DRAFT
PALoomis,Jr.
11/2/62

Honorable Archibald Cox
The Solicitor General
Department of Justice
Washington, D.C.

Re: Securities and Exchange Commission v.
Capital Gains Research Bureau, Inc.

Dear Mr. Cox:

The Commission has very carefully considered your letter of November 1 with regard to the above case and I am writing to express our position with respect to it.

At the outset, I want to express our deep appreciation for the unusual consideration which prompted you to express the willingness that the Government file a petition for certiorari, notwithstanding your own grave doubts as to the wisdom of this course. It is only after the most thoughtful re-considerations that the Commission has unanimously determined to take advantage of ~~your kind~~ your offer and to request that the petition be filed. I must say that I personally, like you, was inclined to the view that rule-making might be the better avenue to deal with the problems presented by this case, but I have been convinced to the contrary.

Before taking up the four major reasons which you advance for not filing a petition I would like to mention certain general considerations which have influenced our thinking. In the first place, the Supreme Court has never spoken with respect to the fraud provisions of any of the federal securities laws, although on at least four occasions, it has passed upon the registration requirements of certain of these statutes. In all four

of these cases, unfavorable decisions below ~~are resolved~~ were reversed and the effect of these opinions has been of immense value. The fraud provisions are of at least equal importance from the viewpoint of investor protection and the possibility of a similar result here, particularly at this time, when we are endeavoring by all available means to raise standards in the securities markets, seems too valuable an opportunity to let pass. ~~Kaxx~~ We are all of he view that if the Supreme Court should grant certiorari, our chances of obtaining a reversal are good.

In the second place, as eloquently pointed out by Judge Clark in dissent, the decision below, coming as it does from the circuit in which our most ~~impt~~ important litigation is likely to arise, seems to represent a ~~xxx~~ retrogression from the generous judicial support which the securities laws have heretofore received. Under present conditions, and in the light of the efforts upon which we are embarked, any such retrogression would be so untimely that we can not accept it lightly.

Turning now to the reasons which you advance against the petition, let me first say that we find them significant and persuasive and were it not for the considerations outlined above, I believe we would be disposed to accept them. It is, of course, unfortunate that the Court of Appeals did not articulate its findings more clearly. We are inclined to believe that the Court ~~of Appeals have~~ has implicitly rejected the argument to which you refer ~~to~~, since it can hardly have concluded that the transactions in question were entered into without conscious purpose. In any event, we are afraid that the decision will be so interpreted. If the Supreme Court takes the case, it will,

I believe, be compelled to resolve this ambiguity in order to explain its own basis for decision, whatever that may be. Consequently, the existence of this ambiguity in our view is merely an additional reason why the Court might choose to decline certiorari. This does not necessarily mean, however, that we should therefor not request it. If certiorari is denied on this or any other ground, we can, and will, proceed to trial on the merits, but unfortunately, in view of the crowded calendars in New York, it is unlikely that we could bring the case again to the Supreme Court without a delay which would probably extend for more than a year.

Secondly, you refer to the 1960 amendments to the Investment Advisers Act. These undoubtedly have considerably complicated our problem in this case. ~~Ixfuxnmy~~ I do not believe that what transpired in 1960 can properly be regarded as a part of the legislative history of a statute enacted in 1940. At the most, the expressions by the Commission in 1958 and 1960 might be regarded as an administrative interpretation. In this connection it must be borne in mind that the Commission was endeavoring to convince the Congress of a need for legislation by pointing out that the scope of the earlier provisions was not clear. To my knowledge, the Commission has never accepted the argument that these provisions are, as we suggested limited ~~as this history suggests~~, although ~~pointing~~ pointed out that ~~xmmxy~~ such an argument could be made and that some ~~question~~ doubt existed. Turning now to the question of whether or not we should deal with this particular problem by rule rather than press for judicial interpretation, as I mentioned earlier, I personally see considerable merit in this course. ~~On the other hand~~, it is, however, extremely difficult to frame rules in this complex area which will after adequate protection against the

unethical and dishonest without imposing undue burdens and restrictions upon the honorable and ~~company~~ competent. On the other hand, judicial interpretation of the general anti-fraud provisions is well adapted to making this distinction in particular cases. Our staff has cited an ~~incidence~~ instance which illustrates this problem. They report a situation in which a particular investment adviser circulates bulletins which purport to represent the results of his financial research and analyses. In fact, it appears that he has no research department and his recommendations arethe results merely of tipes and rumors which he makes no attempt to verify. The results for his clients are unfortunate. Such a course of conduct by an adviser is certainly most undesirable. ~~On the other hand,~~ To deal with it by rule-making would, however, be difficult since we could hardly prescribe the nature of the research facilities which an investment adviser must have and the process which he must follow in arriving at a recommendation without unduly restricting the freedom and professional judgment of ethical advisers. If we should endeavor to proceed against this adviser under the fraud provisions, we would be met with the argument that under the Capital Gains decision, we have no case, since we could not prove that this adviser does not believe in his dubious advice or that in circulating particular recommendations, he was in fact activated by some ulterior motive of the ~~matter~~ nature referred to in the majority opinion. This is not to say that we do not propose to exercise our rule-making powers vigorously, nor that we could not deal with the particular problems present by this record in that manner. We think it important, however, to preserve the vigor of the general antifraud provisions as a supplement, not a substitute for, our rule-making power.

Thirdly, you suggest that the Commission would have more to lose by taking the case to the Supreme Court than it has to gain. With all deference, we are of a different view. As I mentioned, earlier, we think that if the Supreme Court takes the case, our chances of obtaining a decision which will be of substantial value to us are fairly bright and the liklihood of an ~~opportunity~~ obviously which would be seriously damaging, seems to us fairly remote. If the Supreme Court does not take the case, as you point out, this may be interpreted in some quarters in a manner ~~unfax~~ unfavorable to us. On the other hand, most members of the ~~Bar~~ Bench and Bar understand that a denial of certirorari does not necessarily imply any approval of the ~~bel~~ decision below and the first two ~~prior~~ major reasons outlined in your letter furnish a much more likely explanation for any such x denial. ~~On the other hand~~, as we have ~~it~~ learned to our embarassment, the failure on our part to take a case up is cited as evidence of our agreement or at least acquiescence in the decision against us. We are further inclined to feel that we can not in any event hope to prevent the decision of the Court of Appeals from having its impact in the interpretation of the almost identical fraud provisions in the other federal securities laws, particularly in view of the fact that about the only authority cited by the majority in support of its interpretation is Blau v. Lehman which arose under the Securities Exchange Act.

We recognize the force of the considerations which you advance and would normally regard ~~these considerations~~ those particularly when advanced by you as controlling. We believe, however, that circumstances peculiar to our administration of the federal securities laws at this particular time make it imperative that we refrain from acquiescing in the majority opinion of the Court of Appeals and endeavor to secure a more favorable interpretation

of the federal antifraud provisions of our statutes by a Court which has heretofore been hospitable to furthering the objectives of the securities laws. May I again express our gratitude for your generous willingness to allow us to pursue this course.

Sincerely,

William L. Cary
Chairman