

ADDRESS

of

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I am not sure that it is entirely appropriate for me as a representative of the Securities and Exchange Commission to be appearing before you and trying to tell you anything about the problems of stopping security swindles. Your Department has a time-honored reputation for incorruptible investigation and prosecution of swindlers who are unwise enough to make use of the mails. I naturally hope that we are not too young to have acquired a similar reputation in our field. But our experience is short; yours is long. We have studied and learned a great deal from your experience, and much of what I am going to say will perhaps sound like a student's remarks made before his teachers, who are more concerned with whether he has learned his lesson than with adding to their own knowledge. However, so much of our field of operation is inextricably interwoven with yours, and so much of our success dependent on a common understanding and spirit of cooperation between us and you, that I feel there may be some advantage to both of us in my trying to paint you a brief picture of just what it is we are after and how we go about it. In part, I want to describe to you what our job is, so that you can understand how and where we most need your help; and in part I want to show you some of our limitations, some of the portions of the field where our powers and jurisdiction lapse, or at best become extremely tenuous, and where successful prosecution of the broad task in which we are both engaged depends more upon you than on us.

Basically, you and we are concerned with the same simple objective -- protecting as many people as possible from being parted from their money. No one supposes that complete success in this campaign will ever be possible, at least until we can persuade Congress to pass a law requiring everyone to be cautious, intelligent and wise. But pending adoption of such a law, we at least can, and do, try to throw some measure of protection around the gullible public and prevent the fraudulent schemes from becoming too bold or wide-flung.

Not only is our basic objective the same, but in many cases our jurisdictions overlap. In an increasing number of cases prosecutions are based on violations of both of our statutes. This is all to the good, since it makes it additionally difficult for criminals to escape punishment on technicalities. But I believe that the differences in our jurisdictions are more important than their common features, since they enable us to attack the enemy on a broader ground.

In at least one respect our authority, even in the field where our jurisdiction overlaps with yours, is broader than yours. As you know, there are many practices which, although lacking the traditional elements of common law fraud, are nevertheless essentially dishonest and deceptive in character. Some of these are made unlawful under our statutes though not under yours. Moreover, our jurisdiction extends to all transactions involving interstate communication, as well as the use of the mails. On the other hand, your authority is broader than ours in that it applies to all fraudulent transactions effected through the mails whether they involve the sale of securities or not.

The Commission's lines of attack on unlawful security transactions are three-fold. First, by requiring the registration of securities sold in interstate commerce, and of brokers and dealers whose business is interstate in character, we try to dam up at the source many potentially fraudulent activities. Second, by obtaining injunctions against violation of the registration provisions of our statutes, as well as against violations of the provisions dealing with fraud, we stop in mid stream many unlawful enterprises. Third,

although everyone knows that prevention is better than cure, we deal with the worst offenders, whom we have not succeeded in stopping at the outset, by referring their cases to the Department of Justice for criminal prosecution. Let me explain more specifically how at least the first two of these three methods of attack work.

Our first line of attack, registration, requires that before securities be offered to the public a detailed statement of the issuer's history and intentions be filed with us. Similarly, before a broker or dealer may engage in interstate business, he is required to inform us and the public of his past experience and future intentions. The requirement that such information be filed and made public is itself a powerful deterrent to unlawful activity. The publicity which attends these registrations makes a security racketeer reluctant to spread unsavory information out for every one to see. As Justice Brandeis said in his book entitled *Other People's Money*, "Publicity is justly commended as a remedy for social and industrial diseases. Sunlight is said to be the best of disinfectants; electric light the most efficient policeman."

If, instead of spreading his dirty washing out for public inspection, an issuer or a broker attempts to conceal his past or his intentions, his statements give us a valuable starting place for investigation. If we discover his concealment, we may deny the registration and in that way prevent the enterprise from going forward until full facts are disclosed. And merely requiring full information is often enough of itself to put a stop to an inherently dishonest undertaking. There are some limits even to the gullibility of the sucker.

Let me give you one particularly vivid illustration. A registration statement and prospectus filed with the Commission by a mining company trying to sell \$150,000 of stock to the public, contained metallurgical reports prepared by an ex-fruit grower who had taken up the vocation of detecting gold veins. He had no training as a geologist or metallurgist. His determinations were based upon the reactions of a "mineral indicator" of his own invention. You are undoubtedly acquainted with "doodle bugs" and know that they have been consistently repudiated by engineers and geophysicists. The Commission gave the inventor a opportunity to demonstrate his instrument's capacities. We put five cardboard boxes on a table. One of these, number 5, contained a piece of rich gold ore. The others contained assorted vegetables. The doodle bug man tested each box with his mineral indicator and finally reported that there was gold in number 3, but not in number 5. On the basis of his own demonstration the Commission could, and did, prevent the sale of the stock in question until the statement should be amended to show the true character of the doodle bug. I have not heard that any further attempt has been made to sell this stock.

Similarly, we try to keep out of the business security dealers whose past experience has demonstrated their unfitness. The registration of a broker or dealer may also be revoked or denied where, within 10 years of registration, he has been convicted of a felony or misdemeanor involving the purchase or sale of securities; where he is permanently or temporarily enjoined by any court of competent jurisdiction from engaging in or continuing any practice in connection with the purchase or sale of securities; or where he has wilfully violated any provisions of the Securities Act or rules promulgated thereunder.

In the past these security racketeers have rebounded from one injunction after another, and even from stretches in the penitentiary. One, or a dozen,

brushes with the law have not prevented them from trying again, and often succeeding, in capitalizing on a wave of popular interest in some new fad in the sale of securities. The necessity for filing a registration statement with our Commission has proved a source of considerable difficulty and embarrassment to this type of dealer or salesman. Rather than face the Commission, a large number of former bucket shop operators, sell and switch peddlers, boiler room technicians, and others of similar proclivities have turned their attention to other fields of activity where they may still be making trouble for you, but where we can at least hope that the possibilities of general public injury at their hands are greatly reduced. Those who have dared to seek registration have managed to perform prodigious feats of forgetfulness in filling out their statements. We comb the registration statements meticulously and keep constantly on our guard to prevent such persons from slipping through. We have already held hearings in hundreds of cases. Often enough the application is withdrawn the moment the Commission starts to investigate. Others try to brazen it out, and have their registrations denied or revoked by the Commission. The people thus excluded from registration are, by and large, persons who by any standards of fair and honest business dealing should not be in the securities business at all.

Our second line of attack involves the use of court injunctions. We use this method to reach the swindlers who try to avoid the first barrier by starting in business without first registering with us, or who pass our original scrutiny, and then try to sell securities by fraudulent misrepresentations, or to operate generally dishonest businesses. This was the way the Commission was recently able to stop the campaign of the Ladners to sell over \$1,000,000 worth of so-called securities of defunct corporations. They bought up obsolete certificates of Studebaker Corporation of New Jersey, Richfield Oil Company of California, the Willys-Overland Company and other corporations which had gone out of existence through receiverships and reorganizations, and had been succeeded by successor corporations of the same or similar names. In this, as in many other cases, it was not even necessary to go to the expense or trouble of an elaborate trial; the defendants, being caught with the goods, consented to an injunction on the same date that the bill was filed. The injunction is a particularly useful weapon with the first class of scamps - that is, those who try to get away with not registering with us at all; for in those cases all we need to prove is that the securities they are selling, or they themselves, as the case may be, are not registered with us.

Of our third line of attack, that is, criminal prosecution, there is not much for me to say, since the problems involved in putting security selling crooks behind the bars are about the same for you as they are for us.

You probably know how most of the cases involving violations of our Acts originate because you undoubtedly have the same experience -- some poor sucker swallows, hook, line and sinker, the get-rich-quick promises of a "dynamiter", mortgages the family homestead to get the money, and then finds out that it was all a big mistake, and writes a letter to Chairman Douglas, or more frequently to Mrs. Roosevelt. We get thousands of letters of this type every year. In spite of this we have found that one of our chief difficulties in the prosecution of these cases arises from the fact that many of the victims have been so thoroughly sold that they look on us as persecutors of the righteous. The very people who should be of greatest assistance to us become the criminals' chief defenders.

By and large, the bulk of our enforcement proceedings arises out of complaints of this character. Whenever a complaint comes in which indicates a substantial possibility of violation of our laws, or whenever our own surveillance of trading activities and examination of registration statements gives us reason to believe that fraud or illegality is in the wind, we open up a new file and conduct a complete but informal investigation to develop the facts. Although the number of files which have been opened is probably small by your standards, you may be interested to know that in the relatively short period of our existence we have set up approximately five thousand such cases for investigation, and that about seven hundred of these are pending at the present time.

I might also mention that in a good many cases we find when we start our own investigation that your Department is already making an investigation. In such cases it has been our policy to make our files available to your Department, and frequently our own agents have been instructed to cooperate with you in developing the case for the Department of Justice.

These, in brief, are the functions of the Commission. In considering how and where they can be exercised, it is important to remember that our jurisdiction attaches only where a "sale" of "securities" within the definition of our statutes can be established. As I said before, one of the results of the enforcement of the securities acts has been to push the old-time stock swindlers into activities not so readily subject to prosecution under our acts. To some extent, these new activities, though they may be within your province, are entirely outside of ours. For example, we have no jurisdiction over the sale of real estate, or insurance policies, as such. But to some extent, the sharpers have retreated only to a twilight zone, where they attempt to capitalize on the "get rich quick" instinct, by selling with alluring pictures and glib sales-talk, interests in almost every known form of property, and even interests in theories of social and economic evolution. These gentlemen are selling securities in every fundamental sense of the word, as much as if they were selling shares of stock in a gold mine; for the essence of the sale of a security is the acceptance of money in consideration of a promise of return of income from its employment. And generally speaking, their securities are the more alluring and dangerous just because of their novelty and impracticability. But they know, as well as we, that to bring them within the technical definitions of "securities" to which our acts apply calls for a considerable amount of education of the courts to the theories and objectives of modern securities legislation, and they know that it will take us quite a while to catch up with them.

Gradually, we are pushing this twilight zone back. We are getting the courts to realize that a security may be involved in the sale not only of forged or obsolete stocks and bonds, but of the even more doubtful progeny of a bed of Florida oysters or a pair of giant bullfrogs. We have brought within our jurisdiction interests in oil when as and if produced, and interests in the profits of speculative trading accounts. We have even got our fingers on contracts of membership in the type of organization which is devoted to the mighty principle "who is it", and which promises that contributors shall inherit the earth or something near it. But the process is a slow one, and there are still many money-extracting devices which we have not been able to bring under complete control.

Let me be specific for a moment. As I said before, the sale of real estate as such does not ordinarily come within our jurisdiction, nor is there

any reason in the ordinary case why it should. But you are probably all familiar with the now common device of going through the form of a sale of real estate, with collateral contracts by virtue of the substance of which the purchaser in fact receives only a *pro rata* right to participate in the profits which may result from the use or development of the land by the seller. In such cases -- particularly if the land, as is usually the case, is completely inaccessible -- it is obvious that the inducement to the purchaser is not the idea of obtaining possession of the real estate, but the hope of securing a high return of profit from the investment of his money in some one else's enterprise of managing the property or reselling it at a profit. But from a legal point of view what we probably have to establish is a commingling of the investments of several purchasers, so as to bring the transaction within the definition of "security" as a certificate of interest in a profit sharing agreement. With sophisticated promoters, carefully advised by their lawyers, this is often a very difficult thing to prove.

Real estate is only an example. Whiskey warehouse receipts, automatic chewing gum vending machines, groves of tung oil trees, even cemetery lots, are all being sold ostensibly as real or tangible personal property -- with no thought or expectation that the purchaser ever would, or could if he wanted to, take possession or even look at them. We even had a cemetery lot case recently where the contract had a provision actually forbidding the purchaser to use it for burial purposes. In every realistic sense, these agreements are securities as much as are shares of stock.

You are all undoubtedly familiar with these operations, and the only reason I have mentioned them is that our jurisdiction over them is still somewhat doubtful and difficult to establish, whereas yours in general is clear. In the course of our ordinary complaint correspondence a great many of them are brought forcibly to our attention, and we investigate them as far as we can. But often enough we find ourselves stymied by legal technicalities, and must leave to you the work of actually cleaning them up. That is why we refer to you every such case that comes to our attention.

Apart from these purported sales of interests in property, there is one special form of racket against which we are particularly helpless, and against which I am most anxious to secure your cooperation. Peculiarly enough, this racket owes its origin to the enactment of our securities laws and to the setting up of the Securities and Exchange Commission. I am referring to the so-called front-money racket, which, we are fully aware, is being carried on quite extensively through the mails at the present time.

Let me give you an example of the way the "front-money" racket operates. The operator goes to a small business firm in need of financing and tells the officers that while he has assured brokerage connections which will probably be able to float the issue for them, it will first be necessary, before the brokers can even be approached, that the issue be registered with the Securities and Exchange Commission and that prospectuses be prepared and filed. A down payment of anywhere from \$500 to \$3500 is immediately demanded, purportedly to cover the cost of preparing these papers. Often enough this "advance fee" is paid; and then the services rendered gradually taper off, without producing any tangible results. Sometimes prospectuses are filed, but no financing is obtained; and in most cases the operator does not even file a prospectus.

Here is another typical example. The "front-money" man puts an advertisement in the daily newspapers offering his services in furnishing or raising capital. The advertisement usually states that no fee will be charged. The answers are followed up by letters in which the "front-money" artist gains the confidence of his correspondents; he even takes an option on a large block of the stock which is to be issued, but the option is carefully worded to avoid any obligation to purchase or dispose of any of the stock. Then if the victim needs incorporation, he is referred to a certain company which will draw up a charter for a fee. The fee is of course split with the operator. Once incorporated, the company needs a registrar and transfer agent. Another company is recommended; once more a fee is charged and split with the operator. The corporation has to file a prospectus with the Securities and Exchange Commission. It needs a lawyer; so a lawyer is recommended. The corporation reluctantly pays another fee. The front money artist then sends the prospectuses around to a few dealers who are never interested in the proposition. This is the only effort he makes to induce any dealers to distribute the securities. If the client complains of the racketeer's failure to effect distribution, the answer is that the dealers didn't look favorably on the issue, but that the client might take the matter up with any of the dealers personally. In the meantime, the option on the stock has expired unused, the disillusioned victim is out several hundred dollars, and he is no nearer to obtaining his capital than he was before he answered the advertisements. The best he can do is charge up a very substantial fee to education.

One of the worst of these offenders whom the Commission has unearthed so far is an individual who could not register with the Commission himself as a dealer because of his past criminal record for using the mails to defraud, but who set up two stooges and attempted to get them registered. We naturally proceeded against their registrations as soon as we discovered the situation. We have had endless complaints regarding the activities of this gentleman and his various corporations, and are at the present time correlating the evidence for the use of your Department, since your Chief Inspector, Mr. Aldrich, has consented to throw the weight of the Post Office Department into the battle.

From our own point of view we are particularly concerned about the "front-money" racket, not only because of our helplessness to deal with it as it deserves, but because both the technique by which it is carried out and the fact that it flourishes at all tend to cast some reflection in the public mind on all law enforcement agencies and on our Commission in particular. It gets us coming and going; for its very existence depends on an artificially stimulated impression of the complexity of our regulations, and its unchecked progress leads the layman to an unwarranted criticism of our efficiency as a law enforcement body.

The "front-money" racket is a peculiarly cogent example of a situation which needs active cooperation between your Department and ours in the interests of efficiency and of the good reputation of both of us. And while I am on the subject of cooperation, I should like to review briefly the principal arrangements which are now being carried out between us for the purpose of making the most effective use of our several facilities.

(1) We furnish weekly reports to your Department containing the names of all persons involved in new complaint files which we open. Your Department checks these reports and advises us if it has any files on the subject.

(2) Similarly, your Department advises us of all of its new cases involving the sale of securities, and we in turn advise your Department whether we have any files on the subject. Whether or not we already have a file, we send a report of your opening of the case to our regional office in the region where the investigation is being made, so that our regional officials may get in touch with and cooperate with the particular Post Office inspector assigned to the case.

(3) We send promptly to your Department any information which we receive concerning advance fees or front money, sales of cemetery lots and real estate, whiskey and tobacco warehouses receipts, vending machines and sales contracts, and other literature involving the use of the mails which comes to us in the course of our general enforcement activities and which involves some doubt as to whether a violation of our acts is involved.

(4) Whenever your Department requests it, we include in our Securities Violations Bulletin, which goes to the State Securities Commissioners and other similar officials throughout the country, reports of criminal actions on mail fraud cases involving the sale of securities, with the names and personal descriptions of the people involved. Furthermore, we regularly furnish copies of the Securities Violations Bulletin to your Department and representatives and are glad to comply with requests for extra copies.

(5) Your Department reports to us upon the closing of all of its cases involving securities matters, and supplies us with copies of your Daily Postal Bulletin, which includes information as to men who are wanted and advice concerning fraud orders issued by your Department.

(6) An important way in which your Department has helped the Commission has been in the apprehension of criminals who are wanted for violations of both your legislation and ours. So far, we have no medium of publicity comparable to your practice of posting the descriptions of every person wanted for violations of your act on the bulletin board of every branch post office in the country; and except for our few regional offices we have no such convenient agencies to which the public may bring its information and complaints. Your Department has in the past assumed the burden of helping the Department of Justice locate the defendants in all cases where the Post Office and the Commission have joined in the preparation of a case. Now I understand that you are prepared to go even further and make available to our Commission the facilities of your organization to the extent of having your agents accept public information and complaints looking to the apprehension of any criminals wanted for mail frauds in the sale of securities, even though your Department may not previously have taken part in building up the case.

Your Department has been of great assistance to us in suppressing the activities of security swindlers who have fled the country, but who continue to carry on their schemes out of reach of our injunctive or criminal processes. By issuing a fraud order, as you did in the *Chiapas Mining Company* case, you can effectively prevent these criminals from receiving through the mails any remittances from their proposed victims, and can put the investors on notice of the fraudulent character of the enterprise.

I seem to have used up my time talking of our problems and your usefulness in helping to solve them. However, I am sure you will realize that we are at

all times willing and anxious to turn about and use our authority to assist you wherever we can. I hope and trust that the post office officials in Washington and the inspectors in the field will come to us either here or in our regional offices for any help that we can give.

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