excluded the exchange of an instrument for another instrument which merely evidences exactly the same right embodied in the original instrument, thus exchanges of a stock certificate for another stock certificate of ***12** the same character or of an interim receipt for the permanent security are excluded from the operation of the act. Special care is taken to except from the definition of 'sale' preliminary negotiations and agreements between an issuer and an underwriter. Underwriting agreements can thus be entered into prior to the time of the filing of the registration statement. The exception, however, extends no further than the agreement between issuer and underwriters, so as to delay the actual organization of the selling group and the disposition of the security to the dealers until the registration statement shall have become effective.

This paragraph also exempts from the concept of 'sale' the giving to a holder of a security, at the time of the sale of such security to the holder, a right either to conversion or a warrant to subscribe, where neither of these rights are immediately exercisable. This makes it unnecessary to register such a security prior to the time that it is to be offered to the public, although the conversion right or the right to subscribe must be registered. When the actual securities to which these rights appertain are offered the public, the bill requires registration as of that time. This permits the holder of any such right of conversion or warrant to subscribe to judge whether upon all the facts it is advisable for him to exercise his rights.

Paragraph (4) defines the term 'issuer' not only to include the actual issuer of the security but also the guarantor, if there be such a guarantor, in order that adequate disclosure may be made to the investor as to the worth of any such guaranty. Special provisions govern the definition of 'issuer' in connection with security issues of an unusual character, such as fixed investment trusts and certificates of deposit. In instances of this nature basic securities are acquired by a depositing committee or corporation, which then deposits these securities with a trustee. The trustee actually issues the new securities, which represent an interest in the securities deposited with the trustee. These are then delivered to the depositor and are then distributed by the depositor to the public. Under such an arrangement, although the actual issuer is the trustee, the depositor is the person responsible for the flotation of the issue. Consequently, information relative to the depositor and to the basic securities is what chiefly concerns the investor-information respecting the assets and liabilities of the trust rather than of the trustee. For these reasons the duty of furnishing this information is placed upon the actual manager of the trust and not the passive trustee, and this purpose is accomplished by defining 'issuer' as in such instances referring to the depositor or manager.

Paragraphs (5) and (6) are self-explanatory.

Paragraph (7) defines interstate commerce to include foreign commerce.

Paragraphs (8) and (9) need no detailed explanation.

Paragraph (10) defines 'prospectus' broadly as including any written or radio communication offering a security for sale. Thus communications of this character, by virtue of this definition, must comply with the requirements of section 10. The bill, apart from section 16(b), is not concerned with communications which merely describe a security. It is, therefore, possible for underwriters who wish to inform a selling group or dealers generally of the nature of a security that will be offered for sale after the effective date of the *13 registration statement, to circulate among them full information respecting such a security. This could easily and effectively be done by circulating the offering circular itself, if clearly marked in such a manner as to indicate that no offers to buy should be sent or would be accepted until the effective date of the registration statement. From the definition of 'prospectus' two exceptions are made: The first allows dealers, after they have opened negotiations with a prospective purchaser by giving him the required prospectus, to give him such additional information as they may deem desirable. This additional information, of course, by virtue of the provisions contained in sections 12(2) and 16(a)(2) must not contain fraudulent statements or statements that are themselves untrue, either because of the misstatements that they contain or the facts of a relevant character that are omitted. The second exception to the inclusive definition of 'prospectus' permits the ordinary type of broker and dealer advertising. Brokers and dealers are allowed to advertise a security by name and to state the price at which they will procure it for purchasers, provided that they also inform prospective purchasers where a detailed prospectus can be obtained. To avoid the inclusion in such advertisements of misleading and insufficient statements, dealers and brokers are not permitted to go farther in their advertising, unless they are willing to set forth the detailed statements required by the prospectus. It should be noted in this connection that section 10(b)(4) permits the Commission to prescribe forms for prospectuses to be used in newspaper, periodical, and other general advertising.

Paragraph (11) sets forth the important definition of 'underwriter.' The term is defined broadly enough to include not only the ordinary underwriter, who for a commission promises to see that an issue is disposed of at a certain price, but also includes as an underwriter the person who purchases an issue outright with the idea of then selling that issue to the public. The definition of underwriter is also broad enough to include two other groups of persons who perform functions, similar in character, in the distribution of a large issue. The first of these groups may be designated as the underwriters of the underwriter, a group who, for a commission, agree to take over pro rata the underwriting risk assumed by the first underwriter. The second group may be termed participants in the underwriting or outright purchase, who may or may not be formal parties to the underwriting contract, but who are given a certain share or interest therein.

The term 'underwriter', however, is interpreted to exclude the dealer who receives only the usual distributor's or seller's commission. This limitation, however, has been so phrased as to prevent any genuine underwriter passing under the mark of a distributor or dealer. The last sentence of this definition, defining 'issuer' to include not only the issuer but also affiliates or subsidiaries of the issuer and persons controlling the issuer, has two functions. The first function is to require the disclosure of any underwriting commission which, instead of being paid directly to the underwriter by the issuer, may be paid in an indirect fashion by a subsidiary or affiliate of the issuer to the underwriter. Its second function is to bring within the provisions of the bill redistribution whether or outstanding issues or issues sold subsequently to the enactment of the bill. All the outstanding *14 stock of a particular corporation may be owned by one individual or a select group of individuals. At some future date they may wish to dispose of their holdings and to make an offer of this stock to the public. Such a public offering may possess all the dangers attendant upon a new offering of securities. Wherever such a redistribution reaches significant proportions, the distributor would be in the position of controlling the issuer and thus able to furnish the information demanded by the bill. This being so, the distributor is treated as equivalent to the original issuer and, if he seeks to dispose of the issue through a public offering, he becomes subject to the act. The concept of

control herein involved is not a narrow one, depending upon a mathematical formula of 51 percent of voting power, but is broadly defined to permit the provisions of the act to become effective wherever the fact of control actually exists.

Paragraph (12) defines the term 'dealer' to include not merely the ordinary dealer in securities but also the broker. Transactions by a broker, however, provided that they are true brokerage transactions, are not brought within the scope of the bill by the specific exemptions granted in paragraph (2) of section 4. The sole object of this definition is thus to subject brokers to the same advertising restrictions that are imposed upon dealers, so as to prevent the broker from being used as a cloak for the sale of securities.

SECTION 3. EXEMPTED SECURITIES

This section lists securities that are exempt from the act. Paragraph (1) of subsection (a) exempts securities which prior to 60 days after the enactment of the act have either been sold or disposed of by the issuer or have been bona fide offered to the public. Adequate care is taken to prevent the exemption of securities whose issuance has been authorized prior to this time but which have never been offered to the public. Also the exemption does not apply to any redistribution of outstanding issues which would otherwise come within the act.

Paragraph (2) exempts United States, Territorial, and State obligations, or obligations of any political subdivision of these governmental units. The term 'political subdivision' carries with it the exemption of such securities as county, town, or municipal obligations, as well as school district, drainage district, and levee district, and other similar bonds. The line drawn by the expression 'political subdivision' corresponds generally with the line drawn by the courts as to what obligations of States, their units and instrumentalities created by them, are exempted from Federal taxation. By such a delineation, any constitutional difficulties that might arise with reference to the inclusion of State and municipal obligations are avoided. Securities of instrumentalities of the Government of the United States are also exempted, as well as securities issued by a national bank or by a Federal Reserve bank. Securities issued by Governmental instrumentalities are not generally sold in the market while adequate supervision over the issuance of securities of a national bank is exercised by the Comptroller of the Currency. A committee amendment makes it clear that there are also exempt securities issued by a public instrumentality of one or more State or Territories exercising an essential governmental function.

*15 Paragraph (3) exempts short-term paper of the type available for discount at a Federal Reserve bank and of a type which rarely is bought by private investors.

Paragraph (4) exempts securities of a noncommercial character issued by eleemosynary institutions.

Paragraph (5) exempts the securities of building and loan associations and similar institutions, but insists that such institutions as a condition to being exempt from the act must do a true building and loan business by confining their business to the making of loans to their members.

Paragraph (6) exempts all securities issued by common carriers, the issuance of whose securities is already by virtue of section 20a of the Interstate Commerce Act subject to the control and approval of the Interstate Commerce Commission.

Paragraph (7) exempts receiver's certificates and trustee certificates when such certificates have already been approved by the court under whose control the receiver or trustee acts.

Paragraph (8) makes clear what is already implied in the act, namely, that insurance policies are not to be regarded as securities subject to the provisions of the act. The insurance policy and like contracts are not regarded in the commercial world as securities offered to the public for investment purposes. The entire tenor of the act would lead, even without this specific exemption, to the exclusion of insurance policies from the provisions of the act, but the specific exemption is included to make misinterpretation impossible.

Subsection (b) gives a general authority to the Commission to add to the class of express exemptions any security which because of the small amount involved or the limited character of the public offering should properly be excluded from the provisions of the act. To confer such a power upon the Commission permits the Commission by adequate rules and regulations to provide against needless registration of issues of such an insignificant character as not to call for regulation. This general power of the Commission, however, is closely limited by the requirement that it shall not extend to any issue whose aggregate amount exceeds $100,000. The Commission is thus safeguarded against any untoward pressure to exempt issues whose distribution may carry all the unfortunate consequences that the act is designed to prevent.

SECTION 4. EXEMPTED TRANSACTIONS

The provisions of this section exempt certain transactions from the provisions of section 5, which section requires both the registration of securities as a condition precedent to offering them for sale in interstate or foreign commerce or for transporting them in such commerce, and which section also requires that after the effective date of registration prospectuses relating to such securities shall conform to the requirements of the act.

Paragraph (1) broadly draws the line between distribution of securities and trading in securities, indicating that the act is, in the main, concerned with the problem of distribution as distinguished from trading. It, therefore, exempts all transactions except by an issuer, underwriter, or dealer. Again, it exempts transactions by an issuer unless made by or through an underwriter so as to permit *16 an issuer to make a specific or an isolated sale of its securities to a particular person, but insisting that if a sale of the issuer's securities should be made generally to the public that that transaction shall come within the purview of the act. Recognizing that a dealer is often concerned not only with the distribution of securities but also with trading in securities, the dealer is exempted as to trading when such trading occurs a year after the public offering of the securities. Since before that year the dealer might easily evade the provisions of the act by a claim that the securities he was offering for sale were not acquired by him in the process of distribution but were acquired after such process had ended, transactions during that year are not exempted. The period of a year is arbitrarily taken because, generally speaking, the average public offering has been distributed within a year, and the imposition of requirements upon the dealer so far as that year is concerned is not burdensome. Transactions by an underwriter are not exempted. It is true, however, that there is a point of time when a person who has become an underwriter ceases to exercise any underwriting function and, therefore, ceases to be an underwriter. When that point is reached such a person would be subject only to whatever restrictions would be imposed upon him as a dealer.

Paragraph (2) exempts the ordinary brokerage transaction. Individuals may thus dispose of their securities according to the method which is now customary without any restrictions imposed either upon the individual or the broker. This exemption also assures an open market for securities at all times, even though a stop order against further distribution of such securities may have been entered. Purchasers, provided they are not dealers, may thus in the event that a stop order has been entered, cut their losses immediately, if there are losses, by disposing of the securities. On the other hand, the entry of a stop order prevents any further distribution of the security.

Paragraph (3) exempts stock dividends or additional capital stock distributed among the stockholders of a corporation when such distribution is by way of dividend and not by sale. Any crediting of stock dividends to income is to be disclosed by the issuer in whatever income statement may precede the issuance of a security, together with the basis upon which such credit is computed, by the express provisions of paragraph (26) of Schedule A. This paragraph also exempts the distribution of additional capital stock of a corporation when distributed among its own stockholders provided that no commission is paid in connection with such distribution. This paragraph also exempts the distribution of securities during a bona fide reorganization of a corporation when such reorganization is carried on under the supervision of a court.

Reorganizations carried out without such judicial supervision possess all the dangers implicit in the issuance of new securities and are, therefore, not exempt from the act. For the same reason the provision is not broad enough to include mergers or consolidations of corporations entered into without judicial supervision.

Paragraph (4) exempts subscriptions to the capital stock of a corporation where no expense is incurred or commission paid in connection with the subscriptions. No sales pressure being present in connection with subscriptions of this character and no promotion for pecuniary profit being involved, the reason for their exemption is clear.

*17 SECTION 5. PROHIBITIONS RELATING TO INTERSTATE OR FOREIGN COMMERCE AND THE MAILS

Subject to the exemptions allowed by sections 3 and 4, it is made unlawful for any person to make use of the mails or any means or instruments of interstate or foreign commerce (a) before the effective date of registration, or while the registration is suspended, to sell any security or to carry or cause to be carried any security for the purpose of sale or delivery after sale, and (b) after the effective date of registration to transmit any prospectus relating to the sale of any such security that does not meet the requirements set in section 10, or to carry or cause to be carried any such security for the purpose of sale or delivery after sale, unless accompanied or preceded by a prospectus meeting such requirements.

The provisions of this section as to the use of the mails, however, do not apply to the sale of a security where the issue of which it is a part is sold only to persons resident within a single State, where the issuer is a resident and doing business within such State.

SECTION 6. REGISTRATION OF SECURITIES AND SIGNING OF REGISTRATION STATEMENT

(a) A security may be registered so as to permit its sale by use of the mails or instruments of interstate and foreign commerce by filing a registration statement in triplicate with the Federal Trade Commission. The registration statement must be signed by the issuer, its principal executive, financial and accounting officers, and by a majority of its board of directors. When the issuer is a foreign or territorial person, the statement must be signed by its duly authorized representative in the United States, except that in case of a foreign government or political subdivision thereof, it need only be signed by the underwriter.

(b) At the time of filing, the applicant must pay a fee of one hundredth of 1 per centum of the maximum aggregate price at which the securities are proposed to be offered, but in no case less than $50.

(c) The filing of a registration statement or of an amendment takes place upon the receipt thereof or if forwarded in the United States by registered mail, upon the mailing thereof.

(d) The information contained or filed with any registration statement shall be available to the public under appropriate regulations of the Commission, and copies, printed, photostatic, or otherwise, shall be furnished to anyone who applies therefor at a reasonable charge.

(e) No registration statement may be filed within 30 days after the enactment of the act.

SECTION 7. INFORMATION REQUIRED IN REGISTRATION STATEMENT

The registration statement when relating to a security other than a security issued by a foreign government, or political subdivision thereof, shall contain the information and be accompanied by the documents specified in schedule A and when relating to the security of a foreign government or political subdivision thereof the information and

documents specified in schedule B. The Commission, however, may by its rules and regulations provide that any such information *18 or documents need not be included in respect to a class of issuers or securities if it finds that such information or documents are inapplicable to such class and that disclosure fully adequate for the protection of investors is otherwise required. The Commission may further provide by its rules and regulations for the inclusion of such additional information and documents as it may deem necessary or appropriate to effectuate the purposes of the act.

The requirements of schedule A, relating principally to corporate securities, may be briefly summarized as follows:

(1) The investor must be given these essential facts concerning the property in which he is invited to acquire an interest:

(a) The name, locality, and character of the business.

(b) A detailed statement of the capitalization of the issuer with a description of the rights of the holders of the various classes of securities.

(c) The specific purposes for which the security to be offered is to supply the funds.

(d) A list, and the general effect concisely stated, of all material contracts, not made in the ordinary course of the business, including all management contracts, profit-sharing arrangements, and contracts for the giving or receiving of technical or financial advice or service.

(e) A balance sheet that will give an intelligent idea of the assets and liabilities of the issuer, in such form and such detail as the Commission may prescribe.

(f) A profit and loss statement that will give an intelligent idea of the earnings and operations of the issuers for at least 3 years, year by year, in such form and in such detail as the Commission may prescribe.

(2) The investor must be given these essential facts concerning the identity and the interests of the persons with whom he is dealing or to whom the management of his investment is entrusted:

(a) The names of the promoters, directors, and principal executive, financial and accounting officers of the issuer, and the names of the underwriters and of all persons owning more than 10 percent of any class of stock or more than 10 percent in the aggregate of all stock, together with a statement of the amount of the securities of issuer held by all such persons as of the date of the filing of the registration statement and as of 1 year prior thereto.

(b) A statement of the securities of the issuer covered by options and the names of any persons holding more than 10 percent of such options.

(c) The remuneration paid the directors during the past year, and to be paid during the ensuing year and the remuneration to officers or other persons, exceeding $25,000 per year during any such year.

(d) All commissions paid or to be paid to the underwriters.

(e) Any amounts paid within 2 years to any promoter and the consideration therefor.

(f) Particulars concerning the acquisition of any property acquired or to be acquired, not in the ordinary course of the business, to be paid in whole or in part out of the proceeds of the security to be offered, the names of the vendors and the interest of any director, officer, or principal stockholders of the issuer in any such property.

(g) Names of counsel approving legality of the issue.

*19 (3) The investor must be given these essential facts in regard to the price and cost of the security he is buying and its relation to the price and cost of earlier offerings:

(a) Estimated net proceeds to be derived from the security offered.

(b) Proposed price of security to be offered to the public.

(c) Estimated amount of expenses in connection with the sale of the security.

(d) Net proceeds from any security of the issuer sold during the preceding 2 years, price at which such security was offered to the public, and the names of the underwriters.

The requirements of schedule B relating to securities of a foreign government or political subdivision thereof may be briefly summarized as follows:

(1) The investor must be given these essential facts concerning the borrowing government or subdivision thereof:

(a) The name of the borrower and authorized agent, if any, in the United States.

(b) A description of the funded and floating debt of the borrower and a statement of the terms of the loan to be floated and of the security therefor.

(c) Any default in the principal or interest of any external obligation during the preceding 20 years and the terms of any succeeding arrangement.

(d) The specific purposes of the loan.

(e) The receipts, reasonably classified by source, and the expenditures, reasonably classified by purpose, in such detail and form as the Commission may prescribe, for the preceding 3 years, year by year.

(2) The investor must be given these essential facts with regard to the underwriters and counsel:

(a) The names of the underwriters, and all commissions paid or to be paid to such underwriters.

(b) The names of counsel approving the legality of the issue.

(3) The investor must be given these essential facts in regard to the price and cost of the security he is buying:

(a) The estimated proceeds to be derived from the sale in the United States of the security to be offered.

(b) The price at which the security is to be offered to the public in the United States.

(c) The estimated amount of the expenses to be incurred in connection with the sale of the security to be offered.

Schedules A and B are to be accompanied by important documents such as the underwriting agreements, opinions of counsel, and the underlying indentures and agreements in regard to the securities of the issuer.

SECTION 8. TAKING EFFECT OF REGISTRATION STATEMENTS AND AMENDMENTS THERETO

(a) The registration statement becomes effective 30 days after filing. If any amendment is filed prior to the effective date of the registration statement, the registration statement is deemed to have been filed when the amendment was filed; except that an amendment filed with the consent of the Commission prior to the effective date of the registration statement, is treated as if filed with the original *20 statement. This subdivision, as has been explained above, is to afford a waiting or cooling period of 30 days so as to eliminate many of the abuses connected with high-pressure salesmanship and the sale of securities to the public under circumstances permitting an inadequate examination by informed critics of the essential facts.

(b) If it appears to the Commission that a registration statement is on its face incomplete or inaccurate in any material respect, the Commission may, after confirmed telegraphic notice not later than 20 days after the filing of the registration statement and opportunity for hearing within 10 days after such notice, issue an order prior to the effective date of registration refusing to permit such statement to become effective until it has been amended in accordance with such order. When the statement has been amended in accordance with such order the Commission shall so declare and the registration shall become effective at the time provided in subsection (*a*) or upon the date of such declaration, whichever date is the later. This subsection is intended to enable the Commission to make a preliminary check-up of any obvious departures from the standards set by the law without imposing upon the Commission any responsibility as to the truth of the registration statement or as to the soundness of the securities to be offered thereunder.

(c) If an amendment filed after the effective date of the registration statement appears to the Commission to be not incomplete or inaccurate on its face, it becomes effective on such date as the Commission may determine, having regard to the public interest and the protection of investors.

(d) If it appears to the Commission at any time that the registration statement includes any untrue statement of a material fact or omits to state any material fact, the Commission may, after the sending of confirmed telegraphic notice after opportunity for hearing within 15 days after such notice, issue a stop order suspending the effectiveness of the registration statement. When such statement has been amended to meet the objections of the Commission, the Commission shall so declare, and thereupon the stop order shall cease to be effective. In determining whether a stop order should issue, the Commission will naturally have regard to the facts as they then exist and will stop the further sale of securities even though the registration statement was true when made, it has become untrue or misleading by reason of subsequent developments. This subdivision is intended to enable the Commission to prevent any imposition upon its authority by the filing of any untrue, inadequate, or misleading statement. At the same time, it limits the scope of the issues to be considered by the Commission on any stop order and thereby avoids any undue interference with private rights.

(e) The Commission is given adequate power to make a complete examination in order to determine whether a stop order should issue. If any issuer, representative, or underwriter fails to cooperate, or obstructs or refuses to permit the making of an examination, such conduct is proper ground for the issuance of a stop order.

(f) Any notice under this section shall be sent to the issuer, or in case of a foreign government, to the underwriter, or in case of a foreign or territorial person to its authorized representative in the United States.

*21 SECTION 9. COURT REVIEW OF ORDERS

Any person aggrieved by an order of the Commission may obtain a review of such order on questions of law in the Court of Appeals of the District of Columbia. The jurisdiction of such court is exclusive, and its judgment and decree

final, subject to review by the Supreme Court of the United States. Proceedings before the court, unless specifically ordered by the court, do not operate as a stay of any order of the Commission.

SECTION 10. INFORMATION REQUIRED IN PROSPECTUS

(a) A prospectus must contain the same statements made in the registration statement, except that the documents accompanying the registration statement need not be included.

(b) Notwithstanding the provisions of subsection (*a*), (1) when a prospectus is used more than 12 months after the effective date of the registration statement, the information contained therein must be of a date not more than 12 months prior to its use, (2) there may be omitted from the prospectus any of the statements that would otherwise be required under subsection (*a*), which the Commission may by rules and regulations designate as not being necessary or appropriate in the public interest or for the protection of investors, and (3) the prospectus must contain such other information as the Commission may by rules or regulations require as being necessary or appropriate in the public interest or for the protection of investors. The Commission is given power to classify prospectuses according to the nature and circumstances of their use and to prescribe as to each class the form and contents which it may find appropriate to such use and consistent with the public interest and protection of investors. Copies of all radio broadcasts must be filed with the Commission, and the Commission may by rules and regulations require the filing with it of forms of prospectuses used or to be used in connection with the sale of any securities registered under the act.

SECTION 11. CIVIL LIABILITIES ON ACCOUNT OF FALSE REGISTRATION STATEMENT

(a) In case any part of the registration statement contained, at the time it became effective, an untrue statement of a material fact or omitted to state a material fact, any person who shall have acquired such security (unless it be proved that at the time of the acquisition he knew of such untruth or omission) is given the right to sue either at law or in equity in any court of competent jurisdiction-(1) every person who signed the registration statement; (2) every person who was a director of (or person performing similar functions) or partner in, the issuer at the time of the filing of the registration statement; (3) every person who with his consent is named in the registration statement as being or about to become a director, a person performing similar functions, or a partner; (4) every accountant, engineer, or appraiser, or any person whose profession gives authority to a statement made by him, who has prepared or certified any part of the registration statement, with respect to the part prepared or certified by him; (5) every underwriter.

***22** Inasmuch as the value of a security may be affected by the information given in the registration statement, irrespective of whether a particular sale takes place in interstate or intrastate commerce, the civil remedies accorded by this subsection against those responsible for a false or misleading statement filed with the Federal Trade Commission are given to all purchasers regardless of whether they bought their securities in an interstate or intrastate transaction and regardless of whether they bought their securities at the time of the original offer or at some later date, provided, of course, that the remedy is prosecuted within the period of limitations provided by section 13. In this connection, it must be borne in mind that no one is obliged to register a security under this act unless he desires to make use of the mails or of the channels of interstate or foreign commerce in the distribution of the security. But if a person does avail himself of the privilege of registration accorded by this act, it is obviously within the constitutional power of Congress to accord a remedy to all purchasers who may reasonably be affected by any statements in the registration statement. The separability clause in section 25 of the bill makes certain that congressional power in this instance has been vested as far and to whatever circumstances the Constitution allows.

(b) The provisions of subsection (a), however, do not impose an absolute liability. Any person liable under such subsection, other than an issuer, may exempt himself if he sustains the burden of proof-

(1) That before the effective date of the registration statement with respect to which his liability is asserted (A) he had resigned from or had taken steps permitted by law to resign from or ceased or refused to act in, every official capacity or relationship in which he was described in the registration statement as acting or agreeing to act; (B) he had advised the Commission and the issuer in writing that he had taken such action and that he would not be responsible for such registration statement (of course, the Commission upon being so advised would not permit a registration statement to become effective until the name of the person disavowing responsibility was removed from the registration statement and the Commission would be put on its guard, unless such disavowal was clearly explained, to investigate the truth and adequacy of the statement); or

(2) That if the registration statement became effective without his knowledge, upon becoming aware of such fact, he forthwith acted and advised the Commission, in accordance with paragraph (1), and in addition gave reasonable public notice that the registration statement had become effective without his knowledge; or

(3) That as regards any part of the registration statement not purporting to be made on the authority of an expert, and not purporting to be a copy of or extract from a report or valuation of an expert, and not purporting to be made on the authority of a public official document or statement, he had, after reasonable investigation, reasonable ground to believe and did believe, at the time such registration statement became effective, that the statements therein were true and that there was no omission to state a material fact; and as regards any part of the registration statement purporting to be made on the authority of an expert, or purporting to be a copy of or extract from a report or valuation of an expert, or purporting to be made on the authority of a public official document or statement, he had ***23** reasonable ground to believe and did believe, at the time the registration statement became effective, that the statements therein were true and that there was no omission to state a material fact, and that the registration statement fairly represented the statement of the expert or of the official person, or was a fair copy of or extract from the report or valuation of the expert, or was a fair copy of or extract from the public official document.

(c) In determining for the purpose of paragraph (3) of subsection (*b*) of this section what constitutes reasonable investigation and reasonable ground for belief, the standard of reasonableness shall be that required of a person occupying a fiduciary relationship. While subsections (*b*) and (*c*) permit a person who has conscientiously and with competence met the responsibilities of his trusteeship to be relieved of liability, they prevent any person who has not fulfilled his trust from escaping liability by any trick of procedure or unjustified delegation of his duties.

(d) If any person becomes an underwriter after the part of the registration statement with respect to which his liability is asserted, has become effective, then for the purposes of paragraph (3) of subsection (*b*) such part of the registration statement is considered as having become effective with respect to him as of the time when he became an underwriter.

(e) Suits authorized under subsection (*a*) may be either (1) to recover the consideration paid for such securities with interest thereon, less the amount of any income received thereon, upon the tender of such security, or (2) for damages if the person suing no longer owns the security.

(f) All or any one or more of the persons specified in subsection (*a*) are jointly and severally liable, but contribution is allowed amoung them as in cases of contract, unless the person who has become liable was, and the other was not, guilty of fraudulent misrepresentation.

(g) In no case is the amount recoverable under this section to exceed the price at which the security was offered to the public.

SECTION 12. CIVIL LIABILITIES ARISING IN CONNECTION WITH PROSPECTUSES AND COMMUNICATIONS

If any person (1) sells a security in violation of section 5, or (2) sells a security, whether or not exempted by section 3, by the use of the instruments of interstate or foreign commerce or of the mails by means of a prospectus or oral communication which includes an untrue statement of a material fact or omits to state a material fact (the purchaser not knowing of such untruth or omission) and does not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission, he is made liable to the person purchasing such security from him, and the purchaser may sue either at law or in equity in any court of competent jurisdiction to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security. The committee has deemed this shift in the burden of proof as both just and necessary, inasmuch as the knowledge of the seller as to any flaw in his selling statements *24 or the failure of the seller to exercise reasonable care are matters in regard to which the seller may readily testify, but in regard to which the buyer is seldom in a position to give convincing proof.

SECTION 13. LIMITATION OF ACTIONS

No action may be maintained to enforce any liability created under section 11 or 12 of this act unless brought within 2 years after the discovery of the untrue statement or of the omission, or after the discovery should have been made by the exercise of reasonable diligence, or, if the action is based upon a violation of section, unless brought within 2 years after such violation. In no event may any action be brought after 10 years after the security was offered to the public.

SECTION 14. CONTRARY STIPULATIONS VOID

Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of the act or of the rules and regulations of the Commission is made void.

SECTION 15. ADDITIONAL REMEDIES

The rights and remedies provided by the act are in addition to any and all other rights and remedies that may exist at law or in equity.

SECTION 16. FRAUDULENT INTERSTATE TRANSACTIONS

(a) It is made unlawful for any person in the sale of any securities by the use of any means or instruments of interstate or foreign commerce or by use of the mails (1) to employ any device, scheme, or artifice to defraud, (2) to obtain money or property by means of any untrue statement of, or omission to state, a material fact, or (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud upon the purchaser.

(b) It is made unlawful for any person, by use of any means or instruments of interstate or foreign commerce or by use of the mails, to publish, give publicity to, or circulate, any advertisement, newspaper, article, letter, investment service, or communication which, though not purporting to offer a security for sale, describes such security, for a consideration received or to be received, directly or indirectly, from an issuer, underwriter, or dealer, without fully disclosing the receipt, whether past or prospective, of such consideration and the amount thereof. This subsection is particularly designed to meet the evils of the 'tipster sheet', as well as articles in newspaper or periodicals that purport to give an unbiased opinion but which opinions in reality are bought and paid for.

(c) The exemptions provided in section 3 of the act do not apply to this section.

SECTION 17. STATE CONTROL OF SECURITIES

Nothing in this act is intended to affect the jurisdiction of the security commission (or any agency or office performing like functions) of any State over any security or any person.

*25 SECTION 18. UNLAWFUL SENDING INTO STATES

(a) It is made unlawful for any person to make use of the mails or any means or instruments of interstate commerce to sell or deliver any security to any person in any State, where such sale or delivery, if it had taken place wholly within such State, would be in violation of the laws thereof relating to the sale of securities.

(b) The exemptions provided in section 3 of this act do not apply to this section.

SECTION 19. SPECIAL POWERS OF COMMISSION

(a) The Commission is given full power and authority to make, amend, and rescind such rules and regulations as may be necessary to carry out the provisions of the act, including rules and regulations governing registration statements and prospectuses for various classes of securities and issuers and defining accounting and trade terms used in the act. The Commission further is given authority to prescribe the forms in which required information shall be set forth and the methods to be followed in the preparation of accounts.

(b) For the purpose of investigations under the act, the Commission or officers designated by it are empowered to subpena witnesses, examine them under oath, and require the production of books, papers, and documents.

SECTION 20. INJUNCTION AND PROSECUTION OF OFFENSES

The Commission is given power, upon complaint or otherwise, to make investigations if it appears to the Commission that the provisions of this act or any rule or regulation prescribed under authority thereof have been or are about to be violated. Whenever it appears to the Commission that the transactions investigated constitute or will constitute a violation of the act or any rule or regulation prescribed thereunder, it may bring an action in the district court of the United States, the United States court of any Territory, or the Supreme Court of the District of Columbia to enjoin the continuance of such transactions, and it may transmit such evidence as may be available to the Attorney General who may institute the necessary criminal proceedings under this act. Any such civil or criminal proceeding may be brought either in the district where the transmitter of the prospectus or security begins or in the district where such prospectus or security is received.

SECTION 21. JURISDICTION OF OFFENSES AND SUITS

(a) The district courts of the United States, the United States courts of any Territory, and the Supreme Court of the District of Columbia are given jurisdiction of offenses and violations under this act and, concurrent with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by this act. Any such suit or action may be brought in the district wherein the defendant is an inhabitant or has its principal place of business or in the district where the sale took place if the defendant participated therein and process therein may be served in the district of which the defendant is an inhabitant or wherever the *26 defendant may be found. Judgments and decrees so rendered are subject to review as provided in sections 128 to 240 of the Judicial Code. No case arising under this act and brought in any State court of competent jurisdiction is removable to any court of the United States.

(b) In case of contumacy or refusal to obey a subpena issued to any person, any of the said United States courts within the jurisdiction of which said person resides, upon application by the Commission, may issue to such person an order requiring such person to appear before the Commission or one of its commissioners, there to testify or produce evidence; and any failure to obey such order of the court may be punished as a contempt.

(c) No person shall be excused from testifying or producing evidence before the Commission on the ground that the testimony or evidence may tend to incriminate him or subject him to a penalty or forfeiture; but no person shall be prosecuted or subject to a penalty or forfeiture for or on account of any transaction concerning which he is compelled to testify or produce evidence, except that such person so testifying shall not be exempt from prosecution or punishment for perjury.

SECTION 22. UNLAWFUL REPRESENTATIONS

Neither the fact that the registration statement for a security has been filed or is in effect, nor the fact that a stop order is not in effect in respect thereof shall be deemed a finding by the Commission that the registration 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 be held to mean that the Commission has in any way passed on the merits of, or given approval to, such security. It is unlawful to make to any prospective purchaser any representation contrary to the provisions of this section.

SECTION 23. PENALTIES

Any person who willfully violates any of the provisions of this act or the rules and regulations promulgated under authority thereof, or who willfully, in a registration statement filed under this act, makes any untrue statement of a material fact or omits to state a material fact shall, upon conviction, be fined not more than $5,000 or imprisoned for not more than 5 years, or both.

SECTION 24. JURISDICTION OF OTHER GOVERNMENT AGENCIES OVER SECURITIES

Nothing in this act is to be construed to relieve any person from submitting to the respective supervisory units of the Government of the United States information, reports, or other documents that are now or may hereafter be required by any law of the United States.

SECTION 25. SEPARABILITY OF PROVISIONS

If any provision of this act or the application of such provision to any person or circumstance shall be held invalid, the remainder of this act or the application of such provision to persons or circumstances other than those as to which it is held invalid, shall not be affected thereby.

*27 MINORITY VIEWS

This bill follows a commendable and constructive purpose to provide a uniform and protective plan of national control for the marketing of interstate securities.

Section 18, however, injects a destructive principle which detracts from the value of the general scheme of constructive control. It destroys the uniformity of the plan of regulation by giving each State arbitrary control of the sale of interstate securities within its boundaries.

This section also denies the Federal Government its proper function of acting as arbiter between the States in the regulation of interstate commerce.

This section also makes the Federal Government responsible for the enforcement of various laws of the States affecting the sale of interstate securities. It will result in burdensome and vexatious handicaps in the administration of the law and in the transaction of the business it regulates.

SCOPE OF SECTION 18

In substance this section makes its unlawful to sell any interstate security in any State where such sale would be unlawful if it had taken place wholly within that State.

A newspaper or radio advertisement of such a security in interstate commerce, published within such State, is made a criminal offense.

Under section 23 any person who willfully violates any of the provisions of the act commits a Federal offense. Thus a violation of any State law under section 18 is made a severe Federal offense, punishable by the Federal Government at its expense.

Under a State law the maximum penalty for a specific violation of its blue-sky law might be $50. Under this bill the Federal maximum penalty for the same act would be $5,000 or imprisonment for 5 years.

Section 18 makes the Federal Government the enforcing agency for legislation of the State without any discretion as to the wisdom of the State laws. It is proposed that Congress shall give a blindfolded approval thereof.

The State laws that may be violated are largely created by the rules and regulations of State commissions which are subject to constant change without any reference to the uniformity of interstate regulations.

Under section 20 it is the duty of the Commission to apply for injunctions to enforce the provisions of the act which would include the blue-sky laws of every State.

Under the same section it is the duty of the Attorney General to institute criminal prosecutions of violation of the act which includes State laws.

*28 The Federal Government is made to assume the burden of prosecuting criminal offenses created without the knowledge or consent of Congress. This section attempts to prospectively approve laws hereafter passed by the State legislatures and rules and regulations hereafter adopted by State commissions.

It invites the States to recklessly make laws and place the burden of their enforcement on the Federal Government. It withdraws the Federal Government from its impartial control of the conflicting interests of States.

It leaves the commerce of States defenseless against the unfriendly legislation of their sister States except as they too may resort to retaliation as a method of defense.

BURDEN ON BUSINESS

This section would impose unwarranted burdens on the sale of securities. The dealer, in addition to establishing his right to engage in interstate commerce by complying with the Federal act, would be forced to register and meet the

individual requirements of each of the 48 States in which he transacts business. That means registration fees, lawyer's fees, and traveling expenses for each filing. That may be accomplished only by vexatious delays and burdensome expense which, in the case of many legitimate stocks, would probably bar their sale in many States.

This Committee properly refused to approve a provision authorizing the commission to pass on the soundness of a security offered for registration. Many of the State laws require the exercise of that power by their commissions. Thus section 18 compels the Federal Government to be responsible for a policy of State control of interstate commerce that it refuses to adopt on its own account. It subjects the dealer in interstate securities to that burden in every State which sees fit to impose it.

SACRIFICES SOUND PRINCIPLES OF FEDERAL REGULATION

The policy, or the lack of policy, of section 18 is not without plausible reasons for its support. It appeals to the disposition of a State to consider an immediate specific local advantage of more worth than the maintenance of sane and just principles of government, which though less personal in their benefits, are deeper and farther reaching in the penalties their violations impose.

The section purports to give the State uniform control of State and interstate securities within its own boundaries. For that meed of contentment it surrenders the wholesome advantages of uniform regulations for its own commerce in each of the other 47 States. It tears down one barrier to the exercise of its power but it builds up 47 other barriers that may rise to harass the commerce of its own people and their sister States. It would surrender that protection of interstate commerce on which the commercial success of the Nation has so largely been builded-free trade, untrammeled commerce between the States.

*29 BURDEN ON ENFORCEMENT

This section would impose an undue burden on the Federal Trade Commission. That Commission would have to serve as a clearing house for information for each of the 48 States. It assumes responsibility for initiating the enforcement of the laws of each State through its own proceedings and through references to the Attorney General.

The diversified laws of 48 States constantely changed by legislative action, judicial interpretations, and rules and regulations of their commissions would provide harassing handicaps not only to the commission but to every person attempting to legitimately sell stock in interstate commerce.

VIOLATES INTERSTATE PRINCIPLE OF REGULATION

The interstate clause of the Constitution is well founded on reason and historical facts.

Under the Articles of Confederation each State regulated interstate commerce. There was no uniform protection or regulation for interstate traffic. The States penalized the commerce of their neighbors and passed retaliatory acts of favoritism to their local commerce and discrimination against that of their sister States. Out of this grew a contention in some States that they would rather be allied with foreign countries than with their sister States in America. Out of this situation grew 'this wretchedness of the commercial relations, between the States at home.' Out of this situation arose the beginning of the great demand of Madison for a Federal Government with 'uniform commercial regulations.'

The Constitution supplanted State control by Federal control of interstate commerce.

The interstate commerce clause of the Constitution is the remdy prescribed by the Constitution for preventing the evils of State control of interstate commerce.

The first conception of that clause is the necessity of uniform regulation.

The second conception is that of the Federal Government as the impartial promoter of interstate commerce and the impartial umpire to protect commerce against the conflicting and selfish policies of the States.

In other words, the interstate commerce clause is founded on a conception of 'my country' instead of 'my State.'

Section 18 violates every principle of the interstate commerce clause. Instead of affording the country the encouragement and aid of a uniform system of regulation, it proposes that Congress shall abdicate that function and surrender to each of the 48 States carte blanche authority to deny protection to this interstate commerce coming into their borders. It subordinates interstate commerce to the whims and diversities of State regulation.

*30 HARMONY OF STATE AND FEDERAL REGULATIONS

The Constitution has attempted to establish livable relations between the State and Federal Governments. That means State control of State affairs, Federal control of interstate affairs.

The State has police power which it may exercise and incidentally and indirectly impose burdens on interstate commerce where necessary for the protection of the health, morals, and safety of its people.

The Federal Government, within the scope of its authority, exercises a police power which may incidentally and indirectly impose burdens on State commerce. The exercise of this police power by each government is a measure of tolerance to fit into our dual form of government. Beyond that, each government is supreme within its own sphere.

Thus the sane plan of the Constitution for harmonizing State and Federal jurisdiction is not joint or independent control of each subject by both governments, but separate control by each government within the sphere of its own jurisdiction.

The Senate committee has wisely omitted this section from its bill. Judge Healy, the attorney for the Federal Trade Commission, has advised the committee of the burden and impracticability of this section, which should be eliminated from the bill.

CLARENCE F. LEA.
SCHUYLER MERRITT.

(Note: 1. PORTIONS OF THE SENATE, HOUSE AND CONFERENCE REPORTS, WHICH ARE DUPLICATIVE OR ARE DEEMED TO BE UNNECESSARY TO THE INTERPRETATION OF THE LAWS, ARE OMITTED. OMITTED MATERIAL IS INDICATED BY FIVE ASTERISKS: *****. 2. TO RETRIEVE REPORTS ON A PUBLIC LAW, RUN A TOPIC FIELD SEARCH USING THE PUBLIC LAW NUMBER, e.g., TO(99-495))

H.R. REP. 73-85, H.R. Rep. No. 85, 73RD Cong., 1ST Sess. 1933, 1933 WL 983 (Leg.Hist.)

End of Document

EXHIBIT C

H.R. REP. 73-85, H.R. Rep. No. 85, 73RD Cong., 1ST Sess. 1933, 1933 WL 983 (Leg.Hist.)

FEDERAL SUPERVISION OF TRAFFIC IN INVESTMENT SECURITIES IN INTERSTATE COMMERCE

May 4, 1933 (To accompany H.R. 5480)

Committed to the Committee of the Whole House on the state of the Union and ordered to be printed

Mr. RAYBURN, from the Committee on Interstate and Foreign Commerce, submitted the following

(CONSULT NOTE FOLLOWING TEXT FOR INFORMATION ABOUT OMITTED MATERIAL. EACH COMMITTEE REPORT IS A SEPARATE DOCUMENT ON WESTLAW.)

HOUSE REPORT NO. 73-85

May 4, 1933

The Committee on Interstate and Foreign Commerce, to whom was referred the bill (H.R. 5480) to provide full and fair disclosure of the character of securities sold in interstate and foreign commerce and through the mails, and to prevent frauds in the sale thereof, and for other purposes, report favorably thereon and recommend that the bill do pass with the following amendments:

Page 6, line 18, strike out 'or any political'.

Page 6, line 19, strike out 'subdivision thereof' and insert 'or by any political subdivision of a State or Territory, or by any public instrumentality of one or more States or Territories exercising an essential governmental function'.

Page 6, line 23, after the words 'national bank,' insert 'or by any banking institution organized under the laws of any State or Territory, the business of which is substantially confined to banking and is supervised by the State or territorial banking commission or similar official;'.

Page 8, line 19, after the word 'underwriter' insert 'and not involving any public offering'.

I. INTRODUCTORY STATEMENT

1. THE PRESIDENT'S MESSAGE

On March 29, 1933, the President sent the following message to Congress:

To the Congress:

I recommend to the Congress legislation for Federal supervision of traffic in investment securities in interstate commerce.

In spite of many State statutes the public in the past has sustained severe losses through practices neither ethical nor honest on the part of many persons and corporations selling securities.

*2 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.

This proposal adds to the ancient rule of caveat emptor, the further doctrine 'let the seller also beware.' It puts the burden of telling the whole truth on the seller. It should give impetus to honest dealing in securities and thereby bring back public confidence.

The purpose of the legislation I suggest is to protect the public with the least possible interference to honest business.

This is but one step in our broad purpose of protecting investors and depositors. It should be followed by legislation relating to the better supervision of the purchase and sale of all property dealt in on exchanges, and by legislation to correct unethical and unsafe practices on the part of officers and directors of banks and other corporations.

What we seek is a return to a clearer understanding of the ancient truth that those who manage banks, corporations, and other agencies handling or using other people's money are trustees acting for others.

FRANKLIN D. ROOSEVELT.

2. THE SITUATION THAT DEMANDS ACTION

The background of the President's message is only too familiar to everyone. During the post-war decade some 50 billions of new securities were floated in the United States. Fully half or $25,000,000,000 worth of securities floated during this period have been proved to be worthless. These cold figures spell tragedy in the lives of thousands of individuals who invested their life savings, accumulated after years of effort, in these worthless securities. The flotation of such a mass of essentially fraudulent securities was made possible because of the complete abandonment by many underwriters and dealers in securities of those standards of fair, honest, and prudent dealing that should be basic to the encouragement of investment in any enterprise. Alluring promises of easy wealth were freely made with little or no attempt to bring to the investor's attention those facts essential to estimating the wroth of any security. High-pressure salesmanship rather than careful counsel was the rule in this most dangerous of enterprises.

Equally significant with these countless individual tragedies is the wastage that this irresponsible selling of securities has caused to industry. Because of the deliberate overstimulation of the appetites of security buyers, underwriters had to manufacture securities to meet the demand that they themselves had created. The result has been that investment bankers with no regard for the efficient functioning of industry forced corporations to accept new capital for expansion purposes in order that new securities might be issued for public consumption. Similarly, real-estate developments would be undertaken, not on the basis of caring for calculated needs but merely as an excuse for the issuance of more securities to satisfy an artificially created market. Such conduct has resulted both in the imposition of unnecessary fixed charges upon industry and in the creation of false and unbalanced values for properties whose earnings cannot conceivably support them. Whatever may be the full catalogue of the forces that brought to pass the present depression, not least *3 among these has been this wanton misdirection of the capital resources of the Nation.

The irresponsibility which fostered this tragic distribution of securities derived in the main from the abnormal profits possible from the business of selling securities. Despite the fact that that business demands the assumption of responsibilities of a character fully equivalent to those of trusteeship, compelling full and fair disclosure not only of the character of the security but of the charges made in connection with its distribution, the literature on the faith of which the public was urged to invest its savings was too often deliberately misleading and illusive. Even dealers through the exertion of high-pressure tactics by underwriters were forced to take allotments of securities of an essentially unsound character and without opportunity to scrutinize their nature. These then would be worked off upon the unsuspecting public. One would have to turn the pages of history back to the days of the South Sea bubble to find an equivalent fantasy of security selling. It is these facts that have led the President, speaking for the Nation, rightly to demand that such a situation can no longer be tolerated.

3. PRINCIPLES OF THE PRESIDENT'S MESSAGE

Because only the dishonest man could object to the principles of the legislation outlined in the President's message, these principles have met with wide approval from the public, investment bankers, dealers, and industry alike. In brief, the aims set forth by the President are:

(1) An insistence that there should be full disclosure of every essentially important element attending the issue of a new security.

(2) A requirement that whatever action taken by the Federal Government for such disclosure should be limited to that purpose and should be so devised as not to be capable of being construed as an approval or guarantee of a security issue.

(3) A demand that the persons, whether they be directors, experts, or underwriters, who sponsor the investment of other people's money should be held up to the high standards of trusteeship.

The achievement of these ends is the principal purpose of this bill.

4. DISCLOSURES REQUIRED

Resting upon the power of Congress under the Constitution over interstate and foreign commerce the bill closes the channels of such commerce to security issues unless and until a full disclosure of the character of such securities has been made. The items required to be disclosed, set forth in detailed form, are items indispensable to any accurate judgment upon the value of the security. But to require a disclosure of these items by the filing of a registration statement with the Federal Trade Commission would be insufficient, if by the mere act of such filing a privilege immediately to sell these securities was granted. High-pressure salesmanship with all its demonstrated evil effects would not even be scotched. Instead, heightened pressure would be exerted to effect the distribution of an issue before the investing public could digest the information demanded. For this reason and because some check should be exercised as to whether *4 or not the disclosures demanded have been made, a period of 30 days intervenes between the act of disclosure by the filing of the registration statement and the date upon which that statement becomes effective so as to permit the sales of the securities registered under it. The type of information required to be disclosed is of a character comparable to that demanded by competent bankers from their borrowers, and has been worked out in the light of these and other requirements. They are, in the judgment of your committee, adequate to bring into the full glare of publicity those elements of real and unreal values which may lie behind a security. To require anything else would permit evasions; but to require these disclosures fulfills the President's demand that 'there is an obligation upon us to insist * * * that no essentially important element attending the issue shall be concealed from the buying public.'

5. THE NONASSUMPTION BY THE FEDERAL GOVERNMENT OF ANY GUARANTEE

The mechanism devised by your committee for compelling disclosures and for insisting that disclosures shall be both adequate and true has been carefully framed, so that neither action nor nonaction by the Federal Trade Commission can be interpreted as a guarantee or approval of any particular security issued. The right to sell a security follows automatically upon the termination of the stipulated period after the filing of the registration statement. Nonaction by the Commission has no effect to disturb the acquisition of this right to sell the security in interstate commerce. Such functions as are given the Commission, with reference to the initial filing of the registration statement, are limited merely to determining whether the information so filed is complete and accurate on its face. The Commission may inquire to see whether the questions that should have been answered have been answered. But with the truth or falsity of the answers the Commission has no initial concern. If the statement is incomplete and inaccurate on its face, the Commission may require that these gaps shall be filled in before the statement is to become effective.

If, in an unusual case, the Commission is of the opinion that the statements made are materially untrue or materially inadequate, the Commission may institute an investigation and after giving an opportunity for a hearing, if convinced that the statements are untrue or inadequate, issue a stop order that will prevent further distribution of the security. The power so to suspend the right of underwriters and dealers to continue selling the security to the public, after proof that the statements upon the face of which the security is sold are false, is essential for the protection of the investing public.

Thus the grant of control to the Federal Trade Commission conveys with it no right to pass upon the merits of any security, but simply to insist that whatever its merits, facts essential to its character are to be disclosed. An additional safeguard against the construction that the Government in any way approves a security registered with the Commission, is the provision of the bill expressly prohibiting any statement that registration of a security with the Commission is evidence either that the requirements of the act have been met or that the Commission has in any way approved the security.

*5 6. THE IMPOSITION OF STANDARDS OF TRUSTEESHIP

The character of civil liabilities imposed by this bill are described in detail elsewhere. Their essential characteristic consists of a requirement that all those responsible for statements upon the face of which the public is solicited to invest its money shall be held to standards like those imposed by law upon a fiduciary. Honesty, care, and competence are the demands of trusteeship. These demands are made by the bill on the directors of the issues, its experts, and the underwriters who sponsor the issue. If it be said that the imposition of such responsibilities upon these persons will be to alter corporate organization and corporate practice in this country, such a result is only what your committee expects. The picture of persons, assumed to be responsible for the direction of industrial enterprises, occupying 50 or more directorships of corporations is the best proof that some change is demanded. Directors should assume the responsibility of directing and if their manifold activities make real directing impossible, they should be held responsible to the unsuspecting public for their neglect. But to require them to guarantee the absolute accuracy of every statement that they are called upon to make, would be to gain nothing in the way of an effective remedy and to fall afoul of the President's injunction that the protection of the public should be achieved with the least possible interference to honest business. Whereas to insist upon the assumption of duties of trusteeship is to return to the ancient truths of fair dealing. The demands of their bill call for the assumption of no impossible burden, nor do they involve any leap into the dark. Similar requirements have for years attended the business of issuing securities in other industrialized nations. They have already been readily assumed in this country by honest and conservative issuers and investment bankers. Instead of impeding honest business, the imposition of liabilities of this character carries over into the general field of security selling, ethical standards of honesty and fair dealing common to every fiduciary undertaking.

II. GENERAL ANALYSIS OF THE BILL

1. ITS SCOPE

The bill affects only new offerings of securities sold through the use of the mails or of instrumentalities of interstate or foreign transportation or communication. It does not affect the ordinary redistribution of securities unless such redistribution takes on the characteristics of a new offering by reason of the control of the issuer possessed by those responsible for the offering. It carefully exempts from its application certain types of securities and securities transactions where there is no practical need for its application or where the public benefits are too remote.

In respect of unexempted security offerings it provides in substance that:

(1) Any such offering is unlawful until-

(a) A registration statement setting forth prescribed information has been filed with the Federal Trade Commission; and

(b) Such 'registration statement' has remained on file for not less than 30 days, subject to public inspection, thereby giving adequate *6 opportunity for appropriate scrutiny by State securities commissions and independent securities services and advisers.

(2) After such waiting period, such securities may be sold through the mails, or through the use of any instrumentalities of interstate or foreign communication or transportation only if the buyer is given a substantial replica of the information included in the 'registration statement'; and if sales are made without giving the buyer such information, or if even after the waiting period the Commission discovers that the 'registration statement' is or has become false, inadequate, or misleading, because it includes an untrue statement of a material fact or omits to state a material fact, the Commission may be stop order, subject to court reviw, temporarily or permanently stop the further sale of such securities.

(3) Newspaper articles, 'tipster's sheets', and other descriptions of or comments upon securities not purporting to offer such securities for sale must disclose any financial interest of the writer or publisher in their sale.

(4) The directors and officers of the issuers, the accountants, appraisers, and other experts authorizing and furnishing the information included in the 'registration statement,' and the underwriters of the offering, are jointly and severally liable to any buyer for rescission of any sale or for damages, if the registration statement or the information given to the buyer in the course of a sale is false or misleading and the defendant cannot prove both that he did not know and by the exercise of due care could not have known of such false or misleading character.

(5) The Commission may apply to the courts to enjoin any device, scheme, or artifice to defraud, employed in connection with the sale in interstate or foreign commerce of any securities, whether new or already outstanding.

2. EXEMPTED SECURITIES AND TRANSACTIONS

The exemption sections, 3 and 4, exempt, among other transactions in securities, transactions by individuals; the execution by brokers of customer's orders in open market; transactions by a dealer in securities not connected by time or circumstance with distribution of a new offering; securities issued in a reorganization subject to the approval of a court; certificates issued by a receivedr or by a trustee in bankruptcy, with the approval of a court; short-term commercial paper; general obligations of the Federal Government and its corporate instrumentalities, of national banks, of the Federal Reserve banks, of State banks (as suggested by a committee amendment), and the States and their political subdivisions; railroad securities subject to the jurisdiction of the Interstate Commerce Commission; insurance policies subject to the supervision of a State insurance commissioner; and the securities of a nonprofit corporation and of certain building and loan associations. The Commission is given a further discretionary power carefully limited to exempt additional transactions and securities where the aggregate amount of the offering does not exeed $100,000. This power is deemed necessary for the effective administration of the bill, but is expected to be used only in a sparing manner, which keeps in mind the prima facie requirement that every security and transaction not specifically exempted by the *7 terms of the bill should be kept within its scope. Section 5(c) also exempts sales within a State of entire issues of local issuers. In view of these exemptions and the restriction of the bill's application to new offerings, the bill does not affect transactions beyond the need of public protection in order to prevent recurrences of demonstrated abuses.

3. THE CHARACTER OF REGISTRATION AND THE CONDITIONS TO ITS EFFECTIVENESS

Sections 5, 6, 7, 8, and 9 include the provisions for the filing of the 'registration statement' with the Commission, the required lapse of an inspection period between the first availability of such information to the public through the

'registration statement' and the time when selling of securities therein described may lawfully commerce, and the power in the Commission to stop the further improper distribution of securities. It should be noted that the Commission is not empowered to affect at any time the validity, as such, of sales already lawfully made.

The information required to be filed in and with the 'registration statement' is set forth in the schedules annexed to the bill. Because of the basic importance of this 'registration statement', both as a source of information to the prospective buyer and as a foundation for civil liability if the information therein given is false or misleading, the requirements of this 'registration statement' have, of course, been designed to reach items of distribution profits, watered values, and hidden interests that usually have not been revealed to the buyer despite their indispensable importance in appraising the soundness of a security. A balance sheet that gives an intelligent idea of the assets and liabilities of the issuer and a profit and loss statement that gives a fair picture of its operations for the preceding 3 years, must be certified by an independent public accountant. The requirements in respect of securities of foreign governments have been worked out with particular care. To assure the necessary knowledge for judgment, the bill requires enumerated definite statements. Mere general power to require such information as the Commission might deem advisable would lead to evasions, laxities, and powerful demands for administrative discriminations. No honestly conceived and intelligently worked out offering, floated at a fair but not exorbitant profit, will be injured by the revelation of the whole truth which these requirements seek to elicit. The requirement of comparable information, at the time of the offering, of many of the most fraudulent issues, in which the public has suffered the greatest losses in late years, would have prevented their flotation. A compulsory revelation of the whole truth will give impetus to honest dealing in securities and help to bring back public confidence.

4. THE WAITING PERIOD

The compulsory 30-day inspection period before securities can be sold is deliberately intended to interfere with the reckless traditions of the last few years of the securities business. It contemplates a change from methods of distribution lately in vogue which attempted complete sale of an issue sometimes within 1 day or at most a few *8 days. Such methods practically compelled minor distributors, dealers, and even salesmen, as the price of practicipation in future issues of the underwriting house involved, to make commitments blindly. This has resulted in the demoralization of ethical standards as between these ultimate sales outlets and the securities-buying public to whom they had to look to take such commitments off their hands. This high-pressure technique has assumed an undue importance in the eyes of the present generation of securities distributors, with its reliance upon delicate calculations of day-to-day fluctuations in market opportunities and its implicit temptations to market manipulation, and must be discarded because the resulting injury to an underinformed public demonstrably hurts the Nation. It is furthermore the considered judgment of this committee that any issue which cannot stand the test of a waiting inspection over a month's average of economic conditions, but must be floated within a few days upon the crest of a possibly manipulated market fluctuation, is not a security which deserves protection at the cost of the public as compared with other issues which can meet this test. There is no more appropriate function of government than that it should encourage reasonable saving by protecting the fruits of that saving.

5. PROSPECTUSES

Section 10 of the bill requires that any 'prospectus' used in connection with the sale of any securities, if it is more than a mere announcement of the name and price of the issue offered and an offer of full details upon request, must include a substantial portion of the information required in the 'registration statement.' The Commission is given power to classify prospectuses according to the nature and circumstance of their use and to prescribe the form and contents appropriate to each class. While a leeway is given to the Commission to meet the varying exigencies of business transactions, fundamental safeguards necessary to insure a fair disclosure are to be preserved.

'Prospectus' is defined in section 2(1) to include 'any prospectus, notice, circular, advertisement, letter, or other communication offering any security for sale.'

The purpose of these sections is to secure for potential buyers the means of understanding the intricacies of the transaction into which they are invited. The full revelations required in the filed 'registration statement' should not be lost in the actual selling process. This requirement will undoubtedly limit the selling arguments hitherto employed. That is its purpose. But even in respect of certain types of listed issues, reputable stock exchanges have already, on their own initiative, recognized the danger of abbreviated selling literature and insisted upon supervising the selling of literature distributed in connection with such issues, to make certain that such literature includes the same information concerning the issue required in a formal circular filed with and approved by such exchanges. Any objection that the compulsory incorporation in selling literature and sales argument of substantially all information concerning the issue, will frighten the buyer with the intricacy of the transaction, states one of the best arguments for the provision. The rank and file of securities buyers who have hitherto bought blindly should be made aware that securities are intricate merchandise.

*9 6. CIVIL LIABILITIES

Section 11 and 12 create and define the civil liabilities imposed by the act and the machinery for their enforcement which renders them practically valuable. Fundamentally, these sections entitle the buyer of securities sold upon a registration statement including an untrue statement or omission of material fact, to sue for recovery of his purchase price, or for danages not exceeding such price, those who have participated in such distribution either knowing of such untrue statement or omission or having failed to take due care in discovering it. The duty of care to discover varies in its demands upon participants in security distribution with the importance of their place in the scheme of distribution and with the degree of protection that the public has a right to expect. The committee is fortified in these sections by similar safeguards in the English Companies Act of 1929. What is deemed necessary for sound financing in conservative England ought not be unnecessary for the more feverish pace which American finance has developed.

The Committee emphasizes that these liabilities attach only when there has been an untrue statement of material fact or an omission to state a material fact in the registration statement or the prospectus-the basis information by which the public is solicited. All who sell securities with such a flaw, who cannot prove that they did not know-or who in the exercise of due care could not have known-of such misstatement or omission, are liable under sections 11 and 12. For those whose moral responsibility to the public is particularly heavy, there is a correspondingly heavier legal liability-the persons signing the registration statement, the underwriters, the directors of the issuer, the accountants, engineers, appraisers, and other professionals preparing and giving authority to the prospectus-all these are liable to the buyer not only if they cannot prove they did not know of the flaw in the information offered the public but also if they cannot prove that they could not have found that flaw 'after reasonable investigation' and that they 'had reasonable ground to believe and did believe * * * that such statement was true or that there was no such omission.' This throws upon originators of securities a duty of competence as well as innocence which the history of recent spectacular failures overwhelmingly justifies. As a proper safeguard, anyone who has been given an apparent responsibility by the terms of the registration statement can avoid subsequent liability only by disclaiming such responsibility in a public way prior to the effective date of the registration statement or at the first opportunity.

The provisions throwing upon the defendant in suits under sections 11 and 12 the burden of proof to exempt himself are indispensable to make the buyer's remedies under these sections practically effective. Every lawyer knows that with all the facts in the control of the defendant it is practically impossible for a buyer to prove a state of knowledge or a failure to exercise due care on the part of defendant. Unless responsibility is to involve merely paper liability it is necessary to throw the burden of disproving responsibility for reprehensible acts of omission or commission on those who purport to issue statements for the public's reliance. The responsibility imposed is no more nor less than that of a trust. It is a responsibility that no honest banker *10 and no honest business man should seek to avoid or fear. To impose a lesser responsibility would nullify the purposes of this legislation. To impose a greater responsibility, apart from constitutional

doubts, would necessarily restrain the conscientious administration of honest business with no compensating advantage to the public.

The constitutionality of the imposition of liabilities of the character provided by the bill raises no serious question. Even though the activities of the particular persons concerned may be actually intrastate in character, they are, nevertheless, an integral part of a process calling for the interstate distribution of securities. Liability is imposed upon them as a condition of the acquisition of the privilege to do business through the channels of interstate or foreign commerce. The statements for which they are responsible, although they may never actually have been seen by the prospective purchaser, because of their wide dissemination, determine the market price of the security, which in the last analysis reflects those manifold causes that are the impelling motive of the particular purchase. The connection between the statements made and the purchase of the security is clear, and, for this reason, it is the essence of fairness to insist upon the assumption of responsibility for the making of these statements.

7. STATE SECURITY LAWS

The bill carefully preserves the jurisdiction of State security commissions to regulate transactions within their own borders. It goes further and makes that control more effective by preventing evasion of State security legislation by the device of selling in interstate or foreign commerce from outside the State. The fact that security dealers who wish to evade State laws have so frequently resorted to methods of selling securities without entering the State and thus never subjecting themselves to State control makes the elimination of this evil imperative.

The bill thus withdraws securities sold in violation of State laws from the protection that the method of selling them in interstate commerce would otherwise give them. It also makes it unlawful to use the instruments of interstate or foreign commerce in an effort to evade protective State legislation. In this aspect the bill builds itself upon existing precedents. Congress, by the Reed amendment of 1917, forbade sellers of intoxicating liquor from shielding their distribution of liquor in violation of State law behind the cloak of interstate commerce. The same principle was approved by this House, with reference to the sale of securities, by the passage of the Denison bill which sought in this respect to effectuate the same end. In the light of these precedents, together with the upholding of the Webb-Kenyon Act by the Supreme Court of the United States in *Clark Distilling Company* v. *Western Maryland Railway Company* (242 U.S. 311) there can be slight doubt as to the existence of a power in the Nation to prevent the use of means, such as interstate commerce, over which it has control, being employed to evade the settled policies of the States, whether these policies concern securities or intoxicating liquor. The right to withdraw protection of the interstate commerce clause from a commodity, because otherwise it would be sold in violation of State law (upheld by the Supreme Court in the Clark Distilling case), implies of necessity a power in the Nation ***11** to punish an attempt to use interstate commerce in defiance of the very purpose for which the protection of the interstate commerce clause was withdrawn. The wisdom of such an exertion of congressional power bases itself upon the uncontested fact that dealers in securities have cleverly organized their means of distributing securities so as to evade State blue-sky legislation by never entering the State. Such a policy does not interfere with legitimate business, but only by a resort to such a policy can interstate commerce be closed to illegitimate business.

III. SUMMARY OF THE BILL BY SECTIONS

SECTION 1. TITLE

This section provides a short title for the bill.

SECTION 2. DEFINITIONS

Paragraph (1) defines the term 'security' in sufficiently broad and general terms so as to include within that definition the many types of instruments that in our commercial world fall within the ordinary concept of a security. The definition is broad enough to include as securities, for example, certificates of interest in oil, gas, or mining leases or royalties. The definition is again comprehensive enough to bring within its terms certificates of deposit issued by protective committees. It also includes warrants or rights to subscribe to a security, so that the control exerted by this bill commences with the initiation of any scheme to sell securities to the public.

Paragraph (2) defines 'person' in terms sufficiently broad to include within that conception not only an individual but also every form of commercial organization that may issue securities. It includes within the concept of 'person' a government or a political subdivision thereof, although later sections of the bill exempt from its provisions securities issued by the United States, a State, or a Territory, or a political subdivision of any of these governmental units. The term 'trust' is defined to exclude the ordinary noncommercial trust but to include that type of organization, commonly known as a 'business trust' or a 'Massachusetts trust', which, without resort to the device of incorporation, is used to achieve many of the purposes of the ordinary business corporation.

Paragraph (3) defines the term 'sale' or 'sell' broadly to include every attempt or offer to dispose of a security for value. It includes within the definition of 'sale' an offer to buy, thereby preventing dealers from making offers to buy between the period of the filing of the registration statement and the date upon which such a statement becomes effective. Otherwise, the underwriter, although only entitled to accept such offers to buy, after the effective date of the registration statement, could accept them in the order of their priority and thus bring pressure upon dealers, who wish to avail themselves of a particular security offering, to rush their orders to buy without adequate consideration of the nature of the security being offered. From the definition of sale, however, is excluded the exchange of an instrument for another instrument which merely evidences exactly the same right embodied in the original instrument, thus exchanges of a stock certificate for another stock certificate of ***12** the same character or of an interim receipt for the permanent security are excluded from the operation of the act. Special care is taken to except from the definition of 'sale' preliminary negotiations and agreements between an issuer and an underwriter. Underwriting agreements can thus be entered into prior to the time of the filing of the registration statement. The exception, however, extends no further than the agreement between issuer and underwriters, so as to delay the actual organization of the selling group and the disposition of the security to the dealers until the registration statement shall have become effective.

This paragraph also exempts from the concept of 'sale' the giving to a holder of a security, at the time of the sale of such security to the holder, a right either to conversion or a warrant to subscribe, where neither of these rights are immediately exercisable. This makes it unnecessary to register such a security prior to the time that it is to be offered to the public, although the conversion right or the right to subscribe must be registered. When the actual securities to which these rights appertain are offered the public, the bill requires registration as of that time. This permits the holder of any such right of conversion or warrant to subscribe to judge whether upon all the facts it is advisable for him to exercise his rights.

Paragraph (4) defines the term 'issuer' not only to include the actual issuer of the security but also the guarantor, if there be such a guarantor, in order that adequate disclosure may be made to the investor as to the worth of any such guaranty. Special provisions govern the definition of 'issuer' in connection with security issues of an unusual character, such as fixed investment trusts and certificates of deposit. In instances of this nature basic securities are acquired by a depositing committee or corporation, which then deposits these securities with a trustee. The trustee actually issues the new securities, which represent an interest in the securities deposited with the trustee. These are then delivered to the depositor and are then distributed by the depositor to the public. Under such an arrangement, although the actual issuer is the trustee, the depositor is the person responsible for the flotation of the issue. Consequently, information relative to the depositor and to the basic securities is what chiefly concerns the investor-information respecting the assets and liabilities of the trust rather than of the trustee. For these reasons the duty of furnishing this information is placed upon the actual manager of the trust and not the passive trustee, and this purpose is accomplished by defining 'issuer' as in such instances referring to the depositor or manager.

Paragraphs (5) and (6) are self-explanatory.

Paragraph (7) defines interstate commerce to include foreign commerce.

Paragraphs (8) and (9) need no detailed explanation.

Paragraph (10) defines 'prospectus' broadly as including any written or radio communication offering a security for sale. Thus communications of this character, by virtue of this definition, must comply with the requirements of section 10. The bill, apart from section 16(b), is not concerned with communications which merely describe a security. It is, therefore, possible for underwriters who wish to inform a selling group or dealers generally of the nature of a security that will be offered for sale after the effective date of the *13 registration statement, to circulate among them full information respecting such a security. This could easily and effectively be done by circulating the offering circular itself, if clearly marked in such a manner as to indicate that no offers to buy should be sent or would be accepted until the effective date of the registration statement. From the definition of 'prospectus' two exceptions are made: The first allows dealers, after they have opened negotiations with a prospective purchaser by giving him the required prospectus, to give him such additional information as they may deem desirable. This additional information, of course, by virtue of the provisions contained in sections 12(2) and 16(a)(2) must not contain fraudulent statements or statements that are themselves untrue, either because of the misstatements that they contain or the facts of a relevant character that are omitted. The second exception to the inclusive definition of 'prospectus' permits the ordinary type of broker and dealer advertising. Brokers and dealers are allowed to advertise a security by name and to state the price at which they will procure it for purchasers, provided that they also inform prospective purchasers where a detailed prospectus can be obtained. To avoid the inclusion in such advertisements of misleading and insufficient statements, dealers and brokers are not permitted to go farther in their advertising, unless they are willing to set forth the detailed statements required by the prospectus. It should be noted in this connection that section 10(b)(4) permits the Commission to prescribe forms for prospectuses to be used in newspaper, periodical, and other general advertising.

Paragraph (11) sets forth the important definition of 'underwriter.' The term is defined broadly enough to include not only the ordinary underwriter, who for a commission promises to see that an issue is disposed of at a certain price, but also includes as an underwriter the person who purchases an issue outright with the idea of then selling that issue to the public. The definition of underwriter is also broad enough to include two other groups of persons who perform functions, similar in character, in the distribution of a large issue. The first of these groups may be designated as the underwriters of the underwriter, a group who, for a commission, agree to take over pro rata the underwriting risk assumed by the first underwriter. The second group may be termed participants in the underwriting or outright purchase, who may or may not be formal parties to the underwriting contract, but who are given a certain share or interest therein.

The term 'underwriter', however, is interpreted to exclude the dealer who receives only the usual distributor's or seller's commission. This limitation, however, has been so phrased as to prevent any genuine underwriter passing under the mark of a distributor or dealer. The last sentence of this definition, defining 'issuer' to include not only the issuer but also affiliates or subsidiaries of the issuer and persons controlling the issuer, has two functions. The first function is to require the disclosure of any underwriting commission which, instead of being paid directly to the underwriter by the issuer, may be paid in an indirect fashion by a subsidiary or affiliate of the issuer to the underwriter. Its second function is to bring within the provisions of the bill redistribution whether or outstanding issues or issues sold subsequently to the enactment of the bill. All the outstanding *14 stock of a particular corporation may be owned by one individual or a select group of individuals. At some future date they may wish to dispose of their holdings and to make an offer of this stock to the public. Such a public offering may possess all the dangers attendant upon a new offering of securities. Wherever such a redistribution reaches significant proportions, the distributor would be in the position of controlling the issuer and thus able to furnish the information demanded by the bill. This being so, the distributor is treated as equivalent to the original issuer and, if he seeks to dispose of the issue through a public offering, he becomes subject to the act. The concept of

control herein involved is not a narrow one, depending upon a mathematical formula of 51 percent of voting power, but is broadly defined to permit the provisions of the act to become effective wherever the fact of control actually exists.

Paragraph (12) defines the term 'dealer' to include not merely the ordinary dealer in securities but also the broker. Transactions by a broker, however, provided that they are true brokerage transactions, are not brought within the scope of the bill by the specific exemptions granted in paragraph (2) of section 4. The sole object of this definition is thus to subject brokers to the same advertising restrictions that are imposed upon dealers, so as to prevent the broker from being used as a cloak for the sale of securities.

SECTION 3. EXEMPTED SECURITIES

This section lists securities that are exempt from the act. Paragraph (1) of subsection (a) exempts securities which prior to 60 days after the enactment of the act have either been sold or disposed of by the issuer or have been bona fide offered to the public. Adequate care is taken to prevent the exemption of securities whose issuance has been authorized prior to this time but which have never been offered to the public. Also the exemption does not apply to any redistribution of outstanding issues which would otherwise come within the act.

Paragraph (2) exempts United States, Territorial, and State obligations, or obligations of any political subdivision of these governmental units. The term 'political subdivision' carries with it the exemption of such securities as county, town, or municipal obligations, as well as school district, drainage district, and levee district, and other similar bonds. The line drawn by the expression 'political subdivision' corresponds generally with the line drawn by the courts as to what obligations of States, their units and instrumentalities created by them, are exempted from Federal taxation. By such a delineation, any constitutional difficulties that might arise with reference to the inclusion of State and municipal obligations are avoided. Securities of instrumentalities of the Government of the United States are also exempted, as well as securities issued by a national bank or by a Federal Reserve bank. Securities issued by Governmental instrumentalities are not generally sold in the market while adequate supervision over the issuance of securities of a national bank is exercised by the Comptroller of the Currency. A committee amendment makes it clear that there are also exempt securities issued by a public instrumentality of one or more State or Territories exercising an essential governmental function.

*15 Paragraph (3) exempts short-term paper of the type available for discount at a Federal Reserve bank and of a type which rarely is bought by private investors.

Paragraph (4) exempts securities of a noncommercial character issued by eleemosynary institutions.

Paragraph (5) exempts the securities of building and loan associations and similar institutions, but insists that such institutions as a condition to being exempt from the act must do a true building and loan business by confining their business to the making of loans to their members.

Paragraph (6) exempts all securities issued by common carriers, the issuance of whose securities is already by virtue of section 20a of the Interstate Commerce Act subject to the control and approval of the Interstate Commerce Commission.

Paragraph (7) exempts receiver's certificates and trustee certificates when such certificates have already been approved by the court under whose control the receiver or trustee acts.

Paragraph (8) makes clear what is already implied in the act, namely, that insurance policies are not to be regarded as securities subject to the provisions of the act. The insurance policy and like contracts are not regarded in the commercial world as securities offered to the public for investment purposes. The entire tenor of the act would lead, even without this specific exemption, to the exclusion of insurance policies from the provisions of the act, but the specific exemption is included to make misinterpretation impossible.

Subsection (b) gives a general authority to the Commission to add to the class of express exemptions any security which because of the small amount involved or the limited character of the public offering should properly be excluded from the provisions of the act. To confer such a power upon the Commission permits the Commission by adequate rules and regulations to provide against needless registration of issues of such an insignificant character as not to call for regulation. This general power of the Commission, however, is closely limited by the requirement that it shall not extend to any issue whose aggregate amount exceeds $100,000. The Commission is thus safeguarded against any untoward pressure to exempt issues whose distribution may carry all the unfortunate consequences that the act is designed to prevent.

SECTION 4. EXEMPTED TRANSACTIONS

The provisions of this section exempt certain transactions from the provisions of section 5, which section requires both the registration of securities as a condition precedent to offering them for sale in interstate or foreign commerce or for transporting them in such commerce, and which section also requires that after the effective date of registration prospectuses relating to such securities shall conform to the requirements of the act.

Paragraph (1) broadly draws the line between distribution of securities and trading in securities, indicating that the act is, in the main, concerned with the problem of distribution as distinguished from trading. It, therefore, exempts all transactions except by an issuer, underwriter, or dealer. Again, it exempts transactions by an issuer unless made by or through an underwriter so as to permit *16 an issuer to make a specific or an isolated sale of its securities to a particular person, but insisting that if a sale of the issuer's securities should be made generally to the public that that transaction shall come within the purview of the act. Recognizing that a dealer is often concerned not only with the distribution of securities but also with trading in securities, the dealer is exempted as to trading when such trading occurs a year after the public offering of the securities. Since before that year the dealer might easily evade the provisions of the act by a claim that the securities he was offering for sale were not acquired by him in the process of distribution but were acquired after such process had ended, transactions during that year are not exempted. The period of a year is arbitrarily taken because, generally speaking, the average public offering has been distributed within a year, and the imposition of requirements upon the dealer so far as that year is concerned is not burdensome. Transactions by an underwriter are not exempted. It is true, however, that there is a point of time when a person who has become an underwriter ceases to exercise any underwriting function and, therefore, ceases to be an underwriter. When that point is reached such a person would be subject only to whatever restrictions would be imposed upon him as a dealer.

Paragraph (2) exempts the ordinary brokerage transaction. Individuals may thus dispose of their securities according to the method which is now customary without any restrictions imposed either upon the individual or the broker. This exemption also assures an open market for securities at all times, even though a stop order against further distribution of such securities may have been entered. Purchasers, provided they are not dealers, may thus in the event that a stop order has been entered, cut their losses immediately, if there are losses, by disposing of the securities. On the other hand, the entry of a stop order prevents any further distribution of the security.

Paragraph (3) exempts stock dividends or additional capital stock distributed among the stockholders of a corporation when such distribution is by way of dividend and not by sale. Any crediting of stock dividends to income is to be disclosed by the issuer in whatever income statement may precede the issuance of a security, together with the basis upon which such credit is computed, by the express provisions of paragraph (26) of Schedule A. This paragraph also exempts the distribution of additional capital stock of a corporation when distributed among its own stockholders provided that no commission is paid in connection with such distribution. This paragraph also exempts the distribution of securities during a bona fide reorganization of a corporation when such reorganization is carried on under the supervision of a court.

Reorganizations carried out without such judicial supervision possess all the dangers implicit in the issuance of new securities and are, therefore, not exempt from the act. For the same reason the provision is not broad enough to include mergers or consolidations of corporations entered into without judicial supervision.

Paragraph (4) exempts subscriptions to the capital stock of a corporation where no expense is incurred or commission paid in connection with the subscriptions. No sales pressure being present in connection with subscriptions of this character and no promotion for pecuniary profit being involved, the reason for their exemption is clear.

*17 SECTION 5. PROHIBITIONS RELATING TO INTERSTATE OR FOREIGN COMMERCE AND THE MAILS

Subject to the exemptions allowed by sections 3 and 4, it is made unlawful for any person to make use of the mails or any means or instruments of interstate or foreign commerce (a) before the effective date of registration, or while the registration is suspended, to sell any security or to carry or cause to be carried any security for the purpose of sale or delivery after sale, and (b) after the effective date of registration to transmit any prospectus relating to the sale of any such security that does not meet the requirements set in section 10, or to carry or cause to be carried any such security for the purpose of sale or delivery after sale, unless accompanied or preceded by a prospectus meeting such requirements.

The provisions of this section as to the use of the mails, however, do not apply to the sale of a security where the issue of which it is a part is sold only to persons resident within a single State, where the issuer is a resident and doing business within such State.

SECTION 6. REGISTRATION OF SECURITIES AND SIGNING OF REGISTRATION STATEMENT

(a) A security may be registered so as to permit its sale by use of the mails or instruments of interstate and foreign commerce by filing a registration statement in triplicate with the Federal Trade Commission. The registration statement must be signed by the issuer, its principal executive, financial and accounting officers, and by a majority of its board of directors. When the issuer is a foreign or territorial person, the statement must be signed by its duly authorized representative in the United States, except that in case of a foreign government or political subdivision thereof, it need only be signed by the underwriter.

(b) At the time of filing, the applicant must pay a fee of one hundredth of 1 per centum of the maximum aggregate price at which the securities are proposed to be offered, but in no case less than $50.

(c) The filing of a registration statement or of an amendment takes place upon the receipt thereof or if forwarded in the United States by registered mail, upon the mailing thereof.

(d) The information contained or filed with any registration statement shall be available to the public under appropriate regulations of the Commission, and copies, printed, photostatic, or otherwise, shall be furnished to anyone who applies therefor at a reasonable charge.

(e) No registration statement may be filed within 30 days after the enactment of the act.

SECTION 7. INFORMATION REQUIRED IN REGISTRATION STATEMENT

The registration statement when relating to a security other than a security issued by a foreign government, or political subdivision thereof, shall contain the information and be accompanied by the documents specified in schedule A and when relating to the security of a foreign government or political subdivision thereof the information and

documents specified in schedule B. The Commission, however, may by its rules and regulations provide that any such information *18 or documents need not be included in respect to a class of issuers or securities if it finds that such information or documents are inapplicable to such class and that disclosure fully adequate for the protection of investors is otherwise required. The Commission may further provide by its rules and regulations for the inclusion of such additional information and documents as it may deem necessary or appropriate to effectuate the purposes of the act.

The requirements of schedule A, relating principally to corporate securities, may be briefly summarized as follows:

(1) The investor must be given these essential facts concerning the property in which he is invited to acquire an interest:

(a) The name, locality, and character of the business.

(b) A detailed statement of the capitalization of the issuer with a description of the rights of the holders of the various classes of securities.

(c) The specific purposes for which the security to be offered is to supply the funds.

(d) A list, and the general effect concisely stated, of all material contracts, not made in the ordinary course of the business, including all management contracts, profit-sharing arrangements, and contracts for the giving or receiving of technical or financial advice or service.

(e) A balance sheet that will give an intelligent idea of the assets and liabilities of the issuer, in such form and such detail as the Commission may prescribe.

(f) A profit and loss statement that will give an intelligent idea of the earnings and operations of the issuers for at least 3 years, year by year, in such form and in such detail as the Commission may prescribe.

(2) The investor must be given these essential facts concerning the identity and the interests of the persons with whom he is dealing or to whom the management of his investment is entrusted:

(a) The names of the promoters, directors, and principal executive, financial and accounting officers of the issuer, and the names of the underwriters and of all persons owning more than 10 percent of any class of stock or more than 10 percent in the aggregate of all stock, together with a statement of the amount of the securities of issuer held by all such persons as of the date of the filing of the registration statement and as of 1 year prior thereto.

(b) A statement of the securities of the issuer covered by options and the names of any persons holding more than 10 percent of such options.

(c) The remuneration paid the directors during the past year, and to be paid during the ensuing year and the remuneration to officers or other persons, exceeding $25,000 per year during any such year.

(d) All commissions paid or to be paid to the underwriters.

(e) Any amounts paid within 2 years to any promoter and the consideration therefor.

(f) Particulars concerning the acquisition of any property acquired or to be acquired, not in the ordinary course of the business, to be paid in whole or in part out of the proceeds of the security to be offered, the names of the vendors and the interest of any director, officer, or principal stockholders of the issuer in any such property.

(g) Names of counsel approving legality of the issue.

*19 (3) The investor must be given these essential facts in regard to the price and cost of the security he is buying and its relation to the price and cost of earlier offerings:

(a) Estimated net proceeds to be derived from the security offered.

(b) Proposed price of security to be offered to the public.

(c) Estimated amount of expenses in connection with the sale of the security.

(d) Net proceeds from any security of the issuer sold during the preceding 2 years, price at which such security was offered to the public, and the names of the underwriters.

The requirements of schedule B relating to securities of a foreign government or political subdivision thereof may be briefly summarized as follows:

(1) The investor must be given these essential facts concerning the borrowing government or subdivision thereof:

(a) The name of the borrower and authorized agent, if any, in the United States.

(b) A description of the funded and floating debt of the borrower and a statement of the terms of the loan to be floated and of the security therefor.

(c) Any default in the principal or interest of any external obligation during the preceding 20 years and the terms of any succeeding arrangement.

(d) The specific purposes of the loan.

(e) The receipts, reasonably classified by source, and the expenditures, reasonably classified by purpose, in such detail and form as the Commission may prescribe, for the preceding 3 years, year by year.

(2) The investor must be given these essential facts with regard to the underwriters and counsel:

(a) The names of the underwriters, and all commissions paid or to be paid to such underwriters.

(b) The names of counsel approving the legality of the issue.

(3) The investor must be given these essential facts in regard to the price and cost of the security he is buying:

(a) The estimated proceeds to be derived from the sale in the United States of the security to be offered.

(b) The price at which the security is to be offered to the public in the United States.

(c) The estimated amount of the expenses to be incurred in connection with the sale of the security to be offered.

Schedules A and B are to be accompanied by important documents such as the underwriting agreements, opinions of counsel, and the underlying indentures and agreements in regard to the securities of the issuer.

SECTION 8. TAKING EFFECT OF REGISTRATION STATEMENTS AND AMENDMENTS THERETO

(a) The registration statement becomes effective 30 days after filing. If any amendment is filed prior to the effective date of the registration statement, the registration statement is deemed to have been filed when the amendment was filed; except that an amendment filed with the consent of the Commission prior to the effective date of the registration statement, is treated as if filed with the original *20 statement. This subdivision, as has been explained above, is to afford a waiting or cooling period of 30 days so as to eliminate many of the abuses connected with high-pressure salesmanship and the sale of securities to the public under circumstances permitting an inadequate examination by informed critics of the essential facts.

(b) If it appears to the Commission that a registration statement is on its face incomplete or inaccurate in any material respect, the Commission may, after confirmed telegraphic notice not later than 20 days after the filing of the registration statement and opportunity for hearing within 10 days after such notice, issue an order prior to the effective date of registration refusing to permit such statement to become effective until it has been amended in accordance with such order. When the statement has been amended in accordance with such order the Commission shall so declare and the registration shall become effective at the time provided in subsection (*a*) or upon the date of such declaration, whichever date is the later. This subsection is intended to enable the Commission to make a preliminary check-up of any obvious departures from the standards set by the law without imposing upon the Commission any responsibility as to the truth of the registration statement or as to the soundness of the securities to be offered thereunder.

(c) If an amendment filed after the effective date of the registration statement appears to the Commission to be not incomplete or inaccurate on its face, it becomes effective on such date as the Commission may determine, having regard to the public interest and the protection of investors.

(d) If it appears to the Commission at any time that the registration statement includes any untrue statement of a material fact or omits to state any material fact, the Commission may, after the sending of confirmed telegraphic notice after opportunity for hearing within 15 days after such notice, issue a stop order suspending the effectiveness of the registration statement. When such statement has been amended to meet the objections of the Commission, the Commission shall so declare, and thereupon the stop order shall cease to be effective. In determining whether a stop order should issue, the Commission will naturally have regard to the facts as they then exist and will stop the further sale of securities even though the registration statement was true when made, it has become untrue or misleading by reason of subsequent developments. This subdivision is intended to enable the Commission to prevent any imposition upon its authority by the filing of any untrue, inadequate, or misleading statement. At the same time, it limits the scope of the issues to be considered by the Commission on any stop order and thereby avoids any undue interference with private rights.

(e) The Commission is given adequate power to make a complete examination in order to determine whether a stop order should issue. If any issuer, representative, or underwriter fails to cooperate, or obstructs or refuses to permit the making of an examination, such conduct is proper ground for the issuance of a stop order.

(f) Any notice under this section shall be sent to the issuer, or in case of a foreign government, to the underwriter, or in case of a foreign or territorial person to its authorized representative in the United States.

*21 SECTION 9. COURT REVIEW OF ORDERS

Any person aggrieved by an order of the Commission may obtain a review of such order on questions of law in the Court of Appeals of the District of Columbia. The jurisdiction of such court is exclusive, and its judgment and decree

final, subject to review by the Supreme Court of the United States. Proceedings before the court, unless specifically ordered by the court, do not operate as a stay of any order of the Commission.

SECTION 10. INFORMATION REQUIRED IN PROSPECTUS

(a) A prospectus must contain the same statements made in the registration statement, except that the documents accompanying the registration statement need not be included.

(b) Notwithstanding the provisions of subsection (*a*), (1) when a prospectus is used more than 12 months after the effective date of the registration statement, the information contained therein must be of a date not more than 12 months prior to its use, (2) there may be omitted from the prospectus any of the statements that would otherwise be required under subsection (*a*), which the Commission may by rules and regulations designate as not being necessary or appropriate in the public interest or for the protection of investors, and (3) the prospectus must contain such other information as the Commission may by rules or regulations require as being necessary or appropriate in the public interest or for the protection of investors. The Commission is given power to classify prospectuses according to the nature and circumstances of their use and to prescribe as to each class the form and contents which it may find appropriate to such use and consistent with the public interest and protection of investors. Copies of all radio broadcasts must be filed with the Commission, and the Commission may by rules and regulations require the filing with it of forms of prospectuses used or to be used in connection with the sale of any securities registered under the act.

SECTION 11. CIVIL LIABILITIES ON ACCOUNT OF FALSE REGISTRATION STATEMENT

(a) In case any part of the registration statement contained, at the time it became effective, an untrue statement of a material fact or omitted to state a material fact, any person who shall have acquired such security (unless it be proved that at the time of the acquisition he knew of such untruth or omission) is given the right to sue either at law or in equity in any court of competent jurisdiction-(1) every person who signed the registration statement; (2) every person who was a director of (or person performing similar functions) or partner in, the issuer at the time of the filing of the registration statement; (3) every person who with his consent is named in the registration statement as being or about to become a director, a person performing similar functions, or a partner; (4) every accountant, engineer, or appraiser, or any person whose profession gives authority to a statement made by him, who has prepared or certified any part of the registration statement, with respect to the part prepared or certified by him; (5) every underwriter.

***22** Inasmuch as the value of a security may be affected by the information given in the registration statement, irrespective of whether a particular sale takes place in interstate or intrastate commerce, the civil remedies accorded by this subsection against those responsible for a false or misleading statement filed with the Federal Trade Commission are given to all purchasers regardless of whether they bought their securities in an interstate or intrastate transaction and regardless of whether they bought their securities at the time of the original offer or at some later date, provided, of course, that the remedy is prosecuted within the period of limitations provided by section 13. In this connection, it must be borne in mind that no one is obliged to register a security under this act unless he desires to make use of the mails or of the channels of interstate or foreign commerce in the distribution of the security. But if a person does avail himself of the privilege of registration accorded by this act, it is obviously within the constitutional power of Congress to accord a remedy to all purchasers who may reasonably be affected by any statements in the registration statement. The separability clause in section 25 of the bill makes certain that congressional power in this instance has been vested as far and to whatever circumstances the Constitution allows.

(b) The provisions of subsection (a), however, do not impose an absolute liability. Any person liable under such subsection, other than an issuer, may exempt himself if he sustains the burden of proof-

(1) That before the effective date of the registration statement with respect to which his liability is asserted (A) he had resigned from or had taken steps permitted by law to resign from or ceased or refused to act in, every official capacity or relationship in which he was described in the registration statement as acting or agreeing to act; (B) he had advised the Commission and the issuer in writing that he had taken such action and that he would not be responsible for such registration statement (of course, the Commission upon being so advised would not permit a registration statement to become effective until the name of the person disavowing responsibility was removed from the registration statement and the Commission would be put on its guard, unless such disavowal was clearly explained, to investigate the truth and adequacy of the statement); or

(2) That if the registration statement became effective without his knowledge, upon becoming aware of such fact, he forthwith acted and advised the Commission, in accordance with paragraph (1), and in addition gave reasonable public notice that the registration statement had become effective without his knowledge; or

(3) That as regards any part of the registration statement not purporting to be made on the authority of an expert, and not purporting to be a copy of or extract from a report or valuation of an expert, and not purporting to be made on the authority of a public official document or statement, he had, after reasonable investigation, reasonable ground to believe and did believe, at the time such registration statement became effective, that the statements therein were true and that there was no omission to state a material fact; and as regards any part of the registration statement purporting to be made on the authority of an expert, or purporting to be a copy of or extract from a report or valuation of an expert, or purporting to be made on the authority of a public official document or statement, he had ***23** reasonable ground to believe and did believe, at the time the registration statement became effective, that the statements therein were true and that there was no omission to state a material fact, and that the registration statement fairly represented the statement of the expert or of the official person, or was a fair copy of or extract from the report or valuation of the expert, or was a fair copy of or extract from the public official document.

(c) In determining for the purpose of paragraph (3) of subsection (*b*) of this section what constitutes reasonable investigation and reasonable ground for belief, the standard of reasonableness shall be that required of a person occupying a fiduciary relationship. While subsections (*b*) and (*c*) permit a person who has conscientiously and with competence met the responsibilities of his trusteeship to be relieved of liability, they prevent any person who has not fulfilled his trust from escaping liability by any trick of procedure or unjustified delegation of his duties.

(d) If any person becomes an underwriter after the part of the registration statement with respect to which his liability is asserted, has become effective, then for the purposes of paragraph (3) of subsection (*b*) such part of the registration statement is considered as having become effective with respect to him as of the time when he became an underwriter.

(e) Suits authorized under subsection (*a*) may be either (1) to recover the consideration paid for such securities with interest thereon, less the amount of any income received thereon, upon the tender of such security, or (2) for damages if the person suing no longer owns the security.

(f) All or any one or more of the persons specified in subsection (*a*) are jointly and severally liable, but contribution is allowed amoung them as in cases of contract, unless the person who has become liable was, and the other was not, guilty of fraudulent misrepresentation.

(g) In no case is the amount recoverable under this section to exceed the price at which the security was offered to the public.

SECTION 12. CIVIL LIABILITIES ARISING IN CONNECTION WITH PROSPECTUSES AND COMMUNICATIONS

If any person (1) sells a security in violation of section 5, or (2) sells a security, whether or not exempted by section 3, by the use of the instruments of interstate or foreign commerce or of the mails by means of a prospectus or oral communication which includes an untrue statement of a material fact or omits to state a material fact (the purchaser not knowing of such untruth or omission) and does not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission, he is made liable to the person purchasing such security from him, and the purchaser may sue either at law or in equity in any court of competent jurisdiction to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security. The committee has deemed this shift in the burden of proof as both just and necessary, inasmuch as the knowledge of the seller as to any flaw in his selling statements *24 or the failure of the seller to exercise reasonable care are matters in regard to which the seller may readily testify, but in regard to which the buyer is seldom in a position to give convincing proof.

SECTION 13. LIMITATION OF ACTIONS

No action may be maintained to enforce any liability created under section 11 or 12 of this act unless brought within 2 years after the discovery of the untrue statement or of the omission, or after the discovery should have been made by the exercise of reasonable diligence, or, if the action is based upon a violation of section, unless brought within 2 years after such violation. In no event may any action be brought after 10 years after the security was offered to the public.

SECTION 14. CONTRARY STIPULATIONS VOID

Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of the act or of the rules and regulations of the Commission is made void.

SECTION 15. ADDITIONAL REMEDIES

The rights and remedies provided by the act are in addition to any and all other rights and remedies that may exist at law or in equity.

SECTION 16. FRAUDULENT INTERSTATE TRANSACTIONS

(a) It is made unlawful for any person in the sale of any securities by the use of any means or instruments of interstate or foreign commerce or by use of the mails (1) to employ any device, scheme, or artifice to defraud, (2) to obtain money or property by means of any untrue statement of, or omission to state, a material fact, or (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud upon the purchaser.

(b) It is made unlawful for any person, by use of any means or instruments of interstate or foreign commerce or by use of the mails, to publish, give publicity to, or circulate, any advertisement, newspaper, article, letter, investment service, or communication which, though not purporting to offer a security for sale, describes such security, for a consideration received or to be received, directly or indirectly, from an issuer, underwriter, or dealer, without fully disclosing the receipt, whether past or prospective, of such consideration and the amount thereof. This subsection is particularly designed to meet the evils of the 'tipster sheet', as well as articles in newspaper or periodicals that purport to give an unbiased opinion but which opinions in reality are bought and paid for.

(c) The exemptions provided in section 3 of the act do not apply to this section.

SECTION 17. STATE CONTROL OF SECURITIES

Nothing in this act is intended to affect the jurisdiction of the security commission (or any agency or office performing like functions) of any State over any security or any person.

*25 SECTION 18. UNLAWFUL SENDING INTO STATES

(a) It is made unlawful for any person to make use of the mails or any means or instruments of interstate commerce to sell or deliver any security to any person in any State, where such sale or delivery, if it had taken place wholly within such State, would be in violation of the laws thereof relating to the sale of securities.

(b) The exemptions provided in section 3 of this act do not apply to this section.

SECTION 19. SPECIAL POWERS OF COMMISSION

(a) The Commission is given full power and authority to make, amend, and rescind such rules and regulations as may be necessary to carry out the provisions of the act, including rules and regulations governing registration statements and prospectuses for various classes of securities and issuers and defining accounting and trade terms used in the act. The Commission further is given authority to prescribe the forms in which required information shall be set forth and the methods to be followed in the preparation of accounts.

(b) For the purpose of investigations under the act, the Commission or officers designated by it are empowered to subpena witnesses, examine them under oath, and require the production of books, papers, and documents.

SECTION 20. INJUNCTION AND PROSECUTION OF OFFENSES

The Commission is given power, upon complaint or otherwise, to make investigations if it appears to the Commission that the provisions of this act or any rule or regulation prescribed under authority thereof have been or are about to be violated. Whenever it appears to the Commission that the transactions investigated constitute or will constitute a violation of the act or any rule or regulation prescribed thereunder, it may bring an action in the district court of the United States, the United States court of any Territory, or the Supreme Court of the District of Columbia to enjoin the continuance of such transactions, and it may transmit such evidence as may be available to the Attorney General who may institute the necessary criminal proceedings under this act. Any such civil or criminal proceeding may be brought either in the district where the transmitter of the prospectus or security begins or in the district where such prospectus or security is received.

SECTION 21. JURISDICTION OF OFFENSES AND SUITS

(a) The district courts of the United States, the United States courts of any Territory, and the Supreme Court of the District of Columbia are given jurisdiction of offenses and violations under this act and, concurrent with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by this act. Any such suit or action may be brought in the district wherein the defendant is an inhabitant or has its principal place of business or in the district where the sale took place if the defendant participated therein and process therein may be served in the district of which the defendant is an inhabitant or wherever the *26 defendant may be found. Judgments and decrees so rendered are subject to review as provided in sections 128 to 240 of the Judicial Code. No case arising under this act and brought in any State court of competent jurisdiction is removable to any court of the United States.

(b) In case of contumacy or refusal to obey a subpena issued to any person, any of the said United States courts within the jurisdiction of which said person resides, upon application by the Commission, may issue to such person an order requiring such person to appear before the Commission or one of its commissioners, there to testify or produce evidence; and any failure to obey such order of the court may be punished as a contempt.

(c) No person shall be excused from testifying or producing evidence before the Commission on the ground that the testimony or evidence may tend to incriminate him or subject him to a penalty or forfeiture; but no person shall be prosecuted or subject to a penalty or forfeiture for or on account of any transaction concerning which he is compelled to testify or produce evidence, except that such person so testifying shall not be exempt from prosecution or punishment for perjury.

SECTION 22. UNLAWFUL REPRESENTATIONS

Neither the fact that the registration statement for a security has been filed or is in effect, nor the fact that a stop order is not in effect in respect thereof shall be deemed a finding by the Commission that the registration 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 be held to mean that the Commission has in any way passed on the merits of, or given approval to, such security. It is unlawful to make to any prospective purchaser any representation contrary to the provisions of this section.

SECTION 23. PENALTIES

Any person who willfully violates any of the provisions of this act or the rules and regulations promulgated under authority thereof, or who willfully, in a registration statement filed under this act, makes any untrue statement of a material fact or omits to state a material fact shall, upon conviction, be fined not more than $5,000 or imprisoned for not more than 5 years, or both.

SECTION 24. JURISDICTION OF OTHER GOVERNMENT AGENCIES OVER SECURITIES

Nothing in this act is to be construed to relieve any person from submitting to the respective supervisory units of the Government of the United States information, reports, or other documents that are now or may hereafter be required by any law of the United States.

SECTION 25. SEPARABILITY OF PROVISIONS

If any provision of this act or the application of such provision to any person or circumstance shall be held invalid, the remainder of this act or the application of such provision to persons or circumstances other than those as to which it is held invalid, shall not be affected thereby.

*27 MINORITY VIEWS

This bill follows a commendable and constructive purpose to provide a uniform and protective plan of national control for the marketing of interstate securities.

Section 18, however, injects a destructive principle which detracts from the value of the general scheme of constructive control. It destroys the uniformity of the plan of regulation by giving each State arbitrary control of the sale of interstate securities within its boundaries.

This section also denies the Federal Government its proper function of acting as arbiter between the States in the regulation of interstate commerce.

This section also makes the Federal Government responsible for the enforcement of various laws of the States affecting the sale of interstate securities. It will result in burdensome and vexatious handicaps in the administration of the law and in the transaction of the business it regulates.

SCOPE OF SECTION 18

In substance this section makes its unlawful to sell any interstate security in any State where such sale would be unlawful if it had taken place wholly within that State.

A newspaper or radio advertisement of such a security in interstate commerce, published within such State, is made a criminal offense.

Under section 23 any person who willfully violates any of the provisions of the act commits a Federal offense. Thus a violation of any State law under section 18 is made a severe Federal offense, punishable by the Federal Government at its expense.

Under a State law the maximum penalty for a specific violation of its blue-sky law might be $50. Under this bill the Federal maximum penalty for the same act would be $5,000 or imprisonment for 5 years.

Section 18 makes the Federal Government the enforcing agency for legislation of the State without any discretion as to the wisdom of the State laws. It is proposed that Congress shall give a blindfolded approval thereof.

The State laws that may be violated are largely created by the rules and regulations of State commissions which are subject to constant change without any reference to the uniformity of interstate regulations.

Under section 20 it is the duty of the Commission to apply for injunctions to enforce the provisions of the act which would include the blue-sky laws of every State.

Under the same section it is the duty of the Attorney General to institute criminal prosecutions of violation of the act which includes State laws.

*28 The Federal Government is made to assume the burden of prosecuting criminal offenses created without the knowledge or consent of Congress. This section attempts to prospectively approve laws hereafter passed by the State legislatures and rules and regulations hereafter adopted by State commissions.

It invites the States to recklessly make laws and place the burden of their enforcement on the Federal Government. It withdraws the Federal Government from its impartial control of the conflicting interests of States.

It leaves the commerce of States defenseless against the unfriendly legislation of their sister States except as they too may resort to retaliation as a method of defense.

BURDEN ON BUSINESS

This section would impose unwarranted burdens on the sale of securities. The dealer, in addition to establishing his right to engage in interstate commerce by complying with the Federal act, would be forced to register and meet the

individual requirements of each of the 48 States in which he transacts business. That means registration fees, lawyer's fees, and traveling expenses for each filing. That may be accomplished only by vexatious delays and burdensome expense which, in the case of many legitimate stocks, would probably bar their sale in many States.

This Committee properly refused to approve a provision authorizing the commission to pass on the soundness of a security offered for registration. Many of the State laws require the exercise of that power by their commissions. Thus section 18 compels the Federal Government to be responsible for a policy of State control of interstate commerce that it refuses to adopt on its own account. It subjects the dealer in interstate securities to that burden in every State which sees fit to impose it.

SACRIFICES SOUND PRINCIPLES OF FEDERAL REGULATION

The policy, or the lack of policy, of section 18 is not without plausible reasons for its support. It appeals to the disposition of a State to consider an immediate specific local advantage of more worth than the maintenance of sane and just principles of government, which though less personal in their benefits, are deeper and farther reaching in the penalties their violations impose.

The section purports to give the State uniform control of State and interstate securities within its own boundaries. For that meed of contentment it surrenders the wholesome advantages of uniform regulations for its own commerce in each of the other 47 States. It tears down one barrier to the exercise of its power but it builds up 47 other barriers that may rise to harass the commerce of its own people and their sister States. It would surrender that protection of interstate commerce on which the commercial success of the Nation has so largely been builded-free trade, untrammeled commerce between the States.

*29 BURDEN ON ENFORCEMENT

This section would impose an undue burden on the Federal Trade Commission. That Commission would have to serve as a clearing house for information for each of the 48 States. It assumes responsibility for initiating the enforcement of the laws of each State through its own proceedings and through references to the Attorney General.

The diversified laws of 48 States constantely changed by legislative action, judicial interpretations, and rules and regulations of their commissions would provide harassing handicaps not only to the commission but to every person attempting to legitimately sell stock in interstate commerce.

VIOLATES INTERSTATE PRINCIPLE OF REGULATION

The interstate clause of the Constitution is well founded on reason and historical facts.

Under the Articles of Confederation each State regulated interstate commerce. There was no uniform protection or regulation for interstate traffic. The States penalized the commerce of their neighbors and passed retaliatory acts of favoritism to their local commerce and discrimination against that of their sister States. Out of this grew a contention in some States that they would rather be allied with foreign countries than with their sister States in America. Out of this situation grew 'this wretchedness of the commercial relations, between the States at home.' Out of this situation arose the beginning of the great demand of Madison for a Federal Government with 'uniform commercial regulations.'

The Constitution supplanted State control by Federal control of interstate commerce.

The interstate commerce clause of the Constitution is the remdy prescribed by the Constitution for preventing the evils of State control of interstate commerce.

The first conception of that clause is the necessity of uniform regulation.

The second conception is that of the Federal Government as the impartial promoter of interstate commerce and the impartial umpire to protect commerce against the conflicting and selfish policies of the States.

In other words, the interstate commerce clause is founded on a conception of 'my country' instead of 'my State.'

Section 18 violates every principle of the interstate commerce clause. Instead of affording the country the encouragement and aid of a uniform system of regulation, it proposes that Congress shall abdicate that function and surrender to each of the 48 States carte blanche authority to deny protection to this interstate commerce coming into their borders. It subordinates interstate commerce to the whims and diversities of State regulation.

*30 HARMONY OF STATE AND FEDERAL REGULATIONS

The Constitution has attempted to establish livable relations between the State and Federal Governments. That means State control of State affairs, Federal control of interstate affairs.

The State has police power which it may exercise and incidentally and indirectly impose burdens on interstate commerce where necessary for the protection of the health, morals, and safety of its people.

The Federal Government, within the scope of its authority, exercises a police power which may incidentally and indirectly impose burdens on State commerce. The exercise of this police power by each government is a measure of tolerance to fit into our dual form of government. Beyond that, each government is supreme within its own sphere.

Thus the sane plan of the Constitution for harmonizing State and Federal jurisdiction is not joint or independent control of each subject by both governments, but separate control by each government within the sphere of its own jurisdiction.

The Senate committee has wisely omitted this section from its bill. Judge Healy, the attorney for the Federal Trade Commission, has advised the committee of the burden and impracticability of this section, which should be eliminated from the bill.

CLARENCE F. LEA.
SCHUYLER MERRITT.

(Note: 1. PORTIONS OF THE SENATE, HOUSE AND CONFERENCE REPORTS, WHICH ARE DUPLICATIVE OR ARE DEEMED TO BE UNNECESSARY TO THE INTERPRETATION OF THE LAWS, ARE OMITTED. OMITTED MATERIAL IS INDICATED BY FIVE ASTERISKS: *****. 2. TO RETRIEVE REPORTS ON A PUBLIC LAW, RUN A TOPIC FIELD SEARCH USING THE PUBLIC LAW NUMBER, e.g., TO(99-495))

H.R. REP. 73-85, H.R. Rep. No. 85, 73RD Cong., 1ST Sess. 1933, 1933 WL 983 (Leg.Hist.)

End of Document