

Securities Regulation
Spring 2018 (T, R; 10:10 – 11:30 a.m. in Room 205)
Professor Colesanti, Office: Room 034

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Office hours: 12:00 p.m. – 2:00 p.m. Tuesdays, Thursdays; and upon request
Assistant: Ms. Marcela Fernandez, Room 216; (516) 463- 4761

1. *Attendance*

Classes run from January 11th through April 24th. Spring Break is March 26th – March 30th.

I will provide sign-in sheets for each class, which shall be the dispositive evidence regarding your presence/absence. Each student is responsible for signing in. Falsification of sign-in sheets (e.g., signing another student's name) is a violation of the Code of Academic Conduct.

Students are responsible for all material covered in classes from which they are absent. If you believe you must be absent from class for more than the permitted number of hours (i.e., 15%), you should speak with the Office of Student Affairs as soon as possible. Accommodations may be made for students who must be absent for religious reasons, and in cases of truly compelling hardship.

2. *Required Texts*

The statutory supplement is required and is on sale in the HU bookstore.

The course also focuses on approximately 30 federal cases (indicated in bold on the attached Syllabus), all of which are available via the major e-databases.

Additionally, I will occasionally distribute packets containing pleadings, press releases, and/or other materials as an introduction to the two federal laws we will study. Students are responsible for all materials in these packets.

All students are required to register for the class on TWEN, through which I will keep in touch with students.

3. *Final Exam*

There will be an “open book,” 3-hour final exam that includes short answers (multiple choice and true/false) and two essays.

Any student engaging in relevant class participation on a consistent basis will be eligible for extra credit points, at my discretion.

4. *Paper Option*

In lieu of taking the final exam, students may submit a paper in fulfillment of Writing Requirement I or II. Please note that this option requires, among other things, that students complete all homework assignments and attend and participate in class; communicate a concrete topic (via a 4-sentence e-mail to me) by January 26, 2018; submit a 5-page sentence outline by a date TBA; and submit a final, hard copy of the paper by the beginning of the last class.

The paper must relate to one of the 9 topics detailed in the accompanying Syllabus. Moreover, the paper must expressly address class discussion of this topic for at least 2 pages. Additional guidelines for papers will appear on TWEN in late January.

5. *Course Objectives and ABA Expectations*

The current class is designed to assist you in learning:

- The basic structure of the American regulatory mosaic;
- The history of federal securities regulation;
- How to research regulations relating to mandatory securities disclosures and industry registrations, as well as protections against investor fraud;
- How to discern the rule of law governing various securities law issues stemming from the 1933 and 1934 Acts;
- How to effectively communicate analysis of securities statutes, rules, and cases;
- How to integrate practitioner guidance and current events into a fundamental understanding of the 1933 and 1934 Acts; and
- How to prepare meaningful resolutions of issues posed by registration requirements, disclosure obligations, or anti-fraud protections - whether their source is a statute, case law, administrative regulation/order or just tradition.

The American Bar Association requires that you spend at least six hours a week, on average, outside of class preparing for this 3-credit course. This is in addition to the 3 hours we spend each week in class. Please note that this is a minimal, averaged requirement; at times, research for a Paper or preparation for class may require more attention.

6. Syllabus

The Syllabus, which includes 9 topics, is attached. Assignments for each class will be announced beforehand in class, or via TWEN.

Syllabus

I. THE MARKET, AND THE PLAYERS

- (i) The Securities and Exchange Commission (“SEC”)
- (ii) U.S. Congress
- (iii) U.S. Attorneys
- (iv) The stock exchanges
- (v) The state regulators
- (vi) Private litigants and their counsel (arbitrations; class actions)
- (vii) The Federal Reserve and The Treasury Department

Key Concepts

- “self-regulatory organizations” (“SROs”)
- SEC “No Action” letters
- “Blue Sky laws”
- the mosaic of American domestic securities regulation
- exchange/live auction/“open outcry” markets vs. cyberspace markets
- regional stock exchanges
- new regulators (e.g., the Consumer Financial Protection Bureau)

Questions for Discussion

- which regulator is most likely to be first on the scene?
- which regulator takes precedence? Which is more effective?
- have the attempts to isolate the SEC from partisan politics succeeded?
- could any regulator have prevented the recent financial crisis?

Practitioner Tips:

- (1) The Dodd-Frank Act is presently under attack. Nonetheless, the law still has teeth. See <http://www.consumerfinance.gov/speeches/prepared-remarks-by-richard-cordray-on-cfpb-enforcement-action/>. Further, the accompanying Financial Stability Oversight Council has repeatedly evidenced its impact, on several occasions “decertifying” a statutorily significant company. See <http://www.marketwatch.com/story/ge-capital-no-longer-systemically-important-institution-government-rules-2016-06-29>.
- (2) The speed and complexity of present day trading has possibly outpaced efforts at its surveillance. See Commissioner Aquilar, “Addressing Market Instability Through Informed and Smart Market Regulation” (Feb. 22, 2013), available at <http://www.sec.gov/News/Speech/Detail/Speech/1365171492386>.

- (3) In these tumultuous times, are market victims wise to seek redress with the assistance of new heroes? *See* Complaint, *available at*

II. WHAT IS A “SECURITY” ?

Nine Key Cases :

1. *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946).
2. *SEC v. Glenn W. Turner Enterprises, Inc.*, 474 F.2d 476 (9th Cir. 1973); *S.E.C. v. Koscot Interplanetary*, 497 F.2d 473 (5th Cir. 1974).
3. *United Housing Foundation Inc. v. Forman*, 421 U.S. 837 (1975).
4. *Int’l. Brotherhood of Teamsters v. Daniel*, 439 U.S. 551 (1979).
5. *Landreth Timber Company v. Landreth*, 471 U.S. 681 (1985).
6. *Reves v. Ernst & Young*, 494 U.S. 56 (1990).
7. *SEC v. Life Partners*, 87 F.3d 536 (D.C. Cir. 1996)
8. *SEC v. Edwards*, 124 S. Ct. 892 (2004)

Key Concepts

- the “passive investor” and “economic realities” tests
- “vertical” vs. “horizontal” commonality
- to “offer” a security/interstate means
- Ponzi schemes
- “sale of business” doctrine
- viatical settlements
- commercial paper exception

Questions for Discussion

- what determines whether something is a security – the law, or policy?
- why isn’t membership in Mary Kay Cosmetics a *security*?
- has the *Howey* concept evolved? Should it evolve further?
- how far should regulators go in protecting investors from themselves?

Practitioner Tip:

The “Howey test” continues to be vital, both in terms of novel products, State forums, and unexpected defendants. *See Redding v. Montana First Judicial District Court, Mont.*, 144A (July 5, 2012)(stating the rule for determining securities in Montana as the 4-part *Howey* test); *State of Texas v. Life Partners* (Tx. Sup. Ct. May 2015), and “Swaps in Tourre Case ‘Based’ on Securities,” 45 SRLR 1343 (July 22, 2013).

III. INTRODUCTION TO THE 1933 ACT

- 1) Key Provisions
 - a) section 2(a)(1) – definitional section
 - b) sections 3 & 4 – exempted securities and exempted transactions
 - c) section 5 – prospectus delivery requirement
 - d) section 10 – definition of *prospectus*
 - e) sections 11, 12, 17 – liability for misstatements, omissions, fraud
 - f) section 14 – re. attempted waivers
 - g) section 15 – liability of controlling persons
 - h) section 23 – unlawful representations
 - i) section 28 – general exemptive authority

- 2) Procedural Considerations
 - a) statute of limitations (*e.g.*, section 13)
 - b) criminal referrals (section 20(b))
 - c) jurisdictional means

- 3) Concept of “meaningful” disclosure
 - *Regulation S-K as a handbook. *See* Professor Roberta S. Karmel, “Business and Financial Disclosure – The Concept Release on S-K,” NYLJ (June 16, 2016)

Key Concepts

- issuers, underwriters, and dealers
- statutory vs. implied cause of action
- “soft information” and forward looking statements
- applicability of antifraud provisions to all securities
- “not approving” vs. disapproving
- Securities Offering Reform, December 2005

Questions for Discussion

- how has the Internet affected the prospectus delivery requirement?
- are investors today really getting more information?
- are the regulators retreating from the prospectus rules?
- has a company already raised cash by the time it gets to Wall Street?
- how much of the existing protocol is traditional, as opposed to statutory?

Key Cases:

1. *Loeb Rhoades*, 38 SEC 843 (1959)
 2. *In re Ira Haupt*, 23 SEC 589 (1946)
 3. *Ralston Purina*, 346 U.S. 119 (1953)
 4. *Escott v. BarChris*, 283 F. Supp. 643 (SDNY 1968)
 5. *Gustafson v. Alloyd*, 513 U.S. 561 (1995)
 6. *Omnicare v. Laborers District Council*, 135 S. Ct. 1318 (2015)
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IV. REGISTRATION OF SECURITIES (AND EXEMPTIONS THEREFROM)

Sections 2, 3, 4, 5, 10, 11, 12, 13 and 17 of the '33 Act

- a) What must be registered
 - stocks, bonds, notes, investment contracts, etc.
- b) Regulation A
 - Rules 251 - 262
- c) Regulation D
 - Rules 501- 508
- d) Section 3(a)(11)/ Rule 147 intrastate offerings
- e) Rule 144/144A transactions
- f) Section 4(2)
- g) "Regulation A+" (b. 2015)

Key Concepts

- the prospectus delivery requirement
- "merit" vs. "notice" review
- "bad boy rules"
- presumptive underwriter doctrine
- "restricted" securities

- “QUIBs”
- recent reforms re. electronic filings
- “shelf registration”/Rule 415
- Regulation S (re. foreign issues)
- ”non-registered” vs. “unregistered securities”

Questions for Discussion

- to what audience should disclosure be geared?
- what is the cost of “going public”?
- can lawyers be liable for a faulty prospectus?
- why use one exemption instead of another?
- has capital formation been expedited by the J.O.B.S. Act of 2012?

Practitioner Tip:

The SEC is itself conflicted on the permissible amount of advertising attending an exempted offering. *See* “Facilitating General Solicitation at the Expense of Investors” (July 10, 2013), *available at* www.sec.gov. But FINRA has more recently proven quite definite in its view of permissible retail advertising of IPOs. *See* May 6, 2014 discipline of Morgan Stanley Smith Barney LLC. And Congress may have most upset the applecart with the permissible IPO variations endorsed by the JOBS Act; *see* Davis Polk Client Letter from May 2016, “Pre-IPO Companies Can Stay Private Longer.”

V. OVERVIEW OF THE 1934 ACT

Key Provisions

- Section 3 (definitions)
- Section 4 (creation of the S.E.C.)
- Section 7 (margin requirements)
- Section 9 (market manipulation)
- Section 10 (manipulation and deceptive devices)
- Section 11 (trading by members)
- Section 12 (registration requirement for securities)
- Section 13 (periodic reporting)
- Section 15 (broker dealer registration)
- Section 16 (swing trading)
- Section 17 (books and records)
- Section 18 (liability for misstatements)

- Section 20 (liability of controlling person)
- Section 20A (liability to contemporaneous traders)
- Section 21 (investigations and actions)
- Section 21A (“Civil Penalties for Insider Trading”)
- Section 30 (“Foreign Securities Exchanges”)
- Section 32 (penalties)

Key Concepts

- the 1975 amendments
- “floor trading”
- statutorily disqualified individuals (“SDs”)
- “public” companies
- “periodic reporting” (Forms 10-K, 10-Q, and 8-K)
- rule proposal “comment periods” and Section 19

Questions for Discussion

- can we trust a stock exchange to police itself?
- to what extent does the S.E.C. oversee the day-to-day workings of the market?
- how long before an S.E.C. filing becomes public knowledge?
- do disclosure rules serve foremost to chill disclosure?
- what are the jurisdictional limitations – if any - to an S.E.C. investigation?
- is there a private action for required SEC filings? *See Gould v. Winstar Communications* (2d Cir. July 19, 2012).
- do the thresholds for de facto public companies need frequent adjustment? *See* <https://www.sec.gov/info/smallbus/secg/jobs-act-section-12g-small-business-compliance-guide.htm> (announcing a 2016 update).

Practitioner Tip:

- (1) Is the SEC sojourning too far into criminal law waters? *See* Colesanti, *Wall Street as Yossarian: The Other Effects of the Rajaratnam Insider Trading Conviction*, 40 Hofstra Law Review 411 (Winter 2011).
- (2) Have class actions as a deterrent fallen out of favor with the federal judiciary? *See* General Employees’ Retirement System v. Lockheed Martin, 11 Civ. 5026 (July 16, 2013).

- (3) Is foreign application of the SEA dead? See Hamblett, “Circuit Says Cross-Listing Doesn’t Upset ‘Morrison’ Bar,” NYLJ (May 7, 2014)(discussing Second Circuit adherence to *Morrison v. National Australia Bank*, 561 US 247 (2010)).
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VI. THE ECONOMIC CRISIS

A. *Timeline*: October 2008-2012 (?)

B. *Debatable Primary Causes*

- unfathomable Wall Street greed
- delegated regulation
- regulatory sloth
- deregulation
- Congressional inactivity
- the perfect storm
- inscrutable new products

C. *Results*

- (i) stock market: down 39% at its worst point (2/09)
- (ii) bankruptcies: up 30% in 2008/2009 (businesses: up 49%)
- (iii) foreclosures: over 2 million initiated in 2008; 2.8 million in 2009; 3.8 million in 2010; 2.6 million in 2011 [Contra, the Great Depression: 50%].
- (iv) unemployment: 9% as late as Jan. 2013 (now about 4%)
- (v) bank failures: 26 in 2008; 100 in 2009; 157 in 2010; 92 in 2011; 51 in 2012.
- (vi) class action lawsuits: over 300 to date
- (vii) institutional casualties: Bear Stearns, Lehman, Fannie Mae/Freddie Mac...

D. *Responses to Date*

- Treasury Blueprint
- government loans and measures
- EESA of 2008
- ARRA of 2009
- Crisis Commission
- Dodd-Frank of 2010

Key Terms/Concepts

- CDOs
- CDS
- derivatives
- Shadow banks
- Federal loan window

Questions for Discussion

- When did the trouble start, and when was it detected?
- What reforms have crystallized?
- Is securities law relevant?
- What is the downside to merging the SEC with other regulators?

- Are criminal actions advisable?
- What is the ‘consolidated audit trail’? Will it benefit investors?

Practitioner Tip:

How much of the lingering economic mess can be empirically tied to regulatory action/inaction? See Colesanti, *Laws, Sausages and Bailouts: Testing the Populist View of the Causes of the Economic Crisis*, 4 Brooklyn Journal of Corp., Fin. & Comm. Law 175 (Spring 2010).

VII. S.E.C. RULE 10b-5

A. Background/history

B. Scope/Key Cases:

- Sante Fe Industries v. Green*, 469 U.S. 917 (1984)
- Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975)
- Merrill Lynch v. Dabit*, 547 U.S. 71 (2006)
- SEC v. Zandford*, 535 U.S. 642 (2002)
- Dura Pharmaceuticals v. Broudo*, 544 U.S. 336 (2005)
- Halliburton v. Erica P. John Fund, Inc.* 134 S. Ct. 2398 (2014)

C. Elements of a 10b-5 claim

- requirement of a purchase/sale
- fraud/deception
- scienter
- materiality

Additional requirements for private plaintiffs:

- causation (loss causation; transaction causation)
- damages

D. Most common applications: management misstatements; accounting fraud; sales practice abuses; Ponzi schemes; Internet fraud...

*As an insider trading prohibition
-dates from 1961

-related prohibitions: Section 16b of the '33 Act;
S.E.C. Rule 14e-3; Regulation FD.

Key Concepts

- elements of private vs. public actions
- “fraud on the market” theory
- self-effectuating statutes
- the Birnbaum doctrine
- stock “parking” and Form 13D
- the origin and state of 10b-5’s statute of limitations

Questions for Discussion

- how elastic should the prohibition be?
- does it apply to private companies?
- was a private cause of action intended?
- who can be sued? Is there anyone who can’t be sued?
- is “collective scienter” a pleading option? *Teamsters Local 445 v. Dynex Capital Inc*, 531 F.3d 191 (2d Cir. 2008).

Practitioner Tips:

(1) Is Rule 10b-5, at times, too inflexible? *See* Grant McCool, “U.S. appeals court tosses ‘squawk box’ convictions,” **REUTERS** (8/2/12).

(2) Do other of the “securities laws” lessen the burden on regulators? *See also* Mark Hamblett, “Circuit: Intent to Harm Not Element of Advisor Fraud Law,” *NYLJ* (May 5, 2016).

(3) Has Rule 10b-5 become TOO powerful a tool, in some prosecutor’s hands? *See* “SAC Prosecutor Hits the Media Trail,” **NY Times** (Aug. 6, 2013).

VIII. INSIDER TRADING

A. *Background*

- contrary British heritage
- early legal underpinnings in the U.S.
- Ten Key Cases:
 - In re Cady Roberts*, 40 SEC 907 (Nov. 1961)
 - Texas Gulf Sulphur*, 401 F.2d 833 (2d Cir. 1968)

- Chiarella v. United States*, 445 U.S. 222 (1980)
- Dirks v. SEC*, 463 U.S. 646 (1983)
- United States v. Chestman*, 947 F.2d 551 (2d Cir. 1991)(en banc)
- U.S. v. Bryan*, 58 F.3d 933 (4th Cir. 1995)
- US v. O’Hagan*, 117 S. Ct. 2199 (1997)
- Newman and Chiasson v. United States*, 773 F.3d 438 (2d Cir. 2014)
- Salman v. United States*, 580 U.S. ____ (2016)
- United States v Martoma*, 14-3599 (2d Cir. August 23, 2017)(rehearing).

B. Specific Contributions of the Case Law

- Parity of Information Era
- S.E.C. setbacks
- The *O’Hagan* breakthrough
- Recent developments

C. Why the prioritization at the SEC? And why the surprising persistence of the violation?

Key Concepts

- insiders and outsiders
- public vs. non-public companies
- company info and market info
- “tippers” and “tippees”
- breach of a fiduciary duty
- eavesdroppers (*See S.E.C. v. Switzer*, 590 F. Supp. 756 (W.D. Okla. 1984)).
- Forms 3, 4, and 5

Questions for Discussion

- should insider traders go to jail?
- do we need a more clear prohibition?
- why is Section 16b a weak deterrent?
 - are relationships completely governed by State law? *See SEC v. Willis*, 777 F. Supp. 1165 (SDNY 1991).
 - who wins when a Martha Stewart loses?
 - how does Europe deal with the problem?
 - did the *Rajaratnam* verdict ease the SEC’s burden?

-----does the non-statutory prohibition have any champions?
See Peter J. Henning, “What’s So Bad About Insider Trading Law?” (June 26, 2015), available at the SSRN web site.

Practitioner Tips:

- (1) One would think that Section 16(b)’s prohibition is easy enough to comprehend. But questions of whether derivative products and affiliated accounts factor into the mix have kept the private bar busy filing suits for over 60 years. For a relatively recent Supreme Court interpretation see *Credit Suisse Securities (USA) LLC v. Simmonds* (2012)(rejecting the notion that §16(b)’s 2-year SOL is tolled until an insider transaction is filed per §16(a)).
- (2) Does proof of scienter require evidence of a desire to break the law? The SEC may be opening that dangerous Pandora’s Box. See SEC Press Release of August 2, 2012 and accompanying civil complaint, available at <http://www.sec.gov/litigation/complaints/2012/comp-pr2012-148.pdf> (noting that the defendant’s culpability was shown, in part, by his Internet searches for reading materials educating on ways to avoid detection by the SEC).
- (3) Do IPO underwriters and purchasers signing a lock-up agreement jointly constitute a 10% “group” for purposes of section 16(b) liability? See *In re Facebook, Inc., IPO Sec. & Derivative Litig.*, 2014 BL 123366 (S.D.N.Y., MDL No. 12-2389, 5/2/14).
- (4) See SEC Rules 10b5-1 and 10b5-2 for relevant procedural guidance.

IX. THE CALLS FOR REFORM BY CONGRESS

Reforms

- a) The Private Securities Litigation Reform Act of 1995
- b) The National Securities Markets Improvement Act of 1996
- c) The Uniform Standards Act of 1998
- d) The Sarbanes-Oxley Act of 2002
- e) The Dodd-Frank Act of 2010
- f) JOBS Act (2012)
- g) Bills to overturn *Newman/Chiasson* (pending)

Key Concepts

- private attorneys general
- the SEC's "executive" power
- civil fines vs. disgorgement vs. restitution
- "bounties" for insider trading whistle-blowers
- preemption of State regulation
- "most adequate plaintiff"
- heightened pleading standard
- "crowdfunding"

Questions for Discussion

- is a piece of legislation being passed with the assistance of, or in spite of, the SEC?
- have class actions waxed or waned in light of all the Congressional activity?
- should the States bear more of the regulatory burden?
- do partisan politics determine the level of SEC activism ?

Practitioner Tips:

- (1) Rarely have so many securities law proposals been open to input from the public. *See* April 2012 Comment Letter from Hofstra Law Students Melissa Cefalu and others, *available at* <http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=57424&SearchText=>
 - (2) People are universally concerned with the state of regulation, but balkanized on the primary cause for its questionable state. *Compare* "S.E.C. Gets Encouragement From Jury That Ruled Against It," **NY Times** (August 3, 2012) *with* "Tourre Case Buys SEC as Congress Weighs Funding," **Bloomberg** (August 5, 2013).
 - (3) Does the popular press ignore agency rulemaking? *Compare* Michael Lewis, **Flash Boys** (2014)(detailing the growth of flash trading and its attendant woes between 2006 and the present) *with* SEC Fact Sheet, "Banning Marketable Flash Orders/Open Meeting of the Securities and Exchange Commission" (Sept. 17, 2009), *available at* www.sec.gov/news/press/2009/2009-201-factsheet.htm .
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REVIEW: Third week of April.

Suggested order of study: This Syllabus; Class notes; Referenced case law; Handouts.

APPENDIX I

books on reserve this semester:

A Random Walk Down Wall Street by Burton Malkiel

The Great Crash of 1929 by John Kenneth Galbraith

The Hellhound of Wall Street by Professor Michael Perino

additional bibliography:

Fools Gold, by Gillian Tett (Simon & Schuster, 2009)

Levine & Co., by Douglas Frantz (Henry Holt & Co., 1987)

Liar's Poker, by Michael Lewis (Penguin Books, 1989)

Profit from Legal Insider Trading, by Jonathan Moreland (Dearborn, 2000)

Regulation By Prosecution: The Securities and Exchange Commission v. Corporate America, by Roberta S. Karmel (Amazon Books, 1983)

The October 1987 Market Break, Federal Securities Law Reports (Commerce Clearing House, February 9, 1988)

Wall Street, A History, by Charles R. Geisst (Oxford University Press, 1997)

APPENDIX II – TEN USEFUL (AND FREE) WEB SITES

1. <https://lawblogs.uc.edu/sld/the-deskbook-table-of-contents/>
-“Securities Lawyer’s Deskbook”, source of many SEC rules
2. www.seclaw.com
-provides useful updates on securities litigation in various forums
3. www.sec.gov
- the official site of the SEC
- provides corporate filings of public companies via EDGAR
- provides SEC releases for the past 25 or so years
4. www.finra.org
-web site of the largest self-regulator
-features proposed rule changes and arbitration decisions
5. www.nyse.com
-site of the New York Stock Exchange
-includes NYSE Constitution and Rules
-includes full written decisions of disciplinary hearings from 1972-present
6. www.nytimes.com/business { free for a finite number of downloads }
-revised hourly, a timely source of trial verdicts and SEC votes
7. www.sifma.org
- site of the Securities Industry and Financial Markets Association, the industry’s lobbying group (formerly “SIA”)
8. <http://securities.stanford.edu>
-a.k.a the securities class action web site
-details securities class action suits. Updated monthly.
9. www.oag.state.ny.us/investors/investors.html
-site of the New York Attorney General, an active securities regulator
10. <https://www.congress.gov>
-site for pending and final federal legislation