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MEMORANDUM

TO: The Commission

FROM: The Office of General Counsel
The Division of Enforcement

SUBJECT: ALI Federal Securities Code

Attached is a memorandum prepared by the Division of Enforcement concerning Professor Loss' response to some of the staff's proposals for revisions to the Code. Originally it was intended that the memorandum would be submitted to the Commission together with comments from the other divisions and offices. However, as formal comments on Professor Loss' response have not yet been prepared by the other divisions and offices, it is being submitted at this time so that the Commission may be aware of the Division's serious concerns regarding the Commission's consideration of the Code and Professor Loss' response to the staff's proposals.

July 24, 1979

MEMORANDUM

TO: Robert Pozen, Associate General Counsel
Office of General Counsel

FROM: Theodore Sonde, Associate Director
Division of Enforcement

RE: Professor Loss' July 5, 1979 Submission Concerning the Federal Securities Code

The following summarizes the Division's comments on Loss' latest submission. However, a few introductory remarks seem appropriate.

In a sense, Loss' letter to Chairman Williams, with copies to other members of his committee, underscores some of the concerns we have been expressing for the past several months. For example, Loss' letter categorically states that his comments list "all the staff proposals" (emphasis added). The fact is that what he has listed and included within the comments are simply those comments and proposals of the staff which he purported to be willing to "seriously consider." There are literally dozens of proposals of both a minor and major nature which he simply rejected. For example, Stan and others proposed a number of items that Loss rejected out of hand as "too late," not politically feasible, would not be received favorably by his advisors or for other reasons. What is particularly troublesome about his misstatement is that he made it before and was told of his error before. See my letter to Loss dated April 19, 1979. */ Further, his letter puts the Commission in the position where it must now begin to engage in a form of "horse trading" when the Commission has never considered the so-called generic concerns. It would seem that at this time we must begin to review those problems.

One further observation. During our meetings with Professor Loss, a number of comments were made where he made it appear that problems we were encountering were a result of oversights or drafting errors embodied within the POD. Upon review of his latest submission, however, it appears that those "drafting errors" may have been intended all along to reflect substantive changes without being described as such. For example, in Section 605(b) the words "disposing of" have been deleted from the definition of a "group" that acts together. Loss had originally told us that was an oversight. Now it appears that it was intended to effect a substantive change and that he and his colleagues are of a view that such change would be "incongruous." If it is incongruous, then they have made a substantive change in the Williams Act without telling anyone and without even noting that they intended to do so. In fact, this provision was recently cited against us in the Sun case.

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*/ I think we should insist that Loss make clear to all concerned in his introduction that what he has described as "all of the staff's proposals" are only "some" of its proposals that he was willing to consider and that there were numerous other proposals which he rejected for a variety of reasons. Further, it should be made clear that many of the proposals reflect the views of one office or division and not necessarily those of other offices or divisions.

Similarly, we were told by Professor Loss that the language in Section 1819(a)(3) concerning the Commission's right to obtain temporary and preliminary injunctions based on standards only appropriate for permanent injunctions was an oversight, and that temporary restraining orders and preliminary injunctions were never intended to be governed by a need to make the same showing as might be required for a permanent injunction. Now, however, by his latest submission, Loss finds these changes more substantive. Apparently, Loss intends that before we can obtain any form of injunction, we must prove both a violation and a reasonable likelihood of repetition. Today, no such proof is needed for a TRO or preliminary injunction.

It is difficult to make detailed comments based on "his draft." We have, of course, no objections to going back to earlier summaries prepared by your office concerning what Loss at an earlier time had apparently agreed to "seriously consider." However, it would seem that if we are to engage in horse trading as the price for our "enthusiastic support," I would think we would want to start with our own drafts rather than his. Thus, it seems ill advised to sponsor the Code unless we believe it represents a positive step forward. I believe that we need to revisit a number of subjects in connection with our review of the Code. Some of these subjects we are already engaged in reviewing; others we have yet to begin. For example, I see no purpose in further codifying the present provisions of the Williams Act, particularly after Loss has distorted them with various forms of exemptions and deletions, when we need to review the entire subject and seek broader authority than we presently have.

Further, as a result of a number of Supreme Court cases that have been decided and lower court decisions which have been following them, it would seem highly desirable to revisit a number of other subjects. For example, recently the Second Circuit decided Maldonado v. Flynn, CCH Fed. Sec. L. Rep. [Current Binder] ¶95,143 (2d Cir. March 15, 1979), which seems to adopt, at least as to Section 10(b), a very restrictive view of what constitutes fraud. The conduct alleged in that case and found not actionable under the securities laws by a highly respected court based on its reading of the Santa Fe decision seems to resurrect and invite officers and directors of public companies to use their shareholders' money as if it were part of their own piggybanks. I have no confidence that the provisions of the Code will solve any of these kinds of concerns. It would seem that we ought to reexamine such basic questions as whether or not these controlling persons ought to be permitted to engage in any form of self dealing with publicly owned companies without the prior express approval of the shareholders. There are numerous other subjects that we ought to revisit if we are to seriously consider supporting the Code in any form.

Among the sections of the Code which we believe most important and in need of revision are the following:

Section	
241	(director)
262(c)	(fraudulent act: knowledge or recklessness)
297(a)	(misrepresentation)
299.68, 605-06	(tender offers)
1603(a)	(insiders' duty to disclose when trading: general)
1603(b)	(insider)
1604(c)	(false publicity)
1613	(purchase by registrant)
1614	(prevention of fraudulent and manipulative conduct by rule)
1704-05	(civil liability for false 10-K reports)
1706(g)(6)	(standard of reasonableness)
1708	(measure of damages for sections 1703-07)
1722(a)	(implied actions)
1724(e)	(indemnification and insurance)
1806(d)	(public investigations and publicity)
1806(f)	(subpoena enforcement)
1809(a)	(administrative proceedings against professionals)
1819(a)	(injunctions)
1819(m)	(bond for costs)
1819(o)	(service of subpoenas)
1822(a)	(jurisdiction)
2007	(mitigation defense)

It should be noted in this connection that the foregoing is not all inclusive and that we have some significant differences with a number of the approaches that have been set forth by other offices and divisions on some very important items, such as the question of insider trading on the basis of "material fact" versus "a fact of special significance," the relationship, if any, of disgorgement to the granting or denying of injunctive relief, and the question of concurrent jurisdiction. I don't believe that Loss in his comments accurately summarizes a number of our substantive comments in this regard.

I understand that you are in the process of preparing a memo of the critical issues and after we have had a chance to review it, we will be happy to provide you with further comments. However, I think that consistent with Senator Williams' remarks at Bedford Springs, we need to use this opportunity, if we are to engage in it at all, to re-examine the scope of federal regulation in a more conprehensive way than simply responding to Loss' draft.