In the United States Circuit Court of Appeals for the Second Circuit

SECURITIES AND EXCHANGE COMMISSION, APPELLANT

v.

CHINESE CONSOLIDATED BENEVOLENT ASSOCIATION, INC., APPELLEE

ON APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE SOUTHERN DISTRICT OF NEW YORK

REPLY BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION

We regard it as unfortunate, and symptomatic of the weakness of the appellee's case, that the appellee has seen fit to devote a large portion of its brief, not to a discussion of the legal issues presented, but to assertions that the Commission has misstated and distorted the facts. The record is a short and simple one; we rest our case on it, and decline the appellee's invitation to join it in a discussion which could have no objective save to distract the Court from the real issues in the case.

Nor do we propose in this reply brief to reargue the issues presented, as we believe that our main brief presents with sufficient clarity the basic principles which

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we regard as controlling in the situation presented by the complaint and answer. On one or two points, however, further brief discussion may be helpful to the Court.

I

In our main brief (pp. 5–11), we have presented our reasons for believing that the activities of the appellee constitute conduct amounting to the "sale" of securities, as that term is defined in Section 2 (3) of the Securities Act. The definition includes within its scope any "solicitation of an offer to buy" a security for value; and we have pointed out to the Court that "soliciting" offers to buy securities is exactly what the appellee has been doing.

The appellee, in its brief, concedes at least superficial force to our argument, but seeks to answer it by showing that notwithstanding the unequivocal language of the Act, Congress in using the phrase "solicitation of an offer to buy" intended to comprise only a limited class of transactions, and "that it was never contemplated that the Act should be so broadly applied." (Appellee's Brief, p. 8).

In support of its contention appellee resorts to the extraordinary device of quoting to the Court a statement from the legislative history of Section 2 (3) of the Act which has no bearing whatsoever on the issues before the Court. The statement quoted at page 8 of appellee's brief from H. R. Rep. No. 85 dealt with language which was in the definition of "sale" contained *in the bill as then pending before the House, but which before enactment was deleted and transferred to an-*

other section of the statute. In order to correct the misapprehension which would otherwise necessarily arise, we consider it appropriate to give to the Court a detailed statement of the legislative history involved.

Admittedly, both the House and the Senate wished to outlaw, among other things, the methods of high-pressure salesmanship employed by underwriters in the nineteen-twenties to compel dealers to accept participations in new issues of securities. To this end, as a practical matter, it appeared desirable not only to prohibit the underwriter from soliciting dealer purchases before the expiration of the twenty-day cooling period, but also to prohibit the dealer from approaching the underwriter before the security had become effectively registered. The scheme proposed in the House, in H. R. 5480, to effect this purpose, was to include "offers to buy" within the definition of the term "sale," so that offers to buy before registration, as well as "sales" in the ordinary sense, would be comprised within the prohibitions of Section 5.

Obviously, such a scheme of legislative draftsmanship was somewhat artificial, and it may well have been this fact that impelled the House Committee to insert in its Report an explanation of its purpose in including the phrase "offer to buy" in the definition of "sale." This explanation is the one quoted by appellee at page 8 of its brief.

And, likewise, it may well have been this artificiality which led the Congress finally to abandon the House scheme, and to follow a Senate proposal, which deleted the phrase "offer to buy" from the definition

of the term "sale," and instead inserted in Section 5 a direct prohibition against "offers to buy" unregistered securities.

But whatever may have been the reason for the Congressional action, the statement of the House Committee quoted by appellee in its brief refers to language which was not retained in the statute as passed, which is not in the definition of "sale" in the Act as it now stands, and which has no bearing on the questions before the Court.[1]

We reiterate, therefore, our view that the activities of the appellee constitute the solicitation of offers to buy securities, and, as such, have involved "sales" within the meaning of the Securities Act.

II

In further support of our argument that the activities of the appellee constitute "sales" of securities, we referred in our main brief (p. 10) to a published opinion of a former General Counsel to the Commission, and asked the Court to give weight to that opinion as an indication of settled administrative construction of the term "solicitation of an offer to buy." In that opinion it was said that financial and securities houses having no connection with the issuer or principal underwriter of a new issue of securities were engaged in "sales" of such securities when they solicited their

[1] Similarly, the discussion by the Federal Trade Commission in its Release No. 70, quoted at pages 8–9 of appellee's brief, was designed primarily to illuminate the impact of the phrase "offer to buy" in Section 5, rather than to suggest any limitation on the meaning of "solicitation of an offer to buy" in Section 2 (3).

customers to employ them as "buying agents" to purchase the new securities for their customers' accounts.

The appellee states in its brief (p. 10) that it agrees with this opinion "on the facts set forth therein," but seeks to distinguish it on the ground that "those who proposed to send the circulars were dealers and hence within the provisions of the Act."

This purported distinction, we submit, is frivolous. Perhaps the persons referred to in the opinion were "dealers," although that does not appear.[2] Whether they were or not was obviously irrelevant. The question there, as here, was the simple question *whether certain described activities constituted the "solicitation of an offer to buy"* securities, and, hence, "sales" within the meaning of the Act. It was so held in that opinion, and the appellee's admission of the correctness of that opinion "on the facts set forth therein" should, we submit, stand as an admission of its correctness as applied to the like activities involved in this case.[3]

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[2] Likewise, the appellee, by reason of its activities, is probably a "dealer," as defined in Section 2 (12) of the Act (see our main brief, footnote 18, p. 20). However, we have not regarded that feature as controlling.

[3] We cited the opinion as establishing that the activities there discussed, like the activities here involved, constituted "sales" *prima facie* subjecting the solicitors to Section 5. Whether Section 4 *exempts* those activities from Section 5 is a totally separate question, dealt with at another point in our main brief (pp. 12–21). The existence of "sales" is frequently an important question in itself, regardless of the impact of Section 5, since *fraud* in the sale of securities is prohibited under Section 17 of the Act even if the securities are *exempt* from the *registration* requirements of Section 5.

III

In our main brief we explained at length our reasons for believing that the activities of the appellee, viewed in the light of the whole scheme of which they are a part, are activities which should be enjoined. We tried to show that the scheme, as a whole, is one for the distribution of Chinese Government bonds in the United States without the registration required by law, and that the defendant, whether as an "underwriter," as an aider and abettor, or as a patriotic volunteer, is still the efficient agent by which the distribution is achieved in violation of law.

The appellee seeks to escape the force of our argument by a meticulous dissection of the scheme into several disjunct segments. It attempts, by use of a legalistic scalpel, to divert the attention of the Court from the realities of the situation.[4] The courts have shown an increasing unwillingness to accept such self-interested disarticulation as a basis for legal judgment. *Pepper* v. *Litton,* 308 U. S. 295 (1939).

An excellent example of the attitude of the courts towards the type of argument adopted by the appellee is to be found in the case of *Link, Petter & Co.* v. *Pollie,* 241 Mich. 356, 217 N. W. 60 (1928). In that case a broker sued his customer to enforce performance of a contract to purchase securities. The customer defended on the ground that the transaction was in violation of the Michigan Securities Law, which forbade sales of securities not qualified with the Michigan Securities

[4] We appreciate that the appellee questions the reality of our view of the "realities of the situation" (Appellee's Brief, p. 16) Here again, we are willing to rest on the record.