Constitutionality of the Securities Exchange Act of 1934

Jacob Lippman
CONSTITUTIONALITY OF THE SECURITIES EXCHANGE ACT OF 1934

ASIDE from its fundamental scheme, the Securities Exchange Act presents a number of constitutional problems. Assuming that Congress had power to pass a law regulating practices on stock exchanges, did it have the power to enact all of the provisions contained in the statute? The Act not only controls practices on the exchanges through authority over them and their members, but regulates the activities of brokers and dealers who transact their business through a member or through the facilities of the exchange. It fixes the amount of money that brokers may lend to the customers who trade on margin and dictates the sources of credit available to brokers and dealers in financing their transactions in securities. The duty of determining margin requirements is assigned to the Federal Reserve Board, while all other functions are entrusted to the Securities and Exchange Commission which is given broad discretionary powers to make rules and regulations and to enforce the provisions of the statute and the rules and regulations which it promulgates.

2 Cf. Stafford v. Wallace, 258 U. S. 495, 42 Sup. Ct. 397 (1922), which upheld the Packers & Stockyards Act, regulating livestock markets, and Board of Trade v. Olsen, 262 U. S. 1, 43 Sup. Ct. 470 (1923), which upheld the Grain Futures Act regulating boards of trade on which transactions in grain are carried on.
6 Supra note 4.
Finally, the Act imposes criminal liability, not only for violation of the provisions of the statute, but for breach of the rules and regulations made by the Commission.

It is apparent that in framing the Securities Exchange Act of 1934, Congress was extremely careful to include every conceivable practice, instrumentality and person connected with dealings on securities exchanges. We have Commissioner Ferdinand Pecora's word for it that Congress gave the statute most careful consideration and, indeed, the Act bears every evidence of this. Nevertheless the criticism has been made that Congress has left to the Commission much that it should have decided itself, that the Commission is given so much discretionary power that it is not only empowered to make law, but is even in a position to vitiate what appear to be the express provisions of Congress.

The original Fletcher-Rayburn bill, the predecessor of the present statute, had not left so much "law-making" to the regulatory body but had limited the Commission to administrative functions alone. But there were objections to that bill on the ground that it was too rigid; it needed to be more flexible. Mr. Richard Whitney, president of the New York Stock Exchange, testifying before the Senate Committee on Banking and Currency, said:

"The bill as drawn, presumes that the draftsmen have the supreme knowledge of this subject, and grants to us no knowledge. I am perfectly willing to concede that neither side knows it all, and that neither will ever know it all. But I do feel that there is a middle course here granting sufficient, or something, to both sides.

---

9 John T. Flynn, Other People's Money (June, 1934) NEW REPUBLIC 127.
10 For example §16b specifically penalizes directors and officers who make a profit from transactions in securities of their corporations. Then it says: "This subsection shall not be construed to cover any transaction or transactions with which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection."
11 S. 2693.
12 In the original bill the regulatory body designated was the Federal Trade Commission.
"This bill is so rigid and inflexible in its provisions as, in our opinion, to absolutely hamstring and freeze security markets. We therefore suggest an authority which shall study, which shall have power to make regulations, but which, in itself, will not be hamstrung by the provisions of a bill which cannot be changed except by another act of Congress. We therefore suggest the middle course. If an authority is set up, allow it to be flexible and mobile, and do not have it inflexible, so that if disaster does come, as we predict, it cannot be changed without another act of Congress." 13

The spokesmen for the exchanges also protested against giving too much power to the Commission. They felt that there should be very little interference with the exchanges and their members and still less with the corporations whose securities were dealt in on the exchanges. A specimen of this sort of objection is to be found in a statement prepared by Mr. Whitney and given by him to the Senate Committee. 14 Speaking of the Commission's power to make rules and regulations relating to exchanges, their members and brokers and dealers who transact business through such members, he says:

"This long section, which specifies in detail some of the powers which the Federal Trade Commission may exercise, clearly is not a regulation of stock exchanges and the brokerage business, but, in fact, gives the Federal Trade Commission power to manage exchanges and dictate brokerage practices. There is no single activity of a stock exchange from the admission of members to their suspension or expulsion that may

---

13 Hearings before the Committee on Banking and Currency on Stock Exchange Practice on S. R. 84, 72d Cong. and on S. R. 56, 97, 73d Cong. (1934) pt. 15 at 6734. It is interesting to note that in his interview with a representative of the New York Times, as reported in that newspaper for November 14th, 1934, Mr. Whitney expressed a contrary view. The Securities Exchange Act has not only failed to bring about disaster; he says it has been a good thing for the securities business.

14 Id. at 6624-6642.
not be controlled under this subsection. * * * This is not regulation but domination." 15

The flexibility which the exchanges desired and obtained is challenged as an unlawful delegation of power by those who feel that too much discretion is left to the Commission. The all-embracing powers of the Commission are criticized by the exchanges on the ground that they include authority over matters which have nothing to do with control of stock market practices. Aside from the social points of view reflected by the respective arguments, they are interesting because they involve constitutional problems which merit consideration. These are:

I. Has Congress, in giving broad discretionary powers to the Commission, abdicated any of its legislative functions?

II. Did Congress act within its constitutional rights in including within the statute provisions relating to corporations whose sole connection with exchanges is that their securities are bought and sold on these exchanges?

And in connection with these problems there arises a third:

III. Are those provisions valid which make criminal any violation of the Commission’s rules and regulations?

Before we proceed to a consideration of these questions, we must examine the powers granted to the Commission.

ANALYSIS OF THE POWERS OF THE COMMISSION.

A. Powers Relating to Exchanges, Members, Dealers and Brokers.

Every exchange is required to be registered with the Commission unless that body exempts it, and it is made unlawful to deal with or through an exchange unless it is so

15 Id. at 6638, 6639.
registered or exempted. The power to pass upon the application for registration and to permit or deny it, rests with the Commission. The Commission has the authority to make rules and regulations concerning the aggregate indebtedness brokers may incur in their business, in no event to exceed 2,000% of the net capital (exclusive of fixed assets and value of exchange membership) employed in the business; concerning the hypothecation or commingling of customers' securities; concerning pegging, fixing or stabilizing the prices of a security as well as puts, calls, straddles, options or privileges and the endorsement or guarantee of the performance of a put, call, straddle, option or privilege. It has the power to control short sales and stop-loss orders and such manipulative or deceptive devices or contrivances as may require regulation in the public interest or for the protection of investors. It is empowered to regulate or prevent floor trading by members for their own account or for discretionary accounts and to prevent excessive trading on the exchange but off the floor by members for their own account with the right to make exemptions for arbitrage transactions, transactions in exempted securities, transactions by odd-lot dealers and specialists. It may formulate rules and regulations concerning the functions of specialists and odd-lot dealers and require the disclosure of information by specialists to all members of the exchange of all orders placed with the specialists to the extent that the Commission may deem necessary in the public interest or for the protection of investors. The Commission may, however, exempt any exchange from these provisions because of the limited.

16 Supra note 5, Securities Exchange Act of 1934 §8 (b).
17 Supra note 5, Securities Exchange Act of 1934 §8 (e).
19 Supra note 20, Securities Exchange Act of 1934 §9 (b).
20 Supra note 20, Securities Exchange Act of 1934 §9 (c).
21 Supra note 23, Securities Exchange Act of 1934 §10 (b).
volume of business transacted on it.\textsuperscript{27} It has the power to make rules and regulations governing over-the-counter markets.\textsuperscript{28} Every national securities exchange, every member thereof, every broker or dealer who transacts a business in securities through the medium of such member and all those creating markets for the purchase and sale of securities, are required to make such entry and keep such accounts, correspondence, papers, books, records, etc., and make such reports as the Commission may require.\textsuperscript{29}


Securities must be registered with the Commission which may require data over and above the information specifically called for in the Act.\textsuperscript{30} The Commission may make rules and regulations for the withdrawal or striking from listing and registration of securities as well as for the registration of unissued securities and for trading privileges of unlisted securities.\textsuperscript{31} The Commission may require corporations whose securities are registered on a national securities exchange to file with it annual and quarterly reports together with such information and documents and in such form as it may prescribe.\textsuperscript{32} It is made unlawful for a person to solicit proxies and for any member of a national securities exchange or any broker or dealer who transacts business in securities through the medium of any such member, to give a proxy in connection with a security registered with the Commission in contravention of the rules and regulations of the Commission.\textsuperscript{33}

Section 16, subdivision b, provides for penalties in cases

\begin{itemize}
\item \textsuperscript{27} Supra note 25, Securities Exchange Act of 1934 §11 (c).
\item \textsuperscript{31} Supra note 30, Securities Exchange Act of 1934 §12 (d).
\item \textsuperscript{33} Subdivision (a) of §16 requires directors, officers and stockholders owning more than 10% of the stock of a corporation to report their holdings to the Commission and report to it thereafter any change in beneficial ownership thereof.
\end{itemize}
where a profit is made by a large stockholder, a director or officer of a corporation on the strength of information which he has obtained by reason of his relationship with the corporation, but such penalty does not extend to a transaction which the Commission, by rules and regulations, may exempt if not comprehended within the purpose of this subsection.

C. Additional Powers.

Section 19(a) gives to the Commission the following additional powers:

1. After appropriate notice and opportunity for hearing, to suspend for a period not exceeding 12 months or to withdraw the registration of a national securities exchange if the Commission finds that the exchange has violated any provisions of the law or any of the rules and regulations which it has promulgated or has failed to enforce so far as is within its power, compliance by a member or an issuer of a security registered on such exchange;

2. After notice and opportunity for hearing, to deny, suspend the effective date of, suspend for a period not exceeding 12 months, or withdraw registration of a security if the Commission finds that the issuer of the security has failed to comply with any provisions of the law or any of the rules and regulations;

3. After notice and opportunity for hearing, to suspend for a period not exceeding 12 months or to expel from a national securities exchange, any member or officer thereof who the Commission finds has violated any provision of the law or any rule or regulation, or has effected any transaction for any other person who he has reason to believe is violating in respect of such transaction, any provision of the law or any rule or regulation of the Commission;

4. If public interest so requires, to summarily suspend trading in any registered security on any national securities exchange for a period not exceeding 10 days, or, with the
approval of the President, summarily to suspend all trading on any national securities exchange for a period not exceeding 90 days.

The Commission is further empowered under subdivision b of the section to change, alter or add to the rules of a national securities exchange, if such an exchange fails or refuses to make such changes in its rules and practices after an appropriate request to do so has been made, and after opportunity for hearing has been given to it by the Commission, provided the Commission finds that the changes are necessary for the protection of investors or to insure fair dealing in securities traded in on the exchange or to insure fair administration of such exchange. The matters to which this specific authority relates are as follows:

1. Safeguards in respect to the financial responsibility of members and adequate provisions against the evasion of financial responsibility through the use of corporate forms or special partnerships;

2. The limitation or prohibition of the registration or trading in any security within a specified period after the issuance or primary distribution thereof;

3. The listing or delisting of any security;

4. Hours of trading;

5. The manner, method and place of soliciting business;

6. Fictitious or numbered accounts;

7. Time and method of making settlements, payments and terms and of closing accounts;

8. The reporting of transactions on the exchange and by tickers maintained by or with the consent of the exchange, including the method of reporting short sales, stopped sales, sales of securities of corporations in default, bankruptcy or receivership and sales involving other special circumstances;

9. The fixing of reasonable rates of commission, interest, listing and other charges;

10. Minimum units of trading;
11. Odd-lot purchases and sales;
12. Minimum deposits on margin accounts;
13. Similar matters.

The Commission is further directed by subdivision c of Section 19 to make a study and investigation of the rules of the national securities exchanges with respect to the classification of members, the method of election of officers and committees to insure a fair representation of the membership, and the suspension, expulsion and disciplining of members of such exchanges. The Commission is required to report to Congress the results of its investigation together with its recommendations on or before January 3, 1935.

Section 21 authorizes the Commission to make such investigations as it deems necessary in its discretion in order to determine whether any provision of the law or of any of the rules or regulations has been or is about to be violated, and empowers it in its discretion to publish information concerning such violation and to investigate any such facts, conditions, practices or matters which it may deem necessary or proper to aid in the enforcement of the provisions of the Act, in the prescribing of rules and regulations thereunder, or in securing information to serve as a basis for recommending further legislation. In connection with such investigation or any other proceeding, any member of the Commission or any officer designated by it is empowered to administer oaths, subpoena witnesses, compel their attendance, take evidence and require the production of books and records which the Commission deems relevant or material to the inquiry and such attendance of witnesses and production of records may be required from any place in the United States or any state at any designated place of hearing. In case of contumacy or refusal to obey a subpoena, the Commission may invoke the aid of any court of the United States within the jurisdiction of the investigation to compel such production. Failure to testify or to comply with the subpoena is punishable as a contempt.

Subdivision e of Section 21 empowers the Commission to apply for an injunction to any district court if the Commission finds that any person is engaged or about to engage
in any acts or practices which constitute or will constitute a violation of the provisions of the Act or of any rule and regulation thereunder.

Section 23 empowers the Commission as well as the Federal Reserve Board to make such rules and regulations as may be necessary for the execution of the functions vested in them and for such purpose to classify issuers, exchanges and other persons or matters within their respective jurisdictions. The Commission as well as the Federal Reserve Board is required in its annual report to Congress to include such information, data and recommendations for further legislation as it may deem advisable with regard to the matters within its jurisdiction. The orders of the Commission are reviewable but the findings of fact made by the Commission, if supported by substantial evidence, are conclusive.

This résumé of the powers entrusted to the Commission and the duties imposed upon it, indicates the authority of this body. It has been suggested that there is no federal agency which has as much power within its particular field as has the Securities and Exchange Commission. However this may be, it is sufficient for our purpose that the delegation of power to the Securities and Exchange Commission does present constitutional problems for the consideration of the student.

Constitutional Problems.

I. Has Congress, in giving broad discretionary powers to the Commission, abdicated any of its legislative functions?

It may appear from the above enumeration that the Commission has more than regulatory powers, that since it has the authority to determine what practices are permissible, it has legislative functions as well. An examination of the statute and of the decided cases indicates that Congress has not surrendered any of its legislative functions to the Commission. It has in this instance legislated with greater precision and clarity than in past enactments which created regulatory bodies whose powers were upheld by the courts.
The powers of the Commission as stated in the Act do not yield readily to an attempt to classify them because they are obscured by detailed allusions to a very complex reality. Nevertheless these powers can roughly be subsumed under three headings:


B. The Power to Discipline Exchanges, Their Members and Brokers, to Amend the Rules of the Exchanges and to Suspend Trading in a Security.

C. The Power to Require Reports and Other Information from Exchanges, Members, Brokers and Corporations Whose Securities are Traded in on the Exchanges.

A. The Power to Make Rules and Regulations Concerning Practices on the Exchanges. Section 2 of the Securities Exchange Act declares that “transactions in securities as commonly conducted upon securities and over-the-counter markets are affected with a national public interest which makes it necessary to provide for regulation and control of such transactions and the practices and matters relating thereto, * * * and to impose requirements necessary to make such regulation and control reasonably complete and effective * * * to insure the maintenance of fair and honest markets in such transactions.” To administer this control, the Securities and Exchange Commission is created with the powers that we have enumerated, and is authorized to make such rules and regulations relating to practices on the exchanges “as it deems necessary or appropriate in the public interest or for the protection of investors.” Supra note 23, Securities Exchange Act of 1934 §10 (a), (b); supra note 25, Securities Exchange Act of 1934, §11 (a), (b); supra note 28, Securities Exchange Act of 1934 §15; 48 Stat. —, 15 U. S. C. A. §78s (1934), Securities Exchange Act of 1934 §19.
lations. Having set forth such criteria for action, Congress has validly conferred this authority on the Securities and Exchange Commission. The general rule applicable to such delegation of power was expressed by the late Chief Justice Taft in *Hampton & Co. v. United States*.\(^{35}\)

> "The field of Congress involves all and many varieties of legislative action and Congress has found it frequently necessary to use officers of the Executive Branch within defined limits to secure the exact effect intended by its acts of legislation by vesting discretion in such officers to make public regulations interpreting a statute and directing the details of its execution even to the extent of providing for penalizing a breach of such regulations." \(^{36}\)

The only limitation on this power is that Congress lay down a general rule of action. In the words of the Supreme Court in the case of *Interstate Commerce Commission v. Goodrich Transit Co.*,\(^{37}\) cited by Chief Justice Taft in the *Hampton* case:

> "The Congress may not delegate its purely legislative power to a Commission, but having laid down the general rules of action under which a Commission shall proceed, it may require of that Commission the application of such rules to a particular situation and investigation of facts, with a view to making orders in a particular matter within the rules laid down by Congress." \(^{38}\)

Is the standard fixed by Congress sufficiently definite? It may be contended that it has stated no fixed and definite criterion but only the vague suggestion that the rules and

\(^{35}\) 276 U. S. 394, 47 Sup. Ct. 769 (1928).

\(^{36}\) Id. at 406.


\(^{38}\) *Interstate Commerce Commission v. Goodrich Transit Co.*, *supra* note 37, at 214.
regulations be in the interest of the public and the investor. The decisions hold that such a criterion is sufficient. In the Federal Trade Commission Act it was stated that "Unfair methods of competition in commerce are declared unlawful." Without defining the term "unfair competition," Congress empowered the Federal Trade Commission "to prevent persons from using unfair methods of competition in commerce." The authority of the Commission was challenged for indefiniteness but in Sears, Roebuck & Co. v. Federal Trade Commission, it was decided that the term was no more indefinite than "due process of law," "unsound mind," "undue influence," "unreasonable rate," "unjust discrimination," and similar terms which have been considered "sufficiently accurate measures of conduct." A delegation of power similar to that given to the Securities and Exchange Commission is to be found in the Packers and Stockyards Act, which regulates live-stock exchanges and dealers in live-stock. Section 213 of that Act provides:

"Section 213—Prevention of unfair, discriminatory, or deceptive practices:

(a) It shall be unlawful for any stockyard owner, market agency, or dealer to engage in or use any unfair, unjustly discriminatory, or deceptive practice or device, in connection with receiving, marketing, buying or selling on a commission basis or otherwise, feeding, watering, holding, delivery, shipment, weighing or handling, in commerce at a stockyard of live-stock.

(b) Whenever complaint is made to the Secretary by any person, or whenever the Secretary has

40 Id. §45.
41 Ibid.
reason to believe that any stockyard owner, market
agency, or dealer is violating the provisions of subdivi-
sion (a) the Secretary after notice and full hearing
may make an order that he shall cease and desist from
continuing such violation to the extent that the Sec-
retary finds that it does or will exist."

This provision was attacked in *Farmers Livestock Commis-
sion Co. v. United States* on the ground that it was so in-
definite as to give the Secretary of Agriculture legislative
power to determine unfair practices. The court, however,
decided on the authority of the *Sears, Roebuck* case that the
provision was not indefinite and that it was a valid enact-
ment.

Congress, we believe, has been more definite in the Se-
curities Exchange Act than it was in the acts we have re-
ferred to because it has specifically mentioned the practices
which it considers objectionable. Tested by the decisions
referred to above, we believe that the provisions authorizing
the Securities and Exchange Commission to make rules and
regulations relating to practices on the exchanges are con-
stitutional.

B. The Power of the Commission to Discipline Ex-
changes, etc. Among the most emphatic objections of the
spokesmen for the exchanges were those directed at the pro-
visions giving authority to the Commission to discipline ex-
changes and its members. Similar provisions are contained
in the Packers and Stockyards Act referred to above and in
the Grain Futures Act which regulates markets in which
transactions in grain futures are carried on. In both of these
acts these provisions were attacked and in both cases the
courts held them to be valid. In *Board of Trade v. Wallace*
the Commission created by the Grain Futures Act suspended
the Chicago Board of Trade because it violated a provision

---

45 54 F. (2d) 375 (E. D. Ill. 1931).
46 Supra note 15.
of the law. In upholding the statutory authority of the Commission, the court said:

"Granted the constitutional power to designate boards of trade as contract markets upon application by the boards, we perceive no reason why Congress might not properly lodge with some instrumentality the power to suspend or remake such designation upon sufficient cause, first according reasonable opportunity for defending against any charge, as well as for judicial review of any suspending order." 49

In Farmer's Livestock Commission Co. v. United States,60 the right of the Secretary to suspend the registration of the plaintiff as a market agency in accordance with the provisions of the Packers and Stockyards Act was challenged. The right of the Secretary to exercise the right of suspension was declared to be a valid power.

"The withdrawal of a license or suspension from registration is merely the withdrawal of a government permit to engage in a business in which the licensee has no inherent right to engage but in which he may participate only upon compliance with the conditions imposed by the government. If the government has the right to supervise the business, it may fix the conditions upon which parties may engage therein and may without the intervention of a jury withdraw such permission when satisfied that the conditions are being violated." 51

The arguments in these decisions are sound. The power to regulate carries with it as a corollary, the right to punish. Suspension or expulsion is a reasonable punishment. There-

---

49 Id. at 407.
50 Supra note 45. In Tagg Bros. & Moorehead v. United States, 280 U. S. 420, 50 Sup. Ct. 220 (1930), it was decided that the Secretary of Agriculture had the power under the Packers & Stockyards Act to prescribe minimum rates to be charged by market agencies for their services.
60 Farmers' Livestock Commission Co. v. United States, supra note 45, at 378.
fore, the objections to the provisions in the Securities Exchange Act which empower the Commission to discipline exchanges and their members, are untenable.

C. The Power of the Commission to Require Reports, etc. We have seen that the statute requires exchanges, their members and issuers of securities to keep such books and records and to make such reports as the Commission may require. Spokesmen for the exchanges objected to this although it is difficult to see upon what grounds since many regulatory statutes have similar provisions, all of which have been upheld. The general principle has been well stated in *Interstate Commerce Commission v. Goodrich Transit Company.*

"If the Commission is to successfully perform its duties in respect to reasonable rates, undue discriminations and favoritism, it must be informed as to the business of the carriers by a system of accounting which will not permit the possible concealment of forbidden practices in accounts which it is not permitted to see and concerning which it can require no information. It is a mistake to suppose that the requiring of information concerning business methods of such corporations, as shown in their accounts, is a regulation of business not within the jurisdiction of the Commission, as seems to be argued for the complainants. The object of requiring such accounts to be kept in a uniform way and to be open to the inspection of the Commission is not to enable it to regulate the affairs of the corporations not within its jurisdiction but to be informed concerning the business methods of the corporations subject to the Act that it may properly regulate such matters as are really within its jurisdiction. Further the requiring of information concerning a business is not a regulation of that business."
A similar provision in the Grain Futures Act was upheld in *Bartlett Frazier Co. v. Hyde*, the court remarking:

"It is difficult to see how the purpose of the Act can be carried out unless the regulatory agencies are able to inform themselves as to the transactions in Futures conducted on boards of trade by their members. To sustain the part of the Act prescribing the duty and conferring the power to regulate boards of trade and to strike down the part which puts the government in possession of the facts essential to an intelligent performance of its duty, is to confer the shadows and withhold the substance of the authority."  

It would seem, therefore, from the decisions which we have quoted, that the powers of the Securities and Exchange Commission, granted jurisdiction over the subject matter, are sufficiently definite not to constitute a delegation of legislative power, and that they come within the scope of well-established regulatory authority.

II. *Did Congress act within its constitutional rights in including in the statute provisions relating to corporations whose only connection with exchanges is that their securities are bought and sold on them?*

The Securities Exchange Act seeks to regulate practices on exchanges. However, the statute is not limited to these practices but includes jurisdiction over securities traded in on the exchanges as well as their issuers. Securities dealt in on the exchanges must be registered with the Commission; the corporations whose securities are so registered must file reports; trading in the securities is subject to suspension by the Commission if it deems such action necessary. The directors, officers and large stockholders are required to report their holdings in the securities of their corporations and

---

*56 F. (2d) 245 (N. D. Ill. 1932), aff'd, 65 F. (2d) 350 (C. C. A. 7th, 1933), cert. denied, 290 U. S. 654, 54 Sup. Ct. 70 (1934).*

*56 Bartlett Frazier Co. v. Hyde, 56 F. (2d) 245, 246 (N. D. Ill. 1932).*
any change in the ownership of such securities to the Commission. They must account to their corporations for any profits made by them from transactions in such securities if this resulted from confidential information available to them in such capacity. The Act even concerns itself with the solicitation and giving of proxies.

In hearings before the Senate Committee which conducted an investigation into the practices on the securities exchanges as a result of which the Securities Exchange Act was passed, it was argued by opponents of the measure that even if Congress had the power to regulate practices on exchanges, it did not have the right to exercise any control over corporations whose securities were traded in on these exchanges. The objections were based primarily on the theory that such authority was synonymous with control over the corporations themselves. As counsel to the Senate Committee in the hearings on the bill, Commissioner Pecora argued that such powers did not give control over corporations.

The reason for including these provisions in the Securities Exchange Act, is apparent. Without them the bill would be ineffective because a stock exchange is merely a market place in which securities are bought and sold.

How are these transactions effected? Those who operate on exchanges are members who act either as traders, buying and selling securities for their own account, or brokers who, for a commission buy and sell for customers. It is not sufficient that the Commission have jurisdiction over these persons alone. Congress has declared that the purpose of the Act is to prevent unfair practices on the exchanges and to protect the public and the investor. Obviously these practices relate to the securities that are dealt in. They consist mainly of pool operations, which in themselves may include pernicious practices such as the acquisition of options, the use of puts, calls and straddles, matched sales, price pegging, short selling and the dissemination of false information con-

58 Ibid. He said, "Merely because the Commission is given the power to determine what shall be the form and content of the statement of condition is, to my mind, rather a tenuous basis upon which to say the Commission is thereby given the right to control the corporation."
cerning the stock and the financial condition of the corporation whose stock is involved. These practices may entail not only price manipulation of legitimate securities but distribution to the public of worthless stock. In the fluctuation of prices, the average investor is without knowledge as to why there is such fluctuation, either up or down. Prices of securities are supposed to reflect their actual or probable value, but the investor has no way of determining whether such fluctuation is due to manipulation or to the condition of the corporation. This can best be determined by information concerning the financial condition of the corporation, its earning power, etc. For this purpose securities are required to be registered so that financial reports concerning the condition of the issuers may be available. This seems fair and reasonable. Indeed it is not a unique requirement either, for the securities that are traded in on the New York Stock Exchange are listed. This means that the issuers are required to supply the exchange with certain information concerning their affairs.60

As a further safeguard and in line with this primary requirement for registration, it is provided that these corporations keep the public advised of their current conditions by filing quarterly and annual reports. The second requirement is not less proper than the first.

The Commission has also been clothed with power to suspend trading in securities. This is essential if the Commission is to prevent objectionable practices. It is not sufficient that it have the right to go after the manipulators; it must also have the right to safeguard the investor from the disastrous consequences which he may suffer by reason of such manipulation. With the purpose of the statute in mind, it seems reasonable that the Commission should have these powers.

The two final objections appear to have more weight than those we have already discussed. It may well be asked why Congress should have the right to supervise the activities of officers and directors in their transactions involving the securities of their corporations and why Congress should

---

have the right to interfere with the giving or solicitation of proxies involving corporations that may not be engaged in interstate commerce and which are the creatures of the separate states. This argument seems on its surface to have some merit and would in fact be plausible were it not that the disclosures made before the Senate Investigating Committee show how necessary it is to prevent these fiduciaries from dealing without supervision in the securities of their corporations.

The testimony revealed that officers, directors and large stockholders played prominent roles in pool and short selling operations in the securities of their own corporations, with resulting profits to themselves and to the general detriment of the other stockholders. These persons made profits as a result of the confidential information which they obtained in their capacity as officers or directors. In order to prevent price manipulation of securities by insiders, Congress has enacted the provisions relating to officers, directors and large stockholders, making them too subject to control. This is part and parcel of the larger scheme to protect investors.

This concept has also persuaded Congress to enact the provisions relating to the solicitation and giving of proxies. The testimony before the Senate Investigating Committee showed that in many instances, not the customer who is the beneficial owner, but the broker holds the stock, particularly in margin accounts, and that he and not the real owner gives proxies on it. It was also disclosed that there is a widespread practice of soliciting proxies without any explanation to the stockholder as to the subject of the meeting, with the result that the management and policies of the corporation, which are the concern of stockholders, have been entirely removed from their control. In order that stock-

---


61a Cf. Irving Trust Co. v. Deutsch (C. C. A. 2d Ct.) decided September 17th, 1934, published on the first page of the New York Law Journal, November 8th, 1934, in which it was decided that directors who had created an active market for the stock of their corporation on the Curb Exchange and had made large profits in selling their shares thereon were accountable for such profits to their corporation.

holders as investors may receive adequate protection against these practices, the provisions relating to the solicitation and giving of proxies were included in the Act.

Since all of these provisions relating to securities and their issuers are bound up with the general plan of stock market regulation in the interest of the investor, Congress appears to have acted within its constitutional rights. In the words of Mr. Justice Holmes:

"When it is necessary in order to prevent an evil to make a law embracing more than the precise thing to be prevented it [Congress] may do so." 63

Or, as the present Chief Justice has said:

"It does not follow that because a transaction, separately considered, is innocuous, it may not be included in a prohibition the scope of which is regarded as essential in the legislative judgment to accomplish a purpose within the admitted power of the government. [Cases cited.] With the wisdom of the exercise of that judgment, the court has no concern; and unless it clearly appears that the enactment has no substantial relation to a proper purpose, it cannot be said that the limit of the legislative power has been transcended." 64

III. Are those provisions valid which make criminal any violation of the Commission's rules and regulations?

The right of Congress to make criminal the violation of the rules and regulations of a regulatory body is no longer open to doubt. The Supreme Court has conclusively established this right. In United States v. Eaton 65 it was decided

---

64 Purity Extract Co. v. Lynch, 226 U. S. 192, 33 Sup. Ct. 44 (1912). In Badders v. United States, 240 U. S. 391, 393, 36 Sup. Ct. 367 (1916), it was said: "Congress may forbid such acts done in furtherance of a scheme that it regards as contrary to public policy, whether it can forbid the scheme or not."
65 144 U. S. 677, 12 Sup. Ct. 764 (1892).
that the defendant could not be prosecuted for the violation of the regulations of the Commissioner of Internal Revenue under a statute which imposed criminal liability for violation of its provisions, but not for violation of the Commissioner's regulations. A different situation was presented in United States v. Grimaud. The defendants were indicted for grazing sheep on a forest reserve without having obtained permission in accordance with the regulations adopted by the Secretary of Agriculture who was vested with authority over forest reserves by the Forest Reserve Act of 1891. The Act gave the Secretary of Agriculture authority to make such rules and regulations as were necessary to preserve forests on the reserve, and made violation of any such regulation a criminal offense. Demurrers to the indictment were interposed and upheld in the lower court on the ground that such provisions were an attempt on the part of Congress to delegate its legislative power to an administrative officer. The Supreme Court, however, decided that it was constitutional.

"From the beginning of the government various acts have been passed conferring upon executive officers power to make rules and regulations—not for the government of their departments, but for administering the laws which did govern. None of these statutes could confer legislative power. But when Congress had legislated and indicated its will, it could give to those who were to act under such general provisions 'power to fill up the details' by the establishment of administrative rules and regulations, the violation of which could be punished by fine or imprisonment fixed by Congress, or by penalties fixed by Congress or measured by the injury alone." 67

In distinguishing the Grimaud case from the Eaton case, the court said:

66 United States v. Grimaud, supra note 66, at 517.
"It [the court] said that: 'if Congress intended to make it an offense for wholesale dealers to omit to keep books and render returns required by regulations of the Commissioner, it would have done so distinctly'—implying that if it had done so distinctly, the violation of the regulations would have been an offense. But the very thing which was omitted in the Oleomargarine Act, was done in the Forest Reserve Act, which, in terms, provides that 'any violation of the provisions of this act or such rules and regulations of the Secretary shall be punished as prescribed in Section 5388 of the Revised Statutes as amended.'

Under this authority, therefore, the congressional power to make criminal the violation of the rules and regulations of the Commission, must be upheld.

A review of the provisions of the Securities Exchange Act and of the decisions which we have discussed, appears to sustain the conclusion that the broad delegation of power by Congress to the Securities and Exchange Commission, is not a delegation of legislative power but merely of valid administrative functions to be carried out in aid of the law which it has passed to curb unfair practices on securities markets. Congress has fixed a sufficiently definite standard by which the Securities and Exchange Commission is to be guided, namely, the interests of the public and the investor. For this purpose many matters have been included which seem at first to lie beyond federal jurisdiction. But since Congress has deemed such provisions essential to its fundamental purpose, the courts are bound to accept its judgment. In the light of the decided cases it seems fair to say that the powers entrusted to the Commission are valid in all respects and that the Securities Exchange Act is to that extent constitutional.

Jacob Lippman.

New York City.

68 Id. at 519.