The Original Conception of Section 10(b) of the Securities Exchange Act

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The Original Conception of Section 10(b) of the Securities Exchange Act

Steve Thel*

The Supreme Court has generally construed section 10(b) of the Securities Exchange Act of 1934 without reference to its legislative history or the historical context in which it was enacted. This is unfortunate if the intention of those who drafted and enacted the Exchange Act is relevant to the meaning of section 10(b). Section 10(b) is seldom mentioned in the committee reports, floor statements and published hearings on the Exchange Act, but if the conventional sources of legislative history are "bereft of any explicit explanation of Congress' intent" with respect to the section, there is, nevertheless, an extensive published record of congressional and popular debate over stock exchange legislation. This record, together with documents left by those who wrote the Exchange Act, show fairly clearly what contemporaries had in mind for section 10(b).

This article recounts the events that led up to the enactment of section 10(b) and argues that the provision was intended to empower the Securities and Exchange Commission (SEC) to regulate any practice that might contribute to speculation in securities or tend to move se-

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   It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange

   ...) to use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.


curity prices away from investment value, save perhaps those Congress subjected to explicit controls in other parts of the Exchange Act. This interpretation, while consistent with the language and structure of the Exchange Act, is fundamentally different from the prevailing conception of section 10(b).

I. TWO CONCEPTIONS OF SECTION 10(b)

A. The Prevailing Conception

The prevailing conception of section 10(b) took form in a series of important Supreme Court cases which held that certain activities are not actionable under rule 10b-5. The Court did not decide that the rule permitted the activity challenged in these cases; instead, it held that the activity did not violate the statutory provision under which the rule was promulgated, section 10(b). According to the Court, Congress did not intend to authorize the SEC to regulate the conduct at issue in the cases. While the Court's earlier opinions may have reflected nothing more than a conservative determination to restrict rule 10b-5 liability, later opinions suggest that the Court actually believes that Congress did not intend section 10(b) to confer expansive SEC regulatory power.

It would be very hard to define exactly what section 10(b) and rule 10b-5 forbid. It is surely impossible to say it in a nutshell. Nevertheless, the Supreme Court has portrayed section 10(b) in fairly straightforward terms. According to the Court, section 10(b) proscribes

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5. See Blue Chip Stamps, 421 U.S. at 737. The Court candidly stated that it was putting a limit on the effective scope of the rule largely on the basis of "what may be described as policy considerations." Id. One commentator has said that the "common theme [of the cases] seemed to be that plaintiffs always lost." ROBERT CHARLES CLARK, CORPORATE LAW § 8.10, at 316 (1986).

6. Somewhat surprisingly, the Court has followed that vision even when an alternative, reasonable reading of § 10(b) would have been less expansive. See Herman & MacLean v. Huddleston, 459 U.S. 375, 383-84 (1983) (Hochfelder reinforces the conclusion that the action expressly provided under § 11 of the Securities Act does not foreclose a § 10(b) right of action); cf. Bateman Eichler, Hill Richards, Inc. v. Berner, 472 U.S. 299, 318 (1985) (no in pari delicto defense). See generally David M. Phillips, An Essay: Six Competing Currents of Rule 10b-5 Jurisprudence, 21 INO. L. REV. 625 (1988) (analyzing dominant themes in Supreme Court opinions on rule 10b-5).

7. The tie vote in Carpenter v. United States, 484 U.S. 19 (1987), demonstrates the difficulty the Court has encountered in developing a compelling conception of § 10(b).

8. 11A EDWARD N. GADSBY, BUSINESS ORGANIZATIONS—FEDERAL SECURITIES EXCHANGE ACT Pt. 1, at v (1989) (Rule 10b-5 "has been the basis for more litigation than all the other sections of the federal securities laws taken together."). See generally ALAN R. BROMBERG & LEWIS D. LOWENFELS, SECURITIES FRAUD & COMMODITIES FRAUD (1988); ARNOLD S. JACOBS, LITIGATION AND PRACTICE UNDER RULE 10b-5 (2d ed. 1989 rev.).

9. Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976). This formulation has remained the
knowing and intentional misconduct designed to deceive or defraud investors.\textsuperscript{10} If it is unclear just what is within the scope of the section, the Court has clearly stated what is not within the scope of the section by interpreting the section as encompassing two restrictions. First, section 10(b) reaches only knowing and intentional misconduct. Since a person violates section 10(b) only if he knows (or perhaps if he should know) what he is doing is wrong, careless conduct cannot constitute a violation of the section even if it injures others.\textsuperscript{11} Second, only bad conduct involving deception comes within the scope of the section; fully disclosed misconduct cannot violate section 10(b).\textsuperscript{12}

In its rule 10b-5 opinions, the Court has asserted that its narrow vision of section 10(b) is consistent with both the language and fundamental purpose of the Exchange Act.\textsuperscript{13} The Court has never made much use of the legislative history in defining the purpose of the Act or the meaning of section 10(b).\textsuperscript{14} Although the Court has declared that the history of section 10(b) supports its reading, it has usually added


\textsuperscript{11} Section 10(b) does not, by itself, proscribe anything. It merely makes it unlawful to violate Commission rules. Thus, the most that could be said is that § 10(b) and rule 10b-5 together proscribe knowing and intentional misconduct designed to deceive or defraud investors. Nevertheless, the Court has consistently said that the section proscribes things, essentially ignoring the role of rules in the statutory scheme.

\textsuperscript{12} Perhaps the Court has concluded that rule 10b-5 forbids whatever conduct can be prohibited under § 10(b). On the other hand, perhaps the Court has profoundly misunderstood the section as a ban on bad conduct rather than as a delegation of authority to the Commission to regulate misleading, disruptive, or simply useless practices.


\textsuperscript{14} Hochfelder, 425 U.S. at 202 ("Neither the intended scope of § 10(b) nor the reasons for the changes in its operative language [during congressional consideration] are revealed explicitly in the legislative history of the 1934 Act . . . ."); see also Chiarella, 445 U.S. at 226 ("[N]either the legislative history nor the statute itself affords specific guidance for the resolution of this case.").
that section 10(b) has almost no history.\textsuperscript{15}

The Court’s basic position has been that its interpretation is virtually compelled by the language of section 10(b). "The words ‘manipulative or deceptive’ used in conjunction with ‘device or contrivance,’ strongly suggest that § 10(b) was intended to proscribe knowing or intentional misconduct."\textsuperscript{16} The Court has suggested that the language of section 10(b) is "‘sufficiently clear in its context’ to be dispositive,"\textsuperscript{17} but, nevertheless, it repeatedly has gone on to insist that its reading would best fulfill the objectives of the Exchange Act. Limiting section 10(b) to cases of misconduct involving deception, misrepresentation, or nondisclosure, the Court explained, "is fully consistent with the fundamental purpose of the [Exchange] Act ‘to substitute a philosophy of full disclosure for the philosophy of caveat emptor . . . .’"\textsuperscript{18}

B. An Alternative Conception

The Court’s conception of section 10(b) is less than compelling in at least two respects. First, the language of the statute hardly compels that conception. Second, if the Exchange Act has any fundamental purpose, it is not "‘to substitute a philosophy of full disclosure for the philosophy of caveat emptor . . . .’"\textsuperscript{19}

According to the Supreme Court, the language of section 10(b) demonstrates that Congress intended to proscribe purposeful misconduct. In fact, Congress did not itself proscribe any conduct in section 10(b); at most, it authorized the SEC to proscribe conduct.\textsuperscript{20} No con-
duct violates section 10(b) unless an SEC rule prohibits it.21 Had Congress had in mind only "intentional or willful conduct designed to deceive or defraud investors"22 when it used the words "'manipulative or deceptive'. . . in conjunction with 'device or contrivance,' "23 presumably it would have just made such devices illegal instead of leaving the matter to the SEC. There is no obvious reason that a statute which intended to proscribe knowing misconduct would leave it legal. Moreover, the Supreme Court has not suggested one. Indeed, it is hard to understand what administrative role, if any, the SEC would play under the Supreme Court's interpretation of section 10(b).

According to the Court, when section 10(b) provides for the regulation of "manipulative or deceptive . . . device[s] or contrivance[s]," the words "manipulative" and "deceptive" have a pejorative connotation. Even if this is so, it is critical to read the words in their context. Section 10(b) does not authorize regulation of manipulation and deception; it authorizes regulation of the use of manipulative and deceptive devices. It would not strain the language to say that a false financial statement is a deceptive device even if the person responsible for the statement thinks it is accurate. Under this alternative interpretation, if a Commission rule banned the use of false financial statements, someone using a false financial statement in connection with the purchase or sale of a

rule violations to criminal sanctions under § 32, 15 U.S.C. § 78ff (1982 & Supp. V 1987) (criminal penalties for willful violations of any provision of the statute "or any rule or regulation thereunder of the violation of which is made unlawful . . . under the terms of" the Act). Congress might have concluded that not all wrongful conduct should lead to imprisonment or other criminal penalty under federal law; the intended role for the SEC might have been to decide which misconduct should result in criminal penalty and to publish rules announcing its decisions.

The Exchange Act is a carefully written, often subtle piece of legislation; the above reading is not implausible just because it is complicated. However, it is probably correct to say that § 10(b) was intended to authorize the SEC to regulate conduct. The Supreme Court has always interpreted § 10(b) as if it authorizes some SEC rulemaking. See, e.g., Aaron, 446 U.S. at 687-88. The drafters of the Act and members of Congress commenting on § 10(b) seem to have thought the section conferred rulemaking authority. See S. REP. No. 792, 73d Cong., 2d Sess. 18 (1934) (Section 10(b) "authorizes the Commission by rules and regulations to prohibit or regulate the use of any manipulative or deceptive practices which it finds detrimental to the interests of the investor."), reprinted in 5 LEGISLATIVE HISTORY OF THE SECURITIES ACT OF 1933 AND SECURITIES EXCHANGE ACT OF 1934 item 17 (J. Ellenberger & E. Mahar eds. 1973) [hereinafter LEGISLATIVE HISTORY]; Stock Exchange Regulation, Hearings on H.R. 7852 and H.R. 8720 Before the House Interstate and Foreign Commerce Committee, 73d Cong., 2d Sess. 115 (1934) [hereinafter House Hearings], quoted in Hochfelder, 425 U.S. at 202-03, reprinted in 8 LEGISLATIVE HISTORY item 23. Under the first version of the bill that became the Exchange Act, any willful violation of a rule would have been criminally punishable. S. 2693, 73d Cong., 2d Sess. § 24 (1934), reprinted in 11 LEGISLATIVE HISTORY item 34; H.R. 7852, 73d Cong., 2d Sess. § 24 (1934), reprinted in 10 LEGISLATIVE HISTORY item 24. S. 2693 and H.R. 7852 were identical, and both are referred to as the Fletcher-Rayburn bill [hereinafter Fletcher-Rayburn]. This original bill contained § 9(c), the predecessor to § 10(b) of the Act; there would have been no reason to include it had its only purpose been to make rule violations criminally punishable without also creating regulatory authority.

21. Moreover, the statute contemplates that the SEC's rules will regulate—as opposed to prohibit—conduct. See note 345 infra and accompanying text.


23. Id. at 197.
security would violate section 10(b) even if he thought the statement was true.\(^{24}\)

The prevailing view of section 10(b) also misconceives the fundamental purpose of the Exchange Act. Few would dispute the claim that the Supreme Court has identified disclosure as the fundamental purpose of the Exchange Act; indeed, the opinion that the Exchange Act is a disclosure statute is widely held. The Act imposes ongoing disclosure obligations on some security issuers,\(^{25}\) and, to that extent, it does "substitute a philosophy of full disclosure for the philosophy of caveat emptor." Yet the Act does much more.

In addition to requiring security issuers to disclose information, the Exchange Act puts the government in control of stock market credit\(^ {26}\) and the activities of market institutions.\(^ {27}\) Most of the Act concerns market regulation and has little to do with disclosure. The Supreme Court has characterized legislative intent in terms of disclosure only by ignoring the market regulation and credit provisions of the Exchange Act and, remarkably, even section 10 itself.\(^ {28}\)

\(^{24}\) A different argument for reading § 10(b) narrowly is that Congress would not have wanted to punish innocent conduct. *Cf.* Hochfelder, 425 U.S. at 201-10. If this is so, this does not mean that § 10(b) limits the Commission's rulemaking authority but rather that the remedial provisions of the Exchange Act should be read narrowly. *Cf.* Aaron, 446 U.S. at 703 (Burger, C.J., concurring).

The language of § 10(b) does not specify a penalty for violators; the statutory penalty is set out in § 32 of the Exchange Act, 15 U.S.C. § 78ff (1982 & Supp. V 1987); *see also* § 21, 15 U.S.C. § 78u (Supp. V 1987) (injunctions). Section 32 provides for criminal punishment of only willful violations. Moreover, "no person shall be subject to imprisonment under [§ 32] for the violation of any rule or regulation if he proves that he had no knowledge of such rule or regulation." § 32, 15 U.S.C. § 78ff. An innocent violation of § 10(b) is not criminal.


\(^{25}\) *See* § 12 (security registration) and § 13 (required reports) (codified as amended at 15 U.S.C. §§ 78f, 78n (1982 & Supp. V 1987)).

\(^{26}\) § 7 (margin requirements), § 8 (borrowing by exchange members and others) (codified as amended at 15 U.S.C. §§ 78h, 78n (1982 & Supp. V 1987)).


\(^{28}\) The only provisions of the Exchange Act adopted in 1934 that have any meaningful disclosure orientation are the issuer reporting, §§ 12, 13 (codified as amended at 15 U.S.C.
The theme that ties the Act together is a concern with security prices. The Act provides for extensive control over several critical factors affecting prices, including production and dissemination of information that might affect prices, the flow of money into and out of the market, and the basic structure of the securities market.

In section 2 of the Exchange Act, Congress explained why it took control of the securities markets. Section 2 provides a list of reasons that transactions in the securities markets are affected with a public interest, the protection of which justifies federal intervention. Section 2 focuses almost exclusively on the critical importance of market prices. It does not even mention full and honest disclosure or the proxy sections, § 14 (15 U.S.C. § 78n), and, perhaps, part of the control-person trading section, § 16(a) (15 U.S.C. § 78p(a)). See, e.g., H.R. Rep. No. 1383, 73d Cong., 2d Sess. 5-7 (1934) (arguing that mandated public reporting of corporate information would help turn speculators into investors), reprinted in 5 LEGISLATIVE HISTORY, supra note 20, item 18; House Hearings, supra note 20, at 44-46 (pools depended on public ignorance), 783 (distinction between reporting and government control), 937 (constitutional). According to § 2 of the Act (codified as amended at 15 U.S.C. § 78b (1982)), the public interest made it necessary "to require appropriate reports" regardless of the question of fraud. The proxy provisions seem directed more toward influencing corporate governance than investment decisions, and indeed, even the disclosure requirements were expounded to promote changes in corporate behavior. See notes 86 & 90 infra. In any event, during the Exchange Act debates no one characterized the reporting and proxy provisions as the heart of the Act. On the contrary, some critics suggested that these provisions addressed problems best solved by federal incorporation, and therefore had no place in a bill to regulate stock exchanges. See, e.g., H.R. Rep. No. 1385, supra, at 30 (minority views) ("So far as this bill relates to practices of stock exchanges it cannot be severely criticized. But the original fundamental objection still remains, namely, that it gives the commission . . . indeterminate power over all issues of stock, and thus over all corporations in this country."); House Hearings, supra note 20, at 152, 222; cf. id. at 480, 482, 513-14 (testimony of John Dickinson), 787 (comment of Rep. Huddleston), 916-17 (memorandum of the National Automobile Chamber of Commerce); JOEL SELIGMAN, THE TRANSFORMATION OF WALL STREET 87 n.61 (1982); Raoul Desvernine, Memorandum on behalf of commission brokers, quoted in MICHAEL E. FARRISH, SECURITIES REGULATION AND THE NEW DEAL 128 (1970) and in J. SELIGMAN, supra, at 95-96; Investment House Group, Memorandum Re. H.R. 7852, at 5-6 (Feb. 26, 1934) (on file with the Stanford Law Review) ("The Act regulates corporations under the guise of regulating exchanges.") (copy in volume 8 item 28 of James Landis' collection of important papers relating to the preparation of the Exchange Act [hereinafter DOCUMENTARY HISTORY COLLECTION]), copies of which collection are available at the Harvard Law School Library (cataloged as "Securities and Exchange Commission, Legislative History of the National Securities Exchange Act of 1934"), and at the Securities and Exchange Commission Library (cataloged as "Legislative History of the Securities Exchange Act of 1934, 73d Congress 2d Session 1934" under the call number LH/Sea/1934X); Press Release of Richard Whitney, President, New York Stock Exchange 6 (Feb. 14, 1934) (on file with the Stanford Law Review) ("The provisions affecting corporations . . . have no proper place in a bill regulating stock exchanges. Regulations of this character belong in a national corporation law.") (copy in New York Stock Exchange Archives).


30. Section 2 highlights the role of the market as an appraiser of value; the importance of market prices to investors, creditors, and the public treasury; and the widespread quotation of prices established in market transactions. According to § 2, market prices "are susceptible to manipulation and control, and the dissemination of such prices gives rise to excessive spec-
importance of information about issuers. It is hard to believe that
Congress failed to mention the Act's fundamental purpose in this pre-
amble. More likely, the section accurately reflects the public sentiment
of the time and the problems the authors of the Act intended to
address.

One plain-language reading of section 10(b) gives the Commission
broad power to regulate any practice that contributes to disorder in the
securities markets or that displays speculative sentiment. Instead of
limiting section 10(b) to intentional misconduct, the words "manipula-
tive or deceptive device or contrivance" may encompass any practice
that affects securities prices, and section 10(b) may authorize the Com-
mmission to regulate any practice that tends to defeat the fundamental
purpose of the Act: to protect the public's interest in the integrity of
security prices.

If the meaning of section 10(b) is to be found with "the Court's
technical linguistic analysis," then it seems that any act or practice
that can move security prices is a "manipulative device." The word
"manipulative" does not necessarily have a pejorative connotation;
even in the context of the securities markets, commentators have distin-
guished legitimate from illegitimate manipulation. In common and
legal usage, "manipulation" is a broad term that refers to skillful han-
ting or treatment. When the word is used pejoratively, it describes a

31. Congress did express concern about information in another provision of the Ex-
change Act. Section 16(b) stated that "for the purpose of preventing the unfair use of
information," the short-swing trading profits of control persons are recoverable by issuers.
§ 16(b) (current version at 15 U.S.C. § 78p(b) (1982)). While § 16(b) may remove a corpo-
rate insider's incentive to abuse some informational advantages, it does not require disclosure
of the information which control persons might unfairly use. Id.

32. The Securities Acts Amendments of 1975 directed the SEC to facilitate the establishment
of a national market system for securities. As part of this initiative, the Exchange Act was
amended to reflect further congressional findings on the public interest in the securities mar-
(1982)). The 1975 Act amended § 2, but not to reflect any concern with information. The
there is a public interest in assuring broad dissemination of information about prices and trans-
actions).

33. See Aaron v. SEC, 446 U.S. 680, 705 (1980) (Blackmun, J., concurring in part and
dissenting in part) (It is "quite unclear" that the words of § 10(b) connote knowing or inten-
tional misconduct).

34. See notes 56, 274 & 313 infra and accompanying texts. The Supreme Court once
quoted a dictionary to the effect that manipulation is synonymous with unfair or deceptive
Lollipops and Law—A Proposal for a National Policy Concerning Tender Offer Defenses, 19 U.C.
L. Rev. 303, 321 (1986) (criticizing as overbroad the Court's definition of "manipulation" and
calling its use of the dictionary a "stultifying faux pas").

35. See, e.g., 5 U.S.C. § 8101(2) (1982) ("[R]eimbursable [chiropractic] services are lim-
ited to treatment consisting of manual manipulation of the spine . . . ."). 15 U.S.C. § 278g-
use of force that is somehow inappropriate. False statements can apply inappropriate force to security prices, but so can many other things, including trading, and in some circumstances, even true statements.

If securities manipulation means anything in particular, it means conduct intended to induce people to trade a security or force its price to an artificial level.\textsuperscript{36} Section 10(b) does not authorize the regulation

\textsuperscript{3}(d)(1) (Supp. 1987) ("the term 'computer system' means any equipment . . . used in the automatic acquisition, storage, manipulation, management . . . or reception, of data or information"); 19 U.S.C. § 81c (1982) (Foreign merchandise may be brought into a foreign trade zone and "broken up, repacked, assembled, distributed, sorted, graded, cleaned, mixed with foreign or domestic merchandise, or otherwise manipulated."); 49 U.S.C. app. § 1371 (1982) ("The term 'pilot' . . . shall mean an employee who is responsible for the manipulation of or who manipulates the flight controls of an aircraft.").

\textsuperscript{36} See, e.g., R. CLARK, supra note 5, § 8.12.1, at 348 ("Manipulation is behavior aimed at creating trading, or the appearance of active trading, in a security for the purpose of inducing others to buy or sell the security."); CHARLES AMOS DICE, THE STOCK MARKET 414 (1926) ("It is evident to any one that the condemnatory use of the term 'manipulation' . . . is often entirely too comprehensive . . . . By manipulation is usually understood the creation of an artificial price by planned action, whether by one man or a group of men. A campaign is planned and executed to run the price of a stock up or to hammer it down."); TWENTIETH CENTURY FUND, STOCK MARKET CONTROL 107 (A. L. Berheim, E. Clark, J. F. Dewhurst & M. G. Schneider, eds. 1934) [hereinafter STOCK MARKET CONTROL] ("The term 'manipulation' is ordinarily understood to mean the deliberate interference with the free play of supply and demand in the security markets. Usually this term is associated with pool operations designed to raise or depress prices artificially."); Frederick W. Jones & Arthur D. Lowe, Manipulation, in THE SECURITY MARKETS: FINDINGS AND RECOMMENDATIONS OF A SPECIAL STAFF OF THE TWENTIETH CENTURY FUND 444 (A. Berheim & M. G. Schneider eds. 1955) [hereinafter THE SECURITY MARKETS] (the term manipulation "in popular usage has a rather vague and broad connotation. As used in this chapter, the word manipulation will mean planned effort by an individual or group of individuals to make the market price of a security behave in some manner in which it would not behave if left to adjust itself to uncontrolled or uninspired supply and demand."); see also James H. Mathias, Manipulative Practices and the Securities Exchange Act, 3 U. PRATT. L. REV. 7 (1936); James Wm. Moore & Frank H. Wiseman, Market Manipulation and the Exchange Act, 2 U. CHI. L. REV. 46 (1934); Criminal Law—Use of the Mails to Defraud—Stock Market Manipulation as a Scheme to Defraud, 82 U. PA. L. REV. 541, 541 n.4 (student author) (quoting Untermyer, Regulating the Stock Exchange, TODAY, Jan. 27, 1934, at 3).


of manipulation, but rather, regulation of the use of manipulative devices. Just as the Commission can regulate the use of deceptive devices by people who do not intend to deceive, it can regulate devices that are potentially manipulative regardless of the motives of individuals who employ them.

Finding support in the statutory language is not the biggest obstacle to a broad reading of section 10(b). The fundamental problem is that while the Exchange Act was under consideration, there was very little debate over section 10(b) and no substantial opposition to it. If Congress really intended section 10(b) to give the SEC sweeping control over every aspect of the stock market, it is somewhat surprising that no one supported or opposed the section on that basis. In normal circumstances, a proposal to give a federal agency plenary power over the stock exchanges would have been controversial, to say the least, but the Exchange Act was not the product of normal circumstances. In fact, the stock exchanges, about to become subject to the plenary power of the SEC, thought they had achieved a victory; those who pushed Congress to act had sought even more. The sophisticated, interested participants in the debates, as well as the authors of the Act, understood that the Act conferred open-ended rulemaking authority on the SEC. This outcome reflected a compromise most people were glad to accept.

II. THE HISTORICAL BACKGROUND OF THE EXCHANGE ACT

The idea that the general public has an interest in the operations and performance of the stock market sufficient to justify public control of the exchanges attracted a substantial following around the beginning of this century. At the same time, pressure was mounting for public control of the practices of those who sold corporate securities to public investors.37 Sometimes, the same people pushed for legislation on both promotional practices and exchange practices; often, initiatives in either area had implications for the other. Nonetheless, not all of those who wanted to regulate the exchanges were concerned with the activities of security promoters. More significantly, those concerned with promotional practices and those concerned with exchange practices did not always seek the same ends. Although stock promotion became a public issue at about the same time as stock exchange practices, the public's interest in the market was fundamentally different from its interest in marketing.

The government had to take control of sales practices, the argument went, because securities salesmen often resorted to high-pressure techniques or fraud. Stock exchange practices were said to implicate somewhat broader and more important interests. Stock market reformers insisted that, from time to time, speculation and manipulation pro-

37. See generally Louis Loss & Edward M. Cawett, BLUE SKY LAW 3-10 (1958); M. Parrish, supra note 28, at 5-20.
duced financial panics and widespread unemployment. Advocates of statutory responses to improper sales practices, which eventually included state Blue Sky laws and the Securities Act of 1933, usually characterized them as measures to protect investors from fraud. Those who championed a statutory response to speculation and manipulation consistently claimed to be concerned with the interest of the general public, not just investors.

A. The Panic of 1907

The movement for public control over the stock exchanges is generally considered to have begun with the panic of 1907. In October of that year, depositors lost confidence in several New York banks which were thought to be part of a group of stock market operators who met with financial ruin when they failed to corner the market in the stock of a copper mining company they controlled. Prices on the New York Stock Exchange fell precipitously, and the bank run spread. By the time confidence was restored, the country was in a recession, many banks had closed, and many small investors had been ruined. Before long, many people came to believe that stock market operators who stood to profit from lower stock prices had engineered the price collapse. Believing that the price collapse precipitated widespread panic across the economy, these people demanded that the government intervene.

40. See generally FREDERICK LEWIS ALLEN, THE LORDS OF CREATION 112-43 (1935); ROBERT SOBEL, PANIC ON WALL STREET 297-321 (1968). While the stock market was widely held responsible for the panic of 1907 and the economic contraction that accompanied it, monetary and financial conditions may have played a more important role. See MILTON FRIEDMAN & ANNA JACOBSON SCHWARTZ, A MONETARY HISTORY OF THE UNITED STATES, 1867-1960, at 156-68 (1963); PAUL STUDENSKI & HERMAN E. KROOSS, FINANCIAL HISTORY OF THE UNITED STATES 252 (1st ed. 1952).
41. Shortly after the panic of 1907 began, a rumor became current that ‘Wall Street’ had designedly caused it in order to knock down the prices of stocks, frighten weak holders, and profit by the ruin of the community. . . .

. . . [T]he rumor that they had brought on the panic by design and in selfish disregard of public interests, had a wide circulation, and was fraught with possibilities of mischief. The danger of ill-considered legislation, supported by ill-advised public opinion, doubtless moved Governor Hughes to appoint a committee . . . to inquire “what changes if any are advisable in the laws of the state bearing upon speculation in securities and commodities, or relating to the protection of investors, or with regard to the instrumentalities and organizations used in dealing in securities and commodities, which are the subject of speculation.”

Horace White, The Hughes Investigation, 17 J. Pol. Econ. 528, 528-29 (1909); Letter from J.P.
In January 1908, President Theodore Roosevelt informed Congress that it would be desirable to adopt measures "to prevent at least the grosser forms of gambling in securities and commodities, such as making large sales of what men do not possess and 'cornering' the market." Roosevelt did not, however, propose specific legislation to control speculation. Although he was certain that speculation had to be controlled, he was unclear as to what the appropriate legislation would look like or even that controlling speculation with legislation was appropriate.

There is no moral difference between gambling at cards or in lotteries or on the race track and gambling in the stock market. One method is just as pernicious to the body politic as the other in kind, and in degree the evil worked is far greater. But it is in a far more difficult subject with which to deal. The great bulk of the business transacted on the exchanges is not only legitimate, but is necessary to the working of our modern industrial system, and extreme care would have to be taken not to interfere with this business . . . .

Roosevelt identified what was to become the dominant issue in the debate over the Exchange Act. In the end, Congress concluded that the only way to curb speculation without destroying the market was to give control to administrators.

While numerous stock market reform bills were introduced in Congress shortly after the panic, nothing came of them. The govern-

Morgan & Co. to Arsène P. Pujo (Feb. 25, 1913) ("an appreciable portion of the community has come to believe . . . that in large measure the panic of 1907 was actually due to the machinations of certain powerful men"), reprinted in Richard N. Sheldon, The Pujo Committee 1912, in 3 CONGRESS INVESTIGATES: A DOCUMENTED HISTORY 1792-1974, at 2251, 2344, 2345-46 (A. Schlesinger, Jr. & R. Burns eds. 1975); cf. 2 L. Loss, supra note 39, at 1166 (similar point with respect to the 1929 stock market crash).

42. 42 CONG. REC. 1347, 1349 (1908). Roosevelt's message consisted of a list of initiatives "as regards certain of the relations between labor and capital, and between the great corporations and the public," id. at 1347, which were all "part of the campaign against privilege, part of the campaign to make the class of great property holders realize that property has its duties no less than its rights," id. at 1349.

43. Id. at 1349. Roosevelt also acknowledged that there was special difficulty in fashioning a federal response, but he still thought that an effort should be made to deal with the problem, "even if only in a cautious and tentative way." Id.

44. Most of the bills were loosely written and proposed little more than to impose taxes on certain transactions or regulate the use of the mails.

In 1908 it was proposed that the Federal tax on stock sales be revived, not as a revenue measure, but as a means of penalizing speculation [H.R. 18525, 60th Cong., 1st Sess. (1908)]. The rate was set at 50 cents for each 100 dollar share, a figure purposely set high in order to discourage the frequent purchases and sales by which speculators made their profits. The bill raised a storm of protest; it was referred to Committee and never heard from again.

1 M. Myers, supra note 39, at 307-08. See House Hearings, supra note 20, at 16; see, e.g., H.R. 62, 60th Cong., 1st Sess., 42 CONG. REC. 13 (1908) (restrictions on short sales); H.R. 10474, 60th Cong., 1st Sess., 42 CONG. REC. 441 (1908) (regulation of margin trading); H.R. 14641, 60th Cong., 1st Sess., 42 CONG. REC. 952 (1908); H.R. 15250, 60th Cong., 1st Sess., 42 CONG. REC. 1166 (1908); H.R. 16377, 60th Cong., 1st Sess., 42 CONG. REC. 1658 (1908); S. 5678, 60th Cong., 1st Sess., 42 CONG. REC. 2422 (1908); see also 2 L. Loss, supra note 39, at 1165 & n.2 (discussing S. 5678).
ment's most important response to the panic was to investigate.

B. The Hughes Committee

Governor Charles Evans Hughes of New York appointed a committee to determine "[w]hat changes, if any, are advisable in the laws of the State bearing upon speculation in securities and commodities, or relating to the protection of investors, or with regard to the instrumentalities and organizations used in dealings in securities and commodities which are the subject of speculation." The Hughes Committee's June 1909 report focused on securities speculation, especially on the New York Stock Exchange, which it called "probably the most important financial institution in the world."

Both critics and defenders of the market devoted a great deal of energy to defining speculation, but the word never attained a precise definition. The Hughes Committee adopted a common approach and defined speculation as trading with a view to profiting from price changes, thus defining speculation negatively by distinguishing it from investment. "Speculation consists in forecasting changes of value and buying or selling in order to take advantage of them."

Speculation, according to the Committee, "may be wholly legitimate, pure gambling, or something partaking of the qualities of both." In some cases, speculation is "a necessary incident of productive operations," serving to moderate otherwise violent price fluctu-
tions. In other cases, however, it does "an almost incalculable amount of evil. In its nature it is in the same class with gambling upon the racetrack or at the roulette table, but it is practised [sic] on a vastly larger scale."\textsuperscript{50} According to the Committee, the gambling variety of speculation dominated the New York Stock Exchange.\textsuperscript{51}

Like President Roosevelt, the Committee saw the hardest part of stock market reform to be eliminating speculation "which is wasteful and morally destructive, while retaining and allowing free play to that which is beneficial."\textsuperscript{52} The best way to reduce wasteful speculation, the Committee concluded, was simply to discourage those lacking "means and experience" from participating in the market, at least as speculators.\textsuperscript{53}

Although the Committee treated speculation broadly, it did examine a variety of specific practices. Some of these practices were subsequently prohibited or subjected to regulation by the Exchange Act, including trading on credit and various strategies designed to influence price or induce others to trade. Fortunately, the Committee recorded the criticism that had been leveled against all of these practices, including those it concluded were unobjectionable. Moreover, the report treats the subject of manipulation at some length, and thus may provide some evidence of the meaning "manipulative" was intended to convey in section 10(b) of the Exchange Act.

The Committee recognized that short selling and margin buying were widely criticized, but declined to recommend their prohibition or regulation inasmuch as, in its view, trading on credit was just as legitimate in the stock market as in any other market.\textsuperscript{54} The Committee

\textsuperscript{50} Id. at 4. This species of speculation had "most of the pecuniary and immoral effects of gambling." Id. "A continuous stream of wealth, taken from the actual capital of innumerable persons of relatively small means, swells the income of brokers and operators dependent on this class of business; and in so far [sic] as it is consumed like most income, it represents a waste of capital." Id.

\textsuperscript{51} It is unquestionable that only a small part of the transactions upon the Exchange is of an investment character: a substantial part may be characterized as virtually gambling." Id. at 5. Recall that only a year and a half earlier, President Roosevelt had told Congress that "[(t)he great bulk of the business transacted on the [securities and commodities] exchanges is not only legitimate, but is necessary to the working of our modern industrial system." 42 Cong. Rec. 1349 (1908).

\textsuperscript{52} Hughes Committee Report, supra note 46, at 4.

\textsuperscript{53} Id. at 4. One of the Committee’s recommendations was that the New York Stock Exchange discourage members from attempting "to increase the lure of the ticker" by equipping their branch offices with "creature comforts" that might tempt those who otherwise would not speculate, id. at 10, and another was that the Exchange should make it more difficult to buy on margin, id. at 6; cf. Tracy & MacChesney, supra note 36, at 1030 (margin trading leads to improvidence). Many commentators have suggested that participation in the stock market by persons of small means is inconsistent with the social welfare. See, e.g., C. Dice, supra note 36, at 8. Keynes even developed the gambling metaphor. J. Keynes, supra note 47, at 159 ("It is usually agreed that casinos should, in the public interest, be inaccessible and expensive. And perhaps the same is true of Stock Exchanges.").

\textsuperscript{54} Hughes Committee Report, supra note 46, at 5. The Committee also concluded that "short selling tends to produce steadiness in prices, which is an advantage to the community. No other means of restraining unwarranted marking up and down of prices has been
then turned to the subject of "manipulation of [security] prices by large interests." Manipulation was an important issue, but not all manipulation was considered wrong. In particular, there was nothing wrong with a syndicate supporting the price of a new issue with bona fide bids and offers while the securities passed through the hands of speculators and into those of investors; in fact such support was entirely appropriate.

Some other forms of price manipulation were objectionable, however. The Committee censured market operators who created price fluctuations seeking "either the creation of high prices for particular stocks, in order to draw in the public as buyers and to unload upon them the holdings of the operators, or to depress the prices and induce the public to sell." The Committee found manipulation of this sort on the New York Stock Exchange, but expressed confidence that these manipulations were sufficiently patent to experienced observers that the Exchange could prevent the worst excesses.

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suggested to us." Id. at 6. The report summarized the history of unsuccessful short selling legislation in New York, England, France, and Germany. Id. at 7, 18.

55. Id. at 7. The Committee identified two groups of New York Stock Exchange patrons who allegedly engineered manipulations.

Manipulators, whose connection with corporations issuing or controlling particular securities enables them under certain circumstances to move the prices up or down, and who are thus in some degree protected from dangers encountered by other speculators [and] . . .

[floor traders, who keenly study the markets and the general conditions of business, and acquire early information concerning the changes which affect the values of securities. From their familiarity with the technique of dealings on the Exchange, and ability to act in concert with others, and thus manipulate values, they are supposed to have special advantages over other traders.

Id. at 5.

56. Id. at 7. As the Committee used it, the word "manipulation" did not have any negative connotation, let alone one of misconduct: "The first kind of manipulation [legitimate price stabilization efforts for the purpose of making a market for issues of new securities] has certain advantages, and when not accompanied by 'matched orders' is unobjectionable per se. It is essential to the organization and carrying through of important enterprises . . ." Id. at 7.

A 1939 case history of the New York Stock Exchange noted that the Hughes Committee "felt that the manipulation which accompanied the issue of new securities had certain advantages for investors." N.S.B. GRAS & HENRIETTA M. LARSON, CASEBOOK IN AMERICAN BUSINESS HISTORY 342 (1939); see also C. DICE, supra note 36, at 414, 437-38 (legitimate manipulation). The authors of the history, in recognizing that the Exchange Act placed "severe restrictions . . . on the manipulation of security prices," N. GRAS & H. LARSON, supra, at 346, did not seem troubled by the idea that manipulation can be appropriate.

57. HUGHES COMMITTEE REPORT, supra note 46, at 7.

58. Id. at 7. While the Committee criticized wash sales and disapproved of matched orders even to support the price of a new issue, it concluded that the New York Stock Exchange could effectively discourage the manipulation of prices through trades that did not result in any real change in security ownership. Id. at 7-8. In noting that the exchanges had unilaterally forbidden wash sales, the Committee suggested that wash sales were no longer enforceable and were seldom attempted anymore. Id. at 7-8. Matched orders constituted a more serious problem because they continued to be "legal and binding," while "causing an appearance of activity in a certain security which is unreal." Id. at 8. Manipulators could place matched orders with different brokers, so they did not disclose their machinations to anyone subject to Exchange discipline. Id. at 7-8; see also W. VAN ANTWERP, supra note 46, at 174-75. But see STOCK MARKET CONTROL, supra note 36, at 110-11; Hanna, supra note 36, at 15 (com-
The Committee felt that the government had little role to play in discouraging the small speculator or reforming the exchanges.\textsuperscript{59} In fact, the Committee was more worried about the possibility of government intervention in the market than about excessive speculation.\textsuperscript{60} No law, the Committee argued, could clearly distinguish between appropriate and inappropriate transactions, and any effort to reform the exchanges by statute would hobble and eventually destroy the market.\textsuperscript{61} Insisting that statutes would be counterproductive, the Committee thought that "the Exchange, with the plenary power over members and their operations, could provide correctives..."\textsuperscript{62}

Inasmuch as the Committee's report warned against government intervention, the decision to acknowledge that speculation can be harmful may have seemed inconsequential to conservative Committee members. In retrospect, however, that acknowledgement had greater implications than anything else the Committee did. By starting from the position that excessive speculation can undermine the public wel-

mission broker has no incentive to discover matched orders). The Committee nevertheless thought the Exchange could easily discourage manipulation by matched orders. Hughes Committee Report, supra note 46, at 7-8. The Committee also urged the Exchange to forbid large all-or-none orders, which permitted manipulators to publicize large bids or offers without any requirement to actually complete the sale. Id. at 9-10.

59. "In carrying out such a policy exchanges can accomplish more than legislatures." Hughes Committee Report, supra note 46, at 4. The Committee did recommend legislation on the transmission of stock quotations, id. at 15-17, and to deal with a few abuses that did not directly implicate exchange institutions, including false advertisements for securities and bucket shops—organizations purporting to execute customer orders, but which simply closed their customers' transactions on the basis of market price movements instead of actually effecting trades, id. at 5-16; see also I M. Myers, supra note 39, at 311-12.

60. See White, supra note 41. The Committee warned the exchanges that if they failed to clean up the wrongdoing, the state would take action. Hughes Committee Report, supra note 46, at 10-11.

61. Hughes Committee Report, supra note 46, at 4-5. The Committee emphasized the failure of earlier German legislation, which was discarded only after it had rendered the Berlin exchange insignificant on the international markets, impaired the financial standing of Germany, and exposed small speculators to even greater evils than had existed before the legislation. Id. at 21-22. The Committee again echoed President Theodore Roosevelt, who had offered Germany as an example of overly broad legislation. 42 Cong. Rec. 1349 (1908).

The Committee declined even to recommend incorporation of the stock exchanges because it seemed "distinctly advantageous" to allow the exchanges to discipline members instantly and in a summary manner. Also, it seemed possible that incorporation would involve the courts in disciplinary matters, introducing delay and technical obstacles that "would impair discipline without securing any greater measure of substantial justice." Hughes Committee Report, supra note 46, at 10-11. The Committee also rejected the suggestion to subject the books of brokers to examination by some public authority. While recommending that the exchanges periodically inspect their members' books, the Committee feared that public examination of brokerage records would lead to disclosure of confidential information about customers. Id. at 8-9. The President of the New York Stock Exchange made similar arguments to President Franklin Roosevelt in 1933 regarding the inhibiting effect that overly broad legislation would have on the functioning of stock exchanges. Letter from Richard Whitney to President Franklin Roosevelt 6-7 (Apr. 14, 1933) (on file with the Stanford Law Review) (copy in 8 Documentary History Collection, supra note 28, item 2).

fear, the Committee shifted the terms of the stock market debate.\textsuperscript{63} Once the Committee acknowledged that something was wrong with the market, it could not deny that something had to be done. On the contrary, it had to recommend a solution.

When stock market reform becomes a political issue, the public debate has historically brushed over the question of whether reforms are necessary and gone directly to their design: the question of what the reform should be. This rapid progression has shaped the positions of those involved in the debate and thus the compromises reached. Decisions that at first seem startling appear on second thought to be the almost inevitable product of a crisis.

When an economic depression prompts a widespread sense that the stock markets caused the problem, there is seldom any concrete sense of how it transpired.\textsuperscript{64} Even if the convictions of reformers are imprecise or groundless, they can be deeply held. Targets of reform may expect to have more success diverting their critics than educating them.\textsuperscript{65} Because critics never carefully articulated the stock market problems, it is not surprising that they often proposed drastic changes rather than finely tailored solutions. When faced with a suspicious public demanding action, the exchanges have usually tried to appease the public by instituting minimal reforms\textsuperscript{66} and by arguing that any reform program should be tentative and incremental since the market is both very important and quite sensitive.\textsuperscript{67}

The program of flexible reform offered by the exchanges and their

\textsuperscript{63} As one of the first studies of speculation on U.S. stock exchanges, the Committee's report was frequently cited during public and congressional debates over the Exchange Act.

\textsuperscript{64} In 1934, few people claimed to understand how the exchanges worked and what functions they performed. \textit{See} Soule, \textit{supra} note 47, at 4 ("[N]owhere has there been discovered a single complete, systematic and thoroughly critical statement of the place of the stock exchange in a modern economy."). Most members of the House committee responsible for the Exchange Act "were not intellectually equipped to evaluate the details of exchange legislation." M. Parrish, \textit{supra} note 28, at 131-32.

\textsuperscript{65} The Hughes Committee's vague indictment of speculation is a revealing example. Although the Committee was deeply conservative, its report did not challenge the popular perception that the stock market was a casino. Instead, it claimed that government interference with the market would only make matters worse. \textit{Hughes Committee Report}, \textit{supra} note 46.

\textsuperscript{66} \textit{See} S. REP. No. 792, \textit{supra} note 20, at 4 ("Especially during periods of popular agitation, or when legislative action has been threatened, the exchanges have taken steps to raise the standards for the conduct of business by their members and to require corporations to furnish more adequate information for the benefit of investors."); I M. Myers, \textit{supra} note 39, at 307 ("In spite of the continuous criticism which was directed at the activities of stockbrokers, it was found to be very difficult to secure effective legislative control over them. Whenever an outraged public opinion seemed about to be successful in securing the passage of a regulatory law, the Exchange hastened to change its rules and methods sufficiently to make unnecessary the proposed legislation.").

\textsuperscript{67} According to the Hughes Committee, the New York Stock Exchange "affects the financial and credit interests of the country in so large a measure that its proper regulation is a matter of transcendent importance. While radical changes in the mechanism, which is now so nicely adjusted that the transactions are carried on with the minimum of friction, might prove disastrous to the whole country, nevertheless measures should be adopted to correct existing abuses." \textit{Hughes Committee Report}, \textit{supra} note 46, at 5.
apologists after the panic of 1909, and again in 1934, in large part coincided with the approach of the small group of relatively sophisticated critics who realized the limits of their own understanding of the stock market and suspected that even if reforms were instituted, the market would grow around them.\textsuperscript{68} Both the exchanges and their sophisticated critics took the position that the speculation problem called for a rulemaking process that could react to developing knowledge and practices. Of course, the exchanges and the sophisticated critics parted ways when it came to the question of who should control the process.

Thus, representatives of a broad spectrum of opinion agreed that stock exchange reform should be accomplished through bureaucratic regulation rather than statutory fiat. Among the disparate groups that considered flexible regulation appropriate, it was universally agreed that the regulatory authority would have very broad rulemaking power. Exchange critics demanded that any regulatory authority have extreme powers; the exchanges, inasmuch as they proposed to be the authority or at least to control it, pointed out the advantages of plenary power.\textsuperscript{69} Once market reform became inevitable, as it probably had by 1934, everyone agreed that, at the very least, some administrative body should have virtually unlimited authority to regulate the market as it deemed necessary. By the time it was determined that the body would be a public institution, it was too late for the exchanges to argue that boundless authority was inappropriate.

C. The Money Trust Investigation

The charge that a few leaders of finance triggered the panic of 1907 helped prompt Congress to investigate "the money trust."\textsuperscript{70} In 1912, the House of Representatives instructed the Banking and Currency Committee to investigate whether, as "generally believed," control of industry, railroads and banking had become so concentrated in the

\begin{footnotesize}
\textsuperscript{68} For a recent example of the impulse of market critics to respond to crisis by delegating power to bureaucrats, see Corp. Couns. Weekly (BNA), May 24, 1989, at 5 (exchange support of Market Reform Act of 1989, S. 648); Wirth Tells Corporate Counsel to Expect S&L Bailout; See Little 1989 Progress on Glass-Steagall, Takeovers, 3 Corp. Couns. Weekly (BNA), Nov. 16, 1988, at 8 (Senator Timothy Wirth predicting that Congress would respond to the October 1987 stock market crash by delegating more authority to the SEC).

\textsuperscript{69} "Plenary" was the word used by the Hughes Committee in 1909, see note 62 supra and accompanying text, and by the stock exchanges in 1934, see notes 220 & 252 infra and accompanying texts.

\end{footnotesize}
hands of a few financiers as to enable them "to control the security and commodity markets, to regulate the interest rates for money, to create, avert, and compose panics [and] to dominate the New York Stock Exchange . . ."\(^\text{71}\) Representative Arsène Pujo, chairman of both the Committee and its investigative subcommittee, delegated control of the investigation to Samuel Untermyer, the subcommittee's counsel.\(^\text{72}\) Untermyer devoted himself to showing that a very few men, particularly J. P. Morgan, controlled a substantial part of the nation's business.

Although its hearings and recommendations dealt primarily with banking practices, a substantial part of the Committee's efforts went into investigating the New York Stock Exchange practices.\(^\text{73}\) The Committee concluded that the exchange was run for the benefit of its members, often to the detriment of investors and competitors,\(^\text{74}\) "[b]ut it is in respect of the extent and character of the speculation in securities for which it is the agency that the New York Stock Exchange touches most vitally the affairs of the people of the entire country."\(^\text{75}\) Like the Hughes Committee, which it quoted extensively, the Pujo Committee similarly concluded that speculative trading dominated the business of the New York Stock Exchange.\(^\text{76}\) Its objection to speculation echoed that of the Hughes Committee as well: "Such excessive and indiscriminate speculation . . . is not only hurtful in the way that all public gambling is hurtful, but in addition it withdraws from productive industry vast quantities of capital."\(^\text{77}\)

One particularly troublesome aspect of speculation was manipulation\(^\text{78}\):

A very important phase of speculation on the New York Stock Exchange is the manipulation of prices up or down, as desired, without regard to the real value of the securities, and the creation of a false appearance of activity in particular stocks. Besides inciting . . . popular speculation, which rather should be discouraged, this practice prevents the exchange from faithfully reflecting the current value of securities— one of its true functions—and gives those controlling great supplies of capital a further power over the enterprises of the country, since the credit of corporations in no small degree is affected by the prices of their securities.\(^\text{79}\)

\(^{73}\) See H.R. Rep. No. 1593, supra note 70, at 33-54 (review of evidence on New York Stock Exchange).
\(^{74}\) Id. at 33-42.
\(^{75}\) Id. at 42.
\(^{76}\) "[I]n large measure transactions in shares on the New York Stock Exchange are purely speculative . . ." Id. at 43.
\(^{77}\) Id. at 45; see also id. at 116.
\(^{78}\) Id. at 46-52 (review of evidence); Sheldon, supra note 41, at 2255-56.
\(^{79}\) H.R. Rep. No. 1593, supra note 70, at 46.
Although the Committee did not undertake an exhaustive investigation of manipulative practices, it did examine and report on what Professor Loss has called "the notorious market pools."\(^{80}\) The pools—syndicates that manipulated the price of securities toward making a trading profit—often employed deceptive trading practices like matched orders and wash sales to encourage people to trade and, thus, to move prices.\(^{81}\) Nonetheless, the essential point of the pool was to take control of the market, not to deceive people.\(^{82}\)

While it condemned pools, the Pujo Committee considered pools and manipulation to be only particularly troublesome aspects of the larger problem of stock market speculation. The Committee did not lose sight of that larger problem in concentrating on particular practices. In fact, in discussing the most controversial practice—short selling—it warned against a narrow focus.

While your committee has not been impressed with the contention that short selling performs a valuable function . . . there seems no greater reason for prohibiting speculation by way of selling securities in the expectation of buying them back at lower prices than by way of purchasing them in the expectation of at once reselling at higher prices . . .

\(...[A]ll speculation, whether for the rise or for the fall, needs to be curbed rather than stimulated.\(^{83}\)

The Committee concluded that the exchanges should be reformed and that Congress had the constitutional power to mandate reform.\(^{84}\)

\(^{80}\) 3 L. Loss, supra note 39, at 1529. The Committee's report summarized the practices several pools used to manipulate prices. H.R. Rep. No. 1593, supra note 70, at 46.

\(^{81}\) For example, the Committee reported that New York Stock Exchange officers had admitted "that unreal appearances of activity are created through the giving by the same person or persons of simultaneous orders to buy and sell particular stocks . . ." H.R. Rep. No. 1593, supra note 70, at 46. In support of this statement the report quoted the amazing testimony of a former president of the New York Stock Exchange, who, when asked whether he approved of such transactions, answered, "I approve of transactions that pay their proper commissions and are properly transacted. You are asking me a moral question and I am answering you a stock-exchange question." Id. at 47, quoting Money Trust Investigation, supra note 70, at 812 (testimony of Frank Knight Sturgis).

\(^{82}\) One might call any practice that affects security prices deceptive, on the theory that the securities market is generally thought to be an impersonal auction in which all trades are the result of investment decisions and in which prices are not subject to anyone's control. See Berle, Stock Market Manipulation, supra note 36; cf. Frank H. Easterbrook, Monopoly, Manipulation, and the Regulation of Futures Markets, 59 J. Bus. S103, S105 (1986) (describes the "text book model" in which traders are too small compared with the market to affect prices). But even if people assume the market works this way, the concept of "deception" encompasses misleading practices only if a person who misleads without an intent to induce reliance can be said to deceive. The Supreme Court has not yet embraced such an extension of fraud doctrine.

\(^{83}\) H.R. Rep. No. 1593, supra note 70, at 52; see also RALPH F. DEBEDTS, THE NEW DEAL'S SEC 4 (1964) (Pujo Committee report's enumeration of objectionable activities emphasized "those of a speculative nature"); cf. Sheldon, supra note 41, at 2269 ("The recommendations and bills were designed to be weak so as to win unanimous approval among the committee members.").

\(^{84}\) The constitutional basis for federal control over the exchanges remained an issue, and Untermeyer's strong views on the matter helped shape the New Deal securities statutes. See note 89 infra, and notes 127-129 infra and accompanying text. According to the Pujo
The Committee proposed a bill that would have made it unlawful to transmit through the mails any information relating to transactions or operations on a stock exchange unless the exchange's charter contained provisions, satisfactory to the Postmaster General, "safeguarding . . . against fraud and deceit in [certain] particulars." The enumerated particulars went beyond the usual sense of fraud, requiring, for example, that the exchanges impose a minimum 20 percent margin for purchases.

The Pujo Committee's conclusions were widely reported, and many commentators agreed with them. Louis Brandeis drew heavily on evidence compiled by the Committee in his book Other People's Money—and How the Bankers Use It. Brandeis's recommendations, especially his prescription of disclosure as a cure for the ills Untermeyer had documented, greatly influenced the New Deal debate on federal securities regulation. Still, those who emphasize the roots of the securities laws

Committee, "It is doubtful . . . whether the Federal Government has power generally to regulate stock exchanges. We therefore advise no action by Congress to correct such local abuses in the operations of the New York Stock Exchange" as including rules limiting exchange membership or the fixing of commissions. H.R. REP. No. 1593, supra note 70, at 115. Nonetheless, the Committee believed "that Congress has power unconditionally to prohibit the mails, the interstate telegraph and telephone, the national banks, and all other instrumentalities under its control, from being used in executing, negotiating, promoting, increasing or otherwise aiding transactions on . . . stock exchanges." Id. at 116; see also id. at 119-28 (discussion of congressional power to prohibit use of the mails, telegraph, telephone, and national banks for aiding transactions on stock exchanges, and to impose a tax on such business).

85. H.R. REP. No. 1593, supra note 70, at 170. The report sets out the Committee's stock exchange bill. Id. at 170-73.

86. Id. at 171 (§ 1(b)). To discourage short sales, the bill would have required exchanges to prohibit members from lending customers' securities, even with customer permission. Id. (§ 1(f)); see also id. at 163. Exchanges would have also been required to prohibit manipulation, id. at 171 (§ 1(d)), defined by the bill as trading for the purpose of creating a misleading appearance of activity or artificially influencing the market price of the traded security in order to induce others to trade, id. at 172-73 (§ 5(3)).

Exchanges would also have been required to compel issuers to disclose a great deal of financial information, including investment bankers' fees and transactions with officers. Id. at 170-71 (§ 1(a)). While such disclosure requirements are conventionally viewed as devices to protect investors, they were sometimes advocated as a way to achieve broader ends, particularly changing corporate behavior. See note 90 infra. The Pujo Committee was startlingly candid in suggesting that Congress should exert power over the exchanges to reform corporate business practices.

Great and much-needed reforms in the organization and methods of our corporations may be legitimately worked out through the power wielded by the stock exchange over the listing of securities. Much of the confusion and many of the defects in corporate regulation due to the diversity of State laws and to the bidding of the States against one another in laxity of administration in order to attract corporations within their borders may be corrected and uniformity of methods introduced through the listing department of the exchange.


87. Carosso, supra note 70; Sheldon, supra note 41, at 2264-65. But see Donald A. Ritchie, The Pecora Wall Street Exposé 1934, in 4 CONGRESS INVESTIGATES, supra note 41, at 2555-56 (press hostile to Pujo hearings).

88. LOUIS D. BRANDEIS, OTHER PEOPLE'S MONEY (1914).

89. 1 L. Loss, supra note 39, at 123; Carosso, supra note 70, at 421-22, 429, 436; Ritchie, supra note 87, at 2555-56; cf. R. DeBedts, supra note 85, at viii (Brandeis's influence on Franklin Roosevelt); JOSEPH P. LASH, DEALERS AND DREAMERS: A NEW LOOK AT THE NEW DEAL 99,
in Brandeis’s work sometimes forget that Brandeis saw sunlight as a means to an end—the distribution of economic power—and not as an end in itself.99

Although the activities of the Hughes and Pujo Committees were widely reported and ultimately influential, no significant stock exchange legislation was immediately enacted. The effects of the panic of 1907 were short-lived; by the time recommendations were made, the emergency was over. New York mandated several stock exchange reforms,91 and the New York Stock Exchange forbade, or at least discouraged, some of the questionable practices the Committees uncovered,92 but the Pujo Committee’s bill was never enacted into law.93

Over the next twenty years the stock market grew rapidly, especially

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90. Ironically, those who accept the protection of investors through disclosure requirements as the fundamental purpose of the federal securities statutes often refer to Other People’s Money and cite Justice Brandeis’ comments on the efficacy of sunlight as the essential statement of the policy underlying the statutes. See, e.g., A Historical Introduction to the Securities Act of 1933 and the Securities Exchange Act of 1934, 49 OHIO ST. L.J. 329, 399 (1988) (student author). Other People’s Money did not propose extensive required disclosures; it did not cite problems of fraud to justify even the limited disclosure it suggested; and it was not primarily concerned with the protection of investors. Brandeis was primarily concerned with the concentration of economic power. “[T]he thing that troubled him was that ultimately . . . all individuals were at the mercy of those in whom economic power resided, and that this economic power went with the control of the fluid capital of the country.” Max Lerner, The Social Thought of Mr. Justice Brandeis, in Mr. Justice Brandeis 7, 20 (F. Frankfurter ed. 1932).

In Other People’s Money, Brandeis argued that investment bankers had strategically invested to gain control of finance, industry, railroads, and utilities, using money derived largely from the excessive fees and commissions they charged issuers and buyers of securities. Issuers paid exorbitant fees because they were under the control of the bankers. Buyers were simply unaware that securities prices were inflated by excessive investment banker profits. Brandeis proposed to “[c]ompel bankers when issuing securities to make public the commissions or profits they are receiving.” L. Brandeis, supra note 88, at 101. He would have required sellers to disclose only this piece of information and nothing more, reasoning that investors would not buy if they knew how much the bankers were making, and that if investors did not buy, bankers would lose the stream of income which enabled them to control the country. “Publicity is justly commended as a remedy for social and industrial diseases. Sunlight is said to be the best of disinfectants; electric light the most efficient policeman.” Id. at 92. The disease was bigness, not fraud. See also id. at 102-03 (incidental benefit to investors).


93. C. Cowing, supra note 45, at 56-62; D.S. Levin, supra note 39, at 41-42; 2 L. Loss, supra note 39, at 1166; M. Parrish, supra note 28, at 36-38; Carosso, supra note 70, at 428; Sheldon, supra note 41, at 2269-71. The public may have believed that the Federal Reserve Act solved the problems identified by the Pujo Committee. Id. at 2271-73.
the New York Stock Exchange, but little public discussion of regulating the markets occurred. Although there was some agitation for reform, the public at large was no longer concerned. Securities legislation has historically been the product of calamity. The public did not again demand government control of the stock exchanges until the depression of the 1930s.

D. The Crash of 1929 and the Great Depression

While the reports of the Hughes and Pujo Committees and the opinions of courts and commentators that had considered the propriety of particular stock market practices influenced the drafters of the Exchange Act, the central inspiration for the Act was the combination of

94. N. GRAS & H. LARSON, supra note 56, at 343-44 (total number of shares traded annually rose from 172,496,774 in 1915 to 1,124,608,910 in 1929).

95. During this period, most proposals for federal securities legislation emphasized the regulation of issuers and sales practices, not the exchanges. For example, proposals to supplement state “blue sky” laws with federal legislation were frequently advanced. See R. DEBEDTS, supra note 83, at 5-6; M. PARRISH, supra note 28, at 5-41; D.S. LEVIN, supra note 39, at 41-53; cf. JOHN BROOKS, ONCE IN GOLCONDA: A TRUE DRAMA OF WALL STREET 1920-1938, at 96-99 (1969) (extensive criticism of stock market speculation existed during the late 1920s). The commodities markets were brought under federal control in the early 1920s. See generally 1 PHILIP McBRIE JOHNSON & THOMAS LEE HAZEN, COMMODITIES REGULATION § 1.79, at 213-14 (2d ed. 1989); 2 P.M. JOHNSON & T.L. HAZEN, supra, § 4.01, at 220 (1982).

An unusually broad 1924 bill contemplated federal control over both exchanges and corporations through a Corporation Commission. S. 1826, 68th Cong., 1st Sess. (1924). The bill, which was rather loosely drafted, seemed to forbid margin trading, short sales, trading with the intention of influencing price, watered stock, and some abusive trading by corporate officers and employees. Id. §§ 3, 4, 5, 6, 10. The rest of the bill was overtly polemical, not even purporting to fill in the detail of all the substantive reforms it envisioned. For example, it explained that the nation had invested much more in corporate securities than in banks and trust companies, “and it is to the shame of our law makers that adequate protection, or in fact any protection at all, has ever [sic] been given by our National Government for this vast investment . . . .” Id. § 11(d). The “paramount function” of the new Corporation Commission was to protect investments and afford free, fair, broad, and genuine securities and commodities markets, “with all forms of gambling and manipulation eliminated; two elements which are now dominant in our security and commodity markets, and which are now our Nation’s greatest peril and curse.” Id. Thus, “all stock exchanges or marts on which securities are sold should be under the supervision of this commission, with ample laws and power of enforcement to protect the investor. Such powers as are not conferred in this Act to the commission to enforce its purpose and mandates should be quickly given by amendments and enactment of future laws by Congress.” Id. One of the Commission’s first tasks was to draft a national incorporation law. Id.

96. By 1934 there was a substantial body of case law addressed more or less directly to stock exchange institutions and practices. See generally SAMUEL P. GOLDMAN, A HANDBOOK OF STOCK EXCHANGE LAWS (1914); CHARLES H. MEYER, THE LAW OF STOCKBROKERS AND STOCK EXCHANGES (1931). Courts had considered the propriety of a variety of activities designed to influence security prices. Writing in 1931, Adolf Berle, probably the era’s most influential commentator on corporate finance, asserted that courts had already gone much further than commonly assumed to protect the stock market from fraud. Berle, LIABILITY FOR STOCK MARKET MANIPULATION, supra note 96; see also Berle, Stock Market Manipulation, supra note 36, at 394-97. See generally 3 L. LOSS, supra note 39, at 1531-40 (manipulation law before the Exchange Act); Poser, supra note 36, at 697-700.

Although it was contemporaneous with the Exchange Act, Berle’s article is particularly valuable as a statement of public sentiment because it was made before concrete proposals for a statute had engendered a response from special interest groups. In Berle’s view, the courts
the bull market of the 1920s and the dramatic collapse that ended it.

Conventional wisdom holds that the Exchange Act was passed in response to the 1929 crash. This view is correct at least in the sense that stock exchange legislation was inevitable once the public blamed the stock market crash for the Depression. As the reality of the Depression settled in, many people came to blame the collapse of the stock market for their suffering and the country's ruin. Others took advan-

had forbidden the manipulation of prices by deceptive statements and practices, but they had done little, if anything, about the manipulation resulting from concerted trading. Berle, Liability for Stock Market Manipulation, supra note 36, at 272-73. It was primarily this problem that cried out for a solution. While Berle believed that the law had accomplished a great deal to prevent fraud, he noted that American law has not undertaken to impose any liability upon buyer or seller for so arranging his transactions as unduly to inflate or depress the price of the stock. This freedom, which arouses public condemnation more than any other single legal element in the situation, is heavily under fire at the moment . . . . But the principle of laissez faire [sic] in American law remains in this regard unbroken; a group may purchase with the sole aim of raising the price or may sell with the sole aim of depressing it; and granted that they are not connected with the corporation, or have not in some other way assumed obligations to the market or to investors in that corporation, the law leaves them strictly alone.

Id. at 272. While U.S. courts had not found concerted trading that influenced price to be within the scope of the traditional rules against fraud, English judges had denounced such manipulation by trading in Scott v. Brown, Doering, McNab & Co., [1892] 2 Q.B. 724 (C.A.), finding illegal agreements among stockbrokers to purchase shares to induce later purchasers to believe a legitimate market exists and to convince them the shares are selling at a premium, "[w]ithout," according to Berle, "relying on any specific line of tort reasoning . . . ." Berle, Liability for Stock Market Manipulation, supra note 36, at 272. But see Schreiber v. Burlington N., Inc., 472 U.S. 1, 7 n.4 (1985) (Scalia "placed emphasis on the presence of deception."). Berle hoped American courts might reach the same result on the theory that it is somehow fraudulent to trade for the purpose of creating a market price that does not represent the trader's own appraisal of value. Berle, Liability for Stock Market Manipulation, supra note 36, at 273, 279. See generally 5 L. Loss, supra note 39, at 1533-34, 1538-39. The problem of concerted trading is essentially different from the problem of deception, and the manipulation provisions of the Exchange Act may have been intended to address the former at least as much as the latter.

97. First Inaugural Address of Franklin D. Roosevelt (Mar. 4, 1933), reprinted in 2 Documents of American History 299, 240 (H. Commager 8th ed. 1968); Letter from Franklin D. Roosevelt to Sam Rayburn (Mar. 26, 1934) ("The people of this country are, in overwhelming majority, fully aware of the fact that unregulated speculation in securities and in commodities was one of the most important contributing factors in the artificial and unwarranted 'boom' which had so much to do with the terrible conditions of the years following 1929."). reprinted in H.R. Rep. No. 1383, supra note 28, at 2. Telford Taylor, who helped draft the Exchange Act, later wrote that "[t]he New Deal was born of the Great Depression and, to the naked eye of the ruined investor and the unemployed apple-seller, the depression had been touched off by the stock market panic of October, 1929." Telford Taylor, Grand Inquest, The Story of Congressional Investigations 65 (1955); see also D.S. Levin, supra note 39, at 59 ("Few people realized what the crash portended until some time after it occurred, but there was hardly an American who was not aware of its occurrence and who did not date hard times from, and associate his distress with, the black days of October 1929."). See generally C. Cowing, supra note 45, at 5-98; R. DeBedts, supra note 83, at 27-30.

Economists continue to disagree on the nature and extent of economic impact the 1929 stock market crash actually had. Compare M. Friedman & A. Schwartz, supra note 40, at 306-07 ("Partly, no doubt, the stock market crash was a symptom of the underlying forces making for a severe contraction in economic activity. But partly also, its occurrence must have helped deepen the contraction . . . .") and John Kenneth Galbraith, The Great Crash 1929 (1954) (speculative stock market bubble of 1920s and its collapse contributed substantially to the depression of the 1930s) and Susan Previant Lee & Peter Passell, A New Economic View
tage of popular animosity toward Wall Street. By the time Franklin Roosevelt was elected president, most interested parties recognized that the issue was not whether there would be stock exchange legislation, but rather what form the legislation would take.

No one questions that the Exchange Act was the product of the unique circumstances of the Depression, but the speculative boom of the 1920s, the 1929 crash, and the horrible devastation that followed do not inform the Supreme Court's perspective of the Exchange Act. Instead, underlying the Supreme Court's rule 10b-5 cases is the image of a statute directed at nothing more than promoting candor and eliminating fraud. Yet surely, one trying to explain the enactment and objectives of the Exchange Act cannot forget that in 1934 there was a widespread consensus that excessive stock market speculation and the collapse of the stock market had brought down the economy, and that those who enacted the Exchange Act were primarily concerned with preventing a recurrence.

The spectacular rise of the market in the 1920s and the even more spectacular fall that began in 1929 were important in the broader sense that they shaped public and congressional perceptions of the stock market. The premises of much current securities law commentary are that stock prices reflect investors' perceptions of stock issuers, and that prices will more accurately reflect those perceptions—and to that extent be improved—if more extensive and reliable information is available to investors. From this premise, it follows that the appropriate role of securities legislation is to facilitate the efficient discovery and dissemination of accurate information about issuers. According to the prevailing view, Congress intended the Exchange Act to fill that role; the Act's fundamental purpose was "to substitute a philosophy of full disclosure for the philosophy of caveat emptor."

The analytical model of the stock market that prevailed during the depression was very different from the current model. The argument that the stock market will work properly if information is available to market participants assumes that market participants and mechanisms

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98. J. Galbraith, supra note 97, at 160; L. Lowenstein, supra note 47, at 103-04.
99. To appreciate the historical context, it is necessary to bear in mind how depressed the country really was. C. Dwight Dorough, Mr. Sam 220 (1962). For a particularly wrenching account of the situation, see William E. Leuchtenburg, Franklin D. Roosevelt and the New Deal (1963).
are rational and will, if given the necessary information, price securities at their fundamental value. Perhaps the stock market is in fact rational, but the Exchange Act was written on the assumption that it is not. Given the debacle of 1929, Congress could hardly have concluded otherwise in 1934.

The tremendous rise in stock prices during the 1920s and the precipitous drop that began in 1929 proved to many that speculation, rather than sound, long-term investment, was the engine that drove the market. In this view, speculators were concerned not with fundamental value but with predicting the changing prejudices and circumstances of other market participants.\textsuperscript{102} For many who thought the crash had caused the depression, the country's survival depended on restraining speculators; no one suggested that speculation would end if everyone was required to tell the truth.\textsuperscript{103} While speculation had long been criticized on moral grounds as profligate gambling, it began to be seen as a direct cause of terrible and tangible suffering.\textsuperscript{104}

"The prime instrument of perdition on the Stock Exchange [was] supposed to be short selling."\textsuperscript{105} Rumors that bankers were selling short began to spread as soon as the market collapse began in October of 1929.\textsuperscript{106} The public eventually concluded, just as it had after the

\textsuperscript{102} See generally J. Galbraith, supra note 97, at 6-28, 174-76; Warren F. Hickennell, What Makes Stock Market Prices ix (1932); J. Keynes, supra note 47, 147-64; R. Sobel, supra note 92, at 262-90; John Burr Williams, The Theory of Investment Value 33-34 (1938); Adolf A. Berle, High Finance: Master or Servant, 23 Yale Rev. (n.s.) 20, 31 (1933).

\textsuperscript{103} See generally D.S. Levin, supra note 39, at 59-96 (response of the academics and government officials to the crash).

\textsuperscript{104} When the Senate Banking and Currency Committee took up the bill that became the Exchange Act, the first witness, Doctor E.A. Goldenweiss (the director of research and statistics for the Federal Reserve Board), explained that stock prices affect economic activity and that the very efficiency of the market accelerates price movements. Stock Exchange Practices: Hearings on S. Res. 84 (72d Cong.) and S. Res. 56 and S. Res. 97 (73d Cong.) Before the Committee on Banking and Currency, United States Senate, 73d Cong., 1st Sess. 6436-39 [hereinafter Stock Exchange Practices], reprinted in part in 6 & 7 Legislative History, supra note 20, item 22.

[T]he bill under consideration here is actuated, as I understand it, by the desire to moderate and regulate the activities of stock exchanges in such a way as to prevent a recurrence of the excesses of appreciation in stocks, of fantastic rises in stocks . . . and also to prevent the disastrous drops in securities prices, with their repercussions

\textsuperscript{105} J. Flynn, supra note 36, at 216; see also J. Brooks, supra note 95, at 137-43; L. Loss, supra note 39, at 1224 ("short selling has been a favorite whipping boy . . ."). Stock Market Control, supra note 36, at 95 ("volume" and "intensity" of criticism and defense of short selling "varied inversely with the business cycle"); Hanna, supra note 36, at 11 ("Some persons, concluding that the stock market is evil only when it registers declines, seek to isolate the cause of the declines . . . and propose to abolish the short seller or bear."). D. Levin, supra note 39, at 98 (by the end of 1931, "[s]hort selling . . . eclipsed the other issues and became the bête noire of . . . Congress and the administration."). Not all critics of stock market practices condemned short-selling, however. See, e.g., Hanna, supra note 36, at 13 (no evidence short sales significantly depress price); G. Wright Hoffman, Short Selling, in The Security Markets, supra note 36, at 356-401.

\textsuperscript{106} Vincent Carosso, Investment Banking in America 305 (1970); C. Cowing, supra note 45, at 197-200; R. Sobel, supra note 92, at 273-74; see also J. Galbraith, supra note 97, at 118-20.
panic of 1907, that speculators had pushed the market to unreasonable heights and that short sales had precipitated the collapse. Several bills to regulate various aspects of the stock market were introduced even before the end of 1929; many more were introduced before the Exchange Act was adopted in 1934. For Congress, as for the public, short selling was the chief villain. Most of the bills proposed to do little more than prohibit, tax, or regulate short sales.

President Hoover thought manipulators trying to depress prices were demoralizing the stock market, and he encouraged Congress to investigate short selling. The Senate went further in March of 1932, directing its Banking and Currency Committee to make a thorough and complete investigation of stock exchange practices. The committee looked into short selling and accumulated evidence of a variety of unsavory practices, but did not at first develop a very impressive indict-
ment. Only after Franklin Roosevelt's election, when Ferdinand Pecora was appointed chief counsel to the committee, did the investigation "capture the public's attention."113 "[A]ny description of [the federal securities laws'] legislative history must begin with the dramatic hearings that Mr. Pecora conducted."114

Pecora investigated every aspect of the securities business that promised scandal.115 Before Roosevelt was even inaugurated, Pecora revealed fabulous excesses in investment, commercial banking, and the financing of public utilities.116 Among other things, he showed that in the years before the crash, some respected bankers had controlled the market price of securities in which they held an interest by effecting huge purchases or sales as the situation required.117 Instances of such manipulative trading were uncovered repeatedly throughout the course of the hearings.118

on their own accounts; the buying and selling of stocks by officers of corporations who had inside information of the affairs of the corporations and whose transactions on the exchange were conducted in such a manner as to prevent the public from knowing of their dealings; the operations of specialists on their own account; the subsidizing of newspaper men and others whose business it was to disseminate information for brokerage houses and traders with regard to a particular stock in order to aid the market manipulations . . . the improper use by officers of corporations of the stock of the corporations; examples of short selling and selling against the box; the pegging of prices in order to permit issues to be sold to the public at a fixed price; and the manipulation of the affairs of trading corporations and investment trusts for the benefit of those who had the matter of their affairs within their control and to the detriment of the investing public.

This letter, which amounted to a preliminary report, has generally been ignored in discussions of the history of the Exchange Act. The Committee's most fascinating revelations did not begin until after Ferdinand Pecora was appointed counsel. See note 113 infra and accompanying text. However, the committee did not publish its final report until after the Exchange Act was enacted; thus this letter was one of the few thorough and relatively dispassionate criticisms of stock exchange practices available while the Exchange Act was under consideration. The report of the Twentieth Century Fund was another such criticism. See note 182 infra.

113. J. SELIGMAN, supra note 28, at 20; see also Ritchie, supra note 87, at 2561-62.
114. 1 LEGISLATIVE HISTORY, supra note 20, at xiii, xiv. See generally FERDINAND PECORA, WALL STREET UNDER OATH (1939) (reprint); Ritchie, note 87 supra. The published record of the investigation is 27 volumes long. Stock Exchange Practices, supra note 104. The part of the record that includes hearings on the Exchange Act is reprinted in volumes 6 and 7 of LEGISLATIVE HISTORY, supra note 20. The Committee's detailed findings are set out in "STOCK EXCHANGE PRACTICES" REPORT OF THE SENATE BANKING AND CURRENCY COMMITTEE, S. REP. No. 1455, 73d Cong., 2d Sess. (1934), reprinted in 5 LEGISLATIVE HISTORY, supra note 20, item 21.
115. Pecora's attitude is epitomized in the subtitle of his book about the investigation: The Story of Our Modern Money Changers. F. PECORA, note 114 supra. President Roosevelt also railed against the "money changers" in his first inaugural address. 2 THE PUBLIC PAPERS AND ADDRESSES OF FRANKLIN D. ROOSEVELT 12 (1938).
118. Perhaps the most troubling revelation was that Albert Wiggin, the retired chairman of Chase National Bank, had made tremendous profits for himself and his family by selling short the common stock prior to the market collapse. While he was selling short, affiliates of the bank supported the price by effecting offsetting purchases totaling over $800,000,000. Wiggin also shared in the profits of the affiliates' trades and participated in pools in other securities. S. REP. No. 1455, supra note 114, at 62-63, 173-84, 186-99, 325-28; Ritchie, supra note 87, at 2572. Wiggin had been highly respected and even beloved, but these revelations
The revelations of Pecora's investigation set the stage and colored the atmosphere in which the Exchange Act was proposed, considered, and adopted. After exposing the outrageous excesses of the bankers, Pecora redirected the investigation toward stock exchange practices. While Congress deliberated, Pecora was busy uncovering evidence that many exchange members participated in pools like those Untermyer had uncovered twenty years earlier. Pecora, however, undertook a much more thorough investigation of the pools. While the Hughes and Pujo Committees had focused on inherently deceptive trading practices like wash sales and matched orders, Pecora showed that the pools employed a much wider variety of practices to control prices, not all of which were deceptive. The pools' common objective was to influence supply and demand. When deceit was likely to be effective, they deceived; but when the truth was the best way to influence price, they told the truth. The basic manipulative strategy—buying in order to increase price and selling to depress it—did not depend on communication at all, but rather on the brute force of concentrated economic resources.

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destroyed his reputation. Ritchie, supra note 87, at 2572. In Pecora's view, the investigation revealed no more egregious use of an inside position for private profit. F. PECORA, supra note 114, at 113-16. The disclosure of Wiggin's abuses was in large part responsible for § 16 of the Exchange Act. See H.R. REP. No. 1383, supra note 28, at 13 (“These provisions have been called the 'anti-Wiggin provisions.'”).

119. While the hearings created substantial pressure for stock exchange legislation, Pecora and his staff were generally unsuccessful in shaping the legislation. Donald Ritchie, The Legislative History of the Pecora Investigation, 5 CAPITOL STUDIES 87 (1977). Ritchie and Levin, see D.S. LEVIN, note 39 supra, both describe the legislative history of the Securities Act and the Exchange Act in tandem with the progress of the hearings.

120. Ritchie, supra note 87, at 2572-73.

121. S. REP. No. 1455, 73d Cong., 2d Sess. 32-36 (1934) (summarizing evidence), reprinted in 5 LEGISLATIVE HISTORY, supra note 20, item 21. The Committee's final report, published shortly after the enactment of the Exchange Act, concluded that “[t]he exposure of the extent and effect of manipulative practices upon organized exchanges was one of the most salutary and important accomplishments of the investigation.” Id. at 30. Donald Ritchie, the leading historian of the investigation, also views the exposure of market manipulation as a chief accomplishment of the investigation. Ritchie, supra note 119, at 87.

122. See notes 52 & 81 supra and accompanying texts.

123. One way the pools induced outsiders to trade was by convincing them that substantial interests were trading. (“One sure method of pulling traders into a pool is to show a rising market on heavy volume.”) House Hearings, supra note 20, at 110 (statement of Thomas G. Corcoran, counsel with the Reconstruction Finance Corporation); see also Jones & Lowe, supra note 36, at 471. Rumors of pool operations and other manipulations often circulated, and reporting of the transactions of a pool could greatly aid its success. See Michael J. Meehan, 2 S.E.C. 588, 598 (1937); House Hearings, supra note 20, at 112; J. BROOKS, supra note 95, at 106, 109; Jones & Lowe, supra note 36, at 477-81. Some operators, hoping to excite public interest and trading, employed agents to inform brokerage firms that a pool was about to create a price move. W. HICHERNELL, supra note 102, at 58; Twentieth Century Fund, Inc., Conclusions and Recommendations, in THE SECURITY MARKETS, supra note 36, at 689; Herlands, supra note 36, at 159, 164; Jones & Lowe, supra note 36, at 444, 465-71. See generally Thel, note 36 supra.

124. See House Hearings, supra note 20, at 830-33 (discussion of depressing effect of short sales); Market Manipulation and the Securities Exchange Act, supra note 36, at 626 n.10 (manipulators banded together in order to aggregate their economic power and move the market).
E. The Election of Franklin Roosevelt

In the 1932 presidential campaign, Franklin Roosevelt denounced speculation and called for federal regulation of the securities markets. The Democratic Party platform advocated "[r]egulation to the full extent of federal power, of . . . [e]xchanges in securities and commodities." Soon after the election, the new administration asked Samuel Untermyer to prepare a stock exchange control proposal. Untermyer responded with a revision of his Pujo proposal that required the exchanges to regulate themselves, subject to the supervision of the Postmaster General. This scheme was not acceptable to the administration because of doubts about involving the Post Office Department and about self-regulation.

Federal securities laws might be quite different today had Untermyer produced a satisfactory stock exchange bill. Because of his failure, the submission to Congress of stock exchange legislation by the Roosevelt administration was delayed for a year, and the first of the New Deal securities statutes instead addressed the discrete subject of the initial distribution of securities. The exchanges were better able to influence legislation in 1934 than they would have been in 1933. Finally, the men who succeeded Untermyer as draftsmen were particularly talented and left their mark on both the Securities Act and the Exchange Act.

125. R. DeBetts, supra note 83, at 25-27; M. Parrish, supra note 28, at 43-44 (1970); J. Seligman, supra note 28, at 19-20. Roosevelt consistently characterized the issue of exchange regulation in terms of speculation. See, e.g., 3 The Public Papers and Addresses of Franklin D. Roosevelt, supra note 115, at 171 ("A highly organized and expensive campaign of propaganda was directed against the [Exchange Act] by those who did not wish to have speculation in securities limited to decent standards."); id. at 413, 415 (second "fireside chat" of 1934); notes 174 & 176 infra and accompanying texts.

126. 7 History of American Presidential Elections 2742-43 (A. Schlesinger, Jr. ed. 1985). The platform also advocated protecting "the investing public by requiring to be filed with the government and carried in advertisements of all offerings of foreign and domestic stocks and bonds true information as to bonuses, commissions, principals invested, and interests of the sellers," id., embodying the Brandeis proposals put forward in Other People's Money. See notes 88 & 90 supra.

127. D.S. Levin, supra note 39, at 259-60; Raymond Moley, After Seven Years 84, 176-77 (1959); Raymond Moley, The First New Deal 308-10 (1966); M. Parrish, supra note 28, at 44, 113-14; A. Schlesinger, Jr., supra note 97, at 440, 456; J. Seligman, supra note 28, at 51-52; see also note 86 supra and accompanying text. A copy of the Untermyer proposal is included in 2 Documentary History Collection, supra note 28, item 1, and another is attached to a letter from John Dickinson to Adolf Berle (Oct. 5, 1933) (on file with the Stanford Law Review) (copy in Roosevelt Library, Adolf Berle Papers, box 22, Stock Market Investigation—John Dickinson file). The Untermyer proposal was very similar to S. 4647, 72d Cong., 1st Sess. See supra note 108; see also Memorandum from Grosvenor Jones to John Dickinson (August 18, 1933) (on file with the Stanford Law Review) (copy in National Archives, Record Group 40, file 80555/21, box 499, folder 4).

128. R. Moley, After Seven Years, supra note 127, at 177; R. Moley, The First New Deal, supra note 127, at 310; M. Parrish, supra note 28, at 113.

129. Benjamin Cohen, who was responsible for much of the drafting of the Securities Act and the Exchange Act, hardly overstated the case when he later said that in 1933 the financial interests "were so discredited in the public eye that Congress was ready to pass anything." D.B. Hardeman & Donald C. Bacon, Rayburn: A Biography 152 (1987).
Although President Roosevelt was not satisfied with Untermyer’s work, he was determined to introduce some form of securities legislation during the special session of Congress held immediately after his inauguration. He asked his aides for another bill even while Untermyer was at work on an exchange bill.

The new effort was more narrowly focused, and on March 29, 1933, Roosevelt recommended a truth-in-securities bill to Congress, suggesting that a stock exchange bill would follow shortly.

Roosevelt’s proposal set in motion the process that led to the enactment of the Securities Act, but his bill was poorly constructed and even more poorly advocated, and it encountered intense opposition. As a result, Raymond Moley, one of the President’s closest advisors, asked Felix Frankfurter for help with the statute. Frankfurter brought in three of his former students, James Landis, Benjamin Cohen and Thomas Corcoran, who rewrote the bill over one weekend. After further refinements, their revision was adopted as the Securities Act.

It is fair to say that the fundamental purpose of the Securities Act is to “substitute,” at least within the narrow area of the initial distribution of securities, “a philosophy of full disclosure for the philosophy of caveat emptor.” By enacting a disclosure statute first, President Roosevelt and Congress may have led the courts to interpret all future securities statutes as if they were fundamentally intended to be disclo-

130. DONALD A. RITCHIE, JAMES M. LANDIS 44 (1980); J. SELIGMAN, supra note 28, at 52. Commentators disagree over the importance of regulating financial institutions to the New Deal’s overall program. Compare M. PARRISH, supra note 28, at 3 (financial regulation central to New Deal), with 2 A. SCHLESINGER, supra note 97, at 444. President Roosevelt helped promote the securities bills. Raymond Moley, one of his closest aides at the time, subsequently said that Roosevelt thought securities legislation was important. R. MOLEY, AFTER SEVEN YEARS, supra note 127, at 84, 176-77; R. MOLEY, THE FIRST NEW DEAL, supra note 127, at 308-10. However, Roosevelt seems to have left most particulars of exchange legislation to others. But see J. SELIGMAN, supra note 28, at 93 (“Roosevelt assumed personal direction of the efforts to rewrite the bill”).

131. R. MOLEY, AFTER SEVEN YEARS, supra note 127, at 177-78. Moley later wrote that he was “sure that Roosevelt brought in [the second drafting group] . . . through sheer forgetfulness.” R. MOLEY, THE FIRST NEW DEAL, supra note 127, at 310-11. However, Roosevelt had not informed Moley of his decision, and most commentators suggest that Roosevelt set up a second team because he wanted a securities bill and was not sure Untermyer would produce a proposal quickly enough. M. PARRISH, supra note 28, at 44-47; D. RITCHIE, supra note 130, at 44-45; J. SELIGMAN, supra note 28, at 52-53; cf. D.S. LEVIN, supra note 39, at 260 n.3 (Roosevelt may have been angry with Untermyer).

132. 77 Cong. Rec. 937 (1933), reprinted in 1 LEGISLATIVE HISTORY, supra note 20, item 3. The President said that the securities bill “should be followed by legislation relating to the better supervision of the purchase and sale of all property dealt in on exchanges.”

133. R. MOLEY, AFTER SEVEN YEARS, supra note 127, at 178-79; R. MOLEY, THE FIRST NEW DEAL, supra note 127, at 311-12; M. PARRISH, supra note 28, at 47-56.


sure statutes too. Certainly the several securities statutes are often treated as related.136

One might assume that the Securities Act was meant to be the centerpiece of the federal securities statutes inasmuch as it was the first enacted.137 However, the record clearly reveals that the reason for its early enactment was not that it encompassed the most important policy goals, but that the Roosevelt administration was unable to prepare a satisfactory stock exchange bill quickly enough.138 In fact, those most closely involved with the development of the federal securities legislation did not consider the Securities Act to be critical to what they wanted to accomplish.139 In the larger community, influential commentators criticized the Securities Act as it was enacted, on the grounds that full disclosure was not enough to protect investors or the public.140

The Roosevelt administration’s efforts to draft a stock exchange bill

136. It is not clear that those responsible for these statutes saw their work as a cohesive whole. It is noteworthy that the statutory schemes of the different acts do not fit together very well. For example, security issuers must comply with one set of disclosure rules upon the initial public distribution of securities, and another when those securities thereafter trade publicly. The SEC has worked hard to improve the interaction of these rules, and has promoted the integration of their requirements. See, e.g., Sec. Act Rel. No. 6383, Fed. Sec. L. Rep. (CCH) ¶ 72,328 (Mar. 3, 1982) (adoption of integrated disclosure system).

137. Another factor that may give an incorrect appearance of prominence to the information provisions of the securities laws is the frequency with which they are encountered. Courts most often apply the securities laws in rule 10b-5 fraud cases. General corporate lawyers also tend to encounter the securities laws in rule 10b-5 cases, or in preparing disclosure documents. Even lawyers who specialize in a securities practice are unlikely to deal often with the detailed provisions that regulate the business of brokerage firms and other market professionals.

The fact that the disclosure provisions create the most work for lawyers and courts hardly means that they were the main focus of their authors, who sought mainly to control speculation.

138. If anything, the relative ease with which the Securities Act was drafted, considered, and enacted is evidence that it addressed fairly noncontroversial issues—not the sort of fundamental realignment of power contemplated by some proponents of the Exchange Act.

139. R. Moley, After Seven Years, supra note 127, at 178 (“I protested . . . that if securities legislation was to be separated from stock exchange legislation the latter ought to precede the former. Strictly speaking, there was nothing of an emergency nature about the securities act.”); id. at 183-84; see also D.S. Levin, supra note 39, at 261-62; R. Moley, The First New Deal, supra note 127, at 311; J. Seligman, supra note 28, at 52-53; cf. Joseph Alsop, F.D.R.: A Centenary Remembrance 150 (1982) (Exchange Act was “much more important” than Securities Act); Letter from Benjamin Cohen to Felix Frankfurter (Apr. 1933) (on file with the Stanford Law Review) (commenting on criticism that Securities Act dealt only with new issues of securities: “I thought, and assumed, that the Untermyer bill will cover the sale of securities already on the market.”) (copy in Library of Congress, Benjamin V. Cohen papers, box 8).

fell off after the President decided to focus on enacting the Securities Act.\textsuperscript{141} The matter did, nevertheless, continue to receive some attention,\textsuperscript{142} and by October 1933, Assistant Secretary of Commerce John Dickinson had established a committee to study stock exchange legisla-

\textsuperscript{141} J. SELIGMAN, supra note 28, at 53; M. PARRISH, supra note 28, at 108-14; D.S. LEVIN, supra note 59, at 261-62; cf. Letter from Secretary of Commerce Daniel Roper to Richard Whitney (May 26, 1933) (on file with the Stanford Law Review) (no exchange bill likely until following winter) (copy in National Archives, Record Group 40, file 80553/21, box 493).

\textsuperscript{142} A so-called interdepartmental committee representing the Justice Department, Department of Commerce, and Post Office, continued to work on exchange legislation during 1933. See J. SELIGMAN, supra note 28, at 53, 80-81; Letter from Secretary of Commerce Daniel Roper to Adolf Berle (July 18, 1933) (copy in Roosevelt Library, Adolf Berle Papers, box 20, correspondence file). This committee was seldom mentioned during the public debate over exchange legislation, and it is not clear what role, if any, it played behind the scenes. Most historical commentary on the Exchange Act has overlooked this committee.

This committee revised Untermyer's bill. See A Bill to Be Known as the Stock Exchange Regulation Act (on file with the Stanford Law Review) (copy in National Archives, Record Group 40, File 80553/21, box 492); THE STOCK EXCHANGE BILL (A SYNOPSIS AND COMMENTARY BY THE INTER-DEPARTMENTAL COMMITTEE) (prepared by Grosvenor M. Jones, Chief of Finance and Investment Division, Department of Commerce (May 1933)) [hereinafter SYNOPSIS] (on file with the Stanford Law Review) (copies in National Archives, Record Group 40, file 80553/21, box 492 and in Roosevelt Library, Adolf Berle Papers, box 22, Stock Market Investigation—John Dickinson file); see also Memorandum from Grosvenor M. Jones to Secretary of Commerce Daniel Roper (June 16, 1933) (on file with the Stanford Law Review) (describing discussion between Jones, Whitney, and Redmond of New York Stock Exchange about the interdepartmental committee's revisions, with Jones emphasizing that the committee's proposals were unofficial and tentative) (copy in National Archives, Record Group 40, file 80553/21, box 493).

The synopsis of the revised bill started by commenting that stock exchanges had been investigated frequently "because of widespread complaints as to the harmful effects of certain forms of speculation in securities," SYNOPSIS, supra at 2, and concluded with an interesting collection of statements by leading economists on stock exchange speculation, id. at app. A. Despite this broadly stated concern about speculation, the bill was designed to correct the principal evils disclosed in the Pecora investigation, "namely, those related to short selling, pool operations and other forms of manipulation, the activities of 'specialists'... the participation of corporation officers and directors in stock exchange operations, publication of corporate earnings, etc." Id. at 2.

The revised bill was relatively polished. Its central mechanism, like that in the Exchange Act, was the requirement that exchanges submit to federal control as a condition to the use of the mails or any means of interstate commerce. The Postmaster General was to only license those exchanges agreeing to conduct their affairs in accordance with the detailed standards set out in the bill. Interestingly, the Postmaster General was authorized to go beyond the statutory standards and regulate stock exchange conduct in order to protect the public against fraud, oppression, and unfair dealing by prescribing "uniform rules and regulations, in furtherance of or in addition to and not inconsistent with the provisions of this Act." Certain of these regulatory decisions were reviewable by a Stock Exchange Commission, made up of the Postmaster General, the Secretaries of Commerce and the Treasury, the Attorney General, and the Governor of the Federal Reserve Board.

The licensing provisions of this bill encompassed most of the matters subsequently addressed by the Exchange Act. According to the bill, before an exchange could have received a license to operate, it would have had to adopt governing instruments requiring: periodic disclosure by issuers of listed securities of a variety of information; prompt reporting by officers of their sales of issuer securities, and a prohibition on short selling by insiders; a scheme that would make all short sales identifiable on the ticker; a minimum margin of 20% on all transactions; rules banning specialists trading for their own accounts and exchange members trading puts or calls on listed securities; and rules against any member "engaging in the manipulation of the sale of any securities or of the price thereof." The bill defined "manipulation" in terms of deception.
Dickinson was markedly more sympathetic to business interests than were most of the others involved in formulating federal stock exchange policy. In fact, some of them suggested privately that his participation would further delay the progress of exchange legislation. Nonetheless, James Landis, who was already deeply involved in the administration of the Securities Act and who viewed the committee as important, asked to join, and Dickinson allowed him to do so. Adolf Berle and two practicing lawyers also joined the committee at Dickinson’s invitation.

The members of Dickinson’s Committee attacked the question of stock exchange reform from radically different positions. Their report, received by President Roosevelt and sent to Congress in January 1934, set out what the members could agree upon and ignored what they could not.

With the spectacle of the Depression and Pecora’s revelations in the...
background, the report of the Dickinson Committee started from the premise that stock exchange reform was imperative. Corporate officers and pool operators had "artificially influenced" share prices to their own ends, and their practices together with "unintelligent and senseless speculation" on the part of the general public had "stimulated security values to unsound levels from which they have inevitably receded with disastrous consequences to the whole national economy." 149

Most of the report was devoted to "the major problem involved in any consideration of proposed stock-exchange regulation . . . the methods and mechanism through which the proposed regulation is to be applied." 150 The committee concluded that a traditional approach would not work.

Stock exchanges raise essentially new problems in Federal regulation. They do not present a static situation susceptible to fixed standards. On the contrary, it is a highly dynamic, ever-changing picture, subject to untold and unknown possibilities and combinations that are today unpredictable. The thing to be avoided is the placing of this complex and important mechanism in a strait jacket. 151

The committee rejected the suggestion that legislation should "cover in its detailed provisions all known unfair, inequitable, and un-social practices by express provisions with a minimum discretionary power of regulation by the governmental body responsible for enforcement." 152 An administrative agency able to change rules as experience and circumstances dictated would be better suited than Congress to deal with speculation and other problems like those Pecora had uncov-

149. Report to Secretary of Commerce of Committee on Stock Exchange Regulation 3 [hereinafter Report to Secretary of Commerce], reprinted in LETTER FROM THE PRESIDENT, supra note 148.

150. Id. at 5.

151. Id. at 6. The committee proposed no specific legislation. Henry Richardson outlined a bill addressing "what might be regarded as some of the essential features of the problem" and circulated it to the other members of the committee in November 1933. Henry Richardson's Draft of Stock Exchange Legislation (Nov. 16, 1933) (on file with the Stanford Law Review) (copy in 2 DOCUMENTARY HISTORY COLLECTION, supra note 28, at item 2); see M. PARRISH, supra note 28, at 114; J. SELIGMAN, supra note 28, at 82. This proposal was generally an accurate prediction of what the final Exchange Act would provide.

Richardson would have required certification of exchanges using the mails or interstate commerce by a federal stock exchange commission. Richardson's Draft, supra, at 1. This new commission would have included representatives of the general public, as well as agriculture, industry, and the stock and commodity exchanges—all appointed by the President—together with a "federal fiscal representative" from the Federal Reserve Board or Treasury Department. Id. at 3-5. To be approved, an exchange would have to adopt governing documents designed to "secure fair dealing . . . [and] prevent fraud . . . manipulation . . . and other practices inimical to the public welfare . . . ." Id. at 7. Richardson proposed that the statute would require the documents to contain certain provisions, and would address short-selling, specialists, member trading, pools, publicity, wash sales, and margin trading, and would provide minimum standards for listing a security on an exchange, including perhaps requirements as to number of shareholders and aggregate value of securities. Richardson also raised the possibility of delegating administrative authority to the commission, permitting it to require the exchanges to adopt additional provisions. Id. at 8.

152. Report to Secretary of Commerce, supra note 149, at 6.
If regulation of such a complicated business was desirable, the committee recommended the creation of a "Federal Stock Exchange Authority," either a new agency or a separate division of the FTC, which could study the problem and create and administer solutions. Even then, in the view of the committee, primary responsibility should rest in the stock exchanges themselves.

It would have been hard to pick a more distinguished group to address the "methods and mechanism" of control than Dickinson, Landis, and Berle. All three were deeply interested in the central issue of the New Deal: the role of government in economic affairs. Berle was a leading proponent of the view that big business (and, thus, concentrated economic power) had become a fundamental part of life in the United States, and that the federal government should take a leading role in supervising and organizing it. Landis and Dickinson were

153. Your committee believes that the most practical solution from a long-range viewpoint, assuming such legislation to be desirable, is to enact a measure which will provide a system embodying the minimum of specific regulatory provisions in the statute itself and the maximum of discretionary powers of regulation in an administrative agency.

154. Id. at 5-6; see also id. at 3, 13.

155. Id. at 7.

156. See Adolf A. Berle, Jr. & Gardiner C. Means, The Modern Corporation and Private Property viii (1932). Berle's biographer concluded that "Berle and Means laid the ideological foundations for much of the New Deal's industrial, banking, and finance legislation, especially the Securities Exchange Act . . . ." J. Schwarz, supra note 140, at 61. Although many of Berle's ideas may have influenced the final Exchange Act, Berle was not active in the drafting or consideration of the legislation; he was away working for the City of New York at the time. Id. at 91-95.

Berle's writings devote considerable attention to stock market practices and the market as an institution. Id. at 52-55; see generally A. Berle, Liability for Stock Market Manipulation, supra note 36; Berle, supra note 102 (one problem in the stock market stems from an effort to make inherently non-liquid assets liquid); Letter from Adolf A. Berle to James M. Landis (Jan. 17, 1934) (on file with the Stanford Law Review) ("But the deep question—how far we are going to make non-liquid property liquid, impersonal and irresponsible—whether we can—whether we ought to—whether it is safe to go any farther—of course remain unsolved and we cannot solve it. Better therefore indicate the problem, open up the question and have some agency to regulate.") (copy in Roosevelt Library, Adolf Berle Papers, box 22); Letter from Adolf A. Berle to James M. Landis (Jan. 16, 1934) (on file with the Stanford Law Review) (copy in Roosevelt Library, Adolf Berle Papers, box 22). Nonetheless, Berle apparently thought that
both very interested in administrative law and each had made seminal contributions to the field.\textsuperscript{157}

Dickinson's influence on the Exchange Act has not been fully recognized. Dickinson was largely frozen out of the drafting process, despite the fact that his Committee's report was frequently cited in the debate over the Exchange Act and surely influenced the opinions and actions of some policymakers.\textsuperscript{158} Nonetheless, at an early stage in the debate, Dickinson articulately advocated flexible control and legislative delegation. Like many of his contemporaries, Dickinson was quite comfortable with the idea of delegating legislative power to administrative bodies.\textsuperscript{159} Delegation was in vogue in 1934, which no doubt influenced Congress in framing section 10(b). In particular, a broad cross-section of the public and its leaders, including influential representatives of reform of other institutions, particularly large corporations themselves, was more important to the public's well-being than stock market reform. In a speech at the New York Stock Exchange on December 14, 1933, Berle said that "[t]he bottom of the problem lies, it seems to me, not in the exchange, but in the fundamental control of corporations themselves." Speech by Adolf A. Berle, New York Stock Exchange (December 14, 1933) (on file with the Stanford Law Review) (copy in Roosevelt Library, Adolf Berle Papers, box 22). According to Berle, given the lack of responsible government action, the New York Stock Exchange was perhaps the only institution exerting a positive influence on corporations. But because one very clear manifestation of widespread unsatisfactory corporate practices was across-the-board declines in stock prices, "the result was that there gradually came to be a general feeling that the New York Stock Exchange was, somehow, responsible." Id.


158. J. Lash, supra note 89, at 161, 166; Cable from John Dickinson to Felix Frankfurter (Mar. 5, 1934) (on file with the Stanford Law Review) ("[n]ever saw present exchange bill nor knew of any of its provisions until it was printed in present form . . . . Some of your friends here have pursued very double dealing course with me.") (copy in Library of Congress, Felix Frankfurter Papers, Oxford Correspondence file) (draft in National Archives, Record Group 40, file 80553/21, box 492); see also J. Lash, supra note 89, at 159. Dickinson testified before the House and Senate committees that considered the bills that became the Exchange Act. House Hearings, supra note 20, at 505-25, 540-58, reprinted in 9 LEGISLATIVE HISTORY item 23; note 310 infra and accompanying text (executive session of Senate committee). During the hearings, the Committee's report was repeatedly cited and several amendments based on its recommendations were offered. See, e.g., 78 CONG. REC. S1683 (statement of Senator King), 8579 (statement of Senator Gore) (Gore introduced a bill based on the committee's report, but did not offer it as an amendment) (1934). In the end, Dickinson was probably responsible for the "deceptive or manipulative" language so important in the construction of § 10(b). See notes 310-316 infra and accompanying text.

159. See Memorandum from Max Lowenthal to Sen. Duncan Fletcher 1 (Dec. 20, 1933) (on file with the Stanford Law Review) (minutes of conference with Dickinson) ("It is Mr. Dickinson's view that the Government Commission administering the [securities exchange] law should have considerable discretion and leeway . . . .") (copy in National Archives, Sen. 73A-F3, Investigation of Stock Exchange Practices, Correspondence file—Cohen). Dickinson and Landis both favored flexible control, but Dickinson favored exchange self-government under public supervision, while Landis favored more direct federal involvement. M. Parrish, supra note 28, at 115-16; D. Ritchie, supra note 130, at 54 (Landis agreed "with Dickinson on the desirability of granting discretionary power, but, unlike Dickinson, he wanted that power placed solidly in the hands of a regulatory agency."); J. Seligman, supra note 28, at 81-85; D.S. Levin, supra note 39, at 336-38. Dickinson's position corresponded with that taken in the bill Richardson drafted for the committee, note 151 supra, and, as discussed below, by the stock exchanges in their opposition to the Exchange Act. See D.S. Levin, supra note 39, at 337.
business interests, supported the National Industrial Recovery Act, which contemplated private-public cooperation in determining industrial policies. 160

Dickinson had participated in drafting the National Industrial Recovery Act, 161 and was sympathetic to its goals and methods, at least as he saw them. 162 His attitudes reflected those of many conservative, business-oriented people who thought the solution to the depression was state-supervised self-regulation by business. By 1934, many who might have been expected to oppose legislation were willing to have Congress delegate authority over the exchanges to an administrative body. One explanation of the difference between the Supreme Court's conception of section 10(b) and that of the drafters of the Exchange Act may be the marked contrast between modern and depression-era attitudes toward both the stock market and the appropriate role of administrative agencies. Clearly, such attitudes changed radically in the years immediately preceding the enactment of the Exchange Act, and perhaps they have changed radically since then.

Although the Dickinson Committee's report concentrated on "methods and mechanism," it also explored some troubling stock market practices in depth. 163 The objective of the Committee in highlighting these practices was to show that the situation called for "broad


161. F. Freidel, supra note 160, at 422-24; R. Moley, After Seven Years, supra note 127, at 188-89; R. Moley, The First New Deal, supra note 127, at 288-90; 2 A. Schlesinger, supra note 97, at 96-98.


Dickinson thought that industry self-regulation under government supervision would work better than regulation directly administered by a government agency. See, e.g., House Hearings, supra note 20, at 512-14 (testimony of Dickinson) (development of industry-wide uniform accounting methods under National Industrial Recovery Act would be substantially better than single set of nation-wide standards established by FTC under Fletcher-Rayburn), reprinted in 9 LEGISLATIVE HISTORY item 29; Dickinson, The Anti-Trust Laws and the Self-Regulation of Industry, supra; cf. note 159 supra (Dickinson compared with Landis). He also thought that giving government officials unconstrained discretionary power was "incompatible with the essential nature of government by law." John Dickinson, My Philosophy of Law, in My Philosophy of Law: Credos of Sixteen American Scholars 91, 104 (1941); see also Haskins, supra note 144, at 7, 13. Dickinson was in fact one of the few credible critics of proposals to include open-ended administrative power in the federal stock exchange statute. See note 313 infra and accompanying text.

discretionary authority vested in an administrative agency rather than . . . detailed and specific statutory prohibition and requirement of particular practices . . . "164 For example, the problem with prohibiting speculative pools, "the chief evil for which a remedy is demanded,"165 was that the trading techniques employed by manipulative pools were legitimately used during the initial distribution of a security to support its market price. No statute could distinguish between legitimate and illegitimate pools. To attempt to establish a regime of "hard and fast rules" would risk hampering the ability of corporations to attract new investment while inviting fresh abuses.166 A Federal Stock Exchange Authority with "broad discretionary authority," on the other hand, could study the pool problem, develop solutions, and generate and refine regulations to reflect the lessons of experience over time.167

The Committee's emphasis on the "methods and mechanism" of stock market reform should not obscure what the report reveals about contemporary attitudes regarding the need for reform. The Committee was able to focus on administration only after its members agreed on the nature of the stock market problem and on the broad outlines of a solution. The Committee unanimously and unequivocally condemned both speculation and manipulation as serious problems which had contributed significantly to the depression. While this remarkable unanimity did not extend to the question of how to accomplish reform, the Committee members were still able to agree that any solution had to be flexible despite their diverse backgrounds and interests.168 The dispute came down to deciding who should administer the solution.

By the beginning of 1934, it was apparent that Congress would soon turn its attention to stock exchange legislation and would focus on

164. Id. at 13.
165. Id. at 13.
166. Id. at 13-14.
167. Id. at 13-15. The Committee also recommended that the Authority be empowered to require exchanges to "prevent abuses of short selling of such a character as to demoralize the market," and further in "times of grave temporary emergency" to act in conjunction with the Federal Reserve Board to suspend short selling for a limited period. Id. at 17.

The report covered most of the trading practices addressed in the Exchange Act. The Committee recommended flexible treatment of margin trading and specialists and further study of the segregation issue, which was seen as too important to be left to an administrative agency. Id. at 15-17, 19-20. It unequivocally condemned wash sales and matched orders. Id. at 15. The Committee recommended that exchanges require issuers of listed securities: to report the granting of stock options; to refrain from participating in, or financing, any pool trading in their securities other than publicized new-issue pools; to report their knowledge of any price-oriented pool; to disclose to shareholders directors' and officers' trading; and to prohibit directors and officers from participating in price-rigging pools or from disclosing nonpublic information to any pool other than an original-distribution pool. Id. at 17-19. The report recommended that the sales personnel employed by exchange members be required to disclose their participation in pools or the position of themselves or of their firm in the recommended securities. Id. at 19.

168. Dickinson's failure to include any hardline reformers on the Committee—despite the fact that the members of the Committee had divergent backgrounds and interests—may have contributed to the hostile attitude of Pecora's staff toward the Committee.
short sales, margin trading, and pools. The critical question at hand was the proper “method and mechanism” for federal intervention in the stock market. Pecora’s staff wanted the statute to mandate specific changes in the way business was done on the stock exchanges.\textsuperscript{169} James Landis, who was by this time an FTC Commissioner with responsibility for administering the Securities Act, favored flexible administration.\textsuperscript{170} Leaders of the securities industry tried to forestall any legislation,\textsuperscript{171} but many who considered legislation inevitable argued that Congress should delegate responsibility for regulating the market to bureaucrats, perhaps motivated as much by the hope of co-opting the administrators as by the prospect of educating them in the complexity of the securities business.\textsuperscript{172}

III. THE LEGISLATIVE HISTORY OF SECTION 10(b)

A. The Fletcher-Rayburn Bill

During the deliberations of the Dickinson Committee, Landis had his staff at the Federal Trade Commission at work drafting a stock exchange bill. By January 1934, Corcoran and Cohen had joined the drafting effort at the request of subordinates of President Roosevelt and Pecora; eventually, Cohen assumed drafting responsibility. When Pecora received a version late in January, he insisted on revisions that would extend its reach and substitute rigid provisions for flexible ones in several areas.\textsuperscript{173}

\footnotesize{\textsuperscript{169} M. Parrish, supra note 28, at 124. Moreover, [r]ather than grant broad discretionary powers to any regulatory agency, they wanted the bill to specifically prohibit all forms of stock manipulation, such as short selling, pools, and wash sales. Furthermore, they insisted that the bill forbid brokers from buying and selling for their own accounts at the same time they transacted business for their clients . . . . John Flynn, who passionately distrusted all bankers and brokers, warned that any vague sections in the bill would permit shrewd Wall Street lawyers to circumvent its basic intent.

Ritchie, supra note 87, at 2575; see also id. at 2561-62.

\textsuperscript{170} M. Parrish, supra note 28, at 116 n.7, and 124; see also id. at 61-62 (Cohen, Corcoran and Landis all favored flexibility); Matthew Josephson, Infidel in the Temple 304 (1967) (To the remark that the SEC promised no basic changes, “Cohen replied that he himself was opposed to drastic planning of everything by the state and hoped that the Roosevelt administration would remain ‘flexible, experimental . . . dealing with the complex character of modern economic life.’ ”); D.S. Levin, supra note 39, at 346-404 (history of the Securities Exchange Act).

\textsuperscript{171} The New York Stock Exchange tried to convince President Roosevelt that it would put an end to any damaging abuses, and after the Dickinson Committee’s report was released, Richard Whitney, the president of the Exchange, unsuccessfully argued that any legislation would be deflationary. D.S. Levin, supra note 39, at 352-54. Whitney indicated that in order to end manipulative operations the Exchange would regulate member participation in pools and forbid specialists from either accepting options from manipulators or disclosing order imbalances. Id.; see also id. at 356 n.4 (citing Wall St. J., Feb. 14, 1934) (most of the provisions of the bill were already part of the Exchange’s rules); R. DeBedts, supra note 83, at 62-66.

\textsuperscript{172} M. Parrish, supra note 28, at 124-25.

\textsuperscript{173} R. DeBedts, supra note 83, at 59-60; J. Lash, supra note 89, at 159-62; D.S. Levin, supra note 39, at 347-56; D. Ritchie, supra note 130, at 54-55; J. Seligman, supra note 28, at 82-85; Ritchie, supra note 87, at 2575; Thomas Corcoran, Dictated Notes for Autobiography
On February 9, 1934, President Roosevelt, citing the evil of "naked speculation" ranging from margin trading to manipulative pools, told Congress that "it should be our national policy to restrict, as far as possible, the use of these [securities and commodities] exchanges for purely speculative operations." The President, who had already seen the final version of Cohen's bill, recommended that Congress enact legislation to regulate the operations of exchanges "for the protection of investors, for the safeguarding of values, and so far as it may be possible for the elimination of unnecessary, unwise, and destructive speculation." The same day, Senator Duncan Fletcher introduced Memorandum re Regulation of Stock Exchanges 2 (Nov. 24, 1933) (on file with the Stanford Law Review) (copy in 8 DOCUMENTARY HISTORY COLLECTION, supra note 28, item 9).

174. President's Message to Congress, supra note 174. Proponents consistently argued that the goal of the Exchange Act was to control speculation and manipulation. See, e.g., House Hearings, supra note 20, at 44-46, 86 (Corcoran), 808 (Federal Reserve Board), 925 (brief of Corcoran and Cohen); Stock Exchange Practices, supra note 104, at 6465-66 (Corcoran), 7415 (Federal Reserve Board), 7470 (Treasury Department); S. Rep. No. 792, supra note 20, at 3-5; H.R. Rep. No. 1383, supra note 28, at 2; 4 LEGISLATIVE HISTORY, supra note 20, items 8, 10, 13, 14 (reprinting floor debate); see also note 174 supra. Opponents usually expressed the bill's goals in similar terms, often supporting the goal of curbing speculation but voicing reservations about the bill's mechanics. See, e.g., House Hearings, supra note 20, at 735-36 (New York Stock Exchange), 752 (Connecticut Investment Bankers Association); Stock Exchange Practices, supra note 104, at 7443 (municipal bond dealer), 7538 (New York Stock Exchange); Memorandum to Members from National Association of Manufacturers (Feb. 21, 1934) (on file with the Stanford Law Review) (copy in New York Stock Exchange Archives, New York Stock Exchange Subject Files, Series 4: Regulation, box 61); Press Release of Richard Whitney, President, New York Stock Exchange, supra note 28, at 7 ("[T]he Exchange is in hearty sympathy with the purpose of the bill insofar as it seeks to
the final version of Cohen's bill as the National Securities Exchange Act of 1934.177 Sam Rayburn, chairman of the House Commerce Committee, introduced the same bill in the House.178

The Fletcher-Rayburn bill evolved into the Exchange Act over the next several months. With the exception of the establishment of the SEC, all of the important features of the Act trace back to Fletcher-Rayburn. Predecessors of the enacted broker-dealer regulation, credit, issuer reporting, and proxy provisions can be found in Fletcher-Rayburn. However, while an outline of the Exchange Act can be found in Fletcher-Rayburn, the Exchange Act is in fact a very different piece of legislation.

Even though the Exchange Act addresses the same subjects as Fletcher-Rayburn and incorporates its structure, the Act's approach to stock exchange regulation differs fundamentally from it. Fletcher-Rayburn was destined to go through tortuous consideration, and through repeated and substantial amendment, before it became the Exchange Act, one of the most controversial statutes ever enacted.179 Many of the specific reforms proposed in Fletcher-Rayburn were virtually eliminated. Instead of mandating detailed reform itself, Congress established the SEC, authorized the Commission to deal with vaguely defined problems, and ordered studies of several particularly difficult issues.

Section 2 of Fletcher-Rayburn explains the need for federal control of the securities exchanges, asserting that manipulation of security prices and excessive speculation can cause not only depressions180 but prevent manipulation of security prices and unwise or excessive speculation .... We feel, however, that in seeking to achieve these sound purposes the bill has, unfortunately, included a number of rigid and inflexible provisions which would prove unworkable in practice and which may result in freezing all organized security markets."

Some witnesses did mention full disclosure as a goal of the legislation. The director of the Twentieth Century Fund, for example, listed issuer reporting along with limitations on margin trading, segregation, and prevention of price manipulation as essential components of federal regulation.

See Letters from President Roosevelt to Senator Fletcher and Representative Rayburn (Mar. 26, 1934), 3 PUBLIC PAPERS AND ADDRESSES OF FRANKLIN D. ROOSEVELT, supra note 115, at 169-70, reprinted in S. REP. No. 792, supra note 20, at 2, and in Stock Exchange Practices, supra note 104, at 7577-78 ("It has come to my attention that a more definite and more highly organized drive is being made against effective legislation to this end [federal securities regulation] than against any similar recommendation made by me during the past year."); Statement of Rep. Rayburn, Apr. 30, 1934, reprinted in 78 CONG. REC. 7693 (1934) ("Few bills have ever had such thorough consideration as this stock-exchange bill .... [w]e have worked out the terms of this bill under the pressure of the most vicious and persistent lobbying that any of us have ever known in Washington ....").

180. "National emergencies, which produce widespread unemployment and the dislocation of trade, transportation, and industry and which burden interstate commerce and adversely affect the public welfare are precipitated, intensified, and prolonged by manipulation
also unreasonable price fluctuations which interfere with the supply of credit, the calculation of taxes, and the proper functioning of financial institutions. According to the bill, regulation of exchange transactions is "imperative in the public interest for the protection of interstate commerce, and the national banking and Federal Reserve System."\(^{181}\)

While section 2 offered an overwhelming indictment of the stock market, the basic problems Fletcher-Rayburn addressed were speculation and manipulation.\(^{182}\) Although the justification stated in the statute may not reflect the true motivations of the drafters,\(^{183}\) it seems and control of prices and excessive speculation on exchanges." Fletcher-Rayburn, supra note 20, § 2.

181. Id.

The Fund's conclusions were not surprising, but the explicit nature of its indictment of speculation is revealing. Whereas earlier investigators usually criticized speculation as wasteful and as a form of gambling, the Fund criticized it in broader terms: "[T]he unduly large volume of uncontrolled speculation, coupled with the frequent interference with the free play of supply and demand by manipulative activity, interferes with the performance of the proper functions of security exchanges and also has a serious disruptive effect on the national economy." **Stock Market Control**, supra note 36, at 163.

The Fund did not propose to abolish speculation. The trading of speculators hoping to profit on minor price fluctuations contributed immensely to liquidity and price continuity, but had the disadvantage of moving securities prices away from their fundamental value. Id. at 89.

A vivid presentation of what Pecora had revealed of the manipulative practices of pools sharpened the Fund's critique. For example, while the Fund concluded that the much-criticized practice of short selling had little effect on market-wide price moves, id. at 97-107, the notorious "bear pools" used it successfully to drive prices down enough to trigger substantial independent sales in response to stop loss orders and margin calls. This caused prices to collapse to a level at which the "bears" could turn a profit. Id. at 106-07. The Fund concluded that short selling tends to accelerate the decline of prices early in major market moves, but seems to ameliorate the decline in the long run. Id. at 105. This conclusion helped forestall a blanket statutory prohibition of short sales. See **Stock Exchange Practices**, supra note 104, at 6953.

183. The drafters included § 2 in the bill because the Supreme Court had upheld the Grain Futures Act, in Chicago Bd. of Trade v. Olsen, 262 U.S. 1 (1923), on the basis of a similar, explicit congressional finding that the Act promoted important national interests. Thus, the section might have represented an assertion that the bill addressed a subject uniquely fit for federal regulation. **House Hearings**, supra note 20, at 28-29 (statement of James Landis, Commissioner, FTC), 41-42 (Letter from J. Landis to S. Rayburn, Chairman (Feb. 19, 1934) supplementing his statement); see also D.S. Levin, supra note 39, at 348, 350; cf. John H. Stassen, *Propaganda as Positive Law: Section 3 of the Commodity Exchange Act (A Case Study of How Economic Facts Can Be Changed by Act of Congress)*, 58 Chi. Kent L. Rev. 695 (1982) (suggesting that the findings of fact contained in § 3 of the Commodity Exchange Act were included to persuade the Court that the Act was constitutional); Tracy & MacChesney, supra note 36, at 1037 n.*. A draft in James Landis's papers (on file with the Stanford Law Review) (copy in Library of Congress, James Landis Papers, box 150) suggests that the section may have been written by Paul Freund. Freund worked for Corcoran. J. LASH, supra note 89, at 153.

doubtful that they were very concerned about full disclosure inasmuch as they made no allusion to fraud or secrecy.

The cornerstone of the regulatory framework envisioned by Fletcher-Rayburn was exchange registration. No one could lawfully effect trades on an exchange, or report exchange trades, unless the exchange was registered with the FTC. Building on the foundation of exchange registration, Fletcher-Rayburn provided for the regulation of exchange members, stock market credit, and manipulative practices. It further required issuers of securities which were to be traded on a registered exchange, and anyone soliciting proxies relating to such securities, to disclose information.

The most radical change contemplated by Fletcher-Rayburn was the segregation of broker and dealer functions. Many stock exchange members did business as both brokers and dealers; to segregate these functions completely, as the bill envisioned, would have substantially restricted their businesses and might have driven many of them, and perhaps some of the smaller exchanges, out of business. Almost as radical, and perhaps more controversial, was the proposal to regulate the extension of credit by and to exchange members.

Under Fletcher-Rayburn, security issuers became subject to regulation only upon registering their securities with an exchange, a precondition for participation in the exchange market. Such issuers were obliged to file periodic reports with the exchange and with the FTC. Anyone soliciting proxies for registered securities had to disclose certain specified information; the FTC would have the authority to require more. The bill also addressed trading by officers, directors, and owners of at least 5 percent of any class of a particular registered securities. It required them to report their initial holdings and subsequent trades of the issuer’s securities, and forbade them to sell the issuer’s registered securities short, “sell against the box,” or to disclose con-

Supp. V 1987). There is no reason to believe that many members of Congress regarded the purpose of the Act as anything other than the one articulated in § 2.

184. Fletcher-Rayburn, supra note 20, § 4; see also id. § 5 (registration procedures). The bill left regulation of participants in the over-the-counter market to the FTC. Id. § 14.

185. The bill accomplished this by forbidding any exchange member, or anyone transacting a brokerage business through a member, to be a dealer or underwriter in securities. Id. § 10.

186. House Hearings, supra note 20, at 123 (statement of Thomas Corcoran) (The “bill provides for the kind of segregation against which the stock exchange will put up the strongest argument.”); see J. Seligman, supra note 28, at 86 (“Section 10 was tantamount to a declaration of war.”).

187. Fletcher-Rayburn, supra note 20, §§ 6, 7.

188. Id. § 11.

189. Id. § 12.

190. Id. § 13. Among other things, the bill would have required anyone soliciting a proxy for an exchange-registered security to provide both the FTC and the targets of the solicitation with a list of the names and addresses of all persons solicited.

191. In a sale against the box, the seller owns enough securities to deliver the shares that have been sold but chooses to borrow securities in order to make the delivery. Sub-
fidential information regarding such securities for other than a necessary or proper purpose. The bill also declared it unlawful for such insiders to buy securities of the issuer with the intention of selling within six months and provided that any profit from a sale within six months after a purchase would inure to the issuer.192

The original version of section 10(b) of the Exchange Act was section 9(c) of Fletcher-Rayburn.193 Section 9(c) authorized the FTC to forbid the employment of any “device or contrivance” in connection with the purchase or sale of a registered security.

It shall be unlawful for any person, directly or indirectly, by use of any means or instrumentality of interstate commerce or of the mails or of any facility of a national securities exchange . . . [t]o use or employ in connection with the purchase or sale of any security registered on a national securities exchange any device or contrivance which, or any device or contrivance in a way or manner which the [FTC] may by its rules and regulations find detrimental to the public interest or to the proper protection of investors.194

The other parts of section 9 authorized to the FTC to pursue the public interest and the protection of investors. Only section 9(c) referred to the “proper” protection of investors.

On its face, section 9(c) seems to empower the FTC to outlaw anything done in connection with trading in exchange-registered securities.195 The only express limit on the FTC’s power is the requirement of making a finding; otherwise the section contains no particular limitation on the subject matter of FTC initiatives, unless one is implied from section 9’s title: “Regulation of the Use of Manipulative Devices.”196

sequently, the seller completes the transaction by buying stock or using his own stock in order to repay the lender.

ABA Committee on Federal Regulation of Securities, Report of the Task Force on Regulation of Insider Trading Part II: Reform of Section 16, 42 Bus. Law. 1087, 1098 (1987). Fletcher-Rayburn made it illegal for specified insiders “[t]o sell any such registered security, if the person selling does not own the security sold or if the person selling owns the security but does not deliver it against such sale within five days.” Fletcher-Rayburn, supra note 20, § 15(b)(2).

192. Fletcher-Rayburn, supra note 20, § 15.

193. The organization of Fletcher-Rayburn survived in the Exchange Act, but the section numbers changed with the insertion of § 4, establishing the SEC.

194. Fletcher-Rayburn, supra note 20, § 9(c).

195. Section 18 actually conferred the FTC’s rulemaking power. See note 20 supra and accompanying text.

196. One might read the section to permit no more than the regulation of trading strategies, allowing the FTC only to forbid effecting purchases or sales in a manner it finds detrimental. This is a rather strained reading, but one foreseen by Stokes. A memorandum Landis attributed to Stokes proposed striking the words “the purchase or sale of” from § 9(b) of the bill because “[i]t is conceivable that methods of manipulation will be evolved which do not involve a purchase or sale, as, for instance, the publication of fictitious bids and offers.” Memorandum Re Amendments to Draft of April 3, 1934 (Comm. Print 1934) (on file with the Stanford Law Review) (copy in 2 Documentary History Collection, supra note 28, item 22). Section 10(b) of the Exchange Act might also be read to require that trading itself be an element of a manipulative or deceptive device or contrivance, but the “in connection with” language of the section has been interpreted as a jurisdictional predicate, requiring little more than that the device or contrivance touch the securities market. See Blue Chip Stamps v.
In fact, section 9(c) was almost certainly intended to encompass only practices like those enumerated in the rest of the Fletcher-Rayburn bill, or even particularly in section 8 and the rest of section 9—that is, practices that contribute to speculation or tend to move prices away from those prices which would prevail if only long-term investors traded in the market. Perhaps the lack of limiting language in the bill simply reflects the difficulty of characterizing such practices.

Sections 8 and 9 of Fletcher-Rayburn, which became sections 9 and 10, respectively, of the Exchange Act, are usually considered related to each other; considering them together may help in interpreting section 10(b) of the Act. The two sections were treated as closely related in the Congressional debate, and the predecessor provision to section 10(b) was treated, albeit casually, as authorizing administrators to deal with practices similar to those addressed by the provisions that became section 9 and the rest of section 10. Even if the drafters did not view sections 8 and 9 of the Fletcher-Rayburn bill as integrated, the sections may provide the best evidence of the intended meaning of “manipulative” in section 10(b) of the Act. While neither section defined or even employed the term in an operative provision, the title of each includes the word “manipulative” or “manipulation.”

Section 8 of Fletcher-Rayburn carried the same title as section 9 of the Exchange Act: “Prohibition Against Manipulation of Security Prices.” Section 8(a) declared it unlawful to effect a variety of transactions relating to exchange-registered securities, or to participate in disseminating certain types of information relating to such securities. All these practices had been commonly identified with stock exchange operators who were suspected of encouraging speculative trading.

Manor Drug Stores, 421 U.S. 723 (1975) (holding that plaintiffs must have bought or sold a security to maintain a § 10(b) action); Superintendent of Ins. v. Bankers Life & Casualty Co., 404 U.S. 6 (1971); SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968), cert. denied, 394 U.S. 976 (1969); R. CLARK, supra note 5, at 317 (“[E]ven after Blue Chip no one suggests that defendants in Section 10(b) actions must have bought or sold a security.”).

197. The Supreme Court has considered the language of § 9 of the Exchange Act in its efforts to interpret § 10(b), although usually only that of § 9(a)(1). E.g., Santa Fe Indus. v. Green, 430 U.S. 462, 476 (1979); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 204-08 (1976); see also 5 A. JAcoBs, supra note 8, § 5.01, at 1-176 & 1-177 n.14 (legislative history on the relationship between §§ 9 and 10 of the Exchange Act is uninformative).

198. During the hearings on the Act, almost everyone who brought up both sections discussed them together. Corcoran and Landis each said § 9(c) of Fletcher-Rayburn was a catch-all for manipulative practices even before the word “manipulative” appeared in the section. See note 276 infra; cf. S. REP. No. 792, supra note 20, at 18 (predecessor of § 10(b) authorizes regulation of “other manipulative or deceptive practices”).

199. See 5 A. JAcoBs, supra note 8, § 5.01, at 1-176 & 1-177 n.14 (legislative history on the relationship between §§ 9 and 10 of the Exchange Act is uninformative).

200. Section 8(a)(9) of the bill made it unlawful for an investor to execute an option transaction on any exchange, or for an exchange member to have any interest in an option relating to any registered security. Fletcher-Rayburn, supra note 20, § 8(a)(9). The other subparts of § 8(a) and all three subparts of § 9 were also limited in scope to acts related to exchange-registered securities. Id. §§ 8(a)(1)-(a)(9), 9.

201. Cf. S. REP. No. 792, supra note 20, at 17 (“The practices covered by [the successor of § 8(a) of Fletcher-Rayburn] include those commonly resorted to by manipulative pools.”).
Section 9 of the Act reaches all of the practices targeted by section 8 of Fletcher-Rayburn except the practice of cornering the market.202 Fletcher-Rayburn contemplated only a modest FTC role in administering section 8. While the rest of the bill delegated the FTC expansive powers,203 section 8 created a private right of action,204 and contemplated a very small role for the FTC in defining offenses under the section.205

The FTC had a much more prominent role in section 9, the predecessor to section 10 of the Exchange Act, entitled “Regulation of the Use of Manipulative Devices.” In fact, section 9 did nothing more than define a role for the FTC, declaring it unlawful to engage in a variety of practices in violation of FTC-promulgated rules.206 Sections 9(a) and

202. Exchange Act, supra note 1, § 9(a)-(d). Section 8(a)(8) of Fletcher-Rayburn made it unlawful “[t]o acquire substantial control of the floating supply of any security registered on a national securities exchange for the purpose of causing the price of such security to rise on the exchange because of such control of the floating supply.” The inclusion of this provision deserves comment for two reasons. First, it demonstrates that “manipulative,” as used in the title of § 9, was not intended to connotate deceptive practices. Put differently, if cornering the market was seen as a “deceptive” practice, the word “deceptive” had a broad meaning that did not necessarily signify a purpose to mislead or induce reliance. Second, the decision to drop the provision from the Exchange Act suggests that the drafters intended § 10(b) to give the SEC relatively broad authority. It has been suggested by some commentators, it seems wrongly, that Congress intended § 10(b) “to be limited to use in connection with manipulative devices which were new and unknown in 1934.” David S. Ruder, Civil Liability Under Rule 10b-5: Judicial Revision of Legislative Intent, 57 Nw. U.L. Rev. 627, 658 (1963). The historical record does not support this position. The record suggests that everyone connected with the drafting, consideration or adoption of the Exchange Act thought the practice of cornering the market was reprehensible. This provision of Fletcher-Rayburn was omitted only because corners were no longer considered an extensive problem and the exchanges would and could solve it themselves. See House Hearings, supra note 20, at 207; Stock Exchange Practices, supra note 104, at 6514-15; N. Gras & H. Larson, supra note 56, at 341 (from the late 1800s to the early 1900s, operators and “corners” (those seeking to corner the market) were replaced by pools, short selling and margin trading as the perceived obstacles to freely competitive trading on the New York Stock Exchange). It is inconceivable that anyone connected with the drafting or the passage of the Exchange Act would have said in 1934 that § 10(b) did not give the SEC the power to regulate or forbid cornering the market in any security. Thus, whatever the intended limitations to the scope of § 10(b), the SEC was empowered to regulate some devices which were known in 1934.

203. See, e.g., Fletcher-Rayburn, supra note 20, §§ 14 (over-the-counter markets), 18 (special powers of the FTC), 20 (injunctions and the prosecution of offenses).

204. A person participating in a transaction in violation of § 8(a) was liable to anyone who traded at prices “which may have been effected” by the transaction. Id. § 8(b), (c). The applicable measure of damages was the difference between the price of the trade and the best price during the 90 days before and after the trade, together with any additional actual damages. Id.; cf. id. § 8(d) (contribution available for those held liable under § 8).

205. Of the several parts of Fletcher-Rayburn’s § 8, only the one requiring traders to report stabilizing transactions gave the FTC any discretion. Id. § 8(a)(7). In fact, no other part of § 8 even mentioned the FTC. The titles of §§ 8 and 9 suggest that the drafters consciously segregated forbidden from regulated practices. The historical record of the drafting process suggests the same inference. For example, one late draft provided for the regulation of options in § 9. Draft by Benjamin V. Cohen, with annotations by I.N.P. Stokes 16 (Feb. 5, 1934) § 9(b) (on file with the Stanford Law Review) (copy in 2 DOCUMENTARY HISTORY COLLECTION, supra note 28, item 17). The bill, as introduced, prohibited the use of options in some situations in § 8. See Fletcher-Rayburn, supra note 20, § 8(a)(9); notes 200-202 supra and accompanying text.

206. The section’s language might be construed to outlaw short sales and stop-loss or-
9(b), respectively, which governed transactions in exchange-registered securities only, made it unlawful to effect short sales or stop loss orders except in accordance with FTC rules. Section 9(c) is discussed above. 207

The decision to split the provisions directed at manipulation into two sections is instructive. Pecora and others had identified a number of stock market practices which, in their view, served no legitimate purpose and which were generally agreed to be improper; these practices were listed and forbidden in section 8 of Fletcher-Rayburn. Some critics believed that the noninvesting public had an interest in curtailing such practices inasmuch as they compromised stock exchange efficiency and, in turn, reduced general economic welfare. However, these practices were suspect mainly because they directly injured investors. Section 8's investor-protection orientation is underscored by its provision of a private right of action for injured investors.

Section 9 of Fletcher-Rayburn, like most of the rest of the bill, addressed what proponents of reform considered a broader problem critical to the public interest: speculation. Some stock market practices, particularly short selling and margin buying, were thought to be entirely inimical to the public interest; it was imperative that the government control these practices, regardless of the reason they were employed or their effect on individual investors. These practices had been widely condemned, not because they caused direct, measurable injuries to investors, but because they encouraged speculation that could undermine the stability of securities prices. 208 A universal prohibition of these practices was infeasible because investors often employed them legitimately, and they had, according to their proponents, the positive effect of moderating price fluctuations. Accordingly, the drafters of Fletcher-Rayburn did not prohibit these practices but, instead, subjected them to regulation.

Section 9 of Fletcher-Rayburn, especially section 9(c), seems directed at protecting the general public from the harms of speculation. In exercising its rulemaking authority under the section, the FTC was explicitly directed to consider the general public interest as well as the protection of investors. Furthermore, as if to highlight their broad concerns, the drafters refrained from creating a private right of action for investors injured by violations of the section. 209 Instead of attempting

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207. See note 90 supra; text accompanying notes 194-197 supra.
208. Cf. S. Rep. No. 792, supra note 20, at 18 (The predecessor of Exchange Act "subjects to regulation by the Commission short sales and the use of stop loss orders, which greatly facilitate speculation.").
209. The propriety of a private right of action for violations of § 10(b), either in the modern environment or in the context of the immediate post-depression securities markets, is beyond the scope of this article. However, it is difficult to dispute the conclusion that "Con-
to proscribe only knowing and intentional misconduct designed to deceive investors, the drafters of section 9(c) seem to have intended to authorize the FTC to regulate even innocent conduct that might injure the public at large.

Thomas Corcoran explained Fletcher-Rayburn to Congress on behalf of its drafters. Corcoran did not say much about sections 8 and 9 during his extensive testimony before either the House Committee on Interstate and Foreign Commerce or the Senate Banking and Currency Committee. He spent only a few minutes explaining how pool operators used the various practices addressed in section 8, and he had even less to say about section 9. Conceding that there was substantial pressure to ban short selling across the board, Corcoran explained that the bill did no more than delegate administrative authority over the practice because no one knew enough about the potentially beneficial effects of short selling or the best means of regulating it. In the House, he said, "[o]f course . . . [section 9(c)] is a catch-all clause to prevent manipulative devices[,] I do not think there is any objection to that kind of a clause. The . . . [FTC] should have the authority to deal with new manipulative devices." Corcoran did not even mention section 9(c) in the Senate hearings.

The bill's proposal to use specific rules to make extensive changes in the financial markets galvanized the opposition of those who would be most directly affected. The securities industry opposed most of
the bill, especially the segregation requirement. Financial institutions and their regulators opposed the margin and credit provisions. Corporate managers opposed the reporting requirements and regulation of proxy solicitation.

The president of the New York Stock Exchange, Richard Whitney, spearheaded the opposition to Fletcher-Rayburn.214 In addition to orchestrating an intense lobbying campaign,215 Whitney appeared frequently before Senate and House committees considering the bill, insisting that his exchange had promptly addressed the problems Pecora uncovered. While denying that any government action was necessary, Whitney insisted that the New York Stock Exchange would gladly accept the supervision of a governmental body over its efforts to combat fraud, excessive speculation, and price manipulation.216 As Whitney saw it, the critical problem was finding a constructive role for the federal government: the stock exchanges were too complex, and their problems too subtle, to be subject to a broad and inflexible statutory regime.217 His problem with Fletcher-Rayburn was that, although it purportedly addressed exchange abuses, it would in fact “establish indirectly a form of nationalization of business and industry which has hitherto been alien to the American theory of Federal Government.”218

at 85-87; see also note 179 supra (Roosevelt and Rayburn on opposition to proposals for reform); note 221 infra.

214. J. Brooks, supra note 95, at 200-04; C. Cowing, supra note 45, at 240-42; R. De Bedts, supra note 83, at 65-66; D. Hardeman & D. Bacon, supra note 129, at 156-57; J. Lash, supra note 89, at 162; M. Parrish, supra note 28, at 123; D. Ritchie, supra note 130, at 55-56; 2 A. Schlesinger, Jr., supra note 97, at 462-63; J. Seligman, supra note 28, at 89; The Making of the New Deal: The Insiders Speak 131 (K. Louchheim ed. 1983) (Gerhard Gesell’s recollection of Whitney as “the leading proponent of Wall Street groups in opposing SEC legislation”); 78 Cong. Rec. 7696 (1934) (referring, generally, to the campaign of protest against the bill).

215. On Whitney’s lobbying efforts, see, e.g., J. Seligman, supra note 28, at 89. The New York Stock Exchange Archives contain a great deal of material opposing the Exchange Act (New York Stock Exchange Subject Files, Series 4: Regulation; Securities & Exchange Acts of 1933, 1934), as do the files of Secretary of Commerce Roper and Assistant Secretary Dickinson in the National Archives (Record Group 40, file 80553/2, boxes 492, 493) and the files of Thomas Corcoran in the Library of Congress (boxes 266, 267).


217. According to Whitney,

Any attempt to regulate by statute and in minute detail the operation of security markets is impossible of accomplishment. Rules of law effective today would be worse than useless tomorrow and the harm that would be done before the Congress could assemble and amend them would be beyond repair. The purpose of Federal regulation should be to establish supervisory powers with authority to prevent abuses as time and circumstances require.

Stock Exchange Practices, supra note 104, at 6582.

218. Whitney took a different approach to issuer regulation. He suggested Congress address “abuses in corporate procedure” by requiring federal incorporation of all companies engaged in interstate businesses. Id. at 6583; see also House Hearings, supra note 20, at 225 (Whitney’s prepared statement that “bad practices” necessitate federal incorporation law).

219. Stock Exchange Practices, supra note 104, at 6584; House Hearings, supra note 20, at 152. Alarmist criticism was widespread in Congress, see id. at 142-48 (statement of Rep. John G. Cooper) (FTC regulation of exchange listing standards compared to government control of
Whitney proposed the creation of a new federal coordinating authority consisting of representatives of the exchanges, private industry, and federal agencies historically involved with finance and credit. He proposed giving this agency "broad supervisory power," including, among other things, "plenary power to require stock exchanges to adopt rules and regulations preventing not only dishonest practices but also all practices which unfairly influence the price of securities or unduly stimulate speculation."  

Representatives of the other exchanges, investment banks, firms engaged in specialized businesses involving the stock market, and issuers of exchange-traded securities followed Whitney to denounce part or all of Fletcher-Rayburn before the House and Senate committees. They criticized the segregation requirements, especially as applied to the smaller exchanges, and the credit regulation, issuer-reporting, and proxy-solicitation provisions.

Sections 8 and 9 of Fletcher-Rayburn were exceptional in that they aroused little substantive opposition. Indeed, the bill's supporters never expected these sections to generate much controversy. The conciliatory attitudes of the few witnesses who did discuss sections 8 and 9 contrasted starkly with the antipathy almost all witnesses expressed toward the rest of the bill. Opponents of the bill usually found it expedient to concede that the manipulative practices forbidden

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220. *House Hearings*, supra note 20, at 85 (testimony of James H. Rand, Jr.) ("Are we being pushed along the road from Democracy to Communism?") and the press, see J. SELIGMAN, supra note 28, at 85, 93; D.S. LEVIN, supra note 39, at 372-74.


222. *House Hearings*, supra note 20, at 85 (testimony of Thomas Corcoran) ("The provisions of this bill, as to manipulations upon stock exchanges, are agreed to practically everywhere."). 110 ("Section 8 embodies a proposal with which very few people disagree."). Even the business community had criticized the New York Stock Exchange for permitting short selling and pools that allegedly contributed to the sharp decline in stock prices in July 1933.

M. PARRISH, supra note 28, at 109, 111.

223. The attitude of the Detroit Board of Commerce was typical: "While we all recognize that individual investors are entitled to the maximum protection from fraud or manipulation, the [rest of the] present bill, it seems to us, steps way beyond the necessary limits. . . ."

REPORT OF THE NAT'L LEGISLATIVE COMM. 1 (Feb. 24, 1934) (on file with the Stanford Law Review) (copy in 8 DOCUMENTARY HISTORY COLLECTION, supra note 28, at 775)
in section 8 were properly banned and that those regulated in section 9 required reforms.\(^{224}\)

Whitney testified that most practices forbidden by section 8 were already prohibited under New York law; he agreed that if they were not forbidden elsewhere they should be.\(^{225}\) Other witnesses expressed an industry-wide condemnation of various practices designed to upset the market and excite trading, although some argued that self-regulation had been, and would continue to be, more effective in curbing these practices than government initiatives.\(^{226}\) The president of the New

(greater public confidence would strengthen the markets and improve the fortunes of the securities business).

Even James Rand, a vicious critic of the bill who saw it as part of a plan to overthrow the established social order in favor of a planned economy, see House Hearings, supra note 20, at 759, conceded that the prevention of manipulation was a legitimate aim of federal legislation. Id. at 755. For discussions of Rand's allegations and the response to them, see M. Parrish, supra note 28, at 131; A. Schlesinger, Jr., supra note 97, at 457-60; J. Seligman, supra note 28, at 96; D.S. Levin, supra note 39, at 387.

\(^{224}\) There are several probable explanations for this lack of criticism. The practices forbidden by § 8, even if they were pervasive and profitable, did not go to the heart of exchange institutions in the same way as those practices addressed by the more controversial provisions of the bill. In general, for strategic if for no other reasons, provisions that provided only for administrative regulation, such as those in § 9, were seldom criticized.

\(^{225}\) House Hearings, supra note 20, at 203-07; Stock Exchange Practices, supra note 104, at 6608-09, 6615-17 (New York Stock Exchange rules), 6657; cf. House Hearings, supra note 20, at 186, 194-95 (Whitney testifying about the lack of need to regulate speculation); Stock Exchange Practices, supra note 104, at 6506-12 (comment of Roland Redmond, counsel to New York Stock Exchange, on the lack of need for certain stock market regulations), 7736 (testimony of Samuel Untermyer). On the other hand, Whitney testified in the Senate that legislators could not identify in advance all the "manipulative" trading practices that had been, or could be, designed to influence market prices. According to Whitney, a better method of reform would address these practices on a case-by-case basis, "perhaps the way... the common law was written." Id. at 6616; see also Memorandum from F.T. Boyd, Asst. Sec., New York Stock Exchange, on file with the Stanford Law Review ("Section 8 [of H.R. 8720]... prohibits manipulative devices. The Exchange is heartily in accord with the purpose of this section, as it enables the Exchange to enforce its own existing rules upon nonmembers now beyond its jurisdiction.") (copy in New York Stock Exchange Archives, New York Stock Exchange Subject Files, Series 4: Regulation, box 60).

On April 14, 1933, Whitney wrote Roosevelt that the New York Stock Exchange had already forbidden specialists to participate in pools or hold options on stocks in which they specialized and suggested that the Exchange would, if necessary, take steps to prevent brokers as well as officers and directors of issuers from participating. Letter from Richard Whitney to President Roosevelt (Apr. 14, 1933), supra note 61. Soon after Fletcher-Rayburn was introduced, Whitney announced that "[i]n effect... most of the prohibitions against the manipulation of security prices, contained in Section 8 of the bill, are already in the rules of the Exchange." Press Release of Richard Whitney, supra note 28, at 4.

\(^{226}\) House Hearings, supra note 20, at 277 (statement of Frank C. Shaughness, President of the San Francisco Stock Exchange), 336-37 (brief of New England securities dealers), 345 (statement of Michael J. O'Brien, President of the Chicago Stock Exchange), 456 (testimony of G. Herman Kinnicutt, Investment House Group), 508 (statement of John Dickinson); see also A. Vere Shaw, Open Letter to Investors (Jan. 29, 1934) (on file with the Stanford Law Review) (copy in 8 Documentary History Collection, supra note 28, item 19); Lothrop Withington, counsel to the Boston Stock Exchange, Memorandum Concerning Proposed Stock Exchange Legislation 2-3 (on file with the Stanford Law Review) (copy in 8 Documentary History Collection, supra note 28, item 30); cf. House Hearings, supra note 20, at 603-04, 606-07 (proposed Investment Bankers Code would have regulated stabilization and the publication of quotations), 882-83 (self-regulation by exchanges has historically been more effective
York Curb Exchange, the predecessor of the American Stock Exchange, believed that the rules of his exchange had "effectually restrain[ed] manipulative practices and unwarranted activity, which, when all is said and done, stimulated movements in securities." Nevertheless, given public insistence on a legislative solution, he indicated that the members of his exchange were "prepared to recommend the licensing of exchanges by Federal authority, and the enactment, with certain modifications looking primarily to clarity, of the provisions of section 8 of the pending bill which deal with manipulative practices."

In line with their general acceptance of the explicit prohibitions contained in section 8, few witnesses disagreed in principle with the regulatory provisions of sections 8 and 9. While many stressed that they did not consider the practices regulated by these sections necessarily objectionable no one questioned the propriety of regulation. Most witnesses who criticized sections 8 and 9 did not question the goals of the provisions; their criticisms centered on the language employed to secure those ends, and several joined the president of the New York Curb Exchange in suggesting modifications "looking primarily to clarity." The sections on manipulation were refined in subsequent versions of the bill to reflect these suggestions.

The most consistent criticism directed against either section 8 or 9 was that section 8 treated misrepresentations too broadly and imposed too great a penalty. Put simply, anyone making a false statement of a
material fact about an exchange-registered security, with reason to believe he might induce trading, violated section 8(a)(5) of the bill unless he acted in good faith and, in the exercise of reasonable care, had no basis for believing his statement was false. Several witnesses at the hearings said that if a violation of section 8(a)(5) was to be criminal, the section should not reach negligent misrepresentation. The explicit private right of action conferred by section 8, however, generated more concern. Witnesses warned that careful men faced with such far-reaching liability would simply refuse to talk about securities, let alone give advice.

Other parts of section 8(a) that forbade the dissemination of information were not criticized, in fact, their scope broadened in subsequent versions of the bill. Section 8(a)(4) of the bill forbade dealers, brokers, and exchange members from disseminating information that security prices were about to change because of market activity if they believed they might thereby induce trading. Section 8(a)(6) made it unlawful to pay any third party to disseminate such information. These provisions made it illegal to disseminate true reports of market operations. The problem was not that these reports misled investors about particular facts, but, as Corcoran explained, that operators used them to excite the markets in order to exploit investors.

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232. Fletcher-Rayburn, supra note 20, § 8(b)-(e); see note 204 supra and accompanying text.


234. Whitney said that these provisions merely codified existing New York Stock Exchange rules. House Hearings, supra note 20, at 204-05. But see id. at 303 (questioning the effect of the rules on broker-customer communications).

235. See notes 262-263 & 270-272 infra and accompanying texts.

236. House Hearings, supra note 20, at 111-12 (testimony of Corcoran) ("Paragraph (4)—That relates to tipping . . . . Tipping pools, as for instance, a broker tipping that there is or may be a pool operating. It is one of the factors in the success of pools . . . . [D]uring the boom times, there was a great deal of tipping by brokers—that there was a pool operating in connection with a particular stock that the customer had better get in."); see also note 123 supra. The drafters' intention to reach even true statements is evidenced by their concern that brokers who knew of pending market operations would be in a bind: forbidden on the one hand to tell their customers about pending operations and liable on the other for misrepresentations if they made any recommendation without also disclosing what they knew of the operations. See Comment on 7820, at 3-5 (Mar. 8, 1934) (typed with handwritten changes, indexed by Landis as "Draft # 2 for Memorandum, by I.N.P. Stokes, 2nd") (on file with the Stanford Law Review) (copy in 2 DOCUMENTARY HISTORY COLLECTION, supra note 28, item 21) (copy of an earlier draft with handwritten comments on file with the Stanford Law Review and in a collection of documents at the SEC Library, 1 Securities Exchange Act of 1934, 73d Cong.,
Section 8(a)(9)’s flat prohibition of options-related transactions was clearly overbroad. The bill’s proponents did not charge that options were misleading or even susceptible to use as a misleading device. The bill prohibited options trading simply to attack a practice the drafters thought indispensable to pool operators, who used options to take positions in securities at relatively little cost. Several witnesses insisted that, despite the abuse by pool operators, options were not inherently evil. Citing a variety of legitimate roles for options, some recommended that Congress simply delegate regulatory authority over options to an administrative agency, rather than impose an inflexible ban.

In the hearings, critics noted a number of potentially harmful, presumably unintended consequences of other provisions of sections 8 and 9. Section 8(a)(7), for instance, made it illegal to engage in a series of transactions with the purpose or effect of pegging, fixing, or stabilizing the price of a security without first reporting to the exchange and to the FTC whatever information FTC rules required regarding the transactions. Some witnesses were concerned that this might reach arbitrage between an exchange and another market, which may have the effect of bringing together prices across different markets, as well as

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237. Section 8(a)(9) made it illegal to use any exchange facility to trade either an option or any security on which the trader had an option. It forbade a broker to trade a security for a person he had reason to believe had an interest in an option, and prohibited exchange members from owning or guaranteeing any option on an exchange-registered security.

238. House Hearings, supra note 20, at 6, 114 (testimony of Thomas Corcoran), 207 (testimony of Richard Whitney); Stock Exchange Practices, supra note 104, at 6515-17; S. REP. No. 792, supra note 20, at 9.

239. House Hearings, supra note 20, at 457-61 (publicly traded options), 477-78, 485 (employee options), 304, 483, 495, 507, 595 (warrants), 304, 507, 595 (convertible bonds), 646 (acquisition of firm); Stock Exchange Practices, supra note 104, at 7062, 7168 (option to acquire a corporation), 6953; see also Christie, supra note 231, at 8 (warrants and convertibles); Investment House Group, supra note 28, app. at 7-8 (subscription rights); Press Release of Richard Whitney, supra note 28, at 5 (such a harsh rule will destroy the odd-lot business).


any short-swing, in-and-out trading practices. One witness complained that any large transaction might by definition have the forbidden effect of pegging a security's price and suggested limiting the reach of the section to the transactions motivated by a purpose to stabilize prices. Others considered unworkable, and unwise, the requirement that the FTC be notified of all stabilizing transactions before they were executed.

There was also some criticism of the language of section 9. Most frequently, critics expressed concern that the section made short sales and stop-loss orders illegal in the absence of FTC rules permitting them. Some witnesses mentioned the broad language of section 9(c). Whitney, for example, called it "a surprising delegation of power, particularly as any violation of the rules or regulations of the Commission would be a criminal act ...." Even though the delegation of authority in section 9(c) was not yet limited by the "manipulative or deceptive" standard eventually added, it drew very little comment, and that generally mild.

One might argue that this lack of criticism demonstrates that no one thought section 9(c) had a very broad scope. Given the plain lan-

242. House Hearings, supra note 20, at 204.
243. Stock Exchange Practices, supra note 104, at 7167-68 (testimony of A. Sewall on behalf of Pennsylvania businessmen) (Sewall's remarks were made a part of the record of the House committee. House Hearings, supra note 20, at 645-46); cf. Stock Exchange Practices, supra note 104, at 6616 (bargain hunters driving up price by their purchases); Investment House Group, supra note 28, at 7.
246. House Hearings, supra note 20, at 209; see also id. at 258 (Eugene E. Thompson), 305 (Frank R. Hope) ("the section .... might be construed to mean almost anything"); Stock Exchange Practices, supra note 104, at 6910 (repetition of testimony of Frank R. Hope in House Hearings), 6938 (testimony of Alfred L. Bernheim, director of the Securities Market Survey of the Twentieth Century Fund); Investment House Group, supra note 28, at 9 ("[t]his seems to be a power unlimited in scope"). There was also blanket criticism of the unprecedented delegation of authority in the Act. House Hearings, supra note 20, at 485 (John Hancock).
247. For example, the first circular on Fletcher-Rayburn that Whitney sent to the members of the New York Stock Exchange, Circular letter, supra note 245, did not mention the delegation of power in § 9(c), even though the letter was a section-by-section indictment of the bill.
248. The Supreme Court suggested this in Ernst & Ernst v. Hochfelder when it discounted criticism of the provision's breadth. 425 U.S. 185 (1976). "Remarks of this kind made in the course of legislative debate or hearings other than by persons responsible for the preparation
guage of the section however, such an argument comes down to the unlikely assertion that the critics of Fletcher-Rayburn missed section 9(c). Again, a better explanation of the failure of witnesses to comment on section 9(c) is that both the stock exchanges and their critics wanted Congress to delegate broad rulemaking power.\footnote{249}

The dearth of criticism of section 10(b) and its predecessor section is interesting, but not surprising given the circumstances in which the Exchange Act was considered. Many securities industry witnesses were particularly critical of rigid statutory regulation.\footnote{250} At the time, business leaders generally favored cooperation between industry and government;\footnote{251} many witnesses supported Whitney's proposal to substitute "plenary" power for the more inflexible Fletcher-Rayburn proposal.\footnote{252} They could hardly challenge the scope of the power which

or the drafting of a bill are entitled to little weight. . . . This is especially so with regard to the statements of legislative opponents who '[i]n their zeal to defeat a bill . . . understandably tend to overstate its reach.'" \cite{Id. at 203 n.24 (1976) (quoting NLRB v. Fruit & Vegetable Packers, 377 U.S. 58, 66 (1964)) (citations omitted).}

\footnote{249. Proponents of the bill emphasized the flexibility it gave administrators to try new approaches reflecting regulatory experience. James Landis was the first witness to testify for Fletcher-Rayburn before the House Commerce Committee. \textit{House Hearings, supra note 20, at 15.} Landis did not address fundamental questions such as the need for legislation regulating the stock exchanges, which he felt the Pecora hearings had already demonstrated, \textit{id.}, nor did he explain specific provisions of the bill. Instead, he focused on the constitutional basis for federal control, defending the delegation of decisions on the implementation of regulation to bureaucrats. I think it is the general viewpoint of nearly all persons that have dealt with stock market regulation that two aims are desirable: One is flexibility of administration. The problem is very complex, very delicate, very technical. Moreover, our knowledge about many of these things is quite inadequate . . . . The second thing, and I think that every one is agreed about this, is that that being so, what is needed is to intrust [sic] the administration of an act of this type to the best possible administrative agency . . . . \textit{Id.} at 20. Landis cited the Dickinson Committee's report as support for delegation, \textit{id.} at 23-27, specifically referring to the treatment of short-selling in § 9 of the bill. Thus, for example, short sales were subjected to regulation rather than prohibited, even though "the bill proceeds upon the theory of regarding short selling, generally, as a device capable of manipulating prices . . . ." \textit{Id.} at 26.}

\footnote{250. \textit{House Hearings, supra note 20, at 399-402 (Dean Witter), 440 (H.I. Harriman, President, U.S. Chamber of Commerce) ("infinitely better to leave to the commission wide discretionary powers along very definite lines"), 452 (G. Herman Kinnicutt), 480-81 (John M. Hancock on margins), 508 (Dickinson); see also Standard Statistics Company, Inc., \textit{supra} note 231, at 13 ("extremely difficult" to distinguish between unethical and honest trading techniques by statute). But see \textit{House Hearings, supra} note 20, at 481, 486 (John Hancock) (calling for statutory prohibitions of specific conduct, and further study).}

\footnote{251. \textit{See text accompanying notes 159-162 supra.}}

\footnote{252. \textit{House Hearings, supra} note 20, at 309-10 (Frank R. Hope), 532 (Frederick H. Johnson); see also notes 283-286 infra and accompanying text; \textit{cf. House Hearings, supra} note 20, at 350 (Michael O'Brien) (flexibility), 451-55 (G. Herman Kinnicutt) (the Securities Act and exchange control should fall under the same specialized agency), 510-11 (John Dickinson) (flexible regulation of margin trading); \textit{New Path Charted on Exchange Bill, N.Y. Times, Apr. 13, 1934, at 1, 4 col. 3 (New York Board of Trade opposes strict rules which would impair liquidity); Press Release, N.Y. Board of Trade (Apr. 12, 1934) announcing Board's unanimous resolution proposing a Stock Exchange Coordinating Authority with "plenary powers with respect to all necessary rules and regulations that will prevent fraudulent practices, the use of exces-
Fletcher-Raburn delegated to administrators, as Rayburn forcefully pointed out to those who did.\textsuperscript{253}

B. Modification in the House—Manipulation

Proponents of stock-exchange legislation divided over how to respond to the attack on Fletcher-Rayburn, but Rayburn responded by having the bill revised. In an attempt to appease opponents and build a coalition for some form of federal control, he brought representatives of affected interests into the revision process.\textsuperscript{254} The Exchange Act was actually the product of negotiations among many competent and interested actors. Fortunately, there is a record of its consideration, amendment, and perfection. One might argue that this record was never made known to legislators in a fashion that permitted Congress to ratify it. Nevertheless, the very fact that it was not created for public consumption and that it contains honest, frank, and subtle discussions of legislative goals and negotiated tradeoffs may be its greatest strength as evidence of what Congress intended. Rather than serving as a repository for provisions that legislators and staff members could not get enacted, the record is an account of the process by which extraordinary people constructed the Exchange Act.\textsuperscript{255}

On March 19, Rayburn introduced a revised proposal that retreated

\textsuperscript{253} House Hearings, supra note 20, at 309-12 (Frank Hope, President of the Association of Stock Exchange Firms), 394-95 (William Lockwood, counsel to New York Curb Exchange); see also H.R. Rep. No. 1383, supra note 28, at 6 ("Representatives of the stock exchanges constantly urged a greater degree of flexibility in the statute and insisted that the complicated nature of the problems justified leaving much greater latitude of discretion with the administrative agencies than would otherwise be the case. It is for that reason that the bill in dealing with a number of difficult problems singles out these problems . . . but leaves to the administrative agencies the determination of the most appropriate form of rule . . . ."); see note 332 infra and accompanying text.

\textsuperscript{254} M. Parrish, supra note 28, at 124-29; J. Seligman, supra note 28, at 93-95; D.S. Levin, supra note 39, at 375-84; see also House Hearings, supra note 20, at 625 (opening statement by Rayburn), 674 (Corcoran testimony); J. Brooks, supra note 95, at 201-02; D. Hardeman & D. Bacon, supra note 129, at 157; Alfred Steinberg, Sam Rayburn 117 (1975); cf. T. McCraw, supra note 97, at 178 (drafters repeatedly consulted financiers, brokers, and accountants during debate over Exchange Act); L.N.P. Stokes's master draft of comments on Fletcher-Rayburn (on file with the Stanford Law Review) (copy in 4 DOCUMENTARY HISTORY COLLECTION, supra note 28, item 2) (annotated to show criticism). During the subsequent floor debate, members of the Commerce Committee emphasized that they had carefully revised the bill to respond to criticism. See 78 Cong. Rec. 7866 (statement of Rep. Maloney), 7921 (statement of Rep. Mapes), 7935 (statement of Rep. Bulwinkle), 7938 (statement of Rep. Milligan) (1934).

\textsuperscript{255} Those most responsible for drafting the Exchange Act became renowned for their ability to forge political coalitions and enact legislation. As one of the most influential American statesmen ever, Rayburn's greatest skill was getting legislation through Congress. "The avoidance of open controversy [was] his genius." Neil MacNeil, Forge of Democracy 108 (1963) (quoting Rep. Lee Metcalf). Rayburn often advised new members of Congress to go along if they wanted to get along. See Anthony Champagne, Congressman Sam Rayburn 161 (1984); N. MacNeil, supra 107-08, 129; Walter J. Oleszek, Congressional Procedures and
from most of the original bill’s controversial provisions. President Roosevelt endorsed the revision one week later, decrying the intense campaign against stock-market legislation and reiterating his insistence on laws that would not only effectively curtail speculation and manipulation, but would also give federal authorities “such definite powers of supervision over exchanges that the Government itself will be able to correct abuses which may arise in the future.”

Rayburn’s new bill modified the margin and credit regulations and allowed some exchange members to continue as both brokers and dealers. The bill also loosened the restrictions on insider trading, most importantly by omitting the Fletcher-Rayburn proscription against disclosing confidential information.

The revisions affected language in sections 8 and 9, but without altering their basic thrust. Whereas each part of sections 8 and 9 in the original bill applied only to acts or transactions relating to exchange-registered securities, the revised sections reached securities “not so registered” as well. Apparently, this change was intended to


Corcoran and Cohen were adept at drafting legislation that would bring together and wed diverse constituencies. Their joint biographer concluded that they were both influential participants in the New Deal precisely because they responded positively to criticism and formulated compromise proposals that could progress through Congress. J. LASH, supra note 89, at vii (Corcoran and Cohen had a remarkable “sixth-sense feeling for the programs that were politically feasible not simply ideally desirable.”); see also id. at 166-67; Thomas Corcoran, Dictated Notes for Autobiography 3-4 (Nov. 26, 1979), supra note 173 (Corcoran and Cohen redrafted the bill overnight after Roosevelt insisted they work out problems with conservative Senators, influential critics within the administration, and the Federal Reserve Board). Rayburn later said of them: “Taken together these two fellows made the brightest man I ever saw. They never insisted on their views. When I told them what I wanted, they started to work to put it into the legislation, and they wrote it in such a way as to make it stick.” A. STEINBERG, supra note 254, at 113.

256. H.R. 8720, 73d Cong., 2d Sess., reprinted in House Hearings, supra note 20, at 625, and in 10 LEGISLATIVE HISTORY, supra note 20, Item 28.


258. Letter from President Roosevelt to Representative Rayburn (Mar. 26, 1934), reprinted in H.R. REP. No. 1383, supra note 28, at 2; Letter from President Roosevelt to Senator Fletcher, supra note 257. Both letters contain this quotation.

259. H.R. 8720, supra note 256, §§ 6, 7, 10. The bill did, however, direct the FTC to study the feasibility and desirability of complete segregation. Id. § 10(f).

260. Officers, directors and 5% shareholders were no longer forbidden to buy with a view to selling within six months, but any profit from such a purchase and sale would inure to the issuer. Compare id. § 15(b) with Fletcher-Rayburn, supra note 20, § 15(b). The proscription on sales against the box, see note 191 supra, was rewritten to extend the time allowed for delivery to 20 days. H.R. 8720, supra note 256, § 15(c).

261. According to Parrish, “[t]he sections on manipulative devices . . . underwent no substantive revision.” M. PARRISH, supra note 28, at 128. Seligman does not even mention §§ 8 and 9 in discussing the rewrite of Fletcher-Rayburn. J. SELIGMAN, supra note 28, at 97-100 (discussion of Fletcher-Rayburn rewrite). Levin’s exhaustive account of the modification does not the changes in § 8. D.S. LEVIN, supra note 39, at 381-83. Whitney did not discuss the manipulation sections in any detail when he testified in opposition to the revised bill. House Hearings, supra note 20, at 723-36, 729.

262. H.R. 8720, supra note 256, § 8(a)(1)-(8), (e). The regulation of options affected
extend the reach of the provisions to all non-exempt securities, even though the bill gave the FTC ample power to regulate the over-the-counter market.263 In general, the FTC was given discretion to define the effective scope of several section 8 restrictions that had, in their original form, simply outlawed manipulative practices. Specifically, the revised bill made it unlawful to peg, fix, or stabilize the price of securities in contravention of FTC rules,264 and regulated, rather than proscribed, option trading.265

Portions of the revised section 8(a) included the element of purpose,266 responding to the concern that Fletcher-Rayburn imposed mandatory sanctions against wholly innocent conduct without giving market participants adequate guidance as to what was forbidden.267 For example, the first bill reached persons who disseminated false statements with “reason to believe” they might thereby induce trading, but the revision reached only those misrepresentations made for the

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263. The revised bill still provided for extensive regulation of the over-the-counter market. Compare Fletcher-Rayburn, supra note 20, § 14, with H.R. 8720, supra note 256, § 14.

In his Senate testimony, Roland Redmond, counsel for the New York Stock Exchange, had questioned whether there was any reason to restrict § 8 of Fletcher-Rayburn to exchange-registered securities. Stock Exchange Practices, supra note 104, at 6506-07, 6511. I.N.P. Stokes made the same point even before Fletcher-Rayburn was introduced. Draft by Benjamin V. Cohen, supra note 205. Cohen’s Mar. 4 draft revision of Fletcher-Rayburn, which predated eight days of conferences which hammered out the revisions backed by Rayburn, see note 256 supra, had already extended several provisions of §§ 8(a) and 9(c) to include variations of the “not so registered” language that Rayburn included in the revised package. BVC’s Revision of Bill, Mar. 4, 1934, at 13-19 (on file with the Stanford Law Review) (copy in 2 DOCUMENTARY HISTORY COLLECTION, supra note 28, item 19). A memorandum entitled “Principal Changes in New Draft of March 4, 1934” attached to Cohen’s Mar. 4 revision in the Documentary History Collection notes that in several parts of § 8(a) the “[p]rohibition of manipulation [was] extended to unregistered securities.” Id.

264. Fletcher-Rayburn had authorized the FTC to require disclosures of stock price stabilizing operations. Fletcher-Rayburn, supra note 20, § 8(a)(7). The bill had also reached transactions with the “purpose or effect” of stabilizing price. The revised bill only reached transactions undertaken for the purpose of stabilizing stock prices. H.R. 8720, supra note 256, § 8(a)(8); see also note 266 infra.

265. Compare H.R. 8720, supra note 256, § 8(a)(9) with Fletcher-Rayburn, supra note 20, § 8(a)(9). Rayburn also deleted the prohibition of cornering the market in a security “for the purpose of causing the price of such security to rise on the exchange . . . .” See Fletcher-Rayburn, supra note 20, § 8(a)(8).

266. H.R. 8720, supra note 256, § 8(a)(2) (prohibition of matched orders “for the purpose of creating a false or misleading appearance of active trading . . . . or . . . . in respect of the market for such security”); § 8(b) (private remedy for willful violation of § 8(a)).

Only false statements made for the purpose of inducing trading violated § 8(a)(5) of H.R. 8720; under H.R. 7852 it was enough that the speaker had reason to believe his statements would induce trading. But see H.R. 8720, supra note 256, § 8(b) (party not liable in private action if he “did not believe that the statement was false or misleading”). Section 8(a)(8), the stabilization section of H.R. 8720, reached only transactions executed for the purpose of stabilizing prices, while H.R. 7852 had reached any transaction that had a stabilizing effect. See notes 241-244 supra and accompanying text.

267. See, e.g., House Hearings, supra note 20, at 256-58, 485-86; Stock Exchange Practices, supra note 104, at 6508-10; notes 229-244 supra and accompanying text.
purpose of inducing trading.\textsuperscript{268} The revision also dropped the ban on trading for the purpose, or with the expectation, of creating a misleading appearance of the market, although it still outlawed trading for the purpose of influencing price.\textsuperscript{269}

The revised bill’s sections regulating true statements reflected the same overarching concern with whether statements induced trading—as opposed to whether they were honest.\textsuperscript{270} The changes brought more people and situations within the prohibitions of the dissemination of certain kinds of accurate information, and, at the same time, narrowed the scope of the false-statement provision. For example, the revision made it illegal to receive payment for circulating information which tended to suggest that any security’s price was likely to change in response to market activity,\textsuperscript{271} or to circulate or disseminate information about a security in exchange for consideration from a buyer or seller of the security, unless the information was published as an advertisement.\textsuperscript{272}

Although it probably did not seem so at the time, the most significant Rayburn revision in the manipulation provisions was the addition of the word “manipulative” to section 9(c):

> It shall be unlawful for any person . . . [t]o use or employ in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered any manipulative device or contrivance which the Commission may by its rules and regulations find detrimental to the public interest or to the proper protection of investors.\textsuperscript{273}

This was the first time the word “manipulative” appeared in a substantive provision of the bill.\textsuperscript{274} The record of the House committee’s

\textsuperscript{268} H.R. 8720, supra note 256, § 8(a)(5).

In addition to requiring purpose for false statements to be illegal, the new bill changed the good faith defense. Fletcher-Rayburn had forbidden the dissemination of false or misleading information if, among other things, the person “does not prove that he acted in good faith and in the exercise of reasonable care had no ground to believe that the statement was false or misleading.” Fletcher-Rayburn, supra note 20, § 8(a)(5). The revision deleted the reasonable care requirement from the good faith defense, but moved the defense from the prohibition subsection to the private action subsection, suggesting there would be no good faith defense to a criminal charge. Compare id. with H.R. 8720, supra note 256, § 8(a)(5), (b); cf. H.R. 8720, supra note 256, § 8(c) (right of contribution except in certain cases of fraudulent misrepresentation), § 25 (penalties including fine and imprisonment for willful violations of the statute or making false statements “subject to the provisions of section 8(a)(5)”). The measure of damages in private actions was changed from one based on changes in securities prices to actual damages, which the bill did not define. Id. § 8(b).

\textsuperscript{269} H.R. 8720, supra note 256, § 8(a)(3).

\textsuperscript{270} Id. § 8(a)(4), (6).

\textsuperscript{271} Id. § 8(a)(6). Fletcher-Rayburn only proscribed making the payment, not receiving it or acting in consideration of it. Fletcher-Rayburn, supra note 20, § 8(a)(6).

\textsuperscript{272} H.R. 8720, supra note 256, § 8(a)(7).

\textsuperscript{273} Id. § 9(c).

\textsuperscript{274} Fletcher-Rayburn § 2 noted the problem of price manipulation, and the titles of
deliberations on Rayburn's revision does not explain this change.\textsuperscript{275} It seems fair to conclude that the word was simply intended to make it clear that the delegation of authority was not, in fact, absolute.\textsuperscript{276} Rather than extensively delimit FTC authority in section 9(c), the Rayburn revision adopted the word "manipulative" to define the FTC's power by reference, either to the rest of the bill or to section 8 and the rest of section 9.\textsuperscript{277} The revision employed this technique of defining §§ 8 and 9, the precursors to §§ 9 and 10, respectively, included the words "manipulation" and "manipulative."

Other proposals explicitly purported to regulate manipulation. For example, Representative Bulwinkle and Senator Gore introduced bills to create a new stock exchange commission that would grant an exchange license to operate only if, among other things, its rules "reasonably guard against undue speculative activity and unwarranted manipulative practices." H.R. 8575, 73d Cong., 2d Sess. § 3(b) (1934), \textit{reprinted in 10 Legislative History, supra note 20, item 27; S. 3234, 73d Cong., 2d Sess. § 3(b) (1934), \textit{reprinted in 11 Legislative History, supra note 20, item 35. This language suggests that the sponsors did not think that all manipulative practices were unwarranted. See also note 142 supra (interagency committee bill that defined manipulation in terms of deception).

\textsuperscript{275} A mimeographed statement outlining the principal changes was distributed to members of the House Committee on Mar. 19, but it is not included in the record. \textit{See House Hearings, supra note 20, at 674. An undated mimeographed memorandum entitled "Principal Changes Embodied in New Draft for National Securities Exchange Act of 1934" (on file with the \textit{Stanford Law Review}) (copies in 3 \textit{Documentary History Collection, supra note 28, item 13 and in Library of Congress, Thomas G. Corcoran Papers, box 266, Exchange Act Drafts file) may well be the statement distributed to the committee. Landis indexed the memorandum as "Principal Changes Embodied in New Draft of Bill—as introduced Second Time." The memorandum describes many of the provisions of H.R. 8720 that differ from those of Fletcher-Rayburn.

The memorandum describes several changes made in § 8 and goes on to say "[t]he Commission's power under section 9 to prohibit 'any device or contrivance' which it may deem detrimental to the public interest is confined to 'any manipulative device or contrivance.'" A document entitled "Stock Exchange Bill" is appended to the copy of the memorandum in the Documentary History Collection. Senator Fletcher submitted this digest when he introduced Fletcher-Rayburn. 78 CONG. REC. 2264, 2271 (1934) ("The Commission is also given power to forbid any other devices in connection with security transactions which it finds detrimental to the public interest or to the proper protection of investors.").

\textsuperscript{276} Benjamin Cohen had drafted the revised version of § 9(c) by March 4. BVC's Revision of Bill, supra note 263, at 19. The memorandum entitled "Principal Changes in New Draft of March 4, 1934," supra note 263, does not mention this change. In their congressional testimony, Landis and Corcoran had discussed § 9(c) of Fletcher-Rayburn as though it included the word "manipulative," describing the language as a catch-all for "other manipulative devices." See note 212 supra and accompanying text.

An untitled memorandum in Thomas Corcoran's papers, which appears to be a discussion of Corcoran's response to criticism of Fletcher-Rayburn, says of § 9(c):

The stock exchange mechanism is so complicated and the variety of possible transactions so manifold that it would be idle to expect any detailed prohibitions to include all abuses which may be developed. Some power must be given the Commission to regulate or prohibit practices at present not in evidence which may be resort to to defeat the manifest purposes of this legislation. This is the purpose of subsection (c). If the Committee fears that the language used goes beyond this end, it may wish to consider appropriate modification.


\textsuperscript{277} A memorandum dated Mar. 8, 1934, entitled "Suggested Amendments to Stock Exchange Bill," which Landis indexed as "1934, March 8—Draft # 1 for Memorandum, by I.N.P. Stokes, 2nd," suggested adding the following language to the end of Fletcher-Rayburn § 9(c): "and tending to defeat the purpose of any provision of this Act or any rule or regulation thereunder." The memorandum explained that "[t]he limitation suggested seems harm-
the boundaries of the FTC's rulemaking power by reference in an enormously important provision that authorized the FTC to regulate the over-the-counter market.278

If, by "manipulative" devices and contrivances, Rayburn meant the speculative excesses revealed in the Pecora investigation or practices like those listed in sections of Fletcher-Rayburn labeled manipulation provisions—matched trades, false statements, communications about pools, tactics to corner the market, option trading, stabilizing transactions, short selling and stop-loss orders—the term had hardly any meaning.279 Sections 8 and 9 of Fletcher-Rayburn, and the successors of these sections incorporated in the Act, gather together a wide variety of practices with nothing more in common than a possible influence on security prices. So defined, the word "manipulative" would encompass a great deal of innocent conduct.

One change that Rayburn did not make to section 9(c) is more instructive than any that he did make. The most settled tenet of modern-day Supreme Court interpretation of section 10(b) is that Congress intended to proscribe only knowing and intentional misconduct. It is clearly significant that Rayburn added purpose requirements to most of the provisions of section 8,280 but not to section 9. In fact, no one ever even suggested such a change to section 9. This open-ended section was intended to authorize administrators to prohibit stock market practices, regardless of the motives of those who employed them, which were found detrimental to the public interest or the proper protection of investors.281

The House hearings on Rayburn's revision focused primarily on the credit provisions; there was almost no discussion of sections 8 and 9, or the changes therein.282 Whitney, who was by this time speaking for most of the exchanges,283 expressed general opposition to Rayburn's revision.284

less and will silence considerable criticism. It may well be argued that if the present wording stands all the other provisions of the Act regarding stock exchange practices are superfluous."

Suggested Amendments at 10 (on file with the Stanford Law Review) (copies in 2 DOCUMENTARY HISTORY COLLECTION, supra note 28, item 20, and in Library of Congress, James Landis Papers, box 149, and in 1 SEC LEGISLATIVE HISTORY, supra note 236, item 23). On Mar. 9, Senator Fletcher forwarded Landis a memorandum stating that § 9(c) "can mean almost anything." The portion of the memorandum copy included in 8 DOCUMENTARY HISTORY COLLECTION, supra note 28, item 34) (on file with the Stanford Law Review) does not identify the author.

278. The almost limitless delegation in Fletcher-Rayburn was rewritten to authorize the FTC to proscribe rules appropriate to give over-the-counter investors protection comparable to that provided to exchange investors. H.R. 8720, supra note 256, § 14; see D.S. LEVÍN, supra note 39, at 383.
279. See notes 33-36 supra and accompanying text.
280. See notes 266-269 supra and accompanying text.
281. Short selling is probably the best example of a device many thought dangerous regardless of motive.
282. But see House Hearings, supra note 20, at 749 (discussion of § 8(a)(2), (5), (8), (9)), 885-86, 915 (discussion of § 8(a)(9)).
283. Id. at 729-30.
284. Id. at 723-24.
Instead of having a fixed rule of law which can only be changed by an act of Congress, and cannot be changed if Congress is not in session—instead of having a fixed rule of law, we advocate the power being put in a commission to make these rules and regulations, which, if they are wrong, they can immediately change. If they are right, then these rules and regulations will stay in effect.

To this end, Whitney again proposed replacing the pending legislation with a measure giving administrators "full power to prevent excessive speculation and to regulate unfair practices in security transactions."

Without backing away from his basic objection that direct statutory control was a fundamentally flawed approach, Whitney suggested specific amendments. Among other things, he would have empowered regulators to require the exchanges to adopt and enforce rules necessary for the protection of investors or for insuring fair dealing, which would expressly include rules with regard to pools formed for the purpose of influencing security prices, short sales, stop-loss orders, and the cash settlement of transactions tending to corner the market in any security. Whitney felt that with these changes, section 9 could be eliminated. He also suggested, without elaboration, that several other provisions should be "amended or qualified. This is true of section 8, which describes manipulative transactions in very broad terms . . . ."

Lothrop Withington, a lawyer representing the Boston and Chicago Stock Exchanges, followed Whitney and testified in favor of flexible regulation. According to Withington, his clients were concerned that there was "a general misapprehension with regard to the real and sincere desire of exchanges for regulation. I have yet to find any exchange that has not only reached the conclusion that they are going to be regulated, but welcomes regulation . . . ." Withington agreed that legislation should ban practices considered morally wrong by all, citing section 8 of the bill as appropriate government action, although he believed it was worded so generally that "no jury, as a practical matter,

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285. Id. at 726.
286. The New York Stock Exchange and, I am sure, every other exchange in the country, stand ready to furnish your committee with all the technical and expert advice at their command and to assist in drafting amendments to the pending bill or in drafting a new bill, which will give whatever administrative authority may be chosen, full power to prevent excessive speculation and to regulate unfair practices in security transactions.
287. Id. at 725-27 (testimony of Lothrop Withington, counsel for committee of New England brokers and dealers); see also id. at 739-40 (Chicago and Boston exchanges in accord), 801-02 (testimony of R. Cassatt, representing Philadelphia investment bankers) (federal reserve banks should have absolute control over stock market credit), 881 (Investment House Group in accord). But see id. at 741-42 (testimony of Whitney) (Congress should make some manipulative practices criminal and should subject others to commission rulemaking, with sanctions limited to exchange or Commission action).
288. Id. at 728.
289. Id. at 729.
290. Id. at 736.
would convict." His chief concern was that in several respects the pending legislation mistakenly adopted inflexible restrictions on legitimate business practices. Toward the end of improving the bill, Withington proposed vesting "the entire credit control with regard to the margins . . . in the Federal Reserve Board. . . . Putting that check in the Federal Reserve, giving them that uncontrolled check, is a tremendous concession . . . ." As for segregation, the FTC "should be given full arbitrary and uncontrolled power to make rules which would control those exchanges . . . ."

C. Modification in the Senate—Deception

Senator Fletcher's Committee also reviewed Rayburn's March revision, even though it was never introduced in the Senate. Whitney, the day after his House testimony, testified against the Rayburn revision before the Senate Committee. He repeated his opposition to the

291. Id. at 741.
292. Id. at 739.
293. Id. at 740. When asked why the exchanges had not prepared an alternative bill if they recognized the necessity for regulation, Withington assured the committee that he had, in fact, put together an outline in cooperation with representatives of other exchanges. Id. at 745; see Withington, Memorandum Concerning Proposed Stock Exchange Legislation (on file with the Stanford Law Review) (copy in 8 DOCUMENTARY HISTORY COLLECTION, supra note 28, item 30). Withington subsequently submitted a substitute bill to the Senate. Stock Exchange Practices, supra note 104, at 7751 (the table of contents identifies the proposal as "Copy of Whitney substitute stock exchange bill, draft no. 6," id. at unnumbered page facing 7411, but it is, in fact, Withington's bill); see Draft Bill for Regulation of National Stock Exchanges Presented by Lothrop Withington (on file with the Stanford Law Review) (copies in Library of Congress, Thomas G. Corcoran Papers, box 266, Exchange Act Drafts file, and in New York Stock Exchange Archives).

Withington's substitute bill, reviewed by representatives of almost all the stock exchanges, prohibited "unfair practices" generally, Stock Exchange Practices, supra note 104, at 7755 (§ 9, "Unfair Practices Unlawful; Powers of Commission"), and several specific deceptive practices, id. at 7753 (§ 3, "Manipulative Practices Prohibited"), but otherwise left exchange practices under the control of administrative agencies. The extension and maintenance of margin credit was subjected to "such rules as may be established from time to time by the Federal Reserve Board for the purpose of preventing the excessive use of credit for speculation." Id. at 7754 (§ 4, "Regulation of Margin Requirements"). Exchanges were required to be licensed by a new Federal Stock Exchange Commission, with licensing conditioned upon having rules "adequate to prevent unfair practices in security transactions and to protect investors . . . ." Id. at 7755 (§ 6(b), "Licensing of National Stock Exchanges"). For the purpose of preventing unfair practices, the Commission could require exchanges to adopt such rules as deemed necessary for the protection of investors. Id. at 7755 (§§ 9, 11, "Orders of Commission"); cf. id. at 7756 (§ 14, "Court Review of Orders") (orders of the Commission reviewable by the Circuit Court of Appeals of the United States or the Court of Appeals of the District of Columbia).

294. See Stock Exchange Practices, supra note 104, at 7414, 7538; see also Senate Comm. on Banking and Currency, 73d Cong., 2d Sess., Confidential Comm. Print No. 2 Showing Changes to the Text of H.R. 8720 Agreed to by the Senate Committee on Banking and Currency and Proposed Changes Recommended by the Subcommittee (Confidential Comm. Print 1934) (on file with the Stanford Law Review) (copy in 5 DOCUMENTARY HISTORY COLLECTION, supra note 28, item 6); 78 Cong. Rec. 8163-64 (1934). In Ernst & Ernst v. Hochfelder, the Supreme Court said that H.R. 8720 was introduced in the Senate and the House. 425 U.S. 185, 201-02 (1976); see also 5 A. Jacobs, supra note 8, § 5.01 at 1-175 n.6.
revision and suggested several amendments.295 A few days later, Roland Redmond, counsel to the New York Stock Exchange, explained most of the Exchange-sponsored amendments, including several to section 8 that Whitney had not mentioned in his testimony.296 Redmond said that the Exchange would favor giving administrators the rulemaking power conferred by subdivisions (a) and (b) of section 9 of the Rayburn revision—the stop-loss and short sale provisions that eventually became section 10(a) of the Act—but that the Exchange would omit section 9(c), which Redmond called "a general grant of power to the [FTC] to define as a crime any practice which they thought was manipulative, [which] seemed to us to be an altogether too broad grant of power to any administrative body."297

On April 20, Senator Fletcher introduced his Committee's own bill.298 The most important development in Fletcher's substitute was the creation of a Federal Securities Exchange Commission to administer the Act.299 The change was made to keep the Federal Reserve Board and the FTC out of the regulation of stock market credit.300 It was also something of a victory for the securities industry, which had pressed for a new agency from the start.

The Senate revision also modified the manipulation sections of

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295. Stock Exchange Practices, supra note 104, at 7479-90; see also id. at 7527 (Eugene E. Thompson, President of the Associated Stock Exchanges, on H.R. 8720). The New York Stock Exchange submitted two memoranda of proposed amendments to H.R. 8720. Id. at 7488, 7517-22, 7533, 7579-85.

296. Id. at 7539-86. Redmond would have rewritten § 8 to limit it almost exclusively to deceptive practices. Among other changes to § 8, he proposed limiting clause 3, the forerunner of § 9(a)(2) of the Act, to trading undertaken for the purpose of creating a misleading appearance of volume or "establishing price quotations . . . which do not truly reflect the market value of such security," and limiting the tipster sheet provisions, the forerunners of §§ 9(a)(3) and (5), to speech intended to induce trading at prices not reflecting actual market value. Id. at 7559-60, 7580. Specifically, the Exchange would have replaced the 4th through 7th clauses of § 8(a) of H.R. 8720 with two clauses directed at deceptive practices. The first would have made it unlawful to disseminate false information with the intent to deceive and to induce trade. The second would have made it illegal, in connection with any attempted trade, to pay or accept payment for disseminating as news or disinterested opinion information intended to induce trading at prices not truly reflecting market values. Id. at 7580.

297. Id. at 7562. Some people at the New York Stock Exchange thought § 9(c) of H.R. 8720 was too broad. See Comments On Revised Stock Exchange Regulation Bill as Published March 20, 1934, at 6 (undated, marked "Return to Library Office of the Economist") (on file with the Stanford Law Review) ("What comprises a manipulative device? . . . If they know what manipulative devices are, why not specify them? This Section, in the hands of a belligerent or hostile Commissioner, could be used to forbid anyone, or any class of persons, from buying or selling securities for whatever purpose and in any fashion, even for cash.") (copy in New York Stock Exchange Archives, Securities & Exchange Acts of 1933, 1934, SEC box).

298. S. 3420, 73d Cong., 2d Sess. § 4(a) (Apr. 17 (calendar day, Apr. 20), 1934), reprinted in 11 LEGISLATIVE HISTORY, supra note 20, item 37.

299. Id. § 4. The new Commission would have been responsible for administration of the whole Act, except regulation of the extension of securities credit by member banks by the Federal Reserve Board. Id. §§ 7(d), 8(a).

Fletcher-Rayburn, adopting several of Rayburn's proposed changes.\(^3\) Like Rayburn's revision, the Senate's bill referred to "manipulation" in its substantive provisions. One reference was in a context that demonstrates the Senate's interpretation of the term. The anti-pool section of the Senate revision, the predecessor of section 9(a)(2) of the Act, made it unlawful "[t]o manipulate . . . the price of any security registered on a national securities exchange by means of any series of transactions in such security effected with the specific intent of raising or depressing such price."\(^3\) As used here, the word "manipulate" has nothing to do with deception.\(^3\) The senators thought substantial purchases raised prices and substantial sales depressed them,\(^3\) and they thought people should not use trading to cause price changes.\(^3\) More to the point, they said that to do so was to manipulate prices.

The Senate Committee made other changes to the manipulation provisions. Those directed at particular manipulative practices were again restricted to transactions in exchange-registered securities.\(^3\)

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\(^3\) Sections 8 and 9 of Fletcher-Rayburn were renumbered §§ 9 and 10 in the Senate revision with the addition of § 4 which established the new Securities Exchange Commission.\(^3\) S. 3420, supra note 298, § 9(a)(3). Section 9(a)(2) of the Exchange Act forbids trading directed at changing price only if the purpose is to induce trading by others. S. 3420 suggests that Congress was concerned with prices themselves, distinct from a concern with inducing others to trade. See also H.R. 9325, 73d Cong., 2d Sess. § 8(a)(3) (1934) [hereinafter House bill], reprinted in 10 LEGISLATIVE HISTORY, supra note 20, item 30. The version of this section in Fletcher-Rayburn banned trading for the purpose of changing prices with the expectation of creating a false appearance in the market. Fletcher-Rayburn, supra note 20, § 8(a)(3). An earlier draft, presumably written by Cohen, made it unlawful to trade for the purpose of creating a false appearance regardless of expectation. Proposed National Securities Exchange Act of 1934 (Jan. 25, 1934), (on file with the Stanford Law Review) (copy in 1 SEC LEGISLATIVE HISTORY, supra note 236, item 6); see also MEMO RE AMENDMENTS TO DRAFT OF 4-3-34 (1st Comm. Print) (on file with the Stanford Law Review) (copy in 1 SEC LEGISLATIVE HISTORY, supra note 236, item 35). See generally Poser, supra note 36, at 703-05; Thel, supra note 36, at 411-12.

\(^3\) It also seems noteworthy that the Senate Committee followed Rayburn's revision in deleting Fletcher-Rayburn's proscription against bona fide transactions effected "with the expectation that there will be created a false or misleading appearance of active trading in such security or securities, or a false or misleading appearance in respect of the market for such security or securities . . . ." Fletcher-Rayburn, supra note 20, § 8(a)(3). An earlier draft, presumably written by Cohen, made it unlawful to trade for the purpose of creating a false appearance regardless of expectation. Proposed National Securities Exchange Act of 1934 (Jan. 25, 1934), (on file with the Stanford Law Review) (copy in 1 SEC LEGISLATIVE HISTORY, supra note 236, item 6); see also MEMO RE AMENDMENTS TO DRAFT OF 4-3-34 (1st Comm. Print) (on file with the Stanford Law Review) (copy in 1 SEC LEGISLATIVE HISTORY, supra note 236, item 35). See generally Poser, supra note 36, at 703-05; Thel, supra note 36, at 411-12.

\(^3\) The Senate revision also dropped the provision on cornering the market in a security, as had Rayburn's revision. The Senate revision did not include the Rayburn revision requirement that all paid publicity be in the form of advertisements, combined in one subsection the Rayburn revision provisions on payments for publishing information about market operations, S. 3420, supra note 298, § 9(a)(5), and combined into one subsection the provisions on stop-loss orders and short sales, id. § 10(a). In the latter, the phrase "in contravention of . . . rules" was substituted for "except in accordance with . . . rules," making it clear that, in the absence of rules to the contrary, short sales and stop-loss orders would be legal. See notes 206 & 245 supra. The conference committee later adopted this language in § 10(b).

The prohibition of false statements was rewritten to require a materially false statement as opposed to a false statement about a material fact. Unfortunately, this change was not adopted. The stabilization provision was also rewritten. Section 9(a)(6) of the Senate Com-
The residual provision, finally labeled section 10(b), approached the form in which it was to be enacted. The Senate Committee would have made it unlawful:

[t]o use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance which the Commission may by its rules and regulations declare to be detrimental to the interests of investors.\(^\text{307}\)

Like Rayburn’s revision, the Senate revision referred to manipulative devices, but the addition of the phrase “or deceptive” might have indicated that the Senate Committee contemplated greater delegated powers.\(^\text{308}\) Nonetheless, it seems unlikely that the Committee intended a broader delegation of authority than Rayburn had, or, for that matter, anything different from what Fletcher and Rayburn intended in their original bill. Although the Senate Committee never explained this change or any other it made in the section,\(^\text{309}\) it probably added “ma-

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\(^{307}\) Committee’s bill made it unlawful to effect transactions in exchange-registered securities for the purpose of stabilizing price in contravention of Commission rules, S. 3420, \textit{supra} note 298, § 9(a)(6), but it did not specifically require the reporting of information regarding such transactions to the Commission, as had Fletcher-Rayburn, \textit{supra} note 20, § 8(a)(7), and Rayburn’s revision, H.R. 8720, \textit{supra} note 256, § 8(a)(8).

\(^{308}\) The Committee’s report suggests concerns beyond deception. The report begins by quoting President Roosevelt on the evils of stock market speculation, S. Rep. No. 792, \textit{supra} note 20, at 1-2, which it labeled one of “the most potent of the factors which have contributed to the prolonged depression.” \textit{Id.} at 3. Discussing §§ 9, 10, and 16 of the bill (which correspond to the same sections of the Act) together under the heading “Manipulative Practices,” \textit{id.} at 7-9, the Committee neither specifically mentioned § 10(b) nor explained what it meant by the word “manipulative.” The discussion of the short-swing trading provisions of § 16 under this heading suggests the Committee gave the word rather broad compass. \textit{Id.} at 9; see also \textit{id.} at 6 (§§ 9, 10, and 16 provide sanctions for those manipulative and deceptive practices that never fulfill a useful function). Unlike the House, the Senate retained Fletcher-Rayburn’s absolute proscription against short-swing trading by insiders, although it increased the 5% threshold for non-director, non-officer inside shareholders to 10%. The report’s section-by-section summary states that § 10(b) authorizes the SEC to regulate “other” manipulative or deceptive practices, \textit{id.} at 18, again suggesting that the meaning of the section can be found in § 10(a) and perhaps § 9.

\(^{309}\) The addition of “deceptive” was not the only change to the residual section. The newly created commission would be able to “declare” devices and contrivances detrimental whereas the FTC was only able to “find” them under Fletcher-Rayburn, \textit{supra} note 20, and Rayburn’s revision, H.R. 8720, \textit{supra} note 256, but the requirement was detriment to the interests of investors; that the device was detrimental to the public interest was not enough.

The deletion of Fletcher-Rayburn’s reference to the public interest in § 10(b) of the Senate Committee’s bill might serve as a premise for a narrow reading of § 10(b) as an investor-protection statute rather than a public-protection statute, on the theory that the Senate Committee, in deleting the reference, must have intended to give the measure a narrow scope. \textit{Cf.} Memorandum from F.T. Boyd to Roland Redmond, \textit{supra} note 225 (“The phrase ‘in the public interest’ which is found [in § 9 of H.R. 8720 and] all through the Act opens wide the door to the accomplishment of social purposes having no connection with the protection of the investor or the proper regulation of security markets.” (emphasis in original)). The simple, and perhaps correct, answer is that the difference between the versions of § 10(b) in S. 3420 and in the Exchange Act is evidence that there was a struggle over the matter and that the conference committee consciously rejected a narrow delegation in favor of a broad one. It seems more likely, however, that the Senate Committee deleted the public-interest standard because
nipulative” for the same reason the House Committee added “deceptive” earlier: to make it clear that the residual rulemaking authority eventually incorporated in section 10(b) should be read with reference to the rest of the Act.

It is likely that the Senate Committee added the word “deceptive” to section 10(b) in response to a suggestion of John Dickinson. By this time, Dickinson, who had generally been excluded from the drafting process, was something of an opponent of the bill. Dickinson suggested modifying Rayburn’s revision to the Senate Committee in executive session, but the published record of the Committee’s hearings contain neither his testimony nor any written proposals. However, James Landis’s personal papers include a memorandum that is almost certainly a copy of the changes Dickinson proposed.

Along with many other provisions of H.R. 8720, Dickinson criticized section 9(c). According to Dickinson,

''[t]he word ‘manipulative’ is extremely vague and in my opinion supplies no adequate standard for the FTC to act upon. Some word or words should be used which more specifically indicates the nature of the evil designed to be rectified. I suggest that the word “deceptive” be substituted for “manipulative” in [section 9(c)] and in the heading of Section 9 . . . .”

Although others criticized the breadth of the provision, it does not appear that anyone else suggested incorporating the word “deceptive.” However, even if Dickinson’s argument impressed the Senate Committee, it is noteworthy that the Committee did not adopt the suggestion completely. The Committee declined to substitute “deceptive” members were concerned about the propriety of such a broad rulemaking standard, see note 313 infra, and that the conference committee restored the standard because it better expressed the seminal ideas behind the residual provision.

310. See Stock Exchange Practices, supra note 104, at 7536 (Dickinson scheduled to appear in executive session), 7626 (Pecora mentioning a change he thought Dickinson had suggested); Letter from John Dickinson to J. Harry Covington (Mar. 30, 1934) (on file with the Stanford Law Review) (reporting that he suggested changes to the bill in Senate Committee executive session) (copy in National Archives, Record Group 40, file 80553/21, box 493).

311. The scant confidential files of the Committee and Dickinson’s Commerce Department files in the National Archives are also bereft of any such record.

312. Suggested Amendments to H.R. 8720 Submitted by John Dickinson, Assistant Secretary of Commerce (Mar. 30, 1934) (on file with the Stanford Law Review) (copy in Harvard Law School Library, James McCauley Landis Papers, box 1, file 7). The memorandum is written in the first person, and appears to have been written by Dickinson. See also note 314 infra (Dickinson’s authorship and influence).

313. Suggested Amendments to H.R. 8720, Submitted by John Dickinson, supra note 312, at 4-5. Dickinson continued, “[i]t would not be in my opinion for Constitutional purposes a sufficiently clear standard to outlaw any device which the Commission may find ‘detrimental to the public interest.’ ” Id. at 5; see also Dickinson, My Philosophy of Law, supra note 162, at 105-06.

314. The Senate Committee’s chosen modifications to the title of the second manipulation provision (now § 10) and the detriment clause of the residual subsection (now § 10(b)), see notes 309 (modification of detriment clause) and 313 (criticism of detriment clause) supra, are further evidence that the Senate Committee modified § 10 in response to Dickinson’s suggestions.
for “manipulative,” instead adopting both words as a standard.\textsuperscript{315} When the Committee sought to change the section to make the standard refer more explicitly to the rest of the statute, it declined to formulate that reference exclusively in terms of deception. The most that can be said is that “deceptive” and “manipulative” were both added to the section, not in an attempt to change its thrust, but to provide “guidance to those who must determine which types of acts are reached by the statute.”\textsuperscript{316}

The Senate Committee’s report on its own bill was the only committee report that explicitly referred to a precursor of section 10(b) of the Exchange Act, and even these references are not particularly helpful.\textsuperscript{317} The report does, however, clearly demonstrate that the Committee intended to confer extensive power on administrators. After quoting President Roosevelt on stock exchange regulation,\textsuperscript{318} the report recited what had become the official line on stock exchange control: speculation was a terrible problem,\textsuperscript{319} and flexible regulation by an agency with broad discretion was the answer.\textsuperscript{320}

\section*{D. Further Action in the House—The Omission of the Residual Provision}

The House Committee and a special subcommittee revised Rayburn’s revision, this time focusing on problems that troubled members.\textsuperscript{321} The Committee reported its bill on April 27, having generally

\\textsuperscript{315} This is not to say that the Committee intended to substantially broaden the scope of the SEC’s power; in construing the similar language of another provision of the Exchange Act (§ 14(e), 15 U.S.C. § 78n(e) (1972)), the Supreme Court was probably correct to say that “words grouped in a list should be given related meaning.” Schreiber v. Burlington N., Inc., 472 U.S. 1, 8 (1985) (quoting Securities Ind. Ass’n v. Board of Governors of the Fed. Reserve Sys., 468 U.S. 207, 218 (1984)). Moreover, the overworked draftsmen may have intended nothing at all when they joined the words “manipulative” and “deceptive” with “or” instead of “and.” In a confidential committee print showing proposed changes to H.R. 8720, I.N.P. Stokes inserted the words “and/or deceptive.” House Comm. on Interstate and Foreign Commerce, 73d Cong., 2d Sess., H.R. 8720, Confidential Comm. Print showing proposed changes of substance to the text of H.R. 8720 contained in the House Comm. Print of April 5, 1934 (Comm. Print 1934) (on file with the Stanford Law Review) (copy in 4 Documentary History Collection, supra note 28, item 11).

\textsuperscript{316} Schreiber, 472 U.S. at 8.


\textsuperscript{318} S. Rep. No. 792, supra note 20, at 1-2.

\textsuperscript{319} See id. at 3-5 (“Excessive speculation has caused acute suffering and demoralization. It has brought in its train social and economic evils which have affected the security and prosperity of the entire country.”).

\textsuperscript{320} See id. at 5-6 (“From the outset, the committee has proceeded on the theory that so delicate a mechanism as the modern stock exchange cannot be regulated efficiently under a rigid statutory program. Unless considerable latitude is allowed for the exercise of administrative discretion, it is impossible to avoid, on the one hand, unworkable ‘strait-jacket’ regulation and, on the other, loopholes . . . .”).

\textsuperscript{321} D.S. Levin, supra note 39, at 389, 391-94; M. Parrish, supra note 28, at 132-33, 137-38; cf. 4 Documentary History Collection, supra note 28, items 7-15 (on file with the Stanford Law Review) (bills, committee prints and annotations). When Rayburn appointed the
weakened Rayburn's margin, segregation, issuer-reporting, and proxy provisions.322

The Committee also reworked the manipulation sections, limiting several section 8 provisions to exchange-registered securities, combining the fictitious transaction and wash-sale provisions, and deleting the rule against disseminating information about a security for consideration except as an advertisement. Successful inducement of trades, as opposed to a purpose to induce, became a required element in the several remaining section 8 communication provisions.323 Finally, the House Committee deleted the residual rulemaking section, section 9(c) of Rayburn's revision.324

The Committee report does not explain why the members deleted the language included in section 9(c) of two earlier House bills.325 Nonetheless, the report suggests that the House Committee intended the Federal Trade Commission to play a substantial role in regulating the stock exchanges. The report explains that the bill was designed to reach the causes of the "unnecessary, unwise, and destructive speculation" condemned by President Roosevelt through regulation of the stock exchanges and of the relationships of the investing public to corporations.326 While the Committee noted that fraud had been a prob-

322. House bill, supra note 302. The changes made in the provision that became the insider trading section, § 16 of the Act, are perhaps particularly relevant to the meaning of § 10(b) of the Act. The modification deleted the prohibition of short-swing trading, retaining only the prohibition of short-selling and "sales against the box," see supra note 191, and a reporting provision supplemented by required reporting of trades by issuers, directors, and officers to their stockholders. House bill, supra note 302, § 15(a); see M. Parrish, supra note 28, at 138 (committee actions and final debate).

323. This change, which endures in the enacted statute, leaves these proscriptions as the only ones in § 9(a) that reach conduct regardless of purpose. See Market Manipulation and the Securities Exchange Act, supra note 36, at 630.

324. The remaining provisions for the regulation of short sales and stop-loss orders were left in a rewritten § 9 without subparts, still titled "Regulation of the Use of Manipulative Devices."

325. The provision might have been removed at the insistence of Representative George Huddleston of Alabama, a member of the subcommittee that revised H.R. 8720. See M. Parrish, supra note 28, at 132-33 (Huddleston on subcommittee). I.N.P. Stokes's master draft of comments on Fletcher-Rayburn, supra note 254, indicated, apparently with respect to § 9(c), that "Huddleston has doubts [as] to Constility [sic] of this." Huddleston, who had repeatedly expressed doubts about the constitutionality of certain aspects of the bill, seemed more doubtful about the required breadth of the commerce clause than the concept of delegating legislative power to an administrative agency. See, e.g., House Hearings, supra note 20, at 29-32, 125, 517-24.

over and over again, it justified the bill as a restraint on speculation. The Committee also emphasized the bill's "wide delegation of powers to the Federal Reserve Board and the Federal Trade Commission," almost apologizing for failing to deal specifically and directly in the statute with a variety of problems.

E. Compromise between the House and Senate—Section 10(b)

On May 4, 1934, the House passed the bill reported out of the House Committee. The debate on the floor, while extensive, was quite broad. The bill's supporters denounced speculation, Wall Street, and the exchanges. While agreeing that controlling speculation was a laudable purpose, opponents complained that much of the bill did not address exchange practices at all, but instead regulated industry—publicly held corporations. The issuer-reporting requirements drew particular criticism; some members of the House argued that these provisions would empower bureaucrats to run the nation's businesses. Rayburn responded to this criticism in his opening remarks:

This bill now is criticized because it gives too much power to the administrative authorities, but all through the hearings the representatives of the exchanges and the so-called "representatives of business" in this country pounded into the committee the unwisdom of particularizing in the legislation, or going further than simply fixing the outstanding standards for the administrative body to go by. We went through the bill, and everywhere that we could find a place to give authority to the [FTC] to make rules and regulations to govern these matters we gave it to them....

Several Republicans made unsuccessful attempts to amend the bill. Representative John Cooper, the senior Republican on the Commerce Committee, proposed removing criminal sanctions for mere rule violations, complaining that "[i]t is doubtful whether ever in the history of Congress such a wide and sweeping delegation of power has been given..."
to any administrative body to create by rule and regulation crimes punishable by severe fine and imprisonment . . ." 333 Rayburn responded that Cooper had previously urged the committee "not to go into so many details in the bill, but to leave the matter to the rules and regulations of the [Federal Trade] Commission. If we should adopt the amendment . . . it would be tantamount to repealing four-fifths of the law . . ." 334 The amendment was defeated. 335

After the House completed its deliberations and passed the bill, the Senate simply replaced the House bill with the Senate Committee's bill, which it had meanwhile amended in a few respects and to which it had added amendments to the Securities Act. 336

At this point, the conference committee still faced the issue that had dominated the debate over federal stock exchange legislation from the beginning: the methods and mechanism for regulating the exchanges. The conferees finally had to decide what body should control or regulate the stock exchanges, and how much discretion the legislation should delegate to that body. 337

The Senate and House were furthest apart on two related questions: whether to establish a new regulatory authority, and whether Congress or an agency should regulate margin levels. Under the House bill, the FTC would have administered everything except margin levels. The Federal Reserve Board would have regulated the extension and maintenance of margin credit on registered securities, although the bill included a standard the Board would use in setting the rules for the initial

333. 78 CONG. REC. 8112 (1934) (Cooper listed the rulemaking provisions).
334. 78 CONG. REC. 8113 (1934).
335. Id. Representative Schuyler Merritt, the only member of the Commerce Committee to dissent from the favorable report on H.R. 9323, H.R. REP. No. 1383, supra note 28, offered another unsuccessful amendment which made it clear that some opponents of the bill were concerned less with broad rulemaking authority itself than with the FTC's enforcement powers. Merritt proposed replacing the bill with another that would merely require exchanges to register with a new Federal Stock Exchange Commission, with the granting of a license conditioned upon the Commission finding that "the constitution and rules of the stock exchange reasonably guard against undue speculative activity and unwarranted manipulative practices on such exchange, and otherwise govern the activities of the exchange and its members so as to afford reasonably adequate protection for investors." 78 CONG. REC. 8114 (1934) (§ 3); see also 78 CONG. REC. 8113-15 (1934). Merritt's proposal was substantially identical to bills previously introduced in the House, see H.R. 8575, 73d Cong., 2d Sess. (1934), reprinted in 10 LEGISLATIVE HISTORY, supra note 20, item 27, and Senate, S. 3234, 73d Cong., 2d Sess. (1934), reprinted in 11 LEGISLATIVE HISTORY item 35, which had been based on the Dickinson Committee report, 78 CONG. REC. 8579 (1934) (statement of Sen. Gore).
336. H.R. 9323, 73d Cong., 2d Sess. [hereinafter Senate bill], reprinted in 10 LEGISLATIVE HISTORY, supra note 20, item 32. The Senate debate recorded in the Congressional Record is reprinted in 4 LEGISLATIVE HISTORY item 10, and various proposed amendments to the Senate Committee bill are reprinted in 11 LEGISLATIVE HISTORY item 38. The debate and the breakdown of voting by region in the Senate is summarized in D.S. LEVIN, supra note 39, at 396-97, 400.
337. See 78 CONG. REC. 10,111 (1934) (explanation of conference by Sen. Fletcher); H.R. REP. No. 1838, supra note 317 (conference committee); 78 CONG. REC. 10,265-66 (1934) (explanation by Rep. Rayburn); D.S. LEVIN, supra note 39, at 400-02; M. PARRISH, supra note 28, at 139-42; J. SELIGMAN, supra note 28, at 98-100.
extension of credit. In contrast, the Senate bill established a Federal Securities Exchange Commission to administer the Act and the Securities Act. Under the Senate bill, the Board would set margin requirements for member banks, but the new Federal Securities Exchange Commission would set all other margin requirements, and without statutory guidelines.

The conferees agreed to the establishment of a new regulatory commission, now called the Securities and Exchange Commission, to administer most of the Exchange Act and the Securities Act. The conferees divided responsibility for setting and enforcing margin rules between the Securities and Exchange Commission and the Federal Reserve Board. The statute would set standards for the initial extension of credit, and the Board would prescribe regulations for the extension and maintenance of margin credit, with power to deviate from the statutory standards.

In resolving these and most of the other problems facing the committee, the conferees faced the tension between statutory standards and administrative discretion. In almost every instance of substantial conflict between the two bills, the conferees chose the alternative, or invented one, that gave the administrators greater power. No doubt the conferees found delegation of authority attractive, in part, because

340. Id. § 7.
342. See Statement, 78 CONG. REC. at 10,263-65 (1934). The provisions of the Exchange Act that clearly reflect compromises in which the conferees chose the provision of either the House or Senate bill that delegated to administrators greater discretion or power include § 8(c) (hypothecation of customers' securities in contravention of Commission rules) (compare House bill, supra note 302, § 7(c), (d) with Senate bill, supra note 336, § 8(c); § 10(b) (manipulative or deceptive device or contrivance); § 13(b) (form of reports) (compare House bill § 12(b) ("in accordance with accepted principles of accounting") with Senate bill § 13(b)); § 19(a)(1) (SEC could suspend exchange for failing to enforce issuer compliance with the Act) (compare House bill § 18(a) with Senate bill § 19(a)(1)); § 19(b) (changing exchange rules with respect to hours of operation) (compare House bill § 18(b) with Senate bill § 19(b)(4)); and § 24(b) (cf. Senate bill § 23(a) (person objecting to disclosure has right to a hearing)); cf. Senate bill § 13(d) ("Nothing in this title shall be construed as authorizing the Commission to interfere with the management of the affairs of an issuer.") (The statement of the House conference managers, Statement, 78 CONG. REC. at 10,263 (1934), explains that this was omitted from the Act "as unnecessary, since it is not believed that the bill is open to misconstruction in this respect."); Exchange Act § 16 (permitting recovery by issuers of the profits from short-swing trading by control persons; the affected parties, rather than the SEC, must sue to enforce this provision) (compare House bill § 15 with Senate bill § 16). But see Exchange Act § 15 (limiting SEC role in over-the-counter market regulation) (compare House bill § 14 with Senate bill § 15); § 19(c) (directing SEC to study exchange governance and classification of
it enabled them to avoid conflict over specific reforms. They probably also believed that administrative agencies were genuinely better suited than Congress to regulate complicated institutions and practices.

Section 10(b) epitomizes the way the conferees delegated to administrators the problems posed by stock market speculation, together with whatever tools they might need to solve them. Even though the section had been left out of the House bill, the conferees included it, and rewrote the Senate provision to increase the SEC's role in regulating market speculation.343

The Senate bill's residual provision made it unlawful to use or employ any manipulative or deceptive device or contrivance that the SEC declared detrimental. Similarly, Rayburn's revision, the last House bill with a residual clause, outlawed the use or employment of any manipu-

members) (compare House bill § 18(b) (authorizing Commission to change rules regarding these matters) with Senate bill § 19(c) (directing a study)).

Another compromise relating to rulemaking produced what is surely one of the most interesting features of the Exchange Act. See Exchange Act § 32 (codified as amended at 15 U.S.C. § 78f (1982)). The House bill provided for imprisonment in cases of willful violation of some SEC-promulgated rules, House bill, supra note 302, § 32, while the Senate bill provided for imprisonment only for violations of specific statutory requirements, Senate bill, supra note 336, § 30; see also notes 333-335 supra and accompanying text (Cooper's proposed amendment to House bill). The conferees rewrote the provision so that a person who willfully violates a SEC-promulgated rule or regulation, the violation of which is made unlawful or the observance of which is required by the Act, can be imprisoned unless "he proves that he had no knowledge of such rule or regulation." See Statement, 78 Cong. Rec. at 10,263 (1934).

343. See notes 341-342 supra and accompanying text; see also Statement, 78 Cong. Rec. at 10,260-61 (1934). See Exchange Act § 9(a)(4) (disseminating false information for the purpose of inducing trades) (compare Senate bill, supra note 336, § 9(a)(3) (same) with House bill, supra note 302, § 8(a)(4) (inducing trades with false information)); Exchange Act § 9(a)(6) (stabilization by a series of transactions "for the purchase and/or sale") (compare Senate bill § 9(a)(6) (same) with House bill § 8(a)(6) ("purchase and sale").

It is hard to characterize the way the committee rewrote § 9(a)(2), the anti-pool provision. The Fletcher-Rayburn predecessor to § 9(a)(2) of the Exchange Act made it unlawful to effect transactions for the purpose of changing a security's price or for the purpose or with the expectation of creating a false appearance of active trading. Fletcher-Rayburn, supra note 20, § 8(a)(3). The language of this provision was repeatedly revised in the hope of protecting block traders who would normally expect their trades to affect price or create the appearance of active trading in the market. (The hearings on the bill contain several discussions of the meaning of "intent" which seem reminiscent of a first-year law school class. House Hearings, supra note 20, at 112-13; Stock Exchange Practices, supra note 104, at 6508-10.) The Senate bill would have made illegal the use of trades to manipulate the price of a security "with the specific intent of raising or depressing such price," Senate bill, supra note 336, § 9(a)(3), while the House would simply have forbidden trading for the purpose of changing price, House bill, supra note 302, § 8(a)(3).

The conferees agreed to make it unlawful to effect transactions in a security "for the purpose of inducing the purchase or sale of such security by others." The conferees presumably hoped that this language would protect people who traded legitimately in the market but knew their transactions might influence others; the conferees also sought to avoid requiring complainants to prove specific intent. However, this language exempts from the proscription those who trade for no purpose other than to cause price changes. This had been forbidden in all the earlier versions of the bill, and is presumably exactly what the section was intended to address. See Statement, 78 Cong. Rec. at 10,260 (1934) ("Both [the House and Senate] provisions were intended to prohibit pool activities, the rigging, jiggling, or marking up or down of prices by manipulative operations.").
lative device or contrivance which the SEC found detrimental. Both bills by their terms authorized the SEC to prohibit such activity, but did not appear to contemplate lesser forms of regulation.\textsuperscript{344}

The Act makes it unlawful to use devices in contravention of SEC rules, clearly contemplating a finely tailored regulatory program in which the SEC would regulate, instead of just prohibiting, various practices. Moreover, the Act permits the SEC to consider a wide variety of interests in undertaking regulatory initiatives. Whereas the Senate bill authorized the SEC to forbid a device only upon a declaration that it was detrimental to the interests of investors, the Act authorizes the SEC to prescribe rules necessary or appropriate to the public interest, or for the protection of investors. Congress gave the SEC flexibility to regulate in order that it might reshape the market in the public interest.

Two points stand out in the record of the vigorous debate that preceded the enactment of the Exchange Act. First, the purpose of the Act was to control speculation, an objective to which virtually everyone agreed in 1934. Second, Congress intended to give the SEC extraordinary powers to achieve this control. Because the Act’s narrowly defined grants of rulemaking power did not provide for complete and effective control, and because Congress realized that it lacked the expertise to enact a complete program of statutory controls, section 10(b) was designed to serve this purpose.

Broad residual regulatory authority was a key element of the program from its inception.\textsuperscript{345} The predecessor to section 10(b) in Fletcher-Rayburn authorized administrators to control all stock market practices. Almost no one questioned the wisdom of this delegation; those who might have been expected to contest the delegation championed it. Although it went through several revisions, all were directed at clarifying a scope intended from the beginning.

The Senate and the House agreed to the conference report on June 1, 1934,\textsuperscript{346} and President Roosevelt signed the Exchange Act on June

\textsuperscript{344} Id. (The House bill and the Senate bill “contain similar provisions regulating the use of manipulative devices, except that the Senate amendment contains a provision prohibiting the use or employment in connection with the purchase or sale of any security of any manipulative or deceptive device or contrivance—‘Which the [SEC] may declare to be detrimental to the interests of investors.’”). The drafters never intended to limit regulators to prohibiting conduct. See, e.g., S. Rep. No. 792, supra note 20, at 18.

\textsuperscript{345} Substantial studies of the enactment of the Exchange Act have repeatedly concluded that the keystone of the Act was intended to be administrative power. See J. Brooks, supra note 95, at 204-05; R. DeBEdTS, supra note 83, at 81; J. Flynn, supra note 36, at 1; D.S. Levin, supra note 39, at 403-04; M. Parrish, supra note 28, at 143; J. Seligman, supra note 28, at 99-100; Raymond Vernon, The Regulation of Stock Exchange Members 132-34 (1941); G. Wright Hoffman, Securities Exchange Act of 1934, in The Security Markets, supra note 36, at 700, 700.

\textsuperscript{346} 78 Cong. Rec. 10,185 (1934) (Senate); 78 Cong. Rec. 10,269 (1934) (House). There was an interesting discussion of the Securities Act on the Senate floor, in which Senator Fletcher stated that, in the judgment of the conference committee, an offering of securities solely to the employees of an issuer is not a public offering and is therefore exempt from registration under § 4 of the Securities Act. 78 Cong. Rec. 10,182 (1934).
IV. Some Afterthoughts

The extensive record of the debate over the Exchange Act and the historical situation that prompted its enactment together suggest that section 10(b) was designed to give the SEC plenary power over the stock market. At the very least, the legislative history shows that the drafters intended to delegate considerably more regulatory power over speculative practices than is encompassed by the Supreme Court’s conception.

As understood by the Exchange Act’s contemporaries, including its drafters, sponsors, and, in a sense, Congress itself, the Act declared a fundamental change in the relationship between the public and the market. The interests of market participants were to give way to the interests of the public, championed by the SEC. The Act charged the SEC with protecting the public interest and delegated to it the power to regulate an extraordinarily wide variety of conduct. Moreover, it would be up to the SEC to define the public interest, with only the broadest of statutory guidance.

The Court has a profoundly different conception of section 10(b) and of the Act as a whole. This does not necessarily make the Court’s conception incorrect. It is difficult to say how much weight the historical record should be accorded in the contemporary meaning of a statute. Nevertheless, there must be some explanation for this tremendous divergence of views.

It is possible that the Court was pursuing its own agenda when it narrowly interpreted section 10(b). The Court may, for example, have trimmed the SEC’s powers because it disagreed as a matter of policy with expansive regulation of the financial markets, wanted to avoid the difficult issues raised by such a broad delegation of policymaking power, or hoped to contain an explosion of litigation. In fact, however, the Court appears to have attempted to promote what it saw as the will of Congress. While the Court’s conclusions about the intent of Congress may have been inconsistent with the historical record, its holding that the fundamental purpose of the Exchange Act is to substitute a philosophy of full disclosure for the philosophy of caveat emptor simply repeated a well-settled and entirely unexceptional doctrine. Even before the Court intervened, section 10(b) had evolved into a very different animal from anything the drafters intended.

While a comprehensive treatment of this evolution is beyond the scope of this article, a brief examination of the post-enactment history of the Exchange Act in general, and of section 10(b) in particular, sug-

gests at least a tentative explanation.\textsuperscript{348}

A central force at work in shifting the operative meaning of the Exchange Act since its enactment may have been the priorities of the SEC. Through its administration of the federal securities laws, the SEC tacitly declared full disclosure to be the primary interest of the public in the securities markets. According to one distinguished commentator, the SEC developed a split personality soon after its creation.\textsuperscript{349} The highly visible and respected “sunlight” SEC vigorously administered the disclosure and antifraud provisions.\textsuperscript{350} The “regulatory” SEC, “the one that regulates the trading markets, has generally played down, and at times has even disregarded and repudiated, its role.”\textsuperscript{351}

This may be an unfair indictment of the SEC. Perhaps fraud has rightly merited more of the SEC’s attention than have manipulation and market regulation. Or perhaps the SEC has wisely determined that the best way to control speculation is to require securities issuers and certain investors to disclose important developments fully and promptly.\textsuperscript{352} Whatever has motivated it, the SEC has generally emphasized disclosure over technical market regulation.\textsuperscript{353} Given the public record of the work of the SEC, the overwhelming importance of the disclosure and antifraud provisions in private securities law practice, and the composition of the caseload faced by the courts,\textsuperscript{354} it is not surprising that a “full disclosure” emphasis is usually attributed to the securities laws.

The turning point in the evolving interpretation of the securities laws may have been the promulgation of rule 10b-5,\textsuperscript{355} although it could hardly have seemed so at the time. The SEC adopted the rule hastily and without much thought about its consequences.\textsuperscript{356} The rule

\textsuperscript{348} The post-enactment history of the Exchange Act is an interesting example of the interaction of Congress, an administrative agency, and the courts. The Exchange Act is one of Congress’s most carefully considered pieces of legislation, and its subject matter—the stock market—is of profound importance, for both its practical and its symbolic significance in our society. The history of § 10(b), in particular, might serve as an important case study for those who would assign to the courts the role of actually changing the law in response to social, economic, and practical developments.

\textsuperscript{350} Id. at 755, 783.
\textsuperscript{351} Id. at 755.
\textsuperscript{352} For a forceful argument that speculation is still rampant and damaging, despite the Commission’s valuable contribution in ensuring full disclosure, see L. Lowenstein, supra note 47.
\textsuperscript{353} Werner, supra note 349. The history of the SEC’s administration of the securities laws is discussed extensively in J. Seligman, supra note 28, and Joel Seligman, The SEC and the Future of Finance (1985). During the debate in the early 1970s over fixed commission rates, the SEC came under overwhelming pressure to regulate stock exchange operations. By giving in to such pressures, the SEC itself emphasized the open-ended nature of its Exchange Act mandate as it claimed expansive powers practically disavowed only a few years before. See Werner, supra note 349, at 770-72, 772 n.91.
\textsuperscript{354} See supra note 137.
\textsuperscript{355} 17 C.F.R. § 240.10b-5 (1988).
is hardly the kind of finely tailored regulatory measure the drafters apparently contemplated. Instead, it is as broad as almost any statute, a sort of long-arm provision in which the SEC forbids everything the statute gives it power to forbid. Regardless of whether rule 10b-5 was a good idea in the first place, the rule has been given extraordinary prominence, almost eclipsing everything else as a source of federal securities law at least in the courts.

With the explosive growth of rule 10b-5 litigation, courts and private plaintiffs have assumed by default a substantial segment of the policy-setting powers that Congress delegated to the SEC in 1934. The rule, which speaks in terms of fraud, ensures that the bulk of cases arising under it—by the mid-1970s, most cases arising under the federal securities laws—are alleged to turn on some sort of disclosure problem.

Between, on the one hand, the SEC's treating of the securities regulatory scheme as directed at achieving full disclosure, and, on the other, the history of rule 10b-5 litigation in the lower courts, when the Supreme Court finally entered the fray, it would have had to strain to treat section 10(b) as anything other than a disclosure provision. Ironically, then, the SEC may itself bear much of the responsibility for creating the misconception that full disclosure is the fundamental philosophy of the Exchange Act. If so, the SEC may have led the Supreme Court to rewrite the Act in a way that has deprived administrators of powers which section 10(b) conferred.

Regardless of whether Congress was wise to entrust the SEC with the task of creating a regulatory structure or whether the SEC has done a good job, the SEC now has much less power than it once had to regulate stock market practices under section 10(b), at least if the Supreme Court's recent pronouncements on section 10(b) are taken at face

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357. It is in fact based on § 17 of the Securities Act, 15 U.S.C. § 77q (1983), and largely tracks the language of that provision. Cf. Edmund W. Kitch, A Federal Vision of the Securities Laws, 70 VA. L. REV. 857, 861 (1984) ("Had Congress wanted to promulgate a prohibition of such generality, it could have done so and eliminate the intermediate requirement of a Commission regulation. The rule as promulgated drew upon no specific expertise of the SEC. Its generality meant, moreover, that either the Commission or the courts would have to give it substance through case-by-case adjudication.").

358. See supra note 10.


361. The Supreme Court has defined the scope of § 10(b) in negative terms, see notes 3-12 supra and accompanying text, precisely because it began to rule on the meaning of the section only after it was confronted by an explosion of rule 10b-5 litigation. In Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 737 (1975), the Court candidly stated that its decision was in reaction to burgeoning litigation. See also note 5 supra. The Court's subsequent opinions were grounded in the language of the statute, but the Court freely acknowledged that it was interpreting the statute narrowly. See, e.g., Ernst & Ernst v. Hochfelder, 425 U.S. 185, 214 (1976); see also International Bhd. of Teamsters v. Daniel, 439 U.S. 551, 566 n.20 ("On a number of occasions in recent years this Court has found it necessary to reject the SEC's interpretations of various provisions of the Securities Acts.").
value. That is to say, if the Supreme Court's conception of section 10(b) is fixed and if the SEC is held to the limits of that conception in the future, then it seems that the attempt to empower the SEC to regulate the stock market as it saw fit has failed. This would no doubt disappoint the drafters, but the operative meaning of the statutes often changes with time and this may be just another example—albeit a remarkable one. The final chapter on section 10(b) may not yet have been written however. The provision that was designed to create a flexible regulatory system may itself be flexible.

Despite what appear to be strongly held views about Congress's intentions, it is not inconceivable that the Court will reconsider the purpose of the Exchange Act—and with it, the scope of the Commission's power under section 10(b)—if the SEC's priorities change in a manner which suggests a new definition of the public interest in the securities market. If, in fact, the reason the Court has construed section 10(b) narrowly is simply that the SEC has pursued its mandate in a narrow manner, then the Court's conception of section 10(b) may change with changes in the way the SEC administers the securities laws. If the scope of the rulemaking power afforded by section 10(b) turns out to ebb and flow with changes in the way the SEC uses that power, then section 10(b), which was intended to allow regulators flexibility, is itself remarkably supple, in a way that even its creators may not have conceived it to be.

362. The Court has not struck down any rule promulgated under § 10(b), and because of the breadth of rule 10b-5 it did not seem to be intruding on the prerogatives of Congress or the SEC in the cases in which it narrowly construed § 10(b). The confrontation will be unavoidable and difficult if the Court ever does strike down a carefully structured and narrowly focused rule just because it regulates innocent or fully disclosed conduct. Several important rules might not survive scrutiny under the Court's conception of § 10(b), yet the validity of those rules has not been widely questioned. See generally T.L. Hazen, supra note 13, § 12.1 (Supp. 1988); Thel, supra note 36. Future cases will be further complicated by the Insider Trading and Securities Fraud Enforcement Act of 1988, in which Congress more or less ratified an expansive application of rule lOb-5. Pub. L. No. 100-704, § 2 (1988) ("The Congress finds that (1) the rules and regulations [of the SEC under the Exchange Act] governing trading while in possession of material nonpublic information are . . . necessary and appropriate . . . (2) the Commission has, within the limits of accepted administrative and judicial construction of such rules and regulations, enforced such rules and regulations vigorously, effectively, and fairly.")., reprinted in 1988 U.S. Code Cong. & Admin. News (102 Stat.) 4677, 4677; see also H.R. Rep. No. 910, 100th Cong., 2d Sess. 35 ("These findings are intended as an expression of congressional support for these regulations.")., reprinted in 1988 U.S. Code Cong. & Admin. News 6043, 6072.

363. It is sometimes argued that judicial modification of statutes is appropriate (or, at least, likely to occur) because statutes are often rigid and susceptible to becoming obsolete. This argument cannot be applied to § 10(b) without substantial refinement, for almost everyone involved in the debate over the Exchange Act was acutely aware of problems of statutory rigidity and obsolescence, and § 10(b) was designed to avoid them. In changing the meaning of § 10(b), the Court has essentially read out of the provision the expansive administrative power that Congress incorporated just so that the statute would not have to be revisited. See generally Donald Langevoort, Statutory Obsolescence and the Judicial Process: The Revisionist Role of the Courts in Federal Banking Regulation, 85 Mich. L. Rev. 672, 732 (1987).

364. See note 362 supra.