

CHAPTER XI

ON AMENDING THE LAW

On March 13, 1939, representatives of fifteen stock exchanges attended a conference in Washington, D.C., called by the chairman of the Stock List Committee of the New York Stock Exchange. The S.E.C., which had been holding regular round-table conferences with the New York Stock Exchange for many months, was not informed of the nature of the meeting. The newspapers hinted that its purpose was to attempt to secure amendments to the S.E.C. statutes. The committee deliberated for two days and on the evening of March 14 made public a report, a copy of which was sent to the S.E.C. The report proposed the amendment of the anti-manipulative provisions and four other sections of the Securities Exchange Act, as well as certain provisions of the Securities Act. The next day, March 15, the Commission replied to the committee's report with the following statement. [FN 1]

Securities and Exchange Commission has received the report of the committee, headed by John M. Hancock of Lehman Brothers, proposing amendments to the Federal securities acts. We have considered those proposals and make the following observations as respects the chief one.

The chief proposal of this committee is a relaxation of the law against market manipulation. Stripped of its legal phraseology, this proposal would bring the pool operator back into the market. This strikes at the very heart of stock-market regulation. The Securities and Exchange Commission is unalterably opposed to any attempt to legalize manipulation in the stock market. The finding of Congress in 1934 [FN 2] is the conviction of the S.E.C. today, after five years of experience with the law.

This proposal is presented on the ground that it will aid the capital markets. The S.E.C. is deeply concerned with the problem of maintaining a free flow of capital, from the savings of the investor through to the productive channels of industry. To this end the Commission is vitally interested in stimulating the confidence of investors in the securities of American industry. But this Commission cannot stand idly by while any attempt is made to bring investors back into the market on a 1929 basis. Such a proposal would redound only to the benefit of those whose primary interest is served by an increased volume of trading — the broker to whom more trading means quicker profits, the insider, and the market rigger — not American industry nor American investors. Sound recovery cannot be had through the use of injurious stimulants.

The law as it stands today has for five years been increasingly effective in protecting the stock market against manipulation. The modification suggested by the Hancock Committee would weaken the law and make its enforcement exceedingly difficult.

The recommendation would first make the prohibitions against market rigging dependent upon rules drafted by the Commission. The committee asks clarification of the law in the interests of certainty. The proposal, however, only adds uncertainty and confusion by superimposing on the present single statutory test of purpose additional tests of a far more indefinite nature; e.g., the committee's proposed standard of purchases or sales "for the purpose of unduly or improperly influencing the market price of such security." Furthermore, it would make enforcement of the rules dependent upon standards of conduct so indefinite and so subject to differences of opinion as to render the protection of the statute illusory.

The Hancock Committee's suggestion would inevitably involve the Commission in a determination of appropriate price levels for securities bought and sold in our markets, if not in the actual evaluation of such securities. Such activities on the part of the Commission would be directly contrary to one of the basic philosophies of our Federal securities legislation. The proposal would also call upon the Commission to foresee and define every conceivable variety of manipulation. Such a procedure might well result in the ceaseless invention of new techniques to evade regulation. It is in recognition of such human ingenuity that our courts have consistently declined to lay down hard and fast definitions of fraud that might in any way be relied upon as delimiting precedents in future cases involving new and different schemes.

The present prohibition was placed in the statute by Congress as a guarantee against manipulation. To alter the provisions of the statute on this point would involve a change in national policy with respect to manipulation of our public-securities markets. No longer would manipulation be outlawed as a matter of national policy, but the definition and prohibition of manipulation would be left to the discretion of the Commission. Out of almost five years of administrative experience the Commission finds no evidence to indicate and no reason to believe that market manipulation would be less of an abuse today than it was prior to the passage of the Act.

Weakening our safeguards against market rigging will not contribute to business recovery. On the contrary, it will serve to destroy whatever investor confidence has been built up through efforts to clean up the stock exchanges. It will not produce "healthy buying power."

It is interesting to note that the proposal to permit market rigging and pool operations is accompanied by another proposal which would exculpate the corporate insider who wishes to take personal and private advantage of his inside information. Let us not forget that stock-market pools were often the most successful for the manipulator when he worked hand in glove with the corporate insider.

Similarly it is interesting to note that some of the other proposals of the Hancock Committee (such as those dealing with gross sales and cost of sales) go principally to a reduction in the amount of information available to stockholders and the investing public. A stripping away of the protection against pools, a nullification of corporate insiders' responsibilities to their stockholders, and a curtailment of truth to investors — these are not harmonious with old-fashioned, conservative standards for finance.

[NOTE: PAGES MISSING]

tion plans. Our policy in this, as in all matters under the Act, is to place our staff at the industry's disposal with a view to discussing their problems informally. Thus when a plan is presented to the Commission, the applicant will have had the views of the staff concerning the equities of the situation and the requirements of the law. To be sure, the ultimate decision will rest with the Commission. Nevertheless, we feel that this is a helpful procedure. It tends to overcome the frequent complaint of businessmen that they can never get from an administrative department of the Government an indication as to whether or not a proposed course of action is in the right direction.

Many members of the industry have already expressed their realization that cooperation is an effective technique. It is needless to emphasize that this job must be done. We have urged the industry to assume leadership. And that leadership seems to be emerging. But whoever leads, this job remains as one of the most pressing ones.

[FN 1] Mr. Douglas met the newspaper correspondents to give them the statement of the Commission. Discussing the committee's report, he pointed out at the outset that the only comment authorized by the Commission was its prepared statement and asked that his remarks be "off the record." In the course of the discussion, however, at the request of the newspapermen he granted permission to quote certain of his observations. The stenographic transcript of this portion of the press conference is here quoted:

Mr. Douglas: "So, again, not speaking in terms of motives, not attacking the Hancock Committee — because I haven't discussed this with them at all — but

just looking at the end result, if you try to measure this in terms of a program for business recovery, all I can say is that it is a 'phony'."

Chorus of Questions: "Can we quote you on that?"

Mr. Douglas: "That's right, you can quote me on that. Furthermore — "

[At this point, at the continued request of the gentlemen of the press, the reporter began to read, as follows: "If you try to measure this in terms of a program for business recovery."]

Mr. Douglas: "Put it this way, if it is set up as a business recovery program it is a 'phony,' or, it would be a 'phony' on any standards of a business recovery program.

"Again, I am not attacking anywhere along the line the motives of these men. They have their own ideas and they are entitled to express them."

Q. "Could we quote you as saying you are not attacking the motives?"

Mr. Douglas: "Oh, sure. I never talked with them about this. They probably feel very keenly about this and they have set convictions. They have stated them. Well, we are stating ours for what they are worth. And I will tell you this, that if you got this program intelligently interpreted to the American public they would turn it down a hundred to one; there is no question about it. Because there is nothing in here for the investor. You can write that down in your hat, there is nothing in here for the investor."

[FN2] House Report No. 1383," 73d Congress, 2d Session, p. 10.