

November 11th, 1942

Mr. Frank L. Scheffey,
National Association of Securities
Dealers, Inc.,
43 Wall Street,
New York City.

Dear Frank:

As you doubtless know, the SEC staff offered its rebuttal testimony in the PSI cases last week. As I see it, they did not rebut any of the Association testimony but did, over our objection, inject a new issue.

The staff produced five witnesses. Frembd, an employee of the SEC who had testified previously, merely corrected some typographical errors on SEC exhibits. Through Charles Dunn, Fiscal Agent for the Federal Intermediate Credit Banks, the staff tried to show that members of his selling group act as agents. Mr. Stevenson of Salomon Bros. & Hutzler testified that that firm had distributed four issues on an agency basis. Austin P. Montgomery testified with respect to the manner in which he had conducted G.I. trading. We objected to this testimony as not proper rebuttal and not material. However, the staff also had Mr. Montgomery testify that complaint had been filed against him for inducing breach of contract by members of the selling and underwriting groups in PSI; that he had been compelled to sign an agreement to give up G. I. trading and that as a consequence he is going out of business.

The staff also introduced into the record the complaint against Montgomery and the agreement which he signed. We objected very strenuously to bringing in anything about the G. I. proceeding against Montgomery or anyone else, and I think it is too plain for argument that anything about these G.I. proceedings is not within the scope of the issues defined by the SEC for the PSI hearings. However, we had been given a new Examiner, who would permit the SEC staff to put in anything which it chose to offer and after taking the matter under advisement over night, he ruled against us. Then the staff offered a Mr. Sadnick, who claims to have been an employee of R. G. Ilsey & Co. since 1938 and a partner since March 1941. He testified along the same line as Montgomery and his testimony was received over our objections.

We have reserved the right to file a motion before the full Commission to strike all this testimony and, if the motion is denied, to offer surrebuttal. Of course, we used the testimony before the National Business Conduct Committee to cross examine and impeach Montgomery. To a very limited extent we used Ilsey's testimony and one statement in your testimony before the National Committee in the cross examination of Sadnick.

I imagine that in the hearings before the National Business Conduct Committee and in the various memoranda such as your memoranda of February 15, 1941, we have all the information which you possess with respect to these G. I. gentlemen. However, if that is not so, I should appreciate any additional information that you may have.

In cross examination Sadnick admitted that Ilsey had sold \$50,000 bonds short on the syndicate bid on the PSI distribution. However, he claimed not to be familiar with the details. If there is anything about this transaction which we might be able to use, I should like to know of the facts. Among other things, I should like to know the date on which the short sale was made. If you do not have those records, perhaps I can get them from Halsey, Stuart. Sadnick also testified that he never knew of a case where a party to a G. I. trade failed to make good. I questioned him about Ilsey's refusal to pay the agreed concession to Hunnewell & Co. of Boston until forced to make reimbursement to avoid the filing of a formal complaint by the Boston District Business Conduct Committee. Sadnick admitted the transaction but again professed not to know much about the details. He claimed that Ilsey was only waiting until the distribution period was completed so that it could be determined whether the bonds would come back on the market. If you happen to be familiar with the details of that transaction, I should like to have them. The only reason that I knew anything about the Hunnewell transaction was that Ilsey complained about his treatment in that transaction in his testimony before the National Committee in New York.

Very truly yours,

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P.S.....I have given you the foregoing brief summary of what happened at the hearing for rebuttal by the SEC staff with the thought that it would help you to determine whether you have any information or suggestions which might be useful in the event the Association offers surrebuttal. I do not think the evidence about the G. I. cases should be regarded as important in the PSI proceedings. However, it has no place there, and I can see no reason for dragging it in except an effort to prejudice the Association by giving only part of the picture. Consequently, I am trying to inform myself fully about the situation in order to decide whether it is wise or desirable to pay any attention to this move of the SEC staff. It was my understanding that the SEC had agreed that nothing about G. I. would be brought into this proceeding. As you probably know, none of these cases under review involved disciplinary action against a member for having entered into a G. I. transaction.

R.T.J.