

March 23, 1935.

John J. Burns, Esq.,
General Counsel,
Securities and Exchange Commission,
Washington, D. C.

Dear Judge Burns:

Replying to your letter of March 16th permit me to state that I brought your letter before the Investment Bankers Code Committee, and after a discussion of the matter I was directed to make you the following reply.

We wish to call your attention to sections 2, 3, and 4 of Article VI of the Investment Bankers Code which provide: First, that upon confirming any customer's order for the purchase or sale of any security unless the investment banker is acting as agent, he shall, as part of his written confirmation of the order, inform the customer of the fact that he is to act as a principal in the transaction. Secondly, that at or before the completion of a transaction with a customer an investment banker must deliver to the customer a written memorandum of the transaction which states, amongst other things, whether the investment banker acted as principal or as agent for the customer in the transaction. Thirdly, that if in any transaction involving the purchase or sale of any security the investment banker purports to act as an agent to buy or sell on behalf of a customer, such investment banker shall not act as a principal in such transaction, nor, without the consent of his customer, represent any other principal in such transaction.

The following general rules of law are well settled. First, that a broker in securities who has been employed to act as agent of a customer to effect the execution of an order for the purchase or sale of certain securities may not, without the full knowledge and consent of his customer, sell to or buy from himself; that is, if he has been instructed to buy he may not himself supply the securities needed to fill the order, and if he has been instructed to sell he may not himself purchase the securities which his customer wishes to sell. Secondly, that for any wrongful act in this regard on the part of the broker the customer has the privilege of election, upon discovery of the fact, either to adopt or to repudiate the unauthorized act of his broker. Thirdly, that the right to repudiate is unaffected by the question of whether or not the customer has sustained a loss. Fourthly, that the right to repudiate may be exercised whenever the facts come to the customer's knowledge, regardless of how long that may be after the execution has been made. Fifthly, that the customer may, of course, ratify any execution which the broker purports to make on his behalf, even if improper, in which event the customer will be entitled to the benefit of it. Sixthly, that if the broker is also a dealer in securities for his own account, he may sell

March 23, 1935.

his own securities to the customer or buy the customer's securities, provided, of course, that the customer understands that the broker is dealing for himself. Meyers, Law of Stockbrokers, Sections 51, 100, and 135.

From the standpoint of the Code a customer's right either to repudiate or to adopt the execution of an agency order executed at variance with the customer's instructions or in contravention of the broker's legal duties is derived from and depends entirely upon the general law of the land. It is precisely that, no more and no less. The function of the Code Rule in this connection is simply to provide the customer with proper information so that with a knowledge of the facts he may exercise his full legal rights and remedies.

Under the Code the disclosure of the capacity, in which the investment banker is acting in any given transaction, must be given "at or before the completion of the transaction" with the customer. In the opinion of the Code Committee, as between the investment banker and his customer the transaction is not completed until there has been a delivery of the security and payment made therefor. Accordingly, if the required notice is given as part of the confirmation prior to such delivery and payment, it would seem clear that the rights of the customer are fully protected.

The information required by the Code to be disclosed to the customer as to whether the investment banker is acting as principal or as agent is, we believe, information that generally has been given and understood. The importance and advantage of this Code Rule, from the standpoint of the investment banking business, is that it establishes a nationally uniform practice, and when the customer receives the confirmation, if it states the status of the investment banker as different than the customer understood it, the customer can raise the point with reasonable promptness and any misunderstanding may be adjusted immediately, which is generally the best time to settle misunderstandings. In this sense the Rule is a protection both to the customer and to the investment banker.

As yet no actual case has been brought before the Code Committee involving the questions discussed in this letter, but it is the general sense of the Committee that the views herein expressed are sound and correct, and would be recognized as controlling in any case that might arise under the Code.

Yours very truly,

Paul V. Keyser

Counsel for the
Investment Bankers Code Committee.