November 1, 1934

MEMORANDUM: Re Investment Bankers' Code Discussion -

To: Chairman Kennedy

From: Judge Burns

1. This question raises the problems which are now being considered. The Commission is undertaking to revise the requirements with the view to eliminating questions, the answers to which would involve unusual expense or delay and at the same time are not informative from an investor's point of view. It might be noted that in many respects the English Company's Act imposes far more strict burden.

2. (a) This is but a reflection on the generally accepted view of business men that directors need not direct. The law regards them as trustees for the stockholders. They should assume the responsibility which is implicit in their office or resign.

(b) After all, this is merely an argument against the whole Securities Act. Congress has declared its intention of requiring full, fair, and honest disclosure. It is now part of the fundamental law of the land; corporations can no longer seek funds from investors without giving information to which investors are entitled.

(c) The same comment can be made as to 2 (b).

3. It will be difficult for this Commission to take the position that the standard of justice in the Federal Court is higher than the standard of justice in the State Court. There are many instances where Federal law may be enforced civilly in the State Courts. As far as strike suits are concerned, the Act itself gives protection which no other statute, State or Federal, has heretofore given, namely a bond is required to be filed by the plaintiff for costs, and costs, including actual attorneys' fees, etc., can be assessed against the plaintiff. The defendant can thereby be guaranteed reimbursement if it is right, and irresponsible shysters can no longer capitalize their nuisance value.

4. This question is based upon an erroneous assumption. Underwriters are liable only for their pro-rata participation, except in one single instance where they receive a larger percentage of the spread.

5. (a) The plaintiff must prove now that the prospectus contains a misstatement or failure to state a material fact.

(b) The English Act requires the defendant to show that he was not negligent and that he acted in good faith. It is far easier for the defendant to prove his absence of wrong-doing than for the plaintiff to establish negligence or bad faith. The evidence is entirely in the control of the defendant.

(c) The Commission feels that the present requirement, casting upon the defendant the burden of showing that the loss was not due to the misstatement, is essential to the fulfillment of the social aims of the Act. It will be important to note how this provision works out in practice; without theorizing too much we can adopt a pragmatic view to find out its workability.

6. The Commission by one decision (Landis) and in many interpretative decisions has taken the position that sub-underwriters and small dealers exercise due care if in good faith they rely upon data supplied by reputable accountants, lawyers and engineers.

7. As a matter of experience in the Federal Trade Commission, twenty days is almost an absolute minimum for passing upon a statement. It is our opinion that this delay has not the slightest effect on securing firm committments.

8. (a) This is a reasonable suggestion for consideration by the Commission. We are trying our best to harmonize to avoid duplication and to arrive at classifications that will be for the protection of corporations and their investors, but no definite decision has been arrived at.

(b) This presents an impossible program. We are a Commission for filing and registration of information and not for giving approval. This suggestion would entail examination into every piece of property owned by the filing corporation and from the Commission's point of view would be very dangerous in that it would involve necessarily appearing to be giving approval. Nothing would more clearly put the Commission "on the spot".