MEMORANDUM

February 20, 1985

TO: John J. Huber
Director, Division of Corporation Finance

FROM: Daniel L. Goelzer DGoelzer
General Counsel

SUBJECT: NASD Proposal to Alter the Prospectus Delivery Requirements of the Securities Act

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I. Introduction

This responds to your request that this Office provide a legal opinion as to whether implementation of the attached

proposal, submitted by the National Association of Securities Dealers ("NASD"), would be within the Commission's existing rulemaking authority or would require legislation. You have not requested our views on the desirability of adopting this particular proposal, or on the Commission's authority generally to act in the same area with respect to different proposals, and we express no opinion on these matters.

In brief, the NASD proposes that the Commission adopt a rule under the Securities Act defining a confirmation to be a statutory prospectus where certain conditions are met. Although our initial view inclined toward resolving the competing considerations implicated by this proposal in favor of the Commission's authority, after extensive further review, we have concluded that it would be inadvisable for the Commission to rely on its existing authority under the Securities Act as a basis for promulgating this proposed rule.

As discussed more fully below in Parts II through VI, this conclusion is based primarily on our analysis of the relationship between the Commission's interpretive or legislative rulemaking authority under Section 19(a) of the Securities Act and the evidence of Congressional intent with respect to prospectus delivery requirements. A rule adopted under general rulemaking authority must be consistent with the purposes and policies of the enabling statute. While the argument can be made that the timing of the delivery of the statutory prospectus was not a crucial element of the Congress' intention with respect to

prospectus delivery, we have concluded that the better view is that the available evidence of legislative intent is not sufficiently clear to override the actual language of the statute.

II. Interpretive Question Raised by the NASD Proposal

A question has been raised as to the Commission's authority to promulgate the rule proposed by the NASD because the effect of the proposal would be to alter settled requirements, resulting from the operation of Sections 5(b) and 2(10) of the Securities Act, that govern the delivery of prospectuses relating to securities offerings registered under the Act. 1/

1/ Section 5(b) provides:

> (b) It shall be unlawful for any person, directly or indirectly --
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> (1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to carry or transmit any prospectus relating to any security with respect to which a registration statement has been filed under this title, unless such prospectus meets the requirements of section 10; or
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> (2) to carry or cause to be carried through the mails or in interstate commerce any such security for the purpose of sale or for delivery after sale, unless accompanied or preceded by a prospectus that meets the requirements of subsection (a) of section 10.

Section 2(10) provides in relevant part:

> The term "prospectus" means any prospectus, notice, circular, advertisement, letter, or communication, written or by radio or television, which offers

(Footnote continued)

The NASD has proposed that the Commission adopt a rule that would define a confirmation for purposes of Section 5(b) 2/ of the Securities Act to be a prospectus meeting the requirements of Section 10(a), i.e., a statutory prospectus, 3/ if: (1) for

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1/ (Footnote continued)

> any security for sale or confirms the sale of any security; except that (a) a communication sent or given after the effective date of the registration statement (other than a prospectus permitted under subsection (b) of section 10) shall not be deemed a prospectus if it is proved that prior to or at the same time with such communication a written prospectus meeting the requirements of subsection (a) of section 10 at the time of such communication was sent or given to the person to whom the communication was made * * *.

2/ The NASD proposal refers to changes to the requirements of Section 5(b). Thus, it apparently applies both to Section 5(b)(1), which requires that a prospectus used after a registration statement is filed meet certain requirements, and to Section 5(b)(2), which requires that the delivery of a security must be accompanied or preceded by a statutory prospectus. Consequently, the proposal would affect two distinct elements of the prospectus delivery requirements.

3/ For purposes of this memorandum, the term statutory prospectus refers to a prospectus literally meeting the requirements of Section 10(a). Section 10(a) prescribes that certain specified information also included in the registration statement must be contained in the definitive prospectus required, by operation of Sections 2(10) and 5(b), to be delivered before or with a confirmation of purchase or a delivery of securities. This term should be distinguished from the preliminary prospectus, referred to in the NASD proposal, which serves primarily as an interim offering document and may omit certain information pursuant to Rule 430.

(Footnote continued)

offerings on Form S-3, the confirmation incorporates by reference the prospectus that is included in the registration statement as declared effective and contains a statement that the broker will mail a statutory prospectus within 10 business days following the effective date of the offering; and (2) for offerings on Form S-1 or S-2, the confirmation is preceded or accompanied by the most recent preliminary prospectus prepared in accordance with Rule 430 under the Securities Act, and contains the same statement that the broker will mail a statutory prospectus within 10 business days following the effective date of the offering. The effect of this rule would be to permit the delivery of a statutory prospectus to purchasers subsequent to the delivery of the confirmation of the purchase.

Section 5(b)(1) prohibits the use, after a registration statement has been filed with respect to a security, of any prospectus that does not meet the requirements of Section 10. 4/

3/ (Footnote continued)

There is an important distinction between the term statutory prospectus as it is used in this memorandum and the Section 10(a) prospectus as defined by the NASD proposal. The proposal defines a confirmation as a Section 10(a) prospectus in order to come within the language of Section 5(b), but contemplates delivery to the investor of a statutory prospectus actually meeting the requirements of Section 10(a) within ten days after the effective date of the offering.

4/ Section 10 specifies the information that must be furnished to purchasers in certain categories of prospectuses, subject to the Commission's authority to make additional classifications or otherwise vary the form and contents of prospectuses. See infra notes 7-8.

Section 5(b)(2) prohibits the delivery of a security after sale unless it is preceded or accompanied by a prospectus meeting the requirements of Section 10(a). Section 2(10) defines the term "prospectus" to include not only written offers to sell a security, but also a written communication that "confirms the sale of any security," except that a communication provided after the effective date of the registration statement "shall not be deemed to be a prospectus if it is proved that prior to or at the same time with such communication a written prospectus meeting the requirements of subsection (a) of Section 10" is provided.

The effect of Section 5(b)(1), coupled with Section 2(10), is to make it unlawful to send a confirmation, because it would not meet the requirements of Section 10, unless the confirmation is preceded or accompanied by a statutory prospectus. In addition, Section 5(b)(2) requires that the delivery of the security after sale be accompanied or preceded by a statutory prospectus.

The NASD's proposal would remove the requirement that a statutory prospectus be provided to purchasers with or before the delivery of the confirmation of purchase, if certain conditions were met, and would permit delivery of the statutory prospectus within ten business days after the effective date of the offering.

In order to determine whether the Commission may make these alterations to the prospectus delivery requirements by rule, it is necessary to examine the scope of the relevant provisions in the Securities Act that grant rulemaking authority to the Commission.

III. Commission Rulemaking Authority Under the Securities Act

The Securities Act contains no express grant of authority to the Commission to establish or vary prospectus delivery requirements, and no general exemptive authority to reduce or modify the requirements of the Act. 5/ However, several provisions of the Securities Act grant rulemaking authority that is relevant to the prospectus delivery requirements. They are the specific authority in Sections 10(a)(4) and 10(d) to vary the form and content of prospectuses, and the general rulemaking authority granted by Section 19(a). 6/

5/ The Bush Task Force has recommended the adoption of an amendment to the Securities Act that would grant the Commission general exemptive authority under Section 5 of the Act. While such a provision might constitute independent authority to adopt the NASD's proposal, for purposes of this memorandum, we have limited our analysis to the Commission's existing authority under the Securities Act.

6/ The Securities Act contains other statutory grants of rulemaking authority, in Sections 10(b) and 2(10), that pertain to prospectuses. Section 10(b) authorizes the Commission to promulgate rules that permit the use of a prospectus, for purposes of Section 5(b)(1), that omits in part information in the statutory prospectus. Section 2(10)(b) provides that a communication is not a prospectus if

> it states from whom a written prospectus meeting the requirements of section 10 may be obtained and, in addition, does no more than identify the security, state the price thereof, state by whom orders will be executed, and contain such other information as the Commission, by rules and regulations deemed necessary or appropriate in the public interest and for the protection of investors, and subject to such terms and conditions as may be prescribed therein, may permit.

(Footnote continued)

A. Specific Authority -- Sections 10(a)(4) and 10(d)

Section 10(a)(4) of the 1933 Act provides that the Commission may by rules and regulations designate statements that may be omitted from a statutory prospectus if the required statements are not "necessary or appropriate in the public interest or for the protection of investors." 7/ Section 10(d) provides that the Commission may classify prospectuses according to the nature and circumstances of their use or otherwise, and prescribe as to each class the "form and contents" which it may find "appropriate and consistent with the public interest and the protection of investors." 8/

6/ (Footnote continued)

Since the NASD proposal is expressly intended to address the requirements of Section 10(a), these sections are not relevant sources of rulemaking authority for this proposal. As noted above, your request that we consider the Commission's rulemaking authority was limited to the Commission's authority to adopt this proposal.

7/ Section 10(a)(4) has been used, for example, as authority for the promulgation of Rule 492 pertaining to omissions from prospectuses in connection with registrations by foreign governments. See, e.g., Rule 492, Omissions from Prospectuses in Connection with Registration by Foreign Governments or Political Subdivisions Thereof, 41 Fed. Reg. 12010 (Mar. 23, 1976).

8/ Section 10(d) has been used as authority for the promulgation of Rule 431 pertaining to summary prospectuses. See Rule 431 (formerly Rules 434 and 434a), Summary Prospectuses, which the Commission promulgated in 20 Fed. Reg. 8566 (Nov. 19, 1955) and 21 Fed. Reg. 9642 (Dec. 6, 1956) pursuant to Sections 10(b), 10(d) and 19(a).

While these provisions arguably could supplement other existing authority to alter prospectus delivery requirements, we believe that they would not alone supply a sufficient basis to do so. There is little authority construing these provisions. 9/ We believe, however, that the NASD's proposal, which has the effect of altering the timing of prospectus delivery, cannot fairly be characterized as a rule relating to the omission of statements required in prospectuses, or to the prescription of the form and content of prospectuses according to classification. The proposal would not reflect a determination that the information contained in the statutory prospectus is not necessary or appropriate, but only that it may be provided at a later time. 10/

9/ What little direction we have discovered in the legislative history of Section 10 does not suggest any Congressional intent apart from that reflected in the statutory language. See H.R. Rep. No. 85, 73d Cong., 1st Sess. 8 (1933) ("while a leeway is given to the Commission to meet the varying exigencies of business transactions, fundamental safeguards necessary to insure a fair disclosure are to be preserved"). See also id. at 7, regarding the specific disclosures required in the schedules attached to the bill ("To assure the necessary knowledge for judgment, the bill requires enumerated definite statements. Mere general power to require such information as the Commission might deem advisable would lead to evasions, laxities, and powerful demands for administrative discriminations.").

10/ Cf. Canadian Pacific Enterprises v. Krouse, 506 F. Supp. 1192, 1199 (S.D. Ohio 1981) (Unlike other sections relied on by the Commission, Section 14(d)(1) of the Securities Exchange Act does not authorize promulgation of Rule 14d-2. The authority in Section 14(d)(1) to adopt rules prescribing the content of tender offer documents does not extend to the promulgation of a rule that specifies when a tender offer will be deemed to begin by defining "commencement.").

Accordingly, we believe that the Commission's authority to adopt the NASD's proposal depends upon the nature and extent of its authority under Section 19(a).

B. General Authority -- Section 19(a)

Section 19(a) provides:

> [T]he Commission shall have authority from time to time to make, amend, and rescind such rules and regulations as may be necessary to carry out the provisions of this title, including rules and regulations governing registration statements and prospectuses for various classes of securities and issuers, and defining accounting, technical, and trade terms used in this title.

There is little specific authority discussing the Commission's power under Section 19(a) to interpret or implement express statutory directives under the Securities Act. 11/ There is, however, a large body of law governing the construction of general grants of rulemaking authority like Section 19(a).

11/ The Securities Act legislative history indicates that the Commission was to have broad powers under its general rulemaking authority. See To Provide for the Furnishing of Information and the Supervison of Traffic in Investment Securities in Interstate Commerce: Hearings on S. 875 Before the Senate Comm. on Banking and Currency, 73rd Cong., 1st Sess. 250 (1933) [hereinafter cited as 1933 Senate Hearings] (statement of Ollie M. Butler, Attorney, Department of Commerce, Washington, D.C.):

> In drafting this bill it has been endeavored, wherever possible, to avoid enumeration and to give the Commission broad powers of regulation, the theory being that they would be in a better position to determine, after practical experience, what information is needed than we could in advance. For this

(footnote continued)

IV. Judicial Construction of General Grants of Rulemaking Authority

Grants of general rulemaking authority have been construed broadly. The Supreme Court has stated that

> [w]here the empowering provision of a statute states simply that the agency may "make * * * such rules and regulations as may be necessary to carry out the provisions of this Act," we have held that the validity of a regulation promulgated thereunder will be sustained so long as it is "reasonably related to the purposes of the enabling legislation. 12/

Moreover, the courts have rejected the argument that the existence of specific grants of rulemaking authority limits the authority conferred under general rulemaking provisions to "routine housekeeping." The Supreme Court has looked to general

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11/ (footnote continued)

> reason section 15 [of the Senate bill] has been added as an auxiliary to other provisions giving the Commission power to call for such further information as it may require and to establish such rules and regulations as it may find necessary in the administration this act.

In addition, courts generally have pointed to the importance of broadly construing rulemaking authority conferred on the Commission by provisions of the securities laws in view of the Commission's far-reaching responsibilities. See, e.g., Touche Ross & Co. v. SEC, 609 F.2d 570, 582 (2d Cir. 1979).

12/ Mourning v. Family Publications Services, Inc., 411 U.S. 356, 369 (1973) (footnote omitted) (quoting Thorpe v. Housing Authority of the City of Durham, 393 U.S. 268, 280-81 (1969)).

grants of rulemaking authority to uphold the validity of rules related to the purposes of the enabling statute despite the presence of specific grants in the statute under scrutiny. 13/

A general grant of rulemaking power does not, however, provide an agency "with carte blanche authority to promulgate any rules, on any matter relating to the [enabling legislation]

13/ See, e.g., E.I. du Pont de Nemours & Co. v. Train, 430 U.S. 112, 132 (1977) (general rulemaking grant in § 501 of Federal Water Pollution Control Act, 33 U.S.C. § 1361 (1976), supports issuances of categorical effluent limitations under § 301, 33 U.S.C. § 1311 (1976), despite explicit specific rulemaking grants in, e.g., §§ 303, 304, 306, and 307, 33 U.S.C. §§ 1313, 1314, 1316, and 1317); Mourning v. Family Publication Services, Inc., 411 U.S. 356 (1976) (general rulemaking grant in § 1604 supports prophylactic "Four Installment Rule," despite explicit specific rulemaking grants in, e.g., §§ 123, 124, 126, 15 U.S.C. §§ 1633, 1635, 1636 and 1637).

The Commission has relied in several instances on Section 19(a), sometimes in conjunction with other sections, to promulgate rules relating to the prospectus delivery requirements. See, e.g., Rule 153, Definition of "Preceded by a Prospectus," as Used in Section 5(b)(2), in Relation to Certain Transactions, 2 Fed. Reg. 1076 (May 26, 1977) (relying on Section 19(a)); Rule 153a, Definition of "Preceded by a Prospectus" as Used in Section 5(b)(2) of the Act, in Relation to Certain Transactions Requiring Approval of Security Holders, 37 Fed. Reg. 23636 (Nov. 7, 1972) (relying on Sections 2(3), 2(10), 2(11), 4(1), 4(3), 4(4), 5, and 19(a)); Rule 153b, Definition of "Preceded by a Prospectus," as Used in Section 5(b)(2), in Connection with Certain Transactions in Standarized Options, 47 Fed. Reg. 41955 (Sept. 23, 1982) (relying on Sections 2, 7, 10, and 19(a)); Rule 174, Delivery of Prospectus by Dealers; Exemptions under Section 4(3) of the Act, 35 Fed. Reg. 18457 (Dec. 4, 1970) (relying on Sections 4 and 19(a)).

in any manner that the [agency] wishes." 14/ Although the case law governing administrative authority to adopt rules tends to be highly fact-intensive, certain fundamental principles of statutory construction govern an agency's authority to interpret or fill in gaps in statutes under its administration.

The power of agencies to make rules is limited to the "power to adopt regulations to carry into effect the will of Congress as expressed by the statute." 15/ If a reviewing court finds that the Congress has spoken directly on the precise question at issue and that the intent of the Congress is clear, any rule in conflict with that Congressional intent must be struck down. 16/

It has long been held that an agency's rule may not conflict with express statutory provisions; 17/ and the Supreme

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14/ Citizens to Save Spencer County v. Environmental Protection Agency, 600 F. 2d 844, 873 (D.C. Cir. 1979).

15/ Dixon v. U.S., 381 U.S. 68, 74 (1965), (quoting Manhattan General Equipment v. Commissioner, 297 U.S. 129, 134 (1936)).

16/ Chevron, U.S.A., Inc. v. National Resources Defense Council, ___ U.S. ___, 104 S. Ct. 2778, 2780-81 (1984). See Ernst & Ernst v. Hochfelder, 425 U.S. 185, 213 (1976) (rulemaking power "is not power to make law").

17/ See, e.g., Maryland Casualty Co. v. U.S., 251 U.S. 342, 349 (1919).

Court has noted that "where * * * the provisions of the Act are unambiguous, and its directions specific, there is no power to amend it by regulation." 18/ Nevertheless, while the literal words of the statute may be "presumed to show legislative intent," 19/ the fundamental inquiry is determining the intent of the Congress. As the Court of Appeals for the District of Columbia Circuit recently stated:

> Isolating the intent of Congress, of course, is often easier said than done. Thus it has become axiomatic that we must assume that Congress expresses its intent through the ordinary meaning of the words it uses. But the language of a statute is not an inevitable proxy for legislative intent. 20/

Even in the absence of express and specific statutory direction, a rule may not frustrate the purposes and policies that the Congress sought to implement in the statute. 21/ In determining

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18/ Koshland v. Helvering, 298 U.S. 441, 447 (1936) (Treasury Department cannot enforce a regulation that defines gains on the sale of certain securities differently from the "plain terms" of the statute).

19/ See State of Montana v. Clark, Civ. No. 82-02421, slip op. at 13 (D.C. Cir. Nov. 20, 1984).

20/ Id. at 11 (citations omitted). See also SEC v. Sloan, 436 U.S. 103 (1978), in which the court held invalid the Commission's practice of "tacking" 10-day suspension orders after reviewing not only the explicit language of Section 12(k) of the Securities Exchange Act, but also the context of the statutory scheme and relevant legislative history.

21/ See Federal Election Com'n v. Democratic Senatorial Campaign Comm., 454 U.S. 27, 32 (1981) (a reviewing court "must reject administrative constructions of [a] statute,

(footnote continued)

whether a rule conflicts with the statutory policies, the judiciary is the final authority on issues of legislative intent and statutory construction. 22/ If the court determines that the statute is silent or ambiguous with respect to the specific issue, however, a reviewing court's inquiry is whether the agency's rule is based on a permissible construction of the statute. 23/ In such a case, a court may not substitute its own construction of a statutory provision if the agency's construction is reasonable. 24/

V. Authority under Section 19(a) to Adopt the NASD Proposal

The threshold question in determining whether the NASD proposal would be within the Commission's authority under Section 19(a) is whether the rule would be inconsistent with "unambiguous" provisions and "specific" directions of the statute. That Sections 2(10) and 5(b) require delivery of a statutory prospectus before or at the same time as delivery of the confirmation is undeniably clear. Nevertheless, we

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21/ (footnote continued)

whether reached by adjudication or by rulemaking, that are inconsistent with the statutory mandate or that frustrate the policy that Congress sought to implement").

22/ Chevron, supra, ___ U.S. ___, 104 S. Ct. at 2782 n.9.

23/ Id. at 2782.

24/ Id.; Train v. National Resources Defense Council, Inc., 421 U.S. 60, 87 (1975).

believe there is a sufficient lack of clarity surrounding the underlying purpose and role of this requirement in the statutory scheme, and the rationale for inserting the operative language of this requirement in Section 2(10) rather than in Section 5, to warrant the conclusion that the Commission is not foreclosed by the language of the statute from exercising its authority under Section 19(a) to adopt reasonable rules interpreting or implementing these provisions.

As discussed above, however, any such rule would be valid only to the extent that it is consistent with the policies, and reasonably related to the purposes, of the Securities Act. In order to determine whether implementation of the NASD proposal would fall within this authority, it is therefore necessary to review the history of the Securities Act, and the purposes of the prospectus delivery requirements, for further evidence of the Congressional "intent" underlying these provisions.

VI. The Prospectus Delivery Requirements of the Securities Act

A. The Securities Act as Originally Enacted and Construed

The primary objective of the Securities Act was to assure adequate disclosure about securities sold to the public so that investors can make an informed decision as to the purchase

of a particular security. 25/ As originally enacted, Section 5(a) of the Securities Act made it unlawful to sell or to solicit offers to buy securities prior to the effective date of the registration statement filed with respect to those securities. Section 5(b) made it unlawful, after the effective date, to transmit any written communication offering a security for sale, i.e., a "prospectus", unless it contained the information required by Section 10 of the Act (currently the information required by Section 10(a) to be included in a "statutory prospectus"). This one permissible form of written communication was required to accompany or precede transmission of the security for the purpose

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25/ The following statement from the legislative history is representative:

> The object of the legislation, in brief, is to require those who issue securities to be sold to the public through the mails or by use of the instruments of interstate commerce to furnish material information to the public about the securities which they are asking the public to buy.

77 Cong. Rec. 2912 (1933) (statement of Rep. Mapes). See also id. at 2919 (statement of Rep. Rayburn) ("Let me repeat that what we seek to attain by this enactment is to make available to the prospective purchaser, if he is wise enough to use it, all information that is pertinent that would put him on notice and on guard, and then let him beware."). The Preamble to the Securities Act states that the purpose of the Act is "[t]o provide full and fair disclosure of the character of securities sold * * * and to prevent frauds in the sale thereof * * *."; see S. Rep. No. 47, 73d Cong., 1st Sess. 1 (1933).

of sale or for delivery after sale. 26/

26/ Pub. L. No. 73-22, 48 Stat. 74. (1933). Section 5(b) of the Securities Act originally provided:

> It shall be unlawful for any person, directly or indirectly --
>
> (1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to carry or transmit any prospectus relating to any security registered under this title, unless such prospectus meets the requirements of section 10; or
>
> (2) to carry or to cause to be carried through the mails or in interstate commerce any such security for the purpose of sale or for delivery after the sale, unless accompanied or preceded by a prospectus that meets the requirements of section 10.

Pursuant to Section 2(10), as originally enacted, written "communications" that "offer[ed] any security for sale" could be sent to investors after the effective date of the registration statement, provided that they were accompanied or preceded by a Section 10 prospectus. Section 2(10) originally provided in relevant part:

> The term "prospectus" means any prospectus, notice, circular, advertisement, letter, or communication, written or by radio, which offers any security for sale; except that (a) a communication shall not be deemed a prospectus if it is proved that prior to such communication a written prospectus meeting the requirements of section 10 was received, by the person to whom the communication was made, from the person making such communication or his principal * * *.

In view of the Act's purpose to promote informed investment decisions by purchasers of securities, it is not clear why the statute permitted delivery of the mandated prospectus as late in the process as the time of delivery of the security after sale. There is some evidence that the Congress envisioned the prospectus as a selling document that would curb sales talk and facilitate the flow of accurate information to potential investors in securities. The House Report states with regard to the prospectus delivery provisions:

> The purpose of these sections is to secure for potential buyers the means of understanding the intricacies of the transactions into which they are invited. The full revelations required in the filed "registration statement" should not be lost in the actual selling process. This requirement will undoubtedly limit the selling arguments hitherto employed. That is its purpose. 27/

However, the language of the statute was not drafted in a manner to assure attainment of this objective. 28/

27/ H.R. Rep. No. 85, 73d Cong., 1st Sess. 8 (1933).

28/ In reviewing the legislative history of the adoption of the Securities Act and of the 1954 amendments, discussed infra, we have considered the possibility that, in enacting Section 5, the Congress may have relied on the operation of state law or industry practice to permit investors to disaffirm or rescind a purchase after review of a prospectus delivered with the purchased security. We have not discovered any evidence suggesting that this was the case.

(Footnote continued)

There is also some evidence that the Congress expected the prospectus to serve simply as a reference document, a check against earlier representations, and a potential basis for litigation against the seller. A participant in the drafting of an earlier version of the requirement mandating that certain information be furnished to the purchaser when the securities were delivered testified that:

28/ (Footnote continued)

Little discussion of the relationship between the requirements of Section 5(b) and the operation of state contract law appears in legislative materials or published commentary, notwithstanding the fact that numerous proposals to amend the requirements of Section 5 were widely discussed between the securities industry and the Commission and before the Congress during the 1940's. See infra note 36. Such commentary as we have discovered appears to reject serious consideration of any state law rights that may apply on the grounds that state law varies, resort to the courts in such situations is impractical, or the risk of being excluded from future offerings may act as a deterrent to disaffirming a particular purchase. See Proposed Amendments to the Securities Act of 1933 and to the Securities Exchange Act of 1934: Hearings Before the Committee on Interstate and Foreign Commerce, House of Representatives, 77th Cong., 1st Sess. 175-76 (1941) [hereinafter cited as 1941 House Hearings] (testimony of R. McLean Stewart, Investment Bankers Association) (part of this testimony reprinted infra at note 35; L. Loss, Fundamentals of Securities Regulation 97 (1983).

> This is something new. The reason for it is this: Persons who have purchased securities, when the securities arrive from the issuer, having laid aside the advertising or having forgotten all about it, or not having seen any advertising should be given the information which we require in the advertisements with their securities. 29/

He made a similar statement before the Senate:

> We have something new in this bill along that line, and that is that when the security is issued from the issuer or the syndicate under him, his agent or representatives, and it comes to the purchaser, that there should be contained in the envelope or the one delivering should present to the person taking the certificate a statement containing facts similar to that carried in the advertisement. That is as an additional precaution and assistance to the ordinary purchaser. He has probably seen his advertisement and it is passed by and gone, and he wants to have something with which to check if subsequently he sees that this stock is going wrong. He could refer to this information and then write to the Federal Trade Commission if he wanted to check. 30/

Moreover, it is noteworthy that the original statute placed heavy emphasis on the filed registration statement as an

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29/ To Provide for the Furnishing of Information and the Supervision of Traffic in Investment Securities in Interstate Commerce: Hearings on H.R. 4314 Before the House Comm. on Interstate and Foreign Commerce, 73rd Cong., 1st Sess. 24 (1933) [hereinafter cited as 1933 House Hearings] (statement of Hon. Huston Thompson, a former member of the Federal Trade Commission who was a major participant in drafting the Securities Act legislation).

30/ 1933 Senate Hearings, supra note 11, at 107 (statement of Hon. Huston Thompson).

instrument for assuring dissemination of corporate information. The registration statement was a "public record", 31/ the contents of which were available, during the originally mandatory twenty-day "waiting period," for the investor to read before being solicited to purchase the security. 32/ Presumably it was expected

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31/ 77 Cong. Rec. 2923 (1933) (statement of Rep. Parker).

The following colloquy concerning H.R. 5480 took place in the House:

> Mr. Adams: As I understand it, certain information must be given to the Commission prior to the registration?
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> Mr. Parker of New York: Yes.
>
> Mr. Adams: Does this bill, in the gentleman's opinion, make adequate provision for the availability of that information to the public?
>
> Mr. Parker of New York: Why, it is a public record.
>
> Mr. Adams: I am asking for information.
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> Mr. Parker of New York: Yes, it is a public record; and after the application, if you are going to form a corporation and you file your prospectus, answer all these questions, and I am going to underwrite or handle it for you, I cannot sell it for 30 days after you have filed your prospectus, so that everybody will have a chance at least to be put on notice as to what is behind the stock.

Id. (The thirty day waiting period to which Rep. Parker referred was reduced to twenty days by the conference committee.).

32/ See id. at 2912 (Statement of Rep. Mapes) ("in the exercise of reasonable care [the investor] can go to the Federal Trade Commission [after 1934, the SEC] or to the underwriter or the dealer in the securities and find out the facts relating to the business of the corporation issuing the securities * * *.").

that information contained in the registration statement would "percolate down" 33/ through various persons in the securities industry to the ultimate investor, primarily during the highly-important waiting period. In addition, the public nature of the registration statement and the Commission review of that document may have been viewed as prophylactics against the dissemination of misleading sales information. 34/

33/ See 1 L. Loss, Securities Regulation 203 (2d ed. 1961).

34/ In testimony before the House regarding the 1954 amendments to the Securities Act, Professor Loss stated, in answer to a question as to whether investors actually read prospectuses:

> I think, however, that more important than the delivery of the prospectus really is the fact that so long as you have to tell everything publicly to the SEC, and the SEC is going to examine it, that kind of a disclosure acts as a prophylactic even if there were no prospectus at all. I think it would be wonderful, ideally, if we had a statute written that would guarantee that every buyer would get the prospectus for a day or two before he committed himself. I am now satisfied, hindsight being a great teacher, that it would be too cumbersome to try to work out that type of legislation.

Amending Securities Act of 1933, Securities Exchange Act of 1934, Trust Indenture Act of 1939, and Investment Company Act of 1940: Hearings on H.R. 7550 and S. 2846 before the House Comm. on Interstate and Foreign Commerce, 83d Cong., 2d Sess. 112 (1954) [hereinafter cited as 1954 House Hearings] (statement of L. Loss). See also 1 L. Loss, Securities Regulation 185-86 (2d ed. 1961).

This legislative history does not provide clear guidance as to whether the Congress intended the prospectus to serve primarily as a selling document, a source of information on which investors could rely in making investment decisions, or as a reference document, a source of information to which investors might refer after having acquired a security. Nor did the Commission directly address this potential ambiguity in its early years administering the Act; it did, however, adopt a construction of the prospectus delivery requirements that shifted the focus of these requirements toward earlier, rather than later, delivery of the prospectus to investors. The Commission took the positon in 1941, in a published opinion of its General Counsel, that the prospectus mandated by Section 5 was required to accompany or precede delivery of a confirmation. The General Counsel stated that "[t]he term 'prospectus' is defined in the Act broadly enough to include within its meaning an ordinary confirmation; and since the confirmation is not itself a formal prospectus, it * * * must be accompanied or preceded by a formal prospectus." 35/

B. The Securities Act as in Effect Today

In 1954, the Congress codified the Commission's interpretation of the prospectus delivery requirements. The Congress

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35/ Securities Act Rel. No. 2623 (July 25, 1941) (emphasis in original). This interpretation generally had the effect of advancing the latest possible time at which the prospectus

(footnote continued)

amended Section 2(10) of the Securities Act to include within the definition of "prospectus," in addition to any communication

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35/ (footnote continued)

could be provided to the investor. The Commission did not articulate the reasoning underlying its decision to construe the statute in this manner, and the purpose of this requirement is not clear. It does not appear that delivery of the prospectus with the confirmation enlarged any legal rights previously afforded to investors under the Securities Act or under state law. See supra note 28.

The Commission may have believed, however, that this construction provided investors with a strategic advantage in the distribution process. A reference to this practical benefit was subsequently made by a securities industry representative during the 1941 hearings:

> Mr. Boren. * * *. I think that the affirmative and negative power still rests in the investor at the time when he is supposed to pay arrives. Unless he has given you an affirmative reply prior to that time, [i.e., a writing binding him to purchase the securities] you could not do anything?
>
> Mr. Stewart. I suppose the actual law on the matter would be the law of the jurisdiction in which the transaction took place; but we have never been much interested in that, because we do not do business on the basis of resorting to the courts to enforce settlement with our customers. We cannot do business that way. It is the last thing in the world we ever want to do.
>
> So that if an investor does not, when it comes to the time of making payment, wish to go ahead with the transaction, I think that most dealers throughout the country will tell you that the matter is dropped, and the transaction is canceled.

1941 House Hearings, supra note 28, at 175.

See also 1954 House Hearings, supra note 34, at 70 (statement of SEC Chairman Ralph H. Demmler) ("The prospectus, sir, is furnished usually with the confirmation of the order after the registration statement has become effective and before the customer actually writes his check.").

offering a security for sale, one that "confirms the sale of any security." 36/ The House Report accompanying the bill stated:

> The words 'confirms the sale of any security' have been added to avoid any implication of departure from settled interpretations that confirmations are 'prospectuses' [citing the Commission's release supra].
>
> * * * *
>
> * * * The changes also make clear that the formal prospectus when used in compliance with statutory requirements must conform to the provisions of section 10(a) not merely at the time it is sent or given but also must meet such requirements at the time any communication (which requires concurrent or prior delivery of the section 10(a) prospectus) is sent or given. This is a codification of existing interpretations. 37/

The legislative history does not provide any further explanation of the precise purpose of this requirement. This fact is particularly striking since the amendment to Section 2(10) was one of a group of related amendments to the Securities Act that reflected a recognition that the statutorily mandated prospectus

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36/ See Pub. L. No. 83-577, 84 Stat. 74 (1954). The 1954 amendments to the Securities Act represented a consensus on certain limited issues distilled from broader proposals for revision of the statute that had been discussed and debated intermittently since 1940. A continuing source of controversy during this period were industry proposals to permit delayed delivery of the Section 10 prospectus. The Commission opposed these proposals. Indeed, at one point, the Commission suggested that it might be appropriate to require advance delivery of prospectuses. For whatever reason, by 1954 the Commission was apparently satisfied to maintain then-existing prospectus delivery requirements. For a discussion of the proposals leading up to the 1954 amendments, see 1 L. Loss, Securities Regulation 198-205 (2d ed. 1961).

37/ H.R. Rep. No. 1542, 83d Cong., 2d Sess. 21 (1954).

had not been a sufficiently effective vehicle to assure the timely dissemination of information to investors.

The 1954 amendments were intended to respond to certain problems that had become apparent during the administration of the Securities Act. Industry members had argued that, due to their concern that communications during the waiting period might be found to be illegal offers to sell, they were hesitant to transmit information to potential buyers. 38/ In addition, to the extent that sellers did distribute information during the waiting period, it frequently was in the form of an inflexible copy of the registration statement. 39/ Testimony before the

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38/ As the Chairman of the Commission stated in a House Committee Hearing with regard to the 1954 amendments:

> It is clear from the legislative history of the act that the Congress intended that by dissemination of information during the waiting period the public would become informed of the essential facts relating to a proposed issue before the effective date of the registration statement.
>
> The securities industry has contended for many years that, in practice, the free flow of information concerning a new issue during the waiting period has been restricted because of the fear of underwriters and dealers that their communications to prospective customers might be construed to be illegal "offers" of a security before the effective date of the registration statement.

1954 House Hearings, supra note 34, at 21 (statement of Chairman Ralph H. Demmler).

39/ Committee on Interstate and Foreign Commerce, 77th Cong., 1st Sess., Report of the Securities and Exchange Commission on Proposals for Amendments to the Securities Act of 1933 and the Securities Exchange Act of 1934 at 1 (Comm. Print

(footnote continued)

Congress indicated that increased emphasis should be placed on dissemination of information "while it is still early enough for it to be useful." 40/ The House Report reprinted the following testimony:

> The prospectus has not proved to be an effective instrument for informing the public. * * * If the Congress believes that the investor should have certain minimum prescribed information before he purchases the security, and I think it does (certainly it is clear to me that it did in 1933 when the law was adopted), it must revise the law to see that the prospectus is delivered at a time when it can be useful to the investor in making his decision to buy, and not be a mere memorial of a past transaction. 41/

The Congress could have responded to these concerns by requiring delivery of the statutory prospectus prior to the consummation of any purchase of a security; however, it did not

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39/ (footnote continued)

1944). ("The Congress contemplated that the prospectus would be the actual selling document and would contain the more important information appearing in the registration statement. In practice, however, the prospectus too often has been an almost complete copy of the text of the registration statement itself.").

40/ H.R. Rep. No. 1542, 83d Cong., 2d Sess. 13 (1954). The testimony cited was that of the Commission's Chairman Demmler.

41/ Id. (statement of Edward T. McCormick, former SEC Commissioner and President of the American Stock Exchange). See also 1954 House Hearing, supra note 34, at 109 (statement of L. Loss) ("I think what this bill basically is driving at is to give the Commission the power under proper standards to permit dissemination of information in an understandable form during the waiting period, because that is the entire basic premise of the Securities Act, to educate the public.").

do so. Instead, the Congress reaffirmed existing requirements for the delivery of statutory prospectuses and determined to permit a freer flow of information 42/ during the waiting period, primarily by permitting offers by means of preliminary and summary prospectuses filed with the Commission. 43/

VII. Conclusion

As set forth in the preceding discussion, we believe that Section 19(a) of the Securities Act is the most likely source of rulemaking authority for the NASD proposal. Whether the NASD proposal would fall within this grant of authority to adopt rules necessary to carry out the provisions of the the Act depends upon whether the proposal would be reasonably related to the purposes and policies of the Securities Act. The express language of Sections 2(10) and 5(b), requiring delivery of a statutory prospectus to precede or accompany the confirmation, is the first source from which to draw legislative intent, but the legislative and administrative history of these provisions

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42/ H.R. Rep. No. 1542, 83d Cong., 2d Sess. 4 (1954). The Commission acknowledged in commenting on the proposed legislation that the legislation would give sellers more freedom in selling, but indicated that this was not objectionable where there was no prejudice to investors' rights. See id. at 5 (quoting letter of Commissioner Clarence H. Adams, August 27, 1953) ("The Commission agrees with you that it should not sponsor statutory changes which would weaken the present statutory protection of investors. On the other hand, there may be, as you suggest, well-founded proposals for simplifying procedures by various technical amendments.").

43/ Id. at 4; Securities Exchange Acts Amendments: Hearings on S. 2846 before a Subcommittee of the Senate Committee on Banking & Currency, 83d Cong., 2d Sess. 7 (1954).

and their statutory context also provide guidance in determining their purpose.

The history of the prospectus delivery requirements and their statutory context do not, however, offer persuasive evidence of Congressional intent; rather they are susceptible of more than one interpretation. The significant role of the registration statement and the increasing emphasis over time on disclosures in preliminary or abbreviated documents suggest that the statutory prospectus was intended to serve more as a reference document than a selling document. From that perspective, the timing of its delivery would not appear to be crucial to the accomplishment of its purpose. However, even while seeking more effective vehicles for providing timely information to investors, the Congress reaffirmed the specific statutory requirements for delivery of the statutory prospectus. We would not wish to rely on such ambiguous history in construing the prospectus delivery requirements in a manner that differs from their literal terms. Given the ambiguities inherent in the history of these provisions, the language of Sections 2(10) and 5(b) should be viewed as the best evidence of Congressional intent.

Moreover, as indicated in the preceding section, there is ample evidence that a fundamental objective of the prospectus requirements generally, and of the statute as a whole, was to promote the dissemination of material information to investors in the most timely manner possible. While it may not be clear

whether the statute's prospectus delivery requirements were specifically intended to further this objective, we believe that a court would consider this objective relevant to the construction of these provisions and would question the validity of a rule in the form of the NASD's proposal that delayed the delivery of statutorily required information. For these reasons, we believe the Commission should not invoke its rulemaking authority under Section 19(a) to support the potential adoption of the NASD's proposal. 44/

44/ Even assuming, however, that the proposal would fall within the Commission's authority, we think it important to note that the rule could raise another difficult legal question. Under the Administrative Procedure Act, a court must set aside agency action if it is "arbitrary, capricious, an abuse of discretion or otherwise not in accordance with law." 5 U.S.C. 706(2)(A). A court should uphold the validity of a rule under this standard if the agency considered the relevant information, made a decision based upon that information, and articulated a satisfactory explanation of its actions, including a rational connection between the facts found and the choice made. E.g., Burlington Truck Lines v. U.S., 371 U.S. 239, 245-46 (1962).

Adoption of the NASD proposal would represent the reversal of a longstanding Commission interpretation of the prospectus delivery requirements. While there is no prohibition on an agency's reconsideration of a longstanding policy, the agency must justify such a change by the rulemaking record. Chevron, supra, ____ U.S. ____, 104 S. Ct. at 2793; Motor Vehicles Manufacturers Ass'n v. State Farm Mutual Automobile Ins. Co., ____ U.S. _____, 103 S. Ct. 2586, 2870, 2873 (1983); Advanced Micro Devices v. CAB, 742 F.2d 1520, 1542 (D.C. Cir. 1984); Brae Corp. v. U.S., 740 F.2d 1023, 1038 (D.C. Cir. 1984). Where the agency followed a "settled course of behavior," the Supreme Court has stated, there is "at least a presumption that th[e] policies [committed to it by Congress] will be carried out best if the settled rule is adhered to." Securities Industry Ass'n v. Board of Governors, 104 S. Ct. 3003, 3009 (1984), (quoting Atchinson, T. & S.F.R. Co. v. Witchita Board of Trade, 412 U.S. 800, 807-08 (1973)).