PRICE MAINTENANCE IN THE DISTRIBUTION OF NEW SECURITIES

As the result of a series of inquiries which reached a crescendo in the Pecora Investigation of 1933,1 the investment banking industry has become one of the most closely regulated segments of our economic system. The Securities Exchange Commission, administering the Securities Act of 1933,2 the Securities Exchange Act of 1934 3 and subsequent legislation,4 is in close touch with all phases of the industry, and an investigating team from the Antitrust Division of the Department of Justice is now bringing witnesses before an investigatory grand jury in New York 5—the penultimate step in an investigation of the industry which has been under way for several years, and which may culminate in a prosecution under the Sherman Act.5

The attention of investigators has invariably been caught by the huge figures with which investment bankers deal—flotations amounting to less than five million dollars are referred to in the trade as “small issues”—, and inquiries have centered on the concentration of power made possible by the funneling of these impressive sums through a relatively small number of large banking houses.7 Of the three phases of the issuing process—origination, underwriting and distribution 8—, the first has been thought to contain the most dangerous potentialities for monopolistic control, and thousands of pages of testimony have been taken with a view to the diagnosis, treatment and cure of unhealthy relationships between the investment banker and in-

1. *Hearings before Committee on Banking and Currency on S. Res. 84, 72d Cong., 1st Sess. (1932) and S. Res. 56 and 97, 73d Cong., 1st Sess. (1933); Sen. Rep No. 1455, 73d Cong., 2d Sess. (1934). The first full-scale investigation of the industry was undertaken in New York State in 1909 [REPORT OF GOV. HUGHES' COMMITTEE ON SPECULATION IN SECURITIES AND COMMODITIES (1909)], and led to the Pujo Investigation of 1913 [Committee on Banking and Currency—Money Trust Investigation under H. Res. 429 and 504, 62d Cong., 2d Sess. (1913)]. See also 10 TNEC VERBATIM RECORD (1939-40) passim.
7. Supra note 1; see also BRANDIS, OTHER PEOPLE'S MONEY (2d ed. 1932) 28 et seq.; DOUGLAS, DEMOCRACY AND FINANCE (1940) c. 3 passim.
8. ATKINS, EDWARDS AND MOULTON, THE REGULATION OF THE SECURITY MARKETS (1946) 31. The authors describe the origination function as including "discovery, investigation and negotiation."
dustry.\(^9\) Regulatory requirements such as arm's length bargaining\(^{10}\) and competitive bidding\(^{11}\) have been aimed particularly at the origination phase, while underwriting and distribution have been affected less directly.

Recently, however, the distribution phase has been competing with the banker-issuer relationship for the investigatorial spotlight. Price maintenance, an integral part of the mechanism for widespread distribution of new securities, has come under fire from the Trading and Exchange Division of the SEC\(^{12}\) and the Antitrust Division of the Department of Justice, and has been stoutly defended by representatives of the bankers.\(^{13}\) Bills have been introduced in Congress which seek specifically to exempt price maintenance in securities from the operation of the antitrust laws,\(^{14}\) while simultaneously attempts have been made to demonstrate that such "pegging" is both economically unjustified and a direct violation of the Sherman Act.\(^{16}\) In Matter of National Association of Securities Dealers,\(^{16}\) a recent decision by the SEC, the issues are clearly drawn; a detailed consideration of the case will provide a picture of the mechanism of security flotation, while pointing up the arguments for and against price maintenance which are to be analyzed more fully below.

The N.A.S.D., a quasi-governmental organization set up in accordance with the terms of an amendment to the Securities Exchange Act,\(^{17}\) regulates many activities in the investment banking industry which Congress, with the advice of the SEC, decided could best be controlled through a body composed of representatives of the industry.\(^{18}\) Its Rules of Fair Practice,

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12. The Trading and Exchange Division of the SEC will be referred to *infra* as the Staff.


18. The N.A.S.D. membership includes approximately 90 per cent of all eligible secur-
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based on the short-lived N.R.A. Code for Investment Bankers, are enforced by District Business Conduct Committees, with review by the N.A.S.D. Board of Governors, the SEC, and finally the Federal Courts. The instant case came before the SEC as a review of disciplinary proceedings taken by the N.A.S.D. against certain of its members in connection with an issue of bonds by the Public Service Company of Indiana.

HISTORY OF THE P.S.I. ISSUE

Desiring to refund outstanding bonds at a lower interest rate, P.S.I. entered into negotiations during the summer of 1939 with the investment banking firm of Halsey, Stuart & Co., which resulted in an Underwriting Agreement providing for the purchase by the underwriters of bonds in the principal amount of $38,000,000, authority for the issue having been obtained from the SEC and the Public Service Commission of Indiana. The public offering price was set at 102, the underwriters agreeing to pay P.S.I. 100 for the bonds.

The two-point difference, known as the "spread," was divided as follows: manager's fee, ¼ point; underwriting commission, ¾ point; selling concessions to non-members. A strong incentive to membership is supplied by provisions which prohibit members from granting selling group concessions to non-members. The efforts of the Association have been directed largely toward standardization of practices in the over-the-counter market, although many N.A.S.D. members are also members of exchanges. See Grant, The N.A.S.D.: Its Origin and Operation [1942] Wis. L. Rev. 597.

19. INVESTMENT BANKERS CODE COMMITTEE, CODE OF FAIR COMPETITION FOR INVESTMENT BANKERS (1934).

20. Sanctions authorized under the Maloney Amendment include fines, suspension and expulsion from membership in the Association. Since many dealers depend to a large extent on selling group concessions for their business, and such concessions are not allowed to non-members (supra note 17), expulsion from membership in the Association can amount to expulsion from the industry.

21. SEC Rule U-50, requiring competitive bidding in the sale of securities by holding companies and their subsidiaries, had not been adopted at that time. See Holding Company Act of 1935, SEC Release No. 2676 (1941). Issues sold under that rule are, however, distributed under agreements such as those which governed the P.S.I. distribution.

22. The Underwriting Agreement contained an "out" clause, whereby upon the happening of certain contingencies the underwriters could terminate the contract. While these clauses have been criticized as a refusal on the part of underwriters to make a "firm commitment" to the issuer (ATKINS, EDWARDS AND MOULTON, op. cit. supra note 8, at 40) in practice they have rarely been invoked.

23. Matter of Public Service Co. of Indiana, 6 SEC 286 (1939), a decision granting an exemption from Section 6(a) of the Holding Company Act, which prohibits the issuance of securities of a Public Utility Holding company or subsidiary until declarations have been filed and approved by the SEC. The exemption was granted, under Section 6(b) of the Act, because funds were to be used solely to finance the business of a subsidiary (P.S.I. is a subsidiary of the Trustees of Midland United Company), and because the issue had been authorized by the state commission.

sion to members of the selling group, one point. Underwriters and selling group members were permitted to allow a concession of $\frac{3}{4}$ point from the public offering price to N.A.S.D. members not included in either group.

During the negotiations with P.S.I., Halsey Stuart formed a group of 67 underwriters who agreed to purchase the issue from P.S.I., delivery of the bonds and payment to take place seven days after the public offering. The registration statement filed with the SEC became effective on December 7, 1939, on which date the bonds were offered for sale to the public. The distribution group, all of whom were members of the N.A.S.D., included the 67 underwriters, who retained for sale to their customers approximately two-thirds of the issue, and a selling group of 396 dealers, to whom was allotted the remainder. 25

In addition to the registration statement, prospectus and Underwriting Agreement, the process of issuing involved two agreements which contained specific undertakings not to sell below the public offering price until the Manager should elect to change the price or remove price restrictions. These were the Agreement between Underwriters, and the Selling Agreement. 26

The Agreement between Underwriters gave the Manager the right to stabilize, 27 through the purchase and sale of P.S.I. bonds 28 for each underwriter's account, until the termination of the Selling Agreement. The Agreement between Underwriters also contained a repurchase penalty clause.

25. Only 60 per cent of the bonds allotted to the selling group were taken on the issuing date, and not until almost three months later was the entire allotment taken by dealers (supra, note 13, at 59). Despite the desire of dealers to remain on the preferred list of prominent underwriters, they do occasionally, as in this instance, decline an allotment. For examples of attempts by dealers to remain in underwriters' good graces even after such a refusal, see 10 TNEC VERBATIM RECORD (1939-40) 631-2.

26. The Agreement between Underwriters was in the form of a letter addressed to and confirmed by Halsey Stuart, a copy of which was signed by each underwriter. The letter provided that the copies should constitute one agreement among all the underwriters. The Selling Agreement, also in letter form, contained an acceptance blank which was filled in by those dealers who agreed to become members of the selling group. Supra note 13, at 5-6, 57-8.

27. Stabilization by the Manager in this, as in most issues, was conducted by making an offer to buy any of the new P.S.I. bonds at the public offering price. The purpose of such pegging activity is to prevent the over-the-counter price of the issue from dropping below the offering price during the distribution period. In slow issues, the Manager may peg the open market price somewhat below the offering price; in the P.S.I. issue the Manager's open market bid of 102 was reduced to 101 after the first month of the offering.

As is usually the rule, the Agreement between Underwriters stipulated that the Manager should not, at any time, buy or sell for long or short account in excess of ten per cent of the total issue. The P.S.I. issue differed from most, however, in that the agreements provided that in addition to the Manager's open market activities, the other underwriters and selling group members might make purchases and sales in the open market for their own accounts. Id. at 6.

28. Provision is often made for stabilization of any outstanding securities of the issuer which are similar to the new issue, although such stabilization was not necessary in the P.S.I. issue.
which provided that if the Manager, during stabilization, purchased a bond at or below the public offering price, he could require the underwriter to whom the bond was traced either to repurchase the bond, or to forfeit an amount equal to the selling concession plus any broker's commission. The Selling Agreement imposed a similar sanction on members of the selling group as to forfeiture of selling concession, but omitted the requirement as to repurchase.

The issue was offered to the public during a period of uncertainty in the bond market, partially attributable to the commencement of hostilities in Europe. Sales were very slow, and the Selling Agreement was continued in effect for 103 days, the Agreement between Underwriters being terminated two days later. Despite extensive stabilization activities, the bonds were quoted as low as 100 bid, and during the distribution period 1171 bonds were sold below the public offering price; 338 bonds by the underwriters and 833 by members of the selling group.

This price cutting gave rise to numerous complaints to the N.A.S.D. District Committees from underwriters and selling group members who had "held the line." The complaints alleged that those who cut prices in contravention of their contractual agreement were violating a provision of the N.A.S.D. Rules, which requires of N.A.S.D. members "high standards of commercial honor and just and equitable principles of trade." The District Committees fined 70 of the 107 firms charged with violations and dismissed the remaining complaints, but the Board of Governors reversed the cases in which complaints had been dismissed, imposing fines in every instance. The SEC instituted review proceedings in 1941 as to six cases typifying the various fact situations, and a Trial Examiner held hearings in 1942. Oral argument before the Commissioners was delayed until 1944, and at that

29. The purpose of the repurchase provision is two-fold: (1) it encourages placement of the security for investment, by penalizing dealers for sales to "free riders," who buy only for speculation, and if the market price does not advance, unload their purchase during the period of the distribution; (2) it operates as a deterrent to price-cutting, since the dealer stands to lose his entire commission, when the security sold at or below the issuing price comes back on the market and is purchased by the Manager. If the Manager is offering to buy at the issuing price, it is very likely that securities which dealers have sold below that price will come into the open market. Individual bonds are traced to the dealer or underwriter to be penalized through the serial numbers on the bonds.

30. The Selling Agreement was to run for 60 days, but was terminable at any time by the Manager, who also had the privilege of extending for another 60 days. The Agreement between Underwriters was to terminate 30 days after the Selling Agreement, but could be terminated by the Manager at any time after the date of settlement with P.S.I.

31. The P.S.I. distribution was one of the longest in recent years, the average time of distribution for similar issues being eleven or twelve days. Supra note 13, at 7.

32. Id. at 8-9.

33. N.A.S.D. Rules of Fair Practice Art. III, § 1. These Rules together with the Bylaws of the N.A.S.D. were found by the SEC to comply with the requirements of the Maloney Amendment, in an order granting the N.A.S.D.'s application for registration. Matter of Application by N.A.S.D., 5 SEC 627 (1939).
time the Department of Justice, over objections by the N.A.S.D., was permitted to intervene. 34

The SEC handed down an order in June, 1945, setting aside the disciplinary action of the N.A.S.D. in all the cases reviewed. 35 The majority held that the N.A.S.D. had no authority to discipline its members for violating price maintenance agreements, since the N.A.S.D.’s interpretation of its rules conflicted with Section 15A (b)(7) of the Securities Exchange Act, which requires that a securities association’s rules be designed to remove impediments to a free market, and prohibits rules designed to impose schedules of prices. 36 The Commission found that price maintenance agreements were impediments to a free market and that the N.A.S.D.’s action tended to increase, not remove, such impediments. Further, the Commission held that the enforcement of such agreements by the N.A.S.D. amounted to the imposition of schedules of discounts on the Association’s members.

While the interpretation of the Act was decisive, another issue, raised by the briefs and oral arguments of the SEC’s Staff and the Antitrust Division of the Department of Justice, received extensive treatment in the opinions written by the Commission, as well as the lion’s share of the publicity which the case attracted. 37 This issue was the legality of any price maintenance agreement under the antitrust laws. The Staff, agreeing with the Antitrust Division that the Commission had no power to enforce the Sherman Act directly, contended that the agreements must be considered “within the frame of reference” of the antitrust laws. 38 So considered, it was argued,

34. The motion of the N.A.S.D. to strike the appearance of the Department was denied, Sec. Exch. Act of 1934, SEC Release No. 3544 (1944).
35. Supra note 13.
36. 52 STAT. 1070 (1938), 15 U. S. C. § 78 0-3 (1940): “(b) An applicant association shall not be registered as a national securities association unless it appears to the Commission that . . . (7) the rules of the association are designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to provide safeguards against unreasonable profits or unreasonable rates of commission or other charges, and, in general, to protect investors and the public interest, and to remove impediments to and perfect the mechanism of a free and open market; and are not designed to permit unfair discrimination between customers or issuers, or brokers or dealers, to fix minimum profits, to impose any schedule of prices, or to impose any schedule or fix minimum rates of commissions, allowances, discounts, or other charges; . . . “
37. The importance which the antitrust aspect of the case assumed in the eyes of investment bankers is evident from the statement of Colonel Pope, President of the First Boston Corporation, that if the Attorney General should act to enforce his opinion, as expressed in the Antitrust Division brief, post-war expansion and reconversion of industry “will largely cease, unless the Government undertakes to do the financing. . . .” Hearings before Special Committee on Post-War Economic Policy and Planning, Pursuant to H. Res. 408, 78th Cong., 2d Sess. (1944) 444.
38. The Antitrust Division, in its brief, quoted extensively from McLean Trucking Company, Inc. v. United States, 321 U. S. 67 (1944) as authority for its argument that the SEC must consider the Sherman Act as “a touchstone for the legal qualities and characteristics of the Association rules.” Brief of the Dep’t of Justice, 13–6. The majority in the McLean case, affirming an order of the ICC approving the consolidation of several truck
price maintenance agreements were illegal *per se*, and anyone cutting prices would, by refusing to abide by the terms of an illegal contract, be acting honorably, and therefore could not be disciplined under the N.A.S.D.'s rules.

Although the majority of the SEC found that it was unnecessary to consider the question, 20 of the 46 pages in their opinion were devoted to a discussion of the applicability of the antitrust laws to price maintenance agreements. Commissioner McConnaughey, in his concurring opinion, indicated that the "gratuitous comment" of the majority would afford doubtful legal precedent should the issue later be presented directly. Commissioner Healy, dissenting as to the application of the Securities Act, found that the decision of the case required a consideration of the antitrust argument, and determined that the contracts involved did not violate either the letter or the spirit of the antitrust laws.

Both the majority and dissenting opinions of the SEC concluded not only that the agreements in the P.S.I. issue were lawful, but, more generally, that price maintenance agreements in securities distribution were not *per se* in violation of the Sherman Act. While the worries of the investment bankers were thus partially allayed, the Commission pointed out by way of *caveat* that under certain circumstances a particular underwriting agreement might be an unlawful suppression of competition. The ubiquitous presence of the

39. *Supra* note 13 at 47, 52 n. 6.
40. Id. at 55, 72-4.
41. Halsey Stuart had, for a period of more than a year prior to the SEC's decision, omitted price maintenance agreements, repurchase penalty and stabilization provisions from distributions which it managed. (See reference, not mentioning firm's name, in Comm'r Healy's opinion, *supra* note 13 at 55 n. 1.) Difficulties were encountered on several "sticky" issues, however, where price cutting by underwriters occurred shortly after the offering date. Halsey Stuart returned to the use of price maintenance provisions after the N.A.S.D. decision was announced.
42. Factors which the majority found to be important in determining the validity or invalidity of a given distribution were: (1) the size of the distribution groups in relation to the size of the issue; (2) the powers reserved by the Manager; (3) the duration of the distribution; (4) the type and quality of the security; (5) the size and nature of the class of investors to whom the distribution must be made; (6) the extent to which the price of the issue affects other issues "or is permitted, by artificial means, to exceed the competitive limits set by free market forces affecting similar types of securities." Id. at 39. Commissioner Healy,
Antitrust Division investigating team, which has been going through the records of the larger underwriting houses for the past year, and is now hailing officers and partners of these houses before a federal grand jury, has done nothing to put those worries to rest.

**The Applicability of the Antitrust Laws**

The briefs of the SEC Staff and N.A.S.D. and the opinions of the Commissioners, in their discussion of the antitrust issue, emphasized the question of the economic desirability of price maintenance. With that question and the corollary problem as to what, if anything, should be substituted if price maintenance were eliminated, this study is chiefly concerned. However, from the point of view of the Antitrust Division, such discussion is unnecessary, for the Division found the law to be clear as to the illegality of price maintenance agreements. Since, as Commissioner McConnaughey pointed out,\(^4\) the SEC's comments on the antitrust issue in the instant case could be disregarded as dicta in any later litigation, the Division's arguments merit consideration as indicative of the approach which may be followed by the Division in the antitrust suit for which the current Grand Jury investigation is the groundwork. The Commission's comments are also pertinent as indicating the reaction of an administrative tribunal, which may well serve as a guide for a court considering similar issues.

The Division stressed that price-fixing agreements were *per se* in violation of the Sherman Act, citing the rule established in the *Trenton Potteries* \(^{44}\) and *Socony-Vacuum* \(^{45}\) cases. Taken at face value, the phraseology of the Supreme Court, particularly in the latter case, precludes any argument as to the reasonableness or desirability of a particular price-fixing agreement.\(^ {46}\) To the extent that this conclusive presumption of illegality can be considered a doctrine of general application, therefore, the Division's arguments are very persuasive.\(^ {47}\)

while not troubling to outline any criteria, had "little doubt that underwriters may combine in such numbers and under such circumstances as to violate the Sherman Act." \(^ {43}\) Id. at 73.

\(^4\) Id. at 52, n. 6.


\(^46\) "Under the Sherman Act a combination formed for the purpose and with the effect of raising, depressing, fixing, pegging, or stabilizing the price of a commodity in interstate or foreign commerce is illegal *per se*." Id. at 223.

\(^47\) But see Commissioner Healy's demurrer: "... I accept the principle that price-fixing is illegal *per se* and that in price-fixing cases no question of reasonableness is involved. ... For men [engaged in a common undertaking] to agree to observe a public offering price and not to cut that offering price during a reasonable period of initial distribution does not appear to me to be price-fixing or resale price maintenance as those terms are used in the cases under the Sherman Act and the acts supplementing it. Typical price-fixing agreements occur when producers or wholesalers or others normally in competition with each other fix uniform prices or agree not to compete as to price. Here, while there are hundreds of millions of other bonds of roughly similar quality outstanding and being freely traded (except
The N.A.S.D. brief, while assuming a bewildering number of alternative positions, relied chiefly on the "rule of reason" and the Appalachian Coals case. Cases adopting the Trenton Potteries doctrine were distinguished on the ground that the agreements held illegal concerned the fixing of market prices, whereas price maintenance in the flotation of new securities has no effect on the general market, but performs a useful function in the process of distribution of the new issue.

The SEC majority, admitting the weakening of the "rule of reason," emphasized the Congressional policy of recognition of fixed-price distribution, and pointed out that Congress had refused to outlaw stabilization, but had delegated to the Commission authority to regulate the practice.

48. Some of these alternatives were: (1) The Commission had no jurisdiction to decide the question of illegality under the Sherman Act; (2) even if the Commission had jurisdiction the distributing organization was a joint adventure, similar to an integrated combination, and therefore there was no unreasonable restraint of trade or violation of the Sherman Act; (3) if the distributing organization was not a joint adventure but a loose-knit combination, there was no violation of the Sherman Act because the rule of the Appalachian Coals case (infra note 50) applied; (4) conceding arguendo that the distribution was neither a joint adventure nor a loose-knit combination, there was no invalid resale price maintenance agreement; (5) if there was a resale price maintenance agreement otherwise invalid under the Sherman Act, such agreement was nevertheless valid under the Miller-Tydings Amendment to that Act [50 Stat. 693 (1937), 15 U. S. C. § 1 (1940)]. Brief for N.A.S.D. passim, Matter of N.A.S.D., supra note 13.

49. "But the legality of an agreement or regulation cannot be determined by so simple a test, as whether it restrains competition. Every agreement concerning trade, every regulation of trade, restrains. To bind, to restrain, is of their very essence. The true test of legality is whether restraint imposed is such as merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition." Brandeis, J., in Chicago Board of Trade v. United States, 246 U. S. 231, 238 (1918).

50. 288 U. S. 344 (1933). The Court, holding that a selling agency, although it had a tendency to stabilize prices, did not set market prices and was not an illegal restraint of trade, found that "... a close and objective scrutiny of particular conditions and purposes is necessary in each case. Realities must dominate the judgment. The mere fact that the parties to an agreement eliminate competition between themselves is not enough to condemn it... The question of the application of the statute [the Sherman Act] is one of intent and effect, and is not to be determined by arbitrary assumptions..." Id. at 360-1.

51. Supra note 13, at 31. See Jaffe and Tobriner, The Legality of Price Fixing Agreements (1932) 45 Harv. L. Rev. 1164, 1181 for a discussion of the relative merits of the "rule of reason" and that as to the per se illegality of price agreements.

52. The Commission pointed out that the registration statement required under the Securities Act of 1933 must contain information as to the proposed public offering price, and as to fixed commissions which are to be allowed. Supra note 13, at 40.

53. The specific delegation of authority to regulate stabilization applies only as to securities registered on national securities exchanges; see section 9 (a)(6) of the Securities Exchange Act. The Commission has, however, required the filing of full information as to stabilization operations in connection with any issue covered by a registration statement.
In the light of these indications of Congressional intent, the majority concluded that decisions dealing with price-fixing and price-maintenance in other commodities under the Sherman Act must "obviously be read with caution." 54

THE PRESENT METHOD OF SECURITY DISTRIBUTION

In discussing present methods and possible changes in investment banking, two objectives should be kept in mind: the protection of investors and the maintenance of a smooth and continuous flow of capital into industry. It should also be noted that, as illustrated in the P.S.I. issue, three steps are involved in present price maintenance practices: the pricing of the issue; agreements not to cut price, with their accompanying sanctions; and stabilization. Defenders of the status quo maintain that a successful distribution of a new issue depends on the existence of all three steps, while advocates of change argue that the last two create an artificial market price and should be eliminated.

The pricing function demands expert knowledge on the part of the investment banker, and is vital not only to him but to the issuer and investor. In deciding on the public offering price and the spread, 55 the banker must consider a large number of variables, among which are the price on the market of other similar securities, difficulties likely to be encountered in distribution, and anticipated market trends. 56 If the removal of price maintenance

under the Securities Act. The intention to stabilize must be disclosed in the registration statement and prospectus required by that Act. In its opinion in the instant case, the majority argued that the power to define "manipulative" practices in over-the-counter transactions, granted under Section 15(c) of the Securities Exchange Act, could include regulations of stabilization as broad as any which might be adopted under Section 9 (a)(6). The statement that stabilization operations, particularly in relation to new issues were not forbidden altogether, but "subjected to such control as the administrative commission may find necessary in the public interest or for the protection of investors," occurring in the House Report on the Securities Exchange Bill of 1934 [H. R. REP. NO. 1383, 73d Cong., 2d Sess. (1934) 10], was cited as indicative of Congressional intent to remove the entire stabilization problem from the scope of the Sherman Act. Id. at 41-43.

54. Id. at 43.

55. The decision, it should be noted, is not made ex parte, but in a bargaining process between the Manager and the issuer. As will be pointed out infra, this trading is not necessarily weighted on the side of the banker, for the issuer has alternative sources of capital funds available to him should he be dissatisfied with the price suggested by the banker. For example, see the description of "shopping around" by the Shell Union Oil Corporation in 10 TNEC VERBATIM RECORD (1939-40) 610-20, where (at 619), in discussing "the tremendous trading proclivities of the [Shell] management" one banker announced himself as "determined to avoid being crowded up by the company with regard to the terms of the set-up and the price."

56. Other factors to be considered are (1) the conditions and prospects of the issuer's business; (2) the investment rating of the proposed new issue, which determines the availability of the issue for purchase by banks, trust funds and insurance companies; (3) the purpose for which the proceeds of the issue are to be used. See Findings of Fact and Conclusions of Law Requested by N.A.S.D., 39-40, and those requested by the Staff, 25 et seq., Matter of N.A.S.D., supra note 13.
agreements and stabilization should so affect these variables as to lead to increased spreads and lower public offering prices, the cost of new capital might be considerably greater, and in some cases prohibitive for the issuer.

To what extent does price maintenance actually aid in the distribution of new securities? Investment bankers argue that until a security becomes known to the investing public and has been fairly widely distributed, there can be no market which can give any reliable indication of the value of the security. For example, in an issue as large as that of P.S.I., an investor purchasing a single bond at the public offering price, who suddenly needed cash, might, absent price maintenance, be unable to find an immediate buyer except at a price considerably below the offering price. The offering of a few bonds at this lower price could lower the over-the-counter price for the whole issue, and would dissuade other prospective purchasers from buying at the public offering price.\(^{57}\)

Against this position, it is urged that since a variation of a point or less in the offering price can make the difference between a slow, sticky issue and an immediate, out-the-window distribution, a small reduction in offering price would assure a speedy distribution without reliance on price maintenance. The SEC Staff supported this argument with statistics based on issues sold under the present system, which "broke" the offering price despite price maintenance, but rallied at four or five points below that price.\(^{58}\)

These statistics offer no assurance that a slow distribution unsupported by price maintenance would not result in much more substantial price drops.\(^{57}\) Further, while admitting that without price maintenance there would be some increase in cost to the issuer from lower offering prices, the Staff did not consider the probability that spreads would rise to meet the increased risks involved in issuance. The admission that even under boom market conditions removal of price maintenance would result in some increase in the cost of money to the issuer, indicates the danger of permanent elimination of such restrictions. With the return to market conditions where demand for new capital more nearly balances supply, the offering price necessary to assure an out-the-window distribution would be much lower, with a proportionately higher cost of capital to the issuer.

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57. Dealers customarily sell their allotments of a new issue on a net basis at the public offering price, since they receive a commission in the form of a discount from the underwriters. A technical reason for the absence of demand at the public offering price for an offering made in the open market by an individual therefore suggests itself. Prospective purchasers would have to pay a dealer's commission when buying in the market, and could save the amount of that commission by purchasing directly from a member of the selling group. See Gourrich, *Investment Banking Methods Prior To and Since the Securities Act of 1933* (1937) 4 LAW AND CONTEMP. PROB. 44.

58. Staff Brief at 32, Matter of N.A.S.D., supra note 13.

59. The Staff's discussion fails to take into consideration the fact that in the cases considered, a large portion of each issue had been distributed at the public offering price before the distribution was terminated and price maintenance agreements were cancelled.
It is probable that removal of price maintenance from the distribution mechanism would adversely affect the flow of capital to industry, by increasing the cost to the issuer. But this in itself cannot justify the retention of price maintenance devices, if it be shown that the harm done to investors through the operation of the present mechanism is such as to overbalance the advantages which the system may hold for the issuer and underwriter.

Statistics have been cited to prove that upon termination of selling agreements with their accompanying price restrictions, new issues tend to sell below the public offering price, from which it is argued that the fixed price was artificial, and that investors buying at that price paid more than the security was worth. However, other statistics which show securities increasing in price after the close of the distribution period are also available. This apparent contradiction is explained by the self-evident fact that prices in the securities market fluctuate widely and that new issues may go above or below the offering price, depending upon the reception they meet, and as the general market rises or falls. Conclusions as to the effect of price maintenance in creating artificially high prices cannot be drawn from available statistical studies.

The present distribution system, including stabilization and price maintenance agreements, minimizes the risks carried by the underwriter during the issuing process. By the same token, the cost of capital to the issuer is reduced, for the spread which an underwriter can hope to obtain as the result of his bargaining with the issuer is measured in great part by the extent of the risks he must assume.

If the offering price is set too high, early investors may take a loss, but the underwriter has a "sticky" issue on his hands, and both his reputation and that of the issuer suffers. If an issue is priced too low, the issuer fails.

60. Steiner and Lasdon, The Market Action of New Issues—A Test of Syndicate Price Pegging (1934) 12 HARV. BUS. REV. 339. The authors, on the basis of a study covering the period 1924–32, conclude that approximately 75 per cent of the issues studied "broke" from the offering price, which they attribute largely to the removal of stabilization, though admitting that some of the depreciation may be due to declining markets. Strong objections are voiced against "flagrant overpricing."

61. Lasdon, The Market Action of New Issues—A Survey of Investor Experience (1940) 151 COM. AND FIN. CHRON. 1774. One of the co-authors of the article cited supra note 60, upon further study covering 354 issues for the period 1924–37, concludes that only 8.2 per cent of the issues were over-priced, and that in 85 per cent of the issues, investors could have liquidated at a profit within a year after issue. See also Findings of Fact and Conclusions of Law Requested by N.A.S.D. 41 (Matter of N.A.S.D., supra note 13) where the average deviation from the public offering price at the end of each of the first six weeks after distribution was terminated ranged from plus $1/4 to plus $1/2 point for 84 utility issues studied in 1938–40.

62. As was actually the case in the P.S.I. issue, a break in the open market price after distribution has commenced, but before completion of allotment to the selling group, may make dealers very reluctant to enter the selling group. Stabilization and price maintenance agreements reduce the likelihood of such a break, although the possibility cannot be completely eliminated.

63. For the amount of the actual financial loss to the underwriter on a "sticky" issue,
to get his money’s worth, and those who have bought only for speculation get a “free ride.”\textsuperscript{64} The underwriter’s reputation in the industry is largely dependent on the number of correctly-priced and successful issues he has managed.

Distribution of securities is essentially a merchandising proposition, and the new stocks and bonds which a dealer offers his customers must be priced to sell.\textsuperscript{65} There is no attraction inherent in new securities which makes them more desirable than outstanding issues. Each new issue is weighed against the market price of outstanding securities,\textsuperscript{66} and if investors find the issue priced too high, underwriters and selling group members are faced with the tying up of their capital in unsalable merchandise. Thus the investor, though not personally present during pricing discussions between issuer and underwriter, is far from the forgotten man which he is sometimes represented as being.

It would appear, therefore, to be to the advantage of all parties that an issue be correctly priced.\textsuperscript{67} Furthermore, the availability of price maintenance techniques seems to offer certain advantages to issuer and underwriter in the distribution of an issue. But price maintenance imports no reciprocal disadvantage for the investor; in fact, two possible advantages suggest themselves. First, a purchaser of P.S.I. bonds, who is forced to liquidate before the termination of distribution, is enabled to do so at a much smaller

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\textsuperscript{64} For a proposed regulation eliminating, except under very stringent rules, sales to “insiders,” who are frequently in the best position to enjoy a “free ride,” see Sec. Exch. Act of 1934, SEC Release 3807 (1946). The regulation therein proposed has not as yet been promulgated, presumably because of widespread opposition to the proposal on the part of investment bankers.

\textsuperscript{65} Critics of the “artificiality” of present distribution methods frequently draw analogies to the merchandising of other commodities. Such analogies are open to attack, in view of the many dissimilar factors involved, but it should be noted that few commodities fluctuate as rapidly in price as do securities, and that many commodities subject to wide fluctuation, e.g. agricultural products, are protected by government subsidies, price fixing, and hedges through trading in futures, while state Fair Trade acts and the Miller-Tydings amendment to the Sherman Act specifically authorize price maintenance agreements in the merchandising of trade-marked products. Yet in spite of these “artificial” aids to distribution, which indicate the desire to avoid speculation in inventories common to all merchandisers, mark-ups which approached the spreads received by investment bankers would be considered impossibly low in the distribution of other commodities.

\textsuperscript{66} “The pricing of new issues is completely dependent upon the price levels prevailing upon the general securities market.” Findings of Fact and Conclusions of Law Requested by Staff, 25, Matter of N.A.S.D., \textit{supra} note 13.

\textsuperscript{67} “... [F]inancing costs must be borne finally by the issuer or by the industry, utility or government issuing the securities, and it must be passed on by the industry or utility to the consumer, and by the government to the taxpayer. It is therefore extremely important that the new issue be sold in a market which fairly represents as nearly as possible the value of the thing sold.” Hostetler, \textit{Descriptive Analysis} in \textit{Investment Bankers Code Committee}, \textit{op. cit. supra} note 19, at 68.
discount, because of the stabilization activities of the underwriters, than would otherwise be the case. Secondly, to the extent that the cost of capital to P.S.I. is reduced because of price maintenance, the value of the previous investor’s interest in P.S.I. is increased. Referring to the two objectives mentioned earlier, increased costs to the issuer—which may be expected from elimination of price maintenance—outweigh any possible increase in protection to the investor resulting from such elimination, unless some other system of distribution can feasibly be substituted for the present one.

**Alternatives to the Present Distribution System**

In discussing possible alternatives, it will be well to consider two criticisms of the present investment banking structure which are more general than that as to artificiality of price. The first is that there is too great a concentration of power in a few large New York investment houses and that such concentration makes possible subtle and unhealthy banker domination of issuers. The second is that the present distribution system puts too much emphasis on speed and aggressive salesmanship in placing an issue with the investor.

68. In the P.S.I. issue, if the sale had been made within the first month of the offering, the Manager would have bought the bond in at the issuing price; thereafter, the seller would have taken a one point loss. The stabilization bid is sometimes intentionally placed somewhat below the offering price, so that investors who have merely changed their minds will not be encouraged to sell before the termination of the distribution.

69. In the foregoing discussion it has been assumed arguendo that there is no middle ground between elimination of all price maintenance provisions and retention of the present system. The SEC Staff’s brief suggests, however, that stabilization and repurchase penalty provisions could be retained, and that only the agreements not to cut price should be eliminated from the underwriting and selling group agreements. This contention does not square with the Staff’s argument that price fixing is per se a violation of the antitrust laws, since both stabilization and repurchase penalties are designed to support the public offering price. Agreements to offer an issue at a fixed price, which included these two provisions, would seem to amount in fact to agreements not to cut price. See Comm’r Healy, *supra* note 13, at 74, “Why swallow a camel like stabilization of a market price and strain at a gnat like a uniform offering price not to be broken during a period of primary distribution? The one excuse for stabilizing, which everyone agrees is a form of manipulation of market prices, is to protect a public offering price during a period of primary distribution, in order to facilitate that distribution. . . . Are the underwriters and distributors stabilizing against their own price cutting?” Comm’r Healy also dissented from the SEC’s statement of policy in re regulation of stabilization. *Sec. Exch. Act of 1934, SEC Release No. 2446 (1940).*

70. See, generally, the investigations cited *supra* note 1. Douglas, in his *Democracy and Finance*, devotes one chapter to a discussion of the “centralization of industrial control,” against which, he notes, a reaction has set in. *Douglas, op. cit. supra* note 7, at 6 *et seq.* See also the same author’s proposals for regional finance, *id.* at 18 *et seq*.

71. “The unhappy history of many security issues here has been considered as indication of a general lack of direction or deliberate misdirection of the flow of capital into investment and speculation. High pressure salesmen and inadequate or misleading information disseminated through circulars, prospectuses and other advertising media have been especially criticized.” *Twentieth Century Fund, Inc., Stock Market Control (1934)* 42.
The first objection has been met, to some extent, by the requirement in railroad and most utility issues of competitive bidding for the privilege of underwriting the issue. Other factors which have tended to reduce the monopoly of a few large houses have been the availability of alternative sources for capital funds, such as private placements and term bank loans, and a tendency on the part of certain houses to disregard the conventional ethical taboos by actively soliciting underwriting from issuers who have long done business exclusively with one of the large New York houses.

Anxious though the SEC has been to break up "traditional" issuer-underwriter relationships, it has come to the defense of price maintenance, which indicates that the Commission has found no causal relation between price maintenance and the concentration of power which it has sought to reduce. However, any alternative to the present underwriting machinery which might cut down that concentration should receive serious consideration.

See also Atkins, Edwards and Moulton, *op. cit. supra* note 8, at 120-1. Section 12 of the Securities Act of 1933, which prescribes liabilities of persons selling securities by means of false or inadequate information, may be assumed to have dampened some of the ardor of the high-pressure salesmen described above, but it is still true that securities distribution is essentially a selling problem.

72. Competitive bidding has been required in Massachusetts public utility issues since 1870, and by the ICC on railroad equipment trusts since 1926. Western Maryland Equipment Trust, 111 ICC 434 (1926). The SEC adopted rule U-50 requiring competitive bidding for securities of public utility holding companies and their subsidiaries in 1941, and in 1944 the ICC required that all classes of railroad securities except stocks should be sold by competitive bidding. *In re Competitive Bidding in Sale of Securities*, 257 ICC 129 (1944). See Comment (1941) 50 YALE L. J. 1071; (1943) 43 COL. L. REV. 89.

73. Private placement, which will be discussed more fully *infra*, is the sale of securities by the issuer to one or more large institutional investors. Term loans are made by commercial banks, sometimes in conjunction with insurance companies, on a serial repayment basis. Atkins, Edwards and Moulton, *op. cit. supra* note 8, at 38-9. Financing of industry by government agencies, such as the RFC, the Federal Reserve Banks and the Smaller War Plants Corporation, was greatly expanded during the war, and may well continue to be important as an alternative to private capital financing. *Id.* at 11.

74. See, e.g., the break in the industry's united front against competitive bidding, when three firms indicated that they favored such bidding. *In re Competitive Bidding in Sale of Securities*, 257 ICC 129, 130 (1944).

75. "... [W]e have in the past been much concerned with the apparent existence of monopoly abuses in the underwriting business resulting in lack of competition for the performance of the underwriting function with respect to particular issuers. The existence of ties between issuers and investment bankers whereby the same group of underwriters is recognized to have a 'vested interest' in the financing of that issuer has long been recognized as one of the abuses of our underwriting system." *Supra* note 13, at 43. For examples of positive action by the SEC in this regard, see Matter of Blair & Co., 12 SEC 651 (1943); Matter of The Dayton Power and Light Co., 8 SEC 950 (1941), aff'd sub nom. Morgan Stanley & Co. v. SEC, 126 F. (2d) 325 (C. C. A. 2d, 1942).

76. *Supra* note 13, at 22-3, 26-45; Statement of SEC on Regulation of "Pegging, Fixing and Stabilizing" of Security Prices, Sec. Exch. Act, SEC Release No. 2446 (1940) 11, where, in approving the continuation of stabilization activities under SEC regulation, the Commission found that "there are times when the 'free play' of the 'forces' of supply and demand may, if unrestricted, produce socially or economically undesirable consequences."
tion and, conversely, an alternative which gives promise of a further concentration of power should be discarded.

Turning to the objection as to speed of distribution, it is interesting to note that the present method of distribution was evolved to meet the needs of expanding industry at a time when capital funds for investment were relatively scarce and distribution was often a long and difficult business. Investment bankers could not afford to tie up their limited capital resources in one issue for a long period of time, but depended on aggressive sales organizations and price maintenance techniques to expedite distributions as much as possible. During the past decade, however, the great majority of issues have been distributed promptly, with little or no stabilization activity.

Despite the relative ease with which distributions have been completed, Congress in 1940 amended the Securities Act to confer upon the SEC discretion to accelerate the effective date of registration statements, where the Commission finds that a reduction of the twenty-day waiting period is desirable. Further, notwithstanding the infrequent use of stabilization in recent issues, the Commission has, after careful consideration of the pros and cons, allowed the practice to continue under close regulation.

A possible reason for the retention of what at first blush might appear to be an outmoded mechanism is suggested by the authors of a recent publication by the Brookings Institute. They argue that increased demands for

77. Supra note 13, at 34; Atkins, Edwards and Moulton, op. cit. supra note 8, at 42.
78. "American underwriters . . . dare not [because of lack of capital] . . . take the risk of being obliged to carry out their underwriting agreements by themselves investing their own resources in the underwritten securities. They can afford to make such agreements only on the supposition that they will, with great speed, be able to sell the securities to the multitude of direct individual investors." Sec. Exch. Act of 1934, SEC Release No. 2446 (1940) 4.
80. Section 8(a) of the Securities Act of 1933 as amended, 54 Stat. 857, 15 U. S. C. § 77h(a) (1940); Securities Act of 1933, SEC Release No. 2340 (1940). For a discussion of the reasons for the waiting period as originally incorporated in the statute, see Cherrington, op. cit. supra note 79, at 62–4. Under the amendment, the period has been shortened to from twelve to fourteen days, depending on the work-load of the Commission and the type of information submitted; where the issue follows other recent issues of the same company, and it is only necessary to bring information submitted previously up to date, the issue may become effective within six or seven days after registration.
81. The SEC, recognizing the difficulties inherent in "an adjustment between the interests of purchasing investors on the one hand and the needs of industry for capital funds on the other," has embarked upon a policy of piecemeal regulation of stabilization. Sec. Exch. Act of 1934, SEC Release No. 2446 (1940) 10, 13–14. The first step was the promulgation of SEC Rule X–9 A 6–1, Sec. Exch. Act of 1934, SEC Release No. 2363 (1940), which regulates in considerable detail the stabilization activities connected with the offering of a registered security "at the market." For an extreme example of such activities in "at the market" sales, see Otis & Co. v. SEC, 106 F. (2d) 579 (C. C. A. 6th, 1939).
82. Atkins, Edwards and Moulton, op. cit. supra note 8, at 41–2.
capital can now be expected, while at the same time investment by wealthy individuals has been curtailed by high tax rates. These factors should produce a tightening of the money market, with resulting long distributions, more frequent use of stabilization, and a greater incentive to price cutting by the individual dealer. In considering alternatives to our present investment banking industry, geared as it is for speedy and aggressive distribution, it will be important to examine how such alternatives are likely to function in times of tight money.

Those who advocate change in our present investment banking practices are wont to extoll the virtues of the English system, where a free market is said to exist after an issue of securities is offered for sale. It is therefore pertinent to examine wherein English practices differ from ours and how they might be adapted to the needs of our investors and industrialists.

The typical flotation of securities in England is the public prospectus issue. A company in need of new capital contacts an "issuing house," and arranges for the issuance of the desired type of securities. The issuing house does not buy the securities but handles the advertising and the receipt of subscriptions, and obtains the services of a group of underwriters who guarantee to take up whatever portion of the issue is not subscribed for by the public. These underwriters include commercial banks, insurance companies, investment trusts and private individuals who are prepared to pay the subscription price and to retain the securities for investment.

83. Evidence of the tightening of the money market is already available. To the effect that the "honeymoon" in the marketing of new issues is over, see: Hefferman in the N. Y. Times, Sept. 8, 1946, § 3, p. 1, col. 8; the decline in A.T. & T. shares as a result of the company's announcement of a proposed $351,000,000 debenture issue, N. Y. Times, Aug. 24, 1946, p. 18, col. 5-7; id., Sept. 15, 1946, p. 13, col. 8.

84. Twentieth Century Fund, Inc., The Security Markets (1933) 79–84; Steiner and Lasdon, supra note 60, at 343–4; Hearings before Committee on Banking and Currency on S. 3895, 63d Cong., 2d Sess. (1914) 16.

85. For a comparison which is unflattering to the American system, see Twentieth Century Fund, Inc., ibid. But see Hanson, British Method of Securities Distribution (1933) 4 Investment Banking 148; Adkins, British System of Securities Distribution (1934) 4 Investment Banking 213. For a critical treatment of British practices, see Finnie, Capital Underwriting (1934); Mayhew, Planned Investment (1939) New Fabian Research Publications No. 45. Kessler, The American Securities Act and Its Foreign Counterparts: A Comparative Study (1933) 44 Yale L. J. 1133, 1139, n. 22, provides a brief outline of continental distribution methods, which he finds to be closer to the American than to the British system.

86. This technique, which is sometimes described as a "true" underwriting, finds its American counterpart in cases where the issuing company offers additional securities directly to its present investors, and an underwriter guarantees to purchase from the issuer any securities not so sold.

87. Also included are stock jobbers and large brokerage houses, both of whom buy for resale. However, under the segregation of functions which obtains in the English market, jobbers cannot sell directly to investors, but must offer their holdings through brokers. Similarly, brokers cannot be both principals and agents; if they buy securities for their own account, they must sell to their customers through a jobber, who quotes the price at which sale to the customer may be concluded. Hanson, loc. cit. supra note 85.
On the issuing date, subscriptions are received from private investors and brokers, the books remaining open for a short time, usually only two or three days. Securities not sold to the public are then taken by the underwriters, who receive an overall commission plus a sum apportioned to the amount of the issue they actually buy. After the public subscription closes, the security is listed on the London Exchange, usually being quoted at a premium where the issue is oversubscribed, and at a discount if the underwriters take up part of the issue.

Certain basic differences between American and English practice are at once apparent. (1) There is nothing in the English system corresponding to our selling group; (2) neither the issuing house nor the underwriters attempt to stabilize the market; (3) underwriters generally buy for investment, not for immediate resale. To these differences in technique should be added the following differences in the securities market: (1) English issues are smaller in number and size than those in the American market; (2) most British investors, located in or having agents in London, can be reached through newspaper advertising, and decide whether or not to purchase without solicitation from a dealer; (3) British investors generally buy for investment, and are not as sensitive to fluctuations in the market price as are American investors.

These differences indicate two primary objections to the adoption of the English system here. Firstly, there is no assurance that a method of distribution suitable for relatively small issues, where most of the prospective purchasers are geographically accessible, would be effective to maintain the much larger flow of funds, from a widely scattered investing public, which

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88. Methods of payment for securities vary considerably, but the typical practice is to require that a down payment accompany the subscription, final payment being postponed until the next semi-monthly Stock Exchange settlement date. During the interval between the closing of the subscription books and the final settlement, underwriters who do not desire to retain for investment the securities which they are obligated to take up may sell these securities through brokers and jobbers.

89. The issuing house receives an amount comparable to the American Manager's fee, and brokers receive a discount on their subscriptions. The total spread is approximately the same as it would be for comparable issues in this country, but the broker in England receives a much smaller proportion of the spread than does the American dealer. Adkins, supra note 85, at 214.

90. There are indications, however, that the British market is not completely free: "Broker and jobber will try to get the shares held as widely as possible, to make the market a free one. They must be prepared to see that undesirable fluctuations in the market both before and after the issue are 'ironed out' as much as possible. Support is sometimes also given to the market before the issue is made, especially in the case of mining issues. This practice is frowned on by some high-grade issuing houses, but the Treasury itself usually supports the gilt-edged market before the issuing of a government loan." Mayhew, supra note 85, at 13.

91. However, it "should not be assumed that the English investor applies for any issue automatically. The brokers more or less sell the issue to their clients. They keep careful tab on his holdings and if the issue is suitable they will recommend him to put in his application." Hanson, supra note 85, at 150.
has been customary in this country. Secondly, it is unlikely that the habits of the American investor, who is accustomed to being "sold" on an issue, and is acutely conscious of even slight shifts in market price, could easily be changed to conform to the British system. It should also be noted that English writers have condemned their system in no uncertain terms, emphasizing its lack of organization and the tendency of issuing houses to sponsor highly speculative issues.

The objection as to concentration of power in New York, mentioned earlier, appears to apply with equal force to the English system which, if adopted here, would tend to increase this concentration. Issuing houses, desirous of close contacts with large investors and potential underwriters, would locate in New York, and the potential power of issuing houses, banks and insurance companies over issuers would be increased.

Another possible alternative to the present investment banking machinery might be the development of firms with very large capital funds, which would individually buy securities from an issuer and distribute them gradually, either through selling branches or through independent dealers who would purchase from the underwriting firm whenever there appeared to be an opportunity for resale.

In such a scheme, price maintenance would be entirely discretionary with the underwriter, who would presumably have sufficient capital to ride out any temporary fluctuations in the market. However, the emphasis in issuance of securities would be shifted from merchandising, which stresses rapid turnover and maximum volume of sales, to speculative investment with the possibility of large profits for the underwriter in a rising market and disastrous losses during a prolonged slump, which might dissipate the largest capital resources. The freezing of capital, with the increased risks incident upon holding for a long period, would tend to increase cost to the issuer,
and the opportunities for domination of the issuer would be increased since
the number of firms in the underwriting field would be reduced and there
would be a premium on size.

A final possible alternative might be the expansion of the present private
placement and "best effort" techniques. Private placement, now used ex-
tensively by large, well-established issuers, is the sale of new securities di-
rectly to large institutional investors, such as insurance companies, by-
passing the investment banker and, incidentally, the requirements of regis-
tration with the SEC.96 This technique is subject to the obvious limitation
that only securities having an investment rating sufficiently high to meet
the standards set up for insurance companies and trusts may be sold to such
institutions. It is also criticized because it circumvents a major purpose of
the Securities Acts by avoiding the necessity for full disclosure through regis-
tration, and deprives smaller institutions and individual investors of an
opportunity to purchase gilt-edged issues, making it difficult to obtain well-
balanced portfolios. Finally, it results in a very narrow holding of the se-
curity, with possible unhealthy consequences for the issuer.97

The "best effort" operation is an agency relationship between issuer and
investment banker, under which the latter, for a commission, undertakes to
sell, either directly or through a selling group, as much of a new issue as
possible at an agreed selling price.98 This technique has not been used ex-
tensively in new issues, perhaps because issuers are willing to pay invest-
ment bankers a larger spread for assuming whatever underwriting risk in-
heres in current financing methods.99

An expansion of the "best effort" technique would produce little change
in the existing distribution system, for both stabilization and fixed price
issuing would still be desirable from the issuer's point of view. The actual
mechanics of distribution would remain much the same, except that there
would be one less transfer of "title" in the process of issuance of new securi-

96. "The significance of this evasion factor is indicated by the fact that private place-
ment has developed mainly in those classes of securities which are subject to SEC control."  
Atkins, Edwards and Moulton, op. cit. supra note 8, at 110.

97. Id. at 111–3. Other objections which have been made are: (1) the issuer may be
forced to accept a price considerably lower than the actual value of the security, since there
are relatively few large institutional buyers, and it is quite conceivable that they might have
an "understanding" as to the price they will quote; (2) the traditional underwriting method
is still necessary for the flotation of securities not qualified for insurance company portfolios,
and loss of a substantial portion of the underwriters' business might result in the drying up
of the investment banking industry, or in the requirement of much larger spreads. See
Gourrich, supra note 57.

98. Atkins, Edwards and Moulton, op. cit. supra note 8, at 40.

99. Arguments have been made to the effect that investment bankers perform no true
risk-bearing function. Whatever validity might have been attributable to these contentions
during times of "easy money," the recent recession in the stock market, during which many
underwriters sustained sizeable losses, has given concrete proof of the continued existence
of the risk factor, which may become increasingly important if the present trend toward
tighter money markets continues. See note 83 supra.
ties, and spreads might be lowered slightly to compensate for the complete elimination of risk on the part of the underwriters. Price maintenance under such a setup would be easy to enforce, as both the "underwriters" and dealers would be acting as agents for the issuer.

**REGULATION OF THE EXISTING DISTRIBUTION SYSTEM**

Neither the elimination of price maintenance from the present distribution system nor the substitution of the British or some other alternative system offers a practical and desirable solution to the dual problem of safeguarding the investor and assuring the continued flow of capital to industry. It remains to inquire whether the present system, now regulated by the SEC, should be subjected to additional regulation, and if so, by whom.

The SEC, which presently enjoys an enviable reputation among administrative agencies, has been active in the issuance of rules and interpretations designed to protect the issuer and the investor. By requiring competitive bidding and checking closely on underwriting spreads in issues governed by the Public Utility Holding Company Act, the Commission has created a yardstick which serves as a deterrent against any attempted exaction of exorbitant underwriting fees in other issues. The dangers of stabilization have been fully and publicly discussed, and a program of regulation outlined and initiated, while at the same time the Commission has issued regulations facilitating the use of the stabilization technique within its prescribed sphere and under the cold glare of "full disclosure."

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101. Competitive bidding, long a subject of disagreement between the SEC and a majority of investment banking houses, is again under fire, in view of the recent failure of two proposed competitive offerings. N. Y. Times, Sept. 15, 1946, p. 13, col. 8. The charge is made that it is only a "fair weather" mechanism, ineffective in the presence of a declining market. See statement of Col. Pope, supra note 37, at 463. The SEC has recently permitted negotiated financing under the Holding Company Act because of "circumstances peculiar to the instant case," the Commission finding that "the negotiation process may afford a desirable degree of flexibility." Matter of Columbia G. & E. Corp., Cincinnati G. & E. Co., Holding Company Act of 1935, SEC Release No. 6840 (1946) 8, 9.

It seems doubtful that the Commission will seek legislation requiring competitive bidding on all types of securities, for the Commission admits that "it has not always been effective, especially where there is limited response to a particular offering." Matter of N.A.S.D., supra note 13, at 45.


The foregoing is evidence that the SEC has not retrogressed to that stage of moribundity which has caused cynics to suggest that every administrative agency should be abolished after ten years' service. The Commission, as the agency to which Congress specifically delegated authority to regulate the investment banking industry, can be expected to recommend to Congress any statutory changes found to be desirable, and meanwhile has ample latitude under existing legislation to prevent abuses of the machinery of price maintenance.

The difficulties inherent in the enforcement of antitrust decrees, together with the lengthy litigation required in each individual suit where a variety of factors such as those suggested by the SEC\textsuperscript{104} must be considered, militate against the use of the Antitrust Division and the courts in the regulation of securities distributions.\textsuperscript{105} The present distribution system can better be controlled on a continuing basis by a single agency charged with that duty by Congress, namely, the SEC.

**Conclusion**

It is probable that any action brought as a result of the Antitrust Division's present investigation of the investment banking industry will be directed against abuses of the underwriter-issuer relationship, long the favorite target for investigators in this field.\textsuperscript{106} The foregoing discussion has demonstrated that such abuses are not linked with the price maintenance

\textsuperscript{104} See note 42 supra.

\textsuperscript{105} A possible escape from the conflict that would occur between the SEC and a court enforcing an antitrust decree drafted by the Antitrust Division would be the appointment of the SEC as a special master to enforce the decree. Although no statutory authority or judicial precedent for such an appointment exists, such a development would be no more revolutionary than the decree entered in the case of Hartford-Empire Co. v. United States, 323 U. S. 386 (1945), discussed in Comment, 56 YALE L. J. 77.

\textsuperscript{106} "The investigation has taken several turns in the five years it has been under way. . . . In recent months, however, the emphasis was placed on formation of buying syndicates, the implication being that groups formed to negotiate or bid for deals were combinations in restraint of trade." N. Y. Journal American, Oct. 24, 1946, p. 22, col. 2. A hint that the SEC might welcome the assistance of the Antitrust Division in this particular field is found in the N.A.S.D. opinion, where, after emphasizing the existence of ties between issuers and bankers, the Commission describes its attempt to meet the problem "in so far as our limited powers permit" by requiring competitive bidding for utilities securities, and continues ". . . we do not regard our rule as the definitive answer to attempts to restrain competition." Matter of N.A.S.D., supra note 13, at 44. Another likely target which the Commission might prefer to leave to the mercies of the Antitrust Division is found in the possibilities of undue influence in the relations between large underwriters and selling group members. The SEC hinted that here too the antitrust laws should apply. "The natural effect of the strength of the manager cannot, perhaps, be changed by mere regulation. But to the extent that a large house might apply its strength by taking action—e.g., by boycotting those who refuse to accept undesirable participations, it would be tampering with the normal competitive forces of the market." Matter of N.A.S.D., supra note 13, at 45, n. 57.
features of the distribution system, for price maintenance is as important in
issues sold to the underwriters through competitive bidding as those sold
through negotiation.

Any proposal for change in the present method of securities distribution
will require careful consideration by Congress. It is at least doubtful whether
the removal of price maintenance techniques from our present system, or the
substitution of an alternative method, will insure a continuing flow of capital
from investor to industry during the post-war years. The introduction of
any change will be even more hazardous if, as now seems likely, the post-war
period combines continuing demand for new capital with a shrinkage in the
funds available for investment.