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The idea that government regulation can serve a moral purpose has fallen into disrepute. Professor Henry G. Manne, an influential legal scholar, has been particularly outspoken in this regard. "Morals," he wrote, "are a private luxury. Carried into the arena of serious debate on public policy, moral arguments are frequently either sham or a refuge for the intellectually bankrupt."

Indeed, he suggests, to make a personal statement about the immorality of a particular type of securities transaction is to confuse oneself with God. It was not always so. In the early years of the last century, the Progressives believed government had a "moral and a
magisterial mission." In their view, this included "a broad responsibility for uplifting society." They crusaded for honesty, and in doing so, they saw "themselves as the harbingers of a new moral era." In the 1930s, the Progressives' movement gave way to the era of the New Deal. Even as Progressivism appeared to triumph in the New Deal, contemporaries came to believe that the Progressives' focus on moral character had distracted them from the real work of government. Contemporaries withdrew human character from the range of their reforms. In the future, they said, government should be like "engineering"—"cold and analytical." In the years since, as illustrated by Professor Manne, the role of morality in public policy has fallen ever lower. Perforce, when its role is to serve as distraction, sham, or refuge for the intellectually bankrupt, it is safe to say that the age of moral purpose in regulation is over.

Despite current opinion, the important role moral purpose played in creating modern regulatory institutions should not be forgotten. To understand the regulatory regimes our predecessors created and bequeathed to the modern age, one must understand the fundamental impulses that inspired them. Now ignored, or even disavowed, moral purpose once served as such an impulse. This is an area where history has something to offer the law. The greater the modern age's subjective distance from the regulatory vision of an earlier era, the more law needs history to explain what our predecessors thought they were doing.

Moral purpose played a fundamental role in creating the federal regulatory regime for the securities industry. Indeed, in many respects, even though federal regulation was a product of the 1930s, it reflected an orthodox Progressive sensibility. This was no accident. In the spring of

6. Id.
7. See Alonzo L. Hamby, Progressivism: A Century of Birth and Rebirth, in PROGRESSIVISM, supra note 5, at 40, 44.
9. See Hofstadter, supra note 4, at 3.
10. The New Deal was the popular name given to President Franklin D. Roosevelt's ("FDR") domestic legislative program. It has spawned a vast literature. See generally William E. Leuchtenburg, The FDR Years: On Roosevelt and His Legacy 234-35 (1995) (summarizing a number of bibliographies and works on the New Deal).
11. See Kemler, supra note 8, at 49.
12. See id. at 44.
13. Id. at 44-45.
14. See infra Part III.
1932, when Franklin Delano Roosevelt ("FDR") began his campaign for the Presidency of the United States, the potential shape of the future regulatory regime was fluid and open. At least initially, FDR’s policies were shaped by advisers steeped in the “engineering” spirit of the 1930s. The candidate publicly adopted their views. Yet, after he had won the Democratic Party’s nomination, he fell under the influence of orthodox Progressives. In August 1932, FDR turned to a moral policy vision. His purpose, he decided, was to ensure the character of the people who composed the securities industry. He presented this vision to the country in moral terms, and after his election, FDR suggested that his purpose could be implemented with a simple code of ethics. Moreover, when the work of creating law and regulation began in earnest, FDR’s moral purpose was carried forward by Congress and the newly created Securities and Exchange Commission ("SEC" or “Commission”). This Article’s thesis is that FDR’s moral purpose was a deliberately chosen policy and, once chosen, that it played an important role in the creation of the federal regulatory regime. To understand the most fundamental impulses in federal regulation of the securities industry, one must understand this Progressive moral vision.

This is a history of ideas. FDR’s vision was a particular type of idea: a series of statements, all set at a very high level of generality, about the concerns of a future regulatory regime. FDR stated his vision in the context and language of a presidential campaign and transition. Not surprisingly, he was long on rhetoric and short on specifics. Moreover, once legislators and administrators took up his ideas, and sought to give them substance, FDR was increasingly detached from the policy process. Nonetheless, FDR played a critical role in the history of

15. See LEUCHTENBURG, supra note 10, at 46.
16. See id. at 24-25.
17. See infra Part II.A.1.
19. See infra text accompanying notes 194-95.
20. See infra Part II.C.
22. See infra Part II.
23. See infra Part III (discussing, throughout, the congressional debates over the two securities acts and the amendments that were made thereto).
these ideas. He selected them, he pronounced them, and he made them the policy foundation for the laws and regulations to come.

This is also a history of how legislators, administrators, and ultimately judges responded to these ideas. FDR's moral purpose inspired a variety of regulatory measures, including: prohibiting conduct inconsistent with ethical principles; empowering the SEC to preserve the character of the securities industry by expelling the unfit; and requiring securities exchanges and associations to adopt rules enforcing just and equitable principles of trade. These measures carry the force of law. They are not, therefore, ethical principles in the usual sense of the term. Nonetheless, contemporaries repeatedly indicated that they believed their actions would enhance Wall Street's character, including its moral responsibility, honesty, trustworthiness, and professionalism.

In other words, while contemporaries built the regulatory regime with laws, rules, and judicial doctrines, they explained and justified their actions with moral aspirations. Those aspirations reflect the continuing influence of FDR's policy vision.

This Article is comprised of five Parts. Part II describes how FDR selected his policy vision during the presidential campaign of 1932. Part III focuses on how moral aspirations played a significant role in the creation of the legislative and administrative institutions of the regulatory regime. Part IV describes how a seminal appellate case in the early 1940s reflected these ideas and foreshadowed several of the legal doctrines of the modern regulatory regime. This Article concludes by positing that FDR's moral vision was more than a political posture—it was a serious policy initiative whose effects can still be seen in the regulatory regime. Moreover, in recent years, moral trustworthiness has received renewed attention as a significant force in the creation of

24. See infra Part III.A.
25. See 77 Cong. Rec. 937 (1933) (message from the President).
26. See infra text accompanying notes 282-94. For purposes of this Article, the term "morals" will be applied to general aspirations and the term "ethics" to specific principles of conduct.
27. See infra Part III.C.1.
29. Laws and ethical principles are generally distinguished in the sense that the former consist of rules and regulations set down and enforced by legitimate authority, while the latter consist of fundamental principles that apply irrespective of the existence of law and are usually dictated by individual conscience. See Encyclopedia of Ethics 155 (R. Shannon Duval et al. eds., 1999).
30. See, e.g., 78 Cong. Rec. 8161 (1934) (statement of Sen. Fletcher) (asserting that such legislation would restore "moral and economic conduct" and "social responsibility" to the securities industry); 77 Cong. Rec. 2953 (1933) (statement of Rep. Beedy) (commending and endorsing measures that "aim[1] to make prospectuses honest" and implement standards of "business morality").
prosperity. In light of this new thinking, one must wonder whether the orthodox Progressives who shaped FDR's vision were onto something. Perhaps moral purpose has a place in securities regulation after all.

II. FRANKLIN DELANO ROOSEVELT'S POLICY VISION FOR THE SECURITIES INDUSTRY

In 1929, after a sharp crash on the New York Stock Exchange, security prices fell into a staggering decline. By 1932, common stocks had lost almost ninety percent of their pre-crash value. This catastrophic loss of value shocked the saving and investing middle class. The entire economy fell into a Depression, with severe unemployment and deflation in asset values. A Senate Committee investigated the crash, and revealed shocking misconduct by bankers and businesspersons. This economic crisis, and its associated scandals, dominated the politics and policy making of the early 1930s.

A. The Presidential Campaign of 1932

In the spring of 1932, FDR, then Governor of New York, began his campaign for the Presidency of the United States. To assist him in developing and articulating policy positions, he recruited a group of Columbia University professors. This group would soon be called the "Brains Trust." It consisted of Raymond Moley, a professor of criminal

31. See infra text accompanying notes 608-22.
33. See id. at 95.
35. See T.H. WATKINS, THE GREAT DEPRESSION: AMERICA IN THE 1930S, at 51 (1993) (stating that even for those who did not suffer losses in the crash, it "became the one event on which tens of millions could fix their worry as the full dimensions of the debacle slowly began to be discerned").
38. See LEUCHTENBURG, supra note 10, at 46-47.
justice, Rexford Tugwell, an economist, and Adolf Berle, a professor in the law school.40

1. First Vision: Control and Planning

When the Brains Trust set out to advise FDR, they approached their task from a decided point of view. They believed that the American economy was becoming concentrated into a small number of huge corporations. As Berle stated in The Modern Corporation and Private Property,41 two hundred non-financial corporations controlled nearly half of America’s corporate wealth.42 Industrial concentration, he concluded, had reached the point that modern corporations could compete on equal terms with the state.43 In the future, he said, they might even supersede the state “as the dominant form of social organization.”44 Moreover, in Berle’s view, because of the dispersion of stock ownership, the small number of individuals who controlled these corporations45 enjoyed “a new form of absolutism” over their institutions.46

Expressing concern about the power of economic autocrats sounds much like the orthodox Progressive canon. In the early twentieth century, Progressives believed that the great corporations had destroyed the economic individualism of an earlier America.47 The Brains Trusters, however, were not orthodox Progressives.48 Where traditional Progressives feared these huge concentrations of economic power and wanted to break them up,49 the Brains Trust welcomed them as a source of mass production.50 Instead of breaking them up, the Brains Trust wanted to bring them under government control. Specifically, Tugwell

40. See id. The name “Brains Trust” would eventually be applied to a large number of people. In this Article it will be applied only to the small group who were regularly present in campaign policy meetings in the spring of 1932. See REXFORD G. TUOWELL, THE DEMOCRATIC ROOSEVELT 215 (1957) [hereinafter TUGWELL, DEMOCRATIC ROOSEVELT] (stating that Moley, Berle, and Tugwell were the only ones regularly present).


42. See id. at 32.

43. See id. at 357.

44. See id.

45. See id. at 46 n.34.

46. See id. at 124.

47. See HOFSTADTER, supra note 4, at 5.

48. See RAYMOND MOLEY, AFTER SEVEN YEARS 24 (1939) [hereinafter MOLEY, AFTER SEVEN YEARS].

49. See HOFSTADTER, supra note 4, at 227, 236.

50. See MOLEY, AFTER SEVEN YEARS, supra note 48, at 24 (stating that “any attempt to atomize big business must destroy America’s greatest contribution to a higher standard of living for the body of its citizenry”).
said that the government "must set the goals for production and, if necessary, direct investments and establish fair standards for all concerned." In the Brains Trust’s view, the techniques of scientific management had made such control and planning both possible and desirable. As one could expect, this program had significant implications for the securities industry.

In *The Industrial Discipline and the Governmental Arts*, Tugwell discussed how the allocation of capital in the economy could be placed under federal control. The first step would be to limit self-allocation. In its place, a planning agency would assign capital to industries and then apportion the allotted capital among the firms in each industry, based on each firm’s size, contribution to the national output, superior efficiency, or other criteria. Tugwell also suggested that the need to sub-apportion capital would likely decline as the federal administration used combination and association to closely articulate the independent firms presently making up each industry. In other words, a federal planning agency, not the securities industry, would operate the process by which capital is allocated through the economy.

These views were strongly expressed in the Brains Trust’s policy advice. In May 1932, Berle gave the candidate a memorandum entitled *The Nature of the Difficulty*. The memorandum analyzed the nation’s

51. TUGWELL, BRAINS TRUST, supra note 39, at 174. In rejecting orthodox Progressive views, the Brains Trust drew on the writing of Charles Van Hise, a leading exponent of the benefits of large-scale concentrated business. See RAYMOND MOLEY, THE FIRST NEW DEAL 225 (1966) [hereinafter MOLEY, FIRST NEW DEAL]; see also CHARLES R. VAN HISE, CONCENTRATION AND CONTROL: A SOLUTION OF THE TRUST PROBLEM IN THE UNITED STATES 8-20 (1912) (discussing the economic advantages of concentration). The Brains Trust was also influenced by the mobilization of the economy during World War I, both as an example of government management of the economy, and as a metaphor for concerted social action. See LEUCHTENBURG supra note 10, at 36-40.

52. See TUGWELL, BRAINS TRUST, supra note 39, at 133; see also REXFORD TUGWELL, INDUSTRY’S COMING OF AGE 29 (1927) (discussing enhanced productivity made possible by scientific management).

53. REXFORD G. TUGWELL, THE INDUSTRIAL DISCIPLINE AND THE GOVERNMENTAL ARTS (1933) [hereinafter TUGWELL, INDUSTRIAL DISCIPLINE]. This work was published in 1933, but had already been written at the time of the 1932 campaign. See Rexford G. Tugwell, The Spring of Thirty-Two 10 (date unknown) (unpublished manuscript, on file in the Tugwell Papers, 38, in the Franklin D. Roosevelt Library, Hyde Park, New York) (on file with Author) [hereinafter Tugwell, The Spring of Thirty-Two].

54. See TUGWELL, INDUSTRIAL DISCIPLINE, supra note 53, at 203-07.

55. See id.

56. See id.

57. See id.

economic crisis and suggested possible remedies. Berle believed the key to the situation was the public’s loss of its sense of security. Because individuals no longer felt secure in their savings and livelihood, they sought to reduce all of their assets to cash. The logical result was the hoarding of cash and the economic crisis. The remedy, Berle believed, was to restore individual security so that lending, investing and purchasing would resume. This could be done, he proposed, through various guarantees for interest payments, and indirect employment guarantees.

Beyond addressing the current economic crisis, Berle’s memorandum urged FDR to take the “long view.” As a preface to this discussion, Berle said that concentration in the United States economy was growing so quickly that, “[a]t the present rate of trend,” within twenty years, it would look very much like the Soviet economy in Russia. “There is no great difference between having all industry run by a committee of Commissars and by a small group of Directors.” With that in mind, financial reform was needed, particularly for firms large and concentrated enough to list their shares on a stock exchange.

Berle proposed two reforms relevant to this Article. First, that publicity should be given to corporate accounts and stock transactions. Berle later described this as the “[b]eginnings of [s]ecurities [and] [e]xchange legislation.” But in fact, mandatory disclosure schemes had been an important part of the traditional Progressive canon. Berle’s second proposal, on the other hand, went well beyond orthodoxy.

Investment bankers, Berle said, had acted irresponsibly by considering the sale of securities to be their sole concern. By holding to the position that they were only merchants of securities, selling to the public what the public wanted at the moment, they placed the economic

59. See id.
60. See id. at 33.
61. See id.
62. See id. at 33-34.
63. See id. at 33.
64. See id. at 37.
65. Id. at 45.
66. Id. at 45-46.
67. Id. at 46.
68. See id.
69. See id.
70. Id. (including in the published text Berle’s historical notations that, in his view, this was the beginning of the securities and exchange legislation).
72. See The Nature of the Difficulty, supra note 58, at 46.
system of the country at the hazard of "tremendous issues of securities many of which [were] unsound; some of which [were] sound but issued at inflated values; and some of which [were] sound but uneconomically distributed." Therefore, Berle concluded:

[it] seem[ed] necessary that there should be constituted a Capital Issues Board which could perform the functions of a federal Blue Sky Commission, exacting full information about securities sold . . . . Such a commission could be gradually developed to the point where it would exercise a real control over undue expansion of groups of credit instruments, where issue of these reached a point threatening the safety of the financial structure.

Berle did not explain what he meant by real control over undue expansion of groups of credit instruments. Nonetheless, from the text of his memorandum, we can infer that he intended the Board to control the soundness, value and distribution of securities. If exercised, these powers would have given the Board decisive control over the core functions of the securities industry. It also would have been a major step toward Tugwell's proposal to have the federal government allocate capital among, and within, industries.

FDR adopted these proposals for which there is some ambiguous archival support. More importantly, the candidate gave a major speech, delivered on May 22, 1932, at Oglethorpe University, in which he described the Brains Trust's ideas as his own.

In the Oglethorpe Speech, FDR stated that "[t]he country needs[,] . . . the country demands bold, persistent experimentation." The type of experimentation he had in mind was outlined in the text. The economy, FDR said, was characterized by chaos, lack of plan, and great waste. Turning specifically to the history of America's industrial

73. Id.
74. Id. at 47 (omitting Berle's later notations).
75. See id.
76. See infra text accompanying notes 91-96.
79. Id. at 646.
80. See id. at 641.
development, he highlighted its haphazardness and gigantic waste.\textsuperscript{81} There had been "superfluous duplication of productive facilities, the continual scrapping of still useful equipment, the tremendous mortality in industrial and commercial undertakings, the thousands of dead-end trails into which enterprise ha[d] been lured, [and] the profligate waste of natural resources."\textsuperscript{82} The misdirection of capital or credit played an important role in this chaos, because it had "been devoted to unjustified enterprises[,] to the development of unessentials and to the multiplying of many products far beyond the capacity of the Nation to absorb."\textsuperscript{83} "Much of this," FDR said, "could have been prevented by greater foresight and by a larger measure of social planning."\textsuperscript{84} Such little control as had been exercised, he said, was by a "small group of men whose chief outlook upon the social welfare is tinctured by the fact that they can make huge profits from the lending of money and the marketing of securities."\textsuperscript{85} "[I]n the long run," FDR reasoned, the most important problem was that of "controlling by adequate planning the creation and distribution of those products which our vast economic machine is capable of yielding."\textsuperscript{86}

While the Oglethorpe Speech had not been written by the Brains Trust,\textsuperscript{87} they had no objection to its message.\textsuperscript{88} Its call for social planning, and its attack on the outlook of the "small group of men" making huge profits from the lending of money and selling of securities was fully consistent with the advice in Berle's memorandum.\textsuperscript{89} Tugwell thought the speech was "a remarkably suitable beginning for the campaign to come."\textsuperscript{90}

After Roosevelt received the Democratic Party's nomination in July, the Brains Trust followed up on the Oglethorpe proposals. Tugwell gave the candidate a memorandum recommending the formation of a Federal Economic Council.\textsuperscript{91} Tugwell proposed that experts would gauge in advance the average of demand in the economy and then prepare

\begin{itemize}
\item \textsuperscript{81} See id. at 642.
\item \textsuperscript{82} Id.
\item \textsuperscript{83} Id. at 644.
\item \textsuperscript{84} Id. at 642.
\item \textsuperscript{85} Id.
\item \textsuperscript{86} Id. at 644.
\item \textsuperscript{87} Its author was Ernest Lindley, a journalist assigned to the Roosevelt campaign. See TUGWELL, BRAINS TRUST, supra note 39, at 103-04.
\item \textsuperscript{88} See id. at 126.
\item \textsuperscript{89} See Roosevelt, supra note 78, at 642.
\item \textsuperscript{90} TUGWELL, BRAINS TRUST, supra note 39, at 126.
\item \textsuperscript{91} See R.G. Tugwell, Proposal for an Economic Council, in TUGWELL, BRAINS TRUST, supra note 39, app. at 526.
\end{itemize}
coordinated production programs so that "the amount of the goods flowing into the markets" would be proportional to consumers' purchasing power. The Council would accomplish this by, among other methods, encouraging or discouraging the flow of capital into various industries. Tugwell further proposed that the Council should have a Capital Issues Division to focus on this task. At least initially, the Council would operate through "reasoned planning and expert persuasion." Eventually, Tugwell noted, "[i]t might be necessary . . . to implement its powers by constitutional change and enabling legislation."

Berle also gave the candidate a memorandum on this topic. Berle said that "[t]he liberal wing of the [Democratic] Party, particularly the intellectuals, [was] very firm in favor of an economic council." He continued, "[i]n theory, of course, they [were] right." In his view, the industrial situation could lead to only one of two outcomes. "Either the government [would] step[] in through some form of economic administration; or the business machinery, by consolidation, merger, or the like, [would] evolve[] an irresponsible economic government of its own." Moreover, like Tugwell, Berle urged a slow development for the Council, with its authority to grow only as the wisdom of its judgment gathered public confidence.

The proposal for a Capital Issues Board/Federal Economic Council suggests one of those stark alternative histories that are most visible in times of crisis. It is tempting to imagine how different American history would have been if the proposal had been adopted. But no one can predict where it would have led. To do so requires so many speculative assumptions that the exercise is worthless. Even to suggest some of the possible outcomes for the securities industry—nationalization, various forms of government guidance for a putatively independent industry, or chaos and reaction—demonstrates how many different scenarios could have played out. Tugwell's suggestion that implementation may have

92. Id. app. at 525-26.
93. See id. app. at 526.
94. See id.
95. Id. app. at 527.
96. Id.
97. See Memorandum from Adolf A. Berle, to Governor Franklin D. Roosevelt (Aug. 17, 1932), in NAVIGATING THE RAPIDS, supra note 58, at 59.
98. Id.
99. Id.
100. Id.
101. See id.
required changes to the Constitution illustrates both the proposal’s scope, and the limitations inherent in any effort to predict its specific outcome. Nonetheless, it is safe to conclude that development of the peacetime securities industry would have gone off on a radically different path than the one it has actually taken. After the Oglethorpe Speech, it is also evident that this type of thinking was part of the ascendancy within the Roosevelt campaign.

2. The Candidate Turns to People of Character

On August 4, 1932, ten and one-half weeks after the Oglethorpe Speech, FDR dramatically changed his campaign’s policy direction. Because of this change, the eventual regulatory regime for the securities industry would bear no resemblance to the Brains Trust’s Capital Issues Board/Federal Economic Council.

Almost as soon as the Oglethorpe Speech had been given, Tugwell had an inkling that its policies were in trouble. One evening after FDR had returned from the Oglethorpe trip, when he and Tugwell happened to be alone, the discussion turned to the speech. Tugwell hoped that industrial planning and coordination would be one of the important themes of the campaign. FDR, however, seemed hesitant. He said that his principal political adviser had had “a fit and had claimed that the politicians were all scared.” Tugwell recognized that FDR was moving back to orthodox views.

In the following weeks, had it been fully informed, the Brains Trust would have been even more concerned. As the Democratic Party Platform was being drafted and adopted, Tugwell believed FDR neither knew nor cared what it said. In fact, Huston Thompson, author of the plank on securities regulation, kept FDR informed of his work. In early July, Thompson reported that he had headed off a plank calling for

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102. See supra text accompanying note 96.
103. See infra text accompanying notes 189-98.
104. See TUGWELL, BRAINS TRUST, supra note 39, at 271.
105. See id. at 167-69.
106. See id. at 168.
107. See id.
108. Id. at 169.
109. See id.
110. See id. at 195, 261.
"[c]ontrol of the [s]ale of [s]ecurities.""112 The plank written by Thompson called for disclosure and stock exchange regulation.113 At the end of July, FDR told Thompson that he thought the final securities plank was "a very fine one."114

While the Brains Trust appears to have been unaware of the maneuvering around the securities plank, they were very much cognizant of the fact that the Oglethorpe Speech would infuriate Justice Louis D. Brandeis.115 Brandeis was an orthodox progressive. Indeed, as Tugwell put it, he was the "high priest of the orthodox sanctuary."116 Brandeis had been an influential adviser to President Woodrow Wilson117 who had appointed him to the Supreme Court in 1916.118 The Brains Trust did not suspect Brandeis' anger because they believed he supported the status quo. Almost twenty years before, in Other People's Money,119 Brandeis had launched his own withering attack on the securities industry's leading firms.120

In the years before he joined the Supreme Court, Brandeis had widely publicized his economic views. The crucial actor in the economy, Brandeis believed, was the individual with judgment and leadership. The success or failure of an enterprise, he said, depended "'usually upon one man; upon the quality of one man's judgment, and, above all things, his capacity to see what is needed and his capacity to direct others."'121 Moreover, he said, "'there is a limit to what one [person] can do well.'"122 As an organization grows, the person at its head "'has a diminishing knowledge of the [operative] facts'" and "'a diminishing

113. See generally Franklin D. Roosevelt, "I Pledge You—I Pledge Myself to a New Deal for the American People." The Governor Accepts the Nomination for the Presidency, Chicago, Ill. (July 2, 1932), in 1 PUBLIC PAPERS, supra note 78, at 647, 667.
115. See TUGWELL, BRAINS TRUST, supra note 39, at 145.
117. See ALPHEUS THOMAS MASON, BRANDEIS: A FREE MAN'S LIFE 375-403 (1946).
118. See id. at 465. For a discussion of the bitter political battle over Brandeis' nomination and confirmation, see id. at 465-508.
119. LOUIS D. BRANDEIS, OTHER PEOPLE'S MONEY: AND HOW THE BANKERS USE IT (1933 ed.).
120. See id. at 1-34.
121. MASON, supra note 117, at 354 (quoting Brandeis' testimony before the Senate Committee on Interstate Commerce in August 1911).
122. Id. (quoting Brandeis' testimony).
opportunity [for] exercising a careful judgment upon them." Thus, in Brandeis' view, the bigness praised by many contemporaries, including the Brains Trust, would actually saddle the economy with increasing inefficiency as it overwhelmed the individual businessperson's capacity for informed judgment about his or her enterprise.

Brandeis' emphasis on individual judgment carried over into his analysis of the securities industry. In *Other People's Money*, Brandeis called the banker an expert with special knowledge and judgment. As such, a banker should act with detachment and freedom from conflicts of interest, just as a lawyer should not be his or her own client. As Brandeis saw it, this detachment served two purposes. First, when exercising his or her proper functions of granting or withholding credit, and purchasing, refusing to purchase, or selling securities, the banker "pass[es] judgment on the efficiency of [an issuer's] management or the soundness of the enterprise." Only detachment, that is freedom from conflicts of interest, allows the banker to have the clearest professional judgment in those tasks. Second, the banker stands before a large part of his or her customers "in a position of trust, which should be fully recognized." Brandeis believed that such clients need and are entitled to have the banker's unbiased advice.

Brandeis summed up his ideas in his 1914 work, *Business—a Profession*. In it, he said that business, including the business of finance, was ready to join law, medicine, and theology among the professions. He also defined what he meant by a profession. First, he said, "[a] profession is an occupation for which the necessary

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123. *Id.* at 354-55 (quoting Brandeis' testimony).
124. Brandeis also believed that these inefficiencies of size would arise even when organizations were not monopolies. *See id.* at 202.
125. *See* BRANDEIS, supra note 119, at 5-6.
126. *See id.* at 135-36.
127. *Id.* at 135.
128. *See id.* at 134-36. Brandeis' ideas on banker independence were part of a larger analysis. He believed that the conflicts of interest created by bankers taking an active role in management, or by directors serving on multiple boards, were inefficient because they interfered with sound judgment, and dangerous, because they allowed despotic concentrations of economic power. *See* MASON, supra note 117, at 415. In regards to the latter, Brandeis compared J.P. Morgan to Caesar Augustus, because both aggregated great power through the "long-concealed concentration of distinct functions, which are beneficent when separately administered, and dangerous only when combined in the same persons." BRANDEIS, supra note 119, at 4.
129. BRANDEIS, supra note 119, at 136.
130. *See id.*
131. LOUIS D. BRANDEIS, BUSINESS—a PROFESSION (Hale, Cushman & Flint 1933) (1914).
132. *See id.* at 1 (citing also to manufacturing, merchandising, and transportation as "new professions").
preliminary training is intellectual in character, involving knowledge and to some extent learning, as distinguished from mere skill."133 Second, "[i]t is an occupation which is pursued largely for others and not merely for one's self."134 Third, "[i]t is an occupation in which the amount of financial return is not the accepted measure of success."135 Brandeis believed that the business community was ready to work by these standards. As he put it, "[i]n the field of modern business, so rich in opportunity for the exercise of man's finest and most varied mental faculties and moral qualities, mere money-making cannot be regarded as the legitimate end."136 Moreover, he concluded, professionalized business enjoyed an advantage that distinguished it from "petty trafficking or mere money-making," and answered "the narrow money-maker without either vision or ideals ... even on his own low plane of material success."137 In short, when its work was "worthily pursued," the business of finance would be a profession.138

Brandeis' image of the business of finance as a profession whose members should act with detachment, in a relationship of trust with individual clients, and with freedom from conflicts of interest, was hardly consistent with the Brains Trust's goal of bringing it under the control of a federal planning agency. The Brains Trusters were right to fear his fury. Moreover, infuriating Brandeis was particularly dangerous, because the Brains Trust recognized that he was one of the leading influences on FDR's development.139 Moley predicted that Felix Frankfurter, Brandeis' emissary to the world outside the Supreme Court,140 would pay a call to Albany before the dust had settled.141 He was right.

Brandeis appears to have kept in touch with developments during the 1932 political season. He had many consultations with Thompson on the securities plank of the Democratic Party platform.142 He also wrote

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133. Id. at 2.
134. Id.
135. Id.
136. Id. at 4-5.
137. Id. at 12.
138. Id. at 2.
139. See Tugwell, The Spring of Thirty-Two, supra note 53, at 16-17 (stating that "the one real rival of Brandeis for the father role in Franklin's life was Theodore Roosevelt").
140. See generally Bruce Allen Murphy, The Brandeis/Frankfurter Connection: The Secret Political Activities of Two Supreme Court Justices 33 (1982) (positing that once on the Supreme Court, Brandeis could no longer play a public role in the issues of the day, so he used Frankfurter as a messenger and proxy).
141. See TUGWELL, BRAINS TRUST, supra note 39, at 145.
142. See Letter from Huston Thompson, to Hon. Franklin D. Roosevelt, supra note 112.
Frankfurter, on the day Roosevelt accepted the Party's nomination, that "Roosevelt's nomination is a comfort." A few days later, FDR and Frankfurter spoke on the phone, and the candidate suggested that Frankfurter should obtain a copy of the memorandum on "things economic" prepared by the Brains Trust. Frankfurter began to gather information on the campaign and then met with the candidate in person.

At some point before the evening of August 4, 1932, Frankfurter sat down with Roosevelt in Albany to discuss the campaign. Their conversation covered a number of topics. Frankfurter suggested various people who, as informed Washingtonians, could supplement Moley, Tugwell, and Berle. Specifically, he urged Roosevelt to add Max Lowenthal to his campaign staff. On substantive issues, Frankfurter raised various topics, and then listened to FDR's views and took notes. These topics included railroads, utilities, holding companies, agriculture, and others. Finally, while Frankfurter did not expressly raise the topic of the securities industry, he did caution Roosevelt as to his "affirmative policies," at least as to the importance of "language."

143. Letter from Louis D. Brandeis, to Felix Frankfurter (July 2, 1932), microformed on Felix Frankfurter Papers, Reel 16, Frame 797.
144. See Memorandum from Felix Frankfurter, to Governor Roosevelt (July 5, 1932), microformed on Felix Frankfurter Papers, Reel 60, Frames 32-33.
146. The meeting's date is uncertain. However, it is safe to say that it took place before the evening of August 4th, even though Frankfurter's letter to Brandeis describing it is dated August 7th. See Letter from Felix Frankfurter, to Louis D. Brandeis (Aug. 7, 1932), microformed on L.D. Brandeis Papers, Louisville, Box G-9, Reel 65 (frames are unnumbered, the letter is captioned "Aug. 7" and will be found in "Government (G.9-2) Correspondence with Mr. Felix Frankfurter") (note that this letter is placed out of sequence on the microfilm reel, and will be found among correspondence of a later date). Frankfurter urged Roosevelt to add Max Lowenthal to his campaign policy staff, and Lowenthal appeared for a meeting with the candidate on the evening of August 4th. This chronology is also consistent with other evidence. See Letter from Felix Frankfurter, to Hon. Franklin D. Roosevelt (Aug. 5, 1932) (unpublished letter available in Papers as Governor, Series 1, Box 29, in the Franklin D. Roosevelt Library, Hyde Park, New York) (on file with Author) (discussing Frankfurter's thoughts since leaving Albany on a particular political issue).
147. See Letter from Felix Frankfurter, to Louis D. Brandeis, supra note 146.
148. See id.
149. See id.
150. See id.
151. Id. (quoting Frankfurter's letter to Brandeis stating that "[a]s to affirmative policies cautioned him as to the importance of [his] language").
Was this enough to turn Roosevelt away from the Brains Trust? The candidate surely would have listened carefully to any words of caution from Frankfurter, who was his friend,152 an adviser,153 and Brandeis' emissary.154 In any event, when FDR abandoned control and planning, the Brains Trust blamed Frankfurter. Tugwell reported that "when the turn came," Moley cursed Frankfurter as its "chief architect," but Tugwell continued, "probably not within the candidate's hearing."155

In the weeks after the Democratic Convention, Brandeis and Frankfurter were not the only outsiders challenging the Brains Trust's influence over the candidate. Businesspeople also approached Roosevelt, and they had the added advantage that with their policy ideas came significant campaign contributions. As Tugwell put it, the "speculators," Bernard Baruch and Joseph Kennedy, were the most generous and the most demanding.156 For the moment, Baruch played the more important role.

Baruch was a financier, or as people in Washington put it, a "'Wall Street gambler.'"157 He was a "'staunch Democrat.'"158 Like Brandeis, he had played an important role in the Wilson administration.159 Most prominently, during World War I, he had led the nation's program of economic mobilization.160 In 1932, once FDR carried the convention, Baruch offered his services.161 This included extensive financial support—as General Hugh Johnson, Baruch's associate, put it, any time there was a financial crisis in the campaign, Baruch "either gave the necessary money, or went out and got it."162

Like Brandeis, Baruch approached the campaign with a developed body of policy ideas. Baruch believed that "'[a]ll economic movements, by their very nature, are motivated by crowd psychology.'"163 Drawing on Charles Mackay's *Extraordinary Popular Delusions and the*
Madness of Crowds," Baruch believed that no one was immune to crowd madness. Rank, education, graphs, business ratios, the mathematics of price movements, even the condition of the normal trend; all could be swept aside by these mass eruptions. Applying these ideas to current conditions, Baruch believed that the "market madness of 1927 to 1929" had been such an event. Moreover, after the crash, unreasoning pessimism had replaced unreasoning optimism. The fundamental cause of the economic crisis of the early 1930s, Baruch believed, was the corroding fear that gripped the land.

Baruch’s policy ideas were based on this analysis. Most importantly, he believed, the psychology of confidence had to be restored. Johnson stated this proposition eloquently in a draft speech written for possible use at the Democratic Convention: “There is nothing the matter with America . . . . Here, then, are all the elements of an active business and a moderate prosperity—save one—confidence is gone. The present stagnation is a malign spell without economic rhyme or reason. The name of that spell is fear.” As Tugwell summed it up, Baruch believed in “the simple thesis that the [economic crisis] would end when businessmen got back their confidence.”

Baruch proposed a number of specific policies that he believed would restore confidence. Most were fairly conventional. On the eve of the Democratic Convention he urged drastic reductions in federal spending and a balanced budget. He also believed that sacrifices should be made for “frugality and revenue.” These ideas would have a place in the presidential campaign, and would add to the eclectic mix of policies that FDR pursued in his first administration. With respect to planning, however, Baruch’s policy ideas were less conventional.

Baruch believed that some level of planning was needed to rationalize the industrial economy. Indeed, biographer Jordan A. Schwarz has concluded that Baruch’s "principal public purpose" was “to educate the American people to accept planning for economic

164. CHARLES MACKAY, EXTRAORDINARY POPULAR DELUSIONS AND THE MADNESS OF CROWDS (1932) (discussing, among other things, John Law’s Mississippi Scheme, the South-Sea Bubble, and the Tulipomania).
165. See BARUCH, supra note 158, at 227-29.
166. See id. at 228.
167. See id. at 229.
168. See id. at 231.
169. See id.
170. JOHNSON, supra note 157, at 140.
171. TUGWELL, DEMOCRATIC ROOSEVELT, supra note 40, at 239.
172. See Billion Budget Cut Asked by Baruch, N.Y. TIMES, June 27, 1932, at 13.
173. BARUCH, supra note 158, at 244.
stabilization.' Moreover, Baruch had a specific type of planning in mind. He advocated business exercising "group self-government." In a speech given in 1930, he said, "[w]hat business needs ... is a common forum where problems requiring cooperation can be considered, and acted upon with the constructive, non-political sanction of government." In his 1930 speech, Baruch referred to this forum as a "supreme court of business." "Its deliberations," he said, "should be wholly scientific, briefed like an engineer's report and published to the world." 

While the Brains Trust was certain of Brandeis' antipathy, they were less certain of Baruch's thinking. His support for planning could indicate a point of agreement. However, any such agreement would have been very superficial. Baruch was no enemy of planning, but he was no friend of the Brains Trust's goal of bringing the economy under the control of a federal planning agency. Baruch was most explicit in his criticism of such ideas. He did not want, he said, some "repressive, inquisitorial, mediocre bureau," and he strongly opposed setting up any body for economic planning. Indeed, he was ready to characterize such a body as "dictatorial." Hence, despite his support for planning, Baruch appeared to the Brains Trust as someone who, like "most eastern business men, ... want[ed] to permit free play to business." 

Baruch's approach to the campaign followed much the same pattern as that of the Brandeis-Frankfurter camp. Like Frankfurter, he visited the candidate and discussed his views. Also like Frankfurter, he placed a representative on the candidate's policy staff, in this case, his associate Johnson. Tugwell thought Johnson was an orthodox business-minded addition to their group. 

Did Baruch turn Roosevelt away from the Brains Trust? At least some members of the Brains Trust were worried. Tugwell wrote that

174. SCHWARZ, supra note 159, at 6.
176. Id. (quoting Baruch).
177. Id. (quoting Baruch).
178. Id. (quoting Baruch).
179. Id. (quoting Baruch).
180. See Baruch Sees Nation Rising From Slump, N.Y. TIMES, Nov. 12, 1931, at 1.
181. Id. at 16.
182. Memorandum from Adolf A. Berle, to Governor Franklin D. Roosevelt (July 20, 1932), in NAVIGATING THE RAPIDS, supra note 58, at 51.
183. See BARUCH, supra note 158, at 242-45.
184. See MOLEY, AFTER SEVEN YEARS, supra note 48, at 39.
185. See Rexford G. Tugwell, The Progressive Orthodoxy of Franklin D. Roosevelt, 64 ETHICS 1, 22 (1953).
within a week of the convention he was already concerned that Baruch was controlling the candidate.\footnote{186} When he mentioned his concern to Senator Bob La Follette, the Senator replied, "'Oh no, ... not that "confidence" stuff again!'"\footnote{187} However, it is unclear how much influence Baruch actually had over Roosevelt. Moley at least believed that FDR treated him with "reticence" and "semi-detachment."\footnote{188}

With his principal political adviser having a fit, the Democratic Party Platform substituting disclosure and exchange regulation for control over the sale of securities, Brandeis sending words of caution, and one of his principal financial backers advocating a different approach, FDR must have felt tremendous pressure to turn away from the Brains Trust. On the evening of August 4, 1932, he turned. A meeting was held in Albany to discuss upcoming campaign speeches.\footnote{189} All of the major figures involved in formulating the campaign’s policy positions were represented, or attended in person. Johnson represented Baruch, and Lowenthal appeared at Frankfurter’s instigation.\footnote{190} Moley, Tugwell and Berle were there.\footnote{191} Finally, two personal advisers accompanied Governor Roosevelt.\footnote{192} They decided that a speech on stock market publicity should come first, probably within two weeks.\footnote{193} The time had come for the candidate to finalize the campaign’s policy message on the securities industry.

At the present time, FDR believed that the government could not "undertake to tell people in what they shall or shall not invest."\footnote{194} He did feel, however, that the government could do four things: "(a) Make sure that only men of character undertake the flotation of securities, and (b) That all material facts in regard to those securities are known; and (c) That there shall be continuously public accounts; and (d) That manipulative moves by the corporate insiders ought to be disclosed."\footnote{195} The candidate had chosen—in two words—character and disclosure.

\footnote{186}{See TUGWELL, BRAINS TRUST, supra note 39, at 271.}
\footnote{187}{Id. (quoting La Follette and suggesting that an emphasis on confidence was the policy of the incumbent Hoover administration).}
\footnote{188}{MOLEY, FIRST NEW DEAL, supra note 51, at 389.}
\footnote{189}{See Memorandum of Adolf A. Berle (Aug. 5, 1932), in NAVIGATING THE RAPIDS, supra note 58, at 53.}
\footnote{190}{See id. Moley objected to Lowenthal’s participation, but was overruled. See id.}
\footnote{191}{See id.}
\footnote{192}{See id. at 53, 55 (identifying Samuel Rosenman and Basil ("Doc") O’Connor as the two advisers).}
\footnote{193}{See id. at 54.}
\footnote{194}{Id. at 55.}
\footnote{195}{Id.}
The August 4th meeting in Albany changed the course of federal securities regulation. The regulatory regime would be based on character and disclosure, not on a Capital Issues Board/Federal Economic Council. Among contemporaries, Tugwell at least recognized what was happening. The Brains Trust was losing the struggle for FDR's mind. For years afterwards, Tugwell "reproached" himself for his failure to protest. He also continued to believe that the Oglethorpe Speech represented FDR's real convictions. Nonetheless, the decision had been made. The Brains Trust's proposals would not shape the future regulatory regime.

B. Final Vision: Honesty, Honor, the Sacredness of Obligation, Faithful Protection, and Unselfish Performance

Once FDR had settled on character and disclosure as the bases for his securities policy, these concepts appeared prominently in his speeches. Two addresses in particular articulated this new vision.

In Columbus, Ohio, on August 20, 1932, FDR gave the speech that had been discussed at the Albany meeting. It focused on disclosure. His policy, FDR said, was based on telling the truth. "Government," he said, "cannot prevent [people] from making errors of judgment. But Government can prevent ... the fooling of sensible people through misstatements and through the withholding of information on the part of private organizations, great and small, which seek to sell investments to the people of the Nation." While Tugwell was opposed to the speech, Johnson liked it and it expressed Brandeis' views. Just as the

196. See TUGWELL, BRAINS TRUST, supra note 39, at 403 (stating that "[i]t is perhaps overblown to speak of a struggle for his mind. Still, that is how we spoke of it then."). Berle may not have recognized the importance of the August 4th meeting because he was still giving the candidate advice on the Federal Economic Council almost two weeks later. See Memorandum from Adolf A. Berle, to Governor Franklin D. Roosevelt (Aug. 17, 1932), in NAVIGATING THE RAIDS, supra note 58, at 59.
197. See TUGWELL, BRAINS TRUST, supra note 39, at 473.
198. See TUGWELL, DEMOCRATIC ROOSEVELT, supra note 40, at 219.
199. See Franklin D. Roosevelt, The Failures of the Preceding Administration, Campaign Address at Columbus, Ohio (Aug. 20, 1932), in 1 PUBLIC PAPERS, supra note 78, at 659, 652.
200. See id.
201. Id.
202. See Tugwell, supra note 185, at 16.
203. See id.
204. See id.
Oglethorpe Speech had publicly marked the Brains Trust's ascendancy, the Columbus Speech publicly marked its fall.205

The Columbus Speech marked the change in FDR's policy, but his first Inaugural Address is the fullest expression of the moral purpose he had selected. The Address began with the now famous proclamation that "the only thing we have to fear is fear itself."206 It then went on to focus on the ethics of Wall Street, or as the Address described them, the "[p]ractices of the unscrupulous money changers."207 The "moneychangers," FDR said, "stand indicted in the court of public opinion, rejected by the hearts and minds of men."208 They know "only the rules of a generation of self-seekers. They have no vision, and when there is no vision the people perish."209 "The moneychangers," he continued, "have fled from their high seats in the temple of our civilization."210 "We may now," FDR continued, "restore that temple to the ancient truths."211

The ancient truths he had in mind were revealed in the next several passages. First, "[t]he joy and moral stimulation of work no longer must be forgotten in the mad chase of evanescent profits."212 Instead of monetary profit, "more noble" social values should be the standard of success.213 Second, he called for an end to conduct in banking and business that, as he put it, has too often given to a "sacred trust the likeness of callous and selfish wrongdoing."214 Third, he said, "[s]mall wonder that confidence languishes, for it thrives only on honesty, on honor, on the sacredness of obligations, on faithful protection, on unselfish performance; without them it cannot live."215

The above passages from the Inaugural Address plainly reveal Brandeis' influence. Like Brandeis, the President described banking and

205. In the weeks following the Columbus speech, Brandeis expressed his approval. See Letter from Louis D. Brandeis, to Felix Frankfurter (Aug. 25, 1932), microformed on Felix Frankfurter Papers, Reel 16, Frame 808 (stating that FDR "gained much" through the Columbus speech). Baruch publicly announced his support for FDR's candidacy. See Baruch Acclains Roosevelt as Sound, N.Y. TIMES, Sept. 6, 1932, at 1 (deriding talk of FDR's supposed radicalism).

206. Franklin D. Roosevelt, Inaugural Address (Mar. 4, 1933), in 2 PUBLIC PAPERS, supra note 78, at 11.

207. Id. at 12.

208. Id.

209. Id.

210. Id.

211. Id.

212. Id.

213. See id.

214. Id.

215. Id.
business as in the nature of a trust. In addition, his call for a restoration of the joy and moral stimulation of work, and for a standard of success more noble than monetary profit could have been based directly on Business—A Profession. It is interesting that Moley, in his first rough sketches of the address, gave this passage a much more radical tone by saying “it behooves us to restore moral values by driving out—material standards.” The Address’s final phraseology, which transforms the message from the language of forceful change to the language of ethical and professional restoration, is illustrative of the whole campaign.

Baruch’s influence can also be seen. The psychology of confidence and fear was prominently featured. The passage on having “nothing to fear but fear itself” could have been based directly on the draft speech Baruch and Johnson had taken to the Democratic Convention. In Roosevelt’s hands, however, this idea took on new meaning. The failure of confidence was caused by an ethical failure. In essence, FDR synthesized Baruch’s ideas on confidence and Brandeis’ ideas on professional duty into a policy vision that included, and transcended, both. He identified the problem as fear and a crippling loss of confidence. He also identified the cause of the problem as bankers and businesspersons’ callous wrongdoing and breach of sacred trust. Finally, he identified the remedy. Confidence would flourish when business was conducted with honesty, honor, sacred obligation, faithful protection and unselfish performance.

FDR’s first Inaugural Address set out the basic direction for the new administration’s policy toward the securities industry. Instead of planning the allocation of capital to avoid waste, it would seek to revive confidence by restoring securities professionals’ moral character. The ideas of Brandeis and Baruch would animate the federal regulation of the securities industry.

C. A Simple Code of Ethics

As the Roosevelt administration took office, the time had come to turn both campaign and inauguration rhetoric into the more prosaic language of law and regulation. Securities legislation was a “must” of

216. See supra text accompanying note 129.
217. See BRANDEIS, supra note 131, at 2.
218. MOLEY, FIRST NEW DEAL, supra note 51, at 107.
219. See supra text accompanying notes 183-98.
220. See Roosevelt, supra note 206, at 12.
221. See id.
222. See id.
“the first order” for the new administration.\textsuperscript{223} The President decided to go forward with a disclosure bill, while temporarily deferring a bill for stock exchange regulation.\textsuperscript{224} While the administration’s efforts would be focused on disclosure, in his first weeks in office, FDR would make two specific proposals demonstrating the types of regulations he had in mind for the other, character-based component of his policy.

The first proposal was made in a statement about the disclosure bill. The new President took a personal interest in the disclosure bill.\textsuperscript{225} Huston Thompson, author of the Democratic Party’s securities plank, was recruited to draft it.\textsuperscript{226} FDR met with Thompson twice, went over the draft bill, and made specific suggestions.\textsuperscript{227} He criticized the bill’s length and detail, and suggested that Thompson cut down both.\textsuperscript{228} Thompson later told the President that he had reduced the bill’s length as much as possible,\textsuperscript{229} but FDR was still not satisfied. When he sent the bill to Congress, FDR told the press that he had “tried to cut it down but found it impossible.”\textsuperscript{230} In addition, when the press asked whether the disclosure bill completed his program, FDR responded:

[T]he big objective is to restore the old idea that a person who uses other people’s money is doing so in a fiduciary capacity.[\textsuperscript{231}] That applies whether he is a dealer in new securities or whether he is a dealer in old securities. . . . In other words, a person who works in an exchange, . . . is acting as the agent[\textsuperscript{232}] for other people so that he is acting in a fiduciary capacity.\textsuperscript{233}

\begin{thebibliography}{230}
\bibitem{223} See \textit{Moley, After Seven Years}, \textit{supra} note 48, at 176.
\bibitem{224} See \textit{Moley, First New Deal}, \textit{supra} note 51, at 311.
\bibitem{225} See Roosevelt Presidential Press Conferences, Number 7 (Mar. 29, 1933), in \textit{1 Complete Presidential Press Conferences of Franklin D. Roosevelt} 88 (1972).
\bibitem{226} See Huston Thompson, Diary Entry for Mar. 13, 1933 (unpublished manuscript available in the Papers of Huston Thompson, Box 1, Library of Congress) (on file with Author).
\bibitem{227} See id. Diary Entries for Mar. 19 & 20, 1933.
\bibitem{228} See id. Diary Entry for Mar. 19, 1933.
\bibitem{229} See Letter from Huston Thompson, to Hon. Franklin D. Roosevelt (Mar. 28, 1933) (available in Official Files, Number 242, in the Franklin D. Roosevelt Library, Hyde Park, New York) (on file with Author).
\bibitem{230} Roosevelt, \textit{supra} note 225, at 88.
\bibitem{231} In a fiduciary relationship, the client or entrustor depends on the fiduciary and is entitled to trust and rely on the fiduciary’s honesty. \textit{See} Tamar Frankel, \textit{Fiduciary Duties as Default Rules}, 74 OR. L. REV. 1209, 1215-30 (1995) (distinguishing entitlement to trust under fiduciary law, from caveat emptor under contract law). In turn, the fiduciary owes the entrustor a duty of loyalty and a duty of care. See \textit{id}.
\bibitem{232} See generally \textit{1 Restatement (Second) of Agency} § 1 (1958) (“Agency is the fiduciary relation which results from the manifestation of consent by one person to another that the other shall act on his behalf and subject to his control, and consent by the other so to act.”).
\bibitem{233} Roosevelt, \textit{supra} note 225, at 89.
\end{thebibliography}
The second proposal was made to Richard Whitney, President of the New York Stock Exchange. A few weeks after the inauguration, Whitney and the new President had a discussion on topics of mutual interest. In their conversation the two Presidents discussed several of the problems contributing to the economic crisis. In addition, FDR proposed a means for accomplishing the moral reform of Wall Street. Specifically, FDR raised the possibility of the New York Stock Exchange adopting a simple code of ethics—simple enough, FDR apparently said, for the public to understand. Whitney expressed some doubt about whether any code for the securities industry "could be made simple enough for the public to understand." He nevertheless assured the President that the vast majority of the Exchange's members were "anxious to put the security business on a higher plane than it has ever been before."

The idea of a simple code of ethics appears to have been more than just a suggestion for the New York Stock Exchange. FDR did not limit his proposal to the Exchange. He told Whitney that he hoped the code "might become a universal standard." In their conversation, the two Presidents spent some time discussing how regulations adopted by the New York Stock Exchange could be made applicable to other exchanges. In addition, FDR appears to have viewed the simplicity of the code as a serious matter. At about the same time he was suggesting a simple code to Whitney, he was urging Thompson to cut down the length and detail of the disclosure bill. Thus, while the specific context of the proposal was a suggestion to Whitney, FDR did not limit his ideas to the New York Stock Exchange.

In these two proposals, extending the fiduciary doctrine to the buying and selling of securities and creating a code of ethics for the

235. FDR and Whitney talked about discouraging trading abuses, such as pools and traders using short sales to force price declines; about how the securities industry could be segregated into different segments, such as brokers, dealers, and private bankers; and how the Federal Reserve could restrict the credit available for stock market speculation without penalizing commercial and industrial transactions. See id. at 1-4.
236. See id. at 5-6 (mentioning FDR's proposal and responding to his apparent suggestion that it be made simple enough for the public to understand).
237. Id. at 6.
238. Id. at 7.
239. Id. at 6.
240. See id. at 4-5.
241. See supra text accompanying note 236.
242. See supra text accompanying note 228.
securities industry that would be simple enough for the public to understand, FDR suggested specific regulatory vehicles for implementing his moral purpose. These proposals demonstrated that FDR expected concrete action to follow on his campaign and transition rhetoric. In fact, in the coming months and years, action would be taken to turn this vision into a regulatory regime. Indeed, by the time FDR made these statements, the legislative process had already begun.

III. FROM POLICY VISION TO REGULATORY REGIME

When FDR turned from the Brains Trust to Brandeis and Baruch, he did more than shift his favor among competing advisers. He changed the fundamental nature of his policy towards the securities industry. The regulatory regime would be animated by an orthodox Progressive vision. It would be concerned with moral character, honesty, and codes of conduct, not with the planning and control demanded by 1930s era "engineering."\(^{243}\)

The Brains Trust believed that the federal government should direct, and to some degree actually absorb, the core functions of the securities industry.\(^{244}\) Their program sought to make the securities industry responsible by subjecting it to an economic government.\(^ {245}\) The federal government, through a Capital Issues Board/Federal Economic Council, would control the allocation of capital among and within industries, including, apparently, the soundness, value, and distribution of securities.\(^ {246}\) The fundamental purpose of these arrangements would be to eliminate the waste of an unplanned capital market.\(^ {247}\) On May 22, 1932, in the Oglethorpe Speech, FDR signaled his agreement with this vision of the future regulatory regime.\(^ {248}\)

Brandeis and Baruch offered a very different vision. For them, the ultimate goal was to transform the securities industry from within. For Brandeis this meant making bankers professionals by vesting them with the loyalty, independence, and competence that professionals bring to their work.\(^ {249}\) For Baruch it meant restoring the psychology of confidence

\(^{243}\) See supra Part II.B (developing and articulating FDR's revised policy vision that eventually served as the cornerstone of the nation's securities acts).

\(^{244}\) See supra text accompanying notes 53-57.

\(^{245}\) See supra text accompanying notes 51-52.

\(^{246}\) See supra text accompanying notes 53-57.

\(^{247}\) See supra text accompanying notes 80-83.

\(^{248}\) See supra text accompanying notes 77-90.

\(^{249}\) See supra text accompanying notes 125-30.
through a variety of policies, including business self-government. The fundamental purpose of these arrangements would be to restore the character of the securities industry and the confidence of the business community. On August 4, 1932, at the Albany meeting of campaign policy advisers, FDR signaled his turn to this point of view.

By the time Congress took up securities regulation in the spring of 1933, the decisive policy decision had been made. FDR’s program would be based on character, not control. Some contemporaries continued to fear that FDR had radical plans. The new President knew better. He wrote that honest sellers of securities had nothing to fear, and that some were “seeing things at night.” Of course, what they were seeing was the ghost of the Oglethorpe Speech. FDR would be haunted by that ghost, and by the accusation that his current policy was only “‘camouflage’” for a more radical effort to control business. Moreover, the continuing efforts of some liberals in favor of a national planning board could not have helped him. Administration spokespersons took pains to say that no Capital Issues Committee was hidden in the President’s legislative proposals. The New Deal would witness many experiments with public planning, especially in the areas of power, agriculture, and regional development. But for the securities industry, when the future regulatory regime hung in the balance, FDR chose another path.

There is, however, a wide gulf between the general direction pointed out by FDR and a functioning regulatory regime. His moral rhetoric provided a purpose, but it did not provide the standards, requirements, and prohibitions that constitute regulation. Others would supply those more exacting measures.

250. See supra text accompanying notes 170-71, 175-76.
251. See supra text accompanying notes 189-95.
252. See, e.g., 78 CONG. REC. 7944 (1934) (statement of Rep. Britten) (stating that the true objective of securities legislation was to “Russianize everything” through control of credit and other restrictions).
257. See generally ALAN BRINKLEY, THE END OF REFORM: NEW DEAL LIBERALISM IN RECESSION AND WAR (1995) (discussing FDR’s programs and the ideology upon which his programs rested).
The process of transforming moral vision into regulation took place in three distinct phases. In the first, in 1933 and 1934, Congress dealt with the President's bills on disclosure and stock exchanges. Moral purpose played a role in the legislative histories of both. In the second, beginning in 1934, there was a new participant in the regulatory process. The SEC, an independent regulatory commission created by the Exchange Act, quickly demonstrated its commitment to the President's moral vision. In the third, from 1936 to 1940, the SEC sought to apply that vision in its regulatory program. The fundamental institutions of the modern regulatory regime for the securities industry emerged from this process.

A. The President's Legislative Program


In March 1933, Congress took up the President's disclosure bill. It would become the Securities Act of 1933 ("Securities Act"). As the administration's first securities bill, its legislative history closely reflected the policy vision articulated by the new President.

Congressmen expressed concern about investors' "shattered confidence in the business and financial structure of the Nation." They attributed this failure of confidence to the "unethical practices of promoters and fly-by-night investment propositions" of the prior era. They also suggested that a staggering portion of the securities issued during the bubble economy of the 1920s had been tainted with fraud. In fact, the Committee on Interstate and Foreign Commerce, chaired by Congressman Rayburn, stated that fully half of the securities floated in the United States since the World War were worthless. The Committee

258. See infra Part III.A.

259. See infra Part III.A.

260. See supra note 21.

261. See infra Part III.B.

262. See infra Part III.C.

263. See 77 CONG. REC. 937 (1933) (message from President Roosevelt).


266. Id.


268. See id. This estimate came from a Department of Commerce study. See Federal Securities Act: Hearing on H.R. 4314 Before the Comm. on Interstate and Foreign Commerce, 73d Cong. 75 (1933) [hereinafter House 1933 Hearing] (statement of Walter L. Miller, Chief, Foreign Service Division, Bureau of Foreign and Domestic Commerce).
continued, stating that "[t]he flotation of such a mass of essentially fraudulent securities was made possible because of the complete abandonment by many underwriters and dealers in securities of those standards of fair, honest and prudent dealing that should be basic to the encouragement of investment in any enterprise."269

Congressman Mapes, a leading member of Congressman Rayburn's Committee, explicitly described this failure as a matter of character. He said:

I have always wanted to believe in the copy-book statements that those who occupy high positions in the business and financial world were not only men of ability but men of character as well; that the fact that they occupied such positions was an evidence that they were men worthy of confidence. The revelations of the last few years have had a tendency to shake my faith in that respect.270

He then described a public offering by four leading underwriters in which both the amount of the issue and the security behind it had been mischaracterized.271 Congressman Mapes concluded:

[F]our investment banking houses supposed to be reputable—at least, they had a reputation for being reputable before they were put to the test by this depression ... put out statements which were totally misleading and in some respects false, in order to secure the sale of these bonds.272

This focus on investment bankers' reputation had a practical significance. As one Representative put it, the "very names" of banking houses of high reputation "lend confidence to the public."273 Unfortunately, the Congressman believed, the bankers had exploited their reputation, and the confidence it engendered, to sell securities "not worth the paper they are written on."274 As another Congressman added later in the debate, bankers and brokers had solicited the confidence of the public only so they could foist securities on them, without any regard for their "moral duty" to verify the underlying security of what they were selling.275

271. See id.
272. Id.
273. Id. at 2930 (statement of Rep. McFadden).
274. Id.
275. See id. at 2951 (statement of Rep. Eltse).
Senators expressed similar sentiments. In particular, Senator Norbeck, former Chairman of the Senate Committee investigating stock market abuses, spoke on this point. He described an investment banking house that had been involved with Samuel Insull, the utility magnate whose operations collapsed amid massive fraud, as "one of our large financial institutions which had built up a fine reputation during years of square dealing, only to sell out that reputation during the boom." Or, in describing how a bank conducted its securities business, "[t]his is another instance of a reputable banking house with a century of growth and confidence back of it suddenly going wrong in the hands of unsound management, who were so anxious for immediate gain that greed got the better of their judgment." "We all hope for an early business recovery," Senator Norbeck remarked, "but that is impossible without a return to plain, old-fashioned business honesty."

Members in both chambers also expressed the view that legitimate business needed protection from dishonest competition. As the Senate Committee Report put it, the bill's aim was to protect the investing public and "honest enterprise] seeking capital by honest presentation, against the competition afforded by dishonest securities offered to the public through crooked promotion." As one Representative explained:

This legislation is designed to protect not only the investing public but at the same time to protect honest corporate business. The honest director and underwriter will have no fear of the provisions of this law. One of its purposes is to protect them from the illegitimate competition of financial racketeers.

Congressional aspirations for a restoration of bankers' "old-time sense of ethics" echoed FDR's policy. His moral vision had found a home in the legislature. The extent to which his ideas had penetrated congressional thinking is shown by Congressman Rayburn's description of how the Act would affect the securities industry. It would, he said, make underwriters and dealers "responsible." This was a familiar concept in the contemporary climate of opinion, but its meaning had been transformed. For Berle, responsible investment banking meant

276. See supra text accompanying note 37.
278. Id. at 3232.
279. Id.
282. Id. at 2914 (statement of Rep. Greenwood).
283. Id. at 2919 (statement of Rep. Rayburn).
"thinking not merely whether a bond issue or loan can be repaid, but whether the enterprise ought to be started at all."²²⁴ For Rayburn it meant the honesty with which the securities were sold. As Rayburn explained it, the bill made underwriters and dealers "responsible civilly if [they] sell[] stocks upon a misrepresentation; it makes [them] guilty of fraud and criminally liable if [they] sell[] it with misrepresentation[s] and fraudulent intent."²²⁵ Two sections in particular implemented these goals.

Section 12(2) extended civil liability to any person who "sells a security . . . by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements [therein] . . . not misleading."²²⁶ Liability was to the purchaser, but only if the purchaser did not know of the untruth or omission.²²⁷ Finally, sellers could avoid liability if they could sustain the burden of proof that they "did not know, and in the exercise of reasonable care could not have known, of such untruth or omission."²²⁸ Contemporaries described this provision as a statutory declaration of common law liability.²²⁹

Section 17(a) prohibited fraud in the sale of securities.²³⁰ It made it unlawful for any person in the sale of any securities . . . (1) to employ any device, scheme, or artifice to defraud, . . . (2) to obtain money . . . by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in . . . light of the circumstances under which they were made, not misleading, or (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.²³¹

²²⁴ A.A. Berle, Jr., A High Road for Business, 93 SCRIBNER'S MAG. 325, 330 (1933).
²²⁷ See id. Liability was limited to sellers in privity with the buyer. See generally William O. Douglas & George E. Bates, The Federal Securities Act of 1933, 43 YALE L.J. 171, 177 (1933).
²²⁹ See Baldwin B. Bane, Address at the Bond Club of Philadelphia 7 (Dec. 21, 1933) (transcript available in the SEC Library at 2 SEC Speeches, 1934-61).
²³¹ Id.
Based on existing New York law, this provision appears to have been relatively uncontroversial, with even members of the investment banking community speaking in its favor.

Sections 12(2) and 17(a) strongly reflected the President's moral vision. They reached conduct inconsistent with plain, old-fashioned business honesty. They were based on existing law, either common law or statutory. In short, they expressed, in the language of the law, the purpose of moral restoration repeatedly expressed by FDR and members of Congress. This purpose was further reflected in a third, somewhat different provision. That provision was section 11, particularly as it applied to underwriters.

Section 11 made underwriters liable for any untrue statement of a material fact in a registration statement, or the omission of a material fact that was required to be stated therein, or was necessary to make the statements therein not misleading. Underwriters could escape this liability by showing that, after a reasonable investigation, they had reasonable grounds to believe, and did believe, that the statements were true and that there was no such omission. The standard of reasonableness by which such investigations were to be judged was "that required of a person occupying a fiduciary relationship."

The moral purpose animating this duty of investigation, now known as "due diligence," can be seen in the provision's legislative history. The bill Thompson drafted for FDR did not expressly include underwriters in the civil liability provision. After a few days of hearings, Congressman Rayburn asked Raymond Moley for help in redrafting, and Moley brought in a new group to assist him. The new group consisted of Felix


293. See House 1933 Hearing, supra note 268, at 158-59 (statement of Frank M. Gordon, President, Investment Bankers' Association of America) (expressing support for provisions preventing and punishing fraud).

294. See infra notes 295-303.

295. The registration statement was a new requirement, established by the Securities Act, to implement the President's policy in favor of full disclosure about securities offerings.


299. See MOLEY, FIRST NEW DEAL, supra note 51, at 312.
Frankfurter, James Landis, Thomas Corcoran and Benjamin Cohen. Among other provisions, section 11 emerged from their redrafting. After the bill was revised, Rayburn's Committee explicitly linked this section to underwriters' moral responsibility. The Committee Report said that "[f]or those whose moral responsibility to the public is particularly heavy, there is a correspondingly heavier legal liability." A "return to the ancient truths of fair dealing" would be achieved by holding underwriters to the standards imposed by law upon a fiduciary.

The moral purpose of the Securities Act should not be forgotten. Underwriters, dealers, and those who sell securities would be responsible, but now this meant that the law would hold them to their moral responsibility. As Congressman Beedy said on the floor of the House, the Securities Act "set[] up a standard of business morality in this country for men engaged in the private business of issuing and selling securities." This standard, the House Committee Report said, "carry[ed] over into the general field of security selling, ethical standards of honesty and fair dealing common to every fiduciary undertaking.


In February 1934, Congress took up the President's stock exchange bill. It would become the Securities Exchange Act of 1934 ("Exchange Act"). In 1933, when FDR sent his disclosure bill to Congress, he hoped that the stock exchange bill would be ready in ten days. In fact, it would take almost a year to prepare the bill, and in the meantime, the mood in Congress had dramatically changed. The stock exchange bill faced bitter opposition, and its legislative history was long, involved and contentious. The President's moral purpose survived in this

301. See H.R. 5480, 73d Cong. § 11 (1933).
303. Id. at 5.
304. 77 CONG. REC. 2953 (1933) (statement of Rep. Beedy) (addressing the requirement that the prospectus display certain information conspicuously and in certain type).
308. See Roosevelt, supra note 225, at 90.
309. See generally SELIGMAN, supra note 37, at 73-100.
environment, but it was given a new focus, and subjected to heightened challenge.

In many respects, Congress' debates on the stock exchange bill appear similar to those on the disclosure bill. Abuses on Wall Street were again described\(^\text{310}\) and again blamed for the nation's economic problems.\(^\text{311}\) In this instance, Congress focused on the stock exchanges. For example, Senator Norris said that as a result of gambling and manipulation on the exchanges, stock and bond prices had been pushed artificially high.\(^\text{312}\) As always, he said, "when the bubble bursts," the honest investor loses money.\(^\text{313}\) Similarly, Congressman Wolverton said that "highly organized pools and other manipulative practices, encouraged by false and misleading statements," had led to wild and unrestrained speculation, which ultimately played a large part in the collapse of security values.\(^\text{314}\) Moreover, the abuses that had led to the collapse in security values continued to impede recovery.\(^\text{315}\) What was needed, the legislative history reveals again and again, was honest and fair markets where prices rested on real values.\(^\text{316}\)

There are also indications that the stock exchange bill was motivated by moral aspirations similar to those expressed during the previous year. There were suggestions that at least some manipulative practices were morally wrong,\(^\text{317}\) and that the provisions of the bill regulating them were the "moral" part of the Exchange Act.\(^\text{318}\) Senator Fletcher, for example, said that the New Deal program was "a moral attitude in governmental action."\(^\text{319}\) Applying this principle to the stock exchange bill, he said that its cardinal principles were: "first, restoring as a rule of moral and economic conduct, a sense of fiduciary obligation; and, second, establishing social responsibility, as distinguished from individual gain, as the goal."\(^\text{320}\)

\(^{310}\) See, e.g., 78 CONG. REC. 8165-74 (1934) (statement of Sen. Fletcher) (describing the findings of Senate investigative hearings).

\(^{311}\) See S. REP. NO. 73-792, at 3-4 (1934).

\(^{312}\) See 78 CONG. REC. 8394 (1934) (statement of Sen. Norris).

\(^{313}\) Id.

\(^{314}\) Id. at 7863 (statement of Rep. Wolverton).

\(^{315}\) See S. REP. NO. 73-792, at 4.


\(^{319}\) Id. at 8161 (statement of Sen. Fletcher).

\(^{320}\) Id.
Despite these similarities, the legislative history of the stock exchange bill differed in two significant respects from that of the disclosure bill. First, supporters of the later bill stated a more developed theory about why moral integrity was needed in the modern economy. Second, by the time of the later bill, the voices of skepticism had rallied, and they directly challenged the idea that Wall Street’s ethics could be improved.

In 1933, Congress attributed the specific conditions of the economic crisis, a mass of worthless securities, to underwriters’ ethical failures. In 1934, the honesty of financial intermediaries was given a role that transcended contemporary conditions. Their probity was now considered an essential element of the modern economy. In articulating this theory, the report issued by Congressman Rayburn’s Committee said that “[i]f investor confidence [was] to come back to the benefit of exchanges and corporations alike, the law must advance.” Specifically:

As a complex society so diffuses and differentiates the financial interests of the ordinary citizen that he has to trust others and cannot personally watch the managers of all his interests as one horse trader watches another, it becomes a condition of the very stability of that society that its rules of law and of business practice recognize and protect that ordinary citizen’s dependent position. Unless constant extension of the legal conception of a fiduciary relationship—a guarantee of “straight shooting”—supports the constant extension of mutual confidence which is the foundation of a maturing and complicated economic system, easy liquidity of the resources in which wealth is invested is a danger rather than a prop to the stability of that system.

In other words, easy liquidity, without mutual confidence, can be dangerously unstable. Therefore, since “straight shooting” maintains mutual confidence, it preserves social stability. The Rayburn Committee summed this up by saying: “When everything everyone owns can be sold at once, there must be confidence not to sell. Just in proportion as it becomes more liquid and complicated, an economic system must

321. See infra text accompanying notes 324-27.
322. See infra text accompanying notes 328-29.
323. See supra text accompanying notes 265-79.
325. Id. at 5.
326. Id.
become more moderate, more honest, and more justifiably self-trusting."

The legislative history of the stock exchange bill also differed from that of the prior year in the vigor with which skeptics attacked the bill’s moral purpose. The skeptics directly challenged the bill’s foundational premise that the law could make financial intermediaries more honest and more trustworthy. Even the bill’s supporters seem to have lost their moral fervor. For example, in 1933, Congressman Beedy said that the Securities Act set up a standard of business morality for those selling securities, and that he commended and endorsed it. In 1934, he said that he would vote for the stock exchange bill, but he also said:

Here is an act which says we must put American business in a strait-jacket. Under compulsion of law we must set up a standard of business ethics and hold the iron hand of Government over it. . . .

... The theory of it is that we should put these exchanges in a strait-jacket. We should hold over them the iron hand of compulsion by Government, and we should drive them to a course of honesty.

As I read my history, . . . we are doomed to be very much disappointed in the final results. You cannot make men honest by law. You cannot clean up business under legal compulsion. The wits of man will thwart every attempt you make.

Supporters of the bill seemed resigned to this view. As one Congressman put it, “[w]e cannot legislate honesty into Wall Street, but we can legislate to make that gang toe the mark.”

The stock exchange bill was enacted in this atmosphere. Congressman Lea, a key member of Rayburn’s Committee, explained the bill’s approach. It was, he said, “severe in its denunciation and

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327. Id.
328. They also attacked the due diligence standard set out in the Securities Act. As a result of this pressure, the standard was changed from that of a fiduciary to that required of “a prudent man in the management of his own property.” 15 U.S.C. § 77k(c) (1994). Both Senator Fletcher and James Landis indicated that the amendment was intended to restate the meaning of a fiduciary relationship without using that term. See 78 Cong. Rec. 8669 (1934) (explanatory memorandum of Sen. Fletcher); id. at 8716 (communication from James Landis to Sen. Fletcher).
329. Several members also emphasized the impossibility of protecting the “suckers” of the world. See, e.g., 78 Cong. Rec. 8490 (1934) (statement of Sen. Hastings).
332. Id. at 8103 (statement of Rep. Johnson) (arguing for a one percent transfer tax on all securities transactions).
penalties for manipulative” practices by brokers and dealers.333 “It is going to be dangerous,” he said, “to engage in ... fraudulent and deceptive methods for the purpose of defrauding investors.”334

The specific measures were set forth in two provisions. The first would become section 9 of the Act.335 It prohibited several types of abusive transactions on securities exchanges. These were all transactions that had been identified during the Senate’s investigative hearings.336 Thus, section 9 prohibited wash sales, matched orders, pools, false or misleading statements by brokers and dealers for the purpose of inducing purchases of securities, and other specific practices.337 The second would become section 10(b) of the Act.338 It was a catchall provision that authorized the regulatory body that would administer the law to prohibit additional manipulative or deceptive devices or contrivances in connection with the purchase or sale of securities on exchanges or otherwise.339 As Thomas Corcoran, one of the draftsmen of the bill explained it, section 10(b) provided that “[t]hou shalt not devise any other cunning devices.”340

The legislative history of the Exchange Act reveals an ambiguity in Congress’s moral purpose. On a general level, ethical conduct was given a foundational role in public policy. “When everything everyone owns can be sold at once,” honesty and justifiable trust build the mutual confidence needed to hold society together. At the same time, on a more particular level, the specific provisions that applied most directly to the conduct of the securities industry were not explained and justified in moral terms, at least not in the explicitly aspirational language used the previous year. Section 9 was explained as a straightforward effort to stop certain specific abuses,341 and section 10(b) was hardly explained at all.342

333. Id. at 7862 (statement of Rep. Lea).
336. See Senate Stock Exchange Hearings, supra note 256, at 6506 (statement of Thomas Corcoran) (at the time of Corcoran’s testimony, § 9 appeared in the bill as § 8).
339. See id.
341. See House 1934 Hearing, supra note 317, at 115 (statement of Thomas Corcoran).
342. See id. at 115-16.
Indeed, the most explicit statement about the bill’s moral purpose was made in the context of questioning its efficacy in reaching that goal.\textsuperscript{343} As a result, the future of FDR’s vision could depend on how one chose to read this ambiguous legislative record. In any event, in the coming years, the President’s moral purpose would be preserved and fostered by a vigorous new participant in the regulatory process.

\textbf{B. The Crusading Youngsters of the Early Securities and Exchange Commission}

In January 1935, Judge John Burns, the SEC’s first General Counsel,\textsuperscript{344} appeared before a group of investment bankers.\textsuperscript{345} Judge Burns spoke about his hope that the group would protect “professional and business idealism.”\textsuperscript{346} He also spoke about his hopes for the SEC. It would, he hoped, “have a permanent and . . . very salutary effect on the business practices of generations to come.”\textsuperscript{347} This included controlling the “outlaws” in the securities business,\textsuperscript{348} and continuing “the educational process of elevating corporate standards . . . to the end,” he said, “that the principle in business that right is might, will prevail.”\textsuperscript{349} At the end of his address, Burns took questions from the floor. Not all were friendly. One, in particular, turned Burns’ idealism back on him. The industry’s trouble, said the investment banker, was that when they dealt with the Commission they faced “crusading youngsters.”\textsuperscript{350} To this Burns made no specific reply.\textsuperscript{351}

One must always be careful about making inferences from silence. But, in this case, Burns could not deny that many of the Commission’s staff believed themselves to be on a crusade, because the charge was obviously true. Contemporary statements by early Commissioners and

\begin{footnotesize}
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  \item 343. See id. at 116.
  \item 344. At that point in time, the SEC was less than a year old. The Exchange Act authorized it to have a professional staff of lawyers, examiners, and other experts. See Securities Exchange Act of 1934, ch. 404, § 4(b), 48 Stat. 881, 885 (1934) (codified as amended at 15 U.S.C. § 78d(b)(1) (1994)). In 1935, at the end of its first year of operations, the Commission and its staff numbered 696 persons. See SEC, 1 ANN. REPORT 38 (1935).
  \item 345. See Judge John J. Burns, Address Before the Chairmen of the Investment Bankers Regional Code Committees (Jan. 15, 1935) (transcript available in the SEC Library at 2 SEC Speeches, 1934-61).
  \item 346. Id. at 2.
  \item 347. Id. at 3.
  \item 348. See id. at 4.
  \item 349. Id. at 7.
  \item 350. Id. at 11.
  \item 351. See id. Burns responded by describing the steps the SEC was taking, such as creating regional offices, to reduce the administrative burden on regulated firms. See id.
\end{itemize}
\end{footnotesize}
staff contain clear and repeated expressions of the view that the securities laws and the SEC's mission were filled with moral purpose. As illustrated by this speech, Burns was a leading spokesman for this point of view.352

In Burns' view, the crisis of the 1930s had a moral as well as an economic nature.353 It was the deadly vice of avarice or greed and the "failure of morals and religion to put a bridle to the acquisitive motive[s] of leaders in business [that had] made the intervention of the law inevitable."354 These views were reflected in his speeches on securities regulation. He recognized the importance of good will to the securities industry, and the tragic consequences it would face when it lost its reputation for decency and for obeying the law.355 He pointed to the low state of corporate morality on the eve of federal regulation, particularly in regards to the distribution of securities.356 He stated that "[p]ublic confidence [would] return[,] with the enforcement of high standards, and [that] the maintenance of high standards [would be] assured when it [became] unnecessary to depart from them in order to meet the competition of lower standards."357 Finally, he gave the SEC an important role in this task, because "no other agency can so quickly and so effectively restore the confidence of the buying public."358

Other administrators expressed similar views. Joseph P. Kennedy, the SEC's first Chairman, said that its most important objective was "spiritual."359 He continued:

I do not hesitate to employ that word in connection with finance. We are seeking to re-create, rebuild, restore confidence. Confidence is an outgrowth of character. We believe that character exists strongly in the financial world, so we do not have to compel virtue; we seek to prevent vice. Our whole formula is to bar wrongdoers from operating under the aegis of those who feel a sense of ethical responsibility. We

352. See id. at 2.
353. See Judge John J. Burns, Sixty-Sixth Annual Commencement Address, Loyola University, 7-10 (June 10, 1936) (transcript available in the SEC Library at 2 SEC Speeches, 1934-61).
354. Id. at 10.
356. See John J. Burns, Address at the Bondmens Club of Chicago 2, 5-6 (May 23, 1935) (transcript available in the SEC Library at 2 SEC Speeches, 1934-61).
357. Id. at 7.
358. Burns, supra note 345, at 3.
are eager to see finance as self-contained as it deserves to be when ruled by honor and responsibility.\textsuperscript{360}

Kennedy's views are particularly important, both because he was the Chairman, and also because he had worked closely with FDR during the campaign.\textsuperscript{361} As a result, Kennedy had enjoyed ample opportunities in the close quarters of a campaign train to learn Roosevelt's views on the need for character in the securities industry. Moreover, even after he had left the SEC, Kennedy continued to advocate these ideas on FDR's behalf.\textsuperscript{362}

Other examples could be cited for this point of view. The Director of the Commission's Trading and Exchange Division said that there was no room in the securities business other than for "honorable men who regard themselves as engaged in a great and progressive profession."\textsuperscript{363} These professionals, he said, should have "a deep and abiding recognition of their grave responsibilities to their clients and the public."\textsuperscript{364} In fact, among administrators, this sense of ethical purpose pre-dated the SEC. In September 1933, Baldwin B. Bane, Chief of the Securities Division of the Federal Trade Commission, the agency then responsible for administering the Securities Act, also spoke on this point. The recent legislative program, he said, was based on a "moral idea."\textsuperscript{365} It was the "realization that [the economy's] ills [were] due ... to the weakening of [the nation's] moral fibre, [and] to easy temporizing with traditional and tried standards of right and wrong."\textsuperscript{366} "It would be idle," Bane said, "to pretend that [the Securities Act] does not ask something of the security world, but it also promises much in return—the opportunity of creating a true and honorable profession by the assumption and adequate discharge of public responsibilities."\textsuperscript{367} This

\textsuperscript{360} Id.
\textsuperscript{362} See Joseph P. Kennedy, I'm for Roosevelt 8, 93 (1936) (expressing agreement with FDR's "judgment that our economic crisis was in effect a moral crisis" in which the "belief that those in control of the corporate life of America were motivated by honesty and ideals of honorable conduct was completely shattered").
\textsuperscript{363} David Saperstein, Address at the National Security Traders Association 4 (Aug. 4, 1936) (transcript available in the SEC Library at 14 SEC Speeches, 1934-61); see also id. at 13.
\textsuperscript{364} Id. at 4.
\textsuperscript{365} Baldwin B. Bane, Address at the Affiliated Better Business Bureaus 4 (Sept. 12, 1933) (transcript available in the SEC Library at 2 SEC Speeches, 1934-61).
\textsuperscript{366} Id.
\textsuperscript{367} Id.
could be done, Bane said, despite those who "insist[ed] that the morality of high finance is not the concern of democratic government."  

The administrators' sense of moral purpose is demonstrated by the meaning they gave to contemporary ideas. The concept that the securities industry should be responsible was very much in the air. It had played an important role in the Brains Trust's advocacy of a Capital Issues Board/Federal Economic Council, and an equally important role, though one decidedly different in meaning, in Congressman Rayburn's advocacy for the bill that became the Securities Act. Early administrators also expressed it, and their meaning demonstrated their moral purpose. In 1934, Kennedy said that "[t]he whole motive of the Security Act is to be found in the effort—the necessary and no longer escapable effort—to make finance more responsible." In his view, however, responsibility meant acceptance of the new regulations. Moreover, he said, those regulations are "simple and honest" and "rest squarely upon the principles of ethics applicable not only to business but to everyday life."  

Fear of economic waste was also in the air. It had been a central element of the Brains Trust's thinking and had been prominently featured in the Oglethorpe Speech. Early administrators also feared waste, but they understood it in light of their moral purpose. Waste was now a result of improper conduct. In 1935, James Landis, Kennedy's successor as Chairman, said:

Our first consideration, perhaps, in attempting to secure the maintenance of a desirable investment market, is the elimination of certain admittedly wrongful practices. Such an objective calls for the end of those things that mean waste. And fraud means waste. It is equally true that carelessness and disrespect for the standards that should govern in the fields of investment have the same wasteful effect as fraud.

These administrative expressions of support for the moral purpose of the securities laws seem to go beyond a mere coincidence of personal opinion. They suggest, instead, something of an institutional ethos.

368. _Id._ at 1.
370. See _supra_ text accompanying notes 283-85.
372. See _id._
373. _Id._
374. See _supra_ text accompanying notes 79-86.
There are several reasons for thinking so. First, in some instances the institutional nature of the opinion appears relatively certain. Given Kennedy’s reputation as an unreformed speculator—he was participating in pools as late as 1933—\(^{376}\) one could easily suspect that his epiphany about finance’s spiritual dimension came after he was made Chairman of the SEC. Similarly, as a private citizen, William O. Douglas mocked the Securities Act as “a nineteenth-century piece of legislation” that could not be understood unless one could “‘turn back the clock’ to ‘simpler days.’”\(^{377}\) While Douglas squarely placed himself in the camp previously occupied by the Brains Trust,\(^{378}\) as a member of the SEC, he affirmed that the agency was striving “for the ancient standards of simple honesty in the sale of securities.”\(^{379}\) He also urged securities salespersons to have a meticulous regard for the standards of conduct governing fiduciaries.\(^{380}\) Moreover, Chairmen and Commissioners have continued to reaffirm this vision into the present.\(^{381}\) Finally, the agency has recently identified the promotion of high ethical standards in the securities industry as one of the goals animating its strategic plan.\(^{382}\)

The moral purpose inspiring early administrators, and continuing in some degree through the life of the agency, shows how far the regulatory regime had moved from the ideas of the Brains Trust and the Oglethorpe Speech. Even the core concerns of the Brains Trust, responsibility and waste, had been given a moral content. Administrators understood their mission in terms of the ethical principles applicable to both business and everyday life. Their goal, as Burns put it, was to give a new and different spiritual influence to the “individualistic hard-boiled immorality of the

\(^{376}\) See Whalen, supra note 361, at 130-35.
\(^{378}\) See id. at 530 (calling for “a plan for control[ ] ... terms and conditions of the organization, ... amount of securities [that] may be issued, the terms on which they may be issued, and the persons to whom they may be sold”).
\(^{379}\) William O. Douglas, Address Before the Foundation for the Advancement of the Social Sciences 2 (June 22, 1938) (transcript available in the SEC Library at 4 SEC Speeches, 1934-61).
ancient law." Through the securities laws, Burns said, "law has caught up with morals."

**C. Building the Institutions of a Regulatory Regime**

The statutory mandate Congress gave the SEC provided the new agency with immediate opportunities to act on its moral purpose. This was particularly true in regard to the over-the-counter markets and investment advisers. In essence, Congress left it up to the SEC to decide how the over-the-counter markets should be regulated. In the Exchange Act, Congress preserved the securities exchanges' system of self-regulation, subject after 1934 to SEC registration and oversight. Working within this institutional structure, the Commission spent its first months studying how exchanges governed themselves, and recommending various improvements. For the over-the-counter markets, however, Congress declined to establish any comparable institutional structure. Instead, it simply provided for the Commission to prescribe rules that would insure investors in the over-the-counter markets protection comparable to that provided by organized exchanges. Thus, for the over-the-counter markets, the SEC would have to create its own regulatory structure. Similarly, in 1935, Congress instructed the Commission to study investment trusts. As part of its review, the agency also studied investment advisers. The regulatory regime for advisers emerged from this study. In both of these areas, ...
administrators had an opportunity to give their purpose concrete regulatory form.

1. Exchange Act Amendments of 1936: Eliminating the Unfit

In 1934, the SEC's first Chairman told the Boston Chamber of Commerce that "character exists strongly in the financial world," and therefore, the SEC "[did] not have to compel virtue." Instead, it "[sought] to prevent vice." The agency's whole formula, Kennedy continued, was "to bar wrongdoers from operating under the aegis of those who feel a sense of ethical responsibility." At the staff level, contemporaries articulated this thinking in the form of concrete regulatory objectives. Specifically, the Director of the SEC's Trading and Exchange Division said that the agency's efforts were directed toward three goals: (1) eliminating the unfit from the securities business; (2) vitalizing certain principles of fair practice; and (3) encouraging the formation of self-governing associations. Within a few years, all of these goals would be institutionalized within the regulatory regime.

The SEC's regulatory strategy relied heavily on creating a registration system for broker-dealers. Initially, the Commission developed its own administrative system. Its goal was to establish simple requirements that an experienced applicant could easily meet, but that would also give the SEC an effective means of controlling the outlaws in the business. In 1936, congressional action sought to codify this system. This led to the Exchange Act Amendments of 1936 ("1936 Amendments"). The 1936 Amendments provided a statutory basis for the SEC's program to eliminate the unfit from the securities business. In effect, they restricted membership in the industry to firms that could pass something like a good character test. Perhaps, stated more exactly,
they restricted membership to firms that did not fail a bad character test. This was accomplished in two provisions, sections 15(b) and 15(c).

Section 15(b) authorized the Commission to deny or revoke the registration of broker-dealers on several grounds, including false statements made during registration; conviction within the previous ten years of "any felony or misdemeanor... involving the purchase or sale of any security" or the conduct of a broker-dealer; being enjoined from "engaging in or continuing any conduct or practice in connection... with the purchase or sale of any security"; or willfully violating any provision of the Securities Act or the Exchange Act. In carrying out this authority, the Commission is to act by order, "after notice and opportunity for [a] hearing." By mid-1937, the Commission had revoked the registrations of sixteen broker-dealers.

Section 15(c) was intended to supplement the registration system. Specifically, it forbade broker-dealers from effecting transactions or inducing the purchase or sale of securities in the over-the-counter markets by means of any "manipulative, deceptive or other fraudulent device or contrivance." The scope of this provision is much broader than the antifraud provisions enacted in 1934. Section 9 of the Exchange Act reached only certain defined transactions on securities exchanges. Even section 10(b), the Exchange Act's catchall provision, had narrower terms. Section 10(b) reaches "manipulative or deceptive device[s] or

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405. See SEC, 3 ANN. REPORT 27 (1937).
contrivance[s].” Thus, by its express terms, section 15(c)(1) reaches types of fraud in addition to those reached by section 10(b). The 1936 legislative history describes some of these abuses, such as concealment and unfair discrimination. In conjunction with the Commission’s authority, given in the same 1936 Amendments, to deny or revoke the registration of a broker-dealer who willfully violates any provision of the Exchange Act, section 15(c)’s broad prohibition on fraud gave the SEC a powerful tool for policing the character of securities professionals in the over-the-counter markets.

Contemporary sources reveal some of the practices in the over-the-counter markets that motivated the SEC’s program. For example, a few weeks after the enactment of the 1936 Amendments, the SEC reported to Congress on a study that had been mandated by the Exchange Act. The study considered the “feasibility and advisability” of segregating the


411. See generally Russello v. United States, 464 U.S. 16, 23 (1983) (“[W]here Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion.” (alteration in original) (quoting United States v. Wong Kim Bo, 472 F.2d 720, 722 (5th Cir. 1972))).

412. As originally drafted, the section applied to “fraud, concealment, unfair discrimination, or manipulative or deceptive practices.” House Unlisted Securities Hearing, supra note 396, at 4 (quoting the text of the bill). When questions were raised whether this would support SEC regulation of municipal securities dealers in areas other than fraud, James Landis indicated that the section was intended to reach only fraud, and would be redrafted to eliminate confusion. See id. at 12-13 (statement of James Landis, Chairman, SEC) (describing “concealment, unfair discrimination, and manipulation” as among the fraudulent practices the section was intended to reach).


414. The Commission takes the position that section 15(c)’s prohibition on manipulative, deceptive or other fraudulent devices and contrivances is self-operative, meaning that no administrative rule is needed to give it effect. See Brief for SEC at 34 n.46, Charles Hughes & Co. v. SEC, 139 F.2d 434 (2d Cir. 1943) (No. 150). The legislative history supports this interpretation. The bill initially made the section’s prohibitions operative only when the conduct was in contravention of such rules and regulations as the Commission may prescribe. See House Unlisted Securities Hearing, supra note 396, at 4 (quoting the text of the bill). This language, however, was dropped from the final Act. The Commission has also implemented the section in several rules. See 17 C.F.R. §§ 240.15c1-1 to 240.15c1-9 (2000).

functions of brokers and dealers. Among the problems identified in the Report was the "tendency on the part of some over-the-counter dealers to extort exorbitant profits from their customers." However, this was not, according to the SEC, a result of the combination of functions, but rather, an incident of the dealer function whether or not combined with the broker function.

The 1936 Amendments show the logical progression of shaping a moral vision into a regulatory regime. How does a regulator ensure that only people of character undertake the business of securities? In 1936, the answer was to eliminate the unfit, and to define unfitness in broad fraud-based terms. It would be too much to say that the 1936 Amendments responded directly to a statement made by FDR four years earlier in a closed meeting of campaign policy advisers. But the 1936 Act can be placed on an intellectual line of descent that begins with FDR’s decision to make character, not control, the guiding principle of his policy toward the securities industry. Indeed, the links in that line are few and direct: FDR to Kennedy, to administrative implementation, to legislative codification. Moreover, the line did not end in 1936. A year later the Director of the SEC’s Trading and Exchange Division affirmed its continuing force. One of the agency’s prime objectives, he said, was to bring the “full weight of federal authority against those persons who, by past performances, had manifested their unfitness to remain in the securities business.” The Commission, he said, wanted to expel those who adhere to “no principle of decent conduct; who ... shun the methods of fair and honorable business dealing in favor of the weapons of deception, fraud, pettifogging, cozenage and treachery.” After 1936, only people of character, people who do not engage in prohibited misconduct, would be permitted in the community of broker-dealers.


Officials of the early SEC urged the securities industry to think of itself as an honorable, great and progressive profession. They

417. Id. at 77.
418. See id.
420. Id.
421. See, e.g., Saperstein, supra note 363, at 4, 13.
expressed their hope that it was ready to protect "professional and business idealism," and claimed that the securities laws gave it the opportunity to create a "true and honorable profession." Indeed, administrators were already advocating this point of view in 1933, during the brief period when the Federal Trade Commission regulated securities. This type of thinking played an important role in the climate of opinion of the 1930s and in 1938 it would be institutionalized within the regulatory regime.

The SEC's effort to professionalize the securities industry followed an eventful history in the first few years of the Roosevelt administration. An initial effort to organize the industry was made under the auspices of the National Industrial Recovery Act of 1933 ("NIRA"). General Hugh Johnson, Bernard Baruch's representative on FDR's 1932 campaign policy staff, led the agency that administered the NIRA, the National Recovery Administration ("NRA"). Johnson attributed the policy ideas that motivated the NRA program to Baruch, asserting that Baruch's speeches on business self-government "state[d] the whole philosophy of [the] NRA." Baruch later sought to distance himself from this program, saying that he had not been consulted in Johnson's selection and that he was often unhappy with his measures. Nonetheless, whether Baruch approved or not, we can see the influence of his ideas on Johnson and the NRA.

The NRA sought to eliminate unfair trade practices through mandatory codes of fair competition prepared by trade associations, subject to NRA approval. Hundreds of codes were formulated and approved. They addressed a wide range of abusive business practices, including, most commonly, misrepresentations and deceptive advertising, commercial bribery, defamation of competitors, interference

422. Bums, supra note 345, at 2.
423. Bane, supra note 365, at 4.
424. See generally id.
425. See infra text accompanying notes 449-53.
426. See National Industrial Recovery Act, ch. 90, 48 Stat. 195 (1933). After this Act was held unconstitutional by the United States Supreme Court, it was repealed. See 15 U.S.C. § 701 (1994).
427. See JOHNSON, supra note 157, at 251.
428. Id.
431. See id. at 83-140.
432. See id. at 29 (stating that by early 1935, 546 codes and 185 supplemental codes had been formulated and approved).
with contracts, false marking or branding, and false invoicing. As part of this effort, an Investment Bankers Code Committee prepared a Code of Fair Competition for the securities industry. Among other things, it required investment bankers to adhere to "just and equitable principles of trade and business." When the Exchange Act was later enacted, it also contained a provision requiring securities exchanges registering with the SEC to establish rules that would provide for the "expulsion, suspension," or "disciplining" of members for conduct inconsistent with "just and equitable principles of trade." Officials of the SEC expressed their support for the NRA effort. As the Commission's first General Counsel put it, investment bankers' efforts to organize themselves under NRA auspices represented "all that made the medieval Guilds magnificent.

The NRA program came to an abrupt halt in 1935 when the Supreme Court held that its mandatory codes were unconstitutional. However, there had already been some suggestions that the investment bankers code should be transferred from the NRA to the SEC. With the SEC's encouragement, the Investment Bankers' Code Committee remained in operation voluntarily, and worked with the SEC to shape the legislation that would later become the Maloney Act. When the bill finally emerged, it had no opposition.

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433. See id. at 570-77. The codes also regulated purely commercial practices like minimum prices, methods of cost finding, rebates, and others. See id.


435. Id. art. III, § 1.


437. Burns, supra note 345, at 2. In the NRA era, the medieval guilds were viewed much more favorably than they have been since. See, e.g., Harlan F. Stone, The Public Influence of the Bar, 48 HARV. L. REV. 1, 4-5, 7-13 (1934) (stating that much like medieval guilds, professional groups promote the general welfare by controlling their members and are also needed in contemporary society to restore fiduciary honesty). For a more current view, see MANCUR OLSON, THE RISE AND DECLINE OF NATIONS: ECONOMIC GROWTH, STAGFLATION, AND SOCIAL RIGIDITIES 125 (1982) (remarking that while guilds "provided insurance and social benefits for their members," they "reduced economic efficiency and delayed technological innovation").


The resulting law took the form of amendments to the Exchange Act. It is usually referred to as the Maloney Act after its principal sponsor. The Maloney Act preserved NRA-style regulation in the securities industry. Contemporaries, however, took care to distinguish it from the failed NRA experiment. They said that it established a regulatory structure that was similar to the one applied to securities exchanges. There were differences, and they would lead to some anomalies until the entire statutory structure for self-regulatory organizations was revised in 1975. Despite these anomalies, for our purposes, exchanges and associations were treated very much the same. Specifically, the Maloney Act added section 15A(b)(7) to the Exchange Act, which, like the defunct NRA Code for Investment Bankers, and section 6(b) for exchanges, requires securities associations to have rules designed to promote just and equitable principles of trade.

Contemporaries explained the purpose they had in mind for this enactment. The Senate Committee Report on the 1938 bill stated that the legislation was intended to “protect the investor and the honest dealer ... from dishonest and unfair practices by the submarginal element in the industry.” It was also intended to “cope with those methods of doing business which, while technically outside the area of definite illegality, are nevertheless unfair both to customer and to decent competitor, and are seriously damaging to the mechanism of the free and open market.” A securities association was expected to accomplish these goals through cooperative regulation subject to the SEC’s supervision and supplementary powers of direct regulation. Similarly, an SEC official said that the legislation was intended to raise “the standards of those on the edge to the level of the standards of the best.”

444. See infra text accompanying note 448.
445. See Mathews, supra note 440, at 1-2.
446. See id.
448. See S. REP. NO. 75-1455, at 1 (1938).
449. Id. at 3; accord H.R. REP. NO. 75-2307, at 4 (1938).
450. S. REP. NO. 75-1455, at 3.
451. See id. at 4.
Finally, the year after it was enacted, Senator Maloney said that it had been “the purpose of Congress to provide the broadest practicable opportunity for the knowledge and experience of the members of this highly technical calling to be employed in the elimination of undesirable practices and in the promotion of truly professional standards of character and competence.”

In 1939, the National Association of Securities Dealers (“NASD”) registered as the first and to date only national securities association. Its Rules were directed toward eliminating abuses that might lead to the defrauding of investors, and to promoting just and equitable principles of trade. These Rules reflected the NASD’s NRA-legacy. For example, the NRA Code of Fair Competition had included a provision stating:

Where an investment banker recommends to an investor the purchase or exchange of any security, [the investment banker must] have reasonable grounds for believing [that] the security ... is a suitable investment for [the] investor, [based upon] the facts, if any, disclosed by [the] investor as to his other ... holdings and as to his investment situation and needs.

This provision was reproduced in the NASD’s Rules. Now known as the duty of suitability, it plays a central role in the relations of broker-dealers and their customers.

The 1938 Amendments were based on a body of ideas that found a home in the securities laws just as the Supreme Court was driving them from the rest of the economy. Professional standards of character and competence would be achieved through codes of conduct created and enforced by business self-government. As with the 1936 Amendments, it would be too much to claim that the Maloney Act resulted directly from FDR’s statements. Nonetheless, the 1938 Act can be placed on an


455. See id. at 631 (stating the findings and opinion of the Commission).


intellectual line of descent that began with the circle of policy advisers who turned FDR away from the Brains Trust and shaped his final, moral vision: FDR and Baruch to Johnson, to the NRA, to rejection by the Supreme Court, to the Maloney Act, to the NASD’s Rules. After 1939, professional character was more than a moral aspiration. It was a requirement of the regulatory regime.

3. Investment Advisers Act of 1940: Professional Ethics for Advisers

By the late 1930s, the reform period of the New Deal had run its course. Foreign crises and eventually war would consume the remaining years of FDR’s presidency. The SEC, however, continued to focus on the ethics and professionalism of the securities industry. This purpose was reflected in its approach to the final fundamental building block of the regulatory regime for the securities industry: the Investment Advisers Act of 1940 (“Advisers Act”).

Much like the Exchange Act Amendments of 1936 and 1938, the Advisers Act resulted from a regulatory initiative of the SEC. As part of a congressionally mandated review of investment trusts the agency also studied investment advisers. The Advisers Act was based on that study. By the time it passed, it was a consensus measure having the support of virtually all advisers.

Investment advisers’ professionalism, and particularly their professional ethics, dominated the SEC study and the legislative history of the Act. Industry spokespersons emphasized their professionalism. The “function of the profession of investment counsel,” they said, “was to render to clients on a personal basis competent, unbiased and continuous advice regarding the sound management of their investments.” In terms of their professionalism they compared themselves to physicians and lawyers. However, industry spokespersons indicated that their efforts to maintain professional standards had encountered a serious problem. The industry, they said,

459. See Brinkley, supra note 257, at 3.
460. See id.
462. See SEC, REPORT ON INVESTMENT COUNSEL, supra note 390.
463. See S. REP. No. 76-1775, at 19-21 (1940); H.R. REP. No. 76-2639, at 27 (1940).
464. See S. REP No. 76-1775, at 19; H.R. REP. No. 76-2639, at 1.
465. SEC, REPORT ON INVESTMENT COUNSEL, supra note 390, at 34 n.43 (statement of Dwight C. Rose, President of the Investment Counsel Association of America (“ICAA”)).
466. See id. at 23-24 (statement of James N. White of Scudder, Stevens & Clark).
covered "the entire range from the fellow without competence and without conscience at one end of the scale, to the capable, well-trained, utterly unbiased man or firm, trying to render a purely professional service, at the other end." As a result, the Investment Counsel Association of America was organized and issued a Code of Ethics. Nonetheless, the problem remained that the Association could not police the conduct of those who were not members.

The SEC Study noted that it had been the unanimous opinion of all who had testified at its public examination, both members and nonmembers of the Association, that the industry's voluntary efforts could not cope with the "most elemental and fundamental problem of the investment counsel industry—the investment counsel 'fringe' which includes those incompetent and unethical individuals or organizations who represent themselves as bona fide investment counselors." Advisers of that type would not voluntarily submit to supervision or policing. Yet, all counselors suffered from the stigma placed on the activities of the individuals on the fringe. Thus, an agency was needed with compulsory and national power that could compel the fringe to conform to ethical standards.

As a result of the Commission's report to Congress, the Senate Committee on Banking and Currency determined that a solution to the problems of investment advisory services could not be affected without federal legislation. In addition, both the Senate and House Committees considering the legislation determined that it was needed not only to protect the public, but also to protect bona fide investment counselors from the stigma attached to the activities of unscrupulous tipsters and touts. During the debate in Congress, the special professional

467. Id. at 40 (statement of Rudolph Berle, Counsel, ICAA).
468. Id.
469. See id.; see also id. app. H (ICAA Code of Professional Practice).
470. See id. at 40.
471. Id. at 41.
472. See id.
473. See id. at 43 (statement of Dwight C. Rose, President, ICAA).
474. See id. at 41 (statement of Rudolph Berle, Counsel, ICAA).
475. See id. at 43 (statements of James N. White of Scudder, Stevens & Clark and Dwight C. Rose, President, ICAA).
476. See id. at 41 (statement of Rudolph Berle, Counsel, ICAA).
477. See S. REP. NO. 76-1775, at 21 (1940).
478. See id.; H.R. REP. NO. 76-2639, at 28 (1940).
The relationship between advisers and their clients was recognized. It is, said one representative, "somewhat [like that] of a physician to his patient."

The same Congressman continued that members of the profession were "to be complimented for their desire to improve the status of their profession and to improve its quality."

The method chosen for achieving these goals was of a piece with most of the prior legislation—fraudulent practices inconsistent with these ideals were made unlawful. Specifically, section 206(1) made it unlawful "to employ any device, scheme, or artifice to defraud any client or prospective client." Section 206(2) made it unlawful "to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client."

All of the themes of this history are reflected in the legislative history of the Advisers Act. First, the Act was explicitly motivated by the desire to protect and enhance advisers' professional ethics. Second, this objective was to be reached by prohibiting conduct inconsistent with the ideal. Third, even associational self-regulation made an appearance in the idea that all advisers suffered from the stigma placed on the unethical fringe elements, and in the idea that federal regulation was needed to support the industry's voluntary effort to establish a code of ethics. The Advisers Act came late in the New Deal, but it reflected the same moral purpose that had inspired administrators and legislators throughout the 1930s.

When FDR signed the Advisers Act, he recognized this legacy. Since 1933, he said, it had been his "purpose to aid the honest businessman and to assist him in bringing higher standards to his particular corner of the business community." "In every direction," he said, "a conscientious and successful effort ha[d] been made to require the investment banker, the broker, and the dealer, the security salesman,

480. Id. at 9814.
483. See supra text accompanying notes 462-69.
484. See supra text accompanying notes 481-82.
485. See supra text accompanying notes 471-80.
486. See BRINKLEY, supra note 257, at 3 (stating that "by the end of 1937 the active phase of the New Deal had largely come to an end").
487. See id. at 49, 62-63 (discussing the New Deal's long term commitment to increase public control of big business).
488. 86 CONG. REC. app. at 5231 (1940) (statement of the President).
the issuer, and the great financial institutions themselves to recognize the high responsibilities they owe to the public." This statement summarized FDR's policy vision. It also, in retrospect, illustrated the policy's intellectual descent. Gerhard Gesell, then a young attorney for the SEC, later indicated that he had written the statement, and that the President used his text "verbatim." Gesell's flawless ghostwriting suggests that administrators correctly understood the President's vision. Further, the legislative program they had pursued from 1936 to 1940 suggests that they believed their own mission was the same as his—bringing higher standards to the business community. Seen in this light, apparently isolated regulatory initiatives for disparate industry segments can be understood as different expressions of a consistent policy vision. Moreover, once that vision had been institutionalized within the SEC, it would continue to influence the agency's approach to the securities industry. This would quickly become apparent in the Commission's enforcement program.

IV. THE NEW REGULATORY REGIME IN COURT: A SPECIAL DUTY FOR BROKER-DEALERS

When Congress took up the President's securities legislation, it was filled with moral purpose. Moral concerns were given special prominence in the legislative history of the Securities Act. For contemporary legislators, the Act was more than a condemnation of fraud and more than a technical reform of the underwriting process. It was the harbinger of a newly moral securities industry. Moral concerns were given less attention during consideration of the Exchange Act. Indeed, in 1934, congressional skepticism about the efficacy of a moral policy ran high. Nonetheless, contemporary legislators gave concepts like justifiable trust a central role in preserving society's economic order. In short, in both legislative histories, moral concepts had entered the realm of public policy.

Officials of the early SEC were also filled with moral purpose. The Commission's first Chairman spoke of the role of character in restoring confidence, and he described this phenomenon as finance's spiritual

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489. Id.
dimension.⁴⁹⁴ The first General Counsel spoke of confidence, morals, and religion.⁴⁹⁵ Officials described their mission as one of morals, and their purpose as the restoration of traditional standards of right and wrong.⁴⁹⁶ They described their approach as establishing simple and honest requirements that were based upon principles of ethics applicable to both business and to everyday life.⁴⁹⁷ In short, in the securities laws, they believed law had caught up with morals.

The SEC had an opportunity to act on this moral purpose when it set out to create regulatory institutions for the over-the-counter markets and for investment advisers. From 1936 to 1940, the agency’s legislative program reveals the transformation of moral aspirations into the requirements of a regulatory regime. In 1936, the SEC obtained statutory authority to preserve the character of the securities industry through the power to eliminate the unfit from among its ranks.⁴⁹⁸ In 1938, the SEC worked with elements of the industry that had been active in the NRA program to foster truly professional standards of character and competence through the self-government of an association of securities dealers.⁴⁹⁹ In 1940, the SEC recognized and supported investment advisers’ striving for professional status and ethics.⁵⁰⁰

These developments demonstrate the continuing power of the ideas FDR had selected for his policy. They carried Congress and then the SEC. However, in the American system of regulation, the courts also play a critical role in deciding the success or failure of a policy vision. The courts’ response to the moral purpose inspiring legislators and administrators would be a final milestone in the transformation of FDR’s vision into an established regulatory regime. This milestone was reached for the first time in the Commission’s enforcement action against Charles Hughes & Co., Inc. (“Charles Hughes”).⁵⁰¹

Charles Hughes was a registered broker-dealer.⁵⁰² Acting as a dealer, it sold securities to its clients at prices far in excess of the prevailing market.⁵⁰³ Some clients paid almost forty percent over the

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⁴⁹⁴ See Kennedy, supra note 359, at 10.
⁴⁹⁵ See Burns, supra note 353, at 7-10 (discussing the law’s relationship in the context of the complexity of civilization).
⁴⁹⁶ See Kennedy, supra note 359, at 10.
⁴⁹⁷ See id. at 5.
⁴⁹⁸ See supra Part III.C.1.
⁴⁹⁹ See supra Part III.C.2.
⁵⁰⁰ See supra Part III.C.3.
⁵⁰² See id. at 676.
⁵⁰³ See id.
market price. As previously noted, as early as 1936, the SEC had viewed this type of abuse as a matter of deep concern.

In a line of administrative proceedings beginning with In re Diker & Duker in 1939, the Commission treated this type of conduct as a violation of the antifraud provisions of the Securities Act and the Exchange Act. In these cases, the Commission found that "[i]nherent in the relationship between a [broker]-dealer and his customer is the . . . representation that the customer will be dealt with fairly, and in accordance with the standards of the profession." "It is neither fair dealing, nor in accordance with such standards," the SEC continued, "to exploit trust and ignorance for profits far higher than might be realized from [a well-] informed customer." Hence, exacting such profits makes the implicit representation of fair dealing false, and the transaction fraudulent. In later cases, the Commission continued to emphasize that a customer should be "consistently treated in accordance with decent standards." "Not the whim of the dealer," the SEC said, "but a strict rule of fair treatment ought [to] govern the dealer's conduct.

When the Commission brought an administrative proceeding against Charles Hughes, the firm argued that the prices it charged were neither unfair nor unconscionable. The SEC disagreed. The Commission recognized that permissible dealer mark-ups from the market price had "not been fixed by any hard-and-fast rule or specific schedule." However, the Commission continued, mark-ups such as those charged by Charles Hughes "are so far in excess of what may be regarded as reasonable that they unquestionably do violence to [the

504. See id. at 683-84.
505. See SEC, SEGREGATION REPORT, supra note 416, at 76-77.
506. 6 S.E.C. 386 (1939).
507. See id. at 387-89 (analyzing conduct under Securities Act § 17(a) and Exchange Act § 15(c)(1)).
508. Id. at 388.
509. Id. at 388-89.
510. See id. at 389.
512. Id.
513. See In re Charles Hughes & Co., 13 S.E.C. 676, 678 (1943). In an argument not relevant here, Charles Hughes also challenged the methods employed by the Commission to determine the prevailing market price. See id. at 678-79. Ascertaining the market price, and determining the reasonableness of the dealer's mark-up have remained important questions in the application of this doctrine. See 8 LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 3789-98 (3d ed. 1991) (citing a number of cases addressing these questions).
515. Id.
implied] representation of fair dealing," made by every broker-dealer, and absent disclosure by the dealer of enough information to enable the customer to form an independent judgment upon whether or not to complete the transaction, they constituted a fraud.516

The Commission continued that Charles Hughes' fraud was emphasized by its efforts to induce an atmosphere of trust and confidence with its clients.517 The SEC expressly indicated that it was reserving judgment on whether, by eliciting the customers' trust and confidence, Charles Hughes owed them a fiduciary level of duty.518 Nonetheless, the Commission found that by leading some "customers to place special reliance upon it," the firm "emphasize[d] its failure to meet the minimum standards of fair dealing, and ma[de] the fraudulent nature of its [conduct] more evident."519 In sum, the Commission found that Charles Hughes' failure to disclose the size of its price mark-ups was an omission to state a material fact necessary to make the broker-dealer's implied representation of fair dealing not misleading.520 It revoked Charles Hughes' registration as a broker-dealer.521

When Charles Hughes appealed to the U.S. Court of Appeals for the Second Circuit,522 the Commission indicated that this was the first appellate case to address the proposition that a security dealer "by reason of the very nature of his business, impliedly represents to all his customers that he will deal with them honestly and fairly and in accordance with the established standards of the business."523 In its Brief, the SEC explained that its decision had been based on "the special nature of securities and of the markets in which they are traded."524 "[T]he intricate nature of those markets," the Commission said, "has ... plac[ed] dealers in securities in positions of special advantage with relation to their customers and has placed upon them special obligations."525 In effect, the Commission said, "the position of the dealer is so specialized that the investor, as a practical matter, must rely

516. Id.
517. See id. at 680-81.
518. See id. at 681 n.7 (noting the conflicting evidence).
519. Id. at 681.
520. See id. at 681-82.
521. See id. at 682.
524. Id. at 15.
525. Id.
for his protection almost entirely upon the probity of the dealer."525 "[I]n
many ways," the Commission continued, "the dealer in securities has a
position ... analogous to that of [an] expert professional" who
"implies a representative [to lay clients] that he will perform his
undertakings in accordance with the standards of the profession."527 This
was, said the Commission, an "application of the proposition that people
having special knowledge must live up to higher standards than are to be
expected in the old-fashioned horse trade where both parties are
presumed to be on more or less equal terms."528

The Second Circuit affirmed the Commission's decision.529 It
agreed that an over-the-counter firm that actively solicits customers, and
then sells them securities far above the market price, must be deemed to
have committed a fraud.530 Since "[i]t holds itself out as competent to
advise ... it should disclose the market price if sales are ... made
substantially above that level."531 Considering Charles Hughes "as a
principal in a simple vendor-purchaser transaction," the court continued,
the broker-dealer "was still under a special duty, in view of its expert
knowledge and proffered advice, not to take advantage of its customers'
ignorance of market conditions."532 The court also said that the key to
Charles Hughes' success was the confidence it managed to instill in its
clients.533 "Once that confidence was established, the failure to reveal the
[huge] mark-up[s] ... was both an omission to state a material fact and a
fraudulent device."534 "When nothing was said about the market price,
the natural implication in the [purchasers'] untutored minds ... was that
the price asked was close to the market."535 "The law of fraud," the court
said, "knows no difference between express representation on the one
hand and implied misrepresentation or concealment on the other."536 The
court concluded this portion of its analysis by saying that "'[t]he best
element of business has long since decided that honesty should govern

525. Id. at 21.
526. Id. at 20-21.
527. Id. at 23.
528. See Charles Hughes & Co. v. SEC, 139 F.2d 434, 438 (2d Cir. 1943).
529. Id. at 436.
530. Id. at 436-37.
531. Id. at 437.
532. See id.
533. Id.
534. Id.
535. Id.
536. Id.
competitive enterprises, and that the rule of caveat emptor should not be relied upon to reward fraud and deception."

While this analysis appeared to dispose of Charles Hughes' appeal, the Second Circuit went on to say "[w]e need not stop to decide, however, how far common-law fraud was shown." For, the court continued, the business of selling securities has been subjected to a program of regulation, including section 17 of the Securities Act. "Had [it] been in doubt on the matter, [it] would have given weight” to the Commission’s interpretation of that provision. But it need not rely solely on the Commission’s views, the court suggested, because it was ready to opine that "[t]he essential objective of securities legislation is to protect those who do not know market conditions from the overreachings of those who do.” Indeed,” it said, “it is the purpose of all legislation for the prevention of fraud in the sale of securities to preclude the sale of ‘securities which are in fact worthless, or worth substantially less than the asking price.” The Second Circuit concluded that the Commission had correctly interpreted its responsibilities to stop abusive practices in the sale of securities like those perpetrated by Charles Hughes.

The Court of Appeals grounded broker-dealers’ special duty on their expert knowledge, proffered advice, and the confidence they instill in their clients. This duty, the court said, arose even when they act as simple vendors. Nonetheless, in an aside, the court noted that Charles Hughes might have been an agent and fiduciary for at least some of its clients. Like the Commission, the Second Circuit did not base its decision on an agent-fiduciary analysis and thus, the relationship of this fiduciary-type analysis to the special duty was left unclear. However, a contemporaneous statement by a senior official of the SEC throws

537. Id. (quoting Fed. Trade Comm’n v. Standard Educ. Soc’y, 302 U.S. 112, 116 (1937)). In Federal Trade Commission v. Standard Education Society, the case cited by the Second Circuit in Charles Hughes, the Supreme Court held that “[t]he fact that a false statement may be obviously false to those who are trained and experienced does not change its character, nor take away its power to deceive others less experienced.” Id. at 116.
538. Charles Hughes & Co., 139 F.2d at 437.
539. See id.
540. Id. (citing to, among other cases, Duker & Duker, 6 S.E.C. 391 (1939)).
541. Id.
542. Id. (quoting People v. Federated Radio Corp., 154 N.E. 655, 658 (N.Y. 1926)).
543. See id. at 438.
544. See id. at 437.
545. See id.
546. See id. at 436-37.
547. See generally id. at 437-38.
considerable light on this point. James A. Treanor, Jr., Director of the Commission's Trading and Exchange Division, articulated two different legal standards governing a broker-dealer's relationship with its clients.548

First, Treanor said, "the securities firm is typically in a professional relationship with its customer." The relationship arises because a securities "salesman seeks to convince the customer of [his] expertness[,] . . . [he] invites the customer to disclose [information about the] . . . customer's financial resources and needs[, and then,] [o]n the basis of [this] knowledge the salesman seeks to advise."550 "This is as it should be," said Treanor, because "usually the relative value and merits of the thousands of securities outstanding can be understood by the layman only if he has the advice and guidance of a professional."551 But, said Treanor, this manner of conducting business and giving counsel makes the salesman and his firm professionals in the same sense that a lawyer giving counsel is a professional.552 Therefore, the salesman and his firm are the customer's agents; duty bound to "act with an eye single to the customer's welfare," and required to fully disclose any adverse interest they may have in the transaction.553 Moreover, they cannot avoid their obligations by characterizing their role as merely that of a dealer.554

Second, Treanor discussed a firm's obligations when it is acting a "true dealer," that is, when it is selling securities in a "genuine arm's length transaction."555 Even in that case, he said, section 17 of the Securities Act applies to the dealer's conduct, and that section makes it unlawful "to omit to state a material fact if the omission makes misleading the facts which are stated."556 Treanor continued "[v]alue is, of course, a material fact. Every time a dealer makes a sale of a security he places a value on it and if that value is at material variance from the market value, the dealer is under an obligation to disclose that market value."557 Treanor concluded by quoting the Second Circuit's decision in

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548. See James A. Treanor, Jr., Address Before the National Association of Securities Commissioners 2-7 (Dec. 12, 1944) (transcript available in the SEC Library at 14 SEC Speeches, 1934-61).
549. Id. at 3.
550. Id. at 2-3.
551. Id. at 3
552. See id. at 3.
553. Id.
554. See id.
555. Id. at 6.
556. Id. at 7.
557. Id. Treanor continued that "[i]f the failure of the dealer to make disclosure becomes the subject of litigation, what is a material variation will usually be a question of fact for the jury." Id.
Charles Hughes for the proposition that "'[t]he essential objective of securities legislation is to protect those who do not know market conditions from the overreachings of those who do.'"\textsuperscript{558}

Treasnor's statement suggests that there were two lines of analysis conflated into the special duty for broker-dealers. One is an agency doctrine based on the nature of the dealings between the parties. When a broker-dealer invites its clients' trust and confidence, and seeks to advise them, it becomes a professional agent with fiduciary obligations.\textsuperscript{559} The other is a disclosure doctrine. Regardless of the nature of the parties' relationship, whenever a broker-dealer discloses the value of a security to a non-professional, it makes a statement of material fact.\textsuperscript{560} That disclosure could be materially misleading if the broker-dealer omits to disclose that the stated price differs from the market price.\textsuperscript{561}

In time, the two components of the special duty would be identified as separate doctrines.\textsuperscript{562} The agency component would be known as the Trust and Confidence Theory, and the disclosure component would be known as the Shingle Theory.\textsuperscript{563} The latter would be applied in a number of settings.\textsuperscript{564} Finally, while some commentators have questioned its current viability,\textsuperscript{565} the courts continue to recognize it.\textsuperscript{566}

\begin{itemize}
\item \textsuperscript{558} Id. (quoting Charles Hughes & Co. v. SEC, 139 F.2d 434, 437 (2d Cir. 1943)).
\item \textsuperscript{559} See Randall W. Quinn, Deja Vu All Over Again: The SEC's Return to Agency Theory in Regulating Broker-Dealers, 1990 COLUM. BUS. L. REV. 61, 75-76.
\item \textsuperscript{560} See id. at 72-73.
\item \textsuperscript{561} Five years after the Second Circuit's decision, Louis Loss also described this phenomenon. He noted that even though the court considered Charles Hughes to be a principal in a simple vendor-purchaser transaction, it analyzed the firm's special duty in light of its expert knowledge and proffered advice. See Louis Loss, The SEC and the Broker-Dealer, 1 VAND. L. REV. 516, 527 (1948). While there is some "element of advice and [informational] disparity" in most cases, Loss continued, the disclosure doctrine in the case would be applicable even in an arms-length transaction "where the customer was previously unknown to the dealer and can take care of himself and was not solicited and received no advice from the dealer." Id. (opining that courts would uphold this reading of the case).
\item \textsuperscript{562} See Quinn, supra note 559, at 72-76. In addition, over time, the special duty's basis in the Exchange Act would migrate from section 15(c)(1) to section 10(b). See, e.g., SEC v. First Jersey Secs., Inc., 101 F.3d 1450, 1468-71 (2d Cir. 1996) (analyzing doctrine under Securities Act § 17(a) and Exchange Act § 10(b)).
\item \textsuperscript{563} See Quinn, supra note 559, at 72, 75.
\item \textsuperscript{564} See generally LOSS & SELIGMAN, supra note 513, at 3780-85 (discussing the Shingle Theory and relevant case law).
\item \textsuperscript{565} See Roberta S. Karmel, Is the Shingle Theory Dead?, 52 WASH. & LEE L. REV. 1271, 1296-97 (1995) (arguing that because of the Supreme Court's increasingly narrow reading of federal antifraud provisions, the Shingle Theory has probably survived only because it is usually raised in arbitration claims, not federal litigation). In this regard, it is interesting that the doctrine first emerged under section 15(c)(1), since, as previously noted, that section has a wider scope than section 10(b). Hence, even if the commentators are eventually proven right, the doctrine could
\end{itemize}
In Charles Hughes, FDR’s vision found a home in the courts. The Commission’s decision and its Brief to the Second Circuit were full of the language of moral purpose, including fair dealing, the standards of the profession, and the higher standards applicable to expert professionals like doctors and lawyers.\textsuperscript{567} The Court of Appeals for the Second Circuit responded and found that broker-dealers owe their customers a special duty.\textsuperscript{568} Contemporaries’ moral purpose had been successfully argued to an appellate court. FDR’s vision had ceased to be a moral aspiration—it had become a matter of decisional law.

V. CONCLUSION

This history ends with three questions. Was FDR’s moral vision a serious policy initiative? Did he achieve his goals? What meaning does it have for modern securities regulation? None has a simple answer.

Was FDR’s vision a serious policy initiative? In the early 1930s, investment bankers stood in the midst of the extraordinary losses in securities that shocked the investing and saving middle class.\textsuperscript{569} The bankers were ready culprits on whom the public could vent their anger and frustration. As a result, the temptation is strong to conclude that FDR attacked their morality simply as a political ploy. Even Tugwell, one of the best sources on the inner workings of the 1932 campaign’s policy-making process, was of this view, having said that FDR used the moneylending perpetrators of fraud as political “whipping boys.”\textsuperscript{570} Of course, Tugwell had his own bias. He complained that once FDR rejected the Brains Trust’s ideas, he encouraged the public to believe that all of their economic miseries were due to “a few wicked individuals who had transgressed some moral rules.”\textsuperscript{571}

The idea that Roosevelt attacked bankers’ moral failings merely as a political posture has a cynical appeal but it does not ring true. The course of events within the campaign strongly suggests that his moral remain valid in the over-the-counter markets. In other words, the Shingle Theory may be an example of the “other fraudulent” conduct reached by section 15(c)(1).

\textsuperscript{566} See, e.g., Grandon v. Merrill Lynch & Co., 147 F.3d 184, 189-90 (2d Cir. 1998).

\textsuperscript{567} See generally In re Charles Hughes & Co., 13 S.E.C. 676 (1943) (illustrating throughout the remnants of FDR’s policy vision); Brief for SEC, supra note 414 (illustrating the same).

\textsuperscript{568} See Charles Hughes & Co. v. SEC, 139 F.2d 434, 437 (2d Cir. 1943).

\textsuperscript{569} See supra text accompanying note 35.

\textsuperscript{570} TUGWELL, DEMOCRATIC ROOSEVELT, supra note 40, at 243. It should be noted that Tugwell also said that unlike the “really satisfactory foils of Franklin’s sixteen years on stage[,] . . . the electric utilities and the totalitarians,” the moneychangers were “to be rehabilitated rather than eliminated.” Id. at 168.

\textsuperscript{571} TUGWELL, BRAINS TRUST, supra note 39, at 518.
vision was a serious choice. The turn to a moral policy required FDR to overrule his principal policy advisers (including Tugwell) and to backtrack on a major public position. The new policy was also consistent with the ideas of Brandeis and Baruch, both of whom gained admission to the campaign policy-making process just as the turn was made. Indeed, Brandeis and Baruch’s intellectual contribution to federal regulation of the securities industry is a lost tradition. Much of the spirit animating the federal regulatory regime can be found in their ideas, including, for Baruch, the interpretations added in the line of descent through the NRA. Attacking bankers’ moral failings may have produced political benefits, but restoring their ethics and professionalism was a purposeful initiative.

Moreover, even if one assumes that FDR articulated his moral vision simply to exploit popular anger at the securities industry, that does not strip it of all meaning. His policy carried over from the campaign into the regulatory process. Moral aspirations were prominent both as Congress crafted the legislation that became the federal securities laws, and as the SEC set out to implement and enforce those requirements. Both Congress and the SEC focused on the moral purpose of their work; on the need to restore old fashioned business ethics; on the connection between economic confidence and the honesty and trustworthiness of financial intermediaries; and on the need to enhance the professionalism of the securities industry, both by prohibiting conduct inconsistent with their ethical aspirations, and by eliminating the unfit. FDR’s contemporaries took him seriously, whether modern observers choose to or not.

Did FDR achieve his goals? This question could pose serious analytical difficulties. Given the aspirational content of his vision—he spoke of “men of character”; “ancient truths”; more noble social values; and honesty, honor, the sacredness of obligation, faithful protection, and unselfish performance—one could be left wondering what precise regulations would suffice. However, once in office, FDR identified two specific measures that would implement his vision. These statements

572. See supra Part II.A.2.
573. See supra text accompanying notes 249-51.
574. Brandeis’ intellectual contribution to the securities laws’ full disclosure regime is widely recognized. See MASON, supra note 117, at 615.
575. See supra text accompanying notes 426-28.
576. See supra Part III.
577. Roosevelt, supra note 206, at 12.
provide a means for evaluating the extent to which the regulatory regime reflects his goals.

FDR told the press in March 1933 that his principal objective was to restore the idea that dealers in securities, both new and old, and people who worked on exchanges, are fiduciaries.578 Did he succeed? To varying degrees, there are fiduciary or fiduciary-like standards in the regulatory regime for investment advisers, underwriters, and broker-dealers.

Investment advisers are fiduciaries. In 1963, the Supreme Court read the legislative history for the Advisers Act, and decisively concluded that investment advisers are fiduciaries for their clients.579 FDR did not specifically mention advisers in 1933, which is understandable because it was only during the 1930s that investment counsel began to publicly identify themselves as a separate component of the securities industry.560 Nonetheless, their professional status represents the fullest accomplishment of the Brandeisian strand in FDR's policy vision. Advisers are professional fiduciaries who must exercise disinterested judgment on their clients' behalf.571

In addition, underwriters' investigation of registered offerings is measured by a fiduciary-like standard. In 1933, the standard was explicitly fiduciary.582 In 1934, the term "fiduciary" was removed, but the revised standard was drafted with the intent to make it fiduciary in all but name.593 In the legislative history of the Securities Act, this standard was explicitly linked to an underwriter's moral responsibility.594

Finally, broker-dealers' special duty reflects an effort to vest them with the responsibilities of expert professionals. Only the agency component of this duty, properly speaking, gives rise to a fiduciary level of responsibility.595 Yet, as commentators have noted, the agency and disclosure components of the duty tend to blend into each other.596 This is no accident, because both are derived from the same historical purpose. The special duty arose from the policy vision that broker-dealers should treat their clients honestly, fairly, and in accord with

578. See Roosevelt, supra note 225, at 89.
580. See supra text accompanying notes 465-69.
582. See supra text accompanying note 298.
583. See supra note 328. The Supreme Court has indicated that liability under section 11 is based on a negligence standard. See Ernst & Ernst v. Hochfelder, 425 U.S. 185, 208 (1976).
584. See H.R. REP. NO. 73-85, at 9 (1933)
585. See generally Quinn, supra note 559, at 75-76.
586. See id. at 78-79.
professional standards. Hence, when broker-dealers induce their clients’ trust and confidence, they are agents and fiduciaries. At the same time, because of their professional expertise, broker-dealers’ statements about the market can be highly material. Thus, both of the legal doctrines descended from the special duty that flows from the contemporaries’ moral purpose.

FDR’s second suggestion was made to Richard Whitney, President of the New York Stock Exchange. In their meeting in April 1933, FDR suggested a code of ethics that would be simple enough for the public to understand. No one, however, could call the vast and complex regulatory regime governing the securities industry a “simple code of ethics.” Similarly, one should be skeptical of any claim that the public understands the regulatory regime’s many technical requirements. Yet, FDR’s suggestion may not have been in vain. In the core standards governing the public’s relationship with the securities industry, there are understandable, even intuitive concepts.

The statutory provisions enacted in the spirit of moral purpose were of three types. First, conduct inconsistent with contemporaries’ moral aspirations was forbidden. Forbidden conduct included devices, schemes or artifices to defraud, untrue statements, omissions that make statements misleading, manipulation, deception, and other fraud. All of this conduct is recognizable as callous and selfish wrongdoing. Learned counsel debate the precise terms of these provisions, but the public could easily understand their ultimate purpose—securities

587. See, e.g., Brief for SEC, supra note 414, at 6 (reasoning that “a security dealer, by reason of the very nature of his business, impliedly represents to all his customers that he will deal with them honestly and fairly and in accordance with the established standards of the business”).

588. See Charles Hughes & Co. v. SEC, 139 F.2d 434, 437 (2d Cir. 1943).


590. See id. at 5-6.

591. Id.


594. See id.


596. See id.


professionals shall not lie, mislead, manipulate, deceive or defraud. Second, the SEC was given authority to expel broker-dealers whose professional misconduct demonstrates their unfitness to remain in the industry. In 1938, Congress intended that it expected these principles to encompass concepts “technically outside the area of definite illegality.” In the years since, the courts have sustained the view that these principles include ethical as well as legal concepts. One of the more important of these principles was also one of the first to be adopted by the newly formed NASD, the duty of suitability. Judging by the volume of arbitration claims relying on this duty, the public appears to understand that they should expect suitable recommendations from their broker-dealers.

FDR’s suggestion of a simple code of ethics may have been achieved after all. Indeed, the “code” established by these standards and the fiduciary and fiduciary-like duties is very amenable to lay understanding. Thus, within the larger mass of the regulatory regime, there is a body of law and regulation that FDR might very well have recognized as the type of simple code he had in mind.

What meaning does FDR’s vision have for modern securities regulation? In recent years, there have been several developments in the securities markets and in the larger world that give renewed meaning to FDR’s policy and the measures he proposed for its implementation.

Confidence and crowd madness are receiving renewed attention as powerful forces in the securities markets. In the 1990s, several economies in Asia, Eastern Europe and South America experienced devastating financial panic. Investors suddenly lost confidence in


601. S. REP. No. 75-1455, at 3 (1938); H.R. REP. No. 75-2307, at 4 (1938).

602. See Jones v. SEC, 115 F.3d 1173, 1178-80 (4th Cir. 1997).

603. See supra text accompanying notes 454-58.

604. See Lowenfels & Bromberg, supra note 458, at 1557-58.

605. Paul Krugman has described the similarity between current conditions and the 1930s as a return to Depression economics. See generally PAUL KRUGMAN, THE RETURN OF DEPRESSION ECONOMICS (1999) (surveying financial crises of the late 1990s).
entire markets, and their simultaneous rush to withdraw triggered panicked sales of financial assets and sharp declines in values.\textsuperscript{606} Economists are again ready to entertain the idea that exuberance, fear, and other irrational motives play a decisive role in the capital markets.\textsuperscript{607} Baruch's ideas about crowd madness and confidence would be at home in the early twenty-first century.

Similarly, moral concepts are receiving renewed attention as important elements in the creation of prosperity. This intellectual phenomenon dates from the sudden collapse of the Soviet Union. From an ideological, social and economic system covering a major portion of the globe, Soviet Communism suddenly dissolved. Just as FDR and his contemporaries tried to make sense of how the bubble economy of the 1920s could suddenly collapse, and found massive breaches of ethical duty in the economic wreckage, the recent crash of Soviet Communism has revealed stunning ethical failures in Eastern Europe.\textsuperscript{608} Indeed, in its later stages, the communist economy in Poland bore a striking resemblance to a gigantic, nationwide financial fraud.\textsuperscript{609} Some commentators have concluded that communism's final fatal failure was its institutionalization of moral anarchy.\textsuperscript{610} In light of these recent and extraordinary historical events, renewed attention has been given to the influence of institutional regimes in shaping character, and the role of character in producing social conditions at the macro level.\textsuperscript{611}

Interestingly enough, Francis Fukuyama, one of the leading commentators on the historical meaning of the collapse of Soviet Communism,\textsuperscript{612} is also a leading exponent of the idea that cultural and

\begin{thebibliography}{99}
\textsuperscript{608} See generally Patricia A. McCoy, Levers of Law Reform: Public Goods and Russian Banking, 30 Cornell Int'l L.J. 45 (1997) (discussing a number of the domestic failures fueling the collapse of Russia's economic markets).
\textsuperscript{609} See John Clark & Aaron Wildavsky, The Moral Collapse of Communism: Poland as a Cautionary Tale 206-07 (1990) (characterizing Poland's economy as having been dominated by massive lying and manipulation of information about inventories, output, and other data relating to economic enterprises).
\textsuperscript{610} See id. at 204-07 (concluding that "bad moral behavior drives out good, just as bad currency drives out good").
\textsuperscript{611} See, e.g., Angelo M. Codevilla, The Character of Nations 4 (1997) (stating that "governments and the leading elements of society . . . have a lot to do with supporting ways of life, with tearing them down, or with building new ones").
\textsuperscript{612} See generally Francis Fukuyama, The End of History?, Nat'l Interest, Summer 1989, at 3, 4 (stating that the end of the Cold War is not just the "passing of a particular period of postwar..."

http://scholarlycommons.law.hofstra.edu/hlr/vol29/iss4/2

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social institutions play a critical role in economic development. In *Trust: The Social Virtues and the Creation of Prosperity*,*613* Fukuyama concludes that “a nation’s well-being, as well as its ability to compete, is conditioned by a single, pervasive cultural characteristic: the level of trust inherent in the society.”*614* He wrote that a high level of trust reduces the danger of free riding on public goods,*615* and increases economic efficiency by reducing transaction costs.*616* This type of trust, Fukuyama holds, is a type of social capital based on moral consensus.*617* In other words, moral trust and the conditions that create it have again been recognized as foundational elements for a prosperous modern economy.*618*

Perhaps the orthodox Progressives who attached themselves to FDR after the 1932 Democratic Convention were on to something. Perhaps confidence and moral trustworthiness are proper subjects for wise public policy. FDR certainly thought so. In his policy vision he sought to restore confidence by restoring the character of the people who composed the securities industry.*619* In other words, trust and confidence would be restored when they were morally justified. Legislators and administrators understood this vision and articulated it in various ways.*620* In light of modern developments, however, one version stands out. The legislative history of the Exchange Act states that in a highly liquid economy, “[w]hen everything everyone owns can be sold at once,” trust holds society together.*621* “Just in proportion as [an economic system] becomes more liquid and complicated, [it] must become more moderate, more honest, and more justifiably self-trusting.”*622* In other
words, in 1934, those creating the regulatory regime for the securities industry had a pragmatic appreciation for the role of trust that bears a striking resemblance to the principle Fukuyama would identify sixty years later.

FDR’s proposals for implementing his vision—fiduciary duties and a simple code of ethics—also speak to modern times. Commentators have recognized that fiduciary duties provide a legal basis for a justifiable expectation of trustworthiness. FDR’s code should be seen in the same light. As an effort to restore public trust in financial intermediaries—why else make it simple enough for the public to understand?—it represents a practical solution to a vexing problem. How does public policy produce trust? More specifically, how does public policy produce trust on a sufficient scale to influence an entire economy? The idea of a simple code, containing basic ethical principles, propagated across an entire industry, is a serious approach to the problem.

Of course, the “code” that emerged from FDR’s vision has not been codified. It is scattered across multiple sources of authority: law and industry rule, government and self-government, federal agency and profession, statute and judicial doctrine. Ultimately, however, as FDR’s contemporaries repeatedly explained, their goal in all of these endeavors was to bring higher standards of business conduct to the securities industry. When that happened, investors would reward the industry and the capital markets with justified trust and confidence. These ideas have not lost their value. Through a code of conduct, simple, understandable, and strictly enforced, the securities industry can demonstrate its moral trustworthiness and accumulate the social capital of trust. That capital should then help sustain investors’ confidence when the market is under stress. In sum, perhaps moral purpose has a place in securities regulation after all.

623. See Frankel, supra note 231, at 1215-30.