

LEGAL ASPECTS OF THE WORK OF THE  
SECURITIES AND EXCHANGE COMMISSION

Address of

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Washington, D. C.

before

THE CHICAGO BAR ASSOCIATION

Chicago, Illinois

November 29, 1955

It is a great pleasure for me to be in Chicago and have the opportunity of addressing the Chicago Bar Association at its 42nd Quarterly Annual Meeting. It is a particular pleasure for me to be in the Bar Association which I consider "home" and at a meeting in which one of the committees, the Committee on Corporation Law, on which I served while I was an active member of the Association, makes its report for the past year.

There are members of this Association who are familiar with the work of the Securities and Exchange Commission. However, it has been my experience in meeting with many professional groups over the past two years during which I have been a member of the Securities and Exchange Commission, and particularly in the last six months during which I have been its Chairman, that business and professional people generally know that the Securities and Exchange Commission is an important Government agency but are not altogether certain as to its position in the Federal Government and the manner in which it performs its statutory functions. I thought, therefore, it would be interesting to the members of the Chicago Bar Association, not only those of you whose practice involves the Federal securities laws, but also those of you whose legal experience is not particularly in this area, to hear a brief discussion of the Commission's position in the Federal Government and its functions in the regulation of the interstate market in securities.

As to the statutes we administer, the Commission was established by the Congress in the middle 1930's in the exercise of the power granted by the interstate and foreign commerce clause of the Constitution to regulate new issues of corporate securities where the mails or facilities of interstate or foreign commerce are used and to regulate trading in securities on national securities exchanges, that is all major stock exchanges. The statutes were revised in the late 1930's to grant more specific jurisdiction in the field of regulation of the over-the-counter markets in securities. Also, there was added special and detailed regulatory authority with respect to trust indentures, corporate reorganization under the Bankruptcy Act, public utility holding companies, investment companies and investment advisers. The jurisdiction is broad and extensive and its indirect economic impact large.

The amount of new issues of corporate securities registered with the Commission under the Securities Act for sale to the public in interstate commerce in 1954 was \$9.6 billion and in the first nine months of 1955 \$10.1 billion. The market value and volume of all shares traded on national securities exchanges in 1954 was \$28.1 billion and 990 million shares and in the first nine months of 1955 \$29.3 billion and 940 million shares. The net utility assets of the public utility holding companies subject to our jurisdiction at the end of 1954 were \$12.0 billion representing about 20% of the total privately owned public utility business in the

United States and the net assets of investment companies subject to our jurisdiction at the end of 1954 were \$10.3 billion.

The Commission is an independent bipartisan agency composed of five members, each appointed by the President, subject to Senate confirmation, for five-year terms. One Commissioner's term expires each year permitting considerable continuity despite changes in the national Administration. Under the law no more than three of the five Commissioners may be of the same political party. The Commission has administrative responsibility, it has quasi-judicial responsibility, and it has responsibility for adopting rules and regulations under the acts it administers, some of which are quasi-legislative in nature.

Let me give you a few examples of these different functions of the agency. First, in the administrative field, a principal function of the Commission is to examine registration statements relating to new issues of securities to assure compliance with the statutory standards and Commission rules for fair disclosure of the facts about the issuing company and the securities being registered. If the registration statement appears on its face to meet the requirements, it is permitted by the Commission to become effective, thus allowing the securities to be sold. Another example of our administrative function is our activity in enforcing the various provisions of the Exchange Act regarding the conduct of brokers and dealers and national securities exchanges, which require compliance with many statutory and rule provisions concerning

such things as the maintenance of minimum capital, keeping of books and records, hypothecation of customers' securities, margin requirements, the provisions against manipulation and fraud, stabilizing of prices in connection with distributions, as well as the many rules in effect with regard to the conduct of the exchanges and the members of exchanges with respect to such things as short selling, activities of floor traders and the like.

When a violation occurs of sufficient importance to justify the Commission bringing proceedings, the quasi-judicial functions of the Commission are brought into play. For example, under the Securities Act, if a registration statement does not appear to comply with the full disclosure or anti-fraud provisions of the Act, the Commission has power to institute a stop-order proceeding. This immediately adds to our administrative functions additional quasi-judicial responsibilities. Procedurally, the Commission serves on the parties a "statement of matters" alleging deficiencies in the registration statement. A full evidentiary hearing is held before the Commission or, because there would not be time for the Commission to sit on all cases, before a hearing examiner, a legal record is made, the case is briefed and argued before the Commission and the Commission then makes findings of fact and conclusions of law and either suspends the effectiveness of the registration statement or not, depending on the findings it makes which are based upon the record made in the proceedings. This order is appealable to a Court of Appeals of

the United States. Proceedings under the Exchange Act are similar. The Commission has the authority under this Act to revoke the registration of a broker-dealer. This is a drastic power.

When the Commission is sitting to decide whether or not the registration of a broker or dealer in securities should be revoked, it has great responsibility to the public interest. It cannot help but be aware that a judgment adverse to the broker-dealer will deprive that person and possibly his employees of their means of a livelihood. The grounds on which a revocation may be ordered are clearly specified in the statute. In practice the most important ground for revocation of broker-dealers is fraud perpetrated on their customers. The duality of functions involved in the agency's developing the facts on which a proceeding is based and then sitting in judgment on those facts presents problems which have been carefully considered by the Bar over years past. Procedures were established before the passage of the Administrative Procedure Act of 1946 to assure that the decisional functions of the administrative agency are kept completely separate from those of the investigation and prosecution of the case. The Commission itself becomes insulated from the staff in charge of developing and prosecuting the case.

The staff presents what you might describe as the "prosecution side" of the case to the hearing examiner and the rules of evidence are followed at this hearing. The staff then briefs and argues the case before the Commission and, except for matters the Commission may take into

account under the legal principle of judicial notice, it only considers the formal evidentiary record made in the hearing, together with the briefs and arguments, in arriving at its final decision.

Because the volume of work is great, the Commission is aided by a special staff group known as the Office of Opinion Writing. The lawyers in this office, whose function is comparable to that of law clerks of the Federal judges, help the Commission in analyzing records and drafting findings of fact and conclusions of law. In the day to day operations of the Commission, the Opinion Writing Office is isolated from the operating divisions and offices, and the personnel of the Opinion Writing Office take professional pride in avoiding contact with the investigatory and prosecutory staff of the Commission.

So much for administrative and quasi-judicial functions. Let me say a few words about rule-making and how this may be in some cases quasi-legislative in nature. The fact that the Commission may be said in a legal sense to exercise quasi-legislative authority does not imply at all that it is doing anything which derogates from the Congressional legislative power. Just the opposite is the fact.

There are many areas in the regulation by the Congress of interstate and foreign commerce in which the Congress has recognized that complications were so great, need for swift action was so great, need for flexibility was so great, that the Congress established independent agencies for the very purpose of delegating to those agencies powers

which in fact Congress could exercise itself if it wished to, but which are better exercised by administrative agencies.

You are all familiar with the history of the establishment of the Interstate Commerce Commission back in the 1880's, which was the first of the great administrative agencies established by the Congress for this purpose. The Securities and Exchange Commission is similar. There are many provisions in the statutes the Commission administers giving the Commission the power to make rules and regulations. However, the rules which are made pursuant to statute must be in accordance with statutory standards.

For example, in Section 14 of the Exchange Act, the Congress in very broad language gives the Commission the power to make rules and regulations with respect to the solicitation by any person of proxies from the holders of securities which are listed on national securities exchanges. Over the past twenty years the Commission has established a body of regulation, known as the proxy rules, in which it sets forth specific requirements -- all in accordance with the statutory standards expressed in that section of the Exchange Act.

Procedurally, in rule-making the Commission proceeds in a manner not too different from that of a Congressional Committee. The Commission and its staff, Congressional Committees, individual Senators and Congressmen, and the public generally, develop and submit recommendations for rules or revisions of rules. These are examined by the



Commission in the light of its experience in cases and in the light of the statutory standards. Before adopting a new rule or rule revision, the Commission generally promulgates it merely as a proposal for public comment. For informational purposes, copies of proposed rule changes are sent to the Banking and Currency Committee of the Senate and the Interstate and Foreign Commerce Committee of the House so that these Committees, charged with observing the work of the Commission under the Legislative Reorganization Act of 1946, will be advised of the steps proposed to be taken. Written comments are received from the public over a period of weeks or months.

It has been the policy of the Commission in the past several years that there shall be a public hearing on all major rule changes. For example, in the past two weeks the Commission has completed public hearings on its proposed revisions of the proxy rules, and on its proposed revisions of the regulations pertaining to issues of small size under the conditional exemption in the Securities Act for offerings not in excess of \$300,000.

The Commission also considers testimony that may have been given before, and discussions and reports that may have been had or made by, Congressional Committees or their members on the subject matter to which the rule pertains. We are considering, with relation to our revisions in these two areas, the records of the hearings held by a Subcommittee of the Senate Banking and Currency Committee on the

subject of proxies and the hearings held by a Subcommittee of the House Interstate and Foreign Commerce Committee on the subject of speculative "penny" stocks.

Occasionally the Commission is faced with problems involving its relationship as an independent agency performing executive functions to other branches of Government. For example, in its administrative capacity the Commission has broad powers under the statutes to conduct investigations. The purpose of these investigations is to determine whether the acts are being complied with and many investigations lead to administrative proceedings before the Commission or injunctive proceedings in the Federal Courts and some result in indictments and criminal prosecutions. With respect to securities law violations, the Commission has a function which is similar to that of the Federal Bureau of Investigation with respect to other Federal criminal statutes. We have, like other Government agencies, regarded our investigation files as not open to the public, as making public investigation files would seriously impair, and indeed might make impossible, effective investigative work. However, every now and again problems develop.

For example, this past year in a private law suit to which the Commission was not a party, a Federal district court attempted to get possession of certain data which the Commission had in its files as a result of an investigation which it was making of transactions involved in the law suit. After seriously considering the public interest involved

in making its investigative files public, the Commission determined that it would be adverse to the public interest to disclose the contents of its files. The District Court, for the purpose of forcing the Commission to make disclosure, held the Commission's General Counsel to be in contempt of court and sentenced him to sixty days in jail. Naturally, the Commission appealed the ruling to the Court of Appeals, and the Court of Appeals for the Sixth Circuit held that the judicial power vested in the Federal Courts could not be used to require the Commission to produce papers where the Commission determined this would not be in the public interest. The contempt order against our General Counsel was set aside. 1/

Occasionally Congressional Committees, in the very proper discharge of their legislative functions, request information about particular cases which are pending under investigation or in actual litigation. We have been fortunate in working out the furnishing to Congressional Committees of requested information in such a way as not to impair our law enforcement work.

The good relationships which the Commission has with the Congressional Committees result from a mutual recognition by the Committees and the Commission of the basic objectives of the Congress and the

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1/ Appeal of the United States Securities and Exchange Commission and William H. Timbers, Its General Counsel (C.A. 6, No. 12, 503, October 19, 1955)

Commission in the field of law enforcement with respect to interstate commerce in securities.

I will conclude by emphasizing the importance, if the work of the Commission in administering the securities laws is to achieve its maximum effectiveness, of the assumption by members of the Bar of their full responsibility in the field. We are dependent in every phase of our law enforcement activity on the work of responsible lawyers representing those over whom we have regulatory authority. Generally speaking, those lawyers who participate in the preparation of registration statements, in representing registered brokers and dealers and exchanges, in representing issuers and underwriters, and others who come before the Commission, are helpful not only to their clients but to the Commission in achieving conformity with the fair disclosure and anti-fraud provisions of the statutes. Just for example, the registration statements that are filed under the Securities Act today in many cases require little or no comment by the staff of our Division of Corporation Finance. The skill of lawyers in assisting their clients to set forth the pertinent facts fully and concisely is vital to the effective administration of the statutes. Unfortunately, sometimes registration statements are filed without a clear recognition of the importance of compliance with the Acts by those on whom the legal responsibility rests. Companies proposing to issue securities in a number of recent cases seem to have forgotten or overlooked the fact that responsibility for the registration statement rests with them

and with the underwriters, and not with the Commission. It is not the function of the staff of the Commission to rewrite registration statements. Our staff is ready to assist those who in good faith assume the burden of preparing the registration statement and are as helpful as possible in suggesting whatever may be needed by way of additional information if the registration statement, as filed, is not entirely complete. But the Commission's policy in the public interest and for the protection of investors, is immediately to commence stop order proceedings in those cases in which the issuer and underwriter refused to comply with, or ignored, the disclosure standards of the law or where the registration statement appears on its face to be false and misleading. Since the beginning of the present calendar year, the Commission has instituted eight such stop order proceedings and has several investigations under way with respect to a number of other registration statements.

The Commission is in a very real sense appreciative of the many careful and thoughtful comments submitted by lawyers on its rule revision program. We have been greatly aided by some members of this Association who have taken time to write us about many important rule changes made during the past few years or presently under consideration and we urge the legal profession to give us their best efforts, their backing and support as we endeavor to fulfill our responsibilities in administering the Federal securities laws.