

**Chapter 20**  
**Securities Law**

1 Source: Bohlman/Dundas, The Legal, Ethical, & International Environment of Business

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**INTRODUCTION**

- Blue sky laws
- Federal securities laws
  - Securities Act of 1933
  - Securities Exchange Act of 1934
  - Securities Investor Protection Act of 1970
  - Foreign Corrupt Practices Act of 1977
  - Insider Trading Sanctions Act of 1984
  - National Securities Markets Improvement Act
  - Private Securities Litigation Reform Act

2 Source: Bohlman/Dundas, The Legal, Ethical, & International Environment of Business

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**Characteristics of a Security**

- A security is typically defined as
  - Investments using money or other considerations
  - Common enterprise
  - Investor expecting a profit
  - Profit derived primarily through the efforts of others
- Securities laws attempt to protect investors by
  - Full and truthful disclosure
  - Prohibiting fraud
  - Prohibiting insider trading

3 Source: Bohlman/Dundas, The Legal, Ethical, & International Environment of Business

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## Securities Act of 1933

- Promotes disclosure of information and prohibits fraud and deceit
- Requires a registration statement
- Requires registration of a corporation
  - Regulation A—Simplified registration process
- Regulation C, Rule 415—Corporations with stock having a minimum value of \$150 million may register the new securities and sell them over time
- Misrepresentations in registering with the SEC can make the issuer, signers, and those named or participating liable

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## Escott v. BarChris Construction Corp. Landmark Case

- BarChris filed a registration statement that contained material false statements and material omissions
- BarChris, the signers of the registration statement, the debentures, the underwriters, and the corporations' auditors were held liable

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## Exemptions to the Securities Act of 1933

- Exemptions include
  - Small offering exemptions (Reg. D)
  - Private offering exemptions (Reg. D, Rule 506)
  - Intrastate offering exemptions (Rule 147)
- Exempt securities include
  - Government issued securities
  - Stock dividends
  - Stock splits

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## Liability under the 1933 Act

- Criminal
  - Department of Justice
    - 5 years in prison
    - \$10,000 fine
- Civil
  - Sec/ALJ hearing
    - Consent order
    - Cease and desist order
  - SEC/federal district court
    - Injunction
    - Recovery of profits
    - Civil money damages
  - Private parties/court
    - Monetary damages

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## Securities Exchange Act of 1934

- The Securities Exchange Act of 1934 was designed to
  - Insure the integrity of the securities markets
  - Inform the investing public of the financial condition of a business
  - Protect the public from fraudulent activity
  - Regulate security exchanges, interstate broker-dealer, and securities associations
  - Provide continuous disclosure by any business listed on and regulated securities exchange and companies that have assets of \$5 million and 500 or more shareholders
  - Regulate solicitation of proxies and insider trading
- Established the Securities Exchange Commission

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## Proxy Requirement

- Written authorization empowering another person to act for the signer at shareholders meetings
- 1934 Act regulates proxy solicitation procedures

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## Insider Trading and Fraud

- Officers, directors, and key employees obtain advance inside information about matters that can affect the future value of stock
- Insider trading is prohibited by the 1934 Act
- Sec. 16 defines insiders as directors, officers, and owners of more than 10% of any one class of stock
- Any profit made within a six month period is illegal

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## Section 10(b) and Rule 10b-5

- Section 10(b)
  - Makes it unlawful to use in the purchase or sale of any security any manipulative or deceptive device prohibited by SEC regulations
- Rule 10b-5
  - Makes it unlawful for any person through the use of any means of interstate commerce to defraud or mislead anyone in the purchase or sale of any security

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## Disclosure

- Key to liability under Rule 10b-5
  - A substantial likelihood that a reasonable investor would find its disclosure significant
- Timing of disclosure under Rule 10b-5
  - Insiders should refrain from trading on information for a reasonable waiting period

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## Persons Who Have a Duty under Rule 10b-5

- Insider trading rules cover anyone having access to or receiving information of a nonpublic nature from an insider on which the trading is based
  - Tipper/tippee
  - Misappropriation of information

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## Sec. 18 of 1934 Act

- Requires publicly held corporations register with the SEC to file periodic and intermittent reports
  - Form 10-K
    - Audited financial statements
    - Business's current financial status and securities holdings
  - Form 10-Q
    - Quarterly financial changes
  - Form 8-K
    - Material changes
- Private parties relying on the 10K and 8-K reports and proxy statements who are injured may sue

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## Other Securities Laws

- Securities Investor Protection Act of 1970
- Foreign Corrupt Practices Act
- Insider Trading Sanctions Act
- Insider Trading and Securities Fraud Enforcement Act
- Securities Enforcement Remedies and Penny Stock Reform Act of 1990
- National Securities Markets Improvements Act of 1996
- Private Securities Litigation Reform Act

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## State Securities Laws

- Blue sky laws
- Uniform Securities Act

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## International Considerations

- Attitudes toward securities
  - No international agreements have been made regarding stock markets
  - US has criminalized some violations of securities laws
  - Other countries have not done this
- International Securities Enforcement Act allows the SEC to cooperate with other countries to regulate markets and transactions

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## Summary

- Characteristics of a Security
- Securities Act of 1933
- Escott v. BarChris Construction Co.
- Exemptions to Securities Act of 1933
- Liability under the 1933 Act
- Securities and Exchange Act of 1934
- Proxy Requirement
- Insider Trading and Fraud
- Section 10(b) and Rule 10b-5
- Disclosure
- SEC v. Texas Sulphur
- Ernst & Ernst v. Hochfelder
- Persons Who Have a Duty under Rule 10b-5
- Sec. 18 of 1934 Act
- Other Securities Laws
- State Securities Laws
- International Considerations

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