

**BUSINESS LAW II**  
**CHAPTER 7**  
**Securities Law and Corporate Governance**

**I. Background**

- A. Stock market crash on 10/29/29
- B. Great depression
- C. Unregulated Market
- D. Securities Act of 1933
- E. Securities Act of 1934
  - 1. Creation of Securities and Exchange Commission (SEC)

**II. Securities and Exchange Commission**

- A. Administers both Acts
  - 1. Both Acts have purpose of providing investors with sufficient information to make buying/selling decisions
  - 2. Prohibit deceptive, unfair and manipulative practices
- B. Governs SECURITIES
  - 1. Stocks
  - 2. Bonds
  - 3. Very INCLUSIVE
- C. Regulatory Function
  - 1. Interpret securities law
  - 2. Issues new rules and amends existing ones
  - 3. Inspects/investigates securities firms
  - 4. Constantly expanding

**III. Securities Act of 1933**

- A. Governs INITIAL sales of PUBLIC stock (IPO)
- B. Requires disclosure
  - 1. SEE Exemption Chart (p. 116)
- C. Requires that all securities transactions be registered with SEC
  - 1. Registration Statement
    - a. Must be written in plain English
    - b. Must be approved by the SEC
  - 2. Prospectus
    - a. Must include sufficient information to enable an UNSOPHISTICATED investor to evaluate the financial risk involved
- D. **Violations**
  - 1. Intentional Misrepresentation by commission or omission

2. Negligence in not discovering fraud
3. Not following SEC rules

**E. Remedies**

1. Criminal prosecution by DOJ
  - a. 5 years imprisonment
  - b. \$10,000 fine
2. Civil sanctions
  - a. Injunction
  - b. Refund profits
3. Private suits

**F. Defenses**

1. Statement or omission immaterial
2. Purchaser knew of misrepresentation when stock was purchased.
3. Seller exercised due diligence in prep of Registration and reasonably believed that the statements were true.

**IV. Securities Act of 1934**

- A. Governs Securities Exchanges
- B. Requires continuous periodic disclosures
- C. Applies to Exchanges with assets above \$10 million and at least 500 shareholders
- D. Regulates Proxies
- E. Authorizes SEC to monitor the market to detect and deter undesirable practices
- F. Requires Corporate recapture of all short term (6 months) profits for certain insiders

**G. Violations**

1. Fraud
  - a. Applies to public, private, registered and unregistered transactions
  - b. Private parties have right to sue
  - c. Requires
    - i. **Material** misrepresentation or omission
    - ii. **Scienter – a wrongful state of mind**
    - iii. Reliance on the material misrepresentation
    - iv. An economic loss
    - v. Causal connection between the misrepresentation and the loss
2. Insider Trading
  - a. To buy or sell securities based on info not available to the public
  - b. Applies to outsiders as well

**H. Remedies**

1. Criminal prosecution by DOJ

- ii. 20 or 25 years imprisonment
  - iii. \$5 or \$25 million fine
- b. Civil sanctions
  - i. Injunction
  - ii. Fine of 3X profits or losses avoided
- c. Private suits

## **V. Corporate Governance**

- A. **Rights and responsibilities among different corporate participants.**
- B. **Essential** because of the separation between corporate ownership and corporate control
- C. Goal is to promote accountability from managers to owners
- D. Regulatory requirements – SEE Exhibit on p.129