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MORGAN & LOCKWOOD

44 WALL STREET
NEW YORK

February 25, 1942.

Paul W. Frum, Esq.,
Baker, Hostetler & Patterson,
Union Commerce Building,
Cleveland, Ohio.

Dear Paul:

I am enclosing a copy of the Commission's Report in the Cuppia case which you asked for in your letter of February 20, 1942.

I was terribly sorry to hear of your Father's illness and I hope things are better when this letter reaches you.

Let me know when you plan to take up your duties in Washington and if I can be of any help in getting the mass of information together please feel free to call on me.

Ever,

Frank

F. A. TRUSLOW.

Dictated before phone call which I appreciated

Frank

UNITED STATES OF AMERICA

BEFORE THE

SECURITIES AND EXCHANGE COMMISSION

IN THE MATTER OF

THE DISCIPLINARY PROCEEDINGS OF THE NEW YORK CURB EXCHANGE
PURSUANT TO SECTION 21 (a) OF THE
SECURITIES EXCHANGE ACT
OF 1934

REPORT ON INVESTIGATION

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I. THE RELEVANT RULES OF THE NEW YORK CURB EXCHANGE - THE MANNER AND EXTENT TO WHICH THEY WERE VIOLATED.

On February 17, 1941, the Securities and Exchange Commission, acting pursuant to Section 21 (a) of the Securities Exchange Act of 1934, opened a public hearing to investigate the adequacy with which the New York Curb Exchange was enforcing its rules, particularly those relating to the disciplining of its members. The ultimate objective of the investigation was to secure information to serve as a basis for determining whether additional legislation should be recommended in order to assure a more careful enforcement of the rules of national securities exchanges.

The evidence taken during this investigation related almost exclusively to the conduct and disciplining of J. Chester Cuppia and those other members of the Curb Exchange who were charged by the Business Conduct Committee of that Exchange with splitting commissions in violation of its rules. Cuppia was the first witness to take the stand. He had been a member of the Curb Exchange since 1927, on the Board of Governors of the Curb from 1930 to 1938, and a member of at least nine committees of the Curb during the 1930 to 1938 period. Furthermore he was the second largest partner in the firm of E. A. Pierce & Company, possessing an interest which ranged somewhere between four and six percent, and was in sole charge of its Curb Department. Examination of the records of E.A. Pierce & Company disclosed that, in the period from January 2, 1932, to March 31, 1940, the company paid out in commissions to the brokers who handled its Curb business a total amount of $1,036,462. At least $455,875 of this total, or 43.9%, was definitely ascertained to have been paid to six brokers who had returned part of their commissions to Cuppia or Mark, his floor clerk. 1/ Both Cuppia and these six brokers, by participating in this practice, were violating a long-standing provision of the New York Curb Exchange constitution prohibiting the rebating or splitting of commissions. 2/

That a broker's willingness to split commissions with Cuppia and thereby violate an Exchange rule was a determinative factor in Cuppia's

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1/ The evidentiary difficulty of establishing that commissions are in fact split is such that this figure is probably an understatement. Not included among the six brokers, for example, is Hoffman, who got $8,529 of commission business during 1932-1933 and who testified that he had split commissions with Mark and with a Curb member. See p. 4, *infra.*

2/ The relevant part of Article VI, Section 1 of the constitution of the Curb reads as follows:

> "No bonus or percentage or portion of a commission . . . shall be given, paid or allowed directly or indirectly, or as a salary or portion of a salary, to a clerk or person for business sought or procured for any member of the Exchange or firm registered thereon." Violation of this constitutional provision furnishes grounds for suspending or expelling the guilty party. Curb Constitution, Article V, Section 4 (i).

allocation to him of E.A. Pierce's Curb business was clearly demonstrated by the evidence. This is further evidenced by the fact that, while 43.9% of the firm's business went to six brokers who were shown to have split commissions, the remaining 56.1% of the business was divided among fifty-five brokers (and even some of these may have split commissions). 3/ Cuppia, who had been on the Curb's Committee on Commissions from 1932 to 1938 and was therefore acquainted with the prohibition against commission-splitting, admitted to sole responsibility for the existence of this practice in his firm's Curb business, stating that it never came to the attention of any of the other partners of the firm. As a matter of fact, he even confessed that he had indirectly obtained rebates of commissions on business supplied by him since 1929. 4/

Of the brokers who rebated a portion of their commissions to Cuppia, William J. Plate received $197,832 in commissions from E.A. Pierce & Company, and William J. Hennessy received $124,630 worth of commissions. In the case of these brokers Curb officials asserted that the alleged rebate of commissions took place pursuant to subordination agreements under which those individuals were to pay off the purchase price of seats on the Curb which Mr. Cuppia had purchased for them. Cuppia, however, stated that the subordination agreements were in reality subterfuges, that Plate, for example, was a "virtual deputy" and "virtually my employee", and that Hennessy was on a monthly salary basis. The method whereby Plate and Hennessy, although ostensibly Curb members, were kept in this subservient position was the control exercised by Cuppia over their funds. Marion Shade, Cuppia's private secretary, possessed a power of attorney over the bank accounts of both Plate and Hennessy, in which they deposited all of their commissions and from which they withdrew money for their living expenses. Cuppia was thereby enabled to exercise dominion over the funds left in those accounts and regarded those funds as trust funds belonging to him. 5/

The case of Powers, who rebated 50% of his net commissions to Cuppia, was an outright fee-splitting arrangement, intended to help secure for Powers the business of Cuppia's firm. No claim has been made that in this instance the commission-splitting was a means of liquidating a debt owing to Cuppia. The Powers situation is also unique in that, if one believes Cuppia's sworn testimony, Plate, not Cuppia, took the initiative

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3/ See fn. 1.

4/ Mrs. Cuppia had, by virtue of a $50,000 special capital contribution, become a special partner in the firm of Locke, Andrews & Pierce, which wound up its business at a loss in 1932. Cuppia benefited through his wife's interest as a special partner.

5/ No further mention is made in this report of Raymond, an inexperienced nephew of Cuppia's, for whom he also bought a seat. The cost of Raymond's seat was $15,000. The payments which Raymond made to Cuppia by check, to the amount of $4,000, were considered by Cuppia to be in repayment of the purchase price of the seat; but Raymond's cash payments, in the amount of $5,000, whatever they may have been considered to be by Raymond himself, were regarded by Cuppia as rebates on commissions.

in suggesting that Powers enter into the brokerage splitting arrangements with Cuppia. Cuppia also testified that Plate subsequently suggested other people who would be willing to split commissions, implying that he, Plate, was in a position to effectuate such arrangements; and that Plate began to take a "dominating" attitude with respect to Cuppia because he knew that the arrangement with Powers was an outright case of illicit fee-splitting. Furthermore, according to Cuppia, Plate became careless in the handling of Curb business and not only used up all of the money in his own brokerage account but made increasing demands on Cuppia for money. Plate allegedly became more and more extreme in his demands on Cuppia towards the end of 1939 and 1940 and ultimately brought suit against Cuppia to recover commissions which he claimed were rightfully his. Cuppia countered by preferring charges against Plate with the Exchange for failing to arbitrate his dispute, as required under the Curb constitution. 6/ It was apparently only when this private controversy between Plate and Cuppia was thus brought to the attention of the Arbitration Committee of the Curb that the officials of the Curb first became aware of the existence of commission-splitting, forbidden by its constitution but nevertheless governing the allocation of a great part of the Curb business of one of its important member firms for over eight years. Whether a practice as long-continued as this one should have escaped the surveillance of other members of Cuppia's firm, and how it managed to escape the continuing machinery of supervision of the Curb itself, are problems of prime importance, but unfortunately have not been resolved by any of the testimony given in this investigation. It seems clear that some officials of the Curb possess great faith in the efficacy of the Curb's supervisory machinery, and in the ability of the membership of the Curb to acquire knowledge through the informal machinery of the "grapevine". This faith would not appear justified if the commission-splitting involved in this proceeding could have continued undiscovered for such a long period of time by the officials of the Exchange.

The demoralization thus evident in the conduct of E.A. Pierce's managing partner on the Curb, Cuppia, and of its chief floor brokers communicated itself to the firm's floor clerk, Harry Mark, another witness before the Commission. Reardon and McCormack, both floor brokers, acting for E.A. Pierce admitted before the Commission that they had "kicked back" part of their commissions to Mark. McCormack, after agreeing to pay 20

6/ Article VIII, Section 1 reads, in part, as follows:

> "Members, member firms and partners of member firms shall arbitrate all claims or matters of difference arising between such members, firms or partners from any transactions made in the course of their business, under the arbitration procedure of this Exchange;"

Under Section 3 of the same Article, failure to submit to arbitration, or the institution of a court suit prior to arbitration, constitutes "an act contrary to just and equitable principles of trade." Plate contended that his litigation did not concern "transactions made in the course of business," and hence did not call for prior submission to arbitration, see *infra*.

percent of his net commissions to Mark, got a fair amount of E.A. Pierce's business, but finally found Mark's demands too extortionate and refused to give him any more money. While he apparently did get business after his refusal to kick back, Mark continued to plague McCormack with requests for kick backs and promised him more business if he would give Mark more money. Reardon was beset by Mark for "loans", "tips" or "stakes" in the neighborhood of $25 or $50; on cross-examination by counsel for the Curb, he estimated that the total amount of money he gave to Mark was $500. He admitted that he was once "propositioned" by Mark for 10% of his commissions, and said that Mark had promised him that his business would be increased if Mark received larger amounts from him. Evidence was also presented by one Hoffman that Mark got $10 or $25 from him every couple of weeks, over his protests and in the face of Hoffman's bitter feeling that such a procedure was a hold-up and a demeaning practice for a member of the Exchange to engage in. All of this testimony is clear indication that Mark, like his superior, Cuppia, took a secret and personal profit from his position as a source of business for brokers in violation of the governing laws of the Exchange. 7/ This conclusion is supported by the fact that, when the successor firm to E.A. Pierce & Company reorganized its Curb floor business, Mark was removed from the floor of the Curb to the office of the firm.

In their effort to conceal their illicit commission-splitting from the Business Conduct Committee, when it was investigating the situtation, some of the brokers involved broke still another rule of the Exchange -- they made deliberate misstatements to the Committee, for which suspension or expulsion is a mandatory penalty. 8/ They may have made deliberate misstatements to this Committee either because they felt that a serious infraction of a Curb rule was involved, which it was desirable to cover up by all means possible, including outright dishonesty, or because they regarded the activities of the Committee in an irresponsible manner. Neither hypothesis is a flattering testimonial to the moral caliber of the falsifying brokers, and both are indicative of a situation that may be of considerable public concern.

7/ Hoffman claimed that he was called upon by Mark for shakedowns of $25 and $50, but not for a specific percentage of commissions, and stated that another Curb member demanded a specific percentage of the commission business which Hoffman was to get from his firm. While the idea of splitting commissions bothered Hoffman, "hunger" overcame his scruples, and he felt his action was "like grasping a spar in mid-ocean".

Even Walsh, considered by Mark to be his best broker, was involved in an infraction of Rule 346 of the Curb, forbidding the payment of gratuities to members of financial concerns without first obtaining the written consent of the employer thereto and filing written notice of that consent with the Curb Committee on Member Firms.

8/ Article V, Section 4 (f) of the Curb Constitution provides that the Board, when it adjudges that a member has made a material misstatement to a committee of the Exchange, *"shall suspend or expel such member"*. Hennessy, Powers, Reardon and another broker, Francke, were found by the Business Conduct Committee to have made such misstatements to it.

II. THE INADEQUACY OF THE CURB'S ORIGINAL DISCIPLINARY ACTION WITH RESPECT TO THOSE VIOLATIONS

It took a day and a half of public hearings before the Commission's Trial Examiner to present the foregoing facts. The public hearing had, however, been preceded by private investigations conducted by officials of the Commission. They had also had the benefit of studying the 1,485 page record of the extensive inquiry conducted by the Business Conduct Committee of the New York Curb Exchange which had investigated the situation for four months. The Committee met about twice a week, usually starting its hearings as soon as its members could conveniently assemble after the close of their working day at 3:15, and occasionally working until late into the night. Whatever fault is to be found with the Committee lies not in any lack of industry on its part but in the possible lack of direction with which its work was performed. The Committee failed to pursue clearly-indicated lines of further investigation or to recognize the obvious implications of the evidence it had already gathered. Nor was it willing to impose the penalties prescribed by the Curb constitution on parties whose guilt was manifest. A majority of the Business Conduct Committee voted, in lieu of expelling Cuppia, to accept a letter from him which expressed regret for his action and consciousness of its seriousness, pleaded that no charges be filed against him or publicity given his case, and promised that he would remove to South America. They also reprimanded Plate, Hennessy, Powers and Reardon for commission splitting, 9/ violations which would warrant suspension or expulsion if substantiated. 10/ The Board of Governors of the Exchange, also by a split vote, gave the Business Conduct Committee a vote of confidence for disposing of the case in this manner. The proceedings were ended, without notice to any but the transgressors themselves and without publicity.

The quietness with which these proceedings were concluded, characterized as they were by deliberate and proven falsifications on the part of several witnesses, aided and abetted by confessions on the part of two of the principal violators, seems hardly compatible with the importance of the provisions of the Curb's constitution which were violated. The fact that the Committee reprimanded the individuals concerned would ordinarily be construed as an indication of guilt on their part, yet the Curb constitution and the repeated statements of responsible Curb officials are to the effect that violations of the provisions prohibiting commission splitting merit expulsion or suspension. And the constitution itself calls for this penalty in the case of falsification before a committee. As a matter of fact, the Curb, after the Commission's public hearings, expelled Hennessy,

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9/ The fact that McCormack had split commissions was revealed for the first time in the course of the Commission's investigation of this matter.

10/ Raymond, Cuppia's nephew, was reprimanded for refusing to obey the constitutional provision of the Curb requiring members to testify before standing committees, and Plate for violation of the rule requiring arbitration of controversies between members, see note 6, p. 3 *supra*. However, these reprimands are in connection with provisions which are not the major concern of this report.

Walsh was also reprimanded for violating Rule 346 of the Exchange forbidding gratuities, because he gave Mark, Cuppia's floor clerk, occasional gratuities. See note 7, p. 4 *supra*.

Reardon, Powers, and Plate, whom it had previously only reprimanded, 11/ and also McCormack, who was not even suspected of commission splitting prior to the Commission's investigation.

Three members of the Business Conduct Committee, Grubb, Frost and Beane, refused to agree with the Committee majority's disposition of the case, the first two named being strongly of the view "that the Committee should not be swayed by any fear of publicity but that the disciplinary procedure normally prescribed should be followed, that there was a strong possibility of publicity in any event, that the Committee would fail in its duty to the membership if it did not prefer charges for offenses violative of a fundamental factor in the equality essential between members; that the Securities and Exchange Commission might use the absence of affirmative disciplinary action as evidencing an administration of the Exchange which sought to conceal actions by its members prohibited by the Constitution".

Grubb felt that the Committee should have preferred charges against Powers and Raymond to the Board of Governors, although he was not certain that there was adequate evidence against Plate and Hennessy. As a matter of fact, Bijur, chairman of the Committee, while apparently not in favor of outright expulsion of the brokers who had split commissions with Cuppia, felt that they should be made to eliminate themselves from the scene in the same way in which Cuppia had withdrawn. This was also the view of Beane, who, however, chose to express his disagreement by voting against the recommendations of the majority, whereas Bijur voted with them. Had Bijur voted with the minority, there would have been a four to four division, instead of the five to three vote in favor of the Committee's recommendations. Grubb was emphatic, in his testimony before this Commission, in expressing the view that insufficient evidence had been taken on the charges the Committee was investigating, that Cuppia, who was called only once by the Committee, should have been recalled, and that all the brokers found guilty of splitting commissions should have been expelled forthwith, regardless of any effect that such wholesale expulsion might have had on the price of Curb seats.

Three members of the Board of Governors of the Curb (exclusive of Frost and Grubb, who did not vote) voted against giving the Business Conduct Committee a vote of confidence for its handling of the case. Barry, a Class A Governor of the Curb by virtue of being a Curb member, felt that the Committee had been in fact unanimously of the opinion that the record and the data before it demonstrated that commission splitting existed and that commission splitters should be expelled. He was of the view that the Board of Governors should have preferred charges against the individuals found guilty of splitting commissions, come to definitive conclusions thereon, and applied the appropriate penalties, to wit, expulsion. Neftel, another Class A Governor, also criticized the Committee's procedure. He felt that the Committee should have made a preliminary report to the Board and asked the Board for guidance, regardless of whether it thought the evidence sufficient to justify any recommendations, instead of practically settling the matter by itself. Like Barry, he felt that

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11/ Cuppia had retired from the Curb, so that there was no necessity for expelling him. While Powers and McCormack were expelled on March 24, and Hennessy and Reardon on April 1, Plate, the chief violator after Cuppia himself, was not expelled until June 11.

it would have been impossible for him personally to ascertain the relevant facts, which were not supplied to the Board; he would have liked to have the evidence, and to be in a position to act on it. The procedure followed by the Committee in the Cuppia case impressed him as one where the prosecuted party fixed the penalty to be applied to him, whereas, in his view, it was the function of the Board of Governors both to determine the facts and to fix the penalty.

Fred C. Moffat, now chairman of the Board of Governors of the Curb, but who was not a member of the Board during the Cuppia case and who stated that he was still unacquainted with its facts, said that, on the basis of the testimony brought forth at the Commission's public hearing and his "grapevine" information, he would have disagreed with the action taken by the majority of the Business Conduct Committee, although he might have favored acceptance of Cuppia's letter. He would have favored a continuing investigation of the other accused brokers, and the recommending of charges to the Board of Governors, were a proper basis laid therefor.

Apart from the views expressed by dissenting members of the Committee and of the Board, it is perfectly clear that the majority of the Business Conduct Committee and of the Board of Governors found that commission splitting and material misstatmments on the part of the accused parties had taken place, for the report of the Committee to the Board of Governors recited that the Committee "was unanimously of the opinion that the record and the data examined disclosed that splitting of commissions between members had been and was being practiced by certain members of the Exchange," and the offending members were punished by the Committee. The fact that the Committee merely reprimanded the guilty parties at the conclusion of its secret and private investigation, whereas it expelled them after the conclusion of the Commission's public hearing, may evidence a new policy adopted by the Exchange, or a recognition that commission splitting and false testimony merit a more severe penalty than was imposed. In any event, it would seem to indicate that the Exchange in both instances was convinced of the parties' actual guilt.

It seems proper at this point to discuss seriatim the several reasons advanced by Bijur, the chairman of the Business Conduct Committee, and Rea, now president of the Curb, in support of the appropriateness of the action that the Curb originally took with respect to the participants in the commission splitting and the fabrication of testimony. They fall under four major heads:-

(a) The fear that the publicity that would be occasioned by outright expulsions would harm the general public, which would not rightly appraise the significance of what had taken place.

(b) The feeling that the Exchange had, solely by reprimanding the guilty parties and accepting Cuppia's letter of withdrawal, rid itself of Cuppia and the practice of commission splitting and was therefore adequately protecting the public and itself.

(c) The belief that commission splitting is a purely internal affair affecting only the membership of the Curb and not having any adverse effect on the public interest.

(d) The Committee's doubt that it had sufficient evidence against the accused parties to warrant their being found guilty, a doubt frequently expressed in the public hearing conducted by the officials of this Commission, but finding no support in the record of the proceedings of the Committee itself. The first three of these justifications can be disposed of in this section. The other point, in view of its general importance and complexity, will be dealt with in a separate section.

(a) *The Fear of Publicity*

It seems clear that the original choice of reprimand rather than suspension or expulsion as the penalty for the parties found guilty of violating the Curb constitution was primarily due to a desire to avoid the publicity that would result were the latter penalties imposed. The majority of the Business Conduct Committee was apprehensive that the investing public would not be able to perceive that, as the majority of the Committee believed, commission-splitting had no adverse effect on it, but affected only the internal organization of the Curb. The public's inability to distinguish between a demoralized condition which affected some members of the Curb and one which affected the public itself would, it was feared, unjustifiably break down public confidence in the Curb.

It is always difficult to determine human motives where conflicting inferences may be drawn from the surrounding circumstances. It is, we think, of some significance that the Business Conduct Committee of the Curb in considering what action it should take upon this matter discussed the possibility that the price of Curb seats would be depressed if a number of memberships were to be put up for sale as a result of the expulsion of the brokers concerned. Nor does the Committee's discussion of this factor lose all significance merely because one of its members testified that its conclusion to take no public action was not based upon this consideration.

The reason for not filing charges against Cuppia, but allowing him to submit a letter of resignation instead, was apparently to facilitate the transfer of his seat on the Curb. However, it should be noted that the Curb has since reversed its prior policy of refraining from giving public notice of action it has taken. It now takes the official position that publicity must be given to all disciplinary proceedings, regardless of the consequence, and its present policy is generally conceded to be preferable to the policy it had followed in the Cuppia proceedings.

The merit of the further contention that publicity was avoided in the Cuppia proceedings because the Committee was not certain of the guilt of the parties whom it was investigating, is dependent upon an analysis of the sufficiency of the evidence before the Committee, which will be taken up in Section III. 11a/

(b) *Was the Welfare of the Exchange Adequately Served by Reprimands and by Acceptance of the Cuppia Letter?*

Another reason advanced for the Committee's action in accepting the Cuppia letter of withdrawal and closing the proceeding by reprimands of the brokers guilty of commission splitting was that the Committee "had

11a/ Page 16 *infra*.

eradicated the root of evil when it got rid of Mr. Cuppia". When the observation was made that no barrier had been interposed to the continuing transaction of business by the other commission rebating brokers and that the people who had split commissions with Cuppia and Mark were still technically able to transact business on the floor, it was pointed out that the commission splitters had transacted no business on the floor of the Curb since the investigation of their conduct. It is doubtful, however, whether this failure to transact business might not have been due to general business conditions or the personal situation of the commission splitting brokers; Powers, for example, was a very sick man. Furthermore, if, as was suggested by Curb officials, the unfavorable publicity attracted by the commission splitters through the "grapevine" as a result of the Curb's private investigation would, in the "ordinary course of events," cause those brokers to lose their customers, why was the Business Conduct Committee so anxious to avoid direct publicity? And is not this entire justification based on a faith in the efficacy of the Curb "grapevine" that appears unfounded when it is borne in mind that the "grapevine" had not in the first place brought to the attention of the Curb officials the widespread existence of commission splitting?

(c) *The Public Interest at Stake in the Curb's Toleration of Violations of the Commission Splitting Rule*

An argument frequently stressed for the failure of the Curb to take more stringent disciplinary action with respect to parties it had found guilty in its investigation and to publicize the results of its investigation was that the public was not injured by the practice of commission splitting. According to Curb officials, the splitting of commissions was activity detrimental to the interests of fellow members of the Curb, but not conduct which affected adversely the investing public. It must be said, with respect to this argument, that the significant public interest in this case lies not only in the somewhat debatable effect on the public of the specific practice of commission splitting, 12/ but also in a more general proposition. Failure on the part of the Curb to give enforcement to its provisions against commission splitting and its disciplinary procedures in the Cuppia case validly gives rise to the fear that other rules of exchanges, the violation of which will have undeniable adverse effects on the investing public, may similarly be violated and that people of undesirable moral and professional caliber may remain members of exchanges without the exchanges prosecuting adequate

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12/ This Commission has a proper regulatory concern with matters affecting primarily the internal organization of the exchanges, as well as matters primarily affecting the investing public. We are here, however, discussing only the way in which violation of the rule against commission splitting may affect the investing public.

disciplinary proceedings against them. 13/ It is this more general situation which becomes important in considering whether an agency that has been granted the supervisory jurisdiction to see that appropriate rules are adopted by exchanges should also be accorded powers which will insure that those rules are observed. Nevertheless, since the issue of public interest was extensively argued in the record before us, and the assumed absence of public interest was urged as a reason for the Curb's handling of the entire Cuppia incident behind closed doors, it seems in order to discuss the extent to which the public interest is affected by violations of the commission splitting rule. The ensuing discussion is supplied primarily for the light that it may throw on what was actually at issue before the Curb in the Cuppia proceeding.

In support of the argument that the public was not injured by commission splitting, it was pointed out by representatives of the Curb that there was no necessary correlation between a broker's ethical qualities and his business competence. Curb officials maintained that expert brokers able to accord the public competent execution of their orders might well be willing to split commissions and thereby violate the rules of the Exchange; and that the venality of a broker in this regard had no effect on his ability adequately to execute an order. It was alleged that the splitting of commissions in no wise detracted from the broker's giving his undivided attention to an order, nor did it concern the good faith that must obtain between broker and client. It was also pointed out that the mere fact that a broker was willing to split commissions was no indication that he would commit other offenses against the rules of the Curb. Attention was also directed to mechanical safeguards which allegedly assured the public that their orders would be executed competently.

One might go even further and add to the justifications advanced by the officials of the Curb, the human considerations forcefully presented by one of the commission splitting brokers. Commission splitting, according to him, although strenuously resented by the brokers who were compelled to split, was a direct consequence of the dearth of business available to Curb brokers. Brokers operating on what was colloquially referred to as a "breadline" or "taxi line" because of the large number of brokers pressing for the small amount of available business had, he said, no choice but to rebate part of their commissions when requested, a practice felt by them to be "petty larceny" tactics and a "hold-up". While commission splitting may have bothered some of the brokers involved, "hunger" was a force that overcame their scruples.

13/ Speaking of the New York Stock Exchange, Meeker, *The Work of the Stock Exchange* (1930), points out:- "A single word, or even a nod of the head, is sufficient to close a contract for the purchase and sale of stock valued at $15,000. Indeed, millions of dollars' worth of securities change hands in the Exchange each day in just this way without signed agreements, and with less danger of loss through cancellation, per dollar involved, than in any other kind of modern business". (p. 166) A course of business dealing of such a nature imperatively requires that the participants therein possess complete integrity. For a perhaps exaggerated description of the mental and physical equipment required of a commission broker, see Schabacker, *Stock Market Theory and Practice* (1934) 35.

The Curb officials were not unanimous in thus categorically reading out any adverse effect of commission splitting on the public interest. One of them conceded that it was in the nature of hair splitting to debate whether commission splitting was conduct detrimental to the best interests of the Curb, or conduct inconsistent with just and equitable principles of trade which would damage the outside public; another said that, as a matter of practice, it was exceedingly difficult to disassociate practices like commission splitting from the category either of acts that damaged the Curb alone or of acts that violated just and equitable principles of trade and were thus injurious to outsiders. It may be noted, incidentally, that conduct that damages the Curb internally and conduct that affects outsiders dealing with Curb members are both subject to the same penalty i.e., expulsion or suspension.

That the moral turpitude involved in commission splitting in violation of an exchange rule casts no reflection on the professional competence of an erring member and does not necessarily mean that he will violate other rules may be conceded. To advance it as a justification for the action of the Curb, however, seems to misconceive the real issue before the Curb. The problem before the Curb was not whether competent brokers would engage in commission splitting, but the problem of whether it was in the public interest to have customers' orders handed out to brokers on the basis of their willingness to split commissions rather than on the basis of established individual competence. Any pronounced tendency to allocate business to brokers willing to split commissions, a practice in which honest brokers would not engage, would tend to reduce the number of competent and honest brokers available for the business. Even assuming that a mere reduction in the number of brokers would not have an adverse effect on the general level of competence with which orders would be executed, the allocation of business to floor brokers on the basis of their willingness to violate the Curb constitution rather than on the basis of competence would ultimately result in restricting floor brokers more and more to the class of persons of undesirable moral character and would be an unwarranted discrimination against competent brokers honestly ready to abide by the rules of the exchange. 14/ For the Curb not to give proper enforcement to a rule the continued violation of which puts a premium on dishonesty and a penalty on competence and honesty alike tends therefore to be inconsistent with the public interest.

Other considerations relevant to the public interest were not explored in detail, but were suggested by Curb officials in our public hearings. Thus, for example, it was said that commission splitting has been banned by exchanges because it facilitates evasion of the rule against minimum commissions. The practice of commission splitting, were it carried on to a logical conclusion, might, in the face of apparently great competitive thirst for new business, ultimately result in non-compensatory charges. According to Rea, there was some basis for believing that a minimum level

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14/ See Meeker, *The Work of the Stock Exchange* (1930) 456.

of commissions is necessary to the very existence of the Curb as an organization, 15/ and commission splitting might seriously affect this alleged salutary level. In addition, the ultimate tendency of rebating commissions, as in the case of other forms of destructive competition, might well be that the business would pass into fewer hands. 16/ Although the principal injury would be to other members of the Curb who would tend to lose their livelihood if commission splitters were to take over the entire brokerage business of the Curb, the public might also conceivably suffer from the diminished supply of personnel available to administer to its needs, and the retention of personnel that has shown undesirable moral traits in competition. We must recognize therefore that a practice of giving customers' orders to brokers willing to split commissions may result in a lowering of effective honest service to customers.

Even assuming that commission splitting did not favor the incompetent and dishonest brokers, it has the effect of converting nominally independent brokers into virtual employees of the man with whom they split commissions, see *supra* p. 2. The Business Conduct Committee found that the commission splitters before it had violated a "fundamental factor in the equality essential between members". Cuppia's order clerk, Mark, was instructed to "build" brokers up or down on the basis of their willingness to rebate commissions. The allocation of business on the basis of commission splitting was, therefore, calculated in the long run to produce an undermining of professional standards. On the assumption that compensatory remuneration is a *sine qua non* of retaining in any business people with high professional standards, the ultimate effect of continued commission splitting, which operates to reduce the level of commissions, might well have been to bring about non-compensatory standards for brokers.

15/ Note in this connection the argument advanced by Meeker, *The Work of the Stock Exchange* (1930) 456-7:- "Without minimum commission rules, brokerage orders would constantly tend to flow into rash Exchange firms which, to secure business by cut-rate methods, would assume dangerous risks by reason of improperly small margins of profit. Not only would many disciplinary provisions of the Exchange be harder to enforce under such circumstances, but the insolvency of such firms would harm not only themselves and their customers, but also more conservative firms which had done business with them."

16/ It may be noted that the payment of a commission by a seller of commodities to an agent of the buyer, where the agent retains the payment for his own use and benefit, is a species of "commercial bribery" interdicted by Section 2 (c) of the Robinson-Patman Act, *Kentucky-Tennessee Light and Power Co.* v. *Nashville Coal Co.*, 37 F. Supp. 728 (W. D. Ky. 1941). This situation seems analogous to the situation outlined in this report, where various sellers of services (i.e., the commission brokers) have been rebating their commissions to an agent of the buyer of those services (i.e., Cuppia, the New York Curb representative of E. A. Pierce and Co.) for the agent's own use and benefit. The rebating of commissions, even in situations where the rebate inures only to the benefit of the buyer itself, is forbidden under Section 2 (c) of the Robinson-Patman Act because of its tendency to lessen competition and create monopoly. *Oliver Brothers, Inc.* v. *Federal Trade Commission*, 102 F.(2d) 763 (C.C.A.4th, 1939); *Great Atlantic and Pacific Tea Co.* v. *Federal Trade Commission*, 106 F. (2d) 667 (C. C. A. 3d, 1939); cf. *Kentucky-Tennessee Light & Power Co.* v. *Nashville Coal Co.*, *supra*.

The issue before the Curb was likewise not whether a broker who split commissions would necessarily commit other offenses jeopardizing the interests of the Curb or of the outside public. Securities exchanges, as public institutions with a pivotal relation to the flow of interstate credit, are vested with much more than the responsibility of ordinary trade associations to see to it that their members possess moral responsibility and observe their rules, and to police their activities with that criterion in view. No witness before the Commission doubted that brokers willing to split commissions were undesirable members of the Curb, that they did not possess good moral character and that therefore they ought to be expelled. Similarly, however competent a broker might be who lied to a Curb Committee, if he made repeated misstatements, he should not be allowed to remain a member of the Exchange, because of his proven undesirability as a member of the Exchange. In addition to finding four people guilty of commission splitting, see p. 5 *supra*, the Business Conduct Committee reprimanded four people for making misstatements to it on material matters. 17/ Certainly such falsifications would indicate that the parties making them lacked the proper moral qualifications for membership on an exchange. Considering the numerous occasions on which true statements are required on the part of floor brokers, and the public nature of the transactions executed by them, the retention of members with undesirable moral character appears clearly to affect the public interest.

Some effort was made at the public hearings before the Commission to establish that neither competence nor character was any longer a necessary qualification for a broker; mechanical safeguards allegedly assured the customer of a competent and adequate execution of his order. It was contended that the brokerage firm, through the presence of tape spotters, and the Curb, through its general supervisory machinery, were able to check on whether a customer received a fair execution of his order. However, it was conceded that there would be cases where this examining and supervisory machinery would be inadequate, in which cases a customer would have to seek an adjustment for any improperly executed order. In

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17/ Officials of the Exchange testifying before the Commission made several statements that are exceedingly hard to reconcile with this ultimate fact and with the statement of Grubb, a dissenting member of the Committee, that the witnesses before it gave obviously untrue answers and violated the provision prohibiting such misstatements. Thus, for example, Bijur, Chairman of the Business Conduct Committee, at one point doubted whether there was any basis for reporting to the Board that Powers was guilty of misstatements before his Committee. Bettman, a member of the Board of Governors, felt that the only misstatements made to the Committee were those of Powers, which, according to the apparently oral understanding the Committee had with Powers (of which there is no evidence in record), could not be used against him. However, when questioned more closely, Bettman admitted that Cuppia made misstatements to the Committee and that Hennessy, who at first had testified that various payments to Mrs. Cuppia were made as gifts for the purchase of jewelry, later confessed that the money with which the jewelry was bought was in reality Cuppia's money and that he had made similar misstatements concerning checks made out to American Express.

those situations the customer would have to lodge, and the Curb to adjudicate, a complaint. Considering the technical factors which are involved in the proper execution of brokerage orders and customers' relative lack of knowledge of exchange intricacies, a customer may often be unaware that he has been wronged. Furthermore, since a variety of technical factors may have to be looked into if the customer's complaint is to be properly adjusted, the Exchange may be compelled to hold lengthy hearings and make detailed investigations. In that case, even a customer with technical experience who knows that he has been wronged may decide not to press his complaint before the Exchange. In any event, the fact that the Curb does have a procedure for complaints by customers, and active committees to consider such complaints, is of itself evidence that the function of a broker is not restricted to the routine placing of orders subject to automatic mechanical safeguards.

A broker's obligations to his customer is not satisfied by a perfunctory placing of the customer's order; a good broker does not sell his client's stock at the first price that happens to be bid when he arrives at the trading post at which the stock is traded, if he sees an opportunity to get a better price, nor does he purchase stock automatically at the first price at which it is offered. Given an order to buy stock at 26, it is his duty to get the stock for 25-1/2, if possible; given an order to sell stock at 26, he should get 27 for the stock, if the market permits; on the other hand, hesitation on his part may result in loss to his client if the market is progressing in an unfavorable direction. In short, a broker must get for his customer as good an execution as he is able to accomplish, which involves more than the mere securing of a current market price. 18/ The qualities of judgment which must guide a competent broker in his determination of whether to wait in order to secure a better price for his client, or of whether hesitation will lose for the client a favorable market price, are not equally shared by all the brokers who do business on an exchange floor. Nor will any mechanical quotation system reveal whether the broker displayed the proper alacrity or hesitation in executing his order. Since the broker is in fact himself making the price which is recorded on the tape at the time he executes his order, it seems impossible to ascertain, by mere inspection of the tape, whether he could have gotten any price better than the one recorded on the tape. This was conceded by Rea in his testimony. Nor can the office personnel of a firm always check up on incompetent executions, since the tape watchers located in the office of an exchange firm are not infallible. Furthermore, while the customer's order is required to be time stamped in the office of the firm when it is transmitted to the floor it is not required to be stamped at any time thereafter, although a report of the transaction is time stamped before being sent out over the ticker. 19/ A dishonest broker,

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18/ See Meeker, *The Work of the Stock Exchange* (1930) 167-8; Schabacker, *Stock Market Theory and Practice* (1934) 70-1; Twentieth Century Fund, Inc., *The Security Markets* (1935) 238.

19/ There is some slight possibility that the specialist at the post might report whether a broker missed execution, but, in view of his many other duties and the host of people with whom a specialist has dealings, it is doubtful that this would be an effective check on an incompetent floor broker. It seems completely unlikely that a specialist would report whether the broker with whom he had just dealt had gotten the best price obtainable on the transaction.

therefore, with little chance of detection could often make misstatements as to the length of time it took him to reach the crowd around the specialist, whether he went there directly or executed other orders, etc. At this point, it may be noted that, since some time must necessarily elapse between the consummation of a stock transaction on the Exchange and its recording on the stock ticker, the customer for that reason alone will not ordinarily be aware of whether he has been deprived of the best possible execution of his order. 20/ In sum, the alleged mechanical quotation system, while it does afford some independent check on the activities of the floor brokers, is clearly not of itself sufficient to determine whether a customer's order has been competently executed.

That the selection of floor brokers on the basis of competence alone is still desirable is evidenced not only by the inadequacy of the "mechanical quotation" system in revealing improper executions, but by the testimony of Mark, E. A. Pierce's order clerk, that he himself occasionally had to help brokers of indifferent ability out of difficulties and that Walsh, one of his more competent brokers, also had to help such "fair" brokers out of jams that they had gotten into. Situations may frequently occur in which prompt action is a necessity and hence there might not be time to help a confused and incompetent broker execute a customer's order. On the whole, therefore, we conclude that lack of competence in a broker is not adequately remedied by the presence of mechanical procedures or supervisory activities by an exchange and its member firms. A course of business procedure whereby business is allocated on the basis of willingness to break an exchange rule rather than on the basis of competence in the execution of an order does, we think, affect the public interest adversely.

20/ See Schabacker, *Stock Market Theory and Practice* (1934) 76-7; Meeker, *The Work of the Stock Exchange* (1930) 170.

III. THE ADEQUACY OF THE EVIDENCE BEFORE THE BUSINESS CONDUCT COMMITTEE.

(a) *Would the Exchange have reprimanded parties if there was doubt as to their guilt.* As has already been pointed out, a major obstacle to believing that the Business Conduct Committee did not in fact find the parties before it guilty of commission splitting and material falsifications is the fact that it did, in a sense, punish the parties. The fact that only a light penalty was imposed carries with it no implication that the reprimanded parties are innocent. On the contrary, it can be consistent only with a finding of guilt notwithstanding that the guilty parties were given a lesser penalty than that which the constitution of the Curb authorizes for commission splitting and apparently demands for false statements. Rea's explanations that he had only a "moral certainty", or possessed a "feeling" rather than a "finding", to the effect that commission splitting was disclosed in the cases of Hennessy, Raymond, Plate and Cuppia, is also inconsistent with the language of the Business Conduct Committee's report, which recites that the Committee was of the opinion that the record and data before it disclosed commission splitting "had been and was being practiced" by these individuals. Nor is his theory that the Business Conduct Committee issued reprimands in this case because it had only a suspicion of guilt consistent with a record that clearly shows seven members of the Exchange reprimanded for *violations* of the Exchange's constitution, not for mere *suspicions* of violations. Furthermore, if in the language of its report, the Committee was unanimous in feeling that the commission splitting which it had unearthed justified the imposition of severe penalties, how can it be urged by Rea that it did not have strong grounds for preferring charges? And if the Committee were in doubt as to the guilt of the parties before it, why did it not refer these doubts, and the basis therefor, to the governing body of the Exchange, the Board of Governors, to which it was responsible?

(b) *The Powers' Confession* - On May 7, 1940, after he had been interrogated by the Business Conduct Committee, Powers made an informal confession "off the record" to two members of the Committee, Bijur and Stern, to the effect that he had rebated 50 per cent of his commissions to Cuppia, and that he knew of commission splitting arrangements in the case of Plate, Hennessy, and Raymond. He spoke to them, Bijur testified, in an entirely unofficial capacity, qualifying his informal confession with statements that he owed a debt of gratitude to Cuppia, would not testify against him, and would deny his confession were he confronted with it in any proceedings before the Committee proper. The first formal record of this informal confession was not made until six weeks later, on June 21, 1940, when the Committee procured a record confession from Powers, but one which did not implicate Plate, Hennessy or Raymond.

These confessions were most important items of evidence. Grubb, who disagreed with the majority of his co-members of the Business Conduct Committee, even stated at one point that he was not sure that the Committee had any other evidence of wrongdoing that the Powers' confession. In the light of other portions of Grubb's testimony, we believe that he was thinking of direct, rather than circumstantial, evidence.

Representatives of the Curb stated at the public hearing that the second confession was confidential and could not be used. There was considerable question during the hearings as to what "strings" were attached to the second confession. The record does show, however, that the Committee's chairman assured Powers that his testimony was entirely confidential, that Cuppia would never see the confession and would never know who "told on him." We shall therefore assume that the Committee could not use the second confession. However, the importance of Powers' first confession makes it difficult to justify the Committee's hesitant and dilatory attitude with respect to it. Powers' first statement was not even summarized in a memorandum where it was made. Why did the members of the Committee allow six weeks to elapse before questioning Powers concerning his knowledge of commission splitting? Bettman, who was chairman of the Board of Governors when the report of the Business Conduct Committee on the Cuppia case came up for the Board's approval, was not able to offer any adequate explanation. Rea submitted the following explanation: The conversation which Powers had with Bijur and Stern was not in reality a confession, having been obtained while Powers was in a semi-hysterical condition and being accompanied by the avowal that he would deny the confession were he confronted with it. Faced with Powers' assurance that he would deny the confession were he officially confronted with it, the Committee decided to examine other witnesses, so as to be in a better position to force a free statement from Powers later on. When the Committee discovered it was up against a stone wall after it had tried for six weeks to make up an independent case, it subsequently got a second statement from Powers, not implicating Hennessy and Plate.

Rea's explanation does not account for the absence of some written record with respect to Powers' first "confession". The failure to press further at that time the questioning of an allegedly nervous witness (Bijur's and Stern's memorandum of the first confession contains no mention of any unusual mental condition on Powers' part) meant that the Committee would have to build up its case on the basis of statements of witnesses possessed of more poise, many of whom, according to the record, had no compunction about lying to the Committee.

Furthermore, assuming that the investigative process justified the Committee in promising immunity to a witness like Powers, who had voluntarily disclosed information not otherwise available, what policy justifies the according of confidential treatment to the derelictions of other individuals than the confessing party? We think that it was at least inadvisable, and indeed it would seem to have been improper, for the Committee to have told Powers that his testimony was confidential. An agreement not to use a confession against any of the parties implicated obviously nullifies the primary advantage of having obtained the confession. While officials engaged in an inquiry may properly find it advantageous under some circumstances to promise an individual witness some degree of personal immunity, it certainly defeats the purposes of an investigation to promise that his evidence will not be used against other individuals.

(c) *The alleged agreements by Plate and Hennessy to repay Cuppia for the purchase price of their seats.* The arrangement whereby Plate and Hennessy rebated their commissions to Cuppia was sought to be explained, by

officials of the Curb, on the ground that they were in reality repaying Cuppia money which he had expended in purchasing their seats. 21/ Rea, for example, stated at the end of the public hearings that he felt that there was no evidence that either Plate or Hennessy had paid Cuppia any amounts in excess of the sums advanced by Cuppia to them. That this should still have been advanced as an explanation for the arrangements whereby Cuppia retained control over Plate's and Hennessy's funds is inexplicable, in the light of Cuppia's assertion that the purported subordination agreements he had with Plate and Hennessy were in reality subterfuges, Hennessy's eventual admission that the commissions he had deposited in his account were in effect Cuppia's own money and that alleged "presents" and "payments" made by Hennessy were in effect expenditures by Cuppia of Cuppia's own money, and Plate's contradictory and evasive testimony before the Committee.

The record shows that Cuppia had paid $22,500 for Plate's seat, and that, up until 1935 alone, Plate had given Cuppia $35,759.80. Some of these payments are therefore obviously unconnected with the repayment of any outstanding indebtedness to Cuppia. The same letter in which Plate recited that he had already given Cuppia upwards of $35,000 recited that the purchase price of Plate's seat was $202,500 but the seat referred to, that of one Gallaudet, was *not* the seat which Plate had acquired. Furthermore, although Curb seats may at some time have been worth in the neighborhood of $202,500, they were selling for only about a tenth of that amount at the time that Plate acquired his seat. Plate's explanation as to why he signed the October 1935 agreement, whereby he agreed to pay Mrs. Cuppia $164,500, is equally hard to believe. For reasons which will be pointed out later that agreement was, in our opinion, merely a deceitful effort to supply a colorable legal basis for the continued splitting of commissions between Plate and Cuppia.

In the case of Hennessy, Cuppia paid $22,000 for Hennessy's seat, and, as far back as January 24, 1935, Hennessy had obtained a release in the amount of $24,500 from Mrs. Cuppia. This would seem to indicate that no more money was owing on Hennessy's original indebtedness, and that further payments from Hennessy were unqualified arrangements for commission splitting. Certainly Hennessy, at the close of his confused, vague, and conflicting testimony before the Business Conduct Committee, was able to forward no other explanation with respect to the expenditures from his account.

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21 / Cuppia originally had subordination agreements in effect with Plate and Hennessy, which obligated them to reimburse Cuppia out of current commissions for the money that he had lent them in order to purchase their seats. His subordination agreement with Plate, dated August 4, 1932, was, however, cancelled and replaced by a subsequent agreement dated October, 1935. This latter agreement contained an outright commitment on Plate's part to pay Mrs. Cuppia $164,500, and recited that it was for the purpose of settling and defining all of the rights and obligations outstanding between Plate, Cuppia and Mrs. Cuppia.

As we read the record, the policy of exchanges with respect to subordination agreements covering the repayment of loans made for the purchase of seats appears to be somewhat unclear. 22/ It is apparent that the Exchange practice has not yet worked out a complete reconciliation between its explicit constitutional provision prohibiting the splitting of commissions, and its acceptance of subordination agreements, which contemplate that members repay indebtednesses they have assumed from business which they will in the future receive. A subordination agreement has been defined by one of the former officials of the New York Stock Exchange, in public testimony before this Commission, as an agreement whereby "the lender of the money agrees that his right to the repayment of the money will be subordinated to the right of all other claimants against the member or against any firm of which he may be a partner while he is a member." 23/ "In a subordination agreement, the applicant acknowledges his obligation to the person advancing the funds, but it is expressly agreed between both parties to the agreement among other things that, although the applicant may in certain circumstances make voluntary payments of principal and interest from time to time, the debt is not due and payable until at least thirty days after the applicant has ceased to be a member of the Exchange, that the claim of the lender for the repayment of the money advanced is subordinated to the full payment of all claims against the applicant or against any firm of which he may be a partner which may arise out of his or its business transacted while he is a member of the Exchange, and that the lender will not sue the applicant for the recovery of the money while the applicant retains his membership in the Exchange." 24/ If the policy of the Exchanges is that lenders of money to Exchange members for the purchase of seats must assume a creditor position against the borrower member subordinate to that of all other claimants, it seems utterly inconsistent to give the lender complete domination over the commissions received from business which he has given the borrower, allowing the borrower only a drawing account. It seems clear, therefore, that the agreements with Plate and Hennessy were a cover for commission splitting.

22/ Rea originally testified that commission splitting was valid if done to pay off a loan for a seat, that situation being a tacit and unwritten exception which had grown up by usage on the Exchange, but finally said that these subordination agreements constituted neither a legitimate exception to the rule against commission splitting, nor a violation of any rules of the Exchange. Moreover, while he felt that it was unobjectionable for a broker to repay a loan for a seat from business derived from the occupancy of that seat, he was not clear whether a member could split commissions in order to reimburse himself for losses, and it was counsel for the Curb who finally said that this could not be done.

23/ P.446, Vol. II, Transcript of Hearings, in the matter of Richard Whitney & Company. Difficulties in connection with other types of assignments are pointed out on pp.449-50 of the Hearings.

24/ New York Stock Exchange Directory and Guide, G-327; Meyer, *The Law of Stock Brokers and Stock Exchanges* (1931) 89-91, 713. While this analysis of subordination agreements is taken from the experience of the New York Stock Exchange, there is no reason to believe that materially different conditions apply with respect to subordination agreements on the Curb.

(d) *Failure adequately to cross-examine Plate.*

Plate, who was the most important person handling the floor business of E. A. Pierce and who received more in commissions from that firm than any other floor broker, received an incomplete examination at the hands of the Business Conduct Committee. He was called only twice, on April 3 and 22, 1940, in the early stages of the investigation, and was never recalled, even after his accounts, checks, etc. had been requisitioned by the Committee and the testimony had been had of other individuals which might have presented a clue for the further interrogation of Plate. The Business Conduct Committee spent almost all of its April 3 session in pressing upon Plate the seriousness of his failure to resort to arbitration and the penalty of expulsion that attached thereto, and the desirability of having the type of privacy and freedom from public disclosure that characterized arbitration proceedings. Its primary concern at that meeting was with Plate's failure to resort to arbitration, and the publicity he had given to the court proceedings which he had instituted against Cuppia.

Plate defended himself against the charge that he had failed to resort to arbitration by pointing out that the compulsory provision for arbitration in the Exchange constitution applied only to conduct which was "in the course of business", and that he felt that the unauthorized withdrawals which had been made from his banking account did not fall within that category. He also pointed out, at great length, that he had given publicity to the court proceeding only as a means of protecting himself from Cuppia's publicity. Taking the Business Conduct Committee's evident desire to impress upon Plate the seriousness of giving publicity to his dispute with Cuppia in conjunction with the Committee's failure to recall Plate to testify further with respect to commission splitting and its ultimate non-publicized disposition of the entire case, the conclusion seems clear that the Committee was more concerned with suppressing publicity as to disputes between its members, than it was in unearthing the truth as to the extent of the commission splitting between Plate and others with Cuppia.

The essential conditions under which Plate's funds were handled closely paralleled those under which Hennessy's commissions were handled, and the Business Conduct Committee, by dint of forceful and prolonged questioning of Hennessy, finally persuaded Hennessy in effect to confess that his commissions had been split. Shade, Cuppia's personal secretary, had a power of attorney over both Plate's and Hennessy's commissions, which were deposited in the Manufacturers Trust Company, and testified that he took orders from Cuppia as well as from Plate and Hennessy with respect to those accounts. Shade furthermore said that he would have obeyed Cuppia's orders without question in drawing checks upon those accounts; we feel that the large size of some of the checks and his ostensible position of trust with respect to Plate and Hennessy might have suggested his consulting them. While he would have advised Cuppia had Plate and Hennessy made sizable withdrawals, he apparently did not feel that they needed to be consulted concerning any of Cuppia's withdrawals. That these accounts were anything other than Cuppia's private checking accounts is further negatived by Shade's statement that he kept no account of the amounts due to Cuppia by individuals like Plate or Hennessy,

or payments made to Cuppia by them. Plate, despite the fact that his bank statements passed over his desk, and despite the large sums which were deposited at one time or another in his bank account and the large individual checks which were occasionally drawn on that account, seems never to have examined those statements and never to have had any suspicion that anything was wrong. Such complete unawareness on Plate's part of the fact that Cuppia was treating as his own the large funds on deposit in Plate's account and was drawing such large checks to his own order beggars credulity.

Plate said that the funds that were deposited in his Manufacturers Trust bank account were put there in order to save up for a partnership that Plate was going to enter into with Mrs. Cuppia and Hennessy. 25/ The agreement of October 1935, which Plate explained as having given some sort of legal recognition to this arrangement looking towards the future, took the place of the agreement that has already been described as a subordination agreement looking towards the past. Plate's justification of the agreement is clearly implausible. In the first place, although in 1935 the Curb had no written requirements as to the amount of capital which partners of member firms were required to have, the figure of $164,500 inserted in the October 1935 agreement far exceeded any capital that could conceivably have been required. The sums that were put into Plate's bank account and for the recovery of which Plate sued, even after they are reduced by allowances for income tax payments, the actual purchase price of Plate's seat, and other withdrawals from the account which could be recognized as legitimate, also were far in excess of capital requirements for partners of member firms. Furthermore, the agreement itself was worded in a manner which gives the impression that it was intended to justify Cuppia's receipt of money from Plate as a repayment of the purchase price of Plate's seat, although, as is clear from the discussion on p. 18, the agreement in reality embodied a feigned rather than a real obligation.

There are various other circumstances which confirm the conclusion that Plate split commissions with Cuppia. In the first place, it may be noted that Cuppia testified under oath in our public hearing that Plate had split commissions with him. This testimony is supported by abundant circumstantial evidence to the same effect. It also gains strength from the fact that Cuppia was laying himself open to charges of perjury should his testimony prove to be false. We, therefore, do not believe that any feeling of animosity with respect to Plate caused Cuppia to fabricate these accusations. In addition, the fact that the Committee found Plate guilty of failing to arbitrate his dispute with Cuppia is some indication that it disbelieved his story with respect to the Manufacturers Trust bank account. Plate testified that the monies deposited in that account were monies that were definitely appropriated to his own use, and that Cuppia's withdrawal of those funds could only be regarded as a personal injury to himself and did not arise out of the course of Plate's business. For the Committee to make a finding that the Cuppia-Plate dispute should have been submitted to the Arbitration Committee presupposes a prior finding that the dispute arose in the course of Plate's business and is therefore an indication that the dispute concerned

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25/ Later in his testimony Plate stated that his partners in this contemplated firm were to be "Helen Cuppia, a fellow by the name of Hubbard and Du Val."

the question of who was the rightful recipient of commissions earned by Plate and what portion of those commissions was to go to Cuppia. Likewise unexplained by anything in the record and, we think, sources of difficulty in sustaining Plate's defense, are (1) the fact that Plate continued to pay premiums on an insurance policy of $20,000 made out to Cuppia as beneficiary, even after he knew that he had been released from his so-called subordination agreement (carelessness was the only explanation offered by Plate); (2) various letters to Mrs. Cuppia enclosing checks in a total amount of $12,800, which recited that the checks are "in accordance with our agreement" (the only explanation offered here was that Plate was ignorant of these letters); (3) the suspicious but unexplored circumstance that Shade's power of attorney over Plate's account was cancelled shortly prior to the October 1935 agreement and restored after the execution of that agreement, after an interlude during which Plate was "fired" from E. A. Pierce's brokerage line; (4) Plate's contradictions with respect to the $164,500 that was inserted in the October 1935 agreement, which in one place he claimed he saw only after the agreement had been signed, and in another context asserted he had seen put in before the agreement was signed.

Our conclusion is that Cuppia intended the October 1935 agreement to follow the lines of a subordination agreement, but that the insertion of a figure as to Plate's indebtedness so clearly out of line with any figure even remotely related to the value of Plate's seat shows that the purported subordination agreement was merely a device whereby Plate became obligated to continue commission splitting, after having balked at the arrangement and being brought to book by the temporary cessation of his business. Subsequently, Plate, having become more aware of the illegality of commission-splitting, attempted to construe the agreement as an agreement whereby he was saving up funds for a partnership subsequently to be formed; the extreme unpersuasiveness of this explanation has already been considered. We believe that the incredibility of Plate's story is patent and might have been even more clearly disclosed had Plate been recalled by the Committee.

(c) *The Failure to Recall Cuppia to the Stand*

The central figure in the commission splitting activity, Cuppia himself, was called before the Business Conduct Committee only once, early in the course of its investigation. While he was asked by the Business Conduct Committee whether he had split commissions and had replied that he hadn't, there was no exhaustive follow-up of this line of questioning. Later on, when he was clearly anxious to dispose of his seat and to minimize any further personal embarrassment to himself, the Committee, instead of turning to its advantage its ability to block transfer of the seat, permitted Cuppia to transfer his seat on the promise, made in good faith, that he was going to take up residence in Brazil. Cuppia's counsel communicated with counsel for the Exchange, and submitted at least two drafts of letters containing Cuppia's resignation and the statement of his intention to withdraw from the country; the final letter which was submitted contained affirmations by Cuppia that he was sorry for his conduct and conscious of the bad light in which it put the Exchange, and asked for clemency and permission to transfer his seat, on the ground that he was leaving the country. Although counsel for the Exchange apparently did explore the possibility of getting a letter from Cuppia that would disclose whether commission-splitting had taken place, it was not made a condition of the Curb's acceptance of Cuppia's letter that he disclose the brokers who had split commissions with him, a condition which Cuppia later indicated he would have complied with had it been exacted of him.

The fact that Cuppia told his full story to the Commission was in large measure due to the fact that he was testifying under oath before the Commission, whereas he was not under oath before the Curb Committee. Despite this fact, and Rea's testimony that the Business Conduct Committee had no reason to believe that Cuppia would change his testimony if called back to the stand, or could be induced to supply a more informative letter of resignation, more persistent questioning by the Curb might have elicited additional information as to the guilty parties. Considering Cuppia's anxiety to dispose of his seat and his testimony at the public hearings conducted by the Securities and Exchange Commission, it seems probable that testimony implicating other parties could have been gotten from Cuppia had the matter been sufficiently pressed.

(f) *Failure to utilize Hennessy's confession and other circumstantial evidence.*

The Business Conduct Committee found, and the record before them amply sustained their finding, that four of the people testifying before it, including Hennessy, Powers and Reardon, had lied to it concerning "material matters". Such falsifications, taken together with the conflicting and vague explanations of other witnesses and occurring in an investigation the primary purpose of which was to determine whether commission splitting had taken place, seem to constitute strong circumstantial evidence that commission splitting had in fact taken place. Furthermore, no satisfactory explanation has been given as to why Hennessy's later testimony before the Committee that the funds in his account were in reality Cuppia's could not have been employed to upset the explanation originally offered by Cuppia, namely, that the payments made by Hennessy to Cuppia were to repay him for the purchase price of Hennessy's seat.

There were also introduced in the record various checks drawn by Shade against the accounts of Plate and Hennessy. The nature and size of these checks, the fact not only that they inured to Cuppia's benefit, but that various devices were used to conceal Cuppia's receipt of their proceeds, direct or indirect, were facts that should have cast strong doubt upon the veracity of Cuppia's, Plate's and Hennessy's original fictitious explanations of Cuppia's apparent control over their bank accounts. Thus, for example, Plate paid for two $2,400 automobiles for Mrs. Cuppia; wrote checks of $1,272.40, $326.20, $500, and $605 in payment of various travel expenses incurred by the Cuppia's; settled a $590 tailor's bill; and made out smaller checks for various charitable and recreational purposes. Similarly, Hennessy's funds, through checks drawn on his account for Cuppia's benefit, were tapped for contributions of $1,050 and $3,000 on two separate occasions for the purchase of jewelry for Mrs. Cuppia, jewelry which the testimony before the Curb disclosed Hennessy had never seen; a $1,230 check to American Express; $520 expended in the purchase of a boat motor; checks of $650 and $423 for liquor, items the true nature of which Hennessy first attempted to cover up by falsely testifying that they were for his account but later admitted; plus various smaller contributions to charities, travel and general recreation. The conclusion is inescapable that these were not occasional gratuities in which Plate and Hennessy expressed their appreciation of Cuppia's help, but that they were part and parcel of arrangements whereby Plate and Hennessy split commissions and were kept in a position similar to that of "employees" and "virtual deputies", Hennessy, as a matter of fact, actually being restricted to a monthly salary.

Regard for the fact that proof of a practice like commission splitting must, in large measure, be dependent upon circumstantial evidence suggests, in view of all of the foregoing, that the Curb had in its files sufficient evidence from which to conclude that Plate and Hennessy were in fact guilty of commission splitting, and that the Curb might have obtained even more evidence by pursuing the contradictions and improbabilities already present in the testimony before it.

IV - CONCLUSIONS

The central fact disclosed by this Commission's investigation and hearing was that J. Chester Cuppia, since 1927 a leading member of the New York Curb Exchange, during which period he was chairman and member of nine of its important committees and in complete charge of the Curb business of his firm, E. A. Pierce and Co., had for a period of over eight years violated, without apparent check or hindrance, an important provision of the Curb's Constitution. Over that entire period he had arrangements in effect with brokers to whom he allocated the largest individual shares of his firm's business which insured that they split their commissions with him. It was also shown that E. A. Pierce's floor clerk, Harry Mark, participated in the demoralizing practice of soliciting floor brokers, whom he was in a position to favor with the firm's business, for rebates of their commissions.

Commission splitting is a direct violation of Article VI, Section 1, of the Curb Constitution and, in the language of the Curb Committee that subsequently investigated the matter, is "violative of a fundamental factor in the equality essential between members." In our opinion, the allocation of business to brokers on the basis of their willingness to split commissions, under the present organization of the exchanges, (a) constitutes a discrimination against honest brokers unwilling to break Curb rules, (b) will ultimately result in fewer competent brokers being available to handle the public's brokerage business, (c) deprives the broker of his independence and lowers his professional standards by converting him into a virtual employee of the person to whom he rebates his commissions, and (d) will result in a lowering of honest effective service to customers. Cuppia admitted that the commission splitting brokers were his "virtual employees" and "deputies."

The investing public is entitled to the assurance that competence and due regard for their fiduciary responsibilities will characterize the people who handle their exchange transactions. If exchange members allocate the public's business to a broker on the basis of that broker's willingness to split commissions rather than on his competence, such members are blind to their fiduciary obligation. If transactions are executed by brokers who split commissions and thereby break an exchange rule, customers' orders will tend to be executed by brokers lacking in competence and certainly will be executed by brokers lacking in integrity. These basic defects would not be remedied by the protective machinery of the Curb, its mechanical ticker system, time-stamping of orders, tape watchers, etc. Detailed analysis of this system confirms this Commission in the conclusion that, considering the intricacy and speed of exchange operation, integrity and competence on the part of exchange members and floor brokers are still prerequisites if the public is to get adequate protection and service on its orders. Laxity of investigation and discipline such as was disclosed in this proceeding, since it undermines such basic moral and professional standards, must therefore be arrested in the public interest.

In view of testimony by Curb officials concerning the pervasiveness of the Curb's "grapevine", the importance, prominence and persistence of these violations make it surprising that they should have continued for a period of over eight years, unchecked either by ordinary partnership surveillance or by the supervisory machinery of the Curb, and should have

been unearthed only as a result of a falling out between two of the parties to the commission splitting that led to litigation, This Commission can not help but question at least the efficacy of the Curb's investigatory procedure. The subsequent handling of this case by the Curb also compels us to doubt the adequacy of its disciplinary procedure, When the case was under investigation by the Business Conduct Committee, four members of the Curb made material misstatements to it, The making of material misstatements by a member to standing committees of the Curb is an offense for which under the Curb Constitution "the Board shall suspend or expel such members as it may determine". Commission splitting is also cause for suspension or expulsion. The investing public properly assumes not only the existence of such exchange rules regulating the honesty and general conduct of exchange members but also that those rules will be enforced as provided for in the written constitution and rules of the Exchange, Under the procedure followed by the Business Conduct Committee and the Board of Governors of the Curb in this case that legitimate expectation was not realized. Instead of applying the prescribed penalties of suspension or expulsion, the eight-man Business Conduct Committee of the Curb, with three members dissenting, did not apply the prescribed penalty, It accepted a letter of resignation from Cuppia himself, permitted Cuppia to sell his seat, and administered private reprimands to the other parties it had found guilty of commission splitting and falsification, and quietly terminated its proceedings, The Board of Governors, although the tribunal to which the Committee merely reported for final action, approved what the Committee had done, on the basis primarily of the Committee's very brief report, 26/ The avowed purpose behind this departure from prescribed procedure was the desire to suppress publicity which it was feared might react unfavorably on the Curb. So great was this fear that William J. Plate, in his first appearance before the Committee, actually was severely condemned for resorting to the courts and not to Curb arbitration.

The Curb now realizes that it was unwise in avoiding publicity and has adopted a new policy under which publicity is given to all of its disciplinary proceedings. This, of course, is a distinct step forward and is to be commended, It is to be hoped that those exchanges which have not already adopted this policy will do so in the future, However, the fact that the New York Curb Exchange has adopted this policy is no guarantee that other Exchanges will in fact do so. Nor is the fact that the New York Curb Exchange has adopted the policy of making public its disciplinary actions a guarantee that in the future it will always press its proceedings for violations of rules affecting the public to their ultimate conclusions. The Commission's experience in this, as well as in the Whitney Case, 27/ make it plain that a policy of publicity and

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26/ Under Article V of the Curb's constitution, the Board of Governors alone has the power to suspend or expel members, According to Article II, Section 3, the Committee on Business Conduct in a matter of this type is primarily an investigatory body required to report to the Board matters which, in its judgment, require the consideration of the Board,

27/ In the Matter of Richard Whitney et al, 1938.

thoroughness must be made applicable to the disciplinary proceedings of all securities exchanges.

This case in particular clearly illustrates the dangers of leaving to an exchange the final determination of whether its practices and rules, their violation or enforcement, affect the public. In the last analysis, such a determination clearly should rest with an impartial and detached Government agency. We consider that the desire of the Business Conduct Committee to avoid public disclosure of the violations which it unanimously agreed existed, and its failure to pursue the questioning of important witnesses, to follow up confessions and other leads, and to draw the self-evident inferences from the wealth of circumstantial evidence which was presented to it are not consistent with a realistic and forceful approach that would have attended a more objective inquiry. The record of these proceedings leads us to the conclusion that solicitude for the "good name" of the Curb was the primary influence upon the action of the Committee. Insofar as there was a failure on the part of the disciplinary authorities of the Curb Exchange to carry through its investigations to their ultimate conclusion and to take the action which, in respect of commission splitting was contemplated, and in respect of false statements before committees is required, by the Exchange's constitution, the Cuppia Case is reminiscent of the Whitney Case. This case, therefore, like the Whitney Case, points to the need for a residual governmental power which will assure that those rules of an Exchange which affect the public will receive thorough and unequivocal enforcement.

Self-regulation, along informal and expeditious patterns, by an expert and informed private trade group like a securities exchange serves a distinct and irreplaceable function, and this Commission believes such internal self-regulation should be competent to handle most of the problems which will occur in the administration of the exchanges. However, future situations will undoubtedly arise in connection with other national securities exchanges in which informal proceedings by business and social associates of accused parties (particularly if those accused parties possess a preponderant financial power or personal prestige) may be unable either to elicit the truth, or to put in motion the appropriate disciplinary consequences once findings of guilt have been arrived at. In such cases the formal proceedings of an impartial governmental agency will serve as a better instrument for obtaining the truth than the informal proceedings of a private trade association. The reasons why a federal Commission such as the Securities and Exchange Commission is better equipped as an investigatory and disciplinary agency in such cases than the governing bodies of the local securities exchanges can be summarized under four main heads:- (a) the power of the Government to compel witnesses to produce documents under subpoena and to testify under oath, (b) the absence of personal or business affiliations between governmental investigators and the Exchange members under investigation, (c) the fact that the Government will not shrink from taking action against powerful business cliques which may dominate the administration and policies of an Exchange should they themselves be the guilty parties--the situation in the Whitney Case, (d) the fact that the staff of a governmental commission can give full and expert attention to investigations of violations of exchange rules, whereas

members of an exchange committee must perform their functions of investigation and discipline in such time as they may be able to spare from their businesses.

While the foregoing are by no means all of the advantages of Commission rather than Exchange investigation of infractions of Exchange rules which injure the public, the most important is probably that of the subpoena power and the ability to invoke the sanctions against perjury which are attendant upon its exercise. Of almost equal importance is the fact that brokers and dealers serving on business conduct committees, such as that of the New York Curb, are not trained, professional investigators. On the other hand, the staff of a governmental commission such as ours comprises expert financial investigators who are trained in using the investigative techniques that must be employed. Clearly, such a professional staff can work with greater efficiency than a part-time committee, no matter how sincere.

Section 6 of the Securities Exchange Act of 1934, providing for the registration of national securities exchanges, gives the public investor a surface assurance of protection, in that an exchange is obligated to promulgate adequate rules and provide adequate disciplinary proceedings. That protection becomes illusory to the extent that those rules and disciplinary procedures may not in fact be enforced. The fact is that the Commission has at present no sanctions to insure such enforcement. Likewise, the present provisions of Section 19 (b) of the Securities Exchange Act of 1934, providing for the alteration of inadequate rules, and of Sections 19 (a) (1) and 19 (a) (3), providing for the suspension and withdrawal from registration of exchanges and members that have violated the provisions of the act, fail of their ultimate purpose if no sanctions exist that will punish exchanges not properly enforcing compliance with their own rules the violation of which may be injurious to the public. The Commission firmly believes that the policy of cooperation which it has consistently pursued with the exchanges presupposes that rules and procedures desirable in the public interest be adopted, as far as possible, voluntarily by the exchanges themselves rather than by governmental prescription and that the investing public should be able to rely on the integrity of the internal administration of the exchanges in enforcing rules designed for its protection. It therefore becomes as necessary to insure effective compliance with rules of the exchange as it is to be certain of compliance with the provisions of the Exchange Act and the Rules and Regulations enacted thereunder. Existing legislation gives this Commission no express power to compel compliance with exchange rules. The record in this case, as well as its experience in the Whitney Case, convinces the Commission, that in order that the public interest be safeguarded, there should be appropriate power for it to take direct action where an exchange fails to enforce its own safeguarding rules of such importance that their violation entails the penalty of suspension or expulsion.