Michigan Law Review

Volume 62 | Issue 4

1964

A Reappraisal of the Role of Disclosure

Robert L. Knauss
University of Michigan Law School

Follow this and additional works at: https://repository.law.umich.edu/mlr

Part of the Legal History Commons, and the Securities Law Commons

Recommended Citation

Robert L. Knauss, *A Reappraisal of the Role of Disclosure*, 62 MICH. L. REV. 607 (1964).
Available at: https://repository.law.umich.edu/mlr/vol62/iss4/5

This Article is brought to you for free and open access by the Michigan Law Review at University of Michigan Law School Scholarship Repository. It has been accepted for inclusion in Michigan Law Review by an authorized editor of University of Michigan Law School Scholarship Repository. For more information, please contact mlaw.repository@umich.edu.

A REAPPRAISAL OF THE ROLE OF DISCLOSURE

*Robert L. Knauss**

THE *Report of Special Study of Securities Markets*[1] contains the following statements on the role of disclosure:

> "The keystone of the entire structure of Federal securities legislation is disclosure."[2]
>
> "The Commission's functions and responsibilities under the two basic securities laws are broadly of two types: first, to preside over the processes of disclosure, especially by issuers of securities, upon which these laws so basically rely; and second, to regulate substantive conduct in the securities market, both directly, and by supervision of industry self-regulation."[3]

These statements should be compared with that found in the leading textbook on securities regulation: "Then too, there is the recurrent theme throughout these statutes of disclosure, again disclosure, and still more disclosure."[4]

Disclosure, however, is not a simple method of regulation having universal application and universal effectiveness. It assumes a different role and meaning depending on the information to be disclosed, the party on whom the obligation of disclosure rests, and the parties for whom the information is intended. The objective of this paper is to assess the current role of disclosure in its various aspects in security regulation. Following a brief description of the current uses of disclosure in securities regulation, there are separate sections describing and evaluating (1) the obligation of disclosure imposed on issuers at the initial sale of securities, (2) the obligation of disclosure resting on issuers if they have securities which are traded, and (3) obligations of disclosure imposed on parties in the securities business other than issuers. This last section includes obligations of insiders, broker-dealers, and investment advisers, as well as duties of exchanges and over-the-counter dealers to provide market data. A concluding section

* Associate Professor of Law, University of Michigan. Professor Knauss was a member of the Special Study of Securities Markets and is currently a Legal Consultant to the Securities and Exchange Commission.—Ed. The views expressed herein are those of the author, do not necessarily reflect the views of the Commission, and except where specific reference is made do not reflect the findings or recommendations of the Special Study.

1 *Report of Special Study of Securities Markets of the Securities and Exchange Commission*, H.R. Doc. No. 95, 88th Cong., 1st Sess. (1963) [hereinafter cited as *Special Study*].

2 *Special Study* pt. 3, at 1.

3 *Special Study* pt. 4, at 719.

4 1 LOSS, SECURITIES REGULATION 21 (2d ed. 1961).

discusses briefly the broader function of disclosure as a device to control internal corporate affairs.

I. THE VARIOUS ROLES OF DISCLOSURE IN SECURITIES REGULATION

The objective of the Securities Act of 1933[5]—the "truth in securities" bill—was to require that any company selling securities to the public disclose factual data concerning the company. The requirements of disclosure are imposed on the selling companies and parties such as underwriters who sell on behalf of the company. The nature of the disclosure is that of a seller to a buyer. President Roosevelt stated in his message to Congress of March 29, 1933: "This proposal adds to the ancient rule of caveat emptor, the further doctrine 'let the seller also beware.' It puts the burden of telling the whole truth on the seller."[6]

Following the initial distribution and sale by the company, there is a change in the basis of the obligation of the company to disclose. When one investor sells securities to another through the facilities of an exchange or in the over-the-counter market, the company is not a part of the transaction, and receives no direct benefit. The Securities Exchange Act of 1934[7] provides that companies the securities of which are listed on a national exchange must submit annual financial statements and other periodic reports.[8] In addition, such companies must meet requirements established by the Commission for the solicitation of proxies.[9] These obligations do not arise from a buyer-seller relationship, but represent a continuing responsibility of the company as long as its securities are traded on a national exchange. An aspect related to the reporting requirements of the Exchange Act is the rule of most exchanges requiring that the exchange (and thus the public) be informed immediately of any unusual corporate activity.[10]

These obligations of disclosure just mentioned rest on the company—the issuer of the securities and parties acting in its behalf.[11] A broad and growing area of disclosure remains: the

5 48 Stat. 74 (1933), 15 U.S.C. § 77 (1958 & Supp. IV, 1963) [hereinafter cited as Securities Act].

6 Quoted in H.R. REP. No. 85, 73d Cong., 1st Sess. 2 (1933).

7 48 Stat. 881 (1934), 15 U.S.C. § 78 (1958 & Supp. IV, 1963) [hereinafter cited as Exchange Act].

8 See the Exchange Act §§ 12, 13, 48 Stat. 892, 894 (1934), 15 U.S.C. §§ 78*l*, 78m (1958).

9 Exchange Act § 14, 48 Stat. 895 (1934), 15 U.S.C. § 78n (1958).

10 See NEW YORK STOCK EXCHANGE, COMPANY MANUAL A20-22 (1953).

11 Under the Securities Act the obligation of disclosure in the initial distribution rests not only on the issuer, but also on individual officers and directors of the issuer and those held to be underwriters selling on behalf of the issuer.

requirements applicable to various participants in the securities business other than the issuer. Some of the requirements are expressly delineated by statute, and others have been formulated by Commission decision and regulations. It is in this area that the greatest growth in the role of disclosure is taking place. The Exchange Act imposes a positive requirement that all officers, directors, and those holding ten percent of the outstanding stock in a listed company disclose all trades which they make of the company's stock.[12] This is an individual duty of each party as to every purchase or sale.

There are also various disclosures required for other parties who purchase and sell securities. The anti-fraud provisions of the Exchange Act compel positive disclosure by all purchasers and sellers to an extent beyond that needed to avoid a common-law action of fraud.[13] As the involvement of the party increases, his obligations increase. For example, a duty is imposed on a broker-dealer to disclose the manner in which a transaction is executed,[14] as well as the existence of conflicts of interest arising because he has a direct interest in the security he is selling. Recent decisions, and the recommendations of the Special Study go farther and would impose a positive duty of disclosure in numerous other instances.

Other participants in the securities markets, not involved directly in purchasing or selling, such as investment advisers, have been under pressure to make disclosure similar to that of broker-dealers. The Commission has declared it fraudulent for an investment adviser not to disclose the fact he has taken a position in securities he recommends.[15] Developing areas concern the need for the investment adviser to disclose the nature of his investigation and research, and the source of his information. Similar requirements of disclosure are in the developmental stage for corporate public relations men and others, such as magazine and newspaper editors, who are responsible for the appearance of financial information concerning a company.

A remaining aspect of disclosure involves the market-place itself. The exchanges have a responsibility to maintain accurate

12 Exchange Act § 16(a), 48 Stat. 896 (1934), 15 U.S.C. § 78p(a) (1958).

13 See text accompanying note 106 *infra* for duties of sellers and purchasers under the anti-fraud provisions.

14 See text accompanying note 101 *infra* for duties of broker-dealers under the anti-fraud provisions.

15 See text accompanying notes 138-44 *infra* for a delineation of the duties of investment advisers and public relations men.

reporting of current sales and volume of trading.[16] One of the goals of the future development of the over-the-counter market is to provide current market data similar to that available for securities traded on exchanges.

The disclosure obligations of participants in the securities industry are a part of a larger regulatory pattern which has numerous direct restrictions and prohibitions. It is in these areas of restrictive control that "self-regulation" plays an important role. With regard to the issuers of securities, disclosure is the exclusive method of control.

II. DISCLOSURE OBLIGATIONS IMPOSED ON ISSUERS IN THE INITIAL SALE OF SECURITIES

Because of the nature of securities, a buyer cannot make an immediate value judgment, as he would with tangible items. He must look behind the piece of paper and examine the merits of the company which has issued the security. The buyer must of necessity rely on the information given to him and on material generally available from the company. The less information available, the less the market price will be representative of the security's true value and the greater will be the opportunity for fraud.[17] The need for governmental regulation stems from this problem. The obligation of issuers of new securities to disclose financial and other data as required by the Securities Act of 1933 originated largely in the English Company Acts. This obligation and its active enforcement by the Securities and Exchange Commission performs an invaluable function. Disclosure requirements alone, however, cannot protect investors in new securities from loss, and it should be recognized that serious problems remain in spite of the relative success of the Securities Act. A short description of these disclosure requirements and their background will permit a better understanding of the unsolved problems.

A. *History of the Issuance Requirements*

The English law recognized at an early point that some control was needed over companies selling securities to the public. The initial effort was the Bubble Act of 1719,[18] which was enacted

16 See text accompanying notes 145 & 146 *infra*, relating to the reporting of market data.

17 One of the first statements of this view appears in Twycross v. Grant, [1877] 2 C.P. 469, 532. Similar language appears in Hall v. Geiger-Jones Co., 242 U.S. 539 (1917), which upheld a regulatory Blue Sky Law.

18 6 Geo. 1, c. 18.

following the spectacular stock frauds revealed in the bursting of the South Sea Bubble.[19] This act was definitely regulatory, as it in effect prohibited joint-stock companies (corporations) altogether. The prohibition proved unworkable. After several weakening amendments the act was completely repealed in 1825.[20] Stock frauds continued, and in response to public demand, the Gladstone Committee, first of several English committees to study the securities markets during the past 177 years,[21] was appointed in 1841 "to inquire into the laws respecting joint-stock companies with a view to the greater security of the public."[22] The company act[23] which followed the Gladstone Committee report was the real beginning of English corporation law; it had two basic objectives: (1) to obviate the evils of fraudulent and fictitious companies and (2) to protect the public from companies which, while not founded in fraud, were faulty in their nature because of unsound calculations and inadequate management. The answer to both problems, according to Gladstone, was to compel disclosure: "Publicity is all that is necessary. Show up the roguery and it is harmless."[24] The mechanics to achieve this publicity were elementary in scope. All that was required was

19 Parton, *Caricature in the Hogarthian Period*, Harper's New Monthly Magazine, June-Nov. 1875, p. 40, states that "besides the original South Sea Company which began the frenzy, there were started in the course of a few months about two hundred joint-stock schemes, many of which, as given in Anderson's *History of Commerce*, are of almost incredible absurdity. The sum called for by these projects was three hundred millions of pounds sterling, which was more than the value of all the land in Great Britain. Shares in Sir Richard Steele's 'fish pool for bringing fresh fish to London' brought one hundred and sixty pounds a share! Men paid seventy pounds each for 'permits,' which gave them merely the *privilege* of subscribing to a sail-cloth manufacturing company not yet formed. There was, indeed, a great trade in 'permits' to subscribe to companies only planned. . . . The prices paid for shares during the half year of this mania were as remarkable as the schemes themselves. South Sea shares of a hundred pounds par value reached a thousand pounds. It was a poor share that did not sell at five times its original price. As in France, so in England, the long heads, like Sir Robert Walpole and Alexander Pope, began to think of 'realizing' when they had gained a thousand per cent. or so upon their ventures; and, in a very few days, realizing, in its turn, became a mania; and all those paper fortunes shrank and crumpled into nothingness."

20 Companies Act, 1825, 6 Geo. 6, c. 91.

21 The other committees formed to study the securities markets were (1) The Royal Commission of 1854 (Rickard's Report); (2) Lord Doney's Committee (1895); (3) Loveburn's Committee (1906); (4) Greene's Committee (1926); (5) the Bodkin Committee (1937); (6) GREAT BRITAIN BOARD OF TRADE, REPORT OF THE COMMITTEE ON COMPANY LAW AMENDMENT (1945) [hereinafter cited as COHEN REPORT]; and (7) GREAT BRITAIN BOARD OF TRADE, COMPANY LAW COMMITTEE REPORT (1962) [hereinafter cited as JENKINS REPORT].

22 A full discussion will be found in FORMOY, HISTORICAL FOUNDATIONS OF MODERN COMPANY LAW pt. 2, § 4 (1923), and HUNT, THE DEVELOPMENT OF THE BUSINESS CORPORATION IN ENGLAND, 1800-1867, ch. 5 (1936).

23 Companies Clauses Consolidation Act, 1845, 8 & 9 Vict., c. 16.

24 Gladstone in the House of Commons (HANSARD, LXXV [1844] 277), quoted by HUNT, *op. cit. supra* note 22, at 95.

that the promoter file particulars of the name and purpose of the company, together with a copy of every prospectus or circular addressed to the public.[25] There were no provisions specifying the required content of the prospectus, nor were there mechanics for enforcing liability. The history of English securities regulation may be summarized as repeated attempts to increase the effectiveness of the required disclosure. Content of the prospectus was specified in detail;[26] requirements of distributing and filing a prospectus were increased;[27] civil liability of parties preparing the prospectus was tightened;[28] and a distinction was made between private and public companies, with disclosure requirements applying only to the latter.[29]

Only in the past thirty years has there been reasonably effective protection of investors in England concerning new issue distribution. This protection, however, has not been due to a sole reliance on disclosure, but is a result of the development of unofficial regulatory devices, primarily by the London Stock Exchange.[30] The action by the London Exchange has been successful because there is virtually no over-the-counter market in England. This means that a company wishing to sell its securities to the public must acquire a listing on an exchange. Before the London Exchange grants a listing, approval must be obtained from the New Issue Committee. While specific standards are not articulated, the Committee apparently often denies listing even if complete disclosure is present. In this manner undesirable

25 Companies Act, 1845, 8 & 9 Vict., c. 16, § 4.

26 Certain items were required in the Companies Act, 1867, 30 & 31 Vict., c. 131, §§ 30-31, 38. Comprehensive coverage was obtained in the Companies Act, 1900, 63 & 64 Vict., c. 48, and changes were made in the subsequent Companies Act, 1907, 7 Edw. 7, c. 50; 1929, 19 & 20 Geo. 5, c. 23; 1948, 11 & 12 Geo. 6, c. 47.

27 The Companies (Consolidation) Act, 1908, 8 Edw. 7, c. 69, provided that a statement must be filed with the registrar of companies by a public company even if no prospectus was used. In the Companies Act, 1929, 19 & 20 Geo. 5, c. 23, § 29, offers for sale were made subject to prospectus requirements, and underwriters offering on behalf of a company had to furnish a prospectus. It was not until the Companies Act, 1948, 11 & 12 Geo. 6, c. 38, that restrictions on placing of securities were complete. See COHEN REPORT ¶ 22.

28 The Companies Act, 1900, 63 & 64 Vict., c. 48, increased liabilities of directors and promoters. This has remained a controversial area. See NAPIER, HISTORY OF JOINT STOCK COMPANIES' LIABILITY IN A CENTURY OF LAW REFORM 379-411 (1901); COHEN REPORT ¶¶ 41, 64. Further changes were made in Companies Act, 1948, 11 & 12 Geo. 6, c. 38, §§ 60, 63; Prevention of Fraud (Investments) Act, 1958, 6 & 7 Eliz. 2, c. 45, §§ 13, 14.

29 Companies (Consolidation) Act, 1908, 8 Edw. 7, c. 69.

30 In 1930 the London Stock Exchange reformed its rules as a result of abuses in the preceding years, when securities of new companies that had been distributed through the exchange had injured numerous investors. See MAGUIRE, THE STOCK EXCHANGE AS A NATIONAL INSTITUTION (1949).

stocks are kept from the public.[31] In addition to the regulatory work of the Exchange, the issuing houses—a relatively small group of firms that handle the bulk of the underwriting—have been given credit for playing an important, although unofficial, role in investor protection. They, too, go beyond a requirement of disclosure and refuse to be associated with a poorly planned or financed company. While statistical evidence is not available, the latest study of securities regulation conducted by the Jenkins Committee expressed little concern regarding investor frauds in new issue sales.[32]

In the United States, the disclosure device for regulation of issuers of securities was adopted with relatively little discussion as to its merits.[33] The objective of the corrective legislation, as stated in Democratic Party Platform in 1932, was to protect the small investor from fraud in the initial purchase of securities.[34] This purpose was reiterated by President Roosevelt in his address to Congress in 1933.[35] The specific frame of reference was the speculative outburst of the late 1920's and the subsequent market crash.

For several years prior to 1933 many serious writers had been

31 "In (the Record's) Department is a dosier of anyone who in the past has 'kicked over the traces' in any way. And if that person's name is connected, however remotely, with a subsequent subscription of capital, you may be sure that the Stock Exchange Council is going to be very wary before it gives permission to deal in that subsequent issue." WINCOTT, THE STOCK EXCHANGE 128 (1946). See also *The Stock Exchange Committee and the Investor*, 111 The Economist 323 (1930). The role of the exchange was recognized in the Cohen Report and the Jenkins Report, and the Companies Act, 1948, 11 & 12 Geo. 6, c. 38, § 39(1), gives certain exemptions for companies granted a listing in an exchange.

32 "The new issues market is now virtually monopolised by a small number of firms who are experts in this type of transaction and who either devote themselves entirely to it or who combine it with merchant banking and acting as company registrars or the like. Most of these firms are members of the Issuing Houses Association and their high repute, and their determination not to forfeit it, are probably the greatest safeguards which the public have. The nature of the role which they play differs somewhat according to the method of issue employed, but in most cases they will be associated with it either as principals or agents of the company and, if it is unsuccessful, will incur a risk either to their pockets or their reputations or both. Hence the close scrutiny which they give to issues which they sponsor is a far more effective restraint on fraudulent or uneconomic issues than any legal regulations." GOWER, THE PRINCIPLES OF MODERN COMPANY LAW 269 (1957). See also JENKINS REPORT ¶¶ 11, 225, 227.

33 The best commentaries on the legislative history are MOLEY, AFTER SEVEN YEARS 175-84 (1939); James, *The Securities Act of 1933*, 32 MICH. L. REV. 624 (1934); Landis, *The Legislative History of the Securities Act of 1933*, 28 GEO. WASH. L. REV. 29 (1959). See also Gadsby, *Historical Development of the S.E.C.—The Government View*, 28 GEO. WASH. L. REV. 6 (1959).

34 77 CONG. REC. 2923 (1933) (Remarks of Rep. Bulwinkle in reference to the Democratic national platform and President Roosevelt's message to Congress, cited note 35 *infra*).

35 H.R. REP. No. 85, 73d Cong., 1st Sess. 2 (1933).

advocating the need for companies to disclose financial data. For most, the objective was not necessarily to protect the small investor from fraud, but a desire to assure a free and open securities market. For example, in *Main Street and Wall Street*, William Ripley stated: "Must one reiterate that the prevention of fraud, while important, is limited to a few companies; while the registration of a fair market price, consonant with the real earning power of the company, is a matter of daily and universal importance to every shareholder who may have occasion to buy or to sell securities?"[36]

This concern over a free market was based on the theory that, given adequate information, the laws of supply and demand, combined with action by each purchaser for his own best interest, would establish a true market value for the security. For some, the need for a "free market" was tied to a recognition of the great growth of the largest corporations. In *The Modern Corporation and Private Property*, A. A. Berle, Jr., and Gardner Means advocated disclosure on the part of companies because investors, being separated from direct management and control of the company, buy and sell securities on the faith of the market appraisal of the value of the stock. Disclosure is needed because this cannot be a valid appraisal unless there is free and equal information about all companies.[37]

Brandeis, to whom many give credit for being the strongest advocate for full disclosure, also directed his principal fire against the big companies. His famous quotation, "sunlight is said to be the best of disinfectants; electric light the most efficient policeman,"[38] was made in relation to the amount of underwriting commissions received by J. P. Morgan & Co. for their role in selling securities of major companies.

The arguments for disclosure expressed by these men applied equally to the need for continuing disclosure through annual reports, as much as to the need for disclosure at the time of initial offering. All would probably have argued that disclosure would help prevent fraud in the initial sale of securities to small investors, but this was not necessarily their main objective. Individuals such as Douglas, who had their eyes strictly on the problem of protecting the small investor from fraudulent schemes,

36 RIPLEY, MAIN STREET AND WALL STREET, 219 (1927).

37 BERLE & MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (1933) (see particularly pp. 300-25).

38 BRANDEIS, OTHER PEOPLE'S MONEY 62 (new ed. 1933).

doubted that disclosure by companies was sufficient. Douglas advocated the need to control "unsound securities" and "high pressure salesmanship" if the average investor was to be adequately protected.[39]

Many states, following the example of Kansas in 1911, had enacted Blue Sky Laws which provided regulatory schemes to prohibit certain companies from selling securities to the public.[40] In 1933, the first bill submitted to both houses of Congress was basically regulatory and provided that permission to sell securities could be denied on an administrative finding that "the enterprise or business of the issuer . . . is not based on sound principles . . ." or that the issuer "is in any way dishonest" or "in unsound condition or insolvent."[41] With comparatively little discussion, the present Securities Act was substituted for the bill initially filed. The main argument for disclosure was that a regulatory approach was not administratively practical.[42] Whether the disclosure approach alone would in fact protect small investors from fraudulent schemes or the making of poor investments was generally not discussed.

In brief, the Securities Act prohibits a company from directly or indirectly offering to sell securities to the public unless a registration statement has been filed with the Commission. Any offering in writing is deemed a prospectus and must conform to specific requirements. A sale to the public cannot take place until the registration has become effective—at least twenty days after filing—and a current prospectus must be sent at the time of sale if it has not been done previously. The registration statement must contain detailed information about the company and the distribution, including: a description of the business; its organization, financial history, and capital structure; names and compensation of officers and directors; description of special interests of management; description of property; financial statements; and the plan of distribution and intended use of proceeds. The

[39] See Douglas, *Protecting the Investor*, 23 YALE REV. (N.S.) 521, 523 (1934). See also Douglas & Bates, *The Federal Securities Act of 1933*, 43 YALE L.J. 171 (1933). For recent statements advocating regulation beyond disclosure, see Joslin, *Federal Securities Regulation From the Small Investors' Perspective*, 6 J. PUB. L. 219 (1957); Wright, *Correlation of State Blue Sky Laws and the Federal Securities Acts*, 26 CORNELL L.Q. 259, 262 (1941).

[40] Kan. Laws 1911, ch. 133, see 1 Loss, *op. cit. supra* note 4, at 23-105 for citation and general discussion of state Blue Sky Laws.

[41] H.R. 4314 and S. 875, 73d Cong., 1st Sess. § 6 (1933).

[42] 77 CONG. REC. 2918, 2931, 2947-51 (1933) (discussion of S. 875 and H.R. 4314, 73d Cong., 1st Sess. (1933)). *But see* H.R. REP. No. 1363, 73d Cong., 2d Sess. (1934), which stresses the value of publicity in bringing about a situation where the market price reflects as nearly as possible a just price.

prospectus must include all data required by the registration, with the exception of certain specific items such as exhibits, marketing arrangements, and data on subsidiaries.

The Securities Act included two important extensions beyond the English Companies Act designed to offer greater investor protection. First, under the Securities Act there is a waiting period of at least twenty days between the filing of the registration statement and the time when a sale can be made; under the English System the prospectus need not be filed until the time of sale.[43] The second and more important difference is that the Commission closely checks the registration statement for misstatements and omissions. In England the prospectus is filed with the Board of Trade, and little or no checking is done by that organization.[44] Through the informal administrative device of the deficiency letter, the Commission insures that the registration statement and prospectus clearly state the facts.

B. *Evaluation of the Issuance Requirements*

Certainly the disclosures required by Securities Act have made the markets more free, as well as better evaluators of the worth of securities. The legal requirement of disclosure removed any competitive disadvantage incurred by those who had volunteered full information. The high quality of administrative checking has permitted investors to rely on the published prospectus. It can be safely stated that the Securities Act has prevented numerous investors from buying poor quality stocks. Further, knowledge of the detailed scrutiny of registration statements by the Commission has had a prophylactic effect in discouraging shady promoters from attempting to go to the public for capital. The Securities Act appears to have acted well in times of normal market behavior. In times of speculative hysteria, however, the disclosure requirements of the Securities Act, even with the verification of material by the Commission, have not been sufficient to prevent serious investor loss.

The Special Study *Report* dealt with the distribution of securities only to a limited extent, but some material is presented on new issue behavior during the period 1952 to 1962.[45] A survey

43 COHEN REPORT ¶ 27 (1945). In 1948 The Companies Act, 1948, 11 & 12 Geo. 6, c. 38, § 50(5), provided that a period of at least three days must elapse between issuance of the prospectus and the opening of the subscription list.

44 JENKINS REPORT ¶ 227.

45 Of the thirteen chapters of the *Report* of the Special Study, only chapter IV-A dealt with distribution problems. Even here, the emphasis was on the role of the underwriter and not on the issuer.

was made of all companies which sold securities through a public offering for the first time during this period—an estimated 2,880 corporations.[46] The companies were divided into two categories: "promotional"—those formed within one year of going public or those with no net income for at least one of two preceding fiscal years; and "operational"—all others. The survey revealed that by the fall of 1962 a total of thirty-seven percent of the companies which had sold securities to the public between 1952 and 1962 could not be located or were known to be liquidated, inactive, or in receivership, and only thirty-four percent showed a net profit on their last balance sheet. For the promotional companies, a total of fifty-five percent were apparently out of business, and only fourteen percent showed a net profit on the last balance sheet. It is estimated that 1,050 companies making their first public offering between 1952 and 1962 had failed by 1962, after having raised over one hundred million dollars from investors.

While there is need for an avenue for companies to be able to raise risk capital, it appears obvious that many of these companies, particularly those with no operational history, went public only to benefit the promoters, insiders, and underwriters. Thus, one part of the current problem involving new issues is that numerous untried promotional companies which soon fail are able to sell their securities in spite of the initial disclosure requirements. Another aspect is the "hot issue" phenomena.[47] The "hot issue" as described by the Special Study is a security of a new company which is sold at a premium over its offering price immediately after the initial distribution. In many instances the supply of such a security is artificially controlled by underwriters, and active efforts are made to stimulate demand. In most instances, the market price of the "hot issues" fell below the offering price several months following the offering.[48]

High pressure selling is one of the most important factors involved in the sale of unsound securities and the unrealistic prices accompanying the sale of "hot issues." Improper selling practices constitute a large subject, involving qualifications and supervision of salesmen, in addition to direct regulatory control.[49] Here, it is only necessary to point out that, even though a com-

[46] *Special Study* pt. 1, at 491 n.29, 550-53.

[47] See *Special Study* pt. 1, at 516-47.

[48] The unseasoned issues had a greater price fluctuation than the seasoned issues. Of the unseasoned issues offered in 1961, 85% sold at premiums immediately after issue, and by September 1962, 77% of them sold below the offering price. *Id.* at 516-17.

[49] See Comment, 62 MICH. L. REV. 680, 730 (1964).

pany makes adequate disclosure, the investor comes in contact only with the salesman, not with the company. Active touting by an aggressive salesman is far more likely to sell securities than the prospectus, with its often lengthy, dull, and complex presentation.

The combination of the speculative fervor of investors with the attitudes of some promoters, underwriters, and security salesmen created a situation beyond the control of the Commission and the Securities Act. In part, there was a breakdown of disclosure mechanisms. The waiting period designed to provide time for investor study of the issue failed in its objective. Indications of interest were obtained by telephone, and in many instances no preliminary prospectus was sent.[50] The investor's first real information about the company came with the final prospectus mailed with his confirmation of purchase. Investors buying in the market immediately following the distributions were generally not furnished any prospectus at all.[51] As these new issues were not listed on an exchange, there was no requirement for continuous reports, and the investor often could not obtain current information about his company.[52] The great increase in the number of new issues and the limited staff of the Commission meant that detailed checking of registration statements and prospectus was curtailed.[53] Also, even when an investor was presented with an accurate prospectus prior to his purchase, the

50 Unless the offer is in writing, no prospectus need be sent. Securities Act § 5, 48 Stat. 77 (1933), 15 U.S.C. § 77e (1958). See *Special Study* pt. 1, at 547-50. See also *id.* pt. 1, at 265-68 on the problem of the boiler rooms.

51 There is no requirement to send a prospectus when the sales are unsolicited, or when the sale is solicited forty days after the date upon which the security was bona fide offered to the public. Securities Act § 4, 48 Stat. 77 (1933), 15 U.S.C. § 77d (1958). Furthermore, many broker-dealers failed to send a prospectus even for a solicited offer within the forty-day period. *Special Study* pt. 1, at 547-50.

52 See Part III *infra.* A senior partner of one of the largest brokerage houses in the country has said: "In fact, it would be my judgment that newly organized, promotional enterprises with little or no record of business performance, whether they be regulation A or otherwise, should be required to make *monthly* progress reports to their stockholders to keep them informed as to how their money is being used—just as it would be in the case of a partnership. Such monthly reporting should be required until they have reached a stage where their size and maturity and everything about them were such that they would be qualified for listing if they so desired. At that point the requirements could be relaxed to the standards of listed companies." Quoted in *Special Study* pt. 3, at 9-10.

53 During fiscal 1961, 1,830 registration statements were filed, of which 958, or 52%, were filed by companies that had not previously filed registration statements under the Securities Act of 1933. 27 SEC ANN. REP. 29 (1961). During the fiscal 1950, 496 registration statements were filed, of which 112, or 23%, were first filings. 16 SEC ANN. REP. 8 (1950). On the other hand, there were a total of 998 Commission personnel in fiscal 1950, *id.* at 167, while in fiscal 1961 the total number of personnel had increased to 1,087. 27 SEC ANN. REP. 197 (1961). Thus while Commission personnel increased about 10%, first filings increased about 850%.

presentation in most instances tended to discourage reading by all but the most knowledgeable and tenacious. Recommendations of the Special Study were aimed at correcting some of these gaps. Legislation proposed by the Commission would extend the time during which a prospectus must be sent to purchasers.[54] It has also been suggested by numerous sources that the objective of disclosure can be improved by demanding a better written and clearer prospectus.[55] A short form of summary to point out the hazards of investing in a non-operating promotional company, with a clear statement of underwriting costs, equity dilution, and the cost of promoters' shares could be of help.[56] The Commission has taken steps in this direction, but more could still be done.

Even with the disclosure mechanisms working perfectly, would they prevent abuses and investor losses in a period like that of 1959 to 1962? As mentioned above, the English experience has been that something more than disclosure is needed. For the English, an apparently workable solution is provided by the unofficial regulation by the London Exchange and the underwriters themselves. In this country the solution is not so easy. New issues are distributed and traded through the over-the-counter market. The exchanges have a minor role in distributions, and the underwriting community is not currently designed to play a regulatory role. Many of the larger underwriters have in fact worked hard to protect their reputations, and apparently have not become associated with a stock offering unless they believed the company had a good chance of success, and that full and continuing disclosure would be made to investors.[57] These same underwriters attempted to avoid an artificial run-up in price of their newly

[54] On July 30, 1963, the Senate passed S. 1642 (The Securities Acts Amendments of 1963), in which the forty-day period during which all dealers are required to deliver prospectus was extended to ninety days in the case of first issues. 1963 U.S. Code Cong. & Admin. News, No. 9, p. xxi (Aug. 20, 1963). The *Special Study* also recommended that the Commission make acceleration of the effective date conditional on delivery of the prospectus at least two days before the sale. *Special Study* pt. 1, at 558.

[55] See 1 Loss, SECURITIES REGULATION 261-65 (2d ed. 1961), dealing with the problem of the unreadable prospectus; *Special Study* pt. 1, at 552.

[56] "We have a concrete suggestion on this point. It is that each prospectus be accompanied by a one-page summary of the more important facts about the issue, in a form approved by the SEC. The summary should contain at least a brief reference, citing page numbers, to every unfavorable factor described in the prospectus itself and deemed to be of more than incidental importance. Such a one-page summary could tell the investor pretty well what he is getting for his money." GRAHAM, DODD & COTTLE, SECURITY ANALYSIS 677 (4th ed. 1962).

[57] "Most of the older firms exercised careful investment banking judgment in determining which companies were suitable for public ownership, and in so doing still provided many small companies with access to the capital markets." *Special Study* pt. 1, at 553.

issued securities. It was easy, however, to be an underwriter during 1959-62; and a company turned down by one broker-dealer could find someone else who was not as particular.[58]

Recommendations of the Special Study regarding requirements of higher qualifications for underwriters and salesmen and the developing of self-regulatory bodies are commendable. It should be recognized, however, that serious problems remain. Disclosure, as called for in the Securities Act and enforced administratively by the Commission, has done much to assure that, at least in normal times, the market can fairly appraise new securities, and that investors will be reasonably protected. In times of speculative outbursts, disclosure alone is not, and probably cannot be, adequate protection for investors. In the absence of effective federal protection, there is pressure for the states to take a more active role.[59] This leads only to confusion and unfairness. The record of promotional companies is such that some federal action to limit their access to the public market seems desirable. The Commission should attempt to determine various specific factors of success or failure and make proposals as to the additional powers needed.

III. OBLIGATION OF THE ISSUER TO MAKE CONTINUOUS DISCLOSURE THROUGH PERIODIC REPORTS

That a corporation selling stock to a purchaser should disclose financial information concerning the company is merely an extension of the normal seller's obligation based on the nature of the commodity. A more difficult problem has been to justify the need for a corporation to continue to make disclosures. Specifically, the question is the extent of the company's obligation to individuals who purchase from existing shareholders. It is argued that once a distribution is completed, a company has no interest

58 "To a large extent, broker-dealers who managed the underwriting of unseasoned issues of common stock in 1961 were relative newcomers to the field. . . . More than half (271) of these underwriters had been organized less than 6 years before the offering, while over one-fourth (146) were formed either in the year preceding or the year in which the offering was made." *Special Study* pt. 1, at 493-94. As an indication of a tougher attitude toward underwriters, see In the Matter of The Richmond Corp., SEC Securities Act Release No. 4584, Feb. 27, 1963. In this release, the Commission issued a stop order suspending the effectiveness of a registration statement. Among the grounds stated were (1) failure of the registration statement to disclose the limited experience of the underwriter and (2) lack of an independent investigation of the underwriter by the issuer.

59 For example, note the active role of the state of California in developing a strict regulatory program. See SCHLEI, STATE REGULATION OF CORPORATE FINANCIAL PRACTICES: THE CALIFORNIA EXPERIENCE (1961); Dahlquist, *Regulation and Civil Liability Under the California Corporate Securities Act*, 33 CALIF. L. REV. 343 (1945).

in later trading in its securities. The transaction is between two private parties, and the company plays no role. That this argument has been effective is demonstrated by the different obligations of the issuer depending on whether the sale is by the issuer or is between two parties having no relation to the issuer. During a distribution and for forty days thereafter, the issuer has a positive duty to furnish a prospectus to any purchaser.[60] A purchaser who buys the company's stock after the forty-day period, or from a source other than the company, need not be furnished with anything. The anomaly becomes most acute when a company which has shares currently outstanding makes a new offering of identical shares. A purchaser who buys shares of the new offering must be furnished a prospectus; a purchaser buying shares the same day, but purchasing from another shareholder in the over-the-counter market or on an exchange, need not be furnished with any information.[61] There are, however, a variety of requirements which insure that current financial data of many companies is available to the investor who has the initiative to seek it out. However, these requirements do not apply to all companies, and the most pressing problem in this area is the need to expand the coverage.

There is also need to recognize the overlapping function of continuous reporting requirements and the registration and prospectus requirements applicable when a new distribution is made. The investor would be better protected and companies would avoid unnecessary burdens if a closer integration of the requirements could be achieved. A corollary to this integration would be increased availability of the periodic financial reports, and the obtaining of better and more standardized reports from the companies.

A. *Background and Current Practices*

The requirement that companies disclose financial data on a continuing basis has taken two approaches. The first and oldest was initiated by the exchanges. If a company wants to be listed on an exchange it must agree to submit periodic reports. Becoming listed on an exchange came to be a voluntary act by the company, and reporting was one of the commitments made by the company in the listing agreement with the exchange. The London Ex-

60 Securities Act § 4(1), 48 Stat. 77 (1933), 15 U.S.C. § 77d (1958).

61 Under Securities Act Rule 153, if the securities are listed, delivery of the prospectus is accompanied by delivery to the exchange; there is no requirement that a purchaser actually receive a prospectus. 17 C.F.R. § 230.153 (1949).

change required such disclosure before any periodic reports were demanded in the Companies Act,[62] and the New York Stock Exchange had required annual reports of listed companies for several years before enactment of the Exchange Act.[63] The Exchange Act codified this approach, applying it to all registered exchanges and requiring that reports be filed with the Commission as well as the Exchange.[64] Nothing need be given to purchasers, but current information about the company is on file. Currently, all companies listed on a national exchange are required to file the following reports:[65]

(1) Annual Reports (Form 10-K), which must include:
  (a) A balance sheet and profit and loss statement prepared according to the Commission's accounting regulations and certified by an independent public accountant;
  (b) Disclosure of any interest of an officer or director in a material transaction of the corporation; and
  (c) Various data on principal shareholders, officers and directors, including their remuneration, amounts accrued in retirement plans, and exercise of stock options.
(2) Semi-Annual Reports (Form 9-K), which include an uncertified profit and loss statement.
(3) Current Reports (Form 8-K), which must be filed on the occurrence of any event of immediate interest to shareholders, such as
  (a) Change in control;
  (b) Acquisition or sale of a significant amount of assets;
  (c) Involvement in important legal proceedings; and
  (d) Any matter which requires a vote of shareholders.

The second approach toward the obtaining of continuous financial data is to require that information be sent to existing share-

[62] In 1881 the London Stock Exchange began to require annual reports. See DUGUID, THE STORY OF THE STOCK EXCHANGE: ITS HISTORY AND POSITION 355 (1901).

[63] Beginning in 1920 the New York Stock Exhange required comprehensive financial reports prior to listing. See RIPLEY, *op. cit. supra* note 36, at 210.

[64] Exchange Act §§ 12, 13, 48 Stat. 892, 894 (1934), 15 U.S.C. §§ 78*l*, 78m (1958).

[65] Form 10-K, adopted in SEC Securities Exchange Act Release No. 4991, Jan. 28, 1954, is to be used for annual reports pursuant to §§ 13 or 15d of the Exchange Act, for which no other form is prescribed. Form 9-K, adopted in SEC Securities Exchange Act Release No. 5189, June 23, 1955, is to be used for the semi-annual reports required by Rules 13a-13 and 15d-13 of the General Rules and Regulations under the Securities Exchange Act of 1934. 17 C.F.R. §§ 240.13a-13, 240.15d-13 (1949). Form 8-K, adopted in SEC Securities Exchange Act Release No. 4991, Jan. 28, 1954, is to be used for current reports under §§ 13 or 15d of the Exchange Act, filed pursuant to Rule X-13A-11 or

holders. The Exchange Act requires that any proxy solicited by a company listed on an exchange conform to the rules of the Commission.[66] Through its rule-making power, the Commission has enacted comprehensive requirements governing what must be disclosed when proxies are solicited for votes on various corporate matters. For example, the proxy statement sent prior to annual meetings for election of directors must contain the name of each nominee and his principal occupation, amount of equity shareholdings in the company, remuneration (if over 30,000 dollars), retirement benefits, stock options, and any interest in material transactions with the company. In addition, an annual report must be sent containing financial statements which adequately reflect the financial position and operation of the company.[67]

If a company can obtain a quorum without soliciting proxies, there is no requirement under the Exchange Act that the shareholders be sent anything. However, the New York Stock Exchange requires all listed companies to solicit proxies.[68] The proxy machinery is a most effective disclosure device, and for companies listed on the NYSE there is, in fact, a wealth of information available. As will be discussed later, the main problem with regard to listed companies is not the obtaining of information; it is the presentation of such information in a clear and standardized manner, readily accessible to investors.

B. *Evaluation of the Continuing Disclosure Requirements*

1. *Extension of Required Reporting*

A third approach to continuous reporting is desperately needed in order to provide data on companies which are not listed on an

Rule X-15D-11. There are other forms, such as Form 7-K, adopted in SEC Securities Exchange Act Release No. 6820, June 12, 1962 (for quarterly reports of certain real estate companies), which deal with particular kinds of companies.

66 Exchange Act § 14, 48 Stat. 895 (1934), 15 U.S.C. § 78n (1958).

67 SEC Reg. 14A, 17 C.F.R. § 240.14a (Cum. Supp. 1963). Note that the minimum information specified depends on the subject matter of the election, *e.g.*, the selection of auditors; the approval of bonus and profit-sharing plans; approval of pension and retirement plans; modification or exchange of securities; mergers, consolidations, and acquisitions. The Commission recently took a long overdue step in proposing an amendment to its proxy rules requiring that financial statements in annual reports sent to stockholders "be consistent in all material respects" with reports filed with the Commission. The Wall St. J., Nov. 19, 1963, p. 8, cols. 2-3.

68 New York Stock Exchange Rule 499, dealing with suspension from dealings or removal from the list, indicates that the Exchange "would normally give consideration to suspending or removing from the list a security of a company when . . . proxies are not solicited for all meetings of stockholders." The American Stock Exchange is reported to be embarking on a program to achieve the same results. See S. REP. No. 379, 88th Cong., 1st Sess. 24 (1963).

exchange. This approach is simply to place an obligation to disclose, to both potential investors and existing shareholders, on all companies which have securities in the hands of the public. This obligation should be present regardless of any voluntary act on the part of the company to become listed on an exchange. It would apply even if the company has never had a public offering under the Securities Act.[69] As recommended by the Special Study and in proposed legislation proposed by the Commission, it would take the form of extending the reporting requirements of section 13 and the proxy restrictions of section 14, of the Exchange Act to securities traded in the over-the-counter market.[70]

The justification for bringing these companies under federal regulation is that it is in the public interest. At the time the Exchange Act was passed, the bulk of securities in which there was active trading were listed on at least one of the numerous exchanges. It was not until the 1920's that common stock was used to any extent in this country as the sole means of financing ventures other than oil, mining, and other speculative issues, and the distribution and later trading were generally done through the facilities of an exchange. It is reported that, at various times, over 100 exchanges have existed in the United States—and over 35 during the late 1920's.[71] An over-the-counter market did exist, but little was known of its scope or operation.[72] Since the 1930's the over-the-counter market has had tremendous growth. This is due in part to improved communications (the development of the open-end teletype in 1932-33 was a major factor) which made a central location less important; and it appears that the securities acts themselves aided the growth. After the Securities Act, new issues were not distributed through exchanges, and at least their initial trading had to be in the over-the-counter market. Since the Exchange Act, many companies have refrained from listing, and others, such as banks, have delisted in order to avoid the required disclosures.[73]

69 The Exchange Act § 15, 48 Stat. 895 (1934), as amended, 15 U.S.C. § 78*o* (1958), provides that any company registering under the Securities Act and having a value of over $2,000,000 (aggregate offering price plus the value of other securities of the same class) must file periodic reports as required under § 13.

70 *Special Study* pt. 3, at 62; see S. 1642, 88th Cong., 1st Sess. (1963).

71 For early history of securities trading in the United States, see MARTIN, A CENTURY OF FINANCE (1898); MEDHENRY, MEN AND MYSTERIES OF WALL STREET (1870); COLE, EARLY EXCHANGES (1943) (unpublished monograph in Securities and Exchange Commission Library).

72 An over-the-counter market existed prior to the organization of the exchanges. The draftsmen of the Securities Act specifically left the question of the over-the-counter market open until further study. See H.R. REP. No. 85, 73d Cong., 1st Sess. (1933).

73 At the present time only five banks are listed on national exchanges. *Special Study* pt. 3, at 36.

There are virtually no requirements that a company not listed on an exchange send even an annual report to its stockholders. A recent check of the corporation laws of all fifty states and the District of Columbia reveals that twenty-two states have corporate reporting requirements of one type or another. Of these, in only fourteen states are the reports available to shareholders, and in three the requirement may be dispensed with by including a contrary stipulation in the by-laws. Specific requirements of content for reports are generally nonexistent, and only two states require certification by a public accountant.[74] In no state is there any requirement dealing with proxy solicitation or allowing a state agency to exercise control over the form or content of proxy material.

All of the arguments for disclosure raised at the time the securities acts were enacted apply equally well to securities traded over-the-counter. If these protections are needed for investors of listed stocks, they are certainly necessary for holders of over-the-counter stocks. Evidence compiled by the Special Study shows unquestionably that voluntary reporting and the quality of proxies issued by over-the-counter companies are inadequate.[75] Investor fraud appears more prevalent with regard to unlisted securities,[76] and unquestionably a more free and open market is needed for these securities. The double standard should be eliminated, and companies should decide whether they should be listed on an exchange by reference to market considerations rather than a desire to avoid required filing of reports. On the positive side, the addition of a disclosure requirement to the over-the-counter market should increase investor confidence, which could lead to increased trading volume, better markets, and reduced selling costs.

It has been reported that there are about 580,000 corporations in the United States.[77] Conceivably, all of these could have secu-

[74] In Massachusetts, certification is needed for a corporation with over $100,000 in stock. MASS. GEN. LAWS ANN. ch. 156, § 49 (1959). Certification is also required in Pennsylvania, but a corporate by-law may dispense with the requirement. PA. STAT. ANN. tit. 15, § 2852-318 (1958). Almost all states require financial data with tax reports, but these are uniformly considered confidential.

[75] Over 25% of the companies sampled by the Special Study did not send any information at all to shareholders. Major difficulties were found in many instances. *Special Study* pt. 3, at 10-14.

[76] Ninety-three percent of companies involved in fraud actions under the Securities Act or the Exchange Act between January 1961 and June 1962 were unlisted companies not required to file periodic reports. *Id.* at 10.

[77] This is the number filing Federal Income Tax returns. It is estimated that about 50,000 have at least occasional over-the-counter trading. FRIEND, HOFFMAN & WINN, THE OVER-THE-COUNTER SECURITIES MARKET 5, 46 (1958).

rities which are traded at least occasionally. In England, a distinction is drawn between the private and public company, with a private company of under fifty shareholders not subject to disclosure requirements.[78] The recommendations of the Special Study called for all companies with more than 300 shareholders to be brought under the disclosure provisions of the Exchange Act.[79] The current legislative proposal of the Commission would include all corporations with 500 shareholders and one million dollars in assets.[80]

While it can be argued that it is in the public interest to protect even one shareholder, it would seem that the greatest need for investor protection exists when the company has shareholders who are, in fact, involved in trading activity. It is when a security is in the over-the-counter market, in the sense that broker-dealers are quoting a market and trading takes place, that the federal government has an interest. From statistics gathered by the Special Study it appears that, based on the number of dealers quoting a security and the amount of trading as indicated by the shares transferred, companies with 200 or more shareholders should probably be included under the disclosure requirements. An asset test does not seem to have any bearing on the public interest. The survey conducted by the Special Study indicated that twenty-two percent of the companies reporting less than one million dollars in assets had 300 shareholders or more, and about eleven percent had 1,000 shareholders or more.[81] For example, many research and electronic companies have high sales, but operate with leased buildings and equipment and thus report low assets. Also, many of the new promotional companies coming to the market for the first time have low assets, and their sorry record demonstrates the need for continuous reporting to help protect investors.

The higher requirement of number of shareholders and the asset test in the proposed legislation are intentionally designed to reduce the number of companies subject to the disclosure requirements.[82] This reflects a concern over the administrative burden thrown on the Commission in checking these reports. The proposed legislation is unduly cautious, and the coverage should be

78 Companies Act, 1948, 11 & 12 Geo. 6, c. 38.

79 *Special Study* pt. 3, at 62.

80 S. 1642, passed by the Senate on July 30, 1963, 109 CONG. REC. 12962 (July 30, 1963).

81 Tables showing the interrelationship of shares transferred, number of broker-dealers quoting the security, number of shareholders, and asset size are found in the text and appendix to the *Special Study* pt. 3, ch. IX.

82 See S. REP. No. 379, 88th Cong., 1st Sess. 20, 21, 27 (1963).

expanded. Two somewhat contradictory suggestions are made in answer to the argument that the Commission is not capable of policing the increased number of firms. First, it is urged that the Commission should attempt to make better use of automation to check filed reports. The use of existing data processing equipment could greatly improve and simplify the checking process. Instead of storing the reservoir of material about a company in a file drawer at the Commission, it could be placed on computer tape. Periodic reports and proxy materials could be filed in a form to be directly programmed into the computer and automatically cross-checked for various items. Independent analysis would probably still be needed, but it could be kept to a minimum. The second suggestion is to rely to a greater extent on private actions to insure that companies report accurately. As was noted, the Board of Trade in England—the closest equivalent to the SEC—does almost no checking of prospectuses or annual reports, but relies on private remedies as the principal enforcement tool.

The existing specific civil remedies provided by the Exchange Act for false or misleading statements in reports filed with the Commission offer little, if any, advantage over actions for common-law fraud. Aside from showing the presence of a false or misleading statement in a report, a plaintiff must also prove (a) that the price of the security purchased or sold "was affected" by the statement and (b) that he purchased or sold the security in reliance upon the statement. In addition, a defendant may absolve himself from liability by proving "that he acted in good faith and had no knowledge that such statement was false or misleading."[83] Proving that price action was affected by any single factor[84] is an almost impossible task with actively traded securities. When this burden is coupled with the good faith defense, it is not surprising that no case has been located in which a plaintiff was successful in recovering for a false or misleading statement in a filed report.

As a minimum, the liability for false or misleading statements in periodic reports should correspond to the current provisions with respect to false or misleading statements in a prospectus or registration statement. For actions under the Securities Act, the

[83] Exchange Act § 18, 48 Stat. 897 (1934), 15 U.S.C. § 77r (1958).

[84] Similar language is contained in § 9 of the Exchange Act. As an example of the difficulty in proving the causes of price fluctuations, it is worthy of note that the Special Study, after extensive study of the market as a whole and of individual securities, concluded, in reference to the price drop of May 1962, that "neither this study nor that of the New York Stock Exchange was able to isolate and identify the 'causes' of the market events of May 28, 29 and 31." *Special Study* pt. 4, at 859.

burden of showing the effect of the false or misleading statement is reversed, as the innocent purchaser is entitled to damages unless the defendant can prove that the depreciation in value resulted from some cause other than the defect in the registration statement.[85] A defendant other than the issuer may avoid liability if he had a reasonable ground for belief and actually did believe in the truth and accuracy of the statement contained in the registration statement. Perhaps something similar to this is needed to protect a company from accidental reporting mistakes, but the burden should be on the company to prove it had a reasonable basis for its belief in the truth of the statement.[86] The civil liability provisions of the Securities Act have not resulted in a crushing burden on companies.[87] Holding companies to stricter civil liabilities concerning their periodic reports would not be too onerous, and would relieve some of the administrative load of the Commission. There is a great need for companies with actively-traded securities to make periodic reports, and the excuse of administrative burden is not a sound reason for the delay in obtaining as complete coverage as possible.

2. *Integration of Periodic Reports With Registration Requirements*

Better methods of checking filed reports and tougher civil liability provisions are actually separate issues from that of increasing the number of companies required to report. It is generally acknowledged that the current work load of the Commission prevents the careful checking of all filed reports. Increasing this work load by doubling the number of reporting companies[88] would

85 Securities Act § 11(e), 48 Stat. 83 (1933), as amended, 15 U.S.C. § 77k (1958), provides: "If the defendant proves that any portion or all of such damages represents other than the depreciation in value of such security resulting from such part of the registration statement, with respect to which his liability is asserted, not being true or omitting to state a material fact required to be stated therein or necessary to make the statements therein not misleading, such portion of or all such damages shall not be recoverable."

86 Securities Act § 11b, 48 Stat. 82 (1933), 15 U.S.C. § 77k (1958). The burden here is on the defendant to show reasonable investigation and reasonable ground for belief that the statements were correct and true. This is far different from § 18 of the Exchange Act, which provides that the defendant need only prove that he had no knowledge that the statements were false.

87 In fact, only two reported cases were found which involved recovery under § 11 of the Securities Act. A partial explanation is that the administrative checking eliminates most misleading and erroneous statements. In addition, there undoubtedy have been recoveries based on § 11 which were not reported or litigated. See 3 Loss, *op. cit. supra* note 55, at 1721-42, 1747-54; Hayes, *Tort Liability for Misstatements or Omissions in Sales of Securities*, 12 CLEV.-MAR. L. REV. 100 (1963); Simpson, *Investors' Civil Remedies Under the Federal Securities Laws*, 12 DEPAUL L. REV. 71 (1962).

88 During the fiscal year ending June 30, 1962, there were 4,122 annual and other

merely magnify the problem. The Commission directs its primary attention to the investigation of registration statements for new issues. This is necessary and proper with regard to companies going public for the first time. For companies with securities already outstanding, this concentration on new registrations rather than the periodic reports is unwarranted. The periodic reports provide a reservoir of data about a company that includes most of the information that is found in a registration statement. If the periodic reports were prepared and reviewed with the care presently given registration statements, and if there were stronger sanctions for false or misleading statements, there would be little need for a full registration for each new issue.[89]

A closer integration of the disclosure required by the Securities Act with that required by the Exchange Act could greatly reduce the burden on companies subject to these acts, and at the same time better perform the basic function of disclosure. The Special Study recommended that the Commission develop such a program of integration.[90] This is a particularly important recommendation when it is coupled with the proposal that broker-dealers be obligated to make wider use of the filed material. The Special Study suggested that this obligation of the broker-dealer might include "actually consulting available officially filed data prior to recommending or selling specific securities; furnishing copies to customers in appropriate cases. . . ."[91] These recommendations move in the direction of reducing or removing the registration and prospectus requirement for established companies, and substi-

periodic reports filed by issuers under the Exchange Act of 1934. 18 SEC ANN. REP. 43 (1962). Adding to the burden of the Commission were 458 reports of issuers filed under § 30 of the Investment Company Act. *Ibid.* The Special Study estimated that a standard of 200 shareholders or more would subject 6,373 new companies to the requirements of the Exchange Act; a standard of 300 or more would add 5,472; a standard of 500 or more would add 3,973; and a standard of 750 or more would add 2,860. *Special Study* pt. 3, Table IX-F.

89 Certain economies are already present in the two acts. Rule 12b-35 of the Exchange Act provides for a simplified method of registration if a Securities Act registration (Form S-1) is on file. 17 C.F.R. § 240.126-35 (1949). Rule 13a(3) permits a company to file a copy of a Securities Act registration in place of its annual report (Form 10-K); and Rule 13a(4) allows a company to incorporate by reference in its annual report copies of prospectuses filed in accordance with Rule 424 of the Securities Act. Furthermore, the Securities Act permits certain omissions of data required in Form S-1 if equivalent information is on file pursuant to the Securities Act or the Exchange Act. There have been proposals for closer integration of these two acts discussed by Congress. See *Hearings on S. 2846 Before a Subcommittee of the Senate Committee on Banking and Currency,* 83d Cong., 2d Sess. 285 (1954). The Commission endorsed the proposal for high-grade bonds but not for securities. *Id.* at 3-5.

90 *Special Study* pt. 1, at 594-95.

91 *Id.* at 329.

tuting for these requirements obligations of stricter periodic reporting by the companies, as well as disclosure by broker-dealers in *all* sales—not just the sale of new issues. This approach stresses the importance of disclosure in the trading of securities and conforms with the important objective of providing a free market to act as an evaluator of the value of each security. Only the company selling securities to the public for the first time should be required to go through a full registration process. Commission investigation of these companies can become even more detailed. Established companies should be able to file a short form registration containing only data pertinent to the new issue. If a company desires to use a prospectus as a selling tool, this document should conform to minimum requirements; even here, however, a shorter, more flexible form of prospectus would be possible.

3. *Standardized Reporting of Financial Data*

The heart of the disclosure required of issuers is the reporting of financial data—the balance sheet and profit-and-loss statement. The Commission has promulgated accounting regulations which specify the general manner of reporting financial data for all material filed by a company under the securities acts.[92] In most instances, financial reports must be certified by an independent public accountant. In spite of the regulations and required certification, the vast difference in accounting methods often prevents a meaningful comparison between companies. Two companies may in fact have identical operating histories, yet one can present an annual profit-and-loss statement showing a profit, and the other a loss. For example, it has been stated that oil companies can in effect report whatever earnings they desire. Some companies can write off intangible drilling costs in the year in which they are incurred, while others capitalize such expenditures and depreciate them over the expected life of the well. In addition, there is no consistency in the grouping of items such as depreciation, depletion, leases, dry-hole costs, etc.[93] The skilled financial analyst, by dint of hard work, visits to the company, and tracing of historical data, is usually able to make an adequate judgment, but for the

[92] Regulation S-X governs the form and content for reports required under the Securities Act, Exchange Act, Investment Company Act, and Holding Company Act. See generally RAPPAPORT, SEC ACCOUNTING PRACTICE AND PROCEDURE (2d ed. 1963) pp. 3-1, 3-2. Under the Holding Company Act the Commission has gone further and in Rules 26 and 93 required uniform accounts.

[93] See Crane, *A Security Analyst Looks at Annual Reports*, 105 J. ACCOUNTANCY, March 1958, p. 31; Wise, *The Auditors Have Arrived*, Fortune, Dec. 1960, p. 144.

investor who relies only on financial reports comparisons between companies are often impossible.

Lack of standardized accounting procedures reduces the value of disclosure in all instances, but the problem is particularly acute with regard to the periodic reports required by the Exchange Act. These reports provide the basis for comparison of the merits of particular companies, which evaluation in turn determines the market price of the securities. Standardization and uniformity of reporting is not an easy goal. Accounting problems can be extremely complex, and the subject is mentioned only because of its importance in any evaluation of disclosure. Inherent are problems of valuation as well as the mechanics of reporting. It is reported that the proponents of uniformity, even among the certified public accountants themselves, are in a distinct minority.[94] The Commission's regulations specify only broad outlines, and the Commission accepts methods determined according to generally accepted accounting practices.[95] The accountants argue that the proper accounting system must be designed to fit the needs of the particular company, and that there is no "right" way. Even if this argument is sound, it does not answer the question of why financial data, when reported to the Commission and investors, cannot be converted to a uniform format. While it may be true that the Commission has accomplished some progress in improving accounting standards, it has been hesitant in the past to take bold steps toward requiring uniformity. If the accountants do not make faster progress, the Commission must be increasingly more active. One of the main functions of disclosure by companies is to permit the market place to make an evaluation of the worth of securities. Without uniformity of reporting practices this function cannot be properly fulfilled.

IV. DISCLOSURE OBLIGATIONS OF OTHER PARTICIPANTS IN THE SECURITIES MARKETS

The usual concept of the role of disclosure in securities regulation includes only the obligation of the issuer of securities—duties relating to the registration statement, the prospectus, and

94 The American Institute of Certified Public Accountants has a committee working on the problems of uniformity, but it has had little reported success thus far. See Wise, *supra* note 93.

95 "Financial statements may be filed in such form and order, and may use such generally accepted terminology, as will best indicate their significance and character in the light of the provisions applicable thereto." SEC Accounting Series Release No. 12, Feb. 21, 1940.

mandatory periodic reports.[96] Recent developments have demonstrated the increasingly significant role of disclosure in other phases of security regulation, involving parties other than the issuer. Such regulation involves corporate insiders, broker-dealers, investment advisers, and other participants in the securities business. In these instances disclosure is not the sole regulatory device, as it is with issuers, but is coupled with direct requirements and prohibitions. This section will briefly discuss the various aspects in which disclosure obligations relate to parties other than issuers.

A. *Insider Transactions*

Prior to the securities acts, a corporate official who made use of inside information in his personal stock transactions was relatively safe. He could usually be held liable for damages only if an investor could prove all the elements of a fraud action, including the giving of a false or misleading statement, actual misuse of the information, and damages.[97]

In many jurisdictions there has developed a positive duty on the part of directors to disclose pertinent information, particularly in cases involving purchases from existing shareholders. In some instances this duty is absolute, and in others the duty exists depending on the "special facts" of the particular case.[98] Even in the jurisdictions where a duty of positive disclosure is established, it is still necessary for a plaintiff to prove his reliance and damages. If the plaintiff has purchased or sold on an exchange this proof is an almost impossible task.[99]

The securities acts meet the problem of insider transactions in two ways: (1) section 16 of the Exchange Act requires insiders to disclose all transactions in stock of their own companies, and attempts to deter any turnover of stock by an insider within a six-month period;[100] (2) fraud provisions of the Securities Act and the Exchange Act require disclosure of inside information prior to any transaction.[101]

96 The obligations of corporate disclosure rest on others also, such as controlling persons and underwriters acting on behalf of the company. Securities Act §§ 4, 5, 48 Stat. 77 (1933), 15 U.S.C. §§ 77d, 77e (1958).

97 See PROSSER, TORTS § 87 (2d ed. 1955).

98 For discussion of these views and citation of relevant cases, see BAKER & CARY, CORPORATIONS 525-35 (1959); 3 LOSS, *op. cit. supra* note 55, at 1446-48; Hill, *The Sale of Controlling Shares*, 70 HARV. L. REV. 986 (1957).

99 See, *e.g.*, Goodwin v. Agassiz, 283 Mass. 358, 186 N.E. 659 (1933). See also note 111 *infra*.

100 48 Stat. 896 (1934), 15 U.S.C. § 78p (1958).

101 The anti-fraud provisions are Securities Act § 17(a), 48 Stat. 84 (1933), 15 U.S.C.

Each officer, director, or beneficial owner of more than ten percent of any listed security is required to file with the Commission an initial statement of his holdings in all equity securities of the company. Thereafter, monthly reports must be filed reflecting any change in his holdings. The Commission publishes each month an Official Summary of Security Transactions and Holdings summarizing the transactions included in all the various ownership reports filed that month. The regular circulation of this publication exceeds 16,000 copies monthly. In addition, all filed reports are available for inspection at the Commission and at the exchanges.[102] The publicity given these reports by the financial press enables investors to be informed of management's attitude toward its company. Substantial purchases and sales must usually be explained. The net result is that most insiders of listed companies do relatively little trading in their own securities.[103]

There are specific prohibitions in addition to the required disclosures. Section 16(b) of the Exchange Act discourages all transactions by an insider in which a purchase and sale, or sale and purchase, take place within a six-month period, for it provides for the recovery by or on behalf of the corporation of all profits realized. This twofold approach is an example of how disclosure can be supplemented to meet a particular regulatory problem. The automatic recovery of short-swing profits does serve to prevent the more egregious forms of abuse by insiders, though it is a crude tool which still creates numerous problems.[104] Allowing the corporation to recover can be justified on practical grounds, and also on the theory that an officer or director making use of inside information is taking a corporate opportunity and should disgorge his profits.[105]

§ 77q (1958), Securities Exchange Act §§ 10(b), 15(c)(1), 48 Stat. 891, 895 (1934), as amended, 15 U.S.C. §§ 78j, 78o (1958), Rule 10b-5, 17 C.F.R. § 240.10b-5 (1949), and Rule 15cl-2, 17 C.F.R. § 240.15cl-2 (1949). Section 15(c)(1) and Rule 15cl-2 apply just to broker-dealers, while the others apply to "any persons."

102 See discussion, *Special Study* pt. 3, at 15. More than 400 copies of the Official Summaries are received by the press, libraries, and other sources of public distribution.

103 This undocumented opinion is based on a review of numerous published Official Summaries of Holdings and Transactions.

104 Section 16(c) prohibits all short selling by insiders. For discussion of § 16, see 2 LOSS, *op. cit. supra* note 55, at 1037-1132; Painter, *The Evolving Role of Section 16(b)*, 62 MICH. L. REV. 649 (1964). See also Cook & Feldman, *Insider Trading Under the Securities Exchange Act*, 66 HARV. L. REV. 385 (1953).

105 See testimony of Commissioner Ganson Purcell, *Hearings Before the House Committee on Interstate and Foreign Commerce*, 77th Cong., 1st Sess., 1256-57 (1942). This theory is somewhat weak in that at common law there was generally no liability to the corporation unless the purchases were extensive. See BAKER & CARY, *op. cit. supra* note 98, at 535-36. It has been suggested with increasing frequency that the Commission is the proper party to bring actions under § 16(b).

Purchases and sales within a six-month period are presumed to be motivated by inside information. However, if it can be proved that inside information was used in any transaction, the insider has violated the fraud provisions of the securities acts and section 16(b) need not be used. The regulations under the fraud provisions provide that it is unlawful in connection with any purchase or sale in interstate commerce "to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading."[106] This restriction nominally applies to any person, but in practice has been used only against corporate insiders and broker-dealers.[107] In addition to the regular criminal penalties, the courts have permitted private parties to use these sections as the basis for civil liability.[108] In respect to corporate insiders, the affirmative requirement to disclose has been held to extend to anything which affects the value of the security and which is known to the insider, but not to the other party. Private recoveries have been obtained in numerous cases where common-law fraud principles would not have imposed a duty to disclose.[109]

The principal limitation on private sanctions is the immense problem of establishing a basis for recovery when the transactions of the insider or the uninformed investor take place on an exchange. The recent *Cady, Roberts & Co.* case[110] makes it clear that the obligation to disclose applies to exchange transactions. In this case the party making use of inside information was a broker-dealer, and the sanction was a revocation proceeding by the Commission. The difficulty of determining the extent of damages and

106 17 C.F.R. § 240.10b-5(2) (1949). Similar language is present in § 17a and Rule 15c-1-2. The anti-fraud provisions also make unlawful any purchase or sale by means of a scheme to defraud, or any act or practice or course of business which operates or would operate as a fraud or deceit on customers, or by means of any other manipulative or fraudulent device.

107 Actions for failure to disclose have been brought only against parties who would qualify as insiders under § 16 of the Exchange Act. Cady, Roberts & Co., SEC Securities Exchange Act Release No. 6668, Nov. 8, 1961, is the first instance of the expansion of the duty to one who has obtained information from an insider. See Comment, *Insider Liability Under Securities Exchange Act Rule 10b-5: The Cady, Roberts Doctrine,* 30 U. CHI. L. REV. 121 (1962); 60 MICH. L. REV. 651 (1962).

108 Exchange Act § 32, 48 Stat. 904 (1934), as amended, 15 U.S.C. § 78ff (1958). 3 Loss, SECURITIES REGULATION 1449 (2d ed. Supp. 1962), cites a total of 14 criminal cases under 10b-5. For review of the cases involving an implied private remedy, see North, *Implied Civil Liability Cases Under the Federal Securities Laws,* Corporate Practice Commentator, May 1962, p. 1.

109 See, *e.g.,* Speed v. Transamerica, 99 F. Supp. 808 (D. Del. 1951). See also the cases collected in Comment, *supra* note 107, at 129 nn.45-46, 130 n.47.

110 SEC Securities Exchange Act Release No. 6668, Nov. 8, 1961.

the proper plaintiffs makes doubtful the development of effective private sanctions for exchange transactions by insiders.[111]

The principal protection against the exploitation of inside information is to obtain immediate and full disclosure from companies. The reporting requirements of the Exchange Act discussed above serve this purpose. In addition, most Exchange rules require prompt disclosure of any development "which might affect security values or influence investment decisions of stockholders or the investing public."[112] Similar rules should be developed for the over-the-counter market.[113] Section 16 of the Exchange Act, by requiring disclosure of transactions and the forfeiting of short-swing profits, does aid in preventing the more obvious forms of abuse, and these provisions should be extended to insiders of over-the-counter companies.[114]

B. *Broker-Dealers*

Broker-dealers play many roles, and their duties of disclosure depend on which is involved. As an underwriter or in selling new issues, the broker-dealer is acting on behalf of the issuer and under the Securities Act has the same duty as the issuer to provide a prospectus to every purchaser during the distribution. If the broker-dealer is an officer, director, or beneficial owner of ten percent of any listed security, he must disclose his own transactions. If he is an insider, or has access to inside information, he is subject to the disclosure provisions of the fraud regulations. This subsection concerns the disclosures required of broker-dealers acting

111 If privity is required, then there is a difficult problem of tracing shares, and a basic unfairness in that the plaintiff will be determined by the chance of certificate distribution in the clearing house. If no privity is required, then any party who has made a stock transaction during the period the information was withheld is a potential plaintiff. For example, in the *Cady, Roberts* case the broker, Gintel received information that Curtiss-Wright reduced its dividend at about 11:00 a.m. on November 25, 1959. The news did not appear on the Dow-Jones ticker until 11:48 a.m. During the interval Gintel sold about 7,000 shares of Curtiss-Wright. Gintel sold for about $40 a share and the stock closed for the day at about $34 a share. During the following year the price of Curtiss-Wright stock dropped to a low of $14 a share. Is there a recovery due anyone who purchases shares between 11:00 a.m. and 11:48 a.m. who had no knowledge of the reduced dividend, or is the recovery to be limited only to the purchaser who received the actual shares sold by Gintel? If a proper plaintiff is determined how are his damages to be measured? There do not appear to be satisfactory answers to these questions.

112 NEW YORK STOCK EXCHANGE COMPANY MANUAL A20-22. It is reported that the American Stock Exchange has a similar policy. See *Special Study* pt. 3, at 98 n.187.

113 It is reported that since September 1962 the NASD has imposed a similar requirement of prompt disclosure for all companies appearing on the national and regional retail quotation lists. See *id.* pt. 2, at 631.

114 These measures are included in the recommendations of the Special Study and proposed legislation. See note 70 *supra.*

other than in the above roles. As mentioned earlier, the broker-dealer is subject to numerous regulations requiring certain conduct and prohibiting other actions; disclosure, while important, is only part of his total obligation.[115]

In most instances, a broker-dealer acts as an agent for a customer in the purchase or sale of securities. Assuming that (1) the customer approaches the broker without solicitation, (2) cash is paid and the securities are immediately delivered, and (3) the transaction takes place on an exchange, the minimum obligation of the broker-dealer is to execute the transaction quickly, report the market price, and collect his disclosed commission.[116] The three assumptions above, however, are vital in determining the broker-dealer's duties: (1) Brokers are generally salesmen, and as such they recommend and tout particular securities. In many instances the broker is acting as an investment adviser for the customer. (2) The relationship of the parties may be more complex. For example, the broker may act as bailee for securities and cash of the customer; the broker may have discretion in handling the account of the customer; or the broker may be a creditor of the customer where securities are held in a margin account. (3) The security may be purchased not on an exchange, but in the over-the-counter market.

The Special Study reported that less than half the dollar volume of customer purchases in the over-the-counter market are made through broker-dealers as agents. In the majority of transactions the customer is purchasing from the dealer as a principal.[117] This occurs when the selling dealer has the security in his inventory, or when he purchases from another dealer as a principal, then reselling to his customer.[118]

Under agency concepts, as the broker-dealer increases his involvement with a customer (as in the first or second circumstances above), his duties of disclosure increase; but if he acts as a principal and not an agent he has no duties of disclosure beyond avoidance

115 See Comment, 62 MICH. L. REV. 680, 730 (1964).

116 In addition, the broker-dealer has the duties of any agent, such as the obligation to disclose any personal interest in conflict with interests of his customer. See RESTATEMENT, AGENCY § 23 (1958).

117 In terms of numbers of shares, 61% of the purchases were made through broker-dealers as agent. *Special Study* pt. 2, at 612.

118 In this latter situation the broker-dealer will purchase the security from a wholesaler at the wholesale price and resell to his customer at a "mark-up" over his cost. The broker-dealer does not confirm the transaction to the customer until he has purchased the security. This kind of principal transaction is called "riskless," as the risks of ownership are absent. *Id.* at 611.

of fraud. The basic obligations required of any agent are still important with respect to broker-dealers, but they have been supplemented from two sources: specific requirements of the Exchange Act and regulations promulgated pursuant thereto, and the development by case decisions of responsibilities based on the status of broker-dealers.

The specific disclosure obligations found in the Exchange Act and its accompanying regulations are primarily expressions of normal agency duties. Their importance is that they apply to any broker-dealer, even when he is acting as a principal in an over-the-counter transaction. Regulations under section 15 of the Exchange Act provide that a broker-dealer must disclose, in any purchase or sale in the over-the-counter market, whether he is acting as a broker or as a dealer for his own account.[119] If the broker-dealer is acting as a broker he must disclose the amount of commission.[120] Other rules require a broker-dealer to make appropriate disclosure to his customer if he is controlled by or in a control position of the issuer of any security in which he is effecting a transaction,[121] and to inform any customer he advises on securities for a fee of any interest he has in any distribution of securities concerning which he is advising.[122] There are in addition the general fraud provisions.[123]

Under these regulations promulgated pursuant to the Exchange Act, the broker-dealer must disclose to his customer the amount of his commission if he acts as a broker in the purchase or sale of over-the-counter securities. In a transaction on an exchange, the price and amount of commission must also be disclosed. However, in over-the-counter transactions, where the broker-dealer is acting as a dealer, only this fact must be disclosed. The dealer has no duty to disclose his costs or the amount of mark-up he charges his customer; many times the customer has no way of determining

119 17 C.F.R. § 240.15c-1(4) (1949), applies to over-the-counter transactions. See also Exchange Act § 11(d)(2), 48 Stat. 891 (1934), 15 U.S.C. § 78k (1958), which contains a similar rule for exchange transactions.

120 This is made specific only for over-the-counter transactions. Rule 15c-1(4), 17 C.F.R. § 240.15c-1(4) (1949). The exchanges themselves require disclosure of commissions.

121 Exchange Act Rule 15c-1(5), 17 C.F.R. § 240.15c-1(5) (1949).

122 Exchange Act Rule 15c-1(6), 17 C.F.R. § 240.15c-1(6) (1949). Other disclosures are required in specific circumstances. For example, Rule 15c-1(7)(b), 17 C.F.R. § 240.15c-1(7) (1949), requires recording of transactions in discretionary accounts; Rule 15c-2(1), 17 C.F.R. § 240.15c-2(1) (1949), and Rule 8c-1, 17 C.F.R. § 240.8c-1 (1949), require certain disclosures when customers' securities are hypothecated; and Rule 10b-7, 17 C.F.R. § 240.10b-7 (Cum. Supp. 1963), requires disclosure of stabilizing transactions made to facilitate a distribution.

123 See notes 101 & 106 *supra*.

whether the transaction took place at the current market price.[124] It was to meet this problem that the Commission originally developed the "shingle theory" of broker-dealer obligation. This duty to customers is not based on the presence of an agency, but on the professional status of the broker-dealer. When a broker-dealer "hangs out his shingle" he is said to undertake an obligation to his customer higher than that of an ordinary salesman.[125] This higher standard is similar to the obligations long imposed on attorneys, doctors, certified public accountants, and architects in dealing with their customers.[126] Recent cases have applied the same concept to insurance salesmen by requiring that the insurance be suitable for the customer, and that the insurance salesman disclose the basis for his opinion regarding the desirability of the policies recommended.[127]

In regard to broker-dealers, the shingle theory first took the form of requiring that the price of securities be reasonably related to current market value even when the broker-dealer was selling as a principal; thus an unreasonable mark-up is fraudulent unless disclosed.[128] The shingle theory has since been applied to prohibit (1) unauthorized transactions in a customer's account,[129] (2) unauthorized pledging of a customer's securities,[130] (3) the accepting of a customer's securities without disclosing insolvency,[131] and (4) failure to deliver securities promptly.[132] Instead of resting these duties on an agency basis, the Commission has applied them to all broker-dealers regardless of the capacity in which they are acting.

While a broker-dealer cannot charge an unreasonable mark-up,

124 Proposed Rule X-15c-1(10) (July 29, 1942) would have required dealers to disclose in all transactions the best independent bid and offer obtainable in the exercise of reasonable diligence. The proposed rule was withdrawn (SEC Securities Exchange Act Release No. 3940, April 2, 1947) because of pressure from the securities industry and court approval of the "shingle theory" in Charles Hughes & Co. v. SEC, 139 F.2d 434 (2d Cir. 1943), *cert. denied*, 321 U.S. 786 (1944). See *Special Study* pt. 2, ch. VII-D for criticism relating to the lack of customer knowledge about the quality of the markets and the executions of transactions.

125 "Even considering petitioner as a principal in a simple vendor purchaser transaction . . . it was still under a special duty in view of its expert knowledge and proffered advice . . . ." Charles Hughes & Co. v. SEC, *supra* note 124, at 436-38.

126 See MECHEM, OUTLINES OF AGENCY § 525 (4th ed. 1952).

127 See Anderson v. Knox, 297 F.2d 702 (9th Cir. 1961); Hardt v. Brink, 192 F. Supp. 879 (W.D. Wash. 1961).

128 Charles Hughes & Co. v. SEC, 139 F.2d 434 (2d Cir. 1943), *cert. denied*, 321 U.S. 786 (1944). See also Duker v. Duker, 6 S.E.C. 386 (1939).

129 See, *e.g.*, First Anchorage Corp., 34 S.E.C. 299 (1952).

130 See, *e.g.*, Richard A. Sebastian, SEC Securities Exchange Act Release No. 5876, Feb. 12, 1959.

131 See, *e.g.*, SEC v. C. H. Abraham & Co., 186 F. Supp. 19 (S.D.N.Y. 1960).

132 See SEC Securities Exchange Act Release No. 6778, April 16, 1962.

there is still no absolute requirement that the amount of mark-up be disclosed.[133] Currently the broker-dealer discloses his costs and profit if he decides to act as broker (agent), but not if he acts as dealer (principal). This is not a satisfactory situation, and in every instance the customer should be informed of the amount of mark-up or commission. The investor always considers his broker-dealer as working for him, and the mechanics of the trading process should not prevent the investor from receiving the basic information relating to price and costs.[134]

As the relationship between broker-dealer and customer becomes closer, the obligations of the broker-dealer should increase. For example, a phenomenon of recent origin is the depositing by customers of large quantities of fully paid securities and cash with broker-dealers. These securities are usually in the street name of a broker-dealer. With few exceptions, broker-dealers make use of these securities and cash in their normal operations, and no segregation of accounts is maintained. Customer account balances are a source of free money, as most broker-dealers pay no interest to customers for its use. As a minimum, a broker-dealer should provide his customer with periodic statements of transactions, including a report of the extent to which the broker-dealer has used the customer's assets. An explanation of the potential risks in case of broker-dealer insolvency should also be provided.[135]

Under the general fraud provisions, a broker-dealer must disclose material facts needed to make a statement not misleading. The most important current questions concerning broker-dealers center on what a broker-dealer must disclose beyond what is required by the fraud provisions. Must a broker-dealer inform a customer that a particular security is not suitable for his pur-

133 In Arleen W. Hughes, 27 S.E.C. 629, 952 (1948), the Commission held there was a positive duty to disclose actual cost and the amount of mark-up. This duty arose because the broker-dealer was acting as an investment adviser and thus was held to be in a fiduciary capacity, requiring her to fulfill the obligations of an agent even though as a broker-dealer she sold as a principal. At one time the Commission went further and held that "riskless transactions" (see note 118 *supra*) would be treated as agency transactions. Oxford Co., 21 S.E.C. 681 (1946). The Commission has not continued to maintain this position.

134 The *Special Study* recommendation in this area was that all "riskless transactions" be handled on an agency basis. *Special Study* pt. 2, at 676. In addition, the *Special Study* urged wider dissemination of wholesale quotations of bid and asked prices, and new NASD standards relating to the execution of orders and the amount of mark-up.

135 For a general discussion of the handling of customer's accounts and the potential risks to customers, see *id.* pt. 1, at 387-416. The recent insolvency of two New York Stock Exchange Members—Ira Haupt & Co. and J. R. Williston & Beane—provides an unfortunate example of the potential danger to investors.

chase? Must a broker-dealer furnish a current financial statement to customers for any security he recommends? Must a broker-dealer reveal the basis or lack of basis for his opinion about a security? Several recent decisions by the Commission and the courts seem to answer these questions in the affirmative.[136] These obligations rest on a broker-dealer qua broker-dealer—a duty owed to the public because of his status. The defining and cataloguing of these obligations which is currently taking place is the most far-reaching development in securities regulations since the passage of the original acts. It is tied to a recognition of the need for increased professionalism on the part of broker-dealers and the need for higher broker-dealer qualifications. It is also part of the increased emphasis on the trading aspects of securities regulation as opposed to the distribution aspects. The role of disclosure is properly expanding from obligations imposed on the issuers of securities to obligations imposed on the broker-dealers who deal directly with the investor.

C. *Investment Advisers and Corporate Publicity*

Many problems surrounding the giving of investment advice and the dissemination of corporate publicity were stressed in the report of the Special Study.[137] They involve a variety of special situations, and the recommendations were primarily directed toward self-regulatory agencies.[138] Although not articulated as such, the principal shortcomings involved lack of disclosure. An investment adviser who holds himself out to the public as an expert in investment analysis should be held to minimum standards of competence and performance. The public is entitled to good faith opinions based on his independent research, or to be informed

[136] "There is inherent in the dealer-customer relationship the implied representation that the customer will be dealt with honestly and fairly and that the representations respecting a stock which the dealer recommends are reasonably made on the basis of knowledge and careful consideration." In the Matter of Heft, Kahn & Infante, Inc., SEC Securities Exchange Act Release No. 7020, Feb. 11, 1963. See also Berko v. SEC, 297 F.2d 116 (2d Cir. 1961); Herring v. Hendison, 62 Civil No. 1540, S.D.N.Y., May 9, 1963; MacRobbins & Co., SEC Securities Exchange Act Release No. 6846, July 11, 1962; In the Matter of Brown, Barton & Engel, SEC Securities Exchange Act Release No. 6821, June 8, 1962; SEC Securities Act Release No. 4445, Feb. 2, 1962 (dealing with distribution of unregistered securities by broker-dealers).

[137] *Special Study* pt. 1, at 330-87.

[138] The exchanges and the NASD were encouraged to establish rules and practices in respect to broker-dealers who give investment advice, and it was recommended that registered investment advisers other than broker-dealers be organized into self-regulatory organizations. *Special Study* pt. 1, at 387. The New York Stock Exchange is reported to have issued new rules governing member firms' market letters, research reports, and advertising. The Wall St. J., Sept. 25, 1963, p. 9, cols. 2-3.

that no such research has been performed. For example, an investment adviser should disclose whether he has a personal interest in a security which he recommends. The customer of the investment adviser needs this information in order properly to weigh an opinion of the adviser which might be influenced by such a personal interest.

The registered investment adviser's duty to disclose the fact that he has taken a position in securities which he recommends was definitely established by the Supreme Court in its recent opinion in *SEC v. Capital Gains Research Bureau, Inc.*[139] The opinion discusses at length various views on the role of the investment adviser, and includes quotations from the *Code of Ethics and Standards of Practice* of one of the investment counsel associations.[139a] The result is a finding of a "fiduciary relationship" between investment adviser and client, and a failure to disclose potential conflicting financial interests is fraudulent.

> "An adviser who, like respondents, secretly trades on the market effect of his own recommendation, may be motivated —consciously or unconsciously—to recommend a given security not because of its potential for long-run price increase (which would profit the client), but because of its potential for short-run price increase in response to anticipated activity from the recommendation (which would profit the adviser). An investor seeking the advice of a registered investment adviser must, if the legislative purpose is to be served, be permitted to evaluate such overlapping motivations, through appropriate disclosure, in deciding whether an adviser is serving 'two masters' or only one, 'especially . . . if one of the masters happens to be economic self interest.' "[139b]

The language of the opinion gives support to the recent Commission decisions on the positive obligations of broker-dealer, discussed above,[139c] and serves notice that higher standards of conduct based on the "professional responsibility" of broker-dealers and investment advisers will be expected.

Many investment advisers make use of material furnished by the corporation recommended. This obviously is an important source, but if the investment adviser's recommendation is based only on such data, with no independent checking or analysis, this deficiency should be disclosed. If an investment adviser wishes

139 84 Sup. Ct. 275 (1963).
139a *Id.* at 277-85.
139b *Id.* at 285.
139c See note 136 *supra.*

to give recommendations based on astrology, the sticking of pins into the financial pages, or which company provides him with free trips to Florida, this probably should be allowed. The basic need is for the public to be informed of the research techniques used and the basis of the recommendations. The theoretical justification for imposition of a duty to disclose is the same as that discussed above—a type of shingle theory. Registration as an investment adviser imposes a duty to disclose material facts affecting the independence and quality of the advice given.

Although no registration is required of parties other than broker-dealers and those giving investment advice for a fee,[140] there is a need for disclosure with regard to free investment advice and financial information in the public press. Considerable concern was expressed after the revelation by the Special Study that a financial editor of a national magazine had purchased shares immediately prior to the publication of a favorable article concerning the company.[141] The real concern here is not that one individual made a profit through his position, but that readers of the publication were misled into believing that the story was an unbiased product. Readers are similarly misled if a story in an independent publication is planted by a company.[142]

Difficult questions are involved in placing any restrictions on the public press. There are also problems in attempting to draw a line between corporate publicity intended to sell a company's product, and publicity intended to sell a company's stock. There is nothing inherently wrong with the latter, and it may be a legitimate corporate endeavor. The public is used to advertising, and can weigh material which is clearly labeled as advertising. The need is to insure that corporate publicity intended to advertise securities is clearly labeled, and is not misleading. The Commission has taken tentative steps regarding corporate publicity intended to affect the price of securities by requiring certain disclosures by companies of the amount of money spent on such activities. This is of some help, and could be expanded by requiring continuous disclosure of these expenditures in the annual reports. There may also be a need for a tighter fraud statute directed against companies which publish misleading information affecting the price of their securities.[143] What is also needed, how-

140 Investment Advisers Act § 3, 54 Stat. 850 (1940), 15 U.S.C. § 80b-3 (1958).

141 See *Special Study* pt. 3, at 73-75.

142 *Cf.* 16 C.F.R. § 13.10 (1960), the Federal Trade Commission rule against advertising falsely or misleadingly.

143 See the recommendations of the *Special Study* pt. 3, at 102.

ever, is extension of minimum obligations of disclosure to all parties giving investment advice, and to the financial press. The existing fraud provisions should be enforced against these parties, and any new fraud statute should expressly include them.[144]

D. *Disclosure of Market Data*

Market data includes both daily market information on particular securities (*e.g.*, price and volume of shares traded) and information which is published in aggregated form for a period of time (*e.g.*, monthly reports of short positions, monthly odd lot transactions, monthly customer debit and credit balances, weekly reports of round lot sales).[145] Such data is necessary to enable the investor to evaluate the market price of particular securities, as well as the general tone and level of the market. In addition, disclosures of market data aid in the prevention of manipulation, for enforcement officials can thus locate and check unusual market behavior.[146]

Beyond the general provisions which require broker-dealers to keep such books and records as the Commission may prescribe,[147] there is no specific requirement that broker-dealers furnish market data. The only direct reference to the reporting of market data is in connection with exchange rules. The Commission is to register an exchange only upon the finding that it has rules "just and adequate to insure fair dealing and to protect investors."[148] Specifically, the Commission is given authority to promulgate rules for an exchange concerning "the reporting of transactions on the exchange and upon tickers maintained by or with the consent of the exchange including the method of reporting short sales, stopped sales, sales of securities of issuers in default, bankruptcy or receiv-

144 See In the Matter of Carvalho, d/b/a Capital Investment Co., SEC Securities Exchange Act Release No. 7129, Aug. 29, 1963 (broker-dealer held in violation of § 10b-5 Exchange Act for financial public relations activities); SEC v. Chamberlain Associates, Civil No. 61-2150, S.D.N.Y., May 16, 1963 (Company "Financial Public Relations Counsel" who had responsibility for passing stock to the public held in violation of § 17(a) of Securities Act).

145 *Special Study* Table VI-91, pt. 2, at 429. The *Special Study* listed about twenty reports that are being filed on a daily, weekly, or monthly basis with the New York Stock Exchange. In almost all instances only aggregate data is published.

146 Some reports, such as floor traders' reports, are designed specifically for surveillance. In other instances, such as the tape-watching program of the exchanges and the Commission, regulatory purposes are an important by-product. For any market study, such as that attempted by the Special Study for the period of the market break of 1962, reported data is indispensable. See *Special Study* pt. 4, at 815-957.

147 Exchange Act § 17a, 48 Stat. 897 (1934), 15 U.S.C. § 78q (1958). Reports of stabilizing activities (Rule 17a-2), and an annual report of financial condition (Rule 17a-5, Form X-17A-5) are required under this section. In addition, broker-dealers must keep detailed records of transactions and accounts (Rule 17a-3).

148 Exchange Act § 6d, 48 Stat. 885 (1934), 15 U.S.C. § 78f (1958).

ership, and sales involving other special circumstances. . . ."[149]

Currently, the only source of daily market data for individual stocks are the exchange ticker tapes and the clearing house reports. The Special Study criticized exchange reporting as neither providing an accurate measure of volume nor enabling the checking of individual transactions.[150] The reconstruction of the trading even in a single stock for one day is almost impossible. Tape data is incomplete, for certain trades of specialists are not included, and there is no way to identify individual firms which are participating, or whether sales are long or short. There is no way to determine the actual time of a transaction;[151] at best, only a sequence is possible, and as activity increases, accuracy decreases. Individual transactions must be traced through the clearing house data, which is a difficult and time-consuming task.[152]

The Special Study recommended that the exchanges attempt to improve the accuracy and coverage of their reporting of market transactions, and suggested that the reporting be done at the point of execution by each member.[153] This is a sound approach. Current electronic data processing equipment can easily digest the information coming from the individual broker. If all trades were recorded, it would be possible to trace an order back to its source and to determine price, time, and identification of the investor. Broker-dealers already maintain records of transactions, and the obligation to report individual transactions can be justified as part of their general duty as licensed broker-dealers.[154]

The reporting of general market data currently provided by weekly and monthly reports could also be improved. Better integration of these reports is needed, and important additions should

149 Exchange Act § 19b(8), 48 Stat. 898 (1934), 15 U.S.C. § 78s (1958).

150 *Special Study* pt. 2, at 351-58. See also *id.* pt. 4, at 815-957. The reconstruction of the market break data involved months of work and hours of computer time. Even with this, it represented only an estimate.

151 Only secondary sources are available, and these are not complete or consistent. In order to identify participants, clearing house data must be used; to determine the time of each transaction the exchange uses odd-lot records. These records show tape time, which makes them difficult to integrate with the specialists' reports, which show actual time. See *id.* pt. 2, at 355-56.

152 Clearing house data originates from members' reports of transactions which are cleared, and there is no requirement that all transactions go through the clearinghouse. *Ibid.*

153 *Id.* at 357-58.

154 Direct reporting of transactions would involve more record keeping for floor members and new procedures for reporting for all broker-dealers. These added duties are justified under the Exchange Act as being "necessary or appropriate for the protection of investors or to insure fair dealing in securities traded upon such exchange. . . ." 48 Stat. 898 (1934), 15 U.S.C. § 78s (1958). The duties to report market data could also be justified under the "shingle theory."

be made to the material reported.[155] In certain technical areas, such as trading by members and specialist activities, more comprehensive and detailed reports are needed.[156]

While improvements are needed in the reporting of transactions on exchange markets, a whole new system of reporting should be considered for the over-the-counter market. There are no records of volume or price of trades in particular securities. There are no regular reports of general market data. The public has, at best, retail quotations which do not represent actual transactions, but are only "a guide to the range within which these securities could have been sold or bought at the time of computation."[157] As discussed above, in many instances an investor cannot determine market value, and it is impossible to judge the quality or depth of any particular market.[158]

The problem of obtaining market data in the over-the-counter market is complex. Pursuant to recommendations of the Special Study, the Commission and the NASD are currently working to develop an improved system for quotations.[159] This is an important step, but an immediate effort should also be directed toward the broader goal. The individual broker-dealer should report not only quotations, but also the details of each transaction. Modern electronic data processing equipment makes possible a reporting system for over-the-counter transactions that could equal that of the major exchanges.

155 There is need to coordinate the filing of reports, and to reduce the time lag between the time of filing and publication. Specific recommendations in respect to reports of members' trading and specialists' activities were made in *Special Study* pt. 2, at 162-70, 238-42, 246.

156 A related problem of disclosure involves the specialist's book. The book contains the accumulation of market and limit orders for purchases and sales. The orders usually have time limits as well as price limits. Section 11 of the Exchange Act forbids the specialist to disclose the contents of his book to a limited number of people because knowledge of its contents gives a competitive advantage, 48 Stat. 891 (1934), 15 U.S.C. § 78k (1958). There is no statutory restriction, however, preventing disclosure to all members of the exchange and to the public. The Special Study discussed the problem (pt. 2, at 71-78) but did not satisfactorily answer the question of why full publicity should not be given to orders in the hands of the specialist if the desire is for a free and open market. The need for the specialist to keep his book private has not been shown, and unless such a showing is made, steps should be taken to make use of improved methods of communication in order to disclose pending orders fully.

157 This caption is required by the NASD to be placed above retail quotations published by the press.

158 The problems of market data in the over-the-counter market include the difficulties of the investor in determining the broker-dealers cost and mark-up. See Part IV(C) *supra*. Currently, the investor does not even have data showing the number of broker-dealers willing to trade a particular security, as the wholesale quotations are not generally available. See the discussion in the *Special Study* pt. 2, at 533-796, particularly 630-58.

159 See *Special Study* pt. 2, at 590-609.

V. CONCLUSION

Disclosure has now been used as a method of federal regulation of securities in the United States for thirty years, and any broad statement of evaluation must proclaim its success. This general accolade must be tempered, however, by a recognition that the effectiveness of disclosure as a method of regulation depends on the specific situation in which it is used. With respect to initial distributions, current disclosure requirements are invaluable. They have not, however, prevented investors from losing money in the purchase of new securities. Investor losses during the speculative activity of 1959 to 1962 were great. Improvements in disclosure mechanics are needed, but even with improvements, losses will probably continue. High-pressure salesmen and questionable tactics of various underwriters and promoters cannot be prevented by disclosure.

Disclosures by listed companies provide an indispensable reservoir of information. Disclosure plays its most effective role by permitting investors to evaluate securities on their merits. This is also the area where the need for improvement is most pressing. Reporting requirements should be extended to companies with securities traded over-the-counter, and the standards and accounting practices used in preparing periodic reports should be improved and standardized. In addition, there is a need to integrate the reporting requirements of the Securities Acts and the Exchange Act to avoid the duplication of filed information. This would decrease the burden on both the companies and the Commission.

The increased use of disclosure as a method of regulation of broker-dealers and other participants in the securities markets is an important recent development. New obligations owed toward investors are in a period of rapid growth. These obligations do not rest on a formal agency or contract relationship, but arise because of the "professional" status of the broker-dealer. Direct restrictions play a part in these obligations, but the recent developments primarily involve new duties of disclosure which should be encouraged and developed by the Commission.

These concluding statements summarize the preceding evaluation of the role of disclosure in securities regulation. It is a role of unparalleled importance. To complete the picture, however, mention must be made of a by-product of corporate disclosure. This is the role of disclosure as a method of regulation of the internal affairs of a corporation.

During the past thirty years, there has been increasing con-

cern over the power and influence of the large publicly owned corporation.[160] It is frequently stated that the large corporation has an obligation not only to its shareholders, but also to its employees, its consumers, and the community in which it operates.[161] The officers and directors of large corporations have been compared to public officials, and numerous writers have expressed concern as to how best to enforce these broad responsibilities of corporate management.[162] The subject is too broad for this paper, but any evaluation of disclosure in securities regulation must acknowledge that the disclosures required by the securities acts enable employees, consumers, and the general public to obtain information and thus exercise pressure on corporate behavior. For example, the amount executives pay themselves in compensation is of interest to labor groups and the general community, as well as investors. The required disclosure of this compensation certainly influences the level paid.[163] Likewise, the required disclosure of possible conflicts of interest by officers and directors serves to prevent their occurrence. Mr. Justice Frankfurter described this role of disclosure as follows:

> "The existence of bonuses, of excessive commissions and salaries, of preferential lists and the like, may be all open secrets among the knowing, but the knowing are few. There is a shrinking quality to such transactions; to force the knowledge of them into the open is largely to restrain their happening. Many practices safely pursued in private lose their justification in public. Thus social standards newly defined gradually established themselves as new business habits."[164]

One unanswered question, however, is whether the securities laws can be properly used to force additional corporate disclosures

160 BRANDEIS, OTHER PEOPLE'S MONEY (1914), raised the question, but modern discussions usually start with BERLE & MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (1932), and Temporary National Economic Committee, *Final Report and Recommendations*, S. Doc. No. 35, 77th Cong., 1st Sess. (1941).

161 See BAKER, DIRECTORS AND THEIR FUNCTIONS 138 (1945). Note the similar statements of director responsibilities taken from annual reports of large corporations quoted in BAKER & CARY, CORPORATIONS 163 (3d ed. 1959).

162 A good summary of recent material is in Manne, *Current Views on the Modern Corporation*, 38 U. DET. L.J. 559 (1961).

163 "It is the salaries of a few top corporate executives as much as anything else that confirms the worker in his opposition to profit as 'exploitation' and in his conviction that profits must be exorbitant. Every study shows that far from being petty, this resentment is a major factor in industrial conflict." DRUCKER, THE NEW SOCIETY 92-94, 251 (1950). On the effect of disclosure on executive compensation, see 1 WASHINGTON & ROTHSCHILD, COMPENSATING THE CORPORATE EXECUTIVE 27-28 (3d ed. 1962).

164 The quotation appears in an excellent discussion on the value of expanded disclosure in Cary, *The Case for Higher Corporate Standards*, Harv. Bus. Rev., Sept.-Oct. 1962, p. 53.

which may be in the public interest, yet which cannot be justified as necessary for the protection of investors.

The Commission may require a corporation, as a requisite for listing on an exchange, to disclose such information "as necessary or appropriate in the public interest or for the protection of investors. . . ."[165] The Commission may also require information in periodic reports "as necessary or appropriate for the proper protection of investors and to insure fair dealing in the securities"[166] and may prescribe the content of proxy statements "as necessary or appropriate in the public interest or for the protection of investors."[167] Is the different language used in these sections intentional? For example, would it be proper for the Commission to require that every proxy statement for an annual meeting list the number of Negro employees? This information might be important to the community in order for it to judge whether the company is meeting its responsibilities toward ending discrimination, yet it could be argued that it is not information needed to protect investors.

Aside from corporate and securities areas, disclosure as a method of regulation is receiving increasing recognition. It is seen as a means of preventing conflicts of interest involving government employees,[168] and as the remedy for deceptive packaging[169] and hidden costs in borrowing money.[170] Disclosure is not an effective regulatory device in all circumstances and, as evidenced by recent attempts to force organizations such as the NAACP to disclose membership lists, cannot be used indiscriminately.[171] In the area of securities regulation, it has proved its value. As a method of regulation of corporate behavior, disclosure offers the best available means of achieving desired results without the restrictiveness of direct regulatory control. To be effective, however, disclosure requirements should be specifically imposed as needed for corporate regulation. Disclosure for this purpose should not be limited merely to the by-products of that required for securities regulation.

165 Exchange Act § 12b(l), 48 Stat. 892 (1934), 15 U.S.C. § 78*l* (1958).

166 Exchange Act § 13a, 48 Stat. 894 (1934), 15 U.S.C. § 78m (1958).

167 Exchange Act § 14d, 48 Stat. 895 (1934), 15 U.S.C. § 78n (1958).

168 See PREVENTING CONFLICTS OF INTEREST ON THE PART OF SPECIAL GOVERNMENT EMPLOYEES (1963). The Case-Neuberger bill (entitled: a bill to promote public confidence in the integrity of Congress and the executive branch) calls for financial disclosures by congressmen and members of the executive branch. S.1261, 88th Cong., 1st Sess. (1963).

169 S. 387, 88th Cong., 1st Sess. (1963).

170 S. 758, 88th Cong., 1st Sess. (1963).

171 Bates v. Little Rock, 361 U.S. 516 (1960). See also Talley v. California, 362 U.S. 60 (1960). For a discussion of limitations of disclosure as a regulatory device, see Comment, *Disclosure as a Legislative Device*, 76 HARV. L. REV. 1273 (1963).