

MEMORANDUM

DATE November 19, 1940

TO: Miss Olga M. Steig, Chief, Over-the-Counter Unit.
FROM: Arthur Goldman.
SUBJECT: Revision of the Rules under Section 15(c)(1).

Attached hereto is an initial draft of the proposed revision of the X-15C1 Rules.

I have rather concentrated, at this early stage in the study of the problem, upon the approach, general presentation, style and set-up of the rules and to a lesser degree upon the language and substantive matter presently contained therein.

The general scheme adopted was to classify the present rules, with two exceptions, under two main divisions, as follows:-

Fraudulent Device: Misrepresentation.

Present Rule X-15C1-2; Fraud and Misrepresentation.
" " X-15C1-3; Misrepresentation by Brokers and Dealers as to Registration.
" " X-15C1-8; Sales at the Market.

Fraudulent Device: Failure to Disclose.

Present Rule X-15C1-2(in part); Fraud and Misrepresentation.
" " X-15C1-5; Disclosure of Control.
" " X-15C1-6; Disclosure of Interest in Distribution
" " X-15C1-4; Confirmation of Transactions.
" " X-15C1-9; Use of Pro Forma Balance Sheets.

Although the attached draft includes each of the X-15C1 Rules, it is difficult to escape the conclusion that the following of the present rules belong more appropriately within the purview of Section 15(c)(2) than Section 15(c)(1):-

Rule X-15C1-4; Confirmation of Transactions,
Rule X-15C1-7; Discretionary Accounts, and possibly
Rule X-15C1-3; Misrepresentation by Brokers and Dealers as to Registration.

Whereas Section 15(c)(1) outlaws an act designed to induce or effect a transaction by means of manipulative etc. devices, Section 15(c)(2) prohibits an act designed to attempt to induce or to induce or to effect a transaction in connection with which fraudulent etc. acts or practices etc are engaged in. The term "by means of" is defined as "by reason of", "through the instrumentality of" and "by the use of, as a means". Accordingly, the scope of

Section 15(c)(1) appears to be far more limited than that of Section 15(c)(2), in that, under Section 15(c)(1), the culpable act must possess a more direct and proximate bearing upon, and causative relation to, the inducing or effecting of the transaction. Consequently, I submit that:-

- 1) Written confirmation of a transaction is an instrumentality employed in connection with a transaction, and, that such transaction is not induced or effected (Query- when is a transaction effected?) by means of such written notification.
- 2)(a) Overtrading in a discretionary account is a vice employed in conjunction with the effecting of a transaction but forms no element in the effecting or inducing of a transaction.

(b) The failure of a broker or dealer to properly record a transaction with or for a discretionary account is an act subsequent and lacking causative relation to the inducing or effecting of a transaction, and, therefore seems clearly to be an "in connection with" device rather than a "by means of" device.
- 3) The rule relating to misrepresentations by brokers and dealers with regard to registration may, perhaps, also be transposed under Section 15(c)(2). I am, however, reluctant to urge this recommendation as this type of a misrepresentation, although unrelated to the substance of the transaction, may very well induce the transaction.

Attachment

AGoldman/ag