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BOOK REVIEWS


James Madison wrote to Thomas Jefferson in 1791: "Stock and scrip the sole domestic subjects of conversation . . . speculation . . . carried on with money borrowed from two and a half per cent a month to one per cent a week." Madison's words would have applied as well in 1929 as they did then except that money, twenty per cent on call, was a bit cheaper. And the warning words printed in the New York Advertiser of August 9, 1791, would have been even more applicable: "The National Bank Stock has risen so high, so enormously above its real value, that no two transactions in the annals of history can be found to equal it."

But the crash of 1792 is remembered solely by students of financial history. Few people recall or talk about the slumps of 1897, 1907, 1921 or 1938. People were financially ruined then just as they were ruined in 1929—only not so many people. And hard on the heels of each market collapse came spasmodic, "remedial" legislation aimed at practices detectable by even the most casual observer. But 1929 was something different. New rulers of the financial roost like Mike Meehan, the Fisher brothers, Jesse Livermore, and Harry Content operated in the stock market, never center of the nation's financial structure, on a scale never dreamed of before. These mystery men of Wall Street destroyed all precedent and tradition, and they took all industry as their field. They ushered in an era of major manipulation, of tidal movements in speculation, of pools and syndicates so enormous that the operating combines of other days were dwarfed to toy proportions. The outmoded machinery of the New York Stock Exchange collapsed under the strain of keeping pace with the "greatest bull market in history."

But the greatest of all bull markets was followed by the loudest of all crashes. Spasmodic, plug-gap legislation was no longer the answer. Something big had happened and something bigger was necessary to prevent its recurrence. Congress had two alternatives: It could take over the New York Stock Exchange and all other exchanges; or it could deal with securities as it had dealt with railroads in the past—i.e., set up a regulatory commission, a cop to watch over the securities markets. Congress chose the latter course, and enacted the Securities Act of 1933 and the Securities Exchange Act of 1934. The Securities and Exchange Commission was set up as the agency to administer these acts. It is the work of this commission and the administration of the 1933 Act that McCormick depicts in his Understanding The Securities Act and The S. E. C.
McCormick, at present Assistant Director of S. E. C.'s Corporate Finance Division, is well qualified to write such a book. Graduate work in economics at Duke University provided him with a theoretical background. Membership on the S. E. C. staff almost since its inception coupled with C. P. A. practice have given him a practical working knowledge. Impartial readers of his book will be quick to agree that it reflects an admirable interlacing of theory and practice.

Laws dealing with the issuance and trading of securities are not new. Such legislation has almost without exception met with bitter resistance when introduced, especially by those pseudo-champions of "free enterprise." But, as McCormick points out, passage of the 1933 Act was advocated not only by New Dealers but by the majority of the traditionally Republican brokerage fraternity as well. After the 1929 debacle, it was easy for the Monday morning quarterbacks of finance to blame the stock market for the collapse and ensuing depression. Such a view, however, made about as much sense as ascribing a cold wave to a drop in temperature. Wiser heads knew that the Market merely registers, and does not cause, what takes place in the realm of business profits and losses. An answer that made more sense, at least to Congress, was the method in which the Market was operated. Under this heading were such other answers as unfair trading practices, unlimited credit in security transactions, and inadequate information to the public.

The real purpose of the Securities Act of 1933 was to place the truth, the whole truth, and nothing but the truth before prospective buyers of a new security before its actual sale to the public. In determining the scope of the 1933 Act Congress again had two alternatives. First, it could create an agency with power to tell who what to sell. In short, such an agency could say to a corporation, promoter, or broker: "You can sell only bonds and preferred shares to the public." Or—"You can sell only bank stocks and chemical stocks—no others." The second alternative, adopted by Congress, was to permit brokers, promoters or corporations to sell anything to the public as long as the truth was told about the type of security being sold. In effect, if you state the nature of the company's business, what its earnings picture has been, how much money is going to promoters, and so on—if you tell all these things truthfully, then no matter how much the truth hurts, you can sell anything to the public.

The theory behind this choice was that if the public knew all the facts, it would not be deceived and it would buy or not buy accordingly. The theory sounded good. But it hasn't worked out. Here is why it hasn't worked out. The SEC requires that all of the facts be gathered together in a document known as the registration statement. Later, on the basis of this statement, a prospectus is issued. It in turn is checked and re-checked for truth and
accuracy. The prospectus is then made available to the public. There is nothing in it that could possibly mislead even a child.

The only trouble is that nobody bothers to read it—that is, except the SEC and a relatively few brokers and investment bankers.

Sure, it contains the truth. But who wants to read the truth in a 78-page document with fine print? Can you persuade an Italian barber to read it? Or a scrubwoman? Or a hurried businessman? The worst of it is that the truth often hurts. The prospectus, on page 69, discloses that the ABC corporation has been losing money for the last 27 years. There have never been any dividends paid, probably never will be. There is a huge bonded debt. And so on. But Sam the garageman doesn't want to wade through 78 small-type pages to find this out. All he wants to know is, "Did it get by the SEC?" If the SEC "approved" it, then it must be all right. Of course, the SEC has never approved the soundness of any security. The prospectuses even say that. But these precautions are in vain. The public still believes that when the sale of a security has been permitted by federal authorities, it has in some sense been approved and is therefore "safe."

What can be done?—"The only thing the SEC can do under the law is to disclose all the facts to the public . . . the SEC should not inject itself into what a fellow can or cannot sell to the public." That is the answer of former SEC Chairman Ganson Purcell. "Congress hasn't given us permission to outlaw speculation." That is the answer of former Commissioner Robert E. Healy. "We can see that the dice aren't loaded, but we can't save a fool from his folly." And that was the answer of former SEC Chairman, now Supreme Court Justice, William O. Douglas. There is, of course, the other alternative, the one Congress didn't adopt ("telling a fellow what he can or cannot sell to the public"). The Interstate Commerce Commission actually does this; it tells the railroads what securities they can or cannot offer for public sale. To give the SEC such power would require new legislation, however, and such legislation is not yet in sight.

It is to be regretted that the author suggests no concrete proposals, short of new legislation, for improved public safeguards. This writer submits that the Commission could, under existing legislation, require that a simple two or three paragraph statement on the pertinent facts of each new security offered for sale in interstate commerce or by use of the mails be submitted to every person inquiring about the purchase of that security. But if the author is silent on suggestions for improvement here, he hits hard, and justifiably so, in criticizing another weak spot in the 1933 Act—the "waiting" period.

1. For actual examples of how much the truth often hurts, see Velie, Babes in Wall Street, Collier's, April 27, 1946.
Present legislation affords no means for adequate dissemination of information to prospective investors during this period.\(^2\)

After pointing out that this is a "valid criticism of the act," the author specifically recommends that "the statute be amended to permit oral and written offers during the waiting period provided the first written solicitation takes the form of the complete statutory prospectus."

Part II of McCormick's book, *Interpretation of Securities Act of 1933*, will be of most interest to lawyers, especially those who have only occasional SEC business. This section of the book is handled adeptly by one who is not himself an attorney. Treatment of registration and both criminal and civil liability under the Act is as well stated as it is exhaustive. Decisions are adequately cited and analyzed, a feature rarely present in the work of a layman.

The "Truth in Securities" Act is over fifteen years old. To the writer's knowledge McCormick's book is the first authoritative treatment of the Act in operation. Needless to say, Wall Street lawyers will find this book a must. But the Main Street lawyer and the student of law and business will also benefit greatly from the research and analysis it contains.