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Volume 30
Issue 3 *Issue 3 - April 1977*

Article 5

4-1977

The Securities and Exchange Commission and the Code

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Ray Garrett, Jr. and William B. Weaver, The Securities and Exchange Commission and the Code, 30 *Vanderbilt Law Review* 441 (1977)
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The Securities and Exchange Commission and the Code

Ray Garrett, Jr. and William B. Weaver***

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I. INTRODUCTION

Over the years the Commission has responded to suggestions from the private bar that codification of the Federal securities laws should be undertaken in about the way one would expect a Georgia peanut farmer to greet the prospect of a reexamination of agricultural subsidies. He might think it was a good idea if he could do it himself, but he wouldn't like it if someone else were going to do it. The Commission never has had the time to make a serious study of codification, nor can one ever expect it to have. Also, of course, the time is never quite right.[1] Either external affairs are too much in

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[Unless otherwise indicated, all references to the text of the Code are to the latest tentative drafts as of April 1977.]

1. Some 17 years ago one of the authors was asked by Arthur F. Dean, then Chairman of the Committee on Federal Regulation of Securities of the Corporation Section of the American Bar Association, to sound out then SEC Chairman Edward N. Gadsby (now deceased but at that time recently the author's boss) on his attitude toward an ABA sponsored

transition—they always are—or the wrong sign is in the ascendancy and hostile forces could quickly gain the upper hand.

In November 1967, at the time of the Chicago Codification Conference, then Commissioner Chairman Manuel F. Cohen was too sagacious, or too soft when importuned by old friends, to tell the group planning the conference what he really thought of such busybodies. Nevertheless, the proposed new Form S-7 was announced on the day of the conference, and the disclosure study leading to the Wheat Report and its reform rule proposals[2] began shortly thereafter. Dirty minds could only suspect that Chairman Cohen was bent on torpedoing codification by demonstrating the lack of need.[3]

Nevertheless, the same Chairman Cohen agreed that if the Code project was going forward, the Commission, or at least some Commission personnel, should be involved. The ideal person for such a liaison role was Philip A. Loomis, Jr., then the Commission's General Counsel. He joined the initial group of advisors and has continued to serve after becoming a commissioner. While Commissioner Loomis remains the only Commission person who is an official advisor on the entire Code, interchanges of views between the Reporter and Commission staff have increased over the years. Responsible members of the staff have been heard on every aspect of the Code. They have been generous in giving the Reporter the benefit of their experience, alerting him to new problems, and rendering technical advice. This is not to suggest that the Commission is in any way responsible for or necessarily approves of, the Code, in whole or in part. There are and will no doubt continue to be confiict-

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codification project. It was clear that he sensed a natural enemy. "It's a good idea in general, Ray, but the time is not quite right. Those guys would use it as an excuse to poke too many holes in the law." The statement reminded the author of a legendary Chicago alderman whose unwavering view over several decades of political life was "Chicago ain't ready for reform." Having later served as SEC Chairman, the author is more understanding than critical of Ned Gadsby's attitude.

2. U.S. SECURITIES AND EXCHANGE COMMISSION, DISCLOSURE TO INVESTORS—A REAPPRAISAL OF ADMINISTRATIVE POLICIES UNDER THE '33 AND '34 ACTS (CCH 1969). The Study Group was headed by Francis M. Wheat, then Commissioner of the SEC, and is known as the Wheat Report. [hereinafter cited as Wheat Report].

3. It would be unreasonable to expect Mr. Cohen to admit this. It might not even be true. In any event it did not work. As Professor Loss remarked in May 1969, after the issuance of the Wheat Report, "there was also general agreement that there is no inconsistency between administrative reform, as exemplified by the Wheat Report, and codification. Certainly Commissioner Wheat and I agree entirely on that . . . . there is no inconsistency between administrative reform and the longer term legislative codification." 25 BUS. LAW 27 (1969). Unfortunately the Commission did not have the wisdom or courage to adopt the Wheat program of reform except in part. The Wheat Report remains a *tour de force* which did some good but much less than it should have. Later, as a practitioner, Manuel F. Cohen joined the Code's advisors and has participated actively in the project.

ing views within the Commission, on this matter as on just about everything else. In any event, it is premature to ask the Commission to express itself in a formal way.

The objective of the Reporter and his consultants and advisors has been to take advantage of the knowledge and experience of the Commission personnel in order to make the Code better legislation. The official attitude of the Commission toward the Code when it is submitted as legislation may well be crucial to its fate in Congress. One hopes that this continual interchange of views and knowledge has broken down any initial hostility to the whole idea, but we cannot know the final relation of the Commission to the adoption of the Code until the time comes.

Certainly the Commission's fears of codification as a natural enemy have proved without foundation insofar as the Code's treatment of the Commission, its composition, and powers.[4] The Code on the whole accepts the present composition of the Commission; nothing is taken away from the Commission's existing powers and its rulemaking and exemptive authority is increased.

The Code accepts, without discussion, that the proper administrative agency should remain a commission of five members appointed by the President with the advice and consent of the Senate for staggered five year terms, no more than three of the same political party, and with a chairman designated by the President from among the commissioners.[5] This largely cosmetic restatement of the old familiar law embodies more controversy than appears from the Tentative Drafts and the Reporter's comments.

It has not been obvious to all observers that the federal securities laws are best administered by a collegiate body, whether of five members or any other number. From time to time it is urged that the administration of these laws, and presumably of any laws, would be more efficiently performed by a single administrator. A recent embodiment of this view is the report of the "Ash Council" in 1971.[6]

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4. This is not to imply that the fears have been well grounded in other substantive areas. Clearly they have not.

5. The present provisions are found in Securities Exchange Act of 1934 § 4, 15 U.S.C. § 78d (1970) [hereinafter cited as 1934 Act], and, with respect to the designation of the chairman, in Reorganization Plan No. 10 of 1950, 15 Fed. Reg. 3,175 (1950). The Code provisions are in ALI FED. SEC. CODE §§ 1501(a), 1501(b) (Reporter's Revision of Text of Tent. Drafts Nos. 1-3, 1974) [hereinafter cited as RD 1-3].

6. In 1971, President Nixon's Advisory Council on Executive Organization, popularly known as the "Ash Council" (after its chairman Roy Ash, later Director of the Office of Management and Budget) recommended:

> To assure coordination of regulatory matters with national policy goals, to improve the management efficiency of regulatory functions, to improve accountability to the

Policy-making and administration by committee commonly, and no doubt properly, is deplored by management experts. Certainly much time could be saved by the use of a single administrator. Decisions could be made more quickly. Clear and unequivocal policy could be adopted without the compromises and ambiguities sometimes necessary to obtain a reasonable concurrence among five members of equal vote. This does not necessarily mean that such efficiencies would always be realized by a single administrator. Single administrators can also delay, vacillate, and fudge—and they do—because of staff differences or efforts not unduly to favor one or more competing interests among the affected parties rather than lack of consensus among the commissioners. This view favoring a single administrator also emphasizes the administrative side of the Commission's work, and largely ignores the adjudicative side. Presumably in its adjudicatory role a multi-member or collegial Commission insures fairness to the parties and fosters the development of sound doctrine, like other appellate tribunals. The single administrator concept might be more attractive if the Commission's appellate jurisdiction were removed to an administrative court or elsewhere.[7] Even this, however, would not answer the concerns of the

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> Congress and the executive branch, and to increase the probability of superior leadership for regulatory activities the transportation, power, securities, and consumer protection regulatory functions should be administered by a single administrator, appointed by the President.

PRESIDENT'S ADVISORY COUNCIL ON EXECUTIVE ORGANIZATION, A NEW REGULATORY FRAMEWORK—REPORT ON SELECTED INDEPENDENT REGULATORY AGENCIES 6-7 (1971).

In October 1976, the Subcommittee on Oversight and Investigation of the House Committee on Interstate and Foreign Commerce issued a report, *Federal Regulation and Regulatory Reform*, which refers to the Code and other studies that have taken positions on the single administrator versus collegiate form and by failure to recommend otherwise presumably accepts the latter. The "Study on Federal Regulation—Vol. 1, The Regulatory Appointments Process," January 1977, of the Senate Committee on Government Operations, examines in some detail the lack of evidence to support the conclusions and recommendations of the Ash Council, and remains unconvinced of the advisability of single administrators for the SEC and similar agencies. SENATE COMM. ON GOVERNMENT OPERATIONS, STUDY ON FEDERAL REGULATION—THE REGULATORY APPOINTMENTS PROCESS, 95th Cong., 1st Sess. 15-27 [hereinafter cited as Senate Study].

7. This also is an old idea that SEC commissioners have historically opposed. So has one of the authors, but recent experience has at least modified his hostility. For several years now the SEC's preoccupation with market regulation and restructuring and with enforcement cases of a litigious rather than administrative nature has left it with far too little time for its appellate work in administrative adjudications. Furthermore, if the really significant developments in securities law are going to continue to be made in the courts through the Commission's injunctive actions and otherwise rather than in administrative adjudications, what is left of the latter might well be handled by an administrative court. A single administrator might be able to do a better job in supervising the Commission's litigation, or at least as good a job, as the five commissioners. As to a recent effort by the Commission to go "administrative" rather than "injunctive," see *Touche Ross & Co. v. SEC*, pending in the

Senate Committee on Government Operations 1977 study about independence and continuity:

> Historically, Congressional interest in the regulatory agencies is rooted in the notion that these commissions were created by Congress, vested with Congressional authority to regulate interstate commerce and, therefore, had a special relationship to the legislative branch. The commission form, as it has been created and developed by Congress over the past ninety years, is a determined attempt to isolate the agencies both from precipitous change and from control by the Executive Branch. It was for those reasons that Congress established bipartisan commissions composed of multi-members, serving set terms expiring at staggered intervals, who could be removed by the President only upon a showing of sufficient cause. Single administrators holding office at the pleasure of the President would be a profound alteration in the existing relationship the agencies have to the Congress. There can be no doubt that it would result in the creation of executive agencies, and the notion of independence would soon be a threadbare concept indeed—a problem that might be remedied through a set term.[8]

Past and present Commissioners, however, on the whole favor the collegiate body, the "committee" approach.[9] While the bipartisan feature has seldom been important—certainly in recent years the Commission has rarely split along party lines and even more rarely for that reason—the commissioners perceive their differences in background, experience, expertise, and philosophy as enhancing the quality of their decisions and well worth the occasional delays and hassles. In any event, the Code preserves the present arrangement without any effort at searching reexamination.

The position of the chairman has been more controversial in the past few years, at least in the Congress. The chairman, although casting only one vote and having no disciplinary or removal power over the other commissioners, is at least *primus inter pares* and sometimes a good deal more than that. Thus the recent efforts of some congressmen to reduce the influence of the President over the Commission and other independent regulatory agencies have focused on the chairmanship. The extreme proposal, never adopted, was to require that the designation of a member as chairman be subject to the advice and consent of the Senate, and that a chairman, once so designated and approved, could keep his office whether the President liked it or not until either he resigned from

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Southern District of New York and challenging the Commission's authority to bring a public disciplinary proceeding under SEC Rule 2(e). [Current] FED. SEC. L. REP. (CCH) ¶ 95,742 (S.D.N.Y., filed Oct. 12, 1976).

8. Senate Study, *supra* note 6, at 16.

9. The Senate Study reports that of the 19 members of the SEC appointed since 1961, only one, James R. Needham, favors a single administrator for the SEC. *Id.* at 22-23.

the Commission or his term expired.[10]

The Securities Exchange Act of 1934 in the beginning and, as it turns out, even now says nothing about a chairman, but there always has been one. At the first meeting of the Commission, in July 1934, the only business conducted was the election of one of the commissioners, Joseph P. Kennedy, as chairman. It is accepted lore that Mr. Kennedy and every succeeding chairman, although formally elected by the commissioners, were in fact designated by President Roosevelt and President Truman, until 1950, when Reorganization Plan No. 10 made the designation direct and legal.

While Reorganization Plan No. 10 assigns the function of designating the chairman to the President, it says nothing about the chairman's term of office. It has therefore been assumed that a chairman serves as chairman at the pleasure of the President, even though he has the right to serve out his statutory term as a commissioner unless removed for cause. In the view of some members of Congress, especially post-Watergate, this control over the chairman's term of office gives the President too much power over the chairman and thus over the Commission. In the bills that led to the Securities Acts Amendments of 1975, the House inserted provisions that would in effect cause the designation of the chairman to be subject to the advice and consent of the Senate and would give the chairman so appointed and confirmed the right to serve out his term in that capacity. In 1974, a subsequent version of this proposal, H.R. 5050, eliminated the advice and consent feature and qualified the chairman's right to serve out his term by permitting the appointment of a new chairman by a new President. This version has been adopted by the Code.[11] This provision did not survive, however, and

10. Since 1953, the SEC has had ten chairmen. Six of these were designated as chairman concurrently with their appointments as commissioner, so the Senate in effect was advising and consenting to the designation as well as the appointment. This fact is recognized in the Senate Study, and their recommendation is that "whenever a chairman is selected from within the Commission's membership, the designation be subject to advice and consent of the Senate." *Id.* at 175.

11. RD 1-3 § 1501(b) states:

> (1) the President shall appoint a member of the Commission to be the Chairman until (A) he ceases to he a member or (B) a successor Chairman appointed by a successor to the President who appointed him Chairman takes office as Chairman, whichever date is sooner.

Interestingly, the Chairman of the recently created Commodities Futures Trading Commission is appointed by the President by and with the advice and consent of the Senate and serves until his term expires. Commodities Exchange Act § 2(a)(2), 7 U.S.C. § 4(a) (Supp. V 1975). The Chairman of the Consumer Product Safety Commission is chosen by the President from the membership of the Commission. The Chairman retains his office until the end of his term. Consumer Products Safety Act § 4(a), 15 U.S.C. § 2053 (Supp. V 1975).

the 1975 Amendments made no change in the existing law regarding the chairman. The Code will be revised accordingly. With respect to the administrative authority of the chairman and the right of the Commission to delegate authority to staff officials, the Code substantially codifies existing law.

Under the Code, the Commission will continue as a multimember independent regulatory agency. "Independent regulatory agency" is a popular term of uncertain and varying meaning. Over the years, the literature and hot air expended to expound the "true" meaning of the phrase and the proper place of such agencies in Montesquieu's trinity have been prodigious. Without exception, however, when the term is used by members of Congress or of their staff, it means independent of any influence from the President and the Executive Department. Consequently, the congressional concern for the independence, this sort of independence, of an independent regulatory agency tends to vary inversely with the extent of the President's control of the Congress. Since 1932, with a brief exception, this has meant that when the President has been a Republican, the independence of independent regulatory agencies has been very important on the Hill, and in the last few years, more than ever.

It may be, but it is not yet clear, that the results of the 1976 election will, at least for a time, lead to a lowering of the temperature and a more sensible view of the question of independence. If this comes to pass, if the question can be considered with a view to better government, several matters should be borne in mind.

The post-Watergate paranoia raised the spectre that the President or one of his minions can effect a "fix" with respect to some specific investigation or proceeding before the Commission. The danger of this, however, approaches zero if history is any guide. Even in the Watergate period, the worst that could be found against the Commission was that it participated in a series of events that resulted in a denial of access to certain investigatory files to an influential member of Congress that he seemed to have wanted for political purposes, plus some unsuccessful efforts by interested persons to work through the Executive Department to cause the Commission to abandon an enforcement action in a major fraud case. Rather than cause fears and suspicion, this record should engender confidence in the Commission's ability and desire to preserve its independence from improper influences from any quarter. The dirty minds of some others, in or out of government, ought not obscure the Commission's resolute rectitude.

Historically, efforts to exert improper influence over specific

matters, however subtle, have been far more numerous from members of Congress. Everyone in government understands the routine "case work" inquiries of congressional staff personnel. At the agency end it is understood that case work inquiries are not meant to be requests for improper or undeserved actions. It is also understood that they are meant to be invitations to give the matter early and careful attention, especially if the call is from the Congressman himself, and that, if the agency action is prompt and favorable, the member will claim, or at least enjoy, the credit. This genteel fraud is carried out daily. The Executive Department has no regular counterpart. But all calls from the Hill are not case work. Some, if not followed by prompt compliance, have resulted in frequent demands to report, confer, and testify as well as reminders that, at appropriations time, the Commission will need friends and certainly not enemies.

The paranoia lies in allowing such fears of infrequent attempts to exert improper influence to dominate, at the expense of achieving some measure of coordination between agency and Executive Department policies and actions. Agency statutory mandates tend to be stated as absolutes, and more than ever today, with the recent proliferation of new, special-purpose agencies, these absolutes collide. It should not be regarded as shocking that the public interest might be served by some coordination between Commission disclosure policy and, for example, our nation's foreign policy,defense policy, environmental protection policy, equal employment policy, bank regulatory policy, and the like. Suppose by all accepted standards of materiality, the securities laws require a disclosure that the Defense Department or the CIA has quite properly classified in the well-founded belief that disclosure would be disastrous to its efforts and fatal to certain individuals. Surely good sense and the public interest would require that the Commission should consult with such other agencies and give weight to their views. At the very least, it should not be regarded as sinful to do so. If such consultation does not lead to a reasonable accommodation of all policy goals involved, only the President is in a position to resolve the conflict.

William O. Douglas, in his autobiography, *Go East, Young Man*, remembers with evident pride his many direct and detailed consultations with the President on specific matters as well as questions of general policy, while Chairman of the SEC.[12] This may go

12. W. DOUGLAS, GO EAST, YOUNG MAN 284 (1974).

a little far, but it is better than no communication at all on policy matters, which was the case at least from 1973 to 1975.

II. Discretionary Power of the Commission Under Existing Law

Present securities laws delegate different amounts of discretionary power to the Commission. The Securities Act of 1933, as originally enacted,[13] provided the Commission with minimal and narrowly drawn discretionary powers. The Commission could make rules and regulations concerning registration statements and prospectuses, define accounting and trade terms used in the statute, obtain injunctive relief against violators of the Act, and issue stop orders.[14] Securities legislation after the 1933 Act gradually increased the powers of the Commission. The expansion of administrative discretion culminated with the Investment Company Act of 1940, which provided the Commission with broad authority to exempt any person, security, or transaction from any provision of the Act.[15]

One aim of the Federal Securities Code has been to provide uniform discretionary power for the Commission with respect to all of its current responsibilities.[16] For example, section 302(a) of the Code follows the language of the current Investment Company Act provision and provides that the Commission may exempt any person, security, or transaction from any provision of the Code. This broad exemptive power may be a matter of some concern when the Code formally is proposed to Congress. The significance and actual impact of section 302 and other Code provisions which provide for

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13. Securities Act of 1933, ch. 38, 48 Stat. 74 (current version at 15 U.S.C. § 77 (1970 & Supp. V 1975)) [hereinafter cited as the 1933 Act].

14. 1933 Act §§ 6, 7, 19, 20.

15. The Investment Company Act of 1940 § 6(c), 15 U.S.C. § 80a-6(c) (1970). The Investment Company Act, as finally adopted, was a joint product of the Commission and certain industry groups. It is popularly said that the industry wanted everything of a restrictive nature in the statute with plenary authority in the Commission to relieve restrictions. *See* Motley, Jackson & Barnard, *Federal Regulation of Investment Companies Since 1940*, 63 Harv. L. Rev. 1134, 1147 (1950), *revised and reprinted in* Selected Articles on Federal Securities Law 941 (H. Wander & W. Grienenberger eds. 1968):

> As under both [the Securities and Exchange Acts], the SEC has wide discretion as to the form and contents of registration statements and periodic reports. Otherwise there are few sections or subsections which require rules to make them operative, and there is slight opportunity to impose restrictions not specifically stated in the law. But the exemptive power given the SEC under the 1940 Act is all-inclusive and may be exercised by order . . . as well as by rules and regulations.

63 Harv. L. Rev. at 1147, Selected Articles at 957. *But cf.* 17 C.F.R. § 270.17d-1 (1976).

16. The Code's aim has been deflected to the extent that it has been deemed prudent to preserve provisions of the Securities Reform Act of 1975. *See* text accompanying note 46 *infra*.

the Commission's discretionary power are not self-evident from the words of the Code. The proposed changes in the Commission's discretionary power should be viewed in light of the current and historical context of that power.

A. *The Commission's Discretionary Power Under the Securities Act of 1933*

At the time of the enactment of the 1933 Act, congressional power to regulate securities and delegate broad administrative authority to an executive agency was seriously questioned. For example, in 1933 Nathan Isaacs wrote:

> Let us look at the control by the Government of the mails as a basis for attempting to control the financing of business. Obviously the connection is pretty thin . . . . The principle is loaded with danger . . . . Is interstate commerce an essential or only a fortuitous element in the sale of securities? . . . The truth is that securities are made and ordinarily sold, whether in exchanges or in brokerage houses, outside of the channels of interstate commerce . . . . [17]

There was also serious doubt about how far the Constitution would permit the Congress to delegate its legislative power to an administrative agency. Congressional timidity, fostered by this widely held view of restricted federal powers, resulted in a limited grant of authority in the 1933 Act.[18]

Professor, later Justice, William O. Douglas wrote in his article on the Securities Act[19] that the Act presented limited opportunities for the enforcing agency to exercise discretion in controlling the issuance of securities. The actual powers of the Commission were rather limited, and the remaining potential for discretionary power was dissipated by the delegation of concurrent enforcement respon-

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17. Isaacs, *The Securites Act and the Constitution*, 43 YALE L.J. 218, 222, 224 (1933).

18. For example, the Securities Act specifies in considerable detail the contents of registration statements in Schedule A of the Act. The once burning question of the constitutional limits of Congressional delegations of legislative power cooled off quickly after 1933. As discussed below, the wisdom of broad grants of legislative power to administrative agencies is once more a major issue, but as a matter of policy and not of constitutional limitation.

Professor Douglas wrote that in the Securities Act of 1933:

> Congress has supplied an iron-clad standard of conduct which may not be relaxed or tightened up by the Commission. It must act within the rather narrow ambit prescribed for it.

See generally Douglas & Bates, *Federal Securities Act of 1933*, 43 YALE L.J. 171, 214 (1934); Isaacs, *The Securities Act and the Constitution*, 43 YALE L.J. 218 (1934); Rodell, *Regulation of Securities by the Federal Trade Commission*, 43 YALE L.J. 278 (1934); Comment, *Constitutional Law—Power to Enact Federal Securities Act of 1933*, 32 MICH. L. REV. 811 (1934).

19. Douglas & Bates, *supra* note 18, at 171.

sibility to the Federal Trade Commission and the courts.[20] The Commission could stop the issuance of securities within thirty days of the filing of a registration statement; it could interpret accounting and trade terms; it could make rules and regulations concerning registration statements and prospectuses; and it could seek injunctive relief against the violations of the Securities Act.[21] Professor Douglas observed that the Commission could exercise its stop order power only to curb flagrant abuses, because the Commission had limited time to examine registration statements. The Commission's authority to seek injunctive relief was limited by its dependence on a court's discretionary power to grant such relief.[22] Finally, the Commission's general ability to implement the 1933 Act was limited by the lack of administrative power to exempt securities from registration requirements. The Commission's only important discretionary powers were the powers to define terms and to promulgate rules and regulations concerning registration statements and prospectuses.[23] The power to define terms later became crucial to the Commission's ability reasonably to implement the Securities Act.[24]

B. *The Commission's Discretionary Power Under the Securities Exchange Act of 1934*

The Securities Exchange Act of 1934[25] marked a significant change in Congress' delegation of discretionary power to the Commission. The Exchange Act delegated to the new Securities and Exchange Commission affirmative duties and extensive regulatory

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20. *Id.* at 211.

21. *Id.* at 212.

22. *Id.* at 212-13. Professor Douglas obviously failed to anticipate the early development of the delaying amendment and acceleration technique, which more than compensates for what he viewed as deficiencies in the Commission's powers.

23. *Id.* at 213.

24. Over the years this absence of direct, comprehensive rulemaking authority has forced the Commission to exercise a degree of ingenuity in the construction of definitions, which astounds and dismays one who encounters the Securities Act for the first time. The Commission's ingenious use of its power probably began with the "red herring" legend on preliminary prospectuses before the Securities Act amendments of 1954. It was obviously desirable that copies of preliminary prospectuses be distributed to prospective investors prior to the effectiveness of the registration statement. Having the prospectus sit in a public file in Washington for 20 days, as the Act contemplated, would not disseminate the information. Delivery of a preliminary prospectus to a potential buyer, however, looked suspiciously like an offer, and the Act (as then drafted) stated that a preeffective offer was illegal. Since the Commission had no authority to attack the problem directly and legalize the practice by a rule, it did so by defining "offer" not to include the delivery of a preliminary prospectus bearing a legend, in red, that said it was not an offer. That was just the beginning.

25. 15 U.S.C. §§ 78a-78jj (1970 & Supp. V 1975).

powers over securities exchanges, exchange members, securities listed or traded on exchanges, the over-the-counter markets, and broker-dealers.[26] The changing regulatory goal of securities legislation is suggested in testimony by James M. Landis, a draftsman of the Exchange Act, before the House Committee on Interstate and Foreign Commerce. Describing the regulatory goals of the bills that later became law, Landis stated:

> One [regulatory goal] is flexibility of administration. The problem [to which the legislation was addressed] is very complex, very delicate, very technical. Moreover, our knowledge about many of these things is quite inadequate. So, the flexibility and the opportunity to move rapidly, to experiment, as the Exchange itself experiments, in pushing through a regulation or trying something for a time, to see what its effects are, is imperative in legislation of this type . . . . what is needed is to entrust the administration of an act of this type to the best possible administrative agency that can be conceived for that purpose.[27]

Evidence of congressional intent to broaden administrative discretion under the Exchange Act, as compared to the Securities Act, appears in sections granting the general rulemaking authority and other more specific responsibilities of the Commission.[28]

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26. 1934 Act §§ 5-19, 15 U.S.C. §§ 78e-78s (1970 & Supp. V 1975).

27. *Hearings before the House Comm. on Interstate and Foreign Commerce on H.R. 7852 and H.R. 8720*, 73d Cong., 2d Sess. 20 (1934).

28. First, § 11 provides that the Commission shall have the authority to promulgate rules and regulations concerning floor and off-floor trading. 1934 Act § 11, 15 U.S.C. § 78k (1970 & Supp. V 1975). Second, § 6, which specifies the procedure for the registration of a securites exchange, authorizes the Commission to withhold registration until the Commission determines that the exchange is "so organized as to be able to comply with the provisions of [the Exchange Act] and the rules and regulations thereunder . . . and to insure fair dealing and to protect investors." 1934 Act § 6(b)(1), 15 U.S.C. § 78f(b)(1) (Supp. V 1975). A third example of broad Commission power under the 1934 Act is the power to regulate the operation of exchanges and their members and to require their maintenance of records and accounts as specified by the Commission. *Id.* § 17(a), 15 U.S.C. § 78q(a) (Supp. V 1975). Fourth, § 19(c) delegates to the Commission the power to amend exchange rules; this broad power is subject only to general policy constraints such as the protection of investors, the insurance of fair dealing, and fair administration of exchanges. *Id.* § 19(c), 15 U.S.C. § 78s(c) (Supp. V 1975). Finally, § 23(a) confers upon the Commission the power to make "such rules and regulations as may be necessary" for the execution of the functions vested in the Commission by the Act. *Id.* § 23(a), 15 U.S.C. § 78w(a) (Supp. V 1975). Section 23(a) also empowers the Commission to classify issuers, securities, exchanges, and other persons or matters within the Commission's jurisdiction. *Id.*

It has never been clear whether there is any difference between a "rule" and a "regulation," or, if there is, what it is. The Code uses only "rule," but defines it to include a "regulation" (in case there might have been a difference) as well as a "form, note to a rule, or instructions to a form." ALI FED. SEC. CODE § 292 (Tent. Draft No. 5, 1974) [hereinafter cited as TD-5].

C. *The Commission's Discretionary Power Under Later Securities Legislation*

Following the Exchange Act, the expansion of the Commission's power followed the development of the New Deal. The Public Utility Holding Company Act of 1935 gave the Commission broad power to reconstruct the utilities industry, as well as authority to approve or disapprove the issuance of securities and the acquisition of properties by registered holding companies and their subsidiaries.[29] Congress expanded the Commission's discretionary authority as far as practically possible (at least in one direction) in section 6(c) of the Investment Company Act of 1940, which provides that the Commission may exempt any person, security, or transaction from any provision of the Act or any rule promulgated thereunder. This broad exemptive power is subject only to the constraint that the exemption must be appropriate in view of the public interest, the protection of investors, and the policy of the Act.[30]

The discretionary power of the Commission was not changed significantly until the enactment of the Securities Reform Act of 1975[31] which substantially expanded the scope of the Commission's responsibilities. The Commission now has a statutory duty to assure that the rules of exchanges do not have the effect of fixing rates of commission.[32] The 1975 Act also charges the Commission with the implementation of the national market system for securities and

29. For a general review of the Holding Company Act, see Dean, *Twenty-five Years of Federal Securities Regulation by the Securities and Exchange Commission*, 59 COLUM. L. REV. 697, 702-03 (1959). There have been recurrent proposals to transfer the administration of the Holding Company Act to the Federal Power Commission, which proposals have been alternately favored and opposed by the Commission and by spokesmen for the registered holding companies. A pending bill would transfer the administration of the Act to a new Federal energy department. S. 826, 95th Cong., 1st Sess. §§ 306, 712(g) (1977).

30. Investment Company Act of 1940 § 6(c), 15 U.S.C. § 80a-6(c) (1970).

31. The Securities Reform Act of 1975, P.L. 94-29, 89 Stat. 97 (codified in scattered subsections of 15 U.S.C. §§ 77-80) [hereinafter cited as 1975 Amendments].

32. 1975 Amendments § 4, 15 U.S.C. § 78f(e) (Supp. V. 1975) (amending 1934 Act § 6(e)). The Commission may not permit the reestablishment of fixed brokers' commission rates on the exchanges only if it finds:

> that such schedule or fixed rates of commissions, allowances, discounts, or other fees (i) are reasonable in relation to the costs of providing the service for which such fees are charged (and the Commission publishes the standards employed in adjudging reasonableness) and (ii) do not impose any burden on competition not necessary or appropriate in furtherance of the purposes of this title . . . .

Id. By the time the 1975 Act was adopted, the Commission had already eliminated fixed commission rates by rule. On this most contentious issue, those who sought to preserve a more unfettered ability of the Commission to "retreat" in the face of disaster lost. Nobody expects that the Commission could make the findings necessary to fix rates under present or foreseeable conditions. For the Code treatment, see TD-5 §§ 803(i)(2), 1502(b).

expands the Commission's obligations to supervise self-regulatory organizations.[33] For example, the Commission affirmatively must approve all proposed rule changes of these organizations.[34] The 1975 Act further created Commission authority over clearing agencies, transfer agents, security information processors, institutional investment managers, and all broker-dealers not previously subject to registration requirements.[35]

Some of these new responsibilities for the Commission include or retain broad grants of discretionary power. For example, the Commission is authorized to exempt an exchange from the general statutory prohibition of transactions executed by a member for his own account or for the account of its affiliate, including an investment advisory client or fund.[36] Similarly, the Commission can exempt institutional investment managers from, and determine the scope of, the duty to disclose the holdings of the portfolios that they manage.[37]

The expansion of general Commission duties by the 1975 Act was accompanied by detailed specification of Commission responsibilities, statements of goals and objectives that the Commission must pursue, and limitations on the discretionary power of the Commission in executing the law. For example, although Commission responsibilities for national securities exchanges were expanded by the Act, Congress effectively preempted the Commission's initiative with respect to the unfixing of commission rates, and terminated the Commission's discretionary rulemaking authority over trading by exchange members for their own accounts.[38] The Commission's supervision of self-regulatory organizations has been subjected to a detailed statutory procedure.[39] Detailed statutory direction and limited discretion also appear in the 1975 Act provision

33. 1975 Amendments §§ 7, 16, 15 U.S.C. §§ 78k-1, 78s (Supp. V 1975) (amending 1934 Act §§ 11A, 19).

34. 1975 Amendments § 16, 15 U.S.C. § 78s(b)(1) (Supp. V 1975) (amending 1934 Act § 19(b)(1)).

35. 1975 Amendments §§ 15, 10, 11, 15 U.S.C. §§ 78q-1(b)(1), 78q-1(c), 78m(f), 78o(a)(1) (Supp. V 1975) (amending 1934 Act §§ 17A(b)(1), 17a(c), 13(f), 15(a)(1)).

36. 1975 Amendments § 6, 15 U.S.C. § 78k (Supp. V 1975) (amending 1934 Act § 11).

37. 1975 Amendments § 10, 15 U.S.C. § 78m(f) (Supp. V 1975) (amending 1934 Act § 13(f)).

38. 1975 Amendments § 6, 15 U.S.C. § 78k(a) (Supp. V 1975) (amending 1934 Act § 11(a)). The Commission can still permit members to trade for their own account, but only for limited purposes. 1975 Amendments § 6, 15 U.S.C. § 78k(a)(1) (Supp. V 1975) (amending 1934 Act § 11(a)(1)).

39. 1975 Amendments § 16, 15 U.S.C. § 78s(b) (Supp. V 1975) (amending 1934 Act § 19(b)).

concerning the national system for the clearance and settlement of securities transactions.[40] That provision included a detailed set of congressional findings and specifically requires the Commission to consider the effect of clearance on the public interest, the protection of investors, the safeguarding of securities and funds, and the maintenance of fair competition among brokers and dealers and other parties. The Commission further is directed to assure equal regulation of clearing agencies and transfer agents. Additionally, the 1975 Act requires institutional managers to disclose over a dozen specific items, in spite of the Commission's explicit authority under the Act to determine the details and extent of that disclosure.[41]

The tendency of Congress in the 1975 Act specifically to state and limit the Commission's powers and to require extensive determinations by the Commission before action can be taken represents a departure from the prior practice of enacting general statements of Commission powers and duties. This prolixity also is contrary to the general approach of the Federal Securities Code.

III. Discretionary Power of the Commission Under the Federal Securities Code

The Federal Securities Code generally follows the historical pattern of granting broad discretionary power to the Commission. Section 302 of the Code gives the Commission codewide authority to exempt in the following terms:

> The commission, by rule or order, may exempt any person, security, or transaction, or any class of persons, securities, or transactions, from any or all of the provisions of this Code except (1) section 1206 [simplification of public utility holding company systems] (2) a provision that prohibits the fixing of minimum profits or the imposition of any schedule, or the fixing of rates, of commissions, allowances, discounts, or other fees, or (3) a rule of a bank regulator or a self-regulatory organization.[42]

Section 1502 gives the Commission general authority to adopt rules and issue orders (1) to define terms, (2) to classify persons, securities, transactions, and the various filings required by the Code, (3)

40. 1975 Amendments § 15, 15 U.S.C. § 78a-1 (Supp. V 1975) (amending 1934 Act § 17A).

41. For example, every institutional investment manager must disclose for each transaction amounting to more than $500,000: the security, number of shares traded, whether shares were purchased or sold, the per share price, the date of the transaction, the date of the settlement of the transaction, the executing broker or dealer, and the market on which the trade was executed. 1975 Amendments § 6, 15 U.S.C. § 78m(f)(1)(E) (Supp. V 1975) (amending 1934 Act § 13(f)(1)(E)).

42. TD-5 § 302(a).

to permit incorporations by references to filed documents, (4) to deny retroactive effect to interpretive rules, and (5) to disbar attorneys, accountants, engineers, appraisers, or other experts or professional persons. One standard is prescribed for all rules and orders, as follows:

> In exercising its authority under this section, the Commission shall determine (and so state) that its action is necessary or appropriate in the public interest or for the protection of investors . . . and in furtherance of the purposes fairly intended by the policy and provisions of this Code, in addition to satisfying whatever other standards are made applicable by particular provisions.[43]

Subparagraph (c) of section 1502, which tracks the provisions of section 23(a)(2) of the Exchange Act, as amended in 1975, requires the Commission to consider the effect of its rulemaking on competition. The Commission may not adopt any rule change "that would impose a burden on competition" unless it is "necessary or appropriate in furtherance of the purposes of this Code" and the Commission explains its reasons. The Code retains the Commission's broad power to define terms and to determine the content of registration statements, proxy statements, and offering statements.[44] Further, the Code expands the Commission's authority to exempt small offerings within certain limits.[45]

These provisions of the Code suggest that the drafters subscribe to the traditional view of the benefits of substantial delegations of legislative power to administrative agencies that have institutional expertise in the subject matter to be regulated and that also have some independence from the executive branch. As indicated above, the 1975 Act diverges from this philosophy of administrative regulation in some areas. Rather than contradicting so recent an expression of congressional intent, the Code largely has followed and deferred to the 1975 Act.[46] For example, Code section 906(a) restates the 1975 Act provision concerning the prohibition of exchange members trading for their own accounts.[47] The 1975 Act prohibition of fixed commission rates and the procedure by which the Commission

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43. *Id.* § 1502(b).

44. RD 1-3 §§ 403, 501, 602.

45. *Id.* § 511.

46. The Reporter's Introductory Memorandum states that:

> In general, the substance of the 1975 Amendments has been considered to be binding insofar as they go, because of their very recency and because many of them represent political compromises that simply cannot be disregarded.

TD-5, at xxii-xxiii.

47. *Compare* TD-5 § 906a *with* 1934 Act § 11(a)(2)(A), 15 U.S.C. § 78k(a)(2)(A) (Supp. V 1975).

must approve or disapprove rule changes that might affect fixed rates is repeated in the Code.[48] Also the Code repeats the 1975 Act's provisions concerning the Commission's duties to establish a national market system,[49] to supervise self-regulatory organizations,[50] to regulate the national system for the clearance and settlement of securities transactions,[51] and to promulgate disclosure requirements for institutional investment managers.[52]

The Code, however, does not follow the 1975 Act verbatim. Sections are renumbered to reflect the uniform character of the Code; some sections are reworded to clarify the intent of the Congress; and statements of congressional findings often are omitted.[53] More importantly, the Code relies on one omnibus exemptive provision, section 302, as limited by section 1502. Thus, the Code did not follow the 1975 Act amendment to section 4(b) of the Securities Act concerning the exemption of certain secured notes from registration requirements. The Reporter preferred to rely on the general exemptive authority of the Commission found in Code section 302.[54]

Similarly, the Code avoids the 1975 Act's frequent repetition of directions to the Commission to act in the interests of investors or for their protection.[55] That direction appears only once in the Code, in section 1502(b), to which other provisions of the Code make reference.

Another distinction between the Code and present law is that, at present, the Code has not adopted the 1975 Act's definition of the standard applicable to exemptions. Inclusion of this standard probably would clarify when an exemption could be granted. Harvey Pitt, General Counsel of the Commission, has explained the differences as follows:

> [In the 1975 Act], the authority to exempt various persons or entities from certain provisions of the Act has been recast to make it more usable.

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48. *Compare* TD-5 § 908 *with* 1934 Act § 6(e), 15 U.S.C. § 78f(e) (Supp. V 1975).

49. *Compare* TD-5 § 9A01 *with* 1934 Act § 11A(a), 15 U.S.C. § 78k-1(a) (Supp. V 1975).

50. *Compare* TD-5 §§ 801, 805(b) *with* 1934 Act § 19(b)(1), 15 U.S.C. § 78(b)(1) (Supp. V 1975).

51. *Compare* TD-5 §§ 9A04, 9A05 *with* 1934 Act § 17A, 15 U.S.C. § 78q-1 (Supp. V 1975).

52. *Compare* TD-5 § 919 *with* 1934 Act § 13(f), 15 U.S.C. § 78m(f) (Supp. V 1975).

53. For example Code provisions concerning the National System for Clearance and Settlement of Securities Transactions and the establishment of the national market system omit congressional findings of fact. TD-5 §§ 9A01, 9A04, 9A05.

54. TD-5 § 302.

55. *Compare* 1934 Act § 11(a)(1)(H), 15 U.S.C. § 78k(a)(1)(H) (Supp. V 1975) (as amended by the 1975 Act) *with* TD-5 §§ 906(a)(3)(F), 1502(b). Further reliance in the Code upon the general § 302 exemptive power is evident in the Code's restatement of § 17 (a)(1)(C) of the amended 1934 Act.

> Thus, under the Act prior to its recent amendment, exemption was in the public interest or for the protection of investors. Technically speaking, this condition was virtually impossible to meet, since it could be argued that the public interest and the protection of investors will almost always be better served by inclusion of all persons and entities under the Act's structure. [The 1975 Act] recasts the Commission's exemptive authority, so that it may be employed when found to be "consistent with" the public interest or the protection of investors, a more rational and workable standard.[56]

The substantive restatement of the 1975 Act in the Code creates inconsistencies with respect to the Commission's discretionary power. On one hand, the Code generally delegates to the Commission broad exemptive power and the power to define all terms in the Code. On the other hand, the Code follows the 1975 Act's extensive specification of the Commission's duties, including determinations and procedures that the Commission must make or follow before taking certain actions.

The Code's deferral to these recent expressions of congressional intent concerning the discretion of the Commission probably will result in less congressional controversy over the Code's proposals for the Commission's discretionary powers. The changes in the Code reflecting the 1975 Act are not comprehensive, however. The Code's original approach of expanding the Commission's discretionary power remains intact for some parts of the Code. The resulting ambivalence in the Code's approach to the Commission's power suggests that Congress may receive coolly the Code's grant of broad power to the Commission. Therefore, the current congressional concern with the discretionary power of administrative agencies should be considered carefully.

IV. Can the Code Satisfy Current Congressional Concerns Regarding Discretionary Power?

The purpose of Congress in drafting increasingly specific legislative limits to the discretionary power of administrative agencies appears to be based upon two political considerations. First, the growing political power of consumer and other public interest groups, coupled with the increasing awareness of the dismal performance of some regulatory agencies, has encouraged members of Congress to be more aggressive in requiring the direct protection of consumers in recent legislation. To implement this protection, Congress has indicated a desire to create a more adversary relationship between regulatory agencies and their respective regulated indus-

56. Pitt, *Effect of New Procedures, Judicial Review*, in SEC '76 (1976).

tries.[57] Evidence of this concern is apparent in the 1975 Act and its legislative history. The 1934 Act, as amended by the 1975 Act, now requires more affirmative regulation by the Commission of self-regulatory organizations and specifically requires that all rules of the organizations be approved by the Commission according to certain criteria, primarily intended to preserve competition among members. Similarly, the 1975 Act mandates that the Commission proceed toward the development of a national market system and prescribes certain statutory objectives to be achieved by such a system. The objectives include guarantees of economically efficient execution of orders, fair competition among broker-dealers, fair competition among exchange markets, the availability of price and transaction information, and best execution considerations.[58]

Prior to the 1975 Act, congressional committees reacted unfavorably to the Commission's promulgation of rule 19b-2, which limited brokers' trading for their own account as well as institutional advisory accounts to twenty percent of their total business. This disapproval eventually led to the statutory amendment of the rule in the 1975 Act.[59] During the evaluation of the Commission's rule 19b-2, the Senate Committee on Banking, Housing, and Urban Affairs concluded that although the Commission properly was concerned with the public purposes of securities markets, its decision to protect the integrity of the markets through rule 19b-2 was inappropriate. The committee found the rule convoluted and essentially anticompetitive; it further viewed the pending litigation concerning the rule as an indication that a time-consuming and uncertain case-by-case adjudication of the policy question would result rather than the simpler rulemaking procedure envisioned by the Commission.[60]

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57. Ever since the older of the authors was in high school (some 40 years ago) he has been told by teachers who could not have known what they were talking about that regulatory agencies become the captives of the regulated. To say that such an observation is trite does not, of course, dispose of the fact that it might be true. If being captive means being more eager to please the regulated companies (or persons) than to promote the "public interest and the interest of investors and consumers," it is clearly a bad thing. One hears stories that from time to time this may have been true of certain commissions, state and federal. But if a regulatory agency is deemed "captive" because it seeks to understand the regulated companies and to accommodate its regulatory efforts to the realities of their circumstances and problems, the logical conclusion is absurd. Regulatory agencies of all sorts were not established to destroy the subjects of their jurisdiction either through deliberate measures or ignorance or ineptitude or shameless pandering to the passions of the mob.

58. 1934 Act § 11A, 15 U.S.C. § 78k-1 (Supp. V 1975).

59. 1934 Act §§ 11(a), 11(b), 15 U.S.C. §§ 78k(a), 78k(b) (Supp. V 1975).

60. SENATE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS, REGULATION OF SECURITIES TRADING BY MEMBERS OF NATIONAL SECURITIES EXCHANGES AND THE SALE BY INVESTMENT ADVISORS OF REGISTERED INVESTMENT COMPANIES, S. REP. No. 187, 93d Cong., 1st Sess. 12-14 (1973).

The Senate Committee also accused the Commission of favoring certain brokerage interests over the interest of investors,[61] and of promulgating rule 19b-2 to maintain the fixed commission rate structure, despite the Commission's own policy favoring a competitive rate structure. These comments indicate a perception by Congress that the Commission was protecting the securities industry.

Additional evidence of congressional impatience with the pace of the Commission's direct reform of the securities industry appeared in a recent report by the Oversight Subcommittee of the House Committee on Interstate and Foreign Commerce.[62] The report, *Federal Regulation and Regulatory Reform*, which covered regulatory agencies throughout the government, concluded that the Commission was proceeding too slowly in its efforts to remove anticompetitive and otherwise unjustifiable exchange rules.[63] The House Subcommittee also was impatient with the Commission's reluctance to become involved directly with the promulgation of standard accounting procedures and rules facilitating the independence of boards of directors of listed companies.[64]

A second explanation for the determination of Congress to impose constraints on regulatory agencies' conduct and to limit the amount of their discretion probably is the outgrowth of strained relations between the executive and legislative branches during the Nixon administration. The conflict between the two branches and the occasional efforts on the part of the executive branch to present the Congress with a *fait accompli* engendered a certain amount of congressional distrust of the bureaucracy. Concurrently, Congress attempted to become more assertive in managing the federal government. Legislative initiatives, including parts of the 1975 Act, the ERISA legislation, and the Tax Reform Act of 1976 are examples of legislation either originating in or heavily modified by Congress and reflect congressional efforts to exert more direct control over the bureaucracy.[65]

61. *Id.* 12-13.

62. SUBCOMM. ON OVERSIGHT AND INVESTIGATIONS OF HOUSE COMM. ON INTERSTATE AND FOREIGN COMMERCE, FEDERAL REGULATION AND REGULATORY REFORM, 94th Cong., 2d Sess. 51-53 (1976).

63. *Id.*

64. *Id.*

65. ERISA is an extreme example of the tendency. The result is, in a sense, rulemaking by Congress, or more accurately by congressional staff. There is no basis for helieving that congressional staffs are more expert, more attuned to the public interest, and less suhject to corrupting influences in the formulation of rules than are the administrative agencies. And the difficulties of correcting a mistake are vastly increased.

Perhaps these concerns and Congress' impatience with the Commission's reform efforts foreshadow congressional objection to some provisions of the Code, such as the codewide exemptive power under section 302(b). To avoid these objections, one must emphasize the aggregate effect of the Code on the Commission's power. In those terms the Code should satisfy congressional desires to curb excessive administrative power, since the Code's delegation of discretionary power is balanced with constraints created by the Code as well as by circumstances.

V. Limitations on Discretionary Power of the Commission

The primary limitations on the Commission's discretionary power are imposed by sections 302 and 1502. Section 302, which provides for codewide exemptive power, specifically denies the Commission any power to exempt persons from the prohibition against fixed rates or commissions or from rules of self-regulatory organizations. Further the codewide exemptive power must be exercised in conformance with other Code provisions.[66]

Section 1502(a) provides general authority for the Commission's promulgation of rules and regulations. Rules and regulations, including those exempting persons, securities, or transactions under section 302, must satisfy the standards of section 1502(b) and (c). In exercising its rulemaking authority, the Commission must consider the effect of rules on competition. The Commission "may not adopt a rule change that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of this Code . . . ."[67] Also, the Commission must determine that:

> its action [rulemaking] is necessary or appropriate in the public interest or for the protection of investors . . . and [that its action is] in furtherance of the purposes fairly intended by the policy and provisions of this Code . . . .[68]

Other sections of the Code make specific reference to the public interest and the purposes and policy of the Code. Sections 101 and 102 generally state legislative findings and purposes. Sections 1301 through 1311, which prohibit churning, touting, and manipulation and require insiders to disclose material facts if they engage in trading,[69] in part codify Commission rules (including 10b-5) and case law concerning fraud and manipulation. Sections 1301 through 1311

66. TD-5 §§ 302(a), 302(b).
67. *Id.* § 1502(c).
68. *Id.* § 1502(b).
69. RD 1-3 §§ 1303, 1306, 1307, 1308.

thus are much clearer than section 10 of the 1934 Act, which also prohibits deception and manipulation. The combined effect of requiring the Commission's action to be consistent with the policy and purposes of the Code and of clarifying and codifying those policies and purposes probably will limit and control significantly the Commission's exercise of its discretionary power.

Some areas of the Commission's rulemaking authority are regulated directly. Code section 805 requires Commission approval of rule changes by self-regulatory organizations. The Code spells out a procedure that the Commission must follow and thus effectively limits the Commission's discretion in reviewing the rule changes.[70] Code section 914 similarly specifies the extent of the Commission's rulemaking authority in the area of trading and investment advisory services.[71]

Congressional oversight provides yet another important constraint on the Commission's discretionary power. The Code requires that the Commission report annually to Congress on certain matters. The Commission must summarize all requests for exemptions from registration requirements, indicate which requests are granted, and set forth the basis for the exemption.[72] The Commission must report on other areas of particular congressional concern, including self-regulatory organizations, municipal brokers and dealers, clearing agencies, institutional investors, and the continued viability of small broker-dealers.[73] Finally, the Commission report must discuss the Commission's activities concerning the structure of national securities exchanges, the development of a national market system, and a system for the clearance and settlement of securities transactions.[74]

Beyond this formal oversight procedure, the Commission is engaged constantly in explaining and justifying its implementation and administration of the securities laws. The formal and informal oversight by the Congress, which has increased in recent years, con-

70. TD-5 §§ 805(b), 805(e).

71. Two additional Code provisions decrease the likelihood of abuse of discretion by the Commission. Code § 1502(e) (TD-5) requires that *ex parte* communication to the Commission concerning proposed rules be kept in a publicly available file. This action provides some assurance that the Commission will not be secretly influenced by interested parties, especially industry interest groups. Code § 1505(d) (RD 1-3) protects persons who are the subject of investigations by the Commission. If such a person will be the subject of adverse publicity, he is granted a "reasonable opportunity to state his position on the record . . ." or to respond to reports of the Commission at the time the report is published. RD 1-3 § 1505(d)(3).

72. TD-5 § 1501 (i)(7).

73. *Id.* § 1501(i)(9).

74. *Id.* § 1501(i)(12).

strains the Commission's exercise of its discretionary power. Should inappropriate use of this power be revealed through the oversight process, Congress probably would consider remedial legislation. Abuse of discretion is unlikely to occur, however, since it would conflict with the Commission's interest in maintaining its comfortable working relationship with Congress. That relationship is enhanced by the Commission's responsiveness to early warning signals of congressional displeasure, which often are communicated through informal oversight activities.

The expressed attitude of the Commission provides a final basis for the expectation that the Commission's discretionary power under the Code will be exercised properly. In reference to its broad exemptive power under the Investment Company Act, the Commission has stated:

> The very breadth of a power to exempt any person, security, or transaction from any provision of the Act places upon us a grave responsibility that such power be exercised with the greatest circumspection. We must be alert to guard against the possibility that this Commission, established to implement the legislative will to protect investors, become the instrument through which the expressed policies of Congress are thwarted in case by case grants of exemption to any applicant who files and presses an application.[75]

VI. CONCLUSION

Under the Federal Securities Code, the Commission's discretionary power will be restricted by the Code itself, by formal and informal congressional oversight, and by the Commission's traditionally judicious use of its powers. With these restraints, Congress should not be reluctant to grant to the Commission the new powers proposed in the Code. This article has concentrated on the balance between those new powers and the constraints on the Commission. It should be emphasized, as it certainly is elsewhere in this symposium, that the Code's changes of the Commission's responsibilities will enhance the Commission's ability to administer the securities laws fairly and efficiently and to adapt the laws to new developments in the industry. The prospect of this substantial public benefit provides yet more justification for the enactment of the Code.

75. American Participations, Inc., 10 S.E.C. 430, 437 n.8 (1941).