

Chapter 20 Securities Law

1

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

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

4

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

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

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

5

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

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

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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

6

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

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

7

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

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 are directors, officers, and owners of more than 10% of any one class of stock
- Any profit made within a six month period is illegal

10

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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

8

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

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

11

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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

9

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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

12

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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/tippe
 - Misappropriation of information

13

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State Securities Laws

- Blue sky laws
- Uniform Securities Act

16

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

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

14

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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

17

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

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

15

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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

18

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