

Contents

<i>Preface</i>	xxi
<i>Acknowledgments</i>	xxiii
<i>Special Notice</i>	xxv

Chapter 1 Introduction to Securities Markets and Regulation I

§1.1 Securities Markets and Participants	2
§1.1.1 Primary and Secondary Markets	2
§1.1.2 Functions of Securities Markets	3
§1.1.3 Participants in Securities Markets	5
§1.1.4 Interconnection Among Financial Markets	6
§1.1.5 Importance of Informational Technologies	9
Chapter overview (1)	9
Examples and Explanations	10
§1.2 Efficiency of Public Stock Markets	15
Chapter overview (2)	18
Examples and Explanations	19
§1.3 Federal Securities Regulation—Overview	21
§1.3.1 Securities Act of 1933	22
§1.3.2 Securities Exchange Act of 1934	23
§1.3.3 Specialized Securities Laws	26
§1.3.4 Securities and Exchange Commission	27
§1.3.5 Evaluation of Mandatory Disclosure	33
Chapter overview (3)	36
§1.4 Beyond Disclosure: Federal Incursions into Corporate Governance	36
§1.4.1 Sarbanes-Oxley Act of 2002	37
§1.4.2 Dodd-Frank Act of 2010	43
Chapter overview (4)	47
§1.5 State Securities Regulation—State Blue Sky Laws	48
Chapter overview (5)	51

Chapter 2 Definition of Security 53

§2.1 Implications of Definition	54
§2.2 Testing for a “Security”	55
§2.2.1 Investment Contracts—The <i>Howey</i> Test	55

Contents

§2.2.2 Risk Capital Test	57
§2.3 “Securities” in Varying Contexts	57
§2.3.1 Real Estate as Securities	58
§2.3.2 Business Interests as Securities	58
§2.3.3 Pension Plans as Securities	62
§2.3.4 Notes as Securities	63
§2.3.5 Bank Instruments as Securities	66
§2.3.6 Cryptocurrencies and ICOs as Securities	67
§2.3.7 “Stock” as Security	68
Chapter overview	70
Examples and Explanations	71
Chapter 3 Materiality	87
§3.1 Definition of Materiality	88
§3.1.1 “Substantial Likelihood” Test	88
§3.1.2 Who Is a Reasonable Investor?	88
§3.1.3 Relationship of Materiality and Duty to Disclose	89
§3.2 Materiality—Types of Information	90
§3.2.1 Historical Information	90
§3.2.2 Speculative Information	92
§3.2.3 “Soft Information”	94
§3.2.4 Information About Management Integrity	96
§3.2.5 Social/Environmental Disclosure	98
§3.2.6 Materiality in Different Contexts	101
§3.3 Materiality in Context: “Total Mix” of Information	102
§3.3.1 “Total Mix” Test	102
§3.3.2 Safe Harbors for Forward-Looking Statements	104
Chapter overview	108
Examples and Explanations	109
Chapter 4 Registration of Securities Offerings	123
§4.1 Distribution of Securities to Public Investors	124
§4.1.1 Types of Public Offerings	125
§4.1.2 Pricing and Commissions in a Public Offering	128
§4.1.3 Documentation in a Public Offering	130
Chapter overview (1)	133
Examples and Explanations	134
§4.2 Registration of Public Offerings	139
§4.2.1 Section 5: The Heart of the Securities Act	140
§4.2.2 Contents of Registration Statement	141
§4.2.3 Preparation of Registration Statement	144
§4.2.4 SEC Review (and Effectiveness) of the Registration Statement	145

Contents

§4.2.5 Purchases During Registration	149
§4.2.6 State Regulation of Public Offerings	150
Examples and Explanations	154
§4.3 Managed Disclosure During Registration — “Gun Jumping”	163
§4.3.1 Prefiling Period	166
§4.3.2 Waiting Period	172
§4.3.3 Posteffective Period	178
§4.3.4 Summary of Gun-jumping Rules	185
Chapter overview (2)	186
Examples and Explanations	187

Chapter 5 Exemptions from Securities Act Registration 207

§5.1 Exempt Securities	208
§5.2 Offering Exemptions	210
§5.2.1 Intrastate Offerings	215
§5.2.2 Private Placements	218
§5.2.3 Small Offerings	221
§5.2.4 Regulation D	226
§5.2.5 Crowdfunding	236
§5.2.6 Issuer Exchanges	241
§5.3 State Blue Sky Exemptions	241
§5.4 Summary Chart	244
Chapter overview	247
Examples and Explanations	248

Chapter 6 Securities Act Liability 275

§6.1 Common Law of Misrepresentation	276
§6.1.1 Common Law Deceit	276
§6.1.2 Equitable Rescission	277
§6.2 Section 12(a)(1): Violations of §5	279
§6.2.1 Strict Liability	279
§6.2.2 “Statutory Sellers”	279
§6.2.3 Limitations Period	280
§6.3 Section 11: Misrepresentations in Registration Statement	280
§6.3.1 Section 11 Plaintiffs	281
§6.3.2 Section 11 Defendants	283
§6.3.3 Material Misinformation in Registration Statement	283
§6.3.4 Culpability—Defenses and Limitations on Liability	285

Contents

	§6.3.5 Reliance	290
	§6.3.6 Loss Causation	291
	§6.3.7 Damages	291
	§6.3.8 Periods of Limitations and Repose	292
§6.4	Section 12(a)(2): Misrepresentations in “Public” Offerings	294
	§6.4.1 Coverage of §12(a)(2)	294
	§6.4.2 Section 12(a)(2) Defendants	295
	§6.4.3 Elements of §12(a)(2) Rescission Action	296
	§6.4.4 Periods of Limitations and Repose	298
§6.5	Section 15: Liability of Control Persons	298
§6.6	Section 4A(c): Liability in Crowdfunding	299
	§6.6.1 New §4A(c) Action	299
	§6.6.2 Unresolved Issues in §4A(c) Action	300
§6.7	Section 17(a): Liability in SEC Enforcement Action	300
§6.8	Liability Under State Blue Sky Laws	301
	Chapter overview	303
	Examples and Explanations	303
Chapter 7	Secondary and Other Postoffering Distributions	327
§7.1	Definitions of Issuers, Underwriters, and Dealers	329
	§7.1.1 Agent “for Issuer”	331
	§7.1.2 Purchaser from Issuer “with a View” to Distribute	332
	§7.1.3 Underwriter for “Control Person”	334
§7.2	Exemptions for Control and Restricted Securities	335
	§7.2.1 Rule 144: Secondary Distributions in Public Markets	336
	§7.2.2 Exemptions for Secondary Private Placements	339
§7.3	Corporate Reorganizations and Recapitalizations	342
	§7.3.1 Issuer Exchanges	342
	§7.3.2 Fundamental Corporate Transactions—Rule 145	342
	§7.3.3 Downstream Sales and Spinoffs	343
	§7.3.4 Warrants, Options, and Conversion Privileges	344
§7.4	Resales Under Blue Sky Laws	344
	Chapter overview	346
	Examples and Explanations	346
Chapter 8	Securities Exchange Act of 1934	363
§8.1	Regulation of Securities Trading Markets	366
	§8.1.1 Regulation of Stock Exchanges	366
	§8.1.2 Regulation of Over-the-Counter Market	368

Contents

§8.1.3	Alternative Trading Systems	369
§8.1.4	Regulation of Collateral Market Participants	369
§8.2	Regulation of Market Practices	369
§8.2.1	Market Manipulation	370
§8.2.2	Short Selling	372
§8.2.3	Purchasing Securities on Margin	375
§8.3	Regulation of Public Companies	376
§8.3.1	Company Registration with the SEC	376
§8.3.2	Periodic Disclosure	378
§8.3.3	False or Misleading SEC Filings	382
§8.3.4	Oversight of Corporate Misconduct	383
§8.3.5	Corporate Governance Listing Standards	390
§8.4	Proxy Regulation (A Summary)	392
§8.4.1	Mandatory Disclosure in Proxy Solicitation	392
§8.4.2	No Open-Ended Proxies	393
§8.4.3	Shareholder Access	394
§8.4.4	Liability for Proxy Fraud	395
§8.4.5	Exemptions from Proxy Rules	396
§8.5	Regulation of Tender Offers (A Summary)	397
§8.5.1	Disclosure of 5 Percent Ownership	398
§8.5.2	Disclosure in Tender Offer	398
§8.5.3	Regulation of Substantive Terms of Tender Offer	399
§8.5.4	Liability for Deception in Tender Offers	400
	Chapter overview	401
	Examples and Explanations	401

Chapter 9 Rule 10b-5 421

§9.1	Rule 10b-5 Overview	421
§9.1.1	History of Rule 10b-5	421
§9.1.2	Some Essential 10b-5 Pointers	424
§9.1.3	Private 10b-5 Actions and SEC Enforcement	426
§9.1.4	Typical 10b-5 Cases	427
§9.2	Scope of Private 10b-5 Action	428
§9.2.1	Purchasers and Sellers: 10b-5 Standing	428
§9.2.2	Primary Violators: 10b-5 Defendants	431
§9.2.3	Fraud “in Connection with” Securities Transactions	435
§9.3	Fraud Elements of Private 10b-5 Action	437
§9.3.1	Material Deception	438
§9.3.2	Scienter	443
§9.3.3	Reliance and Causation	446
§9.3.4	Damages	450

Contents

§9.3.5 Nature of 10b-5 Liability	454
§9.4 Defenses in Private 10b-5 Action	455
§9.4.1 Limitations and Repose Periods	455
§9.4.2 <i>In Pari Delicto</i> Defense	456
§9.4.3 Contribution and Indemnification	457
§9.5 Comparison to Other Securities Fraud Remedies	458
§9.5.1 Express Federal Remedies for Securities Fraud	458
§9.5.2 State Law Remedies	463
§9.5.3 Racketeer Influenced and Corrupt Organizations Act (Private RICO)	465
§9.5.4 Arbitration and Private Ordering	465
Chapter overview	467
Examples and Explanations	468
 Chapter 10 Insider Trading	 485
§10.1 Introduction to Insider Trading	486
§10.1.1 Classic Insider Trading	486
§10.1.2 Misappropriation of Information — Outsider Trading	486
§10.1.3 Theories for Regulation of Insider Trading	487
§10.2 Rule 10b-5 and Insider Trading	488
§10.2.1 Duty to “Abstain or Disclose”	489
§10.2.2 Insider Trading Primer	493
§10.2.3 Outsider Trading — Misappropriation Liability	495
§10.2.4 Remedies for Insider Trading	502
§10.2.5 Regulation FD and Selective Disclosure	504
Chapter overview	506
Examples and Explanations	507
§10.3 Short-Swing Insider Profits: Disclosure and Disgorgement	520
§10.3.1 Coverage of §16	521
§10.3.2 Disgorging Short-Swing Profits — Mechanical Test	522
§10.3.3 Special Interpretive Issues	524
§10.3.4 Section 16(b) Litigation	527
§10.4 Regulation of Insider Trading Under Sarbanes-Oxley (Revised by Dodd-Frank)	529
§10.4.1 Insider Trading During Pension Plan Trading Blackout	529
§10.4.2 Reimbursement of Incentive Pay When Financials Misstated	530
Examples and Explanations	531

Contents

Chapter 11	Regulation of Securities Industry	539
§11.1	Capacities of Securities Professionals	541
§11.2	Broker-Dealer Regulation	542
§11.2.1	Supervision by SEC and FINRA	543
§11.2.2	Regulation in Public Offerings	544
§11.2.3	Disclosure Responsibilities	546
§11.2.4	Standards of Conduct	548
§11.2.5	Enforcement of Customer Rights	554
§11.2.6	Insurance of Customer Accounts	557
§11.2.7	State Blue Sky Regulation	557
§11.3	Investment Adviser Regulation	558
§11.3.1	Definition of Investment Adviser	558
§11.3.2	Federal Regulation of Investment Advisers	558
§11.3.3	State Blue Sky Regulation	560
	Chapter overview (1)	561
	Examples and Explanations	562
§11.4	Mutual Fund Regulation	573
§11.4.1	What Is a Mutual Fund?	574
§11.4.2	Mutual Fund Costs	576
§11.4.3	Regulation of Mutual Funds	577
§11.5	Private Fund Regulation	580
§11.5.1	What Are Private Funds?	580
§11.5.2	Regulation of Private Funds	580
§11.6	Regulation of Credit Rating Agencies	582
§11.6.1	Accountability of Credit Rating Agencies	582
§11.6.2	Internal Controls in Credit Rating Agencies	583
§11.6.3	Regulation of Credit Rating Agencies	584
	Chapter overview (2)	585
Chapter 12	Public Enforcement	587
§12.1	SEC Investigations	588
§12.1.1	Investigations: Formal and Informal	589
§12.1.2	Investigative Powers	590
§12.2	SEC Administrative Enforcement	591
§12.2.1	SEC Administrative Enforcement Powers	592
§12.2.2	SEC Disciplinary Powers	594
§12.2.3	SEC Settlements and Consent Decrees	595
§12.3	Judicial Enforcement: Injunctions and Other Remedies	596
§12.3.1	Standard for Relief	596
§12.3.2	Types of Relief	597
§12.3.3	Effect of Injunction	600

Contents

§12.3.4	Modification or Dissolution of SEC Injunctions	601
§12.3.5	Statute of Limitations	601
§12.4	Enforcement Against Securities Professionals	601
§12.4.1	SEC Rules of Practice	602
§12.4.2	Accountant Discipline	603
§12.4.3	Lawyer Discipline	604
§12.4.4	Reporting “Up the Ladder”	606
§12.5	Criminal Enforcement	608
§12.5.1	Use of Criminal Law in Securities Enforcement	608
§12.5.2	Criminal Violations of Federal Securities Law	609
§12.5.3	Securities Activities Creating Criminal Liability	609
§12.5.4	Nonsecurities Criminal Law Applied to Securities Activities	612
§12.5.5	Sentencing of Individual and Corporate Offenders	615
§12.5.6	Parallel Enforcement	616
§12.6	State Enforcement	619
§12.6.1	New York’s Martin Act	619
§12.6.2	Enforcement Actions Against Securities Firms	620
	Chapter overview	621
	Examples and Explanations	622

Chapter 13 Cross-Border Securities Transactions 627

§13.1	Offshore Offerings by U.S. Issuers (and Foreign Issuers)	628
§13.1.1	Regulatory Dilemma	628
§13.1.2	SEC Safe Harbors—Regulation S	629
	Chapter overview (1)	635
	Examples and Explanations	636
§13.2	Foreign Securities in the United States	644
§13.2.1	Public Offerings of Foreign Securities	644
§13.2.2	American Depositary Receipts (ADRs)	647
§13.2.3	Private Placements and Rule 144A	650
§13.2.4	Requirements for Foreign Issuers with U.S.-Traded Securities	650
	Chapter overview (2)	654
	Examples and Explanations	655

Contents

§13.3 Extraterritorial Reach of U.S. Securities Laws	660
§13.3.1 Securities Fraud Litigation	660
§13.3.2 Federal Government Enforcement	664
Chapter overview (3)	667
Examples and Explanations	668
 <i>Table of Cases</i>	 675
<i>Index</i>	681