MEMORANDUM OF CONFERENCE

December 17, 1938

PLACE: Office of the President of the New York Stock Exchange

TIME: 12:15 P.M., December 16, 1938

PRESENT: Mr. William McChesney Martin, Jr., President, New York Stock Exchange;
Mr. Paul V. Shields, Member of the Board of Governors of the New York Stock Exchange and Member of the Committee on Public Relations
Mr. William O. Douglas, Chairman of the Securities and Exchange Commission;
Mr. Ganson Purcell, Director, Trading and Exchange Division, Securities and Exchange Commission.

Following a brief discussion of sundry matters of relatively minor concern, Mr. Shields suggested that the Chairman be shown a letter which had been prepared for mailing to the Chairman by Mr. Martin concerning the action of the Board of Governors relative to certain personalities in the Whitney case. The Chairman read the letter and returned it to Mr. Martin with the suggestion that it be sent to him in Washington by mail.

The writer did not see the letter. It is my understanding, however, that the letter stated that after due consideration at its regular meeting on December 14, 1938, the Board of Governors -- 29 members present -- voted not to take any disciplinary action or to recommend any further investigation or hearing with respect to the activities of the persons whose testimony in the Commission's proceedings in the matter of Richard Whitney, et al, was referred by the Commission to the Exchange on November 1, 1938. It was noted that there was one dissenting vote and Mr. Martin and Mr. Shields stated that the Governor dissenting was President Hutchins of the University of Chicago, one of the "public Governors".

Mr. Martin stated that at least two hours' consideration was given to the matter and that the sentiment was divided somewhat as follows:

Consideration was given to the case on the basis of two rules of the New York Stock Exchange, being Sections 6 and 10 of Article XVI of the Constitution of the Exchange, as amended May 16, 1938. The first of these provides for suspension or expulsion on a finding by a majority of the Board of Governors that a member has been guilty of conduct or proceeding inconsistent with just and equitable principles of trade; the second provides for suspension not exceeding five years on a finding by the Board that any act of a member is detrimental to the interest or welfare of the Exchange.

According to Mr. Shields, a group of about ten members of the Board felt that there was no element of guilt in the conduct of any of the persons involved. It was the feeling of this group that the actions of these persons were really in the interest of the Exchange rather than detrimental to it and, in fact, that it would have been much more to the interest of the Exchange if the persons involved had been more successful in their attempts at secrecy and the whole matter had been kept from the public and quietly hushed up. The remaining majority of the Board, while differing on certain points, held generally to the view that while there probably was guilt in the sense of acts having been done which were detrimental to the interest and welfare of the Exchange, the whole matter had been given such publicity through the Commission's proceedings as to require no further inquisition or discipline and that any action that the Exchange might take would add nothing to the practical penalty already meted out by reason of the Commission's proceedings. It was stated that Mr. Hutchins held to the view, among other things, that the Exchange was a public institution whose Governors should not overlook the duty to win public confidence, if it did nothing more, through the taking of some disciplinary action against these members and non-member partners.

Mr. Martin stated that all members of the Board were agreed that expulsion of these persons was out of the question. Mr. Hutchins felt that suspension was called for, while all other members of the Board considered censure the most severe penalty that could be imposed. It was felt that the action of censure would do more to act to the discredit of the Exchange than no action at all. The alternative course of summoning the persons involved before an appropriate committee for further hearing with a view to supplementing the record submitted by the Commission was considered to be the poorest course since it would inevitably result in exoneration by the Exchange, after hearing, of persons accused of misconduct by the Commission.

It appeared that Mr. Martin's and Mr. Shields' views were those of the group other than the first ten mentioned above.

Mr. Shields stated that in his opinion this action of the Board called for reconsideration of the rules involved. He pointed out that all members of the Board felt that conduct or proceeding inconsistent with "just and equitable principles of trade" referred to conduct in connection with business dealings -- actual trading or buying and selling of securities. Hence, the rule did not encompass conduct such as failure on the part of a member to disclose to other members or to officials his knowledge of the insolvency of a fellow member or the fact that the statement of the latter's financial condition on the basis of which he was seeking unsecured loans was falsified. Mr. Shields further stated that the rule respecting acts detrimental to the interest or welfare of the Exchange had been put to a test of the severest nature and had been found completely ineffective -- this, because no member of the Board of Governors felt that the Board was qualified under the circumstances to make a determination that the acts which took place in this matter were, in fact, detrimental to that interest or welfare. In response to a question by the writer, Mr. Shields

acknowledged that the action by the Board in this case had virtually written the rule out of the Constitution, certainly as respects influential members. He said, however, as an argument in support of his contention that the rule should actually be removed from the Constitution, that it would very probably be used for the purpose of suspending an uninfluential member of the Exchange for much less cause and thus, to that extent, was a very dangerous rule. Mr. Shields at this point stated that it was his view that the thing to do was to rewrite the rules. He indicated he would like to have our suggestions on that point. Mr. Martin, however, at this time disagreed with Mr. Shields and stated that the rules in question were not at fault. He stated that in his opinion no matter how the rules had been phrased, their application to the members involved in the Whitney case would not have been made. He made it very clear that the character of the persons involved made any disciplinary action by the Exchange out of the question.

The Chairman at that point indicated that it was not a tolerable situation to have a rule which was applied only to the little fellows and not to the big shots. The Chairman ventured the guess that if he or Shields or Martin, rather than a partner of J. P. Morgan & Company, were involved, the Board would have taken vigorous disciplinary action. Both Mr. Martin and Mr. Shields agreed to this. Mr. Shields specifically stated there was no doubt in his mind but that if he rather than Lamont had been involved, the Exchange would have taken vigorous action against him. Both Martin and Shields likewise admitted that if any inconspicuous, non-influential member were involved, the Exchange, would likewise have taken prompt and vigorous action.

The Chairman then suggested that the case illustrated inadequate balance of power between government regulation and self-regulation. He asked Mr. Martin and Mr. Shields if in effect they were not stating that in cases like the Whitney case, the Exchange had to be in a

position “to pass the buck” to the SEC. Both of them stated that that unquestionably was true – that they hoped some method could be devised whereby hereafter in such cases the SEC could take direct action. This led to a discussion of the nature of the rules which the Commission could adopt. The Chairman raised the question as to whether or not the Commission had any power to adopt such rules.

Further, he pointed out the difficulty from a constitutional point of view which the Commission would have in adopting a rule with any such vague standard as conduct or proceeding inconsistent with just and equitable principles of trade. He indicated, however, that although he had not specifically discussed this question with the Commission, it was his feeling that it might well be felt necessary to adopt some appropriate rule of this character to the end that where the Exchange failed to take action or did not feel that it could, the Government would step in and impose whatever penalties seemed appropriate to it in the circumstances. Both the Chairman and the writer pointed out what had always been assumed to be the advantages which an association of private individuals possessed over the Government with respect to disciplinary action in not being bound by the requirements of legal procedure and constitutional limitations.

Speaking generally, Mr. Shields stressed the inequities flowing from the rules in question, pointing out that the wealthy and influential can escape discipline while the less fortunately placed -- the “little fellow” -- will not only invariably be visited with justified action under the rules, but may well be subjected to punishment as a result of whim or prejudice. Specifically, with respect to the Whitney matter, he pointed out that the Board had only the Commission’s record to act upon and that the transcript of testimony submitted did not, on its face, disclose guilt on the part of persons referred to, and that in the absence of further and contradictory testimony obtained as the result of Exchange hearings, the Board had no choice but

to act as it did. This, Mr. Shields pointed out, was the result of the ability of the influential to retain the most able counsel that money can buy, and to obtain the cooperation of every witness who had any knowledge of the facts in testifying to a complete lack of culpable knowledge.

At the close of the conference, the Chairman indicated that he would consider with the Commission the advisability of perfecting some Commission procedure to supplement that of the Exchange in order to provide a mechanism for proper disciplinary action in situations where the exchange's machinery failed to operate.

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Ganson Purcell
William O. Douglas