CHAPTER 2
THE BASIC STRUCTURE AND PROHIBITIONS OF THE SECURITIES ACT

SECTION 1. THE STATUTORY FRAMEWORK

Statute
Securities Act, §§ 5, 2, 3, 4, 6, 7, 8, 10 (and Schedule A), 11, 12, 13, 17, 19, 20, 24, 9, 22.

Introductory Note

The Securities Act of 1933 has two basic objectives: (1) to provide investors with material financial and other information concerning new issues of securities offered for sale to the public; and (2) to prohibit fraudulent sales of securities. Its scope, however, is limited, for jurisdiction is always tied to some use of the mails or of interstate facilities to accomplish a forbidden transaction; however, the use of the “jurisdictional means” can almost always be found. We commence our study of the 1933 Act with a guided tour through the various sections of the statute.

The basic prohibitions are found in two groups of provisions: First, Section 5 prescribes the rules for compelling full disclosure (and Section 12(a)(1) gives investors a right to rescind if Section 5 is violated). Second, Sections 11, 17 and 12(a)(2) prohibit fraud or misrepresentation in interstate sales of securities. Sections 17, 11 and 12(a)(2) overlap to some extent, but violations of § 17 can trigger criminal sanctions, while the latter provisions exclusively authorize private civil actions. Section 17 also provides a basis for enforcement by the Securities and Exchange Commission through disciplinary proceedings or by way of an injunction. Although the Supreme Court has never decided whether a private right of action will be implied under Section 17(a), lower courts have for some time refused to find any private cause of action created by that Section.¹

The key provision is § 5, around which most of the rest of the Act revolves. Its overall purpose is to require that new issues of securities offered by the use of the mails or other instrumentalities of interstate commerce shall be registered with the Commission, and that a prospectus (filed as a part of the registration statement) shall be furnished to the purchaser prior to the sale or, in some cases, at the time of the delivery of the security after sale. Section 5 can only be understood, however, by taking § 2 into account, for that section defines a number of the technical terms used in § 5. Section 3 exempts from the operation of the Act (except for the antifraud provisions of §§ 17 and 12(a)(2)) a laundry list of different types of securities and thus further limits § 5. In addition, § 4 specifically provides that § 5 shall not apply to certain specified transactions (most notably, private placements)

¹. Reversing an earlier trend, the Courts of Appeal are uniformly concluding that there is no private cause of action under § 17(a). See Zink v. Merrill Lynch Pierce Fenner & Smith, 13 F.3d 339 (10th Cir. 1993); Finkel v. The Stratton Corporation, 962 F.2d 169 (2d Cir. 1992); Newcome v. Esrey, 862 F.2d 1099, 1107 (4th Cir. 1988) (en banc).
and thus further restricts the section. Finally, although § 5 seemingly applies to "any person," we learn in § 4(1) that the section does not apply to transactions by anyone unless the person is "an issuer, underwriter, or dealer"—something quite different. Again, these terms are words of art which are defined in § 2.

The "registration statement" referred to in § 5 is defined in § 2(a)(8). Sections 6 through 8 set forth the procedures for registering securities from the filing of the registration statement with the SEC until it becomes effective. Section 5 also regulates the use of the "prospectus." That term is defined in § 2(a)(10). The information required to be set forth in the registration statement is specified in § 7 (and in Schedule A), and § 10 prescribes the contents of a prospectus.

Other sections of the Act are concerned with enforcement procedures. Sections 11 and 12 give private remedies to buyers of securities. The scope of these remedies is the subject of Part IV on Civil Liabilities. The private remedy sector is rounded out by § 13, which fixes a short statute of limitations for §§ 11 and 12 actions; by § 14 which invalidates any contractual provision that attempts a waiver of remedies; and by § 15 which imposes joint and several liability upon persons in a control relationship with any person liable under §§ 11 or 12.

To complete the overall picture, reference needs to be made to a number of miscellaneous sections. Section 18 partially preempts state laws regulating the issuance and sale of securities to the extent the securities are listed on an exchange or meet certain other standards. Section 19(a) gives the Commission rule making powers, including the power to define accounting, technical and trade terms used in the Act. It also contains the important good faith provision which immunizes from any liability persons who rely upon a rule of the Commission in good faith, even though the rule is later determined to be invalid.

The government may compel compliance in various ways. Sections 19(b) and 20(a) give the SEC investigative powers. Section 20 also authorizes the Commission to seek the judicial remedies of injunction and mandamus. This long-standing remedial power has been expanded in two important steps. First, the Securities Enforcement Remedies Act of 1990 authorized the federal courts to issue cease-and-desist orders for violation of the securities laws, order the payment of penalties in addition to disgorgement, and prohibit persons from serving as officers and directors of public companies (see infra at Chapter 21). Second, the Dodd–Frank Act expanded Section 8A so that the SEC now has the option of relying on administrative proceedings before administrative law judges. However, the power to institute criminal proceedings is exclusively vested in the Attorney General. Criminal penalties are specified in § 24.
Court procedures are prescribed in §§ 9 and 22. Under § 9, a person aggrieved by an order of the Commission may have it reviewed in the United States Court of Appeals. Jurisdiction over "offenses and violations" is vested in the United States district courts by virtue of § 22(a), although the state and territorial courts have concurrent jurisdiction with respect to civil actions under the statute. In suits in the federal courts, venue may be laid in the district where the defendant is found, is an inhabitant, transacts business or where the offer or sale of the security occurred. Process runs throughout the world, and the Court may order security for costs under § 11(e).

With this preview of the overall structure of the 1933 act, § 5 should be examined more closely. The section states the ground rules for making offers and sales of securities during three distinct periods of time: (1) the pre-filing period; (2) the period between the filing of the registration statement and the effective date (the so-called waiting period); and (3) the post-effective period.

Section 5(a) requires an "effective" registration statement as a precondition to the sale of a security; § 5(b) states the prospectus delivery requirements; and § 5(c) governs activities in the pre-filing period. Sections 5(b) and (c) have been significantly relaxed by exemptive rules adopted by the SEC in 2005. Still, these exemptive rules have important preconditions, and thus they do not apply. Hence, once must understand both the complex structure of § 5 and the SEC's more permissive rules. The only way to do this is to review Section 5 in its entirety.

SECTION 2. THE PRE-FILING PERIOD ("GUN JUMPING")

Statutes and Regulations


Congress and the courts have noted the "close working relationship" between the two agencies in their investigative capacities. United States v. Stringer, 521 F.3d 1189 (9th Cir. 2008); SEC v. Dresser Industries, Inc., 628 F.2d 1368, 1386 (D.C.Cir. 1980) (en banc), cert. denied, 449 U.S. 993 (1980). For the scope of the SEC's enforcement efforts, see infra at Chapter 21.

5. Under Section 23(a), process may be served "wherever the defendant may be found." Similar language appears in Section 27 of the 1934 Act. In Fitzsimmons v. Barton, 589 F.2d 330 (7th Cir. 1979), nationwide service under Section 27 and F.R.C.P. Rule 4(e) without a constitutional attack on the basis of the Due Process Clause of the Fourteenth Amendment. In Bersch v. Drexl Firestone, Inc., 389 F.Supp. 446 (S.D.N.Y. 1974), rev'd in part on other grounds, 519 F.2d 974 (2d Cir. 1975), cert. denied, 423 U.S. 1018 (1975), service of process on a British corporation by mailing a copy of the summons and complaint pursuant to F.R.C.P. Rule 4(d)(1)(D), return receipt requested, to its office outside the United States was held sufficient, even though the envelope containing the summons and complaint was returned to the sender, marked "delivery refused". The court held defendant was "found" at its head office, despite its effort to avoid service of process merely by returning the papers. In SEC v. Unifund SAL, 910 F.2d 1028 (2d Cir. 1990), the district court ordered service of process to be made by sending all relevant papers to the defendant in care of defendant's New York broker with instructions to forward the papers by overnight carrier to the defendant in Beirut. Service was held proper under § 27 of the Securities Exchange Act and Fed.R.Civ.P. 4(e) and 4(i). But see Prewitt Enterprises, Inc. v. OPEC, 353 F.3d 916 (11th Cir. 2003) (service in foreign country must be proper under foreign law).

6. Some explanation should be made as to the SEC's system of rule numbering. Since about 1940, the rules have been published in the Code of Federal Regulations, Title 17, Chapter II. The general rules and regulations under each act administered by the SEC appear...