

## THE FEDERAL SECURITIES CODE AND ITS EFFECTS ON EXISTING UNITED STATES SECURITIES REGULATION

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The proposed Federal Securities Code [1] is the extraordinary result of ten years of careful analysis and debate by the American Law Institute, the American Bar Association, and the Reporter for the Code, Professor Louis Loss of the Harvard Law School. It is a consolidation and simplification of six separate federal securities statutes [2], and is therefore the realization of a dream for lawyers, scholars and others who have worked with the federal securities laws and wished for a time when the acts might be simplified and integrated into one statute [3]. Whether or not the proposed legislation is in fact adopted, the quality of the work underlying it merits careful consideration of its treatment of the regulation of securities in the United States. This article discusses the need for, the movement toward, and the process of codification. Thereafter, it describes the structure of the Code and some of the important changes the Code would effect in the law. Finally, it examines the extra-territorial application of the Code.

### 1. Introduction

#### *1.1. The need for codification*

The legislative reaction to abuses in the purchase and sale of securities during the 1920s produced, between 1933 and 1940, six federal statutes regulating various aspects of securities transactions and the securities markets. On the whole, these laws have worked well. However, as is perhaps inevitable during a period of legislative revolution, inexplicable inconsistencies have been found to exist between comparable provisions of these various laws. Such inconsistencies have led to some confusion both among members of the bar and the judiciary. Consequently, there has gradually developed considerable support for the codification of these laws into a single piece of legislation, the effect of which would be to eliminate existing overlaps and inconsistencies and to reexamine the entire scheme of investor protection with a view toward improving efficiency of regulation.

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### 1.2. *The movement toward codification*

The idea of codification has a lengthy history. However, no action was taken to begin a codification project until 1966 when, following publication of Milton Cohen's landmark article, "*Truth in Securities*" Revisited [4], the American Bar Association Committee on Federal Regulation of Securities held a two-day conference on codification. At that conference it was evident that there was a strong desire for the codification effort to begin in earnest [5]. By 1969 the effort was undertaken under the auspices of the American Law Institute.

### 1.3. *The codification process*

The proposed official draft of the Federal Securities Code, approved by the American Law Institute in May 1978 and by the American Bar Association in February 1979, is the product of six tentative drafts, each of which was reviewed and approved by the American Law Institute and each of which was the subject of a significant number of proposed tentative drafts which were analyzed and commented upon by many individual experts in the field of securities law. The Reporter of the project, Professor Louis Loss, was assisted primarily by three groups of advisers: (a) a small group of consultants; (b) a larger group of advisers, including seven former SEC commissioners and distinguished members of the judiciary, academia and the bar; and (c) the American Bar Association's Committee on Federal Regulation of Securities, which consists of approximately 300 lawyers whose professional interests lie primarily in the area of securities law [6]. In addition, the Reporter consulted with a number of persons who had particular expertise and interest in certain technical parts of the Code and with various staff members of the Securities and Exchange Commission and of the appropriate congressional subcommittees.

Enormous time and expense have been invested into the drafting process. This can be appreciated from the fact that the American Law Institute spent over \$ 450,000 in connection with the drafting process and that the estimated dollar value of the time contributed by private practitioners who participated in the project represents an amount in excess of \$ 3,000,000 [7].

In spite of the fact that few pieces of proposed legislation will come to the United States Congress with as much expert work behind them as the proposed Federal Securities Code, and despite the endorsement of the American Law Institute and the American Bar Association, the proposed official draft of the Federal Securities Code is not assured of being enacted into law. Support of the Securities and Exchange Commission is critical and strong opposition by the Commission would seriously if not totally undermine any hope of the Code being officially enacted into law. The Commission's staff has conducted an intensive and critical review of the Code and the Commission itself is presently formulating its official position on the Code. It is highly likely that the Commission's views on the Code

will result in some significant changes and compromises in various parts. Also, many interest groups will try to get one or another part changed. Congress will try to accommodate these suggestions as it considers the Code.

Even though the Code is neither in its final form nor yet enacted into law, it has exerted considerable influence on concerned members of the United States legal community. Numerous commentators have studied and discussed various portions of the Code [8].

Most of the published commentary on the Code to date has been concerned primarily with describing the differences between the Code and existing law and with suggesting technical changes in the Draft. However, there has been criticism [9] and at least one broad-based attack on the Code from a private practitioner who contends that:

[F]irst, the Code grants too much power to the Securities and Exchange Commission to formulate, interpret, and enforce the federal securities laws; second, several of the provisions expanding plaintiffs' rights will create additional litigation without a commensurate improvement in investor protection; and third, enactment of the Code is not essential to the solution of existing problems in the federal securities area [10].

The Code, in its numerous drafts, has also been referred to in at least 38 different judicial decisions [11]. Thus, while the prospects for having the Code immediately enacted into law maybe dim, the Code does serve, at the present time, as both a model and a research tool in the area of securities law.

## 2. Structure and changes

### 2.1. *Structure of the proposed Federal Securities Code*

The proposed Federal Securities Code has three objectives:

- (1) simplification of an inevitably complex body of law in the light of some four decades of administration and litigation;
- (2) elimination (so far as possible) of duplicate regulation; and
- (3) reexamination of the entire scheme of investor protection with a view to increasing its efficiency and doing so, in President Roosevelt's words, "with the least possible interference to honest business" [footnote omitted] [12].

In order to achieve these goals, the Code is organized into twenty parts, each of which is designed to cover a specific subject area. Two of these parts play a critical role in eliminating the overlaps and inconsistencies which exist in the present law. The first, entitled "Definitions", unifies definitions applicable to all the components of the Code; the second, entitled "Exemptions", sets forth a single set of Code-wide exemptions from the Code's registration requirement. The diverse subjects covered by the other parts of the Code relate to such matters as issuer registra-

tion; distributions; post-registration provisions; broker, dealer and investment adviser registration and qualifications; self-regulatory organizations; market regulation; national market and clearance settlement systems; municipal securities; broker-dealer insolvency; trust indentures; investment companies; utility holding companies; fraud, misrepresentation and manipulation; civil liability; and administration and enforcement.

In accordance with the notion that the principal motivating force behind the drafting effort is the codification of existing law, the fundamental concepts underlying the existing statutes have, for the most part, been retained. Nevertheless, the Code does contain a number of substantive changes, particularly in the areas of disclosure, fraud, and civil liability. These changes are necessary in order to improve regulation efficiency within the confines of basically unchanged fundamental concepts. In this brief article, it is impossible to summarize all of the changes; however, the authors will discuss the most significant areas of change.

## 2.2. Significant areas of change

### 2.2.1. Disclosure

The disclosure philosophy is based upon the principle that investors must be given an accurate and complete rendition of all facts material to the making of informed decisions concerning purchase, sale, or retention of securities. It is embodied in the Securities Act of 1933 (1933 Act) [13] and the Securities Exchange Act of 1934 (1934 Act) [14], and is maintained by the Code as well. However, implementation of the philosophy differs as between the current law and the Code.

Pursuant to existing law in most cases a company must file a new registration statement under the 1933 Act whenever a new public offering of its securities is made. The registration statement must contain a prospectus, a document designed to disclose all material facts; and the prospectus must be delivered to each investor prior to, or simultaneously with, the confirmation. Under the Federal Securities Code, registration of *securities* is replaced by registration of *companies*. That is to say, under the Code a company must register as such "after the first fiscal year-end at which it has at least \$ 1,000,000 of total assets and five hundred holders of its securities" [15] or when the first "distribution" is made of any of its securities [16]. The registration statement must contain "whatever information, financial statements, material contracts, and other documents the Commission specifies by rule" [17]. Therefore, under the Code, unlike under existing law which sets forth general areas of information that can be required to be disclosed, the Commission has considerable discretion in determining what information is required to be included in the registration statement. It is unlikely that any of the requirements of the 1933 registration statement would be simplified under the Code, however.

As a result of the Code's scheme of company, rather than security issue, registration, the Code replaces the 1933 Act registration statement with an "offering statement". This must contain "a prospectus together with whatever information, finan-

cial statements, material contracts, and other documents the Commission specifies by rule" [18] and it must be filed for each nonexempt "distribution" of securities by *any* person. No distinctions are made between primary distributions by an issuer and secondary distributions by controlling or noncontrolling persons. Consequently, the definition of "distribution" [19] and the content of various exemptions are critical to an understanding of the Code's disclosure provisions.

The Code's one-time registration of companies is permanent and followed by continuous disclosure on a current basis, similar to that of the 1934 Act. Under this scheme, each company has only one file and all reports, documents, and filings are placed into the same file. Emphasis on this one-time, permanent registration of companies is so fundamental to the Code's regulatory scheme that significant advantages are granted to companies that have been "continuously a registrant for one year" [20]. Such a company is relieved from the requirement to prepare, file and distribute extensive offering statements on the theory that by virtue of its registration under the Code, there is already sufficient information available to the public to enable investors to make informed decisions concerning that company's securities. Also, when the security of a company that is not a one-year registrant has been sold, the purchaser may repudiate the transaction by delivering a notice of disaffirmance to the seller's business address not later than the second full business day after the buyer's receipt of a prospectus and notice of his right to disaffirm the purchase [21]. This disaffirmance privilege aims to resolve the situation that arises under the 1933 Act in which a buyer frequently commits himself to purchasing a security before he ever has an opportunity to review the prospectus.

### 2.2.2. Exemptions

(1) *Issuer sales of securities.* The Federal Securities Code provides issuers with several exemptions from the offering statement requirement. Theoretically, the Code maintains the principal exemptions existing under the 1933 Act. However, in order to avoid the numerous interpretive problems that arise under the 1933 Act, the Code modifies some of these exemptions. For instance, the private placement exemption [22] is clarified and referred to as a "limited offering". Under this exemption there is no limit on the number of permitted offerees, and sales may be made to any number of institutional investors and/or to no more than thirty-five other persons [23]. Purchasers need not be sophisticated, wealthy, or closely related to the issuer; nor do they have to have access to or be furnished with offering statement information. Unrestrained active solicitation of prospective purchasers is controlled by a prohibition against "general advertising" in contravention of SEC rules but this prohibition is not framed as a condition for having a valid "limited offering" [24]. Resales of securities acquired in a limited offering are not subject to a specific holding period, per se, but may not result in more than thirty-five noninstitutional buyer-owners at any one time during a restricted selling period. A restricted selling period for a one-year registrant is one year; the period for a non one-year registrant is three years. In spite of all these modifications in the

exemption, the Code does leave open the possibility of uncertainty in that it authorizes the Commission to add to, or modify, the conditions for a "limited offering" when the issuer is not a one-year registrant. On the whole, however, the Code solves most of the difficulties that arise under the existing private placement exemption.

The intrastate offering exemption of the 1933 Act [25] is another exemption maintained in modified form in the Code. However, the Code materially changes the substantive parts of that exemption. The Code's concept is that of "local distribution" and requires that sales must be "substantially restricted" to residents or persons with primary employment in a single state or in an area in contiguous states or a state and a contiguous foreign country as defined by Commission rule [26]. Unlike existing law, offers to nonresidents do not destroy the exemption; sales to some nonresidents are permitted; and the problem of selling in a densely populated metropolitan area covering several states may be resolved by Commission rule. Furthermore, unlike existing law the issuer is not required to be incorporated in the state of the offering. Such improvements are needed and will be welcomed by most securities practitioners.

A review of the limited offering and intrastate offering exemption indicates a clear intention to resolve present uncertainties in the exempt transaction area by creating an objective set of requirements that expand the opportunities to avoid the offering statement requirement, particularly if a company is a one-year registrant. The Code contains several other exemptions for transactions and securities [27]; for the most part, these are continuations of the exemptions presently available under the 1933 and 1934 Acts. Unlike the 1933 Act, however, the Code provides plenary authority for the Commission to exempt, by rule or order, any person, security or transaction, retroactively or prospectively, from all or any of the provisions of the Code, subject to a very few narrow exceptions [28]. This exemptive authority parallels that which presently exists in the 1933 Act but is not restricted either by dollar amount or type of issuer. In addition, the Code contains a specific exemption not found in the present law for all offerings of not more than \$ 100,000 [29]. The net effect of the Code's exemption scheme (including the liberalized concepts of today's private placement and intrastate exemptions) is likely to improve the ability of issuers to raise capital without having to bear the costs and other burdens of the registration process.

(2) *Secondary sales of securities.* Sales of securities by persons other than issuers also must comply with the registration requirements of the Code or be exempted therefrom. This approach differs from that of existing law which presupposes a registration statement requirement only for sales that are transacted by a controlling person of an issuer [30]. However, the Code provides a number of exceptions and exemptions pursuant to which secondary sellers can sell without being concerned with the offering statement requirements of the Code. In addition to the exemptions available to issuers, secondary sellers under the Code may rely upon two exemptions that are unavailable to issuers. First, the Code contains a "trading

transaction" exception to its definition of distribution [31], which is a successor provision to the present Rule 144 [32] promulgated under the 1933 Act. A "trading transaction" must be made "through a broker or with or by a dealer" who performs no more than his usual function and receives no usual compensation. There is, however, no specific prohibition against solicitation as there is at present under Rule 144. There is likely to be a restriction on volume in a trading transaction, but the exact limitations are left to Commission rule, in part because of the rapid evolution of the securities markets.

The second and probably the most open exemption available only for secondary sales is that provided for "secondary distributions" [33]. This provision, designed to facilitate block trades, exempts any resales by a secondary seller of securities issued by a one-year registrant if the seller does not own more than 15 percent of the voting securities of that registrant. It is an unconditional exemption, non-existent in the present law, and it permits a seller to pay a broker unusual compensation or to engage in unusual solicitation in order to effectuate the sale.

Since all nonexempt distributions must be made in compliance with the Code's offering statement requirements, the Code, unlike existing law, provides a means by which secondary sellers can register or force the registration of their securities offerings. If the issuer is a one-year registrant, a secondary seller may file a very simple "distribution statement" containing information about the seller and the distribution [34]. If the issuer is not a one-year registrant, then the Code allows a secondary seller to demand that the issuer file an offering statement subject to some very complex and carefully drafted restrictions designed to ensure that the demand registration process is not abused [35].

### *2.2.3. Fraud and civil liability*

The Code makes substantial changes in the area of fraud and civil liabilities. Today's problems in the area are caused by the superficial and inconsistent manner in which the various existing statutes treat fraud and civil liabilities, and the resulting efforts of the courts to devise a balanced set of antifraud principles and remedies. There has developed a large melting pot of judge-made law clustered primarily around the judicially implied remedies provided for by Rule 10b-5, promulgated under the 1934 Act. This body of law, when considered in connection with the express liability provisions of the 1933 and 1934 Acts, has created tremendous confusion and uncertainty in the area. The Code brings some order and logic to the area by collecting in one part [36] all of the prohibitions against fraudulent and manipulative conduct which are haphazardly scattered throughout the existing securities laws, and by collecting in another part [37] all the provisions providing for civil liability. In these parts the Code clarifies the elements of the available causes of action; defines the role of reliance, causation and privity; establishes a consistent statute of limitations; clarifies standing to sue; establishes measures of damages; and carefully delineates the standards of care applicable to the various kinds of conduct.

Generally, the Code prohibits “fraudulent acts” or “misrepresentations” in connection with such activities as purchases and sales of securities, proxy solicitations, tender offers, investment advice, and a company’s filings, records and publicity. “Fraudulent act” is defined very broadly [38] and provides the elasticity that is necessary for judicial and administrative flexibility in applying the prohibitions contained in the Code to new imaginative fraudulent schemes. The Code also imposes a limited duty to correct a misrepresentation [39], an affirmative obligation on insiders (including tippees) to disclose material facts when they trade [40], and specific prohibitions against churning, touting, fictitious quotations, manipulation and stabilization [41].

The Code’s scheme of civil liabilities codifies, with some reforms, most of the existing express liability provisions, as well as most of the judicially implied liabilities. The uniformity and clarity of the Code’s approach is weakened only by specific recognition of a court’s power to create a private action based upon a violation of the Code even though such right is not expressly created by the Code [42]. The Code contains four subparts related to civil liabilities: one concerns sales and purchases of securities that violate the nonfraud provisions of the Code, such as its offering or registration statement filing requirements; another deals with sales and purchases that violate its antifraud prohibitions; another covers false and misleading registration statements, other filings and publications; and the last subpart deals with such areas as manipulation and stabilization, failure to register on demand, proxy solicitations, acquisitions and tender offers, short-term insider trading, unlawful trading and advisory practices, credit provisions, churning, and breach of certain fiduciary duties. Each of these provisions to some extent reflects a rethinking and a reworking of currently existing statutory and judicial law and lore, including that which concerns the elements of claims and the available remedies. Some of the more significant reforms in these areas are as follows.

1. Unlike existing law, the Code establishes monetary limits for some actionable conduct other than knowing misconduct. Where a defendant did not engage in a direct transaction with the plaintiff and did not act with knowledge, monetary damages for that defendant are limited generally to the greatest of \$ 100,000, 1 percent of the defendant’s gross revenues received during the last fiscal year before the filing of the action (to a maximum of \$ 1,000,000), or the defendant’s profit [43]. As a result of this damages limitation, the huge dollar risk arising from civil liability for negligent conduct in market transactions, which exists under present law, is minimized.

2. Under existing law, certain officers, directors, accountants and underwriters can be held liable for damages for a registration statement containing false and misleading statements of material fact if such persons have been found to be negligent. In the original text of the proposed official draft adopted by the American Law Institute, such persons would be subject to liability for failure to exercise reasonable care in connection with the annual report required by the Code to be filed with the Commission [44]. As a result of significant opposition to that concept

[45], the Code was amended at the annual meeting of the American Law Institute in May 1979 so that the Code does not now take a position with respect to the imposition of such a liability on these persons. In other words, the Code leaves it to Congress to decide what to do.

3. For the most part, the Code eliminates reliance as an element of the plaintiff's burden of proof.

4. For the most part, the Code also eliminates transactional causation as an element of the plaintiff's burden of proof. However, a defendant may reduce damages in some instances by proving that the plaintiff's losses were not caused by the violation.

5. The Code clarifies the fact that aiders and abettors of fraudulent conduct may be found liable.

6. The Code eliminates almost all of the privity limitations presently found in the 1933 Act.

### *2.3. Other areas of significant change*

While the reforms relating to the disclosure and civil liability parts of the Code are clearly those that will have the greatest impact upon existing law, the Code does make other, important changes in the law. For example, there is at present a significant amount of overlap between federal and state regulation of securities. The Code employs an innovative means to coordinate federal and state securities regulation and virtually eliminates the authority of states to impose disclosure requirements in addition to those required by federal law [46]. Under the Code, states are in fact prohibited from regulating the distribution of certain specified high quality securities and will have only very limited authority in the area of tender offers. This meshing of federal and state regulatory schemes has been approved by the principal organization of state securities administrators and represents a major step toward eliminating senseless overlap in this area.

With respect to market regulation, the Code in large part simply integrates, rearranges and clarifies the 1975 amendments to the federal securities laws, making very few substantive changes. The Code does provide a single registration procedure for brokers, dealers, municipal broker-dealers and investment advisers as well as a single scheme of administrative discipline, thereby simplifying present law and codifying some of the existing fiduciary concepts, such as the "shingle theory". Furthermore, unlike existing law, the Code subjects investment advisers to qualification and financial responsibility requirements and their regulation is much tighter in almost all respects [47]. Separate parts of the Code are designed to handle all matters related to the self-regulatory organizations such as the exchanges, the NASD, the clearing agencies and the Municipal Securities Rulemaking Board, thereby again eliminating much unnecessary duplication.

Except in certain limited respects, the Code does not alter the basic regulatory schemes of the Trust Indenture Act of 1939 [48], the Investment Company Act of

1940 [49], and the Public Utility Holding Company Act of 1935 [50]. The most significant changes in the Trust Indenture Act center around the inclusion of the concept of the mandatory and optional indenture provisions found in the American Bar Foundation's Model Debenture Indentures. The Code permits the incorporation of these provisions by reference, rendering it unnecessary to set them forth in the actual indenture [51]. Uniform construction of these provisions is solved through the provision that the statutory and optional provisions are to be interpreted, applied, and enforced exclusively as a matter of federal law, thus preempting state law. The Investment Company Act is not revised substantially by the Code, in part because of the difficulty of reaching a consensus on some important questions. Several important problems under that Act are nevertheless resolved. For example, mini-accounts, which create Investment Company Act problems under existing law, are excluded from the definition of investment companies and are treated through the Code's regulation of investment advisers; the "inadvertent investment company" problem is helped through a looser and more realistic definition of investment company, designed to exclude enterprises not intending to be the traditional investment company [52]. With respect to the Public Utility Holding Company Act of 1935, the principal changes are evident in the exemption area where the statutory language has been modified to conform to hoary administrative interpretation [53].

The proposed administrative and enforcement scheme under the Code is vast in its application and effect, particularly for those involved in enforcement matters [54]. The powers of the Commission with respect to administration and enforcement matters are a controversial aspect of the Code. The Commission and its staff feel that their powers are not sufficiently broad while certain members of the bar actively engaged in enforcement matters believe that the Code's changes serve to provide the Commission with too great an opportunity to exercise and abuse its authority. This controversy will ultimately be decided in the halls of Congress.

### 3. The extraterritorial reach of the Code [55]

The existing statutory treatment of the extraterritorial application of the federal securities laws has long been recognized as inadequate [56]. Accordingly, the drafters of the Code undertook to devise a comprehensive provision setting forth a general set of principles to indicate the extent to which any part of the Code applies extraterritorially. This provision [57] applies with respect to various classifications of transactions, conduct and status rather than with respect to particular sections of the Code. While the extraterritorial applications are confined "[w]ithin the limits of international law" [58] they are designed to be substantively broad. It is left to Commission rulemaking authority to tailor the expression of power in the international law sense to the appropriate policy considerations of the Code.

First, the Code covers all purchases and sales of securities, proxy solicitations,

tender offers and activities of investment advisers that occur (in each case) within the United States, even if initiated outside the United States [59]. Thus, if a French company were to offer securities in the United States or if an English company were to invite tenders by the American shareholders of a Canadian company, or if a Swiss investment adviser were to recommend to a United States resident a Japanese security traded only abroad, the Code would apply.

Second, the Code applies to nonresidents who register as issuers, brokers or investment advisers [60]. However, foreign brokers, for example, need not register if they do business only with persons situated outside the United States or with existing clients who are not United States citizens and are present only temporarily in the United States [61].

Third, all conduct other than that mentioned in the first part above "whose constituent elements occur to a substantial (but not necessarily predominant) extent within the United States" or "some or all of whose constituent elements occur outside the United States but cause a substantial [Code violating] effect within [the United States]" is also covered [62].

Fourth, other subsections treat the observe problem, *i.e.* conduct that is initiated within the United States but occurs outside the United States [63]; that is to say, with respect to registration, proxy solicitation, tender offers and investment advice, only the antifraud provisions apply. Thus, a registration statement prepared in the United States for use abroad (for example, a Eurobond offering) would not have to comply with the registration provisions of the Code but would be subject to the antifraud rules.

Finally, the Commission is given extremely broad authority, within specified limitations, to contract the areas covered or to expand, or increase the subject matter that is covered by the extraterritorial application provisions [64].

The *prima facie* breadth of the extraterritoriality provision will no doubt concern or even alarm non-Americans although the limitation of "within the limits of international law" is expressly stated. However, the Code provision is a clear improvement over the sketchy treatment of the subject under existing statutes, builds on the substantial body of case law in recent years [65] and provides for further tailoring of the coverage by Commission rule.

#### 4. Conclusion

The Code sets forth a grand scheme of regulation for securities-related matters. Yet the many differing interests affected by such a scheme inevitably make passage of such legislation a matter of compromise. The effort to accommodate to the Securities and Exchange Commission's objections to the Code is ongoing and will undoubtedly result in a modified version of the Code being considered by Congress in its hearings. The hearing process will be a lengthy one and it is unlikely that the Code will be enacted during the next three to five years. Nevertheless, the Code will

have immediate and substantial importance, both as a research tool and as encouragement to the Commission to effect substantive changes in its policies and procedures under the existing federal securities laws. The Code can be and should be considered a success for these reasons alone.

## Notes

[1] ALI Fed. Sec. Code Proposed Official Draft (March 15, 1978), as amended by Supplement No. 1 dated May 17, 1979 [hereinafter cited as POD or the Code]. Some changes in the ALI Code will appear in the proposed legislation as a result of comments by the Securities and Exchange Commission, subsequent legislation, and the correction of nonsubstantive technical errors. Copies of the POD and the official draft are available from the American Law Institute, 4025 Chestnut Street, Philadelphia, PA. 19104.

The authors wish to alert the reader to publication of the official draft of the Code in May 1980. It contains a section-by-section commentary by Professor Loss and constitutes the best textbook on the federal securities laws since Professor Loss's three-volume treatise entitled *Securities Regulation*.

[2] Securities Act of 1933, 15 U.S.C. § 77a (1976) [hereinafter the 1933 Act]; Securities Exchange Act of 1934, 15 U.S.C. § 78a (1976) [hereinafter the 1934 Act]; Public Utility Holding Company Act of 1935, 15 U.S.C. § 79 (1976); Trust Indenture Act of 1939, 15 U.S.C. § 77aaa (1976); Investment Company Act of 1940, 15 U.S.C. § 80a-1 (1976); Investment Advisers Act of 1940, 15 U.S.C. § 80b-1 (1976).

[3] One of the early suggestions that the various securities laws should be treated as a single whole appears in the 1951 edition of Professor Loss's treatise on securities. In describing the then six separate statutes regulating various securities matters, Professor Loss urged that these different acts should be treated "as a single piece of legislation . . . which is what ideally they should be". Loss, *Securities Regulation* at vi (1st ed. 1951). For a history of thought regarding codification which goes back to 1940, see Loss, *The American Law Institute's Federal Securities Code Project*, 25 Bus. Law. 27 (1969) at 29.

[4] Cohen, "Truth in Securities" Revisited, 79 Harv. L. Rev. 1340 (1966).

[5] For a summary of the views expressed at the ABA conference, see *Conference on Codification of the Federal Securities Laws*, 22 Bus. Law. 793 (1967).

[6] The authors are members of this Committee.

[7] None of the project participants actually received any compensation.

[8] For an extensive symposium on the Code, see *Symposium: American Law Institute's Proposed Federal securities Code*, 30 Vand. L. Rev. 311 (1977); Bartell, *Federal-State Relations under the Federal Securities Code*, 32 Vand. L. Rev. 457 (1979). See also Committee on Federal Regulation of Securities, *ALI Proposed Federal Securities Code*, 34 Bus. Law. 345 (Nov. 1978).

[9] See, e.g., Kripke, *Securities Law Reform and the Federal Securities Code*, 33 U. Miami L. Rev. 1453 (1979); and Benston, *Required Periodic Disclosure Under the Securities Acts and the Proposed Federal Securities Code*, 33 U. Miami L. Rev. 1471 (1979).

[10] Lowenfels, *The Case Against the Proposed Federal Securities Code*, 65 Vir. L. Rev. 615 (1979) at 616.

[11] *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438 (1976); *Foremost-McKesson, Inc. v. Provident Securities Co.*, 423 U.S. 232 (1976); *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975); *Fidenas, AG v. Compagnie Internationale Pour L'Informatique, CII Honeywell Bull, S.A.*, [1979 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,947 (2d Cir. 1979); *Stern v. Merrill Lynch, Pierce, Fenner and Smith, Inc.*, [1979 Transfer Binder] Fed. Sec. L.

Rep. (CCH) ¶96,931 (4th Cir. 1979); *McNeal v. Paine, Webber, Jackson and Curtis, Inc.*, 598 F.2d 888 (5th Cir. 1979); *Mansbach v. Prescott, Ball and Turben*, 598 F.2d 1017 (6th Cir. 1979); *Continental Grain (Australia) Pty. Ltd. v. Pacific Oilseeds, Inc.*, 592 F.2d 409 (8th Cir. 1979); *United States v. Chiarella*, 588 F.2d 1358 (2d Cir. 1978); *Great Western United Corp. v. Kidwell*, 577 F.2d 1256 (5th Cir. 1978); *Securities and Exchange Commission v. Commonwealth Chemical Securities, Inc.*, 574 F.2d 90 (2d Cir. 1978); *Goldberg v. Meridor*, 567 F.2d 209 (2d Cir. 1977); *Tarasi v. Pittsburgh National Bank*, 555 F.2d 1152 (3d Cir. 1977); *Fridrich v. Bradford* [1976-1977 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶95,723 (4th Cir., Sept. 15, 1976); *Exchange National Bank of Chicago v. Touche Ross and Co.*, 544 F.2d 1126 (2d Cir. 1976); *Fridrich v. Bradford*, 542 F.2d 307 (6th Cir. 1976); *Straub v. Vaisman and Company, Inc.*, 540 F.2d 590 (3d Cir. 1976); *United States v. Dixon*, 536 F.2d 1388 (2d Cir. 1976); *Rochez Brothers, Inc. v. Rhoades*, 527 F.2d 880 (3d Cir. 1975); *Harris v. American Investment Company*, 523 F.2d 220 (8th Cir. 1975); *Bersch v. Drexel Firestone, Incorporated*, 519 F.2d 974 (2d Cir. 1975); *C.N.S. Enterprises, Inc. v. G&G Enterprises, Inc.*, 508 F.2d 1354 (7th Cir. 1975); *American Standard, Inc. v. Crane Co.*, 510 F.2d 1043 (2d Cir. 1974); *National Nutritional Foods Association v. Food and Drug Administration*, 504 F.2d 761 (2d Cir. 1974); *Smallwood v. Pearl Brewing Company*, 489 F.2d 579 (5th Cir. 1974); *United California Bank v. Salik*, 481 F.2d 1012 (9th Cir. 1973); *Cohen v. Franchard Corporation*, 478 F.2d 115 (2d Cir. 1973); *Zeller v. Bogue Elec. Manufacturing Corporation*, 476 F.2d 795 (2d Cir. 1973); *Elkind v. Liggett and Myers, Inc.*, [1979 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶96,908 (S.D.N.Y., 1979); *Brscan Limited v. Edper Equities, Ltd.*, [1979 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶96,882 (S.D.N.Y., 1979); *Steinberg v. Carey*, 470 F.Supp. 471 (S.D.N.Y., 1979); *Hendrickson v. Buchbinder*, 465 F.Supp. 1250 (S.D. Fla., 1979); *Touche Ross and Co. v. Securities and Exchange Commission* [1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶96,415 (S.D.N.Y., 1978); *Altman v. Knight*, 431 F.Supp. 309 (S.D.N.Y., 1977); *Fox v. Kane-Miller Corp.*, 398 F.Supp. 609 (D. Md., 1975); *Crowell v. Pittsburgh and Lake Erie Railroad Company*, 373 F.Supp. 1303 (E.D. Pa., 1974); *Stewart v. Bennett*, 362 F.Supp. 605 (D. Mass., 1973).

The Code was accorded the greatest weight in the following decisions cited above: 544 F.2d 1126 (2d Cir. 1976), 523 F.2d 220 (8th Cir. 1975), 508 F.2d 1354 (7th Cir. 1975), and 510 F.2d 1043 (2d Cir. 1974).

In addition, the authors would like to call the reader's attention to two decisions that were rendered in the early part of 1980: *Chiarella v. United States* [Current] Fed. Sec. L. Rep. (CCH) ¶97,309 (U.S. S.Ct., Mar. 18, 1980) and *Marbury Management, Inc. v. Kohn* [Current] Fed. Sec. L. Rep. (CCH) ¶97,357 (2d Cir., April 21, 1980).

[12] POD, Introduction, at xv.

[13] 15 U.S.C. § 77a et seq. (1976).

[14] 15 U.S.C. § 78a et seq. (1976).

[15] POD, § 402(a).

[16] POD, §§ 403, 502(a).

[17] POD, § 404.

[18] POD, § 502(c)(1).

[19] "Distribution" means an offering other than (1) a limited offering or (2) an offering by means of one or more trading transactions. POD § 242. The section also sets forth the conditions of a "limited offering" and a "trading transaction".

[20] POD, § 299.16.

[21] POD, § 504(b).

[22] 15 U.S.C. § 77d(2) (1976).

[23] POD, § 242(b).

[24] POD, § 503(b).

[25] 15 U.S.C. § 77c(a)(11) (1976) and Rule 147, 17 C.F.R. § 230.147 (1979).

[26] POD, § 514. Considerable thought was given to repealing the intrastate offering

exemption, but in large part as a political matter, the exemption in modified form was retained in the Code. See Bartell, *Federal-State Relations under the Federal Securities Code*, 32 Vand. L. Rev. 457 (1979).

[27] POD, pt. III and § 512.

[28] POD, § 303.

[29] POD, § 512(e). The Commission has the authority to reduce the dollar amount of the exemption to not less than \$ 50,000 in any twelve month period or to impose conditions upon or withdraw the exemption when the offering exceeds \$ 50,000.

[30] Technically this approach of the 1933 Act results from the interaction of the exemptions contained in sections 4(1) and 4(4) of the 1933 Act and the definition of underwriter contained in Section 2(11) of the 1933 Act. See Cheek, *Exemptions Under the Proposed Federal Securities Code*, 30 Vand. L. Rev. 355 (1977) at 371–373.

[31] POD, § 242(c).

[32] Rule 144, 17 C.F.R. § 230.144 (1979).

[33] POD, § 512(d).

[34] POD, § 510.

[35] POD, § 502(b).

[36] POD, pt. XVI.

[37] POD, pt. XVII.

[38] POD, § 262.

[39] POD, § 1602(b).

[40] POD, § 1603.

[41] POD, §§ 1606–1610.

[42] POD, § 1722.

[43] POD, § 1708(c).

[44] POD, § 1704.

[45] See 55 ALI Proceedings 347–379 (1978).

[46] See generally Bartell, *supra* n. 26.

[47] For a critique of the Code's provisions relating to investment advisers, see Brown, *Principal Changes Which Would Be Effected Under the Proposed Federal Securities Code in the Federal Regulation of Investment Advisers*, 34 Bus. Law. 395 (Nov. 1978).

[48] 15 U.S.C. § 77aaa et seq. (1976).

[49] 15 U.S.C. § 80a-1 et seq. (1976).

[50] 15 U.S.C. § 79 et seq. (1976).

[51] POD, § 1305; see Stark, *The Trust Indenture Act of 1939 in the Proposed Federal Securities Code*, 32 Vand. L. Rev. 527 (1979).

[52] POD, § 281.

[53] See Hawes, *Public Utility Holding Company Act of 1935 – Fossil or Foil?*, 30 Vand. L. Rev. 605 (1977).

[54] For a detailed examination of the Code's provision relating to administration and enforcement, see Mathews, *ALI Proposed Federal Securities Code: Part XV – Administration and Enforcement*, 30 Vand. L. Rev. 465 (1977).

[55] For a thorough analysis of the extraterritorial aspect of the Code, see Loss, *Extraterritoriality in the Federal Securities Code*, 20 Harv. Int'l L.J. 305 (1979). For a criticism of the Code's approach in this area, see Karmel, *The Extraterritorial Application of the Federal Securities Code*, 7 Conn. L. Rev. 669 (1975); but see Curtis, *The Extraterritorial Application of the Federal Securities Code: A Further Analysis*, 9 Conn. L. Rev. 67 (1976), for a reply to former SEC Commissioner Karmel by one of Professor Loss's students.

[56] See 1934 Act, Section 30(b) and Schoenbaum v. Firstbrook, 405 F.2d 200, 207 (2d Cir. 1968), cert. denied sub nom., Manley v. Schoenbaum, 395 U.S. 906 (1969).

[57] POD, § 1905.

[58] POD, § 1905(a)(1).

[59] POD, § 1905(a)(1)(A).

[60] POD, § 1905(a)(1)(B).

[61] POD, § 1905(b)(2).

[62] POD, § 1905(a)(1)(D).

[63] POD, §§ 1905(a)(2) and 1905(b)(1).

[64] POD, § 1905(c). For a general discussion of the Commission's broad rulemaking power under the Code, see Committee on Federal Regulation of Securities, *supra* n. 8.

[65] For a discussion of that case law by a present SEC Commissioner, see Loomis, Jr. and Grant, *The U.S. Securities and Exchange Commission, Financial Institutions Outside the U.S. and Extraterritorial Application of the U.S. Securities Laws*, 1 J. Comp. Corp. L. & Sec. Reg. 39 (1978).

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