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AN OVERVIEW OF RULE 415 AND SOME THOUGHTS ABOUT THE FUTURE

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The views expressed herein are those of Commissioner Treadway and do not necessarily represent those of the Commission, other Commissioners, or the staff.

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Few Commission rulemaking proceedings have been as controversial as Rule 415, a controversy which will come before the Commission for resolution in mid-November. Despite the volumes written and spoken on the subject, it may be useful for all of us to develop a longer-term sense of perspective, regardless of the outcome in November.

Since Rule 415 is the subject of a pending rulemaking proceeding, I will not be able to respond to questions after my comments. I will, however, be pleased to answer questions in other areas.

Changes in the underwriting process inevitably evoke numerous objections. Let me read the criticisms of another:

> "The objections...that were most strongly urged...were based upon apprehensions that...[the rule, if adopted] would:
>
> A. Lead to overpricing [by causing hasty, ill-planned bidding for issues];
>
> B. Destroy the traditional relationship between investment banker and issuer [by having deals done at the last minute, on a free for all basis];
>
> C. Interfere with 'free enterprise'; [by concentrating economic power]
>
> D. Injure the small [or regional] dealer [who would be excluded from syndicates as major firms compete in an accelerated bidding process; and then sell on an institutional basis to minimize market risks];
>
> E. Conflict with the Securities Act of 1933 [by undermining the basic concepts of due diligence and investor protection]."

If those criticisms sound familiar, they should be. They have been around for 42 years, coming from a 1941 Commission release announcing the adoption of Rule 50 under the Public Utility Holding Company Act, which required that securities of public utility holding companies be sold by competitive bidding.

A Bit of History

Aside from Rule 50, another bit of history is that the first hearings on Rule 415 were held in 1940. That's right, 1940. It was not called Rule 415 at the time, but the issues were the same. I will return to that bit of history later.

Turning our focus to current times, it's sometimes easy to grow weary. At times, it seems as if we have been debating Rule 415 much longer than 26 months. It was only in August, 1981, as part of the overall integrated disclosure proposals, that little-noticed Rule 462A was highlighted as a separate issue. The August, 1981 announcement was long and complicated, and proposed Rule 462A was largely overlooked. But by the Spring of 1982, Rule 462A (later renumbered and now known as Rule 415) had become a battle field. Particularly vocal was the investment banking community. In response to the controversy, on March 3, 1982, the Commission adopted Rule 415 on a temporary basis, setting December 31, 1982 as its expiration date.

The Commission simultaneously announced public hearings on Rule 415. Controversy had erupted even before the hearings, focusing on alleged improper lobbying efforts by one investment banking firm critical of Rule 415. At the hearings on June 28th, Chairman Shad recused himself, leaving only three sitting Commissioners.

The hearings lasted a full week. Forty witnesses testified, and the transcript of the proceeding exceeds 1,000 pages. The hearings were contentious and emotional, bringing to my mind the controversy surrounding the hearings in the early 1970's on the elimination of fixed commission rates. Indeed, many of the witnesses were veterans of those hearings, and some of the arguments, pro and con, about competition, effects on the market, and the effect on regional firms had a familiar ring. But this time, in addition to representatives of major Wall Street and regional brokerage firms, numerous issuers testified. Large issuers almost unanimously supported Rule 415, although some tempered their support by stating that they would not use Rule 415 for primary equity offerings.

Regional brokerage firms roundly condemned Rule 415, particularly in the equity area. They claimed it would cause their exclusion from participation in traditional syndicates, because Rule 415 would cause offerings to be done by major underwriters on a "single-handed" basis, or with a small syndicate, because of the lack of time for traditional syndication. The absence of a traditional syndicate, regionals further contended, would cause small investors to be excluded from the market and the market would become further institutionalized. Critics claimed that the shortened timetable would undermine traditional due diligence, adversely affecting investor protection. The National Association of Securities Dealers joined these critics, further testifying that Rule 415, if it had been in effect at the time, would have permitted Penn Central and Equity Funding and their insiders to dump millions of dollars of stock on an unsuspecting market immediately before bankruptcy. Several major firms endorsed many of these arguments as strongly as their regional counterparts. Some major firms testified that, while they believed they would prosper under Rule 415, such prosperity would come at the expense of other firms and damage to the system and the investing public.

Large issuers disagreed, some quite vigorously. They responded that it was not the Commission's role to dictate how or even whether underwriting syndicates should be formed, and certainly not the Commission's role to protect the interests of regional firms. Issuers further claimed that the accuracy of registration statements was their primary responsibility, not that of the underwriters and, moreover, they were indemnifying the underwriters. Underwriters and investors decried this attitude as inimical to the public interest and charged that Rule 415 would put underwriters in the untenable position of not being able to conduct proper due diligence.

More debate, likewise emotional, was heard about treating debt and equity issues differently and about the merits of a cooling-off period.

The Reconsideration

On September 1, 1982, by a 2-1 vote, the Commission extended Rule 415 on a temporary basis through December 31, 1983, based on testimony during the hearings that the experience under Rule 415 was inadequate to permit reasonable conclusions. Commissioner Thomas dissented, attacking the rule on numerous fronts. She charged that Rule 415 failed to provide time for underwriters to discharge their due diligence responsibilities, that Rule 415 could cause small and regional broker-dealers to be eliminated from major underwritings, causing them to drop out of the underwriting and marketmaking business completely, and that this would harm the small and medium-sized issuers dependent upon them for financing. Commissioner Thomas also expressed concern that Rule 415 would lead to greater concentration of financial intermediaries. This, she feared, would continue the trend toward institutionalized securities markets and discourage individual investor participation. This could lead to an unfair two-tiered pricing system and jeopardize the liquidity and stability of the primary and secondary securities markets.

The Road to Rule 415

That slice of history accurately can be described as a controversy. Yet, shelf registration is not novel. Then Commission Chairman Manuel Cohen gave speeches about shelf registration in the early 1960's. Since at least the late 1960's, Guide 4 to the Guides for the Preparation of Registration Statements had included instructions for delayed or continuous offerings of securities. Moreover, shelf registration long has been available for (i) certain secondary offerings; (ii) dividend, interest reinvestment, or employee benefit plans; (iii) rights offerings; (iv) the conversion or exercise of outstanding securities; and (v) securities pledged as collateral. Shelves have been permitted in other areas, such as for mortgage pass-through securities. To a large extent, however, these types of offerings historically have been viewed as special purpose situations, in some way differing from traditional primary offerings.

I said earlier that the first Rule 415 hearings occurred in 1940. As odd as that must have sounded, I was not speaking in jest. Beginning in October, 1940, the Commission held a series of conferences with the Investment Bankers Association, the NASD, the New York Curb Exchange, the NYSE, and other industry representatives to consider amendments to Section 6(a) of the Securities Act, then interpreted as permitting the registration only of securities proposed to be offered promptly. Separately, bills had been introduced in Congress which would permit shelf registration on an unlimited basis. The bills were designed to "permit the registration of securities for offering at some indefinite future date without any amendment of the registration statement...". The Commission supported the concept, but only if the registration statement was required to "be brought up to date before offering any of the securities" which had not been offered within a reasonable time after the effectiveness of the registration statement. What the Commission was suggesting was a post-effective amendment, generally unknown at the time, but clearly the Commission also contemplated the general availability of shelves.

Neither bill passed. One distinguished observer commented that the failure of the bills to become law merited "comment as reminders that Congress did not retreat in supporting a construction of Section 6(a) which would limit registration to those securities presently intended to be offered." From those events thus came support for the theory that registration should be allowed only for securities presently intended to be offered. Even without changes in Section 6(a), the Commission began to develop administrative exceptions to permit shelf registration in limited circumstances. I listed those earlier.

Against this historical background have been recent changes in the market and the regulatory scheme which have influenced the progress toward Rule 415. In the late 1970's several significant external factors -- primarily economic -- converged dramatically. The phenomenon of interest rate volatility stands out. Until the mid-1970's, money was generally available at relatively stable cost. Without the pressure of volatile interest rates, issuers, underwriters, and regulators had few time concerns. Equity issues gave rise to even less concerns about precise timing. But in 1980 the prime rate changed an unprecedented 42 times. Time became money in a real sense, and the term "market window" became widely known.

A parallel external development was the institutionalization of the market and increased block trading. Institutional holdings of all New York Stock Exchange listed stocks increased from approximately 16% in 1957 to 36% in 1980. In 1980, institutional investors accounted for two-thirds of public share volume on the New York Stock Exchange. Block transactions accounted for 29% of reported NYSE share trading volume in 1980, 32% in 1981 and 41% in 1982. In 1965 block transactions accounted for a miniscule 3%.

Along with these two developments in the U.S. markets came an influence from abroad. As more U.S. issuers went offshore for debt issues, underwriters and issuers became aware of a choice of markets. The European market, essentially unrestricted by regulation, became a forum for innovation. Debt underwritings often were "fast-track" or "bought" deals, as the large dollar holdings concentrated in the hands of banks or other financial institutions could be rapidly committed. But the European market generally lacked the depth of our market, the "window" could be small, and issuers and bankers had to move quickly. With United States issuers and investment bankers participating in both markets, one market tended to influence the other.

At the same time developments in computerized data retrieval and high-speed international telecommunications increased the ability of underwriters and issuers to do "fast deals" where and when they were most favorable, without regard to geographic barriers.

On a different front, regulatory developments were having a quiet but equally significant impact, setting the stage for full realization of the impact of these dramatic economic and technological factors. As the quality of periodic disclosure has improved since 1964, a continuous disclosure system progressively has made more sense. After all, if the same information is already on file at the Commission, readily accessible to all, what is the logic of reproducing it? Why go to all that trouble, expense and delay to give the information to two categories of people: those who already have it if they want it, and those who would not read it if they had it. The argument is almost that simplistic. The integrated disclosure system adopted by the Commission in March, 1982 was the culmination of a twenty-year effort. Events along the way included Forms S-7 and S-16 as initial short forms, with at least some blessing of incorporation by reference as a disclosure technique. These developments generally received almost universal approbation, even from those who today oppose Rule 415.

On a parallel track with integrated disclosure was the selective review of registration statements. This was not a conscious attempt to speed up the registration process, or to commence a debate about shelf registration, but rather a practical response to Commission budgetary constraints. The number of registration statements processed by the Commission has quadrupuled since the mid-1960's, while the staff has declined in numbers. Notice now can be given within 48 hours that the staff has not selected a filing for review, thereby permitting almost immediate effectiveness. Selective review, combined with short forms and incorporation by reference, has created a registration process that facilitates "fast deals," certainly for large and repeat issuers.

That's my analysis of the road to Rule 415. Economic, technological and regulatory events have converged. That leaves the paternity of Rule 415 muddled, and accurately tracing its antecedents is an exercise which demands that we look long before and beyond August, 1981.

Summary of Comments and Some Thoughts About Due Diligence

The recent comment period on Rule 415 closed September 12. The Commission received letters from 150 commentators. 117 came from corporations and related associations. Twenty-one came from securities firms and associations. Only 5 came from law firms or associations. I suppose the reason so few law firms commented was that they did not dare be caught in the middle of the controversy between issuers and underwriters.

Ninety percent of the commentators favored the adoption of Rule 415 in some form; eighty percent favored the adoption of Rule 415 in its present form. Issuers unanimously expressed satisfaction with the rule. Opinion within the securities industry was divided. Almost half, primarily regional firms, recommended that Rule 415 be rescinded. Other industry commentators recommended adoption of Rule 415 either in its entirety, with its availability limited to investment grade debt, or subject to some other modification.

The securities industry commentators reiterated previously expressed concerns, but focused particularly on due diligence and retail distribution. They argued that Rule 415 has accelerated a trend toward institutionalization and concentration. They also asserted that regional firms have been excluded from underwriting syndicates, making it difficult for individual investors to participate in Rule 415 offerings.

The issue of due diligence received the most comment from all commentators as a body. Issuers generally believe that underwriters' opportunity to conduct due diligence has not suffered, and some claim it has improved. Securities industry commentators, however, claim that the fast time schedules, "bought deals" and "competitive" offerings, have shifted the traditional balance between issuers and underwriters and have effectively precluded underwriters from satisfying their due diligence obligations.

The letter from John Whitehead of Goldman, Sachs conveys this concern most sharply:

> "In the Rule 415 environment...issuers have sought to dictate contractual terms at the time securities are put up for bid. Thus it has become common for underwriters to receive only one comfort letter from the issuer's accountants, typically at the closing rather than at the offering date and (in any event) less comprehensive than before. Further, issuer's representatives and issuer's counsel's legal opinions have became considerably narrower. Underwriters' ability to insist on historic safeguards in these areas has been significantly reduced because of the time and competitive pressures made possible in the Rule 415 environment and investors also suffer as a result."

The letter from Merrill Lynch underscores concern about due diligence, asking for relief from underwriters' liability as a prerequisite to any availability of Rule 415:

> "[The rule] has accelerated the decline in the level and quality of disclosure by precluding, for all practical purposes, an opportunity for independent and experienced scrutiny by underwriters and their counsel. However, given the institutional nature for that market, we recommend that the rule be limited to issuances of non-convertible debt and preferred stock rated not less than investment grade. At the same time, we view relief from underwriters' liability as a prerequisite to the continued availability of Rule 415 in any form."

Morgan Stanley, initially one of the strongest opponents of the rule, now recommends its adoption, but, like other industry commentators, seeks protection from liability:

> "[W]e believe that it would be difficult, if not impossible, to return to the pre-Rule 415 offering environment. These changes are likely to remain with us regardless of the Commission's final action on the Rule....[W]e believe it is time to support its adoption on a permanent basis so that our capital markets continue to evolve in an atmosphere of regulatory certainty....[However,] [a]s we have indicated in the past, we strongly urge the Commission to address the issue of underwriters' liability <u>in conjunction</u> with any final action on Rule 415."

As I noted earlier, some issuers feel that the due diligence process is working better. For example, Citicorp wrote that

> "Rule 415 has greatly enhanced the Commission's efforts to improve the integrated disclosure system. Historically, due diligence efforts were largely ad hoc and included only the underwriters of a particular deal. Since early 1982 we have held periodic due diligence sessions involving a more comprehensive universe of participants. All of these efforts have involved a single law firm which has been selected to act as underwriters' counsel to all firms selling our securities in both the domestic and Euro markets, as well as such other legal counsel as a particular underwriting firm may select. Since the adoption of Rule 415 we have consistently scheduled and held regular quarterly due diligence sessions with all the firms with which we have an active relationship (usually ten or more) plus their counsel."

Numerous other issuers claim to have instituted these and other practices designed to provide continuous due diligence and expressed their belief that due diligence is better under Rule 415 than previously.

Seven industry commentators stongly urged the Commission to adopt a proposal advanced by Merrill Lynch, so-called Rule 177, which would provide underwriters with a safe harbor from liability under Section 11 of the Securities Act. Merrill Lynch also urged the Commission to adopt a proposal limiting underwriters' liability for documents incorporated by reference. This proposal would confine liability to the issuer, signing officers, directors, and consenting experts. The securities industry commentators took little comfort from Rule 176, even though four of the eight factors enumerated in Rule 176 arguably give an underwriter in a Rule 415 or other offering involving information incorporated by reference some measure of comfort about due diligence.

The comments, the June, 1982 hearings, and, as much as anything, my personal instincts underscore due diligence as the most delicate issue. As we all know, in past years most registration statements were fully reviewed. Comments often were extensive, and amendments were frequent. In fact, it was not until the late 1960's that the Commission delegated to the Division of Corporation Finance the authority to declare registration statements effective, relieving the Commission of the task of acting directly on every registration statement.

But this was only the tip of an elaborate and highly structured exercise. Underwriters, issuers, auditors and counsel participated in an orderly preparation of the registration statement. Due diligence checklists were exhaustive; the verification process was intensive. The precise timing of an offering was a secondary consideration, as due diligence assumed a life of its own. The idea of flexibility and of an issuer being able to pick and choose an effective date and tell the underwriter what it was a few hours in advance was beyond sensible contemplation. To those who grew up with this process, there was a sense of order, purpose and predictability, if not a rather likeable degree of stateliness.

In marked contrast, today's registration statement may contain little more than a bare description of the offering. It may not even tell the reader who management is, what they are paid, or who the underwriter is. Traditional information may be largely incorporated by reference from various Exchange Act filings, prepared by the issuer alone, with no participation by underwriters and their counsel, and with no contemplation of an offering.

All of this has, I agree with the commentators, shifted leverage from the underwriter to the issuer. Tough-minded issuers, of which I understand there are many, now negotiate from strength on a "take it or leave it" basis. Anecdotes like the following abound:

> "No, we're not going to change our prior filings; since we're not, there's no reason for you to look at those items. No, we're not going to give you two cold comfort letters. No, we're not going to negotiate the representations and warranties in the underwriting agreement. And if you want the deal, bid."

That is quite a change, and that is why I call due diligence the most delicate issue. Underwriters have lost leverage with issuers. Underwriters continue to have Section 11 liability. But whether the Commission can or will lessen that liability is an open question.

Is Rule 415 The Problem?

Many, validly and in utmost good faith, have voiced concern that Rule 415 has or will change the markets radically and for the worst. But is Rule 415 the culprit? Or, as some believe, is Rule 415 only a procedural device, and are shelf registrations really anything new? The lengthy debate has yet to develop a consensus.

Come mid-November, one possibility is that Rule 415 simply will be made permanent, in its present form. If that occurs, and if many witnesses who appeared at the 1982 hearings and recent critics are correct, that will result in (1) further institutionalization of the securities markets, (2) the virtual elimination of the individual investor from primary equity offerings, as he has been eliminated from underwritten debt issues, (3) more dominance by large firms, (4) more "one-handed," "two-handed," and "bought" deals, (5) damage to regional firms, (6) inadequate time for meaningful due diligence, and (7) uncertain exposure for underwriters. That is a bleak outlook.

But what if Rule 415 is not adopted at all, or is adopted on a substantially modified basis? Does the outlook change? In terms of concerns about institutionalization of the market, that's already underway. We need only look to the debt market and to block trading statistics. In terms of increases in "one-handed," "two-handed" and "bought" deals, the pressures causing them are as much economic as regulatory, perhaps more. Many issuers and underwriters now have done "bought deals." When corporate treasurers get together to share experiences, anyone who has not done a "bought deal" is regarded as behind the times, if not inept. In terms of the damage to regional firms from super-accelerated deals, does eliminating Rule 415 change anything, since Form S-3 and incorporation by reference will remain with us? As to inadequate time for due diligence, how much time exists now, since registration statements can be effective in 48 hours? Does eliminating Rule 415 resolve the due diligence issue?

Those questions are intentionally couched in an extreme tone. That is because there are no particularly clear or satisfying answers. But if these problems did not arise solely because of Rule 415, which I believe to be the case, they will not be answered fully in November. Forty years of regulatory developments and recent years of intense economic pressure will not be reversed by the Commission's action in November, and the broader issues will continue to be debated.

Left to work freely, market forces would dictate that Rule 415 should be adopted as a recognition of reality. But does the existence of powerful market forces mean that the Commission should embrace Rule 415? Some Rule 415 supporters would simply say yes. After all, these days it's not fashionable for regulators to interfere with market forces.

Other supporters of Rule 415 would further argue that shelf registrations have been around for a long time and that expanding their availability under Rule 415 is hardly radical. Yet, I would point out that in many of the shelf offerings traditionally permitted, no underwriter has been involved, and the prospective purchaser already may have a relationship with the issuer and may be receiving certain information. In such offerings, there is no special or organized selling effort, and no special commissions are paid to underwriters to recruit a body of new stockholders. Supporters of Rule 415 may wish to debate whether that is a controlling distinction.

Some supporters of Rule 415 say that our generally satisfactory experience with the secondary trading market, premised on continuous disclosure and an "efficient market" theory of dissemination of information, supports expanding Rule 415 to all primary distributions. Proponents of that approach are quick to point out that the size of the well-functioning secondary market dwarfs the size of primary distributions. But, again, there arguably is a difference. In a primary distribution, the issuer receives money by selling a new interest to a third party, giving rise to a new economic relationship. Like much in the Rule 415 area, the validity of that distinction can be debated, but it exists.

Those who argue against Rule 415 note that Congress rejected the following arguments made against adoption of the Securities Act of 1933:

(1) No waiting period should be mandated since it interfered with a "free market."

(2) It was inconvenient, if not impossible, for underwriters to do "due diligence," and to hold them civilly liable for documents of the issuers was unfair.

(3) The registration process would be cumbersome and slow; the markets moved too rapidly and were too erratic or volatile.

(4) The registration process was too costly.

Yet, Congress determined in 1933, by statute, that issuer convenience, or cost, or insulating issuers from volatile markets was not controlling. Nor was Congress persuaded that underwriters should be protected against civil liabilities. Rather, Congress envisioned almost an adverserial relationship, in that underwriters, to protect themselves, had to exercise a healthy degree of skepticism about the Company's statements. Investor protection and a degree of orderliness were declared paramount. How, then, critics of Rule 415 ask, can the Commission -- long dedicated to investor protection and fair and orderly markets -- adopt Rule 415?

That sums up the debate that will occur at the November meeting.

Some Perspective

While the Rule 415 debate can focus on a number of issues, the recurring central issues seem to be automatic effectiveness without a waiting period and the civil liability of underwriters. Yet, those issues have been with us since the Commission's inception. In 1933, when it became apparent that some form of securities law would be adopted, the organized Street focused on those two issues as being key and lobbied vigorously to exclude both from the legislation. Despite vigorous lobbying, the Street lost on both issues.

Undaunted by defeat, the Street, led by then president of the New York Stock Exchange, Richard Whitney, launched a multi-year lobbying effort to change these two aspects of the Securities Act, along with many aspects of the Exchange Act enacted in 1934. They insisted that a waiting period interfered with the market and that underwriter's liability discouraged public financings. The combined effect was to undermine much needed capital formation.

The Commission was a new and relatively weak agency with an uncertain future, and we should remember how adversarial the relationship was between the Commission and the NYSE. John Brooks, in Once In Golconda, tells the tale of the first visit of the five commissioners to the floor of the NYSE in July, 1934.

> "The Securities Exchange Act began functioning on July 1, and a few days later the cops arrived bodily on Wall Street's corner when the five new commissioners came for their first visit to the Stock Exchange. A tight-lipped Dick Whitney led them on a formal tour of inspection, having first taken the precaution of surrounding the floor with guards to restrain any brokers who might seek to do the visitors physical harm. The brokers stared coldly at the commissioners; trading came almost to a standstill; and in this atmosphere of suppressed hostility the new era dawned."

Business desperately needed capital in 1933 and 1934, and that need continued throughout the 1930's. The lobbying effort to eliminate underwriters' liability and allow automatic effectiveness of registration statements gathered momentum. A NYSE victory appeared possible after five years of effort.

Obviously, that victory did not occur, or we would not be engaged in our current dialogue about Rule 415. What happened? One answer is "Jersey Lightning." That story is also told Once in Golconda.

> "It will be recalled that we left Whitney's private financial affairs in parlous condition, as he entered 1932 still living like the millionaire that, as the national symbol of Wall Street, he was universally assumed to be, but actually a negative millionaire, owing some two million dollars that he could not pay. The next couple of years were somewhat better for him. All but giving up hope of a miraculous recovery of his disastrous Florida fertilizer interests, he now undertook a new and at first more fruitful investment plunge. All through the years of Prohibition, the favorite bootleg drink in the New Jersey hills where he had his country estate was "Jersey Lightning," a harsh but authoritative apple jack that had been distilled locally for generations before Prohibition and, of course,

had continued to be produced massively though inconspicuously in those well-wooded hills and valleys -- then still remarkably remote and unpopulated -- without the blessing of law. Incredibly (or so we can say in hindsight), this urbane and sophisticated man came to believe that after repeal Jersey Lightning would capture the fancy of the whole country, and become a standard national drink like Scotch or bourbon; and to make it a still more attractive investment prospect, the stuff had the great commercial advantage of requiring very little aging to be potable, or as potable as it would ever be. Accordingly, early in 1933, with repeal clearly on the horizon at last, Whitney and one of his brokerage associates took over a chain of old New Jersey and southern New York State distilleries and organized Distilled Liquors Corporation for the purpose of producing and marketing alcoholic beverages as soon as repeal should become effective. The firm's principal product was, of course, to be apple jack. Whitney himself, and the firm of Richard Whitney & Company, initially subscribed for between ten and fifteen thousand shares of Distilled Liquors stock at $15 a share."

"Repeal became effective in December; Distilled Liquors leaped into business like a racehorse leaving the starting gate, and, as the great boom in liquor stocks continued, by the spring of 1934 its price on the over-the-counter market was being quoted at 45. Meanwhile, Whitney had continued to accumulate shares of it for himself and for his brokerage firm, and at that boom price his holdings were worth far more than a million dollars."

"Right there, if he had been another man, he might have sold out wholly or in part, paid off all his debts except those to his brother and the Morgan firm -- the debts that were, literally or figuratively, in the family -- and made a fresh start. But he had a gambler's faith in Distilled Liquors, not to mention in his own judgment; so he went on carrying the stock and owing the money, looking forward confidently to a glorious day when Jersey Lightning would be drunk everywhere, eagerly ordered by the harried commuter with five minutes between office and train and suavely served in fashionable houses and country clubs, and Whitney would at last have the money to live as he had always lived. In that same spring when he was suffering his great public defeat in Washington on the Securities Exchange Act, he was close to the business miracle that alone could salvage his tangled private affairs -- as close, that is, as he would ever come."

But by late 1937 Whitney's financial situation was reversed.

> "Distilled Liquors by Autumn was down to 9, and Richard Whitney & Company was pegging it there virtually unassisted, by meeting all offers; during the whole of 1937 the firm was the buyer in over 80 percent of all transactions in the stock. Down this rathole dollars by the hundreds of thousands simply disappeared, and more were constantly needed."

Sadly, Richard Whitney got caught with his hand in the cookie jar. He had used funds of the New York Stock Exchange Gratuity Fund to cover his speculations in Distilled Liquors. He also embezzled funds from the New York Yacht Club, of which he was treasurer, and from the estate of a friend, of which he was the executor and of which the residual legatees were Harvard University and St. Paul's School. Richard Whitney, the head of NYSE, the "White Knight of Wall Street," was indicted. The strength of the Old Guard was broken, a reform faction emerged within the NYSE, and a truce was declared between the NYSE and the Commission. Efforts to change the Securities Act and the Securities Exchange Act ceased.

Richard Whitney has been blamed for much over the years. Until today, though, I doubt that you ever heard anyone blame him for Rule 415. Perhaps I'm stretching the point, but the fact remains that almost 50 years later, we debate the same issues.

Conclusion

I invite you to visit the Commission in November. I assure you the debate will be interesting.