

14.4: Summary and Exercises

Summary

Beyond state corporation laws, federal statutes—most importantly, the Securities Act of 1933 and the Securities Exchange Act of 1934—regulate the issuance and trading of corporate securities. The federal definition of *security* is broad, encompassing most investments, even those called by other names.

The law does not prohibit risky stock offerings; it bans only those lacking adequate disclosure of risks. The primary means for realizing this goal is the registration requirement: registration statements, prospectuses, and proxy solicitations must be filed with the Securities and Exchange Commission (SEC). Penalties for violation of securities law include criminal fines and jail terms, and damages may be awarded in civil suits by both the SEC and private individuals injured by the violation of SEC rules. A 1977 amendment to the 1934 act is the Foreign Corrupt Practices Act, which prohibits an issuer from paying a bribe or making any other payment to foreign officials in order to gain business by inducing the foreign official to influence his government in favor of the US company. This law requires issuers to keep accurate sets of books reflecting the dispositions of their assets and to maintain internal accounting controls to ensure that transactions comport with management's authorization.

The Securities Exchange Act of 1934 presents special hazards to those trading in public stock on the basis of inside information. One provision requires the reimbursement to the company of any profits made from selling and buying stock during a six-month period by directors, officers, and shareholders owning 10 percent or more of the company's stock. Under Rule 10b-5, the SEC and private parties may sue insiders who traded on information not available to the general public, thus gaining an advantage in either selling or buying the stock. Insiders include company employees.

The Sarbanes-Oxley Act amended the 1934 act, creating more stringent penalties, increasing corporate regulation, and requiring greater transparency.

Exercises

1. Assume that the United States enters into a multilateral treaty with several third-world countries under which then-existing private claims to molybdenum and certain other minerals in the United States are assigned to an international agency for exploitation. When the owner of a US mine continues to dig for ore covered by the treaty, the Justice Department sues to enjoin further mining. What is the result? Why?
2. A foreign government enters into a contract with a US company to provide computer equipment and services for the intelligence arm of its military forces. After the equipment has been supplied, the foreign government refuses to pay. The US company files suit in federal court in the United States, seeking to attach a US bank account owned by the foreign government. The foreign government claims that the US court has no jurisdiction and that even if it does, the government is immune from suit. What is the result?
3. Would the result in Exercise 2 be any different if the US company had maintained its own equipment on a lease basis abroad and the foreign government had then expropriated the equipment and refused to pay the US company its just value?
4. The Concentrated Phosphate Export Association consists of the five largest phosphate producers. The Agency for International Development (AID) undertook to sell fertilizer to Korea and solicited bids. The association set prices and submitted a single bid on 300,000 tons. A paid the contract price, determined the amounts to be purchased, coordinated the procedure for buying, and undertook to resell to Korea. The Justice Department sued the association and its members, claiming that their actions violated Section 1 of the Sherman Act. What defense might the defendants have? What is the result?
5. Canada and Russia have competing claims over fishing and mining rights in parts of the Arctic Ocean. Assuming they cannot settle their competing claims through diplomatic negotiation, where might they have their dispute settled?

SELF CHECK QUESTIONS

1. Anne operated a clothing store called Anne's Rags, Inc. She owned all of the stock in the company. After several years in the clothing business, Anne sold her stock to Louise, who personally managed the business. Is the sale governed by the antifraud provisions of federal securities law? Why?
2. While waiting tables at a campus-area restaurant, you overhear a conversation between two corporate executives who indicate that their company has developed a new product that will revolutionize the computer industry. The product is to be announced in three weeks. If you purchase stock in the company before the announcement, will you be liable under federal securities law? Why?

3. Eric was hired as a management consultant by a major corporation to conduct a study, which took him three months to complete. While working on the study, Eric learned that someone working in research and development for the company had recently made an important discovery. Before the discovery was announced publicly, Eric purchased stock in the company. Did he violate federal securities law? Why?
4. While working for the company, Eric also learned that it was planning a takeover of another corporation. Before announcement of a tender offer, Eric purchased stock in the target company. Did he violate securities law? Why?
5. The commercial lending department of First Bank made a substantial loan to Alpha Company after obtaining a favorable confidential earnings report from Alpha. Over lunch, Heidi, the loan officer who handled the loan, mentioned the earnings report to a friend who worked in the bank's trust department. The friend proceeded to purchase stock in Alpha for several of the bank's trusts. Discuss the legal implications.
6. In Exercise 5, assume that a week after the loan to Alpha, First Bank financed Beta Company's takeover of Alpha. During the financing negotiations, Heidi mentioned the Alpha earnings report to Beta officials; furthermore, the report was an important factor in Heidi's decision to finance the takeover. Discuss the legal implications.
7. In Exercise 6, assume that after work one day, Heidi told her friend in the trust department that Alpha was Beta's takeover target. The friend proceeded to purchase additional stock in Alpha for a bank trust he administered. Discuss the legal implications.

Answers

1. c
2. c
3. a
4. d
5. a
6. e

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