

REGULATION OF INVESTMENT NEWSLETTER
PUBLISHERS: THE SEC'S POWER REACHES A
NEW *LOWE*

INTRODUCTION

In recent years, the number of persons engaging in the business of giving investment advice has steadily increased.¹ Many of these investment advisers render their advice through subscription investment newsletters.² These newsletters typically consist of weekly or biweekly reports that summarize the condition and prospects of the stock or bond market and the general economy, and give specific recommendations on particular securities and other investments.³ The publishers of these newsletters have, in the past, been regulated by the Securities and Exchange Commission (SEC) under the Investment Advisers Act of 1940.⁴ However, the United States Supreme Court's recent decision in *Lowe v. SEC*⁵ narrowly interpreted the Act's definition of investment adviser.⁶ The Court's strict statutory construction consequently placed many investment newsletter publishers outside the scope of the Act.⁷

History has shown that investment newsletters provide unscrupulous investment advisers with a vehicle for tremendous personal gain at the expense of both the newsletters' subscribers and the general

¹As of September 30, 1982 the number of investment advisers registered with the SEC was 5,445. 48 SEC ANN. REP. 84 (1982). As of March 22, 1984 the number of registered investment advisers had grown to 8,078. One thousand one hundred sixty-eight of these advisers reported that they issue periodic reports on a subscription basis, 1,006 reported that they issue special research reports or bulletins, and 541 reported that they issue charts, graphs or formulas that are used to evaluate securities investments. J. Fedders, Remarks at Seminar Sponsored by the American University School of Communication and the National Center for Business and Economic Communication (Oct. 22, 1984). By September 30, 1984, the number of investment advisers registered with the SEC had grown to 9,083. 50 SEC ANN. REP. 93 (1984).

²Harroch, *The Applicability of the Investment Advisers Act of 1940 to Financial and Investment Related Publications*, 5 J. CORP. L. 55, 56 (1979).

³*Id.* at 56 n.3.

⁴15 U.S.C. §§ 80b-1 to 80b-21 (1982).

⁵105 S.Ct. 2557 (1985).

⁶15 U.S.C. § 80b-2(a)(11) (1982).

⁷The Court held that the Act does not regulate "nonpersonalized publishing activities." *Lowe*, 105 S.Ct. at 2570. Thus, the Court's interpretation of investment adviser excludes virtually all investment newsletter publishers whose only investment advisory activity is the publication of such newsletters. Individuals who engage in other investment advisory activity, such as rendering personal investment advice, in addition to publishing investment newsletters would still be regulated by the Act.

public.⁸ Until the Court's decision in *Lowe*, investment newsletter publishers were regulated by the Act, the primary objective of which is "to protect the public from frauds and misrepresentations of unscrupulous tipsters and touts and to safeguard the honest investment adviser against the stigma of the activities of these individuals by making fraudulent practices by investment advisers unlawful."⁹ The Senate Report on the Securities Exchange Act of 1934 highlighted the potential for abuses in the publication of investment newsletters by noting,

that it was not uncommon for market operators to employ a publicity agent to tout a stock in which they were momentarily interested [One] witness admitted that his business was 'financial publicity,' and that his articles were published for the purpose of interesting the public in the stock in which he and those who employed him were interested, thereby causing the market value of the stock to increase; and for his work he was paid by calls and options.¹⁰

Thus, one purpose of the Act is to protect members of the investing public from being victimized by the misrepresentations of investment advisers. Another purpose was, until *Lowe*, believed to be the prevention of "scalping," a practice whereby the publisher of an investment newsletter trades a security which he has recommended and reaps a financial gain by virtue of the effect which his recommendation has on the market price of that security.¹¹ The Court's recent interpretation of the Act however, has stripped the SEC of its most powerful tool for protecting the public against frauds and other misconduct committed by investment newsletter publishers.

⁸ See, e.g., *SEC v. Blavin*, 557 F. Supp. 1304, 1308 (E.D. Mich. 1983), in which an investment newsletter publisher reaped a profit of over \$76,000, in less than four months, by engaging in a practice known as "scalping." See *infra* note 11 for a description of "scalping."

⁹ HR, REP. No. 2639, 76th Cong., 3rd Sess. 28 (1940).

¹⁰ S. REP. No. 792, 73d Cong., 2d Sess. 8 (1934).

¹¹ Scalping has been described as follows:

It is generally conceded by publishers and broker-dealers alike that any recommendations of an advisory service with a sizable circulation could have at least a short-term effect on a stock's market price. A broker-dealer, publisher, or employee of either, who knows of a pending recommendation and buys the stock before the recommendation, and then sells after the market price has felt its impact, is engaging in a practice known to Wall Street as "scalping."

2 T. FRANKEL, *THE REGULATION OF MONEY MANAGERS*, 387 (1978) (quoting, SEC, Report of the Special Study of Securities Markets, H.R. Doc. No. 95, 88th Cong., 1st Sess., pt. 1, 372 (1963)).

This note will first discuss the mechanisms of the Investment Advisers Act and their application to investment newsletter publishers. Next, this note will evaluate the Court's recent interpretation of the Act and the resulting impact of that interpretation on the SEC's ability to protect the public against the misdeeds of investment newsletter publishers. Finally, the note will recommend changes to the Act which will enable the SEC to properly oversee the conduct of investment newsletter publishers, without infringing on the first amendment rights of those publishers.

1. REGULATION OF INVESTMENT NEWSLETTER PUBLISHERS BEFORE
Lowe

A. *The Investment Advisers Act of 1940*

The Investment Advisers Act of 1940¹² is the federal statutory mechanism that regulates persons who advise others on the purchase or sale of securities. The Act requires all persons who fall within its definition of investment adviser, and use the mails or any other instrumentality of interstate commerce in connection with their business as investment advisers, to register with the SEC.¹³ The Act defines "investment adviser" as

any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities.¹⁴

The Act, however, excludes several classes of persons from its definition of investment adviser.¹⁵ One such class is "the publisher of any bona fide newspaper, news magazine or business or financial publication of general and regular circulation."¹⁶ Thus, any person who fits the general definition of investment adviser, but falls into one of the specifically enumerated exclusions,¹⁷ is not deemed to be an investment adviser for purposes of the Act.

¹² 15 U.S.C. §§ 80b-1 to 80b-21 (1982).

¹³ *Id.* at § 80b-3.

¹⁴ *Id.* at § 80b-2(a)(11).

¹⁵ *Id.* at § 80b-2(a)(11)(A) to (F).

¹⁶ *Id.* at 80b-2(a)(11)(D).

¹⁷ *Id.* at § 84b-2(a)(11)(A) to (F). In addition to the bona fide newspaper exclusion, the Act also contains exclusions for banks and bank holding companies which are not investment companies, certain professionals, such as lawyers, accountants, engineers, teachers, brokers or dealers, who render investment advice incidental to the practice of their professions, and "such other persons not within the intent of [the definition of investment adviser]." *Id.*

In addition to the registration requirement, the Act and the rules promulgated pursuant to the Act¹⁸ require any person applying for registration as an investment adviser to disclose certain information to the SEC on Form ADV.¹⁹ Part I²⁰ of Form ADV requires disclosure of information about the applicant's business entity and all persons controlling that entity.²¹ For example, the applicant must state whether the applicant's business entity is a corporation, partnership, or sole proprietorship.²² The applicant must also disclose all persons who, directly or indirectly, have the power to exercise a controlling influence over the management or policies of the applicant's business and all persons who wholly or partially finance the business.²³ Finally, the applicant must disclose whether any person affiliated with the applicant's business has made a false or misleading statement on any application filed with the SEC under the Act or has been convicted of certain specified crimes within the past ten years.²⁴

Part II²⁵ of Form ADV requires disclosure of information about the applicant's basic operations including the nature of services offered,²⁶ the fees charged,²⁷ the types of clients advised,²⁸ the types of investments generally recommended,²⁹ the methods of analysis utilized,³⁰ the investment strategies employed³¹ and the sources of information used³² by the applicant in formulating recommendations. Part II also requires

¹⁸17 C.F.R. §§ 275.0-2 to 279.7 (1985).

¹⁹*Id.* at § 275.203-1(a). The recently amended text of Form ADV can be found at 5 FED. SEC. L. REP. (CCH) 1f 57,101 at 44,343 to 44,349-31 (Nov. 7, 1985) [hereinafter cited as Form ADV].

²⁰Form ADV, *supra* note 19, at 44,347 to 44,349-10.

²¹*Id.*

²²*Id.* at 44,349-2.

²³*Id.* at 44,349-3.

²⁴*Id.* at 44,349-4. For example, the applicant must disclose whether, within the last ten years, the applicant or any affiliate has been convicted of any crime involving fraud, false statements, bribery, forgery, counterfeiting, extortion or wrongful taking of property or any other crime involving an investment or an investment related business. *Id.*

²⁵*Id.* at 44,349-11 to 44,349-31.

²⁶*Id.* at 44,349-12 to 44,349-13.

²⁷*Id.*

²⁸*Id.* at 44,349-13 to 44,349-14.

²⁹*Id.* at 44,349-14 to 44,349-15.

³⁰*Id.* at 44,349-15.

³¹*Id.* at 44,349-16.

³²*Id.* at 44,349-15 to 44,349-16.

disclosure of information about the applicant's other business activities,³³ including activities or affiliations in the securities industry³⁴ and the applicant's participation in connection with securities transactions of clients.³⁵

Once an investment adviser becomes registered under the Act,³⁶ the investment adviser has a duty to amend Form ADV if the information provided becomes inaccurate for any reason.³⁷ Furthermore, the investment adviser must provide each advisory client and prospective advisory client with a written disclosure statement containing the information required by Part II of Form ADV.³⁸ The Act also empowers the SEC, in certain situations, to censure, limit, suspend or revoke the registration of an investment adviser, if the SEC finds that such a sanction is in the public interest.³⁹ For example, the SEC may impose sanctions if the investment adviser has willfully made a false or misleading statement on any registration application,⁴⁰ if the investment adviser has been convicted of specified crimes within ten years prior to filing any registration application,⁴¹ or if the investment adviser has willfully violated specified statutes or rules.⁴²

B. Case Law

Until recently, investment newsletter publishers were deemed to fall within the Investment Advisers Act's definition of investment adviser,⁴³ and were therefore subject to the Act's registration

³³*Id.* at 44,349-17.

³⁴*Id.* at 44,349-17 to 44,349-18.

³⁵*Id.* at 44,349-18 to 44,349-19.

³⁶Registration is accomplished simply by filing Form ADV and paying a \$150 nonrefundable fee to the SEC. 17 C.F.R. § 275.203-1, -3 (1985). The SEC must either grant the registration within 45 days or institute proceedings for a hearing on notice concerning a denial of the applicant's registration. 15 U.S.C. § 80b-3(C)(2) (1982).

³⁷17 C.F.R. § 275.204-1 (1985).

³⁸*Id.* at § 275.204-3(a). This disclosure can be accomplished simply by providing the client with a copy of Part II of Form ADV or a written document containing at least the information required by Part II of Form ADV. *Id.*

³⁹15 U.S.C. § 80b-3(e) (1982).

⁴⁰*Id.* at § 80b-3(e)(1).

⁴¹*Id.* at § 80b-3(e)(2). The crimes listed in this section are the same as the crimes which must be disclosed by the applicant on Form ADV. *See supra* note 24.

⁴²15 U.S.C. § 80b-3(e)(4) (1982). Some of the statutes specifically mentioned in this section include the Securities Act of 1933, 15 U.S.C. §§ 77a-77aa (1982 & Supp. II 1984), and the Securities Exchange Act of 1934, 15 U.S.C. §§ 78a-78kk (1982 & Supp. II 1984).

⁴³15 U.S.C. § 80b-2(a)(11) (1982).

requirements.⁴⁴ Because the Act empowers the SEC to revoke or limit an investment adviser's registration,⁴⁵ the SEC had the power to permanently prevent an individual from publishing stock market newsletters simply by exercising this revocation power.⁴⁶ In *SEC v. Wall Street Transcript Corp.*,⁴⁷ this revocation power was challenged by an investment newsletter publisher as an unconstitutional infringement of freedom of the press.

1. *SEC v. Wall Street Transcript Corp.*

In *Wall Street Transcript*, the SEC initiated an investigation of an investment newsletter because the newsletter's publisher, the Wall Street Transcript Corporation, was not registered as an investment adviser.⁴⁸ The United States District Court for the Southern District of New York refused to enforce the SEC's subpoena duces tecum which was issued pursuant to the SEC's investigation.⁴⁹ The district court based its refusal on its conclusion that the newsletter was a " `bona fide newspaper' or `financial publication of the general and regular

⁴⁴*Id.* at 80b-3. However, § 80b-3(b) states that the registration requirement does not apply to:

- (1) any investment adviser all of whose clients are residents of the State within which such investment adviser maintains his or its principal office and place of business, and who does not furnish advice or issue analyses or reports with respect to securities listed or admitted to unlisted trading privileges on any national securities exchange;
- (2) any investment adviser whose only clients are insurance companies; or
- (3) any investment adviser who during the course of the preceding twelve months has had fewer than fifteen clients and who neither holds himself out generally to the public as an investment adviser nor acts as an investment adviser to any investment company registered under subchapter I of this chapter, or a company which has elected to be a business development company pursuant to section 80a-53 of this title and has not withdrawn its election. For purposes of determining the number of clients of an investment adviser under this paragraph, no shareholder, partner, or beneficial owner of a business development company, as defined in this subchapter, shall be deemed to be a client of such investment adviser unless such person is a client of such investment adviser separate and apart from his status as a shareholder, partner, or beneficial owner. *Id.* at § 80b-3(b).

⁴⁵*Id.* at § 80b-3(e).

⁴⁶*See, e.g.,* In re Lowe Management Corp., [1981 Transfer Binder] FED. SEC. L. REP. (CCH) 9 82,873 (May 11, 1981).

⁴⁷422 F.2d 1371 (2d Cir.) *cert. denied* 398 U.S. 958 (1970).

⁴⁸*Id.* at 1373.

⁴⁹*Id.* at 1374. The SEC has authority to investigate violations and has subpoena power under the Investment Advisers Act, 15 U.S.C. § 80b-9(a), (b) (1982). The SEC may enforce a subpoena in any federal court within the jurisdiction in which the investigation is being conducted. *Id.* at § 80b-9(c).

circulation.”⁵⁰ Thus, the court held that the investment newsletter publisher was expressly excluded from the Act's definition of investment adviser, and therefore, was not required to register.⁵¹

The SEC appealed to the United States Court of Appeals for the Second Circuit, contending that the district court incorrectly determined that the investment newsletter fit within the Act's bona fide newspaper exclusion.⁵² The Second Circuit agreed with the SEC's contention and noted that the determinative issue was not whether the publication had a sufficient number of the usual indicia of a typical newspaper.⁵³ Rather, the court stated that “[t]he phrase ‘bona fide’ newspapers . . . means those publications which do not deviate from customary newspaper activities to such an extent that there is a likelihood that the wrongdoing which the Act was designed to prevent has occurred.”⁵⁴ The court recognized that the publication in question consisted mostly of reprinted reports assessing securities issues and that the publication placed an emphasis on particular securities issues and companies.⁵⁵ Thus, the court examined the publication's substance and content rather than its form. Accordingly, because the publication contained investment advice which was within the regulatory intent of the Act, the court held that the publication was not a bona fide newspaper⁵⁶ and that the publisher of the Wall Street Transcript was therefore subject to the Act's registration requirements.⁵⁷

After concluding that the publication fell within the scope of the Act, the court next addressed the publisher's contention that the Act, on its face, abridged the constitutional guarantee of freedom of the press.⁵⁸ The court held that the Act was constitutionally valid,⁵⁹ stating that

[i]t is not necessary to . . . [assume] that the activities involved in giving *commercial investment advice* are entitled to the identical constitutional protection provided for certain forms of social, political or religious expression. . . . Promoting the sale of a product is not ordinarily associated with any of the interests the First Amendment seeks to protect. As a rule, it does not affect the political process, does not contribute to the exchange of ideas, does not provide information on matters of public importance, and is not . . . a form of

⁵⁰ *Id.*

⁵¹ *Id.* at 1374-75.

⁵² *Id.* at 1376.

⁵³ *Id.* at 1377.

⁵⁴ *Id.*

⁵⁵ *Id.* at 1378.

⁵⁶ *Id.*

⁵⁷ *Id.*

⁵⁸ *Id.* at 1378-81.

⁵⁹ *Id.* at 1379.

individual self-expression. It is rather a form of merchandising subject to limitation for public purposes like other business practices."⁶⁰

Thus, although the court specifically held that the Act, on its face, did not contravene the first amendment,⁶¹ the underlying rationale for the court's holding was the principle that commercial speech was not within the realm of speech protected by the first amendment. This principle, however, is no longer valid constitutional law;⁶² the United States Supreme Court has subsequently held that commercial speech is entitled to at least some degree of first amendment protection.⁶³

2. *The Rise of Commercial Speech*

Six years after the Second Circuit's decision in *Wall Street Transcript*, the United States Supreme Court held that commercial speech is protected by the first amendment in *Virginia State Bd. of Pharmacy u. Virginia Citizens Consumer Council, Inc.*⁶⁴ Thus, if the content of investment newsletters consists of commercial-speech, then those newsletters are entitled to at least some degree of first amendment protection. *Wall Street Transcript* is of little value in determining whether investment newsletters constitute commercial speech because the court merely stated that the

⁶⁰*Id.* (emphasis added) (quoting *Banzhaf v. FCC*, 405 F.2d 1082, 1101-02 (D.C. Cir. 1968) *cert. denied sub. nom.* Tobacco Institute Inc. v. FCC, 396 U.S. 842 (1969)).

⁶¹*Wall Street Transcript*, 422 F.2d at 1379.

⁶²*See infra*, note 64 and accompanying text.

⁶³*See*, *Virginia State Bd. of Pharmacy v. Virginia Citizens Consumer Council Inc.*, 425 U.S. 748 (1976). Since *Virginia Pharmacy*, the Court has struggled to determine what types of speech fall within the category of commercial speech. Although it is clear that "purely commercial advertising" is commercial speech, see *infra* note 69 and accompanying text, the Court has afforded commercial speech protection to some types of speech which are not so clearly "purely commercial advertising." See, e.g., *Linmark Associates, Inc. v. Willingboro*, 431 U.S. 85 (1977) (real estate "For Sale" signs held to be protected commercial speech); *Ohralik v. Ohio State Bar Ass'n*, 436 U.S. 447 (1978) (Court relied on commercial speech line of cases in upholding regulation of attorneys' solicitation of clients).

Furthermore, the Court has also struggled to delineate the contours of permissible restrictions on commercial speech. See, G. GUNTHER, *CONSTITUTIONAL LAW* 1380-1406 (10th ed. 1980). Despite the lack of clarity in the commercial speech area, it is at least clear that regulation of commercial speech is subject to an intermediate level of judicial scrutiny. *Id.* at 1397. Thus, commercial speech falls somewhere between fully protected speech, such as political speech, and completely unprotected speech, such as libel. *Id.*

⁶⁴425 U.S. 748, 762 (1976).

publication in question was "commercial investment advice."⁶⁵ Furthermore, *Wall Street Transcript* was decided prior to a whole line of United States Supreme Court decisions which have helped define the contours of commercial speech.⁶⁶

In *Central Hudson Gas and Electric Corp. v. Public Service Comm'n.*,⁶⁷ the Court stated that commercial speech is

expression related solely to the economic interests of the speaker and its audience Commercial expression not only serves the economic interest of the speaker, but also assists consumers and furthers the societal interest in the fullest possible dissemination of information Even when advertising communicates only an incomplete version of the relevant facts, the First Amendment presumes that some accurate information is better than no information at all.⁶⁸

Thus, in *Central Hudson* the Court clearly indicated that all advertising of products or services falls within the definition of commercial speech. Indeed, the United States Court of Appeals for the Third Circuit has stated that, "[t]he Supreme Court has confined the category of 'commercial speech' to cases involving 'purely commercial advertising.'"⁶⁹

An investment newsletter does not constitute product -or service advertising by the individual who is providing the product or service. The publisher's product is the newsletter, not the stocks and bonds about which the newsletter makes recommendations. However, the newsletter does serve the economic interests of the subscribers. In a sense, the newsletter is an "advertisement" (either positive or negative) for the securities about which the newsletter comments. The "advertisement" for the product is distinct from a conventional advertisement only because the "advertisement" comes from someone other than the person providing the product. The newsletter merely

⁶⁵*Wall Street Transcript*, 422 F.2d at 1379.

⁶⁶See, e.g., *Central Hudson Gas & Electric Corp. v. Public Service Comm'n.*, 447 U.S. 557 (1980); *Bates v. State Bar of Arizona*, 433 U.S. 350 (1977); *In re R.M.J.*, 455 U.S. 191 (1982).

⁶⁷447 U.S. 557 (1980).

⁶⁸*Id.* at 561-62.

⁶⁹*Ad World Inc. v. Township of Doylestown*, 672 F.2d 1136, 1140 (3d. Cir.) cert. denied 456 U.S. 975 (1982) (citing *Pittsburgh Press Co. v. Pittsburgh Comm'n on Human Relations*, 413 U.S. 376 (1973)). In *Pittsburgh Press*, the Court described a "purely commercial advertisement" as one which does "no more than propose a commercial transaction." 413 U.S. at 385. In *Virginia Pharmacy*, the Court characterized the purely commercial advertisement at issue as follows: Our pharmacist does not wish to editorialize on any subject, cultural, philosophical, or political. He does not wish to report any particular newsworthy fact, or to make generalized observations even about commercial matters. The "idea" he wishes to communicate is simply this: "I wish to sell you the X prescription drug at the Y price." 425 U.S. at 761.

recommends the purchase or sale of a security and gives the reasons for its recommendation. Thus, in order to determine whether investment newsletters deserve the same first amendment protection afforded to commercial speech, it is instructive to apply the rationale behind protecting commercial speech to the type of speech contained in investment newsletters.⁷⁰

In *Virginia Pharmacy*,⁷¹ the Court explicitly extended first amendment protection to commercial speech. In striking down a Virginia law against price advertisement of prescription drugs,⁷² the Court examined the individual and societal interests in allowing the commercial expression.⁷³ The Court then balanced these interests against the state's justification for the advertising ban.⁷⁴

The first interest considered by the *Virginia Pharmacy* Court was the advertiser's purely economic interest.⁷⁵ The Court analogized the advertiser's interest to the interests of the contestants in a labor dispute.⁷⁶ The Court stated that the interests of the parties involved in a labor dispute are primarily economic.⁷⁷ However, "it has long been settled that both the employee and the employer are protected by the First Amendment when they express

⁷⁰ Rather than engage in a semantic discussion of whether these newsletters fit into the category of "commercial speech," it is more instructive to apply the analysis which brought commercial speech under first amendment protection to the speech contained in investment newsletters. The fact that the majority of commercial speech cases decided by the Court have dealt with advertising does not compel the conclusion that commercial speech includes only advertising. Accordingly, even in cases involving advertising, the Court has defined commercial speech in broad terms which would encompass more than advertising. For example, the Court defined commercial speech in *Central Hudson* as "expression related solely to the economic interests of the speaker and its audience." *Central Hudson*, 447 U.S. at 561.

⁷¹425 U.S. 748 (1976).

⁷²*Id.* at 770.

⁷³*Id.* at 762-65.

⁷⁴*Id.* at 766-70.

⁷⁵*Id.* at 762.

⁷⁶*Id.*

⁷⁷*Id.*

themselves on the merits of the dispute in order to influence its outcome."⁷⁸ Thus, the Court concluded that the fact that the advertiser's interest is a purely economic one "hardly disqualifies him from protection under the First Amendment."⁷⁹

Like the advertiser in *Virginia Pharmacy*, the investment newsletter publisher has a purely economic interest. The publisher produces his newsletter for the sole purpose of selling subscriptions. If the newsletter makes accurate predictions and sound recommendations, the newsletter will presumably attract more subscribers and the publisher's economic benefit will be increased. Therefore, the investment newsletter publisher, like the advertiser and the labor picketer, should not be denied first amendment protection simply because the publisher's interest is purely economic.

The second interest which the Court considered in *Virginia Pharmacy* was the consumer's interest in the free flow of advertising information.⁸⁰ The Court stated that the "particular consumer's interest in the free flow of commercial information . . . may be as keen, if not keener by far, than his interest in the day's most urgent political debate."⁸¹ Thus, the Court was concerned with the recipient's interest in having access to the commercial speech. By considering the recipient's interest, the Court recognized that commercial speech, like other types of protected speech, performs the important function of providing individuals with access to a variety of ideas. The Court has long recognized the importance of the individual's access to information as one of the rationales behind the first amendment's protection of freedom of expression. For example, the Court has stated that, "[i]t is the right of the public to receive suitable access to social, political, esthetic, moral, and other ideas and experiences That right may not constitutionally be abridged."⁸²

Individuals who subscribe to investment newsletters have a strong interest in receiving the information communicated by those newsletters. This information enables the recipients to make investment decisions which are rational and well informed. The very fact that individual subscribers are willing to pay for investment

⁷⁸*Id.*

⁷⁹*Id.*

⁸⁰*Id.* at 763-64.

⁸¹*Id.* at 763.

⁸²*Red Lion Broadcasting Co. v. FCC*, 395 U.S. 367, 390 (1969).

newsletters indicates that those newsletters do have some value to each of those individual subscribers.⁸³

Finally, the *Virginia Pharmacy* Court considered society's interest in the free flow of advertising information.⁸⁴ As the Court stated,

[s]o long as we preserve a predominantly free enterprise economy, the allocation of our resources in large measure *will* be made through numerous private economic decisions. It *is* a matter of public interest that those decisions, in the aggregate, be intelligent and well informed. To this end, the free *flow* of commercial information is indispensable.⁸⁵

This rationale is equally applicable to both investment newsletters and advertising. The free flow of opinions regarding the value of securities can only enhance the public's ability to make informed decisions regarding personal investments.

Society's interest in the free flow of information has also long been recognized by the Court as an important rationale behind the first amendment's protection of freedom of expression.⁸⁶ As the Court has stated, "[the first] [a]mendment rests on the assumption that the widest possible dissemination of information from diverse and antagonistic sources is essential to the welfare of the public."⁸⁷ The unimpeded dissemination of information is especially important to members of the investing public. Indeed, the federal securities laws⁸⁸ are generally based on the premise that full disclosure is the best means of providing investors with the information needed to evaluate the merits of a potential investment and that full disclosure protects the public from abuses in the securities markets.⁸⁹ Therefore, the availability of investment information performs one of the same functions as the

⁸³The newsletters involved in *Louie*, for example, have yearly subscription rates ranging from \$30 to \$900. *Lowe*, 556 F. Supp. 1359, 1361 (E.D.N.Y. 1983).

⁸⁴*Virginia Pharmacy*, 425 U.S. at 764-65.

⁸⁵*Id.* at 765.

⁸⁶*See, e.g.*, *Associated Press v. United States*, 326 U.S. 1, 20 (1945); *New York Times Co. v. Sullivan*, 376 U.S. 254, 270 (1960); *Red Lion Broadcasting Co. v. FCC*, 395 U.S. 367, 395 (1969).

⁸⁷*Associated Press v. United States*, 326 U.S. 1, 20 (1945).

⁸⁸Federal securities legislation consists of six principal statutes: Securities Act of 1933, 15 U.S.C. §§ 77a-77aa (1982 & Supp. II 1984); Securities Exchange Act of 1934, 15 U.S.C. §§ 78a-78kk (1982 & Supp. II 1984); Public Utility Holding Company Act of 1935, 15 U.S.C. §§ 79 to 79z-6 (1982); Trust Indenture Act of 1939, 15 U.S.C. §§ 77aaa-77bbbb (1982); Investment Company Act of 1940, 15 U.S.C. §§ 80a-1 to 80a-64 (1982 & Supp. II 1984) and the Investment Advisers Act of 1940, 15 U.S.C. §§ SOB-1 to 80b-21 (1982).

⁸⁹R. STEVENSON, CORPORATIONS AND INFORMATION: SECRECY, ACCESS AND DISCLOSURE 8-82 (1980).

availability of commercial advertising-enabling consumers or investors to make intelligent decisions.⁹⁰ Furthermore, society has an additional interest in protecting the free flow of investment information insofar as that information protects investors from fraud and self dealing.⁹¹ Finally, full disclosure of investment information and rational decision making in the securities markets results in market prices which accurately reflect the value of securities.⁹² Thus, society reaps a great benefit by the free flow of investment information.

Therefore, the interests which led the *Virginia Pharmacy* Court to extend first amendment protection to commercial advertising are also present in the context of investment newsletters. First, a publisher of a newsletter has an economic interest similar to that of an advertiser. Second, a subscriber to a newsletter has an interest in receiving investment information, which facilitates rational investment choices, similar to a consumer's interest in product advertising, which facilitates rational product consumption. Finally, society has an interest in rational decisionmaking both in the securities markets and in the consumer products markets.

Despite the strong individual and societal interests in the free flow of investment information, there is also a competing governmental interest in the regulation of investment newsletter publishers. The manipulation of the stock market by investment newsletter publishers is a practice which can cause substantial harm to individual investors and society in general.⁹³ Individual investors can lose a tremendous amount of money once it has been determined that the price of a stock has been artificially inflated because of a scalping

⁹⁰See, *Virginia Pharmacy*, 425 U.S. at 765.

⁹¹R. STEVENSON, *supra* note 89, at 82.

⁹²See, e.g., MANNE, WHAT KIND OF CONTROLS ON INSIDER TRADING DO WE NEED IN THE ATTACK ON CORPORATE AMERICA? 121-22 (1978):

An "efficient" stock market is one that rapidly and correctly evaluates new information and integrates that information into the market price of shares. Study after study demonstrates the almost unbelievable efficiency with which our major stock markets perform this function. Indeed, no matter at what point econometricians test to see whether a given new development has yet impacted a share price, the impact always seems to have already occurred. This finding has led some slightly incredulous researchers to conclude that the stock market instantaneously reflects any available information relevant to stock price.

⁹³See *supra* notes 8-11 and accompanying text.

scheme.⁹⁴ Furthermore, society in general is harmed when the market price of securities does not accurately reflect their value.⁹⁵ Finally, the numerous opportunities for fraud presented by investment newsletters requires that the publishers of those newsletters be closely regulated.⁹⁶

In sum, the individual and societal interests in receiving and regulating investment newsletters are similar to the individual and societal interests in receiving and regulating commercial advertising. Since the same strong interests are applicable to both forms of communication, the constitutionality of restrictions on these forms of communication should be judged by the same standard. Therefore, the investment newsletters should receive the same first amendment protection as commercial advertising.

II. LOWE v. SEC

The United States Supreme Court was recently presented with an opportunity to resolve the issue of whether the contents of an investment newsletter constitute commercial speech in *Lowe u. SEC*.⁹⁷ The Court, however, circumvented the difficult constitutional issues by holding that impersonal investment newsletters are not regulated by the Investment Advisers Act because they fall within the Act's exclusion for bona fide newspapers, news magazines or business or financial publications of general and regular circulation.⁹⁸ This holding has effectively eliminated the SEC's ability to regulate the publishers of investment newsletters under the Act since virtually all investment newsletters contain impersonal financial advice.⁹⁹

Christopher Lowe is the president of Lowe Management Corp., Lowe Publishing Corp., and Lowe Stock

⁹⁴ See 2 T. FRANKEL, *supra* note 11, at 387-90.

⁹⁵ See Note, *Stock Scalping by the Investment Adviser: Fraud or Legitimate Business Practice?*, 51 CALIF. L. REV. 232, 235 n.17 (1963). It is generally conceded that the stock market crash of 1929 was, in large part, caused by the artificial inflation of the market prices of stocks. See, e.g., O'Brien & Moye, *The Sale of Business Doctrine: Landreth Adds New Life to the Anti-Fraud Provisions of the Securities Acts*, 11 VT. L. REV. 1, 5 n.32 (1986).

⁹⁶ See *infra* note 158 and accompanying text.

⁹⁷ 105 S.Ct. 2557 (1985).

⁹⁸ *Id.* at 2571.

⁹⁹ If an investment newsletter contained advice which was tailored to a particular individual's needs, then that newsletter would not be a very profitable venture for the publisher - the potential market for that newsletter would consist of one person.

Chart Service, Inc.¹⁰⁰ From March, 1974 until May, 1981, Lowe Management Corp. was registered as an investment adviser.¹⁰¹ In 1977 and 1978, Christopher Lowe was convicted of two New York felonies and two misdemeanors arising out of his conduct as an investment adviser.¹⁰² Pursuant to the Act,¹⁰³ the SEC instituted administrative proceedings against Lowe and Lowe Management Corp.¹⁰⁴ The SEC found that Lowe had violated the reporting provisions of the Act, failed to amend Lowe Management's investment advisory registration form to reflect Lowe's convictions relating to his conduct as an investment adviser, and aided and abetted willful violations of the Act's antifraud provisions.¹⁰⁵ Accordingly, in an order dated May 11, 1981, the SEC revoked Lowe Management's registration as an investment adviser and barred Lowe from association with any investment adviser.¹⁰⁶

Despite the sanctions imposed by the SEC, Lowe and his corporations continued to publish and distribute two investment advisory newsletters, the *Lowe Investment and Financial Letter* and the *Lowe Stock Advisory*.¹⁰⁷ Lowe also solicited subscriptions for a third newsletter, the *Lowe Stock Chart Service*.¹⁰⁸ A typical *Lowe Investment and Financial Letter* provided both a short-term and long-term forecast.¹⁰⁹ It also offered advice on the relative

¹⁰⁰SEC v. Lowe, 725 F.2d 892, 894 (2d Cir. 1984).

¹⁰¹*Id.*

¹⁰²*Id.* In 1977, Lowe pleaded guilty to making false representations to a client. Lowe had told the client that \$2,200 had been invested for the client's benefit and a 27% return earned, when in fact Lowe had misappropriated the funds for his own use. Lowe also pleaded guilty to failing to register in New York State as an investment adviser. *Lowe*, 725 F.2d at 894. Thus, Lowe was convicted of violating N.Y. GEN. Bus. LAW § 352-c (McKinney 1984) and N.Y. GEN. Bus. LAW § 359-eee (McKinney 1984). In 1978, Lowe pleaded guilty to tampering with physical evidence. Lowe had altered a copy of a \$10 money order to have it appear to be for the amount of \$10,000. Lowe also pleaded guilty to third degree larceny for fraudently drawing checks on an account to which worthless checks had been deposited. *Lowe*, 725 F.2d at 894. Thus, Lowe was convicted of violating N.Y. PENAL LAW § 215.40 (McKinney 1975) and N.Y. PENAL LAW § 155.30 (McKinney 1975).

¹⁰³15 U.S.C. § 80b-3(e) (1982).

¹⁰⁴*Lowe*, 725 F.2d at 894.

¹⁰⁵*Id.*

¹⁰⁶*Id.* at 895. Although the SEC's revocation of Lowe's registration as an investment adviser was based on Lowe's convictions in 1977 and 1978, see *supra* note 102, Lowe was subsequently convicted in New Jersey of two charges of theft by deception in the third degree. *Lowe*, 725 F.2d at 895. These subsequent convictions stemmed from Lowe's fraudulent misrepresentations that checks drawn on his personal account and on one of Lowe Publishing Corp.'s accounts were good and negotiable. *Id.* Thus, Lowe was convicted of violating N.J. STAT. ANN. § 2C:20-4 (West 1982).

¹⁰⁷*Lowe*, 725 F.2d at 895.

¹⁰⁸*Id.*

¹⁰⁹*Id.*

desirability of investing in, among other things, stocks, Treasury bills, and money market funds and generally described the state of the market.¹¹⁰ It also recommended particular stocks and groups of stocks for purchase or sale.¹¹¹ The typical *Lowe Stock Advisory* had a brief introductory examination of general market trends followed by specific purchase, sale, and hold recommendations, particularly for low-priced stocks.¹¹²

Because Lowe continued to publish his investment newsletter in violation of the SEC's order, the SEC brought a civil action in the United States District Court for the Eastern District of New York seeking to enjoin Lowe and his corporations from publishing investment advisory materials.¹¹³ The SEC alleged that Lowe violated the Act by engaging in the business of an investment adviser without being registered,¹¹⁴ by not disclosing¹¹⁵ to newsletter subscribers Lowe's criminal conviction and the SEC's 1981 order, and by publishing investment newsletters in violation of the 1981 order, which is judicially enforceable¹¹⁶ under the Act.¹¹⁷ Lowe, on the other hand, contended first that the revocation of his registration as an investment adviser violated his first amendment rights of free speech and press; second, that the Act's exclusion for bona fide newspapers was unconstitutionally discriminatory and therefore violated his fifth amendment equal protection rights; and third, that the Act was facially unconstitutional under the first amendment.¹¹⁸

The district court, in reaching its decision, avoided the first amendment issue by utilizing a novel interpretation of the Act. The court stated that "[t]he Act is construed to require registration of publishers of impersonal investment material, but is not interpreted to empower the Commission to deny registration to such publisher...nor to revoke their registration previously granted."¹¹⁹ Thus, the district court concluded that Lowe was required to register, but the SEC could not revoke Lowe's registration or apply other sanctions as long as the

¹¹⁰*Id.*

¹¹¹*Id.*

¹¹²*Id.*

¹¹³ SEC v. Lowe, 556 F. Supp. 1359, 1360 (E.D.N.Y. 1983).

¹¹⁴ 15 U.S.C. § 80b-3(c) (1982).

¹¹⁵ *Id.* at § 80b-6.

¹¹⁶ *Id.* at § 80b-9.

¹¹⁷ *Lowe*, 556 F. Supp. at 1362.

¹¹⁸ Petition for Writ of Certiorari at 6, SEC v. Lowe, 725 F.2d 892 (2d Cir. 1984), *cert. granted* 53 U.S.L.W. 3204 (U.S. Oct. 2, 1984) (No. 83-1911).

¹¹⁹ *Lowe*, 556 F. Supp. at 1369. The district court construed the Act in this manner because of the constitutional avoidance doctrine, which requires a court to first ascertain whether a construction of the statute is fairly possible which will result in the avoidance of the constitutional question. *Id.* at 1368.

record, reporting and disclosure requirements of the Act were complied with.¹²⁰ Furthermore, the court concluded that Lowe's failure to disclose his prior criminal convictions did not violate the antifraud provisions of the Act.¹²¹ Although the district court upheld the constitutionality of the Act,¹²² it refused to enjoin Lowe from publishing his investment newsletters since those newsletters contained only "impersonal investment material."¹²³

The United States Court of Appeals for the Second Circuit rejected the district court's construction of the Act¹²⁴ and reversed the lower court's decision.¹²⁵ The court of appeals first concluded that Lowe's publications did not meet the exclusion for bona fide newspapers and, therefore, Lowe was subject to the registration requirements of the Act.¹²⁶ The court next concluded that the Act, on its face, did not abridge freedom of the press.¹²⁷ In rejecting Lowe's first amendment challenge, the court relied heavily on Wall Street Transcript.¹²⁸ Despite acknowledging that Wall Street Transcript was decided prior to Virginia Pharmacy,¹²⁹ the court nevertheless held that Wall Street Transcript was still good law.¹³⁰ The court stated that "government does not lose its power to regulate commercial activity deemed harmful to the public whenever speech is a component of that activity."¹³¹

¹²⁰*Lowe*, 556 F. Supp. at 1369. The result of the district court's decision was that certain provisions of the Act would not apply to publishers of investment newsletters. The Act, however, makes no distinction between personal and impersonal advice. Thus, although the district court's construction may be an effective way for Congress to regulate investment advisers without contravening the first amendment, the construction is simply not warranted on the face of the Act.

¹²¹*Id.* at 1370.

¹²²*Id.* at 1368.

¹²³*Id.* at 1369.

¹²⁴*Lowe*, 725 F.2d at 896.

¹²⁵*Id.* at 902.

¹²⁶*Id.* at 898.

¹²⁷*Id.* at 901.

¹²⁸422 F.2d 1371 (2d Cir.), *cert. denied* 398 U.S. 958 (1970). *See supra*, notes 48-63 and accompanying text.

¹²⁹425 U.S. 748 (1976).

¹³⁰*Lowe*, 725 F.2d at 899.

¹³¹*Id.* (emphasis in original) (quoting *Ohralik v. Ohio State Bar Association*, 436 U.S. 447, 456 (1978)).

The court then held that Lowe's first amendment rights were not violated either by the SEC's revocation of Lowe's registration, or by a permanent injunction preventing Lowe from publishing investment advisory newsletters in the future.¹³² Finally, the court rejected Lowe's equal protection challenge to the Act's bona fide newspaper exclusion stating that this conclusion was compelled by its earlier holding that the first amendment does not prohibit the regulation of investment newsletters since those newsletters constitute commercial activity.¹³³

Despite the inviting opportunity to decide whether investment newsletters fall within the protected realm of commercial speech, the United States Supreme Court, in *Lowe*, avoided this issue and held that the publisher of impersonal investment advice is not an investment adviser under the Act.¹³⁴ The Court reasoned that Congress, being sensitive to the first amendment, did not intend to regulate the press by licensing nonpersonalized publishing activities.¹³⁵ Therefore, the Court concluded that Lowe's publications fell within the Act's bona fide newspaper exclusion.¹³⁶

In reaching its decision, the Court engaged in an extensive discussion of the legislative history of the Act.¹³⁷ However, the Investment Advisers Act was passed as part of a larger package which also contained the Investment Company Act of 1940.¹³⁸ The Investment Company Act also contains a definition of investment adviser.¹³⁹ That definition, however, specifically excludes "a person whose advice is furnished solely through uniform publications distributed to subscribers thereto."¹⁴⁰ Thus, the Court's use of broad statements from the legislative history which applied to both the Investment Advisers Act as well as the Investment Company Act is of dubious validity.

¹³²*Lowe*, 725 F.2d at 902.

¹³³*Id.* at 900 n.5.

¹³⁴*Lowe*, 105 S.Ct. at 2573-74.

¹³⁵*Id.* at 2570.

¹³⁶ *Id.* at 2573. Although the Court's interpretation of the Act is similar to the district court's interpretation, the two interpretations are distinct. The district court held that publishers of impersonal advice are investment advisers and subject to the registration requirements of the Act, but that certain provisions of the Act could not be applied to publishers of impersonal advice. *Lowe*, 556 F. Supp. at 1369. The Supreme Court, on the other hand, held that publishers of impersonal advice are not investment advisers and therefore are not subject to any of the provisions of the Act. *Lowe*, 105 S.Ct. at 2573-74.

¹³⁷*Lowe*, 105 S.Ct. at 2563-69.

¹³⁸ 15 U.S.C. §§ 80a-1 to 80a-64 (1982).

¹³⁹*Id.* at § 80a-2(a)(20).

¹⁴⁰*Id.* at § 80a-2(a)(20)(B)(i).

Accordingly, Justice White, in his concurring opinion, refers to the legislative history relied on by the Court as “a hodge-podge of materials that are either completely irrelevant or reflect approaches that were explicitly rejected by the framers of the statute.”¹⁴¹ Furthermore, the Court itself recognized that “neither the text of the Act nor its legislative history defines the precise scope of [the bona fide newspaper] exclusion.”¹⁴²

The Court further supported its interpretation of the Act by stating that Congress did not intend to subject investment newsletter publishers to the Act because of the possibility that the registration requirement would be an unconstitutional prior restraint on freedom of the press.¹⁴³ However, such an assumption about Congress' intent is not only speculative, it is highly unlikely in view of the fact that commercial speech was not protected by the first amendment until thirty-six years after the Act was passed.¹⁴⁴ Indeed, the Court itself has noted that “[n]umerous examples . . . of communications . . . are regulated without offending the first amendment, such as the exchange of information about securities, . . . corporate proxy statements, . . . the exchange of price and production information among competitors, . . . and employers threats of retaliation for the labor activities of employees.”¹⁴⁵

Similarly, Justice White criticized the Court's assumption of Congressional intent as reasoning which begs the question.¹⁴⁶ Justice White stated:

What we have been called on to decide in this case is precisely whether restraints on [Lowe's] publications are unconstitutional While purporting not to decide the question, the Court bases its statutory holding in large measure on the assumption that Congress already knew the answer to it when the statute was enacted If the policy of constitutional avoidance amounts to no more than a preference for implicitly

¹⁴¹*Lowe*, 105 S.Ct. at 2579 n.7 (White, J., concurring).

¹⁴²*Id.* at 2570.

¹⁴³*Id.* at 2570-71 and n.50.

¹⁴⁴*See supra* notes 63-64 and accompanying text.

¹⁴⁵*Ohralik*, 436 U.S. at 456 (citing *SEC v. Texas Gulf Sulphur Corp.*, 401 F.2d 833 (2d Cir. 1968), *cert. denied* 394 U.S. 976 (1969); *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375 (1970); *American Column & Lumber Co. v. United States*, 257 U.S. 377 (1921); *NLRB v. Gissel Packing Co.*, 395 U.S. 575

¹⁴⁶*Lowe*, 105 S.Ct. at 2582 (White, J., concurring).

deciding constitutional questions without explaining our reasoning, and if the consequences of adopting the policy is a statutory decision more disruptive of the legislative framework than a decision on the narrow constitutional issue presented, the purposes underlying the policy have been ill-served.¹⁴⁷

Justice White then addressed the constitutionality of the Act¹⁴⁸ and concluded that the registration requirement does not violate the first amendment.¹⁴⁹ However, because the means chosen to regulate *Lowe* were extreme,¹⁵⁰ Justice White concluded that the Act was unconstitutionally applied to *Lowe*.¹⁵¹ Accordingly, he agreed with the Court's result.¹⁵²

Despite the dubious support which the Court used to reach its holding in *Lowe*,¹⁵³ the inevitable effect of the holding is that the SEC has been stripped of its most powerful tool for regulating the conduct of investment newsletter publishers. Because such publishers are no longer regulated by the Investment Advisers Act, the SEC must find other vehicles for regulating fraud, scalping,¹⁵⁴ and other misdeeds committed by investment newsletter publishers. Although the *Lowe* Court suggested some alternatives,¹⁵⁵ these alternatives are an inadequate means of regulating investment newsletter publishers.

III. REGULATION OF INVESTMENT NEWSLETTER PUBLISHERS AFTER *Lowe*

The *Lowe* Court, recognizing the impact which its holding would have on the SEC's regulatory power, indicated that other remedies against scalping are available for the protection of investors.¹⁵⁶ The Court stated that "[t]he mail-fraud statute would certainly be available for many violations, and the SEC has recently had success using § 10b-5 against a newsletter publisher."¹⁵⁷ However, scalping is not the only unscrupulous practice which

¹⁴⁷*Id.*

¹⁴⁸*Id.* at 2582-87.

¹⁴⁹*Id.* at 2586-87.

¹⁵⁰*Id.* at 2586.

¹⁵¹*Id.* at 2587.

¹⁵²*Id.*

¹⁵³*See supra* text accompanying notes 134-49.

¹⁵⁴For a description of scalping, see *supra* note 11.

¹⁵⁵*Lowe*, 105 S.Ct. at 2573 n.56.

¹⁵⁶*Id.*

¹⁵⁷*Id.* The mail fraud statute can be found at 18 U.S.C.A. §§ 1341-1345 (1984 & Supp. 1985). Section 10b-5 referred to by the Court is a provision in the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1982).

newsletter publishers engage in.¹⁵⁸ Furthermore, the usefulness of these remedies in many scalping situations is at best questionable, and at worst, completely unavailable.

A. *The Mail Fraud Statute*

The mail fraud statute¹⁵⁹ makes it unlawful for any person to devise a scheme or artifice to defraud and use the mails to carry out that scheme or artifice.¹⁶⁰ The essential elements of a violation of the mail fraud statute have been stated as follows:

- [1] the act of having devised or intended to devise a scheme or artifice to defraud; [2] the act of placing or causing to be placed in an authorized depository for mail matter a letter intended to be sent or delivered by the post office; and [3] the willful use of the mails with the specific intent to carry out some essential step in the scheme or artifice to defraud.¹⁶¹

Thus, the mail fraud statute requires a willful and intentional use of the mails in carrying out a scheme to defraud.

Although this statute may be effective in preventing some occurrences of scalping, it is plainly lacking in many other respects. Most notably, the requirement that the mails be used is irrelevant to the protection of the investing public against the misdeeds of investment publishers. For example, the mail fraud statute would not be

¹⁵⁸ Investment newsletters provide ample opportunity for fraud by misleading subscribers about the success rates of the publications' predictions as well as the approval of the publications by prominent economists, business executives and other important financial figures. *See, e.g.*, SEC v. Suter, 732 F.2d 1294, 1296-98 (7th Cir. 1984). Furthermore, investment newsletters can cause a great deal of harm to subscribers simply by providing incorrect information without any intent to deceive or mislead.

¹⁵⁹ 18 U.S.C.A. §§ 1341-1345 (1984 & Supp. 1985).

¹⁶⁰ 18 U.S.C.A. § 1341 (1984) provides:

Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, or to sell, dispose of, loan, exchange, alter, give away, distribute, supply, or furnish or procure for unlawful use any counterfeit or spurious coin, obligation, security, or other article, or anything represented to be or intimated or held out to be such counterfeit or spurious article, for the purpose of executing such scheme or artifice or attempting so to do, places in any post office or authorized depository for mail matter, any matter or thing whatever to be sent or delivered by the Postal Service, or takes or receives therefrom, any such matter or thing, or knowingly causes to be delivered by mail according to the direction thereon, or at the place at which it is directed to be delivered by the person to whom it is addressed, any such matter or thing, shall be fined not more than \$1,000 or imprisoned not more than five years, or both.

¹⁶¹ United States v. States, 362 F. Supp. 1293, 1297 (E.D. Mo.), *aff'd*, 488 F.2d 761 (8th Cir. 1973), *cert. denied* 417 U.S. 909 (1974).

available against a publisher who sells an investment newsletter at a newsstand or by some means other than the mails.¹⁶² Furthermore, the mail fraud statute requires that there be some fraud; the statute does not protect investors from the harms caused by the knowing dissemination of completely erroneous information. As a result, a violation of the mail fraud statute is more difficult to prove than a violation of the Investment Advisers Act.¹⁶³ Finally, the mail fraud statute provides a remedy only after the fraud has occurred. The Investment Advisers Act, on the other hand, provides a prophylactic mechanism¹⁶⁴ which facilitates prevention of fraud before it occurs.

B. Rule 10b-5

Section 10(b) of the Securities Exchange Act of 1934¹⁶⁵ states that it is unlawful for any person "[t]o use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe."¹⁶⁶ Rule 10b-5,¹⁶⁷ which was promulgated pursuant to section 10(b), prohibits material misstatements and omissions as well as fraudulent acts in connection with the purchase and sale of securities.¹⁶⁸ Rule 10b-5 has long been the cornerstone of fraud liability in securities transactions.¹⁶⁹ However, Rule 10b-5, like the mail fraud statute, is an inadequate mechanism for regulating fraud, scalping and other misdeeds committed by investment newsletter publishers.

An enforcement action by the SEC under Rule 10b-5 has problems similar to those confronted in an

¹⁶²Some possible examples of distributing newsletters by means other than the mails include the use of private carriers, such as Federal Express, as well as the use of personal computer hookups.

¹⁶³For example, § 80b-6(2) of the Act does not require a showing of acienter. See *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 200-01 (1963).

¹⁶⁴15 U.S.C. § 80b-3 (1982).

¹⁶⁵15 U.S.C. §§ 78a-78kk (1982).

¹⁶⁶*Id.* at § 78j(b).

¹⁶⁷17 C.F.R. § 240.10b-5 (1985).

¹⁶⁸*Id.*

¹⁶⁹See, T. HAZEN, *THE LAW OF SECURITIES REGULATION* §§ 13.2-13.12 (lawyer's ed. 1985).

action under the mail fraud statute.¹⁷⁰ For example, an enforcement action under Rule 10b-5 requires a showing of scienter,¹⁷¹ whereas an enforcement action under section 80b-6(2) of the Investment Advisers Act does not require a showing of scienter.¹⁷² In addition, a Rule 10b-5 action requires that the fraud be "in connection with" the purchase or sale of a security.¹⁷³ The Investment Advisers Act, on the other hand, has no requirement comparable to the "in connection with" requirement of Rule 10b-5.¹⁷⁴ Finally, Rule 10b-5, like the mail fraud statute, provides a remedy only after the fraud has occurred. The registration requirement of the Investment Advisers Act, on the other hand, enables the SEC to prevent fraudulent and manipulative conduct before it occurs.

IV. PROPOSALS

A. Amendments to the Investment Advisers Act

Given the difficulties in regulating investment newsletter publishers under the mail fraud statute and Rule 10b-5, the *Lowe* Court's suggestion that other remedies against scalping are available to the SEC is not very reassuring. Nevertheless, the opportunities for improper personal gain by investment newsletter publishers are as prevalent as before. Furthermore, many of these newsletters, because of the *Lowe* decision, are subject to less regulation than ever before. Accordingly, Congress should enact the following changes to the Investment Advisers Act¹⁷⁵ which would bring publishers of investment newsletters back within the scope of the Act without granting the SEC enforcement power which would violate the first amendment rights of newsletter publishers.

First, the definition of investment adviser¹⁷⁶ should be changed to read as follows:

"Investment adviser" means any person who, for compensation, directly engages in the business of advising others as to the value of securities or as to the advisability of investing in, purchasing, or selling securities; but does not include . . . (D) any investment advisory publisher . . .

¹⁷⁰ See supra notes 151-53 and accompanying text.

¹⁷¹ See *Aaron v. SEC*, 446 U.S. 680, 691 (1980).

¹⁷² See *Capital Gains Research*, 375 U.S. at 200-01.

¹⁷³ 17 C.F.R. § 240.10b-5 (1985).

¹⁷⁴ See, e.g., 15 U.S.C. § 80b-6 (1982).

¹⁷⁵ Although the SEC has authority to promulgate rules and regulations under the Act, 15 U.S.C. § 80b-11 (1982), the changes proposed in this note would have to be legislated by Congress because of the *Lowe* Court's holding that a publisher of impersonal investment advice does not fall within the Act's definition of investment adviser. *Lowe*, 105 S.Ct. at 2573-74. If these changes were implemented by an SEC rule, then the SEC's interpretation of the Act's definition of investment adviser would be in direct conflict with the Supreme Court's interpretation of that definition.

¹⁷⁶ 15 U.S.C. § 80b-2(x)(11) (1982)

Next, the following definition of "investment advisory publisher" should be added to the definitions section¹⁷⁷ of the Act:

"Investment advisory publisher" means the publisher of any newspaper, news magazine or business or financial publication who renders impersonal investment recommendations or issues or promulgates analyses or reports concerning securities and who does not otherwise qualify as an investment adviser as defined in this section.

Once this distinction is made between investment advisers and investment advisory publishers, the registration and reporting requirements¹⁷⁸ of the Act would be applicable only to investment advisers and not investment advisory publishers. In addition, the SEC's power to impose sanctions¹⁷⁹ on investment advisers who do not render impersonal investment advice through publications would remain unchanged.

Finally, the following liability provision, which would be applicable to investment advisory publishers, should be added to the Act:

-

It shall be unlawful for any investment advisory publisher, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails,

- (a) To employ any device, scheme or artifice to defraud,
- (b) To publish any untrue statement of a material fact or to omit to publish a material fact necessary in order to make the published statements, in the light of the circumstances under which they were published, not misleading, or
- (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.

It shall not be necessary, in order to prove a violation of this section, to show that the investment advisory publisher acted with scienter.

¹⁷⁷*Id.* at § 80b-2.

¹⁷⁸*Id.* at § 80b-3(c).

¹⁷⁹*Id.* at § 80b-3(e).

This section would allow the SEC to bring an enforcement action against investment advisory publishers who engage in fraud or scalping. Although this section closely resembles Rule 10b-5, it does not contain the "in connection with" requirement,¹⁸⁰ nor does a violation of this section require a showing of scienter.¹⁸¹ Finally, as an additional deterrent to unscrupulous behavior by investment advisory publishers, Congress should explicitly provide the victims of fraud and scalping with a private right of action against investment advisory publishers.¹⁸²

B. Constitutionality of the Proposed Amendments

If the proposed amendments to the Act are enacted, the liability provision for investment advisory publishers would almost certainly be challenged as having an unconstitutional chilling effect on investment advisory publisher's first amendment rights. Given that investment newsletters constitute commercial speech,¹⁸³ the test announced in *Central Hudson*¹⁸⁴ must be applied to the proposed amendments in order to determine their constitutional validity. In *Central Hudson*¹⁸⁴ the Court stated that, for commercial speech to be protected by the first amendment,

it at least must concern lawful activity and not be misleading. Next, we ask whether the asserted governmental interest is substantial. If both inquiries yield positive answers, we must determine whether the regulation directly advances the governmental interests asserted, and whether it is not more extensive than is necessary to serve that interest.¹⁸⁵

Thus, the crucial issue becomes whether the regulatory scheme, as changed by the proposed amendments to the Act, would be upheld under the *Central Hudson* test.

First, stock market newsletters concern lawful activity: investing in the market. Because the *Central Hudson* test requires that the speech must not be misleading, the liability provision which proscribes fraudulent, deceptive or manipulative conduct is constitutionally valid as applied to newsletters. Thus, under the *Central Hudson* test,

¹⁸⁰ See supra text accompanying note 173.

¹⁸¹ See supra note 171 and accompanying text.

¹⁸² The United States Supreme Court has explicitly rejected the notion that an implied private right of action exists under the current antifraud provisions of the Act. *Transamerica Mortgage Advisors, Inc. v. Lewis*, 444 U.S. 11, 24 (1979).

¹⁸³ See supra notes 64-96 and accompanying text.

¹⁸⁴ 447 U.S. 557 (1980).

¹⁸⁵ *Id.* at 566.

the SEC is not prevented from protecting investors from false or misleading statements regarding securities.¹⁸⁶ Furthermore, the second part of the test is met because the government's interest in deterring scalping and in protecting investors from being victimized by frauds and misrepresentations of investment advisory publishers are clearly substantial.¹⁸⁷ Therefore, the first two prongs of the *Central Hudson* test yield positive answers.

The *Central Hudson* test next requires the determination of whether the regulation directly advances the asserted governmental interests.¹⁸⁸ Subjecting investment advisory publishers to enforcement actions by the SEC under the Act directly advances the government's interests in deterring fraud and scalping. Thus, the proposed amendments enable the SEC to more easily deter improper behavior by investment advisory publishers.¹⁸⁹

Finally, the *Central Hudson* test requires that the regulation must be no more extensive than necessary to further the governmental interests.¹⁹⁰ The proposed amendments place virtually no burden on investment advisory publishers while greatly facilitating the SEC's ability to deter fraud and scalping.¹⁹¹ Thus, the proposed amendments to the Act are no more extensive than necessary to achieve the governmental interests.

¹⁸⁶15 U.S.C. § 80b-9(e) (1982) expressly provides the SEC with the power to bring an action for injunctive relief, "[w]henver it shall appear to the Commission that any person has engaged, is engaged, or is about to engage in any act or practice constituting a violation of any provision of [the Investment Advisers Act of 1940]." *Id.*

¹⁸⁷*See supra* notes 8-11 and accompanying text for an illustration of the impact which an unscrupulous investment newsletter publisher can have.

¹⁸⁸*Central Hudson*, 447 U.S. at 566.

¹⁸⁹*See supra* text accompanying notes 180-81.

¹⁹⁰*Central Hudson*, 447 U.S. at 566.

¹⁹¹Clearly, the SEC's ability to regulate investment advisory publishers would be greatly enhanced by subjecting such publishers to a registration requirement. However, the *Lowe* Court itself suggested that a registration requirement would be unconstitutional. *Lowe*, 105 S.Ct. at 2570. The Court cited *Lovell v. City of Griffin*, 303 U.S. 444 (1938), in support of its conclusion that the drafters of the Act could not have intended the Act to apply to publishers of investment newsletters. Justice White criticized the use of *Lovell*, which struck down an ordinance prohibiting the distribution of literature within the city without a permit, as reasoning which "begs the question." *Lowe*, 105 S.Ct. at 2582 (White, J., concurring). *See supra* text accompanying notes 146-47. Regardless of Justice White's criticism, the Court's use of *Lovell* implicitly suggests that the Court would not uphold a registration requirement for investment newsletter publishers.

CONCLUSION

By utilizing a narrow interpretation of the Investment Advisers Act of 1940 in *Lowe*, the United States Supreme Court avoided some difficult constitutional issues. However, the Court pushed the constitutional avoidance doctrine too far and left a substantial portion of investment advisers largely unregulated. Despite the Court's assurances, the remaining alternatives for the regulation of investment newsletter publishers are, to a great extent, inadequate. Accordingly, Congress should enact the amendments to the Investment Advisers Act which are proposed in this note. By adopting these changes, investment newsletter publishers will be adequately regulated by the SEC, without an unconstitutional infringement on those publishers' first amendment rights.

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