

"ENFORCEMENT WORK IN THE GENERAL COUNSEL'S OFFICE."

ADDRESS

of

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Mr. Lane, when he addressed you two weeks ago, roughly divided the work and the personnel of the General Counsel's office into two sections - enforcement and interpretative.

I would like to say at the outset, however, that there is no fine demarcation between the work of these two sections. There is much overlapping, and often a problem which has originated in one group will pass for a phase, or perhaps altogether, into the hands of the other. As a consequence the closest cooperation and understanding is essential. Each must know what the other is doing. The enforcement men must know the latest clarifications which have been given to a particular section of the statute; the interpreters must understand the practical significance of their work. There is therefore a constant communication between us - and our relations are so cordial that at times I am certain neither Mr. O'Brien nor myself is sure which one is immediately responsible for a particular matter - the truth is, we are *both* working on it and the niceties of our respective jurisdictions are of no concern to us. We have even on occasion "swapped" men - on a strictly loan basis to start - but sometimes for so long a period that adverse possession has almost set in. To tell the truth, I have no real objection to such a procedure - providing it is not too one-sided; the men are bound to profit from the diversity of their experience.

Also, in the enforcement section itself we are constantly being called upon for a quick interpretative opinion. Scarcely a day goes by that I do not get some question - sometimes from an outsider, but more often from one of my own men, or perhaps a phone call from a regional administrator, where the necessity of an immediate answer is apparent and there is no time to indulge in elaborate research - on such occasions, experience, with a liberal sprinkling of common sense, is all you have to rely upon, and there is nothing to do but clear your throat and come forth with an opinion on the question involved which you hope will later be supported by sufficient legal precepts and cases to make it hold water.

In other words, *we* are sometimes interpreting, and *they* are sometimes enforcing - which makes us all one big family or law shop - which is after all the way it should be.

But to return to strictly enforcement work, which is my subject, I thought you might be interested in having me tell you the way the enforcement work of the Commission has been set up and is being carried out.

The work has been largely regionalized. As you know, the Commission has established nine zones in key cities throughout the country, as well as a field office to cover the region immediately adjoining Washington. These regional offices are the front line trenches of our enforcement program. They are manned by able lawyers, accountants, engineers and other personnel, and each is headed by a regional administrator who, with what advice and assistance we can give him from Washington, is immediately responsible for enforcement in his region. I cannot say enough of the whole-hearted cooperation and enthusiastic support which each of these administrators has given our enforcement program. Without it the fundamental purpose of our statutes - the protection of the investing public - would have fallen far short of its goal.

In addition to this force in the field, a sizable group of attorneys, and a few accountants, are maintained in Washington. Their duties are to originate, supervise, review and assist in the work in the field. If a particular region is short-handed and a case of importance requires immediate attention, it is the practice temporarily to assign one or more of my staff to that particular case. In other words, we must constantly be ready to augment the forces already in the field at a moments notice. In addition, there are certain types of cases which, because of their complexity or the latitude of their scope, can best be handled from Washington. In such cases a program is worked out in harmony with the views of the regional administrators involved.

Most cases originate with a complaint. Some person, usually one who can ill afford to suffer a loss, writes in and complains about some investment he has made. It is immediately looked into. Our files are examined for any information we have on the subject. Letters are written. When sufficient evidence has been obtained to indicate there may have been a violation of the statute, the case is set up as an investigation file, and is sent to the proper regional office for investigation, with as many suggestions as our office is able to give at the moment. Occasionally our information comes from some source other than a complaint - our own observance of a market trend, a "tip", a suggestion from a cooperating enforcement agency, some special study the Commission has made, and the like. But in each instance the procedure of initiating the investigation is essentially the same.

The investigator is impressed with the idea that he should not pre-judge his case. The object of the investigation is to get at the facts - not necessarily to make a case. An investigating agency which operated on any other principle would soon be subjected to criticism. Fairness is essential.

The direction that our investigation takes of course depends on the nature of the violation involved. Certain essential facts are fairly general, however, and sooner or later must be established before there can be any violation. Evidence of mailing, or of use of the instrumentalities of interstate commerce, such as the telephone or telegraph, or under the Exchange Act of the facilities of an exchange, must be developed. Similarly, under the Securities Act, it is essential to show there was a sale of a security involved, in contrast to the sale of something which could not be classified as a security within the statutory definition. This sometimes involves a real interpretative problem, and when the question is close it has been the custom to request our office for an opinion before proceeding further.

There has been a tendency lately, in fact, for racketeers in the investment field to retreat just beyond the realm of our jurisdiction. This, I take it, is a tribute to our vigilance, but the problem of protecting the investors is none the less real. Sales of that which is essentially real estate, such as deeds or leases to oil or mining properties, cemetery lots and the like, if uncoupled with some sort of an investment contract which would make it a security, do not fall within our statute. So also whiskey warehouse receipts. These fields have attracted large numbers who formerly constituted the securities selling underworld.

More recently we have had a rash of what we call the "advance fee" or "front money" artists. Their scheme is, for a substantial fee paid in advance, to urge a small company to permit them to assist in raising additional capital. If the concern is unincorporated, they agree to take care of the incorporation. They undertake to seek and obtain an underwriter, paint glowing pictures of ample cash flowing into the coffers of the company to insure the rosiest of futures and any expansion program which this small business may dream of. If they actually incorporated the company and offered the stock for sale, our statute might be involved. But the difficulty is that they stop far short of that. They take the fee--and do nothing. Thousands and thousands of dollars have been taken from the credulous small business men in this way, and their only gain has been in the sad school of experience. Some of these advance fee racketeers have flooded our registration division with impossible and unusable prospectuses--holding out to the business men that they are competently and adequately taking care of their registration problems with this Commission. This in itself has proven a real problem downstairs, and the men in the Registration Division have appealed to us to do something about it. Accordingly we have gone forward with these cases in the hope of discovering some way to stop them.

In one case on the Pacific Coast we resorted to a proceeding to revoke the registration of a broker-dealer. In that case, the dealer had failed to reveal the name of a blind partner who had a criminal record in the East. This gave us ground on which to proceed. Needless to say, the dealer could not long withstand our scrutiny and soon consented to the revocation. An even more effective remedy was had in the recent Gage case in Florida. There it was discovered that the mails had been used in soliciting business men to sign up. While no sale of a security was involved, with the active cooperation of the Postal authorities we were able to have an indictment returned charging mail fraud, which was followed by a trial which resulted in a verdict of guilty and a substantial sentence. A few more cases such as these and the advance fee boys will be seeking safer fields in which to employ their talents.

So also, through the Postal people, or at times with the cooperation of other investigatory and prosecuting agencies, we have been able to effectively protect the public from the ravagings of unscrupulous swindlers, even though no violations of our statutes were actually involved. State prosecutors - at first a little wary - have more recently become intensely interested in cleaning their own back yards, particularly when we have been able to demonstrate to them that larceny or embezzlement or forgery has taken place and that the crimes involved are essentially state and not federal matters.

By far the greater part of our investigative and enforcement work, however, is naturally concentrated on violations of our own statutes. Quite a few cases center about Section 5 of the Securities Act, where either no registration is in effect and no exemption is apparent, or where securities are being sold and delivered without a prospectus meeting the requirements of the statute.

Still another group of cases are what we call "trading cases," where an artificial market is created and maintained in contravention of the provisions of Section 9 of the Exchange Act--wash sales, matched orders, a series of transactions on the exchange to give an appearance of active trading, raising the price artificially for the purpose of inducing others to buy - all these involve long and arduous trading investigations. This includes a study and

analysis of numerous brokerage and exchange records. In the early stages they are the responsibility of the Trading and Exchange Division, but as they ripen into cases, the General Counsel's office has a definite participation. The New York office has a preponderance of such cases and devotes a considerable portion of its time to them.

Under the 1933 Act, most of the investigations center about Section 17-- the fraud provisions of that statute. This section makes it unlawful by use of the mails or the instrumentalities of interstate commerce, in the sale of a security, to employ any device, scheme or artifice to defraud, to obtain money or property by false or misleading statements, or to engage in a course of business which would operate as a fraud or deceit upon the purchaser. It is a sweeping section, and the principal weapon of the commission in its campaign to eliminate the securities racketeers. The types of fraud are as varied as man's imagination can make them, and they have even changed in character and emphasis as the enforcement work of the Commission has progressed.

At first the most flagrant type of fraud was the sell-and-switch, boiler-room operation, where a battery of salesmen would be employed to make thousands of telephone calls to unsuspecting victims whose names were obtained from a purchased "sucker list", or even at times from pages of a telephone directory--starting on the Atlantic seaboard in the morning and following the sun to the west coast late at night--gaining the confidence of the victims, making a little money for them at first on some decent stock and persuading them each time to reinvest their profits, and finally ending up by switching them into a cat or dog which they were trying to unload--without a chance to make a dime and every likelihood of losing every cent invested before they were through.

Then again they would actually pay "dividends" for a while out of their own pockets in an effort to lull the victim into a sense of security, and entice him to pay in additional capital. Money received from new customers for investment was used to pay false profits to the old--the old Ponzi racket. Everyone was happy--until the bubble burst. Installment selling was resorted to--something even the small investor could afford.

In one case - the Kopald Quinn case - the investors were induced to buy securities on an installment basis, delivery not to be made until fully paid for, at outrageously advanced prices achieved by clever manipulation of the market. When everyone had signed up, the plug was pulled - support was withdrawn from the market, which caused the stock to drop to practically nothing - and everyone's account was closed out, leaving all that had been paid in to be enjoyed by the perpetrators of the scheme. Ample jail sentences have taken care of the principal actors in this particular case, and the prosecution of this case has had the desired result of frightening others from similar enterprises.

Lurid promotional oil and mining literature was once the vogue. Impossible promises and predictions were made in these sheets - all to allure the credulous investor who dreamed of making his small, hard earned savings grow into fabulous sums overnight. He put up his money, but as time went on and these glowing promises failed to be realized, he eventually came to know that he had bought a hole which had long been dry, or a shaft barren of gold - if indeed his money had been invested at all by these unscrupulous promoters.

These schemes were vast promotions. Many of their perpetrators are now serving long terms in federal prisons. Others have scattered to the wind. While these practices are not altogether stamped out, I think there is no question but that our agency has done much to lessen their menace.

However, other schemes, not so widespread and perhaps not so vicious, have grown up which still give us much concern, and keep our investigators ever busy. We have recently had a number of insolvency cases--cases where a broker has accepted money and securities from a customer for the purpose of investing the proceeds in other securities for him, but where he has in fact "bucketed" the orders--not effected the transactions at all, but kept and dissipated the money himself. Because of his insolvency he cannot possibly make good. The recent Lawson case involving the Police Commissioner of the City of Baltimore was a case like this.

So also we have had a series of what we call "thrift plans", or "top trust" cases. In these cases the investor is persuaded to put his money into buying a certificate of participation in an investment trust, usually in small monthly payments, about ten dollars, over a ten-year period. Various oral misrepresentations are made by the salesmen--that it is as safe as a savings bank; that the contract will pay \$2,000.00 on the \$1,200.00 invested; that the money can be taken out at any time--all false. But the most serious violation is failing to reveal the load or charge for the service--sometimes as much as 20 or 25 percent of the investment, and mostly taken out early in the game, so that the investor has practically no equity in his investment during the first years of the contract, and his only hope of getting any return at all upon his money (and that not a certainty) is to continue his monthly payments over the entire period. Quite often he has lost his job, and counted on drawing out the money already invested. He finds he can get back only a fraction of what he has put in. This is not what he thought he was buying, and many an investor has told us so in no uncertain terms. We are doing our best to correct this abuse.

This will give you some idea of the various types of fraud investigations which we have conducted during the 4-1/2 years of the Commission's existence. It by no means exhausts the field. I could go on, far into the night, giving you case after case, each with facts peculiarly its own.

After a case has been as thoroughly investigated as possible, it is sent into our office for review, with a recommendation for some sort of action on the part of the Commission. While the investigations has been in progress, we have been receiving interim reports on it, so we are not entirely unacquainted with the direction the investigation has taken, and have probably made certain suggestions relative thereto. If no violation of statute has been developed and nothing can apparently be done through any coordinating agency, the case is closed.

If the offense is presently going on, the injunctive remedy is resorted to. A complaint is filed in the appropriate federal court; a preliminary, and ultimately a permanent injunction against the continuance of the offense is sought, and usually obtained. We have had a large number of consents to injunctions after the bills have been filed.

In a very few cases we have had to go further, and have had defendants cited for contempt of the injunction. Usually, however, the injunction is sufficient and the practice complained of ceases.

Another and more drastic remedy is the invoking of one of the Commission's quasi-judicial functions - the instigation of a hearing with a resulting order depriving the respondent of some right or privilege. Common among these have been 19 (a) (3) proceedings under the Exchange Act, to expel or suspend a member of a national securities exchange, and 15 (b) proceedings to revoke or suspend the registration of a broker or dealer. The Meehan and Wright cases are examples of the former. The cases under 15 (b) are too numerous to mention. Under the Securities Act, too, stop order proceedings may be instituted under Section 8 (d) for false or misleading statements in a registration statement. These, however, are conducted by the Registration Division.

The final, and of course the most stringent remedy of all, is the power of the Commission to refer cases to the Attorney General for criminal prosecution. To complete an investigation to this stage of course takes much time and painstaking effort. It takes an ability not only to discover the facts, but to set them up in a written report with sufficient clarity and in such detail that the Department will thoroughly understand them. When a criminal report is finally ready, it is taken up with the Department and, if they agree, it is referred to the appropriate United States Attorney for prosecution.

Even then our task does not end. It has been found, if we are to have any sort of effective criminal enforcement at all, we must cooperate with the United States Attorney, first in understanding the case, then in presenting the matter to the Grand Jury, and after an indictment is returned, in the final preparation and trial of the case. Except in rare instances, we have not been permitted to prosecute these cases ourselves—I hope this situation may sometime be remedied and that one day we shall be permitted to appear and try at least the more involved and complicated of our own criminal cases. But under the present arrangement, I have been informed by United States Attorneys throughout the country, that the assistance of our men has been invaluable and that their efforts have been primarily responsible for bringing these criminals to justice—I suppose that is reward enough.

I do not want to close without saying a word of praise for the untiring efforts of the men and women engaged in enforcement work. Long hours have at times been required, and have been given without question. Long absences from home have been common occurrences. And yet in the several years I have been engaged in this work, I have heard no word of complaint. Rather, the enthusiasm and ardor which has characterized all the activities of the Commission has seemed to grip those engaged in this work. They have seen the vision, they have caught the spirit. It is no wonder, with this type of persons working for it, that in these days when it is the popular thing to criticise and condemn, the work of this Commission is still the subject of commendation and praise.