The Proposed Federal Securities Code: A Response to Its Critics

Allen E. Throop
The Proposed Federal Securities Code: A Response to Its Critics

ALLEN E. THROOP*

The author comments on the statements made by the speakers at the Fourth Annual Baron de Hirsch Meyer Lecture Series and offers answers to some of the Code's problems as raised by the lecturers. He also gives recognition to some of the major achievements of the Code.

At the outset, I should make clear that my comments are or may be subject to certain conflicts of interest. I was privileged to be one of the Advisers on the panel of the American Law Institute (ALI), where I shared in the meditations, directed by Professor Loss, which resulted in the proposed Federal Securities Code.1 Hence, I may be in support of the adoption by Congress of the Code or of something which bears a close resemblance to it. Furthermore, my admiration of Professor Loss originated with our fraternization on the early legal staff of the Securities and Exchange Commission (the Commission); and I may well have inherited from that era some bureaucratic bias. On the other hand, any such bias hopefully has been neutralized by the forty-year period that has elapsed since the termination of my service with the Commission, during which time I have been continuously exposed to the legal and financial problems of those whose business involves constant compliance with the mandates of the federal securities laws.

I regret that I was not present for the February 1979 Baron de Hirsch Meyer Lectures or for the animated discussion which followed them. From a review of the transcript of the proceedings, however, there emerge the following underlying questions: (1) Is there a need for any codification of our present federal securities laws? (2) If so, does the Code, in its substantive aspects, do too much or too little? (3) What are the principal achievements of the Code? and (4) Is the time “ripe” for congressional consideration of the Code?

In answer to the first question, it is not surprising that, with the possible exception of the views expressed by Professor Benston,2

* Counsel, Corcoran, Youngman & Rowe, Washington, D.C.; S.J.D., Harvard University, 1926; LL.B., Harvard University, 1925.
2. See Benston, Required Periodic Disclosure Under the Securities Acts and the Pro-
there was no basic challenge of the need for an effort to bring order out of the present melange of our federal securities laws; and it would be carrying coals to Newcastle to engage in any extended argument in support of an affirmative answer to this question.

Work on the Code began in 1969. During the preceding thirty-five years the business and financial communities had been subjected to eight major congressional enactments involving securities regulation, to numerous amendments of those enactments and to a formidable array of judicial and administrative developments. As pointed out by Professor Loss in the Introduction to the Code, further legislative developments have occurred since 1969. If, without reciting the complexities, inconsistencies and duplications in these layers of nearly a half-century of legislative and related administrative activity, further support were needed for the present codification effort, an additional observation may be made. The Code is not solely an academic product of Professor Loss, as the Reporter of the Code, although members of the advisory panel would agree that the project could never have been performed effectively without his intensive dedication and superb direction. Nor is the Code merely the product of the joint efforts of Professor Loss and the advisory panel. The project which led to the Code was in fact initiated by the ALI upon the recommendation of the Committee on Federal Regulation of Securities of the American Bar Association (ABA) and was made possible only by generous grants by a number of disinterested foundations and by countless hours of dedicated effort by many people. Furthermore, successive parts of the Code were submitted to and discussed annually by the Council of the ALI and its full membership, as well as by the ABA Committee. Each of the parts so submitted was the product of several two or three-day meet-


ings of the advisory panel during the year, which was therefore not
infrequently revised as the result of consideration given it by the
other groups. Thus, the ALI and the ABA, working in conjunction
with the advisory panel, have put forth a major effort to resolve the
many questions and problems caused by the sundry federal laws
regulating securities transactions.

The second question, whether in its substantive aspects the
Code does too much or too little, is highlighted by the contrasting
views expressed in their lectures by Professor Kripke and Professor
Benston. Professor Kripke would be "unquestionably enthusiastic"
in support of the Code if it were (or even if it were recognized as)
"merely what it is supposed to be, a codification and not a reaffir-
manation in principle of the current validity" of the statutes it codi-
fies; whereas Professor Benston's view is that any codification effort
should have been much more far-reaching and should rest upon
thorough and complete "empirical evidence." He felt that imput
should come from economists, accountants and others, so that the
product would not be merely "lawyer's law." Professor Benston
would expect and hope that any such studies would result in the
complete or substantial abandonment of any mandatory disclosure
philosophy.

5. Speech by Homer Kripke, Fourth Annual Baron de Hirsch Meyer Lecture Series,
University of Miami (Feb. 9, 1979) at 40 (transcript on file at the University of Miami Law
Review).

6. Panel Discussion, Fourth Annual Baron de Hirsch Meyer Lecture Series, 33 U. MIAMI
L. REV. 1519, 1529 (1979) [hereinafter cited as Panel Discussion]. Professor Wolfson ex-
pressed the view that there should have been empirical investigations in at least certain areas,
such as limited offerings and secondary distributions. Wolfson, Comments on the Proposed
1495 (1979). Dean West suggested that there should have been a "thorough reexamination of
the entire scheme of investor protection [which] ought to have involved members of the
accounting profession, financial economists and representatives of corporate America." West,

7. The Fed. Sec. Code, supra note 1, at xxii of the introduction states:
So far as substantive change is concerned, the Reporter and the advisory groups
have tried to limit themselves to what might loosely be called "lawyer's law."
That is to say, one hopes that legislators will respect the judgment of expert
judges, practicing lawyers, academicians and administrators on questions such as
burden of proof and measure of damages; but there is no particular reason why
the Congress should look to the Institute with respect to political questions like
the interrelation between the securities and antitrust laws or price maintenance
in the sale of investment company shares.

8. Benston, supra note 2, at 1480. Professor Benston also stated:
I can say that the research that I have done and read—and I am willing to change
my mind—leads me to the conclusion that the professed values that the Act seeks
to support are not being supported, in fact, by the disclosure aspects of the Act,
which is one thing I have researched.

Panel Discussion, supra note 6, at 1533-34.
The suggested conversion of a codification effort with respect to the present mass of federal securities laws into a reform measure, drastically altering the underlying disclosure philosophy of those laws, is completely unrealistic. The fundamental nature of disclosure in federal securities regulation was emphasized by Chairman Williams when, in transmitting to the Congress the Annual Report of the Securities and Exchange Commission for the year ending September 30, 1977, he described "the philosophy of full disclosure" as the "lynch-pin of investor protection." Furthermore, whatever may be the infirmities in a regulatory philosophy based on disclosure, it is inconceivable to assume that the Congress would accept any codification whose basic premise would both reverse nearly half a century of federal regulation and be completely at loggerheads with the Commission's convictions. This, of course, is not to say that any code which is presented to the Congress must in all respects have the endorsement of the Commission.

With respect to the need for "empirical evidence," on which Professor Benston urges that any codification should have been based, certain observations should be made. First, the ALI is not fundamentally a "reform" organization. It was initially conceived as doing for court decisions what the Code would do with respect to statutory and decisional federal securities law. But its "Restatements" have been intended to be more than mere compilations and digests, and frequently reflect a thorough analysis of conflicting precedents, with rational support for a particular, and occasionally new, approach to a difficult problem. Hence, it is not surprising that the Code, although reflecting the "lawyer's law" approach of the ALI membership, is, as it should be, more than a mere compilation and digest.

Second, the advisory panel included Vincent L. McKusick, Chief Justice of the Supreme Judicial Court of Maine, Thomas E. Fairchild, Chief Judge of the United States Court of Appeals for the Seventh Circuit, and Henry J. Friendly, Senior Circuit Judge of the United States Court of Appeals for the Second Circuit, who has probably made more significant contributions to the difficult legal problems presented by federal securities legislation than any other member of the judiciary, with the possible exception of the members of the Supreme Court. The advisory panel from time to time also included current or former members of the Commission itself, as

well as recognized academic leaders in the field of corporate and securities law and practitioners who for years had dealt with major business and financial matters. The advisory panel also had the benefit of the expertise of Professor Kripke in the fields of finance, accounting and law. These were persons whose experience certainly had not left them unaware of the problems of the nonlawyer under federal securities legislation.

Third, the fact that a codification effort with respect to the federal securities laws was under way has obviously been known to Professor Benston and other well-informed economists ever since it was undertaken in 1969. Certainly if there were organized groups of economists, accountants or others, whether professors or practitioners, who felt that any such codification effort should rest, at least in part, upon empirical studies, they were free to conduct such studies. I am sure that any definitive results of such studies would have been welcomed by Professor Loss, his colleagues, the ALI and the ABA. The usefulness of such studies cannot be denied, but the added demands of personnel, time and financial support which would have been required cannot be ignored. Furthermore, it is unfair for economists or others, whether lawyers or nonlawyers, to comment on the Code as if they had just been informed of its contents.

Finally, the Code, in the form in which it has received the endorsement of the ALI and the ABA, is not an "all-or-none" package. It should be, and certainly will be, the subject of thorough consideration at hearings of informed Congressional committees. At these hearings there will be a full opportunity for an expression of the views of professional economists and accountants, as well as representatives of the business and financial communities.

Accordingly, if we assume that the Code should receive fundamental endorsement, even though it neither confines itself to the

10. To quote a comment from the floor during the Panel Discussion: Professor Benston, I am confused, very frankly. I can understand your statement about empirical studies, but I feel that your statement sounded like an objectionist's statement, when the fact is that the number thirty-five has existed in the drafts of the Code for some years, and economists, to my knowledge based on what you are saying, have not done any empirical studies. They did not have to wait to be asked by The American Law Institute to do empirical studies; they could have done it. Instead I find, gentlemen, three of you sitting here saying: "But where are the empirical studies?" That does not quite make sense to me.

Panel Discussion, supra note 6, at 1530.

11. Professor Loss stated, "If we had set out about nine years ago to do an empirical study of each of the several hundred questions we have had to decide, my grandchildren might still be working on this Code some day. That is a simple fact of life." Id. at 1522.
linguistic rearrangement of existing statutes nor completely revises the fundamental framework of present federal securities law, the next question to be asked is: What are some of its principal achievements?

Any consideration of this question can well become sidetracked because of a failure to make a distinction between the nature of a particular change wrought by the Code and the specific terms of that change. The writer respectfully submits that much of the discussion at the seminar failed to make this distinction. Thus, all participants in the discussion appeared to share in the frustration occasioned by the cloudy parameters of what is not a "public offering." At the seminar, however, there appeared to be more attention given to how the maximum number of thirty-five noninstitutional purchasers was arrived at in order to have a nonpublic offering, than to the benefits to be derived from some definitive numbers test and from the related provisions of the Code implementing such a test. Certainly the basic structure of the Code would not be altered if Congress, on the basis of studies presented by Professor Bentson, Dean West or others, were to decide that some other number is preferable. The important point is that the Code, at long last, with proper safeguards, provides reasonably clear criteria for determining what is a "limited offering," in lieu of some vague concept as to what is not a "public offering."

Somewhat comparably, Dean West, in a painstaking analysis, concluded that the time-period and other specific terms of the tender-offer provisions of the Code are in substance slanted in favor of the management of the target company, to the detriment of its stockholders. Dean West failed, however, to give adequate recognition to the confused realities of the present situation, as currently demonstrated by Leroy v. Great Western United Corp., decided by the Supreme Court of the United States on June 20, 1979. In that case a tender-offerer, headquartered in Dallas, Texas, initi-

12. The common frustration was reflected in the opening remarks of Professor Sowards at the Panel Discussion, when he said: "First of all, for forty years lawyers did not know what the private offering exemption was; I still do not know this afternoon." Id. at 1519.

13. Professor Sowards, however, refers to a definitive number as "a refreshing breath of air. Somebody has finally given us a magic number." Id. at 1521. See note 32, infra.

14. FED. SEC. CODE, supra note 1, § 242 (b).

15. In recognition of this achievement Professor Kripke described the "limited offering" exemption of the Code as a "great advance over the present situation." Panel Discussion, supra note 6, at 1526.

16. West, supra note 6, at 1488-94.

ated a tender offer in that city addressed to the stockholders of a Washington corporation having its principal office and more than half of its assets in Idaho. The offeror, who had met the federal tender offer requirements, was frustrated by Idaho's threatened application of its tender offer statute in Texas. The United States Court of Appeals for the Fifth Circuit upheld an injunction against the operation of the Idaho statute, granted by a federal district judge for the Northern District of Texas, on the ground that the statute was preempted by the tender offer provisions of section 14(d) of the 1934 Act and placed an impermissible burden on interstate commerce.\textsuperscript{18}

In a five-to-three decision, the Supreme Court, in an opinion by Justice Stevens, held that venue did not lie in the Northern District of Texas, and that accordingly, apart from the question which had been raised as to personal jurisdiction over the defendant as an officer of Idaho, the constitutional question as to the preemption of the Idaho tender offer statute need not be considered. The merits of the constitutional issue were avoided in Justice White's dissenting opinion, in which he was joined by Justices Brennan and Marshall, who would have held that venue in the Northern District of Texas and personal jurisdiction over state officials of Idaho were authorized by the 1934 Act, and would have come to grips with the question of federal preemption.\textsuperscript{19}

Again, as in the case of the clarification by the Code of the "private offering" concept, the specific time-periods for filing or mailing requirements could be altered on the basis of consideration by the Congress of the Code and relevant studies presented to it, without affecting the basic structure of the Code. Tender offers are here to stay, and the possible need for a more exhaustive examination of the details of the tender-offer provisions of the Code should not prevent its early consideration and adoption in some form by the Congress.

Perhaps even more significant than the tender-offer provisions of the Code are the broad preemptive provisions of section 1904, together with the Code's provisions for coordination of federal secu-

\textsuperscript{18} 577 F.2d 1256 (5th Cir. 1978).

\textsuperscript{19} 99 S. Ct. at 2720. Section 1904 of the Fed. Sec. Code, supra note 1, would preempt the state statutes. The Court's decision highlights the need to resolve the present chaos created by the existence of tender offer statutes in some 37 states, and emphasizes the need for the adoption of the tender offer provisions of the Code. That need is emphasized by subsequent lower court decisions. \textit{Compare} City Investing Co. v. Simcox, [1979 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,942 \textit{with} Telvest, Inc. v. Bradshaw, No. 79-0722-R (E.D. Va., filed Aug. 24, 1979).
curities regulation and state blue-sky legislation, as well as the "local distribution" exemption of section 514. These provisions have been endorsed by the North American Securities Administrators Association (NASAA) as the result of extended negotiation and collaboration between the Reporter, the Chairman of NASAA's Code Liaison Committee and the similar committee of the Midwest Securities Administrators. This endorsement represents a tremendous achievement, the benefits of which should not be lost.

The Code may also be faulted by its critics for its retention, in substance, of the 1934 Act provisions relating to the recovery of short-swing profits received by corporate insiders.20 Indeed, Professor Kripke questioned the need for the retention of these provisions. He noted that they were originally enacted as a "rough and ready effort" to eliminate questionable conduct on the part of corporate fiduciaries. He felt that a more effective resolution of the problem would be the broad application of rule 10b-5.21 Although this criticism has some merit, it should be noted that at least one of the reputable financial services deems the short-swing trading reports which must be filed with the Commission to be of such significance to investors, that it regularly publishes summary reports of insider transactions.22 Furthermore, there has been no outcry by insiders regarding the burdens associated with the statutory reporting requirements, trading restraints, or profit recovery penalties. Certainly, however, if the appropriate congressional committees were persuaded by Professor Kripke or others that these provisions are merely a useless remnant from another era, they could be eliminated without affecting the other Code provisions.

A somewhat similar failure to recognize basics is found in the seminar discussion of the provisions of the Code which specify the essential elements of a "distribution."23

It will be recalled that under the Code it is the existence of a "distribution" which, in the absence of an exemption under sections 512 to 515, requires the utilization of an "offering statement."24 This

22. For each of the issues of Common Stock which are the subject of quarterly review by The Value Line Investment Survey, the Survey tabulates the number of "Insider Decisions" to buy or to sell reported for each of the fifteen preceding months.
24. Id. § 502.
document replaces the registration statement currently required by the 1933 Act. Furthermore, a "distribution" is defined as any offering of securities other than a "limited offering" or an offering by means of one or more "trading transactions." A "limited offering," as defined, would exist only if there were not more than thirty-five initial purchasers, excluding institutional investors; a "trading transaction," as defined, would consist of a transaction by a broker or dealer where the security is not being offered for the account of the issuer and was not the subject of a "limited offering" within a specified one- or three-year period, depending upon the status of the issuer as a "one-year registrant" at the time of resale. Furthermore, under section 242(b)(1)(B) no "distribution" would be involved in the normal resale by the initial buyer of securities purchased by him in a "limited offering," if such resale occurs more than one or three years after completion of the offering. Nor would any resale during the one-year or three-year period constitute a "distribution," provided that the resulting total number of non-institutional owners of the securities sold in the previous "limited offering" does not at any one time exceed thirty-five. Finally, under the Code the "offering statement" requirements would apply to a non-exempt secondary "distribution" of securities of an issuer that has not attained the status of a "one-year registrant." Furthermore, even if the issuer were a "one-year registrant," comparable but somewhat simpler "distribution statement" requirements would apply where the secondary distributor owns more than fifteen percent of the issuer's voting securities.

The seminar generated considerable discussion regarding the correctness of these specific tests. Moreover, some panel members

27. Id. § 242(b).
28. Id. § 242(c).
29. Id. § 242(b)(1)(B).
30. Id. §§ 502, 510.
31. Id. § 512(d).
32. Reference has been made to the discussion of the validity of thirty-five as the maximum number of non-institutional initial purchasers in the case of an offering which is deemed not to involve a "distribution" and thus not to require the use of an offering statement. See note 13 supra, and accompanying text. Except for the clear analysis by Professor Wolfson, however, the exclusion of institutional purchasers from that number received relatively little notice. See Wolfson, supra note 6, at 1503-04. Additionally, the significance of certain factors in determining freedom to resell received little attention. These include (1) the total number of resulting non-institutional owners of the issue, (2) the status of the issuer as a one-year registrant, and (3) the seller's percentage of ownership of the issuer's voting securities. See Fed. Sec. Code, supra note 1, §§ 242, 512.
expressed concern over Code provisions which grant rulemaking authority to the Commission. It was feared that the use of this authority might lead to further restrictions on the resale of securities of "non-one-year registrants." But, to a large degree, the discussion misses the real question—whether, subject to the possible congressional revision of certain terms, the "limited offering" and "distribution" concepts of the Code are preferable to the corresponding "nonpublic offering" and "underwriter" concepts of the 1933 Act.

The applicability of the current registration requirements depends, or may depend, upon an after-the-fact determination by a court or the Commission. This factual determination may extend into several areas. For example, in the case of security sales by or for the issuer, it would have to be determined whether a "public offering" was involved. Also, in the case of sales by a person who acquired the offered securities from the issuer, it would have to be ascertained whether the reseller was an "underwriter" within the meaning of the statute. Finally, even if the reseller did not obtain the offered securities from the issuer, it would have to be determined whether the person from whom they were acquired was "any person directly or indirectly controlling or controlled by the issuer, or any person under the direct or indirect common control with the issuer."

It was suggested at the seminar that the provisions of rules 144 and 146 clarify the "public offering" and "underwriter" concepts of the 1933 Act, and that the application of the "limited offering" and "distribution" concepts of the Code would in substance parallel those rules. Accordingly it was urged that, at least to that extent, the Code is unnecessary. But there was emphatic concurrence at the seminar as to the major burdens and sheer complexities involved in any attempt to comply with rules 144 and 146, complexities

33. See, e.g., Wolfson, supra note 6, at 1504; Panel Discussion, supra note 6, at 1521.
35. Id. § 77b(11).
36. Id. § 77(d)(2); 17 C.F.R. § 230.146 (1978).
38. Id.
40. Id. § 230.146.
41. See, e.g., Speech by Homer Kripke, Fourth Annual Baron de Hirsch Meyer Lecture Series, University of Miami (Feb. 9, 1979) at 36 (transcript on file at the University of Miami Law Review.)
42. See, e.g., Wolfson, supra note 6, at 1510.
43. Id. at 1508. An instance of the Commission's efforts to clarify rule 144 and certain
which almost since their initial adoption the Commission has recognized and has been attempting to remedy. In addition, even if the provisions of the Code were substantially comparable to the present rules, a determination under the Code as to the existence of a "limited offering," unlike reliance upon rules 144 and 146, would not merely serve as a "safe harbor" against subsequent criminal prosecution or Commission-sought injunction. Those provisions would specify definite criteria by which to determine, for all purposes, whether an issuer or any other seller of an issuer's securities need conform to the "offering statement" requirement of the Code. That determination would rest upon a solid statutory basis rather than upon the vague authority of the Commission to make rules "necessary to carry out" the provisions of the Act.45

Passing, then, various specific terms of the Code which on review by the Commission and the Congress may call for some modification, certain major achievements of the Code should be emphasized.

1. Correlation of Scattered, Duplicative and Inconsistent Provisions. This was one area where the lecturers, with the possible exception of Professor Benston, joined in substantial commendation of the Code. Dean West put it well when, although evidencing some skepticism as to certain provisions of the Code, he stated that he was "basically very supportive" of the importance of the codification effort, and that part II alone, containing definitions applicable throughout the Code, would have been "worth it all."46

Thus the Code has brought order out of the "mildly chaotic" state of the present scattered, duplicative and inconsistent statutory provisions. In this connection, the Code reflects a great deal of integration, rearrangement and systemization of the "monstrosity" created out of the 1934 Act by the eighty-four page Securities Acts Amendments of 1975.47 Those amendments, although ingeniously effectuating a number of needed basic reforms, were of necessity the

related rules is reflected in SEC Release No. 33-6099, (August 2, 1979) [Current volume] FED. SEC. L. REP. ¶ 2787, in which the Commission, referring to four previous comparable releases since 1977, published a collection of interpretations, primarily of rule 144, in order to "resolve certain recurring issues that have arisen under the rules," and in the hope that the release would "reduce the need for members of the public to request interpretive advice from the staff regarding the rules in question." ¶ 2787 at 2923-2, 2923-3.

44. FED. SEC. CODE, supra note 1, at §§ 242(a)-242(b).
46. West, supra note 7, at 1485.
48. FED. SEC. CODE, supra note 1, at xxxviii.
result of a patchwork process. Equally significant is the full treatment in two separate but coordinated parts of the Code of the provisions governing criminal liability and civil liability. 49

2. Exempt Offerings. As evidenced by the discussion following the lectures, the provisions of the Code with respect to exemption from its “offering statement” requirements 50 are of great interest. Here, as indicated above, the Code goes far to clarify and make meaningful some of the fundamental concepts of the 1933 Act which have baffled the business and financial communities and the Commission itself for many years.

After the seminar’s extended consideration of these provisions it would be gratuitous to endeavor to summarize them. It is significant that:

(a) The Code eliminates, or in any event effectively lowers, the present regulatory barriers to the modest financing of small business enterprises; the tremendous importance of this to our economy was only recently emphasized by Chairman Williams; 51

(b) The elaborate and crippling provisions of rule 146, even though purportedly designed to facilitate a valid private offering, would be supplanted by the clear-cut “limited offering” criteria of the Code; 52

(c) The genuinely regional enterprise, regardless of its interception by the boundary line of two states, can proceed readily with its financing, subject of course, to the absence of fraud or misrepresentation and to the blue-sky requirements of the states involved; 53

(d) The criteria to be applied in determining whether an offering statement is required in connection with resales of securities

49. Id. pts. XVI, XVII.
50. Id. §§ 302; 502(b)(6); 512.
51. It is to be noted that the Commission recently simplified the registration and reporting requirements for limited offerings by small businesses. Securities Act Release No. 6049 (Apr. 3, 1979), 44 Fed. Reg. 21562 (1979).


52. Fed. Sec. Code, supra note 1, at § 242. The need for relief from the present unduly restrictive provisions of rule 146 is indicated by the Commission’s request for comments on proposed rule 242. The rule would eliminate all requirements for the furnishing of specific information by the issuer in an unregistered offering made by it only to persons investing $100,000 or more (“accredited persons”) where the total offering price does not exceed $2,000,000, and would simplify informational requirements where the purchasers consist of only accredited persons and not more than thirty-five nonaccredited persons. SEC Release No. 33-6121, (Sept. 11, 1979) [Current volume] Fed. Sec. L. Rep. (CCH) ¶ 82,205. See [1979] 519 Sec. Reg. & L. Rep. (BNA) A-1.

53. Id. § 514.
A RESPONSE TO THE CRITICS

purchased from the issuer are clearly defined;\textsuperscript{54}
(e) The undefined status of a “control” relationship, so critical with respect to secondary transactions under the present law, would no longer need to be determined;\textsuperscript{55}
(f) An exemption from the “offering statement” requirements has been retained for small offerings, with some regulatory latitude granted to the Commission as to offerings that exceed $50,000;\textsuperscript{56} and
(g) The Code grants the Commission a general exemptive power, exercisable by rule or order, with respect to the requirements of the Code, except for certain “policy-oriented” provisions.\textsuperscript{57}

3. Market Regulation. Understandably enough, the discussion following the lectures was in large measure devoted to consideration of the revised procedures of the Code which would govern all “primary” or “secondary” distributions of securities. There was, however, somewhat less than adequate recognition of the importance of the continuing informational requirements of the Code\textsuperscript{58} with respect to any substantial enterprise, not only from the standpoint of the prospective initial investor and the “target” stockholder, but also from the standpoint of the existing investor. The existing investor’s question is not necessarily whether to purchase in a public offering or to accept or reject a tender offer, but whether to retain, sell, or add to his investment in an unsolicited transaction. Closely related are the requirements of the Code applicable to professionals and institutions whose business is buying, selling and trading outstanding securities, as well as to broker-dealers and investment advisors.\textsuperscript{59}

4. Civil Liability. It is in the area of civil liability, as Professor Loss pointed out in his lecture, that the Code perhaps accomplishes most in bringing order out of the “really chaotic” state of the present law.\textsuperscript{60} Such accomplishment is manifested in four major respects:

\textsuperscript{54} Id. §§ 242(b)(1)(B) and (C), and 512(b),(c) and (d).
\textsuperscript{55} Id. § 510; ALI FEDERAL SECURITIES CODE § 509(e)(5) comment (Tent. Draft No. 1, 1972).
\textsuperscript{56} FED. SEC. CODE, supra note 1, at § 512(e).
\textsuperscript{57} Id. § 1804.
\textsuperscript{58} Id. § 402.
\textsuperscript{59} Id. §§ 701-706.
\textsuperscript{60} Loss, supra note 47, at 1445. With reference to the treatment by the Code of the Rule 10b-5 area, Professor Loss stated: “Our main aim there was to try to achieve some sort of philosophically consistent lines that have developed in this field; to try to make some sense out of measure of damages, some sense out of statute of limitations, some sense out of
First, the scattered provisions in present legislation which expressly impose civil liability are frequently inconsistent and sometimes overlapping. The Code supplants these provisions with a single part XVII. The provisions of the Code are arranged in an orderly manner and separately recognize definite categories of civil liability, including liability arising from the sale or purchase of securities in violation of the law, fraud or misrepresentation, false findings, misconduct of fiduciaries or investment advisers, market manipulation or “insider” trading, violation of the Code’s provisions applicable to proxy solicitations or tender offers, or the rules promulgated by self-regulatory organizations and the excessive extension of credit. These provisions are correlated with the substantive mandates of the Code but are not commingled with them, and provide criteria applicable to such significant elements of civil liability as the burden of proof, the causation of loss, available defenses, the measure of damages, and ancillary relief.

Second, the Code goes far to resolve the uncertainties of implied liability which have developed over many years. The courts, with frequent lack of uniformity in result, have struggled to ascertain whether it was the “intent” of Congress, absent express provisions, to impose civil liability for failure to comply with a statutory mandate. Additionally, the courts have disagreed as to whether such liability must be based upon the defendant’s scienter or recklessness, or need involve only negligence. In addition to the resolving of these uncertainties by its specific provisions, the Code, in section 1722(a), meets the need for judicial development of the law by au-

---

62. Id. § 1703.
63. Id. § 1705.
64. Id. § 1709.
65. Id. § 1710.
66. Id. § 1714.
67. Id. § 1713.
68. Id. § 1721.
69. Id. § 1716(a).
70. Compare Blue Chips Stamps v. Mason Drug Stores, 421 U.S. 723 (1975) with Wilson v. First Houston Investment Corp., 566 F.2d 1235 (5th Cir. 1978), as to which a petition for certiorari was pending at the close of the October 1978 term. In the latter case a majority of the Court, in holding that a private cause of action should be implied, reviewed recent relevant decisions of the federal courts and carefully applied the “four-prong” analysis enunciated by the Supreme Court in Cort v. Ash, 422 U.S. 66 (1975).
A RESPONSE TO THE CRITICS

authorizing the courts, subject to certain restrictive guidelines, to recognize private actions based on a violation of the Code for which there is no express provision.

Third, the Code wisely recognizes and ingeniously implements the need for differentiating between market transactions, where the buyer-seller relationship is fortuitous, and face-to-face transactions involving direct communication between the buyer or seller. This difference is most significant in ascertaining the identity of those entitled to relief and the applicability of the "consolidated action" provisions of section 1407(c) of the Judicial Code. Distinguishing between these two types of transactions is also important in applying the defense of plaintiff's knowledge, and in determining the measure of damages.

Fourth, the Code specifically confirms that forecasts of probable future facts, if made without appropriate basis or qualification, may be as detrimental to a prospective buyer or seller as representations of existing fact. The Commission, contrary to its earlier longstanding approach, has recently encouraged the use of projections, and has now, by rule, provided a "safe harbor" from liability for projections made on a reasonable basis and in good faith, relating to an issuer's future economic performance or to management's plans for future operations. It would be far preferable, however, to have a statutory basis, rather than an interpretive rule, by which to determine to what extent liability may be based on unrealized forecasts.

It would unduly extend these comments to emphasize the many other achievements of the Code, and I will therefore consider briefly the present status of the Code and the program which lies ahead.

As indicated above, the work on the Code began in 1969, with the encouragement of the Securities and Exchange Commission, which had assured the ALI of its cooperation. Beginning in 1972, successive parts of the Code were annually reviewed by the ALI membership and a proposed final draft had taken shape by mid-

73. Section 1711, which authorizes a court, upon learning that an action is pending against the same defendant in another court and that the aggregate prayers for damages exceed the limitation as to the action, to transmit the records before it to the judicial panel authorized by 28 U.S.C. § 1407, only applies to actions based on market transactions. Id. § 1711.
74. Id. §§ 265; 1703(b), (e).
75. Id. §§ 265; 1703(b), (e).
76. Id. §§ 256, 297(b).
1977. During this period, the Commission was kept informed of the progress of the codification program with at least one of its then current members being on the advisory panel. Particular provisions of the Code, especially in the later stages, were considered with and benefitted from the comments of Commission's staff members. Consequently, by the end of 1977 the Commission was aware of the essential provisions of the Code, although it had neither approved nor disapproved of any of its provisions.

At the time of the seminar, the Code was undergoing scrutiny by the House of Delegates of the ABA, and an endorsement was forthcoming. Professor Loss stated in his lecture that the appropriate subcommittee chairmen in both Houses had enthusiastically welcomed the Code and were prepared to introduce implementing legislation. The introduction of such legislation, however, was and is being deferred pending the submission to the Committees of the Commission's views.

Professor Loss also indicated that he had been holding discussions with the operating-division heads of the Commission and was receiving their comments on the Code. He hoped that the views of the staff would be available for Commission consideration by early March.

Subsequent comments by Chairman Williams, however, caused some concern that any endorsement of the Code by the Commission, even with possible specific revisions, may be further delayed. In March Chairman Williams stated that the staff of the Commission, having completed its discussions with Professor Loss, would begin preparation of a memorandum for the Commissioners, and accordingly, any Commission action on the Code was still several months away. Furthermore, Commissioner Pollack, although stressing the tentative nature of his views pending the staff's review, has strongly questioned whether "at this juncture" any attempt to review or pass a complete code is a wise move. His reasons apparently are that the Code is "massive" (as indeed is the confused mass of legislation which it would replace); that the Code was drafted during a dynamic period against a moving target of legislative and judicial development; and that portions of the Code (which were not identi-
fied) may become obsolete by the time the Congress considers them. The Commissioner Pollack also suggested the possible desirability of separate periodic consideration of various parts of the Code. I respectfully submit that such a "piecemeal" approach, though it may have achieved substantive improvements in some areas, is at the root of the present complexity of the federal securities laws. As Professor Loss put it in his lecture, past efforts of this sort have in effect constituted repeated patches of a very rusty boiler.

The desirability of a thorough review of the Code by the Commission before implementing legislation is introduced in Congress is understandable, and its views will properly receive serious consideration. It is, however, hoped that an unduly long delay, foreshadowed by Chairman Williams, will not materialize and that the concerns expressed by Commissioner Pollack will not prevail. This would mean that the Commission would favor an early submission of the Code to the appropriate congressional committees. It would not mean that before any such submission the Code must in all respects have been endorsed by the Commission. Rather it would mean that the Commission would recognize the value of affording an opportunity for the expression of the views of all interested parties before the congressional committees, and for the consideration of such views by the Commission, as well as the Congress, in arriving at the final provisions of the Code.**

It is true, as Commissioner Pollack indicates, that there have been significant legislative and regulatory developments in the last ten years. Most of these developments, however, occurred during the formulation of the provisions of the Code and were taken into account as it was being drafted. It is also true that during recent years innumerable uncertainties and inconsistencies, particularly in the area of civil liability, have arisen. They have been generated by judicial and administrative mind-reading of the "intent" of Congress with respect to the availability of implied liabilities and remedies where the operative legislation contains only general mandates or prohibitions. This very situation especially warrants the expeditious submission to Congress of specific criteria established by the

84. Id.
85. Id.
86. Loss, supra note 47, at 1450.

** Author's note: In view of the time lapse since the writing of these comments, as well as the pending consideration of the Code by the Commission, the legislative status of the Code may have substantially changed by the date of publication.
Code for the resolution of a multitude of these uncertainties and inconsistencies.

The drafting of the Code was of necessity done against a moving target of legislation; and Commissioner Pollack's views seem in large part to reflect his concern that the target will keep moving. But the Code, through its reorganization and logical classification of the securities statutes and rules, will provide a far better framework than now exists in which to incorporate in an orderly manner whatever may be the unpredictable and possibly erratic future changes in our present federal securities laws.

There may be those who will take the view that there should be no consideration by the Congress of the Code until there can be an assurance of a fairly static state in federal securities regulation for some years to come. If so, the work product of those who, in the public interest, gave much thought and countless hours to a project made possible by the collaboration of the membership of the ALI and the ABA and by the substantial contributions of others can be put in the archives of the Library of Congress as an interesting but futile relic.