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SECURITIES AND EXCHANGE COMMISSION
WASHINGTON

SECURITIES EXCHANGE ACT OF 1934
Release No. 3033

In the Matter of THE RULES OF THE NEW YORK STOCK EXCHANGE File No. 4-26	FINDINGS AND OPINION OF THE COMMISSION

APPEARANCES:

Chester T. Lane, General Counsel, *Ganson Purcell*, Director of the Trading and Exchange Division, *Gerhard Gesell*, *Irving P. Terman*, and *Homer Kripke*, for the Commission.

Lester Bennett, *Timothy N. Pfeiffer*, *F. Trowbridge vom Baur*, and *Harry F. Bliss, Jr.*, of *Milbank, Tweed & Hope, Esqs.*, New York City, for the New York Stock Exchange.

Robert B. Holt and *Franklin T. Hammond, Jr.*, of *Gaston, Snow, Hunt, Rice & Boyd, Esqs.*, Boston, Massachusetts, for the Boston Stock Exchange.

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This proceeding was instituted by the Commission under Section 19 (b) of the Securities Exchange Act of 1934 1/ to determine whether changes in a rule,

1/ Section 19 (b) provides:

"(b) The Commission is further authorized, if after making appropriate request in writing to a national securities exchange that such exchange effect on its own behalf specified changes in its rules and practices, and after appropriate notice and opportunity for hearing, the Commission determines that such exchange has not made the changes so requested, and that such changes are necessary or appropriate for the protection of investors or to insure fair dealing in securities traded in upon such exchange or to insure fair administration of such exchange, by rules or regulations or by order to alter or supplement the rules of such exchange (insofar as necessary or appropriate to effect such changes) in respect of such matters as (1) safeguards in respect of the financial responsibility of members and adequate provision against the evasion of financial responsibility through the use of corporate forms or special partnerships; (2) the limitation or prohibition of the registration or trading in any security within a specified period after the issuance or primary distribution thereof; (3) the listing or striking from listing of any security; (4) hours of trading; (5) the manner, method, and place of soliciting business; (6) fictitious or numbered accounts; (7) the time and method of making settlements, payments, and deliveries and of closing accounts; (8) the reporting of transactions on the

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hereinafter described, of the New York Stock Exchange are necessary or appropriate for the protection of investors or to insure fair dealing in securities traded in upon such exchange or to insure fair administration of such exchange. 2/ The Rule relates to transactions in securities which are listed and traded under the Act upon the NYSE and are also listed and traded or admitted to unlisted trading privileges, pursuant to the Act, on one or more of the other registered securities exchanges. 3/ The Rule affects persons who are members not only of the NYSE but also of one or more of the other exchanges. 4/ The NYSE is a national securities exchange, registered under the

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1 cont'd/ exchange and upon tickers maintained by or with the consent of the exchange, including the method of reporting short sales, stopped sales, sales of securities of issuers in default, bankruptcy or receivership, and sales involving other special circumstances; (9) the fixing of reasonable rates of commission, interest, listing, and other charges; (10) minimum units of trading; (11) odd-lot purchases and sales; (12) minimum deposits on margin accounts; and (13) similar matters."

2/ The Securities Exchange Act of 1934, the New York Stock Exchange and the rule of the New York Stock Exchange which is the subject of this proceeding are hereinafter referred to, respectively, as the "Act", the "NYSE" and the "Rule".

3/ Securities of this kind will hereinafter be called "dually traded securities".

Under the terms of the Act, a security (other than an exempted security) can lawfully be traded on a national securities exchange only when the security is effectively registered for such exchange in accordance with the provisions of the Act. There are two classes of registered securities: (1) listed securities which are listed and admitted for trading on application of the issuer and (2) securities admitted to unlisted trading privileges which are admitted for trading on the application of an exchange. The NYSE has no securities admitted to unlisted trading privileges although many securities listed on the NYSE are admitted, pursuant to the Act, to unlisted trading privileges on other exchanges.

4/ A "member" of an exchange as used herein and as defined by Section 3 (a) (3) of the Act means "any person who is permitted either to effect transactions on the exchange without the services of another person acting as broker, or to make use of the facilities of an exchange for transactions thereon without payment of a commission or fee or with the payment of a commission or fee which is less than that charged the general public, and includes any firm transacting a business as broker or dealer of which a member is a partner, and any partner of any such firm."

We shall hereinafter use the terms "dual member" and "local member" as follows:

"Dual member" means an individual or partnership which is at the same time a member of the NYSE and of one or more of the other registered securities exchanges.

"Local member" means an individual or partnership which is a member of one or more registered securities exchanges and is not a member of the NYSE.

Act. Seventeen exchanges in fifteen cities other than New York are likewise registered as national securities exchanges. 5/ All of these exchanges are recognized by the Act to be instrumentalities of interstate commerce. For convenience, the seventeen registered exchanges in cities other than New York will hereinafter be called "regional" or "local" exchanges. 6/

This proceeding arose under the following circumstances:

Section 8 of Article XVI of the Constitution of the New York Stock Exchange reads:

> "Sec. 8. Whenever the Board of Governors, by the affirmative vote of seventeen Governors, shall determine that a member or allied member is connected, either through a partner or otherwise, with another exchange or similar organization in the City of New York which permits dealings in any securities dealt in on the Exchange, or deals directly or indirectly upon such other exchange or organization, *or deals publicly outside the Exchange in securities dealt in on the Exchange*, such member or allied member may be suspended or expelled, as it may determine." (Italics supplied)

On February 14, 1940, a special committee of the NYSE, known as the Stott Committee, which had been appointed September 28, 1939 by the president of that exchange to study the problem of multiple trading 7/ in securities listed on such exchange, recommended in a report to the Exchange's Board of Governors "that the Committee on Member Firms of the Exchange be directed to proceed to enforce Section 8 of Article XVI of the Constitution with respect to such dealings of members on other exchanges in securities listed on this Exchange, in such manner and at such time as they deem advisable." The Board of Governors on February 28, 1940, adopted this recommendation, and the Exchange on July 12, 1940, issued an official circular to the members of the NYSE which reads as follows:

5/ The seventeen registered national securities exchanges located in cities other than New York are the Baltimore, Boston, Chicago, Cleveland, Cincinnati, Detroit, Los Angeles, New Orleans, Philadelphia, Pittsburgh, San Francisco, St. Louis, Salt Lake, and Washington stock exchanges and the Chicago Board of Trade, the San Francisco Mining Exchange and the Standard Exchange of Spokane.

6/ Our use of the adjectives "regional" or "local" is in no way meant to imply that the seventeen registered exchanges located outside the City of New York are unimportant or mere appendages of the NYSE.

7/ The term "multiple trading", also called "dual trading" refers, in this proceeding, to trading in dually traded securities on both the NYSE and one or more of the regional exchanges.

"On February 28, 1940 the Board of Governors upon the recommendation of the Special Committee on Multiple Exchange Trading, adopted a resolution directing the Committee on Member firms to proceed to enforce Section 8 of Article XVI of the Constitution with respect to public dealings by members on other exchanges in securities listed on this Exchange.

"Pursuant to this resolution the Committee on Member Firms has ruled that after *September 1, 1940, any member, allied member or member firm acting as an odd-lot dealer or specialist or otherwise publicly dealing for his or its own account (directly or indirectly through a joint account or other arrangement) on another exchange in securities listed on the New York Stock Exchange, shall be subject to proceedings under Section 8 of Article XVI.* 8/

"The foregoing does not limit the right of members, allied members or member firms to execute orders for account of others on an agency basis on other exchanges." 9/ (Italics supplied)

Meanwhile, on April 10, 1940 the Commission instructed its Trading and Exchange Division to study and report to the Commission on those phases of multiple trading which were pertinent to a consideration of the action taken by the Board of Governors of the NYSE on February 28, 1940. On October 24, 1940 Commissioner Pike, on behalf of the Commission, submitted to the NYSE a copy of a summary of findings and conclusions to be contained in the Report

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8/ The term "Rule", as hereinafter used, has reference to Section 8 of Article XVI of the NYSE Constitution as interpreted by the NYSE Committee on Member Firms in its ruling of July 12, 1940.

A provision similar to Section 8 of Article XVI has been in the Constitution and Rules of the NYSE since 1863. The section was put in its present form in 1925. Prior to July 12, 1940, this provision had never been construed to prohibit NYSE members from dealing on exchanges outside the City of New York in securities listed on the NYSE. The Rule is said to rest upon that portion of Section 8, Article XVI which subjects to suspension or expulsion any member who "deals publicly outside the exchange in securities dealt in on the Exchange." We very much doubt the soundness of the construction given to this constitutional provision by the Rule. The language and history of Article XVI, Section 8 of the NYSE Constitution indicate that, insofar as it refers to dealing on exchanges, the reference is to exchanges *in the City of New York*. However, we do not propose to decide the propriety of the construction adopted in the Rule but we shall proceed to determine the operation of the Rule in the light of the purposes of the Act.

9/ Following the issuance of this ruling the Committee on Member Firms adopted the policy of granting, upon application, extensions of the effective date of the ruling beyond September 1, 1940.

to the Commission to be submitted by the Trading and Exchange Division on the Problem of Multiple Trading. At the same time the Commission requested the Board of Governors of the NYSE to rescind its resolution of February 28, 1940, pursuant to which the Committee on Member Firms made its ruling. The NYSE refused to comply with this request. On November 22, 1940 the Trading and Exchange Division submitted its full Report to the Commission on the Problem of Multiple Trading on Securities Exchanges. On December 20, 1940, the Commission, pursuant to Section 19 (b) of the Act, formally requested the NYSE to

> "effect such changes in its rules, as that term is defined by Section 6 (a) (3) of the Act, 10/ as may be necessary to make it clear that the rules of the exchange or their enforcement, shall not prevent any member from acting as an odd-lot dealer or specialist or otherwise dealing 11/ upon any other exchange outside the City of New York of which he is a member." 12/

The NYSE, by reply dated December 27, 1940, advised that it could not accede to the Commission's request in this respect. 13/ Thereupon, on January 2, 1941, the Commission directed that a hearing be held "on the question whether the Commission should, pursuant to Section 19 (b) of the Securities Exchange Act of 1934, by rule or regulation or by order alter or supplement the rules of such exchange insofar as necessary or appropriate to effect the above specified changes therein, as rrquested by the Commission on December 20, 1940."

10/ Under this section the "rules" of an exchange refer collectively to its constitution, articles of incorporation with all amendments thereto, and existing by-laws or rules or instruments corresponding thereto, whatever the name.

11/ The term "dealing" refers to the activities of a "dealer" as defined in Section 3 (a) (5) of the Act; that is, a person engaged in the regular business of buying and selling securities for his own account. Mr. Stott in the course of his testimony in this proceeding and counsel for the NYSE in their brief have stated that the Rule does not prohibit a dual member from making a principal transaction on a regional exchange for his own account unless he is acting as a dealer. The Rule also does not limit the right of dual members to execute orders for the account of others on an agency basis on regional exchanges.

12/ Our letter of December 20, 1940, made it clear that we had reference to dual members who deal in dually traded securities upon one or more of the regional exchanges.

13/ At the same time, the NYSE acceded to the request contained in the Commission's letter of December 20, 1940 that application of the Rule be held in abeyance pending final determination of the matter. By circular dated December 28, 1940 the NYSE extended, until further notice, the existing exemptions granted from the ruling and agreed to grant, upon application, similar exemptions to any other member firms which on July 12, 1940 were engaged as odd-lot dealers and specialists on another exchange in securities listed on the NYSE.

A hearing before a Trial Examiner was held after due notice. Counsel to the NYSE and counsel to the Commission submitted requests for specific findings of fact, and the Trial Examiner rendered his report, to which exceptions were filed. Counsel also filed briefs and reply briefs and were heard before this Commission.

At the outset we deem it desirable to outline briefly the nature of the discussion which is to follow. First, we shall describe the technical background necessary to understand the problems raised by the Rule, including a description of practices and matters relating to the mechanics of trading on national securities exchanges. We shall then proceed to determine, pursuant to Section 19 (b) of the Act, whether changes in the Rule are necessary or appropriate for the protection of investors or to insure fair administration of the NYSE. In order to make such determination we shall consider the effects of the Rule and the arguments advanced by the NYSE in justification of its Rule. Finally, we shall consider whether Section 19 (b) of the Act authorizes us to alter or supplement the Rule.

THE BACKGROUND OF THE RULE

It appears that the situation to which the Rule is addressed arises as a result of practices and of matters relating to the mechanics of trading on the stock exchange markets of the country.

The NYSE maintains a more or less continuous auction market, with trading "posts" at which shares of stock are traded in "round lots" (generally 100 share lots). At these posts are located the specialists. A "specialist" is a member of the exchange who, with the approval of the governing authorities of the exchange, deals publicly on the floor of such exchange, for his own account as principal, in round lots of specified securities and also as a broker executes orders for others on a commission basis. Another recognized function of that exchange market is to fill orders for odd lots. An "odd lot" is any number of shares less than the round-lot unit of trading. Odd lots are traded on the floor of the exchange through "odd-lot dealers" 14/ who act as principals and who alone may accept orders to buy or sell such odd lots. Virtually all of the odd-lot business on the NYSE is conducted by three odd-lot dealers (as of January 30, 1941) who have no direct dealings with the public; they deal only with NYSE members, the so-called "commission houses". 15/

14/ An "odd-lot dealer" is a member of an exchange who, with the approval of the governing authorities of such exchange, exercises the function of dealing on the exchange, for his own account as principal, in odd lots of specified issues of stock.

15/ A "commission house" is a firm primarily engaged in the business of effecting transactions in securities for the account of members of the public. See, *Glossary to the Commission's Report on Feasibility and Advisability of the Complete Segregation of the Functions of Dealer and Broker (1936)*.

Many of the securities which are listed on the NYSE are also traded on one or more of the seventeen regional exchanges. The largest volume of trading in dually traded securities, however, occurs on the NYSE which has more members and a far greater volume of business than any other exchange. Consequently, the prices prevailing in transactions conducted upon the NYSE in dually traded securities carry considerable weight in determining the prices of such securities in transactions upon the regional exchanges. This is not always true in the case of every dually traded security, for there are a few dually traded securities as to which the greater volume of trading occurs on a regional exchange. At July 12, 1940, nine of the regional exchanges 20/ had provisions and facilities for the execution of transactions in dually traded securities based upon NYSE prices. On six of these nine exchanges, namely, the Boston, Chicago, Cincinnati, Cleveland, Philadelphia and Pittsburgh Stock Exchanges, dual members 21/ acted as odd-lot dealers or specialists 22/ in dually traded securities or financed, through joint account, local members who handled the odd-lot books 23/ in such securities; 24/ other books were handled by local members independent of any affiliation with NYSE members.

Round-lot executions on these 6 regional exchanges in dually traded securities differ from those on the NYSE, depending in each case upon the independence of the local market, the rules of the regional exchange, and the practices of the dealer on the local floor. 25/ In some instances an independent auction market is maintained, although round-lot bids and offers

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20/ These nine regional exchanges are the Boston, Chicago, Cleveland, Cincinnati, Detroit, Los Angeles, Philadelphia, Pittsburgh and San Francisco Stock Exchanges.

21/ A dual member acting as odd-lot dealer or specialist on a regional exchange in dually traded securities is called a "dual odd-lot dealer or specialist". A local member acting as odd-lot dealer or specialist on a regional exchange is called a "local odd-lot dealer or specialist."

22/ On the Chicago Stock Exchange the functions of an odd-lot dealer and specialist in any dually traded issue are combined in the same individual.

23/ The term "odd-lot book" means the privilege granted by the governing authorities of an exchange to a member thereof to be the odd-lot dealer in a specified stock on the floor of such exchange.

24/ A major inducement to NYSE members in financing such local odd-lot dealers is to obtain the brokerage commissions on the offsetting transactions executed on the NYSE for the joint account. The connection may also procure for such dual members additional business obtained by their affiliated local members from the public in securities which are traded on the NYSE but are not traded on the affiliated local members' regional exchange.

25/ A "round lot" on the regional exchange in dually traded issues follows generally the unit of trading prescribed for those issues by the NYSE except that on the Chicago Stock Exchange it may be a trading unit of 50 shares. In many local issues the regional exchanges have smaller units of round-lot trading.

tend to be made in the light of prevailing quotations on the NYSE. In other instances, the round-lot market is mechanical, the price on the regional exchange being determined by the NYSE ticker.

The methods for executing odd-lot orders employed by these regional exchanges are similar, in many important respects, to those employed for executions on the NYSE. In the case of dually traded securities, the essential difference is that, in lieu of basing odd-lot executions upon the prevailing round-lot market on the local exchange floor, they are based upon the NYSE transactions as reported on the ticker tape of that exchange. To cite the example employed earlier, we may assume that a customer places an order in the office of a member of a regional exchange to buy 25 shares of X stock "at the market" and the customer stipulates that such execution is to be effected on the floor of the local exchange. The local exchange member would transmit such an order at once to the floor of the local exchange by private wire, where it would be received by the registered odd-lot dealer in X stock. 26/ The odd-lot dealer is required to accept all odd-lot orders tendered to him. Upon receipt, the order would be time-stamped but, unlike the NYSE procedure, it would not then immediately be eligible for execution. Instead, three minutes would have to elapse before the order could be regarded as eligible for execution. After three minutes had elapsed, the first round-lot transaction in X stock reported on the NYSE ticker tape would fix the price which the customer was to pay for the stock; if a price of $50 was reported on the tape, the customer would pay $50-1/8 per share. 27/

Trading on the local exchanges in dually traded issues is facilitated by the existence on the floor of these exchanges of the New York "tape", which reports the current transactions on the NYSE floor. In addition, current quotations on the New York market in these issues are made available to the dual odd-lot dealers or specialists through wire and other direct arrangements for "flash" or continuous quotation services.

The odd-lot dealers or specialists on the regional exchanges, like the odd-lot dealers on the NYSE, are faced with the necessity of keeping their long and short positions within the bounds of what they feel is reasonable in terms of market conditions, available capital, and other factors. It is, therefore, essential for them also to resort to the round-lot market for offsetting transactions. The record indicates that by far the larger portion

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26/ On some exchanges, the odd-lot dealer receives the order directly without the intervention of an order clerk, while on other exchanges the NYSE procedure is followed, whereby an order clerk transmits the order from a booth at the edge of the floor to the odd-lot dealer.

27/ No allowance is made here for the variations in this procedure which occur at market openings, when "tape lateness" is announced, or when the rules of the regional exchange permit executions based upon round-lot transactions effected in the local market.

of such offsets are made on the NYSE since the round-lot markets in dually traded securities on the regional exchanges are not sufficiently active either to take or furnish the securities necessary to enable the dealers to reduce their positions. If these odd-lot dealers or specialists are not NYSE members, they must pay non-member commission rates 28/ in connection with any offsetting transactions which are executed upon the NYSE. When they are dual members, however, they are entitled to NYSE members' commission rates (which are substantially lower than non-member rates) and, consequently, pay substantially less for effectuating such offsetting transactions upon the NYSE. 29/

We have, hereinabove, described the technical background underlying the problems raised by the Rule. As we have previously stated, we requested the NYSE to effect on its own behalf such changes in its Rule as may be necessary to make it clear that the Rule or its enforcement would not prevent any NYSE member from acting as an odd-lot dealer or specialist or otherwise dealing in dually traded securities upon any regional exchange of which he is a member. The NYSE has not made the changes so requested. We shall now proceed to examine the effects to date and the future consequences of the Rule and the arguments advanced by the NYSE in justification of the Rule for the purpose of determining, pursuant to Section 19 (b) of the Act, whether changes in the Rule are necessary or appropriate (1) for the protection of investors or (2) to insure fair administration of the NYSE.

EFFECTS OF THE RULE

1.

The first question for decision is: are changes in the Rule necessary or appropriate for the protection of investors?

Aside from the trading conducted upon the regional exchanges -- which are recognized by the Act to be instrumentalities of interstate commerce -- there is a large and constant flow of business across state lines between the exchanges and their members and investors. Transactions in dually traded issues constitute a substantial part of all the trading conducted upon the Boston, Chicago, Cincinnati, Cleveland, Philadelphia and Pittsburgh Stock Exchanges and a very material portion of such transactions are or were, before July 12, 1940, the date when the Rule was announced, handled by dual members acting as odd-lot dealers or specialists on those exchanges.

28/ Article XVII of the NYSE Constitution prescribes the minimum rates of commission which must be charged and collected by NYSE members who execute orders on the NYSE on behalf of non-members. This rule will hereinafter be called the "minimum commission rule".

29/ When, for example, a local Cleveland member sells for his own account 100 shares of stock at $25 per share on the NYSE floor through an NYSE member, the local member has to pay a commission of $15. When the stock is sold by a Cleveland member who is also an NYSE member, the so-called "clearance commission" applicable to his transaction is only $3.90.

On August 31, 1940, the last day before the effective date of the Rule, there were 249 dually traded issues on the Boston Exchange, 106 on the Chicago Exchange, 13 on the Cincinnati Exchange, 58 on the Cleveland Exchange, 408 on the Philadelphia Exchange and 64 on the Pittsburgh Exchange. The dually traded issues on these six exchanges were handled by odd-lot dealers 30/ or specialists who were dual members, local members financed by NYSE members in joint account, or purely local members. The following table shows the number of such odd-lot dealers or specialists on the dates indicated and the number of dually-traded issues handled respectively by members affiliated with NYSE members 31/ and by those not so affiliated:

		AFFILIATED WITH NYSE MEMBERS		NOT AFFILIATED WITH NYSE MEMBERS	
Exchange	Date	No. of Odd-lot Dealers	No. of Issues	No. of Odd-lot Dealers	No. of Issues
Boston	12/31/40	14 (*)	89	24	113
Chicago	8/31/40	8	57	(**)	48
Cincinnati	7/12/40	3	10	--	--
Cleveland	7/12/40	1	11	3	22
Philadelphia	7/12/40	4 (*)	25	17	101
Pittsburgh	7/12/40	4	20	(**)	25

(*) 11 of the dealers on the Boston Exchange and 2 of the dealers on the Philadelphia Exchange are local odd-lot dealers financed by NYSE members.

(**) The record does not show the number of local odd-lot dealers in dually traded issues on these exchanges.

The record shows what has already occurred where the Rule was put into effect and what has happened in anticipation of the effectiveness of the Rule as well as what may be expected to follow if the temporary exemptions granted by the NYSE are revoked and the Rule is made fully effective. It reveals that the 8 dual member firms who were acting as odd-lot dealers on the Chicago Exchange in 57 dually traded issues were not permitted by that exchange to avail themselves of the temporary exemptions, 32/ and that these firms have already relinquished their dual odd-lot books in these securities. Only local members could replace them. However, due to the capital requirements necessary to obtain an appointment from the Chicago Exchange to conduct an odd-lot business, a substantial portion of the local Chicago members were not eligible for appointment.

30/ In some of the dually traded issues there are no odd-lot dealers.

31/ The term "affiliated with NYSE members" is used here broadly to cover both dual members and local members financed by NYSE members.

32/ The Chicago Stock Exchange considered it in its interest to refuse to allow its dual odd-lot dealers and specialists to apply for temporary exemptions from the Rule.

Moreover, the capital of those local members who were appointed to conduct the odd-lot books in dually traded issues which were relinquished by the dual member firms constitutes only about 10% of their predecessors' capital. It appears further that one of the dual member firms, Paul H. Davis & Co., was, on July 12, 1940, the odd-lot dealer or specialist in 29 dually traded securities and also the general odd-lot dealer 33/ in 114 local securities. According to the testimony of Ralph Davis, a partner of this firm, the entire book was being operated at a "good" profit, and the 29 dually traded securities, which were more active than the local securities, contributed about 75% of the firm's profits. Even though the firm dropped its odd-lot books in the 29 dually traded securities on September 1, 1940, in compliance with the Rule, it has had to maintain about the same overhead as before in order that its trading in the 114 local stocks might be serviced adequately. The result has been a decline in trading profits; in fact, for December, 1940, the firm suffered a loss in the operation of its books. If the operation of these local books continues to be unprofitable, Ralph Davis testified, it is doubtful whether the firm will remain in the odd-lot business. Thus, as a result of its relinquishment of the odd-lot books in 29 dually traded securities as required by the Rule, the Davis firm may be forced to discontinue service on the 114 local odd-lot books which it now handles.

On the Boston Exchange, in anticipation of the effectiveness of the Rule, the books of certain dual members were dropped and reallocated to local members. However, as of the time of the hearing, 6 odd-lot books in dually traded issues on that exchange had not been taken up and no local members had been found who were willing and able to take them. The three dual member firms which operated odd-lot books on the Cincinnati Exchange relinquished their odd-lot books in ten dually traded securities shortly after it became known that the Rule was to be invoked. The Board of Trustees of that Exchange was able to find only one local dealer to take over these books. This dealer, according to the testimony of the president of the exchange, had a total capital of only $8,000 available for the business. Prescott & Co., the only odd-lot dealer affected by the Rule on the Cleveland Exchange, gave up its odd-lot books in 11 dually traded issues. As a result of the readjustment that took place, four of these issues are no longer handled by odd-lot dealers. As yet there has been no reallocation of the odd-lot books in dually traded securities on the Pittsburgh Exchange since the persons there affected by the Rule are operating under temporary exemptions. The four dual odd-lot dealers on the Philadelphia Exchange who operated the books in 23 dually traded issues, applied for exemptions from the Rule. As of January 1941, there was no change in the handling of these books.

33/ A "general odd-lot dealer" on the Chicago Stock Exchange is a person who is required to give odd-lot executions on all non-dually traded issues on the exchange.

In summary, the Rule, even under limited application, has already had disrupting effects on the operation of the odd-lot books in dually traded issues on the regional exchanges. The record evidences that enforcement of the Rule is likely to result in (1) the further loss of odd-lot books in dually traded issues on the Boston, Cleveland and Pittsburgh Exchanges, (2) the reallocation of such odd-lot books on the Cincinnati and Pittsburgh Stock Exchanges to local members with more limited capital resources, and (3) the placing in jeopardy of odd-lot books in some or all of 114 local issues on the Chicago Stock Exchange.

The effects which have followed a limited application of the Rule portend more serious consequences in the future, should the Rule become fully effective. It is clear that the dual member firms have more capital and far greater resources than are available to local member firms. If the Rule should become fully effective, all of these dual member firms will be precluded from acting as odd-lot dealers or specialists or otherwise publicly dealing for their own account in any dually traded securities on the regional exchanges. Various representatives of the regional exchanges testified concerning the serious effects which can be expected to follow in the future, 34/ if enforcement of the Rule is permitted.

The president of the Boston Exchange estimated that if the Rule became effective, a minimum of 25% of all dually traded issues, or about 50 in number, would be without an odd-lot dealer on the Boston Exchange. The firm of Proctor & Cook, dual members of the Boston Exchange, finances the odd-lot books in 21 dually traded securities. George N. Proctor, the firm's partner who has operated the odd-lot books on the Boston floor for many years, testified that if the Rule is enforced, his firm would not be willing to continue in the odd-lot business. Harry W. Besse, an odd-lot dealer of long experience on the Boston Exchange and associated with Draper, Sears & Co., dual members, indicated that if he withdrew from that firm, as required by the Rule, in order to operate independently as an odd-lot dealer, he would have to relinquish some of the books which his present association enables him to handle. Malcolm Amsden, Walter J. Brown and Ray E. Southgate, local odd-lot dealers in joint account with

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34/ Counsel for the NYSE has objected to the trial examiner's admission of testimony by representatives of the regional exchanges regarding the probable consequences of enforcement of the Rule. We overrule this objection because we believe that in this type of proceeding the testimony of persons qualified as experts with respect to the probable effects of the Rule is competent opinion evidence. See VII Wigmore, *Evidence* (3d ed. 1940) §§ 1918-1923, 1976. See also *Opp Cotton Mills, Inc.* v. *Administrator*, 312 U.S. 126 (1941) and *John Bene & Sons, Inc.* v. *Federal Trade Commission*, 299 Fed. 468 (C.C.A. 2d 1924) where the Circuit Court said at page 471:

> "We are of opinion that evidence or testimony, even though legally incompetent, if of the kind that usually affects fair-minded men in the conduct of their daily and more important affairs, should be received and considered; . . . "

NYSE members in 21 dually traded securities, stated in substance that if the Rule compelled the withdrawal of such financial assistance, they would not have the resources necessary to continue to operate their books.

On the Chicago Stock Exchange, where no temporary exemptions were obtained, 35/ certain effects of the Rule have already been observed. According to the testimony of Arthur M. Betts, Chairman of the Board of Governors of the Chicago Stock Exchange, the round-lot markets on that exchange in certain of the dually traded issues have become thinner since September 1, 1940, because the local odd-lot dealers and specialists appointed after September 1, 1940, have been unwilling or unable to take as much stock for their own account as their predecessors, the dual odd-lot dealers. If this drying up of the Chicago round-lot market in dually traded issues continues, it may jeopardize the Chicago markets in local issues.

Enforcement of the Rule would require dual odd-lot dealers on the Pittsburgh Exchange to relinquish their books in 20 dually traded issues. It was testified that the Pittsburgh Exchange, anticipating this contingency, was having considerable difficulty in finding persons with adequate capital to take over the odd-lot books in the event they must be dropped by the dual member firms. It seems that only one local member has indicated a willingness to operate some of these books and he is inactive on the Exchange at the present time. Even if all of the odd-lot books in dually traded issues now handled by dual members on the Cincinnati and Pittsburgh Stock Exchanges should be reallocated to local members, detriment to these exchanges would result since the local members' capital resources are relatively very limited. Finally, the 4 dual odd-lot dealers who now operate under temporary exemptions on the Philadelphia Exchange will be obliged to give up their books in 23 dually traded issues.

If the Rule should become fully effective, the volume of trading on the Boston Stock Exchange would be perceptibly reduced, since, according to the estimates of the president of that exchange, the odd-lot books in about 50 issues would be dropped. Such reduction in volume of trading would in turn affect the earnings of the exchange derived from the operation of its clearing house-earnings which are important to the well-being and continuance of the exchange. For similar reasons, loss of trading volume and the harm resulting from such loss would be in store, also, for the other regional exchanges. Representatives of the Pittsburgh and Cincinnati Exchanges expressed fear that the Rule was a threat to the very existence of those exchanges. In brief, the evidence shows that enforcement of the Rule is likely to result in irreparable damage to the local exchanges.

35/ See footnote 32, *supra*. 79 of the 300 members of the Chicago Exchange were also members of the NYSE.

If the markets in securities traded upon the regional exchanges become seriously impaired, delistings are likely to occur both in local and dually traded issues, fewer brokers and dealers will seek memberships on the regional exchanges and the general effect will be a weakening not only of the existing regional exchange system but also of the brokers', dealers', and bankers' facilities with which the exchanges are functionally interlocked. Furthermore, deleterious economic consequences to trade and industry, particularly to growing industries located in areas surrounding the regional exchanges, can be expected to ensue. For many years the regional exchanges and the market facilities which they maintain have been important factors in the financial lives of their communities. 36/ They have lent vitality to such communities by facilitating the financing of local enterprises and by providing a seasoning mechanism for the security issues of expanding companies, thus assisting them to attain financial stability. If, as a result of enforcement of the Rule, these important functions now performed by the regional exchanges are materially impaired, the nation's trade and industry would be adversely affected.

In view of the foregoing discussion, the harm which investors would suffer from enforcement of the Rule needs little elaboration. The investor as well as the public at large, is deeply concerned with any injury which the existing regional exchange system may suffer; he is equally concerned with the effect of such injury upon trade and industry. 37/ If the regional markets in dually traded issues are destroyed or materially decreased, the public investor who wishes to buy or sell such securities will have to trade on the NYSE and pay the higher costs 38/ attending such transactions. Even if the issues affected by the Rule continue to be traded on the regional exchanges, the customer can expect slower deliveries and poorer service in many cases. The debilitation of regional exchange services in dually traded issues will also permeate their trading services in local issues as well. The investor may therefore be faced with the alternative of trading only in

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36/ The Philadelphia Stock Exchange was organized in 1790, two years before the NYSE, the Boston Stock Exchange in 1834, the Chicago Stock Exchange in 1882, the Cincinnati Stock Exchange in 1885, the Pittsburgh Stock Exchange in 1894 and the Cleveland Stock Exchange in 1900.

37/ Cf. Section 2 of the Act:

> "For the reasons hereinafter enumerated, transactions in securities as commonly conducted upon securities exchanges and over-the-counter markets are affected with a national public interest * * *
>
> "(1) Such transactions (a) are carried on in large volume by the public generally * * * (c) involve in large part the securities of issuers engaged in interstate commerce; (d) involve the use of credit, directly affect the financing of trade, industry, and transportation in interstate commerce ,* * *"

38/ E.g., the New York stock sales and transfer tax, higher mailing charges.

the centralized market located in New York or in the over-the-counter market. To the extent that the regional exchange markets are impaired as a result of the Rule and trading in issues now registered upon the exchanges shifts to the over-the-counter market, the investor will be deprived of the benefits of exchange trading and listing. 39/

The NYSE asserts that no serious consequences will ensue if the Rule is made fully effective because, it claims, all or substantially all of the odd-lot business now being done on the regional exchanges in dually traded securities will be handled by local members. In support of its argument the NYSE points to the fact that on July 12, 1940, when the Rule was published, a large number of the odd-lot dealers in dually traded issues (on the Chicago, Boston, Pittsburgh, Cincinnati, Cleveland and Philadelphia Stock Exchanges) were local members with no NYSE affiliations and, further, that on the other 11 registered regional exchanges (which, on July 12, 1940, had no dual odd-lot dealers) all of the odd-lot business was conducted by local members.

The fact remains, however, that a substantial number of odd-lot dealers in dually traded securities on the 6 regional exchanges named above were also NYSE members or were financed by NYSE members and that these dual odd-lot dealers handled nearly as many dually traded issues as did the local members. It is important that the substantial service rendered to the public investor by these dual odd-lot dealers should not be unduly or unnecessarily impaired. It is of course true that on July 12, 1940 there were no dual odd-lot dealers on 11 of the registered regional exchanges, but the volume of trading in dually traded issues on nearly every one of these 11 exchanges is relatively slight and the record shows that only 3 of these 11 have regular facilities for odd-lot trading. Hence, the application of the Rule to these exchanges is not significant. The fact that the odd-lot books in many dually traded securities are handled by local members affords no basis for the contention that local members could or would take up the

39/ The Securities Exchange Act of 1934 provides substantial advantages to investors with respect to securities listed on a national securities exchange. We mention only a few. For example, Sections 7 and 8 of the Act deal with margin requirements and the use of credit by members, brokers and dealers. Both sections seek to prevent the excessive use of credit in securities transactions on the exchange and thereby to achieve a greater measure of security for the investor-customer's property. Section 9 affords protection against manipulative, deceptive, or other fraudulent practices. Under Sections 12 (a) and 13 (a) the issuer of registered securities must file up-to-date information which discloses financial facts necessary to make an informed judgment as to the value of such securities. Section 14 (a) prohibits the solicitation of corporate proxies in contravention of such rules as the Commission prescribes in the interest of security holders. The Commission's proxy rules seek to make possible intelligent corporate suffrage. Finally, Section 16 requires disclosure of securities transactions by corporate insiders and controls their profits in these transactions, thereby deterring the use of insider's information in a manner detrimental to the public investor.

large number of odd-lot books which would require appointments if the Rule is permitted to become fully effective. There is no indication in the record that the local members are capable of taking up these books, and there is ample testimony to the contrary.

It seems clear to us that the NYSE contention that the Rule will have no serious consequences is refuted by the record. 40/ The proof shows clearly that the Rule, unless it is changed, will cause serious harm to investors. Accordingly, we determine that changes in the Rule are necessary and appropriate for the protection of investors.

2.

The second question for decision is: Are changes in the Rule necessary or appropriate to insure fair administration of the NYSE?

Under the terms of the Rule, if a dual member exercises his right to act as odd-lot dealer or specialist in dually traded securities upon any regional exchange of which he is lawfully a member, he does so under pain of expulsion or suspension from the NYSE. Since a NYSE membership is deemed more valuable than the right to act as a dealer in dually-traded securities on any other exchange, it is clear that the dual member who engages in dual trading will, if he must make the choice, retain his NYSE membership and relinquish his right, as a member of another exchange, to act as odd-lot dealer or specialist in dually traded securities upon such other exchange. Therefore, if the Rule is enforced, the immediate consequence will be that all dual members who are engaged in dual trading will cease acting as odd-lot dealers or specialists in dually traded securities on regional exchanges and will be prevented from financing local members in joint account even though such dual members are as fully and lawfully members of those exchanges as of the NYSE and even though such dually traded securities are as lawfully traded on the regional exchanges as on the NYSE. Thus, the NYSE is not merely governing the conduct of its members on its own exchange; it is attempting, by means of the Rule, to govern their conduct as members of other exchanges.

The term "fair administration" is not defined in the Act. Consequently, we have examined other portions of the Act and have looked to the purposes and legislative history of the Act for aid in construing "fair administration" as used in Section 19 (b). 41/

40/ The additional argument has been made, with reference to the odd-lot books which have already been relinquished as a result of the Rule, that the loss of income to odd-lot dealers who operated these books is trivial since the securities involved are low-priced stocks having little trading activity on the regional exchanges. This is true, but it overlooks the loss of trading service to public investors in such securities on the regional exchanges.

41/ Cf. *U.S.* v. *Dickerson*, 310 U.S. 554, 562 (1940); *U.S.* v. *American Trucking Associations*, 310 U.S. 534, 543-544 (1940); *Securities and Exchange Commission* v. *Universal Service Ass'n et al.*, 106 F. (2d) 232, 237 (C.C.A. 7th, 1939); *Securities and Exchange Commission* v. *Associated Gas and Electric Co. et al.*, 99 F. (2d) 795, 797-798 (C.C.A. 2d, 1938).

It should be noted, first, that the regional exchanges, as well as the NYSE, are recognized by the Act to be instrumentalities of interstate commerce, second, that Congress has found that transactions in securities as commonly conducted upon securities exchanges "constitute an important part of the current of interstate commerce", third, that such transactions "directly affect the financing of trade, industry, and transportation in interstate commerce" and the "volume of interstate commerce" and, finally, that one of the declared purposes of the regulation provided by the Act is "to protect interstate commerce". 42/ It should be noted also that Congress has given expression to the policy of fostering competition among exchanges and of keeping such competition fair. 43/

Bearing in mind the legislative intent to make regulation and control under the Act "reasonably complete and effective" in order to effectuate the purposes of the Act (Section 2 of the Act), it is clear that, in determining whether changes in the Rule are necessary or appropriate to insure fair administration of the NYSE, we should consider not merely the effects of the Rule upon the NYSE and its members but also the effects which enforcement of the Rule is likely to have upon the regional exchanges and their members, upon trade and industry in the areas served by those exchanges, and upon competition between the NYSE and the other exchanges.

We have previously described the probable consequences of the Rule upon the regional exchanges and upon trade and industry in the areas served by those exchanges. 44/

An adequate consideration of these effects shows that enforcement of the Rule is likely to impede the functioning of important instrumentalities of interstate commerce and to curtail or materially impair an important segment of the existing channels for the distribution and marketing, in interstate commerce, of dually traded securities. It seems to us, therefore, that the Rule would operate as an unreasonable and unjustified restraint upon interstate commerce and that enforcement of the Rule would violate one of the basic purposes of regulation under the Act, a purpose which is closely related to the

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42/ See Section 2 of the Act.

43/ The reports of the Senate Committee on Banking and Currency and the House Committee on Interstate and Foreign Commerce accompanying the amendments to Section 12 (f) of the Act which were enacted in 1936 (Sen. Rep. No. 1739, 74th Cong., 2d Sess., p. 3; H.R. Rep. No. 2601, 74th Cong., 2d Sess., p. 4) expressly state that the amendments represent an endeavor by Congress to

> ". . . create a fair field of competition among exchanges and between exchanges as a group and the over-the-counter markets and to allow each type of market to develop in accordance with its natural genius and consistently with the public interest."

44/ See *supra*.

public policy regarding unreasonable restraints and the maintenance of fair competition as declared by Congress in the Sherman Act, the Clayton Act and the Federal Trade Commission Act. 45/ Moreover, although it is claimed by the NYSE that the Rule is aimed at "unfair competition" between dual members and

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45/ Cf. *Eastern States Retail Lumber Dealers' Association v. United States*, 234 U.S. 600 (1914), in which an action was brought by the United States under the Sherman Act for an injunction against certain alleged combinations of retail lumber dealers, which, it was alleged, had entered into a conspiracy to prevent wholesale dealers from selling directly to consumers of lumber. The defendants adopted the method of distributing, to their members, reports listing the names and addresses of wholesale dealers who sold directly to consumers. Members were requested to report any instance they knew of wholesale dealers soliciting, quoting, or selling directly to consumers. The circulation of such information among retailers had and was intended to have the effect of causing such retailers to withhold their patronage from the concerns listed. The Supreme Court, in affirming the decree of the District Court, said, at page 614:

> "A retail dealer has the unquestioned right to stop dealing with a wholesaler for reasons sufficient to himself, and may do so because he thinks such dealer is acting unfairly in trying to undermine his trade.
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> * * * * *
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> "When the retailer goes beyond his personal right, and, conspiring and combining with others of like purpose, seeks to obstruct the free course of interstate trade and commerce and to unduly suppress competition by placing obnoxious wholesale dealers under the coercive influence of a condemnatory report circulated among others, actual or possible customers of the offenders, he exceeds his lawful rights, and such action brings him and those acting with him within the condemnation of the act of Congress, and the District Court was right in so holding."

Cf., also, *Dr. Miles Medical Co. v. Park & Sons Co.*, 220 U.S. 373 (1911), where Mr. Justice Hughes (in answer to the argument that, because a manufacturer may make and sell, or not, as he chooses, he may affix conditions as to the prices at which purchasers may dispose of the article) said, at pages 404-406:

> "But because a manufacturer is not bound to make or sell, it does not follow that in case of sales actually made he may impose upon purchasers every sort of restriction. Thus a general restraint upon alienation is ordinarily invalid.
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> * * * * *
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> "With respect to contracts in restraint of trade, the earlier doctrine of the common law has been substantially modified in adaptation to modern conditions. But the public interest is still the first consideration. To sustain the restraint, it must be found to be reasonable both with respect to the public and to the parties and that it is limited to what is fairly necessary, in the circumstances of the particular case, for the protection of the covenantee. Otherwise restraints of trade are void as against public policy."

other members of the NYSE, it seems to us that enforcement of the Rule would itself constitute unfair competition and therefore not fair administration. This will be clearer after we have discussed the arguments advanced by the NYSE in justification of its Rule.

The NYSE contends that the Rule is a measure designed for the purpose of preventing a NYSE member, who is also a member of a regional exchange, from engaging in a type of transaction, in connection with his offsetting transactions, 46/ whereby he "unfairly competes with his fellow [NYSE] members" by enabling "non-members of the NYSE to avail themselves of the floor of the NYSE without paying the minimum non-member commission required by the Constitution of the NYSE" (Reply brief of the NYSE, page 8; NYSE requested finding 24). At the hearing herein, the NYSE submitted an exhibit, Exhibit H, purporting to describe a series of three transactions which, according to counsel for the NYSE, furnish "an elementary mathematical illustration" of how certain transactions effected by the dual member result in evasion of the NYSE minimum commission rule.

In each of the three transactions described in the exhibit, a round lot of 100 shares of dually traded no par stock is involved. In the first transaction, a local member places an order with an NYSE commission house for the purchase of 100 shares on the NYSE. It is assumed that the price on the NYSE is $50 per share. In the second transaction, the local member, instead of buying through a broker on the NYSE, buys 100 shares of the same stock on his local exchange from a dual member dealing for his own account in this stock. In this transaction, it is assumed that the dual member sells the stock at a price of 50-1/8. In the third transaction, which is related to the second, it is assumed that the price on the NYSE is still $50 per share and that the dual member offsets his sale to the local member by buying 100 shares of the stock on the NYSE at that price. In the first transaction, the NYSE commission house collects from the local member the minimum non-member commission which, in this case, amounts to $18. Since the price of the stock on the NYSE is $50 per share, the total cost to the local member is $5,018. In the second transaction, the local member pays no commission since he buys directly on the local exchange from a dual member dealing for his own account. In this transaction, therefore, the total cost to the local member is $5,012.50. In the third transaction (the offsetting transaction), the dual member buys 100 shares of the same stock on the NYSE at $50 per share, the price assumed to be still prevailing on that exchange. The dual member pays a total of only $5,000 for these 100 shares, since as a member of the NYSE he is not required to pay the non-member commission. After paying the Federal tax of $6 on the transfer of the 100 shares which he has previously sold for $5,012.50, the dual member's profit as a result of these two transactions is $6.50.

46/ As we have previously pointed out (*supra*), a dual member acting as odd-lot dealer or specialist in dually traded securities on a regional exchange often sells or buys round lots of such securities on the NYSE in order to offset a long or short position which he may have acquired as a result of his trading on the regional exchange. As a member of the NYSE, he can effect such offsetting transactions upon the NYSE without paying the rates of commission prescribed by the NYSE minimum commission rule for non-member transactions.

Counsel for the NYSE claims that the problem to which the Rule is directed is the alleged evasion of the NYSE minimum commission rule in respect of all offsetting transactions on the NYSE (i.e., the third type of transaction illustrated in Exhibit H) arising out of dealer transactions on regional exchanges by dual members (i.e., the second type of transaction illustrated in Exhibit H). The problem exists, the NYSE claims, irrespective of whether these transactions are round-lot or odd-lot transactions or whether the local member is acting as principal for his own account or as agent for the account of a customer.

To illustrate, when the local member, dealing for his own account, buys an odd lot of dually traded securities on the regional exchange from a dual odd-lot dealer, he pays the prevailing NYSE round-lot market price, the odd-lot differential of 1/8 of a point, and, in some cases, the member commission prescribed by the regional exchange. On the other hand, if he bought the odd lot on the NYSE through a NYSE commission house, he would have to pay the minimum non-member commission prescribed by the NYSE in addition to the prevailing NYSE round-lot market price and the odd-lot differential of 1/8 of a point. The member commission on the regional exchange is much lower than the non-member commission on the NYSE. Hence, the NYSE contends, there is an incentive to the local member to deal with the dual odd-lot dealer on the regional exchange rather than with the NYSE commission house, and the NYSE commission house loses a possible commission on such business .

When the local member acts as a broker for the account of a customer, he is said to have a similar incentive to place his orders on the regional exchange with the dual odd-lot dealer or specialist. When, for instance, a customer places an order with a local member for the purchase or sale of a round lot of a dually traded issue, the local member can execute the transaction either on the regional exchange or on the NYSE, in which case he must pay a full non-member commission. In that case he will make no net commission on the transaction since he must pass on to the NYSE commission house the commission which he receives from his customer. However, if the local member can execute the order on the regional exchange by buying from or selling to a dual member, he retains the commission paid to him by his customer. Similarly, if a customer places an order with a local member to purchase or sell an odd lot of a dually traded issue, the local member can effect this transaction either on the regional exchange or on the NYSE. If he transacts the business on the regional exchange, through a dual odd-lot dealer, he will earn a commission on the transaction, since he will charge the customer a prescribed commission in addition to the cost of the stock. If, however, the local member transacts the business on the NYSE, he will be charged the non-member commission prescribed by the NYSE. The commission which the local member charges to the customer in this transaction is not retained by him for he must, in turn, pay the commission to the NYSE member for effecting the transaction. Thus, if the local member can execute the order on the regional exchange, he retains the commission paid to him by his customer. But if he must execute the order on the NYSE, he must pass the commission on to a NYSE commission house.

At this point, a few comments on Exhibit H are appropriate. In the first place, the NYSE furnished no proof of the occurrence of any specific transactions such as are described in Exhibit H and no evidence was furnished as to the frequency of such transactions. It was testified merely that the Stott Committee 47/ believed that the alleged practice which these transactions are intended to illustrate could and did take place.

Furthermore, it was assumed, that the dual member, in the second transaction described in Exhibit H, sold the stock to the local member at a price of 50-1/8. Since a round lot transaction is described, it is obvious that the 1/8 of a point which represents the difference between the prevailing price on the NYSE and the price charged on the regional exchange by the dual member is not the 1/8 differential which is applicable to odd-lot transactions. Rather, it represents the minimum unit of price quotation and it can be shown that the NYSE argument fails, unless the dual member and the local member, in this transaction, agree upon a price which is precisely 1/8 of a point higher than the price prevailing on the NYSE. If the price were exactly the same as that prevailing on the NYSE, the dual member would not enter into the transaction, under the circumstances assumed in Exhibit H, since he would suffer a loss if he sold the stock to the local member at $50 per share, paid $50 per share in the offsetting transaction and, in addition, paid the Federal tax on the sale to the local member. On the other hand, there would be no incentive for the local member to buy on the regional exchange at a price of 50-1/4 or more, since the over-all cost of the purchase would, in that case, exceed the total cost of effecting the transaction on the NYSE, even including the NYSE non-member commission. Furthermore, if the local member were willing to pay 50-1/4 or more, it would be possible for the dual member to make a profit in an amount greater than the minimum non-member commission, in which case the NYSE has stated that it has no objection to the practice. Still, although it is clear that a price of precisely 50-1/8 in the second transaction is essential to the NYSE argument, no proof has been presented of the occurrence of any such specific transactions or of the frequency of such transactions.

It is also clear that the "unfair competition", of which the NYSE speaks, has no reference to that type of competition which might exist if the public customer could buy stock on a regional exchange at a better price than he could buy the same stock at the same time on the NYSE. For, when a public customer places an order on a regional exchange for the purchase or sale of a dually traded security, he must pay the minimum non-member commission prescribed by the regional exchange for the execution of his order. That minimum commission, with few exceptions, is equivalent to the minimum non-member commission prescribed by the NYSE and the record shows that a public customer trading on a regional exchange, whether he places his order with a local member, acting as broker, or with a dual odd-lot dealer or specialist, 48/ must pay a full non-member commission equal in amount to

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47/ See *supra*.

48/ Some of the regional exchanges have constitutional provisions or rules requiring that certain orders executed by members as principals must be executed in such fashion that the price reflects an amount equivalent to the full non-member commission of the particular exchange.

that which he would have to pay on the NYSE. Consequently, the practice at which the NYSE Rule is allegedly aimed could not possibly constitute "unfair competition" in the sense that public customers are induced to trade on a regional exchange rather than on the NYSE by an offer of better price terms on the regional exchange. 49/

We are not persuaded that the practice illustrated by the type of transactions contained in Exhibit H constitutes "unfair competition" as claimed by the NYSE. Exhibit H and the NYSE arguments based thereon show that the basic purpose of the Rule is to effect a change in the methods of trading on the regional exchanges so that transactions like the second and third transactions described in Exhibit H will be eliminated to the end that some of the business now conducted on the regional exchanges will be diverted to the NYSE for the benefit of those members of the NYSE, not engaged in dual trading, who conduct odd-lot and commission business on the NYSE. It seems to us that this attempt by the NYSE to divert business from other exchanges, particularly by the means adopted here, constitutes unfair competition on the part of the NYSE. Furthermore, insofar as the Rule discriminates against those members of the NYSE who engage in dual trading, the Rule constitutes unfair administration of the NYSE.

At best, the Rule is an attempt by the NYSE to implement its minimum commission rule. Whether or not that object might be justifiable, we are of the opinion that it cannot properly be achieved by measures such as this Rule which, as we have previously pointed out, would seriously impede the functioning of important instrumentalities of interstate commerce, would unreasonably restrain interstate commerce and would have other undesirable consequences. 50/ In view of the foregoing, we find that changes in the Rule are necessary to insure fair administration of the NYSE.

We have determined that changes in the Rule are necessary or appropriate for the protection of investors and to insure fair administration of the NYSE. Our authority to order such changes is challenged by the NYSE. If such authority exists, it is found in Section 19 (b) of the Act and we now turn to further examination of that section.

49/ We do not mean to imply that unfair competition would exist if better price terms were available to a public customer on one exchange than could be obtained on another exchange.

50/ Cf. the *Eastern States Lumber* case, cited *supra*, fn. 45, where the Supreme Court said, at page 613:

> "The argument that the course pursued is necessary to the protection of the retail trade and promotive of the public welfare in providing retail facilities is answered by the fact that Congress, with the right to control the field of interstate commerce, has so legislated as to prevent resort to practices which unduly restrain competition or unduly obstruct the free flow of such commerce, and private choice of means must yield to the national authority thus exerted."

The Commission's Authority Under Section 19 (b) of the Act

Counsel to the Commission maintain that the subject covered by the Rule falls within subdivisions (5), (9), (11) and (13) of Section 19 (b) of the Act and that the Act confers power upon this Commission to order changes in the Rule. 51/ Counsel for the NYSE challenge this position, asserting that the matters dealt with in the Rule are not within the provisions of Section 19 (b). There are no precedents under this Section to aid us in construing it since during the seven years that have elapsed following the passage of the Act this is the first time there has been any formal proceeding under Section 19 (b).

It is clear that under the rules of law governing construction of statutes Section 19 (b) should be construed broadly to accomplish its purposes. 51A/ Before discussing the specific provisions of Section 19 (b), it seems appropriate that we look to the general purposes of the statute insofar as they may be helpful in construing that section. 51B/ These purposes are set forth in Section 2 of the Act, which is entitled, "NECESSITY FOR REGULATION AS PROVIDED IN THIS TITLE." Section 2 recites that transactions in securities as conducted upon national securities exchanges are affected with a national public interest, which makes it necessary to provide for regulation and control of such transactions and "of practices and matters related thereto", and "to impose requirements necessary to make such regulation and control reasonably complete and effective, in order to protect interstate commerce . . . and to insure the maintenance of fair and honest markets in such transactions." It should be noted that the regulation contemplated by the Act was to be "reasonably complete and effective"; that it was to cover not only national securities exchanges but also "the practices and matters related thereto"; that interstate commerce was to be protected, and that fair markets in securities transactions were to be maintained. All of these matters, as set forth previously in this opinion, were considered by us in determining whether changes in the Rule are necessary or appropriate for the protection of investors or to insure fair administration of the NYSE.

51/ It is clear that we are authorized to alter or supplement the Rule if it affects any one of the matters enumerated in the first twelve subdivisions of Section 19 (b) or "similar matters" as stated in subdivision "(13)".

51A/ In determining the proper construction of Section 19 (b) we must also bear in mind the cardinal rule of statutory construction that remedial statutes are to be liberally construed in order to accomplish their purposes. See *Securities and Exchange Commission v. Crude Oil Corporation*, 93 F. (2d) 844 (C.C.A. 7, 1937); *Securities and Exchange Commission v. Universal Service Association*, 106 F. (2d) 232 (C.C.A. 7, 1939); *Securities and Exchange Commission v. Associated Gas and Electric Company*, 99 F.(2d) 795 (C.C.A. 2, 1938); *Securities and Exchange Commission v. Payne*, 1 F.R.D. 118 (S.D.N.Y., 1940). The United States Circuit Court of Appeals for the Second Circuit recently held that a proceeding by this Commission under Section 19 (a) (3) of the Act, which parallels the procedure of Section 19 (b), was remedial in purpose. *Wright v. Securities and Exchange Commission*, 112 F.(2d) (1940).

51B/ "The meaning to be ascribed to an Act of Congress can only be derived from a considered weighing of every relevant aid to construction." See *United States v. Dickerson*, 310 U. S. 534, 562 (1940). See also *United States v. American Trucking Association*, 310 U. S. 334 (1940)

We turn next to the specific provisions of Section 19 (b). There we find that the Commission is authorized, upon determining that it is "necessary or appropriate for the protection of investors or to...insure fair administration of such (national securities) exchange" to alter or supplement the rules of an exchange "in respect of such matters as" those enumerated in the twelve subdivisions of Section 19 (b) and "similar matters". It is clear from this language that Congress did not intend to empower this Commission to alter or supplement *all* rules or a national securities exchange. At the same time, it is plain that the language "such matters as" and "similar matters" calls for a broad construction of the section.

We turn, first, to subdivision "(11)" which deals with "such matters as", "odd-lot purchases and sales". The Rule admittedly is aimed at practices of NYSE members with respect to odd-lot purchases and sales upon regional exchanges. However, counsel for the NYSE claims that the phrase "rules of such exchange . . . . in respect of . . . odd-lot purchases and sales" has reference only to the manner and method of making odd-lot purchases and sales upon *the particular exchange* whose rules may be under consideration, in this instance, upon the NYSE. We are asked, in effect, to interpolate the phrase "on such exchange" immediately after the words "odd-lot purchases and sales" in subdivision (11). The short answer to this argument is that Congress could easily have added those words had that been its intention. Since Congress did not do so, we see no reason for restricting the plain language of subdivision (11) in the manner suggested by counsel for the NYSE. Furthermore, in the case of some of the matters enumerated in Section 19 (b) it is perfectly clear that they affect the exchanges as a group and are not confined to one exchange alone. We know of no reason for concluding that subdivision (11) is to be so confined. Besides, it would be entirely unrealistic, in view of the express purposes of the Act, to restrict the meaning of subdivision (11) in this manner. As we have seen, many of the members of one exchange are also members of other exchanges and many security issues are listed and traded on two or more exchanges. It is reasonable to assume, therefore, that the rules of any particular exchange with respect to odd-lot purchases and sales of such dually traded securities will almost inevitably affect such purchases and sales, and the practices relating thereto, on other exchanges. Moreover, the reasonableness of such an assumption has been amply demonstrated in this proceeding. The evidence shows clearly that the Rule has already had serious effects and would in the future (if it is fully enforced) have more serious effects on odd-lot purchases and sales on six registered national securities exchanges. 52/

52/ Even under the view of NYSE counsel concerning the meaning of subdivision (11), that subdivision would apply to the Rule, for the loss of odd-lot books in dually traded issues on the regional exchanges would tend to divert some of this odd-lot business to the NYSE. The Rule, therefore, would affect odd-lot purchases and sales upon the NYSE.

We turn next to subdivision "(5)" which deals with "the manner, method and place of soliciting business". The NYSE asserts that its Rule is not one in respect of this subdivision, since Congress intended by this subdivision merely to give the Commission power to deal with the overt conduct of exchanges and their members in "going out after business". By definition, argues the NYSE, "soliciting" carries with it ordinarily the connotation of "requesting something with some degree of earnestness." The courts, however, have held that *soliciting* may be practiced by means other than personal entreaty or use of words, that it requires no particular degree of importunity and that conduct intended or calculated to invite patronage or business may also amount to soliciting. 53/

We believe that "soliciting" in subdivision (5) is not limited to some form of entreaty alone but must be given a broader meaning. Our conclusion is reached particularly in view of the context in which the word is used. In construing subdivision (5), the meaning of "soliciting business" must be considered in connection with and in the light of trading practices in the market place or "exchange" 54/ where facilities are provided for bringing together purchasers and sellers of securities. Various kinds of business in securities are transacted on the "floor" of the exchange by the exchange members with varying functions in that market. Some are members of commission houses, others floor brokers, still others traders, specialists, odd-lot traders, and finally there are the bond brokers and dealers. To meet the needs of the small investor a market in less than round lots of stock has grown up. This odd-lot market constitutes the major part of trading in dually traded securities on the regional exchanges. 55/ Any regular member of an exchange may take up the business of dealing in odd lots provided he meets the prescribed exchange requirements. The odd-lot dealers have representatives on the floor specifically designated and registered by the exchange to conduct that type of business. These odd-lot dealers on

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53/ *Chicago Park Dist.* v. *Lattipes*, 364 Ill. 182, 4 N.E. (2d) 86 (1936); *People* v. *Murray*, 307 Ill. 349, 138 N.E. 649 (1923); *State* v. *Shiffrin*, 92 Conn. 583, 103A. 899 (1918).

54/ Section 3 (a) (1l) of the Act defines "exchange" to mean "any organization, association, or group of persons, whether incorporated or unincorporated, which constitutes, maintains, or provides *a market place or facilities for bringing together purchasers and sellers of securities* . . ." (emphasis supplied).

55/ For the month of July 1940, the proportions of odd-lot trading to total trading in dually traded securities on the following regional exchanges were:

37.9% on Boston Stock Exchange
66.9% on Chicago Stock Exchange
75% (approx.) on Cincinnati Stock Exchange
74.4% on Cleveland Stock Exchange
61.9% on Philadelphia Stock Exchange
90.1% on Pittsburgh Stock Exchange

the regional exchanges always stand ready to deal in any number of shares less than a round lot, and this makes it possible for the small local investor to purchase or sell odd lots of listed stocks at all times. Thus, an odd-lot dealer's presence on the floor of an exchange constitutes a continual holding out by the exchange and by him that he is there to do that kind of business. In that sense, the odd-lot dealer is "soliciting business", much as the broker or dealer advertising himself to be a member of several exchanges is in effect soliciting business for execution on such exchanges. Similarly, a dual member who functions both as specialist and odd-lot dealer solicits business not only in his capacity as an odd-lot dealer, but also in his capacity as a specialist. In this connection, it should be noted that the Rule applies to a dual member who acts as "an odd-lot dealer or specialist" in dually traded issues.

Prior to July 12, 1940, the NYSE did not attempt to penalize those NYSE members who stand on the floor of the regional exchanges (of which they are also members) as properly authorized odd-lot dealers or specialists in dually traded issues, and in that way solicit odd-lot transactions in such issues. Enforcement of the Rule would change that practice for it would subject to suspension or expulsion from the NYSE any NYSE member who acts as a dual odd-lot dealer or specialist, or otherwise publicly deals for his own account on the floor of another exchange, even though he is a member of such other exchange. The Rule thus would limit the circumstances under which and the places where NYSE members may solicit business and is, therefore, a rule in respect of the "manner, method and place of soliciting business" within the meaning of Section 19 (b) (5).

It is also apparent that the Rule is in respect of such matters as "the fixing of reasonable rates of commission, interest, listing and other charges" within the meaning of subdivision (9) of Section 19 (b). As we have already indicated, the NYSE has contended that the purpose of its Rule is to prevent the alleged evasion, by dual odd-lot dealers or specialists, of the provision of the NYSE constitution which prescribes minimum commission rates. 56/ If that is the object of the Rule, it is apparent that the Rule is designed as a means of enforcing and implementing the NYSE minimum-commission rule and relates, therefore, to such matters as "the fixing of reasonable rates of commission, interest, listing, and other charges" within the meaning of subdivision (9).

56/ Indeed, the Chairman of the NYSE's Special Committee on Multiple Trading indicated that the purpose of the Rule might have been achieved by amendment of the NYSE minimum commission rule.

There remains to be considered subdivision (13), covering rules of an exchange which deal with "similar matters" to those enumerated in the preceding twelve subdivisions. 57/ Congress must have intended, by using the general term "similar matters", to broaden the scope of Section 19(b) so as to include rules of an exchange covering matters other than those specifically enumerated in the first twelve subdivisions. 58/ The only qualification is that such "matters" be *similar* to those specifically enumerated, that is, that they should be "somewhat like" or have "a general likeness" to them. 59/

There is no occasion for us to attempt, now, to define the precise limits of our authority under subdivision (13) of Section 19(b). All of the first twelve subdivisions relate to practices and matters on national securities exchanges which are of vital concern to the exchanges, the public investor and the national public interest. The Rule, as we have seen, would have serious adverse effects upon the investors, upon the regional exchanges, upon interstate commerce and trade and industry. Clearly, the Rule relates to "similar matters" within the meaning of subdivision (13) of Section 19(b).

It is evident, therefore, that there is plenary authority vested in this Commission under subdivisions (5), (9), (11) and (13) of Section 19(b) to order changes in the Rule.

57/ The NYSE urges that since all the subdivisions are introduced by the words "in respect of such matters as," and these words mean "similar matters," the phrase "similar matters" in subdivision (13) is redundant. Such a construction would render subdivision (13) meaningless. But, elementary rules of statutory construction require that, if possible, effect should be given to every word or clause used in a statute. See *McDonald vs. Thompson*, 305 U.S. 263, 266 (1938); *Ginsberg & Sons vs. Popkin*, 285 U.S. 204, 208 (1932); *Petition of Public National Bank of New York*, 278 U.S. 101, 104 (1928); *Mason vs. United States*, 260 U.S. 545, 554 (1923). And we find it possible to give full effect to subdivision (13). In any event, the NYSE seems to concede that we have authority under Section 19(b) with respect to "similar matters", although the NYSE derives our authority from the introductory words while we emphasize subdivision (13).

58/ This construction is bolstered by the language introducing the subdivisions of Section 19(b). The authority of this Commission to change rules of an exchange is granted in regard to "such matters as" those enumerated in the 13 subdivisions which follow immediately after the phrase "such matters as." The phrase "such as" generally connotes illustration or suggestion and its use, here, suggests that the specifically enumerated items are merely illustrative and not all-inclusive. *Cf. Behlen Sons' Co. vs. Ricketts*, 30 Oh. App. 167, 164 N.E. 436 (1928); *Traders Ins. Co. vs. Dobbins & Ewing*, 114 Tenn. 227, 86 S.W. 383 (1905).

59/ See Webster, *New International Dictionary*, (2d ed. 1941)

UNITED STATES OF AMERICA
BEFORE THE SECURITIES AND EXCHANGE COMMISSION

At a regular session of the Securities and Exchange Commission, held at its office in the City of Washington, D. C., on the 4th day of October, A. D., 1941.

In the Matter of

THE RULES OF THE NEW YORK STOCK EXCHANGE

File No. 4-26

ORDER PURSUANT TO SECTION 19 (b) OF THE SECURITIES EXCHANGE ACT OF 1934

The Commission, on December 12, 1940, having requested the New York Stock Exchange, in writing, pursuant to the provisions of Section 19 (b) of the Securities Exchange Act of 1934, to "effect such changes in its rules as that term is defined by Section 6 (a) (3) of the Act, as may be necessary to make it clear that the rules of the exchange, or their enforcement, shall not prevent any member from acting as an odd-lot dealer or specialist or otherwise dealing upon any other exchange outside the City of New York of which he is a member"; the president of the New York Stock Exchange, by letter dated December 27, 1940, having advised the Commission that such exchange refused to comply with said request; and the Commission having issued an order for proceedings and notice of hearing on the question of altering or supplementing the Rules of the New York Stock Exchange as provided by Section 19 (b) of the Securities Exchange Act of 1934;

Notice having been duly served upon the New York Stock Exchange; hearings having been held at which the New York Stock Exchange appeared by counsel; and the trial examiner having filed his report; and

The Commission having duly considered the entire record in this proceeding and the briefs of counsel; having heard oral argument; being fully advised in the premises; having entered its findings as contained in the Findings and Opinion of the Commission this day issued; and having determined that changes in the rules of the New York Stock Exchange are necessary or appropriate for the protection of investors and to insure fair administration of the New York Stock Exchange;

IT IS ORDERED, pursuant to Section 19 (b) of the Securities Exchange Act of 1934, that Section 8 of Article XVI of the Constitution of the New York Stock Exchange be and it hereby is altered so as to read as follows:

> "Sec. 8. Whenever the Board of Governors, by the affirmative vote of seventeen Governors, shall determine that a member or allied member is connected, either through a partner or otherwise, with another exchange or similar organization in the City of New York which permits dealings in any securities dealt in on the Exchange, or deals directly or indirectly upon such other exchange or organization, or deals publicly outside the Exchange in securities dealt in on the Exchange, such member or allied member may be suspended or expelled, as it may determine; provided, however, that nothing herein contained shall be

construed to prohibit any member, allied member or member firm from, or to penalize any such firm for, acting as an odd-lot dealer or specialist or otherwise publicly dealing for his or its own account (directly or indirectly through a joint account or other arrangement) on another exchange, located outside the City of New York (of which such member, allied member or member firm is a member), in securities listed or traded on such other exchange."

IT IS FURTHER ORDERED, that this order shall become effective on the 6th day of October, 1941.

By the Commission.

Francis P. Brassor,
Secretary.

(SEAL)

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Special Committee on Multiple Exchange Trading
Box 2 ff "6 - Internal Correspondence"