MEMORANDUM

124-2

To: Louis Loss, Chief Counsel
Trading and Exchange Division

From: Gerald W. Siegel, Attorney
Trading and Exchange Division

Date: February 4, 1948

Subject: Legislative history of subsection 17(b), Securities Act of 1933.

The most significant fact discovered in the research on this subject is that there are no recorded Congressional discussions on section 17(b) of the Securities Act in either chamber, or in committee hearings.1/ The conclusion that little thought was devoted to the scope and purpose of this provision is inescapable. The halting and obfuscated development of subsequent interpretations of the section by staff members of the Commission further corroborates this impression. Resort to reports of Committee hearings, Conference reports, and the Congressional Record produced only two brief statements about section 17(b). These are both in Report No. 85, Committee on Interstate and Foreign Commerce, House of Representatives, 73rd Congress, First Session, May 4, 1933. The first, appearing on page 6 of that report under the subdivision 'General Analysis of the Bill H. R. 5480' is as follows:

"1. Scope . . . (3) Newspaper articles, "tipster sheets", and other descriptions of or comments upon securities not purporting to offer such securities for sale must disclose any financial interest of the writer or publisher in their sale."

And on p. 24 of the same report the statement is made that "This subsection is particularly designed to meet the evils of the 'tipster sheet', as well as articles in newspapers or periodicals that purport to give an unbiased opinion but which opinions in reality are bought and paid for."

On an objective reading of these statements it cannot be said that Congress intended that the provision should apply only to the more extreme artifices enumerated, such as 'tipster sheets' and newspaper articles. The committee statement as to the scope of 17(b) expressly includes the general category, 'other descriptions of or comments upon securities', and the statement as to its purpose is sufficiently broad to include all paid-for publicity, the section being designed only particularly,

1/ Insofar as 17(b) is related to investment advisers it was felt that the subject might have been discussed during the period preceding adoption of the Investment Adviser's Act; however, a search of the hearings revealed no mention of the subject.

7

not exclusively to meet the evils of the tipster sheet, and articles in newspapers and periodicals. In the Congressional Record for May 11, 1933,2/ there appeared a report prepared by William A. Gray, Counsel for the Senate Finance Committee during 1932, which was considered by the Senate. The following extracts from this report may be helpful in shedding additional light on this question.

"John J. Leavenson

"The testimony of John J. Leavenson and R. J. Cornell is illustrative of another flagrant instance of the employment of a publicity writer, and in which instance a member of a New York brokerage firm, which firm was a member of the New York Stock Exchange, was interested.

"Mr. R. J. Cornell had formerly been connected with the bureau of securities of the department of law in the State of New York, and in the course of his duties he made an investigation of certain transactions which Mr. J. J. Leavenson had with Mr. Raleigh T. Curtis.

"Mr. Curtis was an individual who wrote a financial column in the New York Daily News and signed himself "The Trader." Mr. Leavenson described himself as a free-lance trader who, during the year 1929 and part of 1930 conducted certain operations through the brokerage firm of Burnham, Herman & Co., by which transactions he made a profit of approximately $1,136,000. During that time, by the purchase and sale of stocks on behalf of Raleigh T. Curtis, he made for Mr. Curtis approximately $19,000 between May 3, 1929, and March 1, 1930. During this time Mr. Curtis was writing the column in the New York Daily News under the name of "The Trader", and the testimony of Mr. Cornell shows that he was constantly boosting the stock in which Mr. Leavenson was trading and in which he was given, without the deposit of a single cent of money, a profit of $19,000. Mr. Leavenson stated that this was done out of pure friendship, and denied that his motive was to pay him for publicity. Mr. Curtis could not be found to be questioned on the subject.

"Each one of the transactions in which Mr. Leavenson was engaged, the interest of Mr. Curtis therein, and the boosting of the stock by "The Trader" will be found in detail in Mr. Cornell's testimony.

"Aside from the vice of paid publicity, of which this case is a strong illustration, Leavenson admitted (record, vol. II, p. 619) that one of the persons interested in his operations was a man named

2/ Vol. 77, Part 3, p.3226

Rodney, who was a partner in the brokerage firm of Burnham, Herman & Co., through which Mr. Leavenson conducted his operations.

"As will be noted hereafter, the New York Stock Exchange has since adopted rules to correct the vices shown to exist in this matter.

"David M. Lion

"Another illustration of the publicity which was paid for (and it may be safely assumed that when publicity is paid for the publicity will be in aid of the market manipulations in which those who made the payments are interested) will be found in the testimony of David M. Lion.

"When asked his business, he stated that it was "financial publicity", and, without covering his testimony in detail, he admitted (vol. II, p. 675 of the record) that his articles would be published for the purpose of interesting the public in the stock in which he and those who employed him were interested for the purpose of causing a rise in the market value of the stock, and for this work he was paid by calls and options.

"He went to the extent of employing a man to talk on the radio. This man was introduced as an economist and the president of a financial research institution, which was only the name of a business conducted by the individual in the case. He conducted over 30 such operations at one time; was employed by pool operations and individual traders and among those names he mentioned were some who were members of the New York Stock Exchange. His operations and earnings were detailed and it seems unnecessary in this report to analyze such earnings, and again it may be said that the conduct of business in this manner has since been prohibited by a rule adopted by the New York Stock Exchange."

Early interpretations by the Commission tend to support the view of this writer that 17(b) was designed to prohibit the use by brokers, dealers and underwriters of <u>any</u> paid-for publicity without disclosing the consideration when such publicity purports to be an independent and unbiased opinion. In a memorandum prepared in June 1936,3/ it was held that if a broker distributes many copies of an analysis of a particular security, and has paid more than printing costs, then the Commission should inquire, among other things, as to whether the analysis was by a reputable service, and whether the price was merely a subterfuge, and really a subsidy to influence the recommendation. A slightly more definite position was taken in a letter written by the General Counsel's office on August 28, 1937.4/ Some dealers were planning to distribute an independently prepared security analysis, and pay the analyst 50 cents per copy over printing costs. It was stated that

3/ Memo, G. E. Strong, June 5, 1936

4/ Letter, Wing, Lakin and Whedon (Standard Oil of California) August 28, 1937.

this payment for the publication of an analysis, even though prepared initially independently by the analyst, tended to show that a consideration was being paid for the work, and a disclosure should be made under 17(b). It has been decided that the preparation by an investment service for brokers, for distribution to their clients, of special analyses and security opinions on companies not analyzed in their regular advisory service because of lack of market interest, is within 17(b) and requires a full disclosure of consideration.5/ Where the analysis was especially prepared for a particular offering, it was determined that a full disclosure of the consideration was necessary under 17(b) even though the publication was accompanied by a prospectus.6/

The San Francisco Stock Exchange made a block subscription for its members to a service which described various stocks, selected by the service. Issues of the analyses were sold to the general public. In a letter considering the applicability of Section 17(b) it was stated that while the General Counsel believed the conservative course would be to disclose the consideration, it would not recommend any action in case no disclosure was made, since the service was deemed to be substantially like that of Fitchs', Moodys' and Poors'.7/

In SEC v. Torr, 15 F. Supp. 315 (1936), involving a violation of Section 17(a) by a failure to disclose a profit-participation arrangement between persons recommending the purchase of a security and persons interested in its sale, the District Court for the Southern District of New York said, "In principal (sic) there is no difference between the method of recommendation pursued here and the hired employment of a tipster sheet that purports to give impartial information." It then cited from U.S. v. Brown, 79 F(2d) 321, CCA-2nd, the general statement that "when a person gives advice to buy a stock under circumstances that lead the listener or reader to believe that the advice is disinterested, and suppresses the fact that for giving such advice he is in reality being paid by one anxious to sell the stock, the purchaser acting on the advice is imposed upon, and deceived."8/ The deception can be just as real, and just as costly to investors, whether it results from reading an out-and-out tipster sheet or a dressed up, respectable looking document, prepared by an investment service company. In fact, the danger of deceit today is probably even greater in the area of "independent" reports prepared by apparently reputable research analysts, since the public is more wary in its reception of crudely prepared tip sheets or articles, while the investment advisors now wear the badge of respectability

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5/ Letter, Standard Statistics Co. March 13, 1940.

6/ Letter, S. F. Regional Office, December 18, 1937.

7/ Letters, from S. F. Regional Office September 28, 1939 to S. F. Regional Office October 5, 1939, re Walkers Securities Synopses.

8/ SEC v. Torr, 15 F. Supp. 315, 317. Rev'd, other grounds, 87 F(2d) 446 (C.C.A. 2d, 1937)

and reliability which results from a none-too-clear public understanding of the significance of registration with the Commission under the Advisers Act. Consequently, the best safeguard against unholy alliances between advisers and persons interested in the sale of particular securities is a rigid adherence to Section 17(b) and the insistence upon a full disclosure of consideration received for purportedly independently prepared security analyses.

That the language of Section 17(b) is literally broader than a mere interdictment of tipster sheets and similar publications cannot be denied. Early constructions of the section, mentioned above, also support the belief that it was designed to cover descriptions of securities purportedly independently prepared, except the regular and periodic publications of reputable investment services, such as Fitchs', Moodys' and Poors'. The intent of the provision would seem to be that if a person wants to publish or circulate a report or analysis of securities which does not purport to be sales literature, then he must make a full disclosure of the consideration received from the issuer or underwriters or dealers, so that his readers will know what, if any, is his financial interest in the sale of such securities. It appears futile and intent defeating to insist upon compliance with 17(b) by the authors of tipster sheets and newspaper articles, while at the same time permitting investment advisers or others to publish similar articles without disclosing whether or not these publications were in fact subsidized by persons desiring to stimulate sales. To leave such a dangerous loophole in the law could hardly have been the intention of a Congress which was thoroughly aroused and disgusted with the loose and fraudulent practices in the securities business.

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