In the United States Circuit Court of Appeals for the Second Circuit

SECURITIES AND EXCHANGE COMMISSION, APPELLANT

v.

CHINESE CONSOLIDATED BENEVOLENT ASSOCIATION, INC., APPELLEE

ON APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION

STATEMENT OF THE CASE

THE PROCEEDINGS

This is an appeal by the Securities and Exchange Commission from a final judgment entered on September 23, 1940 (R. 4), by Judge George Murray Hulbert in the United States District Court for the Southern District of New York, upon motion of Chinese Consolidated Benevolent Association, Inc.[1] The judgment granted the appellee's motion for judgment on the pleadings and denied a similar motion by the Securities and Exchange Commission. The action was instituted by the

[1] In the interests of brevity, Chinese Consolidated Benevolent Association, Inc., is hereinafter referred to either as "defendant" or "appellee"; the Securities and Exchange Commission is referred to as the "Commission"; and the Securities Act of 1933 is referred to as the "Securities Act" or the "Act."

Commission by a complaint filed in the District Court on June 12, 1940 (R. 4), pursuant to Section 20 (b) of the Securities Act of 1933 [48 Stat. 86, 15 U. S. C. § 77t (b)]. The Commission sought to enjoin Chinese Consolidated Benevolent Association. Inc., its agents, representatives, and employees, from continuing activities alleged to be in violation of Section 5 (a) of the Act. On June 12, 1940, the defendant filed an answer admitting all the factual allegations of the complaint, but denying that it was violating the Act (R. 26). The Commission filed its motion for judgment on the pleadings on the same date pursuant to Rule 12 (c) of the Rules of Civil Procedure (R. 27). A similar motion was filed by the defendant on June 26, 1940 (R. 28).

Jurisdiction to entertain the action was conferred upon the District Court by Section 22 (a) of the Act. On August 26, 1940, after argument of counsel on both sides, Judge Hulbert rendered an opinion (R. 30). On September 19, 1940, an order was signed in accordance with the opinion and on September 23, 1940, the judgment was entered. This judgment also dismissed the Commission's complaint upon the merits, with prejudice against another action upon the same grounds. The Commission filed a notice of appeal on October 25, 1940 (R. 2).

STATUTE INVOLVED

A brief description of the Securities Act [48 Stat. 74, 15 U. S. C. 77a–aa] may be helpful as a background for the Court's consideration of the specific violations which have been alleged. Generally speaking, the Act affords protection to the investing public simply by requiring publicity of the material facts and circumstances concerning securities publicly offered. This purpose is effectuated by the requirement that a registration statement, describing the securities and the issuer, be filed with the Commission [Sections 5 (a), 6 (a), and 7, and Schedule B]; and by the further requirement that a prospectus summarizing the important information in the registration statement be furnished to all persons to whom securities are offered [Section 10]. The Commission has no authority to pass upon the merits or value of securities [Section

23]. Its sole function in the registration process is to require that accurate information is made available to persons to whom securities are offered.

In particular, this case involves the application of Section 5 (a) of the Act. That section, subject to certain exemptions provided by Sections 3 and 4, forbids the sale, or delivery after sale, of securities, by means of the mails or instruments of interstate commerce, unless a registration statement is in effect as to such securities. The Act is applicable to governments [Section 2 (2)] and Section 7 provides that foreign governments or their underwriters must file registration statements containing the information described in Schedule B of the Act. Section 20 (b) authorizes the Commission to institute actions in the district courts of the United States to enjoin existing or threatened violations of the Act.

THE FACTS

There is no dispute as to the facts in this case. The answer admits all of the facts alleged in the complaint, but disputes the conclusions of law drawn therefrom. The admitted facts may be summarized as follows: On September 1, 1937, the Government of the Republic of China authorized the issuance of $500,000,000 principal amount of bonds known as "4% Liberty Bonds of the Twenty-sixth Year of the Republic of China" (hereinafter referred to as "Liberty Bonds"), and on May 1, 1938, that Government authorized the issuance of $50,000,000 principal amount of "5% United States Dollar Bonds" (hereinafter referred to as "U. S. Dollar Bonds") (R. 5).

The defendant is a New York corporation with a membership of approximately 25,000 Chinese (R. 5). On October 8, 1937, just one month after the authorization of the Liberty Bonds, the defendant organized a committee known as the General Relief Fund Committee (hereinafter referred to as the "Committee"). Among the purposes for which this Committee was formed was the solicitation and receipt of funds from members of the Chinese communities and of the general public in New York, New Jersey, and Connecticut, for transmittal to China (R. 6).

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By means of advertisements inserted in newspapers which were sent through the mails, as well as by mass meetings and personal appeals, the Committee has urged the members of Chinese communities in New York, New Jersey, and Connecticut to purchase Liberty Bonds and U. S. Dollar Bonds and has offered to accept funds for the purchase of bonds from the individuals with whom it has communicated (R. 6–7).

As a result of its activities, the Committee has received a sum in excess of $600,000 to be used for the purchase of Liberty Bonds and U. S. Dollar Bonds (R. 7). The funds collected have been delivered to the New York Agency of the Bank of China, which transmits them through the mails to a branch of the bank in Hong Kong, China, with instructions to purchase the bonds. The bonds are returned through the mails to the bank in New York, which mails them to the purchasers (R. 7–8). In some cases, the bonds have been mailed to the purchasers in care of the defendant (R. 8). No charge is made by the Committee for its services in connection with the receipt and transmittal of funds to be used for the purchase of bonds, nor do the members of the Committee receive compensation from any other source in connection with its activities (R. 8–9). It does not appear that the Committee or any of its members have any official or contractual connection with the Republic of China or any branch thereof (R. 6).

No registration statement under the Securities Act has ever been in effect for either the Liberty Bonds or the U. S. Dollar Bonds (R. 5). Despite this fact, since the authorization of the bonds the defendant has been the medium through which, as aforesaid, over $600,000 of bonds of both categories have been sold to residents of the States of New York, New Jersey, and Connecticut (R. 6). The defendant has used the mails and the instruments of interstate and foreign commerce, or has caused those means to be used, in soliciting purchases of the bonds, in the transmittal of funds to China, and in delivering these securities after sale to residents of the United States (R. 7–8).

QUESTIONS INVOLVED, OPINION OF THE LOWER COURT, AND ERRORS CLAIMED

(a) The specific questions involved in this case are:

(1) Is the defendant selling securities in violation of Section 5 (a) of the Act?

(2) Are the actions of the defendant exempt under Section 4 (1) of the Act?

(3) Is the defendant an aider and abettor of a violation of the Act? and

(4) Should diplomatic channels be utilized rather than recourse to the courts?

(b) As we analyze Judge Hulbert's opinion (R. 30), his conclusions are as follows:

(1) The defendant is not selling securities;

(2) The defendant is not an underwriter;

(3) Whether or not the Republic of China conforms to the Act the defendant is exempt; and

(4) Diplomatic channels, rather than recourse to the courts, should be utilized.

(c) The Commission claims that the lower court committed error in reaching the above conclusions.

ARGUMENT

I

THE DEFENDANT IS SELLING, AND CAUSING TO BE DELIVERED AFTER SALE, UNREGISTERED SECURITIES BY MEANS OF THE MAILS AND INSTRUMENTS OF INTERSTATE AND FOREIGN COMMERCE

The Commission is not attempting to prevent the solicitation of contributions for the benefit of the Republic of China. The failure to register securities being sold in the United States through the mails is the matter complained of. If the Chinese Government or its underwriter should file a registration statement, the Commission, upon proper representations, would exercise its full statutory discretion to expe-

dite registration in order to fulfill the expressed Administration policy of giving all possible aid to nations struggling against aggressors.[2] To ignore the sale of unregistered Chinese securities would set a precedent which would be equally available to Germany, Italy, or Japan.

The course of conduct carried on by the defendant and its agents falls squarely within the prohibition of Section 5 (a) of the Act, which reads:

> SEC. 5. (a) Unless a registration statement is in effect as to a security, 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 sell or offer to buy such security through the use or medium of any prospectus or otherwise;
>
> (2) to carry or cause to be carried through the mails or in interstate commerce, by any means or instruments of transportation, any such security for the purpose of sale or for delivery after sale.

Section 5 is catholic in its application; it applies to *any* person who performs the proscribed acts. Section 2 (2) of the

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[2] Congress itself has recognized that the proper method of assisting oppressed foreign governments in raising funds in the United States is by facilitating the registration process rather than by ignoring the Act. On February 8, 1940, the Senate adopted the following resolution:

"*Resolved*, That it is the sense of the Senate that the Securities and Exchange Commission should expedite the consideration of the application for the registration of any bonds, securities, or other obligations issued by the Republic of Finland or any of its political subdivisions, upon application made to such Commission for such purpose by the Republic of Finland, or by any representative committee of citizens of the United States hereafter organized and duly authorized to act on behalf of the Republic of Finland for the purpose of obtaining funds through the sale of such bonds, securities, or other obligations." (Senate Resolution No. 234, 76th Congress, 3d Session.)

Act defines the term "person" to include a corporation such as the defendant, and a government such as the Republic of China.[3] Obviously then, Section 5 (a) automatically becomes applicable in the presence of four factors: (i) the sale, or delivery after sale, (ii) through the mails or in interstate commerce,[4] (iii) of a security (iv) for which no registration statement is effective under the Act.

The last three factors are, in effect, admitted in this case. The securities involved are bonds, and are expressly included within the definition of "securities" in the Act [Section 2 (1)]. The Act is applicable to securities issued by a foreign government [Section 7]. It is admitted that no registration statement is in effect for either the Liberty Bonds or U. S. Dollar Bonds sold by the defendant. Similarly, it is admitted that the mails and instruments of interstate and foreign commerce have been used or caused to be used at various times in each transaction.

Only one question has been raised concerning the application of Section 5 (a) itself to the defendant's activities—whether those activities actually involve the "sale" of securities within the meaning of the Act. The defendant claims that it has been acting as the agent for purchasers in the United States and that it cannot, therefore, be selling securities. The Commission asserts that, since the defendant has been soliciting offers to buy from members of the Chinese community, it has been selling securities within the meaning of the Act.

The admitted facts are that the defendant has urged numerous persons to purchase bonds of the Chinese Government and that, as a result of its activities, it has received orders for more than $600,000 in bonds. As agent for the purchasers

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[3] Sec. 2 (2) reads: "The term 'person' means an individual, a corporation, a partnership, an association, a joint-stock company, a trust, any unincorporated organization, or a government or political subdivision thereof. * * *"

[4] The term "interstate commerce" is defined in Section 2 (7) of the Act to include foreign commerce.

it has transmitted these orders through the Bank of China in New York to the Bank of China in China.

Upon these facts it cannot be doubted that the defendant is "selling" securities. Section 2 (3) of the Act provides:

> The term "sale", "sell", "offer to sell", or "offer for sale" shall include every contract of sale or disposition of, *attempt or offer to dispose of, or solicitation of an offer to buy, a security* or interest in a security, for value; except that such terms shall not include preliminary negotiations or agreements between an issuer and any underwriter. * * * [Italics supplied.]

The inclusion in this definition of "every * * * attempt or offer to dispose of, or solicitation of an offer to buy, a security * * * for value" is decisive upon this question.

The words "sell" and "sale" are of broader connotation under the Securities Act than they are in common usage. Congress intentionally so defined them, for the House Report stated:

> Paragraph (3) defines the term "sale" or "sell" broadly to include every attempt or offer to dispose of a security for value.[5]

The Securities Act is a remedial statute which should be construed liberally to accomplish its general purpose. *Securities and Exchange Commission* v. *Crude Oil Corporation*, 93 F. (2d) 844, 846-847 (C. C. A. 7th, 1937); *Securities and Exchange Commission* v. *Starmont*, 31 F. Supp. 264 (E. D. Wash. N. D. 1940).

The courts, following this view, have endeavored to give full effect to the intention of Congress to have the terms "sale" and "sell" construed broadly. For example, in *Securities and Exchange Commission* v. *Starmont*, *supra*, Judge Black permanently enjoined persons who, without prior registration, had merely been requesting members of the public to indicate

[5] H. R. Report No. 85, 73d Cong., 1st Sess., May 4, 1933, accompanying H. R. 5480, at page 11.

whether they would, at a future date, subscribe to stock of a corporation then unincorporated.[6]

Prior to the *Starmont* case, Judge Patterson, in a case involving Section 17 (a) of the Act (making it unlawful to use fraudulent means "in the sale of any securities"), held that certain individuals who were paid a commission merely to *recommend* the purchase of certain securities to their customers were engaged in the "sale" of those securities.[7]

This Commission, long prior to the present case, interpreted the word "sale" as used in the Securities Act, in connection with a transaction very similar to that here involved.[8]

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[6] In the course of his opinion, Judge Black said: "* * * The Act defines 'sale' and 'sells', and 'offer to sell', and 'offer for sale', likewise more broadly than the lawyer or the layman previously thought or even imagined. The term 'sale', for instance, or 'sell', as well as 'offer for sale' includes every contract for sale or disposition, or attempt or offer to dispose of, or solicitation of an offer to buy securities or interest in securities, except that such term shall not include preliminary negotiations or agreements between issuer and an underwriter. In the very well-considered opinion of Judge Webster in this very Court almost two years ago, in an action between these same parties, it was pointed out that this statute was not a penal statute but was a remedial enactment. * * * It is to be liberally construed so that its purpose may be realized. That is important for it means that these definitions of sale and of security are to be liberally construed. Their construction is to be at least as broad as the language of the Act * * *" (pp. 266–267).

[7] *Securities and Exchange Commission* v. *Torr*, 15 F. Supp. 315, 317 (S. D. N. Y. 1936); reversed on other grounds, 87 F. (2d) 446 (C. C. A. 2d, 1937); permanent injunction subsequently granted, *Id.*, 22 F. Supp. 602 (S. D. N. Y. 1938).

[8] Administrative interpretations by a Commission of a statute which it is authorized to administer are entitled to considerable weight as an aid to interpretation by the courts. *United States* v. *American Trucking Associations, Inc.*, 310 U. S. 534 (1940); *Norwegian Nitrogen Products Co.* v. *United States*, 288 U. S. 294, 315 (1933); *Fawcus Machine Co.* v. *United States*, 282 U. S. 375, 378 (1931); *Securities and Exchange Commission* v. *Associated Gas and Electric Co.*, 99 F. (2d) 795, 798 (C. C. A. 2d, 1938).

That opinion was made public on February 9, 1937. At that time, and ever since, the Commission has deemed solicitations of precisely the same nature as involved here to be "sales" of securities. The interpretation took the form of an opinion by the Commission's then General Counsel, which was authorized to be published by the Commission (Securities Act Release No. 1256). This opinion, in part, read:

> As I understand the situation, in cases where corporate bonds have been called for redemption and a registration statement for new debentures of the same issuer has been filed with this Commission but is not yet effective, certain financial and securities houses propose to circularize holders of the called bonds with a view to securing orders for the purchase of the new debentures. The circular letters will contain a notification of the call of the bonds for redemption and a suggestion that the securities be presented for payment. They will further advise the bondholder that a registration statement for a new issue of debentures of the same company, bearing a specified interest rate, has been filed with this Commission, and that the new debentures are expected to be offered for subscription within a short period, and will proffer the services of the circularizing house as "buying agent" to purchase new debentures to replace the called bonds. The proposed communications will also state that these services will be confined to the execution of orders solely for the account of customers, and that no representations or recommendations are made with respect to the new debentures.
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> *In my opinion, a circular letter of this type would obviously be a "solicitation of an offer to buy" the new debentures, and would therefore involve a "sale" of such debentures within the meaning of the term "sale" as defined in Section 2 (3) of the Securities Act of 1933, as amended.* [Italics supplied.]

It is to be noted that in that case, as in this, the seller was soliciting offers to buy and offering its services as agent for

the purchasers. So here, the urging by the defendant that residents of the United States purchase bonds of the Chinese Government is clearly a "solicitation of an offer to buy a security" within the meaning of Section 2 (3) of the Act.

The fact that the defendant acts as agent for the purchasers in transmitting the funds it collects does not alter the character of its action in soliciting offers to buy. It is indisputable that the defendant is not acting as agent for the prospective purchasers at the time it first approaches them.[9] At that time the defendant solicits offers to buy bonds and is therefore engaged in "selling" securities within the meaning of the Act. It is only after these "sales" are effected that the defendant does anything on behalf of the purchasers.

The District Court failed to observe the importance of the time at which the agency relationship between the defendant and the purchaser arises. In the opinion Judge Hulbert states:

> The defendant simply acted for its members more effectively than they might have done for themselves with a saving of their labor and loss of time. Is the defendant more amenable to the provisions of the Act than its individual members for whom it acted? (R. 36.)

This statement not only overlooks the fact that the defendant does not act as an agent of the purchasers in soliciting offers to buy, but it also confuses the facts by assuming that the defendant acts only for its own members. The admitted facts of the case are that the defendant solicits offers to buy generally from members of the Chinese communities in New York, New Jersey, and Connecticut.

We submit that the facts and the law heretofore discussed establish that in the absence of an effective registration statement covering the securities sold, the defendant's activities are forbidden by Section 5 (a) of the Act.

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[9] Judge Hulbert apparently misinterpreted a statement to this effect in our brief submitted to him.

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II

THE ACTIONS OF THE DEFENDANT ARE NOT EXEMPT UNDER SECTION 4 (1) OF THE ACT

The defendant has asserted and the District Judge has found that the activities of the defendant are exempt from registration under the first clause of Section 4 (1) of the Act, which reads:

> SEC. 4. The provisions of section 5 shall not apply to any of the following transactions:
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> (1) Transactions by any person other than an issuer, underwriter, or dealer; * * *

We believe that an exemption under this section is not available to the defendant. As a preliminary to a discussion of the interpretation of specific terms in this section we believe that it will be helpful to outline the general scope of the Securities Act.

The Act (except for Sections 12 and 17, which are not here in issue) is designed to require disclosure of material facts concerning securities when they are distributed by an issuer or controlling stockholder; it imposes no registration requirements when securities are the subject of ordinary trading transactions between individual investors. The Act accomplishes this end by exempting from the registration procedure transactions which are not customarily a part of the distributive process, that is, transactions in which neither an issuer, an underwriter, nor a dealer (selling during the period of distribution) takes part.

The intention of Congress to require registration in the case of distribution of securities is expressed in the portion of the House Committee Report [10] pertaining to Section 4 (1):

> Paragraph (1) broadly draws the line between *distribution* of securities and *trading* in securities, indicating that the act is, in the main, concerned with the

[10] H. R. Report No. 85, p. 15, footnote 5, *supra*.

problem of distribution as distinguished from trading.[11] [Italics supplied.]

The term "distribution" is not defined in the Act, but it has been interpreted by the Commission as follows:

> * * * "Distribution," * * * comprises the entire process by which in the course of a public offering a block of securities is dispersed and ultimately comes to rest in the hands of the investing public. * * * It is a process without finite boundaries and often includes one or more "redistributions" by which portions of the issue are repurchased from speculative buyers, or so-called "weak hands," with a view to replacement with permanent investors.[12]

The Securities Exchange Act of 1934, enacted one year after the Securities Act, regulates trading in securities as distinguished from distribution.

With this background in mind it seems clear that Section 4(1) is intended to provide an exemption for individual transactions between investors with relation to securities which have already been issued and are outstanding. It is not intended to grant an exemption to any transaction wherein

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[11] Although legislative materials are proper in any event as aids to interpretation [*United States* v. *Dickerson*, 310 U. S. 554 (1940); *United States* v. *American Trucking Associations, Inc.*, 310 U. S. 534 (1940)], in the interpretation of the Securities Act the House Committee Reports are particularly persuasive, since the Act was presented as an entirety to the House, no amendments being permitted unless they were offered by the Committee. H. Res. 130, May 5, 1933, Cong. Rec., Vol. 77, Part 3, p. 2910.

[12] *In the Matter of Oklahoma-Texas Trust*, 2 S. E. C. 764, 769 (1937), *aff'd*, *Oklahoma-Texas Trust* v. *Securities and Exchange Commission*, 100 F. (2d) 888 (C. C. A. 10th, 1939). See also "Some Problems of Exemption under the Securities Act of 1933," pp. 116–117, Law and Contemporary Problems, January 1937, Duke University Law School, by Allen E. Throop and Chester T. Lane, a former and the present General Counsel to the Commission.

a party to the purchase or sale is engaged in the initial distribution of securities.

The admitted facts in this case disclose that a new issue of Chinese Government bonds is being sold to residents of the United States. The defendant is the active party soliciting purchases. The purchase price is transmitted to the Republic of China. This is clearly not a trading transaction, but an original sale of securities such as Congress intended to be subject to the registration process.

Unusual mechanics are involved in this distribution. The defendant is not in a contractual relationship with the issuer and is motivated by patriotism rather than profit. Regardless of these mechanics, in the final analysis the defendant is distributing securities for the benefit of the issuer. Although these unusual features give rise to the arguments asserted by the defendant, an understanding of the structure and purpose of the Act makes it clear that there is in fact no merit in the claim to an exemption under Section 4(1).

As pointed out earlier, the Securities Act, being a remedial statute, should be so construed as to effectuate its general purpose of preventing sales of securities which have not been registered. See page 8, *supra*. Not only is this true, but in establishing any exemption from the general prohibition of the Securities Act, the burden is on the person claiming the exemption. *Securities and Exchange Commission* v. *Sunbeam Gold Mines Company*, 95 F. (2d) 699, 701 (C. C. A. 9th, 1938). In that case the court said:

> * * * Being an exception from the general policy of the act, anyone claiming to be within its terms has the burden of proof that he belongs to the excepted class—that is, that his offer is not to the public. Schlemmer *v.* Buffalo R. & P. R. Co., 205 U. S. 1, 27 S. Ct. 407, 51 L. Ed. 681, and cases there cited.
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> Furthermore, the terms of such an exception to the "general policy" of the act must be "strictly construed" against the claimant of its benefit. Spokane & Inland R. Co. *v.* U. S., 241 U. S. 344, 350, 36 S. Ct. 668, 60 L. Ed. 1037.

Cf. Edwards v. *United States*, 113 F. (2d) 286, 289 (C. C. A. 10th, 1940), *cert. granted*, 61 S. Ct. 51 (Oct. 14, 1940).

The defendant has not met, and cannot, in our opinion, meet this burden. We submit that the exemption provided by Section 4 (1) does not apply because the admitted facts disclose a "transaction by an issuer" and that the defendant is an "underwriter." These contentions will be discussed in the following pages.

A. Each Sale by the Defendant Is Part of a Transaction by an Issuer

As pointed out above, the purpose of Section 4 (1) is to exempt ordinary trading transactions, not distributions. To achieve this purpose, the section excludes from the exemption transactions by an issuer.

The issuer in this case is the Republic of China. Each completed transaction in the distribution of the Chinese bonds includes: a solicitation by the defendant of an offer to buy; an offer to buy made by an individual purchaser; and the acceptance of that offer by the Chinese Government. There is no separate and distinct transaction carried through by the defendant; its solicitation merely initiates a transaction to be completed by the Republic of China. Since each completed transaction is one effected by an issuer, the transaction is not exempt under Section 4 (1) of the Act.

The defendant argues that it is not itself an issuer or an underwriter and that, therefore, Section 4 (1) exempts its solicitation of offers to buy. This argument assumes that the exemption applies to component parts of a single transaction, while excluding other parts. There is no support for this position in the statute. On the contrary, the Act prohibits "sales" (which as defined include solicitations of offers to buy) in all transactions by an issuer regardless of the character of the person making the solicitation. If Congress had intended to exempt all persons other than issuers, underwriters, or dealers, regardless of their participation in a trans-

action by an issuer, it seems that it would have been simple to reach this result by drafting Section 4 (1) to read:

> The provisions of Section 5 shall not apply to any of the following persons:
>
> (1) Persons other than issuers, underwriters, or dealers.

Congress carefully distinguished between the terms "classes of securities," "transactions," and "persons," as is evidenced by Sections 3, 4, and 5 of the Act. It therefore obviously intended to exempt "transactions," rather than "persons," when it used the word "transactions" in Section 4 (1).

To interpret Section 4 (1) as granting an exemption to this defendant would mean that the courts would be powerless to restrict persons knowingly performing essential functions in the distribution of securities by an issuer. The proper interpretation was adopted in *Landay* v. *United States*, 108 F. (2d) 698 (C. C. A. 6th, 1939), in which case an officer of a corporation was indicted and convicted even though the issuing corporation was not prosecuted. Also, in many civil cases brought by the Commission to restrict violations of Section 5 and Section 17 of the Act, the courts have enjoined representatives, agents, and employees of the principal defendants.[13]

In addition to the cases cited above, the Commission has commenced a number of proceedings against other Chinese organizations which have been engaged in selling Liberty Bonds and U. S. Dollar Bonds of the Chinese Government in the United States. In all of these cases consent injunctions have been obtained even though the defendants were in the

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[13] See, for example, *Securities and Exchange Commission* v. *Wickham*, 12 F. Supp. 245 (D. Minn. 1935); *Securities and Exchange Commission* v. *Crude Oil Corporation*, 17 F. Supp. 164, 167 (W. D. Wis. 1936), *affirmed*, 93 F. (2d) 844 (C. C. A. 7th, 1937); *Securities and Exchange Commission* v. *Associated Gas & Electric Co.*, 24 F. Supp. 899 (S. D. N. Y. 1938), *affirmed*, 99 F. (2d) 795 (C. C. A. 2d, 1938); *Securities and Exchange Commission* v. *Torr et al.*, 22 F. Supp. 602 (S. D. N. Y. 1938).

same position as the defendant in this case.[14] In one other case the Commission obtained a consent injunction against a patriotic bond subscription society selling Japanese bonds in Hawaii.[15]

On the basis of the foregoing we urge that this Court interpret Section 4 (1) in accordance with the expressed intent of Congress in order to make it applicable to distributions generally, and not in such manner as to exclude from the prohibition of Section 5 individual parts of a distributing transaction. The method by which any distribution is carried through is a matter of mechanics; the fact that a new issue of bonds is being sold to residents of the United States without registration through the medium of this defendant is a matter of substance. The whole purpose of the Act would be perverted if an exemption which was intended only for trading transactions were enlarged to exempt portions of distributions.

B. The Defendant Is an "Underwriter" Within the Meaning of Section 4 (1) of the Act

Transactions by an underwriter are not exempted under Section 4(1) of the Act. The Commission asserts and the defendant denies that the defendant is an underwriter. The

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[14] The cases in which this practice was followed were *Securities and Exchange Commission* v. *Chinese Patriotic Society and Chinese Consolidated Benevolent Association of Fresno, Chinese Relief and Refugee Association*, Civil Action, File No. 643RJ (D. C. S. D. Cal. C. D., Nov. 2, 1939); *Securities and Exchange Commission* v. *Chinese Benevolent Association of Philadelphia*, Civil Action, File No. 786 (D. C. E. D. Pa., March 4, 1940); *Securities and Exchange Commission* v. *The China Society*, Civil Action No. 220 (D. C. Ore., Oct. 30, 1939); *Securities and Exchange Commission* v. *China War Relief Association of America et al.*, Civil Action, File No. 21404R (D. C. N. D. Cal. S. D., Nov. 3, 1939); *Securities and Exchange Commission* v. *The Seattle Chinese Patriotic League*, Civil Action, File No. 116 (D. C. W. D. Wash. N. D., Oct. 23, 1939).

[15] *Securities and Exchange Commission* v. *Patriotic Bond Subscription Society of Hawaii, and Kango Kawasaki, et al.*, Equity No. 733 (D. C. Hawaii, Jan. 20, 1939).

difference in opinion arises not from any question as to what acts the defendant is performing, but whether, as a matter of law, the doing of those acts constitutes the defendant an underwriter.

The term "underwriter" is defined in Section 2 (11) of the Act, which reads:

> *The term "underwriter" means any person who* has purchased from an issuer with a view to, or *sells for an issuer in connection with, the distribution of any security,* or participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking; but such term shall not include a person whose interest is limited to a commission from an underwriter or dealer not in excess of the usual and customary distributors' or sellers' commission. As used in this paragraph the term "issuer" shall include, in addition to an issuer, any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer. [Italics supplied.]

There can be no dispute that the defendant has solicited offers to buy (that is, has "sold" within the statutory definition of a "sale") Chinese bonds; [16] has collected over $600,000 in subscriptions and has transmitted this amount to China for the purchase of bonds. Therefore, there can be no question but that the defendant has been selling for the benefit of the issuer.

The principal difference between the activities of this defendant and those of the ordinary underwriter of an industrial issue is that the defendant's activities are motivated by patriotism rather than by profit, and its services are contributed voluntarily rather than pursuant to a contract with the issuer. Since there are no judicial interpretations of the term "underwriter," as defined in the Act, it is necessary to construe that

[16] The fact that the defendant may be considered an agent of the buyers in transmitting the funds has no bearing on whether it is an underwriter in soliciting the orders to buy.

term in the light of its context, its legislative history, and administrative interpretations.

The legislative history of Section 2 (11) makes it apparent that Congress did not intend to require the elements of compensation or a contract with the issuer in order to make a distributor of securities an underwriter. In an earlier draft of the Securities Act, which was considered by the House Committee on Interstate and Foreign Commerce, the definition of underwriter was as follows:

> *"Underwriter" includes any person who,* in connection with the distribution of any security *engages or participates in the* purchase or *sale* or the direct or indirect underwriting of the purchase or sale *of such security for a commission, bonus, underwriting spread, or discount, or any other consideration, paid or to be paid,* directly or indirectly, *by the issuer,* or an affiliate of the issuer, or any person controlling or controlled by the issuer or an affiliate of the issuer.[17] [Italics supplied.]

This definition, of course, would have made the underwriting relationship depend upon the receipt of compensation. In abandoning that definition and adopting the definition which is included in the bill as enacted, Congress showed a clear intention of extending the term to include all persons who sell for an issuer, whether or not they do so for profit.

With respect to the position apparently taken by the District Court that the defendant is not an underwriter because it was not in a contractual relationship with the seller, the structure of Section 4 (1) refutes this position. That section, as pointed out above at pp. 12–15, *supra*, exempts transactions which are not involved in the distributive process. It is designed to *exclude* from the exemption transactions by persons who take part in the distribution. It clearly includes dealers who in the ordinary course of business are in no contractual relationship with the issuer. It would be anomalous to adopt an interpretation which would permit an exemption to a person

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[17] Confidential Committee Print of H. R. 5480, dated April 10, 1933, Section 2 (m).

who would be an underwriter but for the absence of a contractual relationship, while refusing an exemption to dealers who are a step further down the line and who customarily have no contract relationship whatsoever with the issuer.

With respect to administrative interpretations this Commission has always construed the term "underwriter" to give effect to this clearly expressed intent of Congress. *In the Matter of Canusa Gold Mines, Limited*, 2 S. E. C. 548, 558–559 (1937); *In the Matter of Reiter-Foster Oil Corporation*, 6 S. E. C. 1028, 1037 (1940). The former case stands for the proposition that where an issuer benefits from a distribution, the securities are sold *for* the issuer; the latter case supports the proposition that a person's status as an underwriter does not depend upon the receipt of pecuniary profit.

It is difficult to conceive of a clearer case than this one of "selling for" an issuer. The defendant induces the purchase of bonds from the Chinese Government and causes the transmittal of the entire purchase price to the issuer. The defendant and its agents receive nothing for their services—the entire benefit of the transaction is received by the issuer. If the situation is viewed from a realistic standpoint, what is occurring is that the Chinese Government is selling bonds to residents of the United States and the defendant is the agency through which these bonds are distributed in New York, New Jersey, and Connecticut. The Chinese Government is half way around the world and the defendant is handling all the details and making all the contacts with purchasers. Regardless of formal agency relationship, compensation, or contracts, the reality of the situation is that the defendant is the institution, and the only one, with which investors have any contact.[18] Thus, the defendant is an underwriter within the meaning of Section 2 (11) of the Act and there is no exemption under Section 4 (1).

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[18] Actually, as asserted in our brief in the lower court, the defendant is performing the functions not only of an underwriter but of a dealer. Customarily in the distribution of securities one agency manages the distribution generally and a group of individuals or concerns makes the direct approach to the public. In this case the defendant combines these two functions.

It is advisable to note that if a contrary opinion prevails, the securities of many foreign governments can without registration find a market in the United States through the medium of their nationals in this country. There is a large enough body of interested persons who have emigrated from almost every large foreign nation to make such distributions possible. If volunteers can undertake such activity without subjecting themselves or their governments to the Act, most foreign governments or their underwriters would be freed from the necessity of registration. Yet Congress clearly envisaged registration of foreign issues when it adopted the Act (see Sections 2 (2), 6, and 7, and Schedule B), and the Senate reaffirmed this position in adopting the Resolution urging the Commission to expedite registration for patriotic groups formed to sell Finnish bonds. (See page 6, *supra*.)

III

THE DEFENDANT SHOULD BE ENJOINED AS ONE WHO IS AIDING AND ABETTING A VIOLATION OF THE SECURITIES ACT

Section 5 (a) (2) of the Act provides:

> Unless a registration statement is in effect as to a security, it shall be unlawful for any person directly, or indirectly . . .
>
> (2) to carry or cause to be carried through the mails or in interstate commerce, by any means or instruments of transportation, any security for the purpose of sale or for delivery after sale.[10]

Whatever the relationship between the Chinese Government and the defendant may be, it is clear beyond doubt that the Chinese Government itself is transmitting or causing to be transmitted to the United States unregistered securities issued by it. As pointed out above, over $600,000 of these bonds have been sold to residents of the United States through the defendant alone. Under Section 5 (a) (2) not only the sale but

[10] Interstate commerce, as defined in Section 2 (7) of the Act, includes commerce with a foreign nation.

also the delivery after sale of unregistered securities is made unlawful.

The admitted facts also show that the defendant is instrumental not only in initiating the transactions but also in aiding the delivery of the securities (R. 8).

It is well settled that equity courts can and should restrain all persons who are the means by which violations of law are accomplished. *Federal Trade Commission* v. *Standard Education Society*, 302 U. S. 112, 119–120 (1937), *motion to amend opinion denied*, 302 U. S. 661 (1938), *rehearing denied*, 302 U. S. 779 (1937); *Board of Trade of City of Chicago* v. *Price*, 213 Fed. 336, 337 (C. C. A. 8th, 1914); *Knapp* v. *Hyde*, 50 F. (2d) 272 (S. D. N. Y. 1931); *Federal Trade Commission* v. *Wallace*, 75 F. (2d) 733, 738 (C. C. A. 8th, 1935); *cf. Mayo* v. *Dean*, 82 F. (2d) 554, 556 (C. C. A. 5th, 1936); *Day* v. *United States*, 19 F. (2d) 21, 22 (C. C. A. 7th, 1927); *United States* v. *Taliaferro*, 290 Fed. 214 (D. C. W. D. Va. 1922).

See also *Local No. 167* v. *United States*, 291 U. S. 293, 299 (1934). In that case, it is true, the point at issue was whether an injunction which was appealed from should enjoin the appellants from doing certain things, and did not involve the question of whether certain persons could be enjoined. However, the statement of the court as to the breadth of the injunction is equally applicable to this case. The court there said:

> The United States is entitled to effective relief. To that end the decree should enjoin acts of the sort that are shown by the evidence to have been done or threatened in furtherance of the conspiracy. *It should be broad enough to prevent evasion.* In framing its provisions doubts should be resolved in favor of the Government and against the conspirators. [Italics supplied.]

In *Virginian Ry.* v. *Federation*, 300 U. S. 515, 552 (1937), which involved the constitutionality of the Railway Labor Act, the Supreme Court made another statement which is peculiarly apt in this case:

> * * * Courts of equity may, and frequently do, go much farther both to give and withhold relief in furtherance of the public interest than they are accustomed to go when only private interests are involved. *Pennsylvania* v. *Williams*, 294 U. S. 176, 185; *Central Kentucky Gas Co.* v. *Railroad Commission*, 290 U. S. 264, 270–273; *Harrisonville* v. *W. S. Dickey Clay Co.*, 289 U. S. 334, 338; *Beasley* v. *Texas & Pacific Ry. Co.*, 191 U. S. 492, 497; *Joy* v. *St. Louis, supra*, 47; *Texas & Pacific Ry. Co.* v. *Marshall*, 136 U. S. 393, 405–406; *Conger* v. *New York, W. S. & B. R. Co.*, 120 N. Y. 29, 32, 33; 23 N. E. 983. * * *

Even where a defendant is acting in a minor capacity, but nevertheless is assisting and aiding the commission of unlawful acts, he may be enjoined. Thus, in *Board of Trade* v. *Price*, 213 Fed. 336 (C. C. A. 8th, 1914), the Board of Trade sought to enjoin a brokerage company and one Price from purloining its market quotations. The lower court refused to grant an injunction against Price, holding that the evidence was insufficient to establish that he was interested in the business. The Circuit Court of Appeals reversed the decision and ordered an injunction entered against Price on the ground that, although not interested in the business, he had aided and abetted the conduct of that business. The court stated (at page 337):

> *One who knowingly aids, assists, or facilitates the conduct of a business which is contrary to law and is a trespass upon the private rights of others cannot escape responsibility merely because he has no proprietary or pecuniary interest in it.* He who gratuitously helps is held with him who profits. A careful examination of the evidence has convinced us that the appellee was fully informed of the character of the business and the methods employed in carrying it on; also that, though he may not have been financially interested in it with his brother, who confessedly was at the head of it, he nevertheless aided and assisted by his joint control and handling of the funds upon

> which the business necessarily depended from day to day. * * * [Italics supplied.] [20]

The principle that all persons who are the means by which violations of law are accomplished should be restrained has been applied in injunction suits instituted by the Commission.

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[20] *Cf. McArthur & Griffin* v. *Matthewson & Butler*, 67 Ga. 134, 144 (1881); *Palo Alto Banking & Investment Co.* v. *Mahar et al.*, 65 Iowa 74, 21 N. W. 187, 189–190 (1884); *Lincoln* v. *Claflin*, 7 Wall. 132, 138 (1869). Persuasive analogies are found in the line of cases holding that persons aiding in a fraudulent scheme are liable to those defrauded for the loss sustained, *Lomita Land & Water Co.* v. *Robinson*, 154 Cal. 36, 97 Pac. 10, 14 (1908); *Blair* v. *Guarantee Title Co. of Long Beach*, 103 Cal. App. 260, 284 Pac. 719, 723, 725 (1930); *Zinc Carbonate Co.* v. *First Nat'l Bank*, 103 Wis. 125, 79 N. W. 229 (1899); *Downey* v. *Finucane*, 205 N. Y. 251, 98 N. E. 391 (1912); *Hornblower* v. *Crandall*, 7 Mo. App. 220 (1879), *aff'd*. 78 Mo. 581 (1883); *Colt* v. *Woollaston*, 2 P. Wms. 154, 24 Eng. Rep. 679 (1723); and in cases which establish the principle that anyone aiding and abetting a trespass or any other tort is liable for the damages inflicted, *Sperry* v. *Hurd*, 267 Mo. 628, 185 S. W. 170, 173 (1916); *Gerhardt* v. *Swaty*, 57 Wis. 24, 14 N. W. 851, 856, 857–858 (1882); *Hunt* v. *Di Bacco*, 69 W. Va. 449, 71 S. E. 584, 587 (1911); *Hilmes* v. *Stroebel*, 59 Wis. 74, 17 N. W. 539 (1883). By analogy also, one who aids and abets the perpetration of unlawful acts is liable under Section 332 of the Criminal Code (18 U. S. C., Sec. 550), which, of course, applies to criminal actions for violations of the Securities Act. See *Coplin* v. *United States*, 88 F. (2d) 652 (C. C. A. 9th, 1937), *cert. denied*, 301 U. S. 703 (1937). Injunctive proceedings should lie against such aiders and abettors in order effectively to curtail their activities, for a mere criminal prosecution might not be effective for that purpose. This is one of the reasons why the right to secure injunctions was granted to the Commission. Hearings before the Committee on Interstate and Foreign Commerce, House of Representatives, on H. R. 4314 (73d Cong., 1st Sess.), pp. 240–241 (April 5, 1933); Hearings before the Committee on Banking and Currency, United States Senate, on S. 875 (73d Cong., 1st Sess.), p. 226 (April 6, 1933).

See *Securities and Exchange Commission v. Timetrust, Inc.*, 28 F. Supp. 34, 43 (N. D. Cal. S. D. 1939), where Judge St. Sure said:

> There is ample authority to support the validity of a suit to enjoin persons who are aiding and abetting the commission of unlawful acts.

It is, therefore, the position of the Commission that the defendant should be enjoined as one who has been aiding and abetting in violation of the Act.

IV

INJUNCTIVE RELIEF IS THE PROPER REMEDY IN THIS CASE RATHER THAN RECOURSE TO DIPLOMATIC CHANNELS

The District Court in its opinion stated (R. 37):

> The Republic of China is, of course, officially represented in the United States, but it does not appear whether "its authorized representative" has ever been requested to file a registration statement. (No attempted backdoor entrance to this Court can be permitted to compel such a result; the channels of diplomacy are open through the Department of State.)

The Commission submits that the District Court was in error in refusing to issue an injunction for this reason. Congress specified only one method by which the Commission could put a halt to violations of the Act; in Section 20 (b) it authorized the Commission to ask the courts for injunctions. It specified this remedy in spite of the fact that the Act is specifically applicable to securities issued by foreign governments. Unless some compelling reason of international policy intervenes, it is difficult for the Commission to understand why the statutory method should not be followed in this case.

The situation might be different if it were necessary for the Republic of China itself to file a registration statement. However, Section 6 (a) of the Act specifically permits a regis-

tration statement for securities issued by a foreign government to be signed only by the underwriter of such securities. It would, therefore, be impossible to make representations to the Republic of China through the State Department or otherwise that it is under a duty itself to file a registration statement.

On the other hand, the defendant is a domestic corporation within the jurisdiction of the court. It is not acting in a merely ministerial capacity; it is the agency primarily responsible for the distribution of Chinese bonds in this area. No reason appears why it should be treated in any different way than any other private organization engaged in a violation of the Securities Act.

CONCLUSION

Before concluding we wish to reiterate that the Commission's action in instituting this proceeding is not motivated by a desire to prevent contributions from being solicited for the assistance of China. Nor would the Commission have any reason to object to the sale of Chinese securities, if those securities were registered in accordance with the provisions of the Securities Act. In fact the Commission, upon proper representations, would undoubtedly exercise its full discretion to expedite such registration. But the Commission cannot ignore an obvious violation of the Act without opening the way for violations by other persons with less worthy motives.

We respectfully submit that the District Court erred in granting the defendant's motion for judgment on the pleadings, in denying the Commission's motion of the same nature, and in dismissing the Commission's complaint with prejudice against the institution of another action upon the same grounds.

We submit further that the final judgment appealed from should be reversed and the District Court instructed to grant the motion for judgment on the pleadings filed by the Com-

mission and to issue the injunction prayed for in the complaint.

Respectfully submitted,

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U. S. GOVERNMENT PRINTING OFFICE: 1941