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Finance Writers

As Insiders

By J. A. Livingston

ON APRIL 26, 1932, Fiorello H. La Guardia, a Congressman from New York city who later would become Mayor, brought a small brown trunk before the Senate Banking and Currency Committee in Washington and pulled out of it canceled checks endorsed by financial writers who wrote ballyhoo articles about stocks being "bulled" — manipulated upward — in Wall Street.

The ballyhoo was in the '20s, when pools weren't in backyards for swimming but in Wall Street to give investors baths. La Guardia named as payola recipients employees of the New York Times, New York Herald Tribune, New York Evening Post, Wall Street Journal, New York Evening Mail and Financial America.

As a consequence of his and similar revelations, one section of the Securities Act of 1933 specifically prohibits payments to writers for favorable articles about stocks unless disclosure of the payment is made.

Yet not until last month did the Securities and Exchange Commission bring an action against a writer on a major newspaper. This is a precedential case on the use of inside information under the Securities Exchange Act of 1934.

The writer is Alex N. Campbell of the Los Angeles Herald-Examiner. On July 25, the SEC asked for an injunction against him and his son, Alex N. Campbell Jr., editor of the Western Financial Journal. Campbell is still with the Herald-Examiner, but his column, "Market Comment," is not appearing.

The SEC asserts that Campbell Sr. and others associated with him would purchase stocks prior to one of his columns about them. Shortly thereafter, they'd sell. "Increases in price . . . occurred in approximately three out of four instances."

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RULE 10B-5 UNDER the Securities and Exchange Act specifies, among other things, that it's "unlawful to omit a material fact . . . in connection with the purchase or sale of any security."

Heretofore, 10b-5 has been applied primarily to corporate officers, directors, or brokers acting on inside information about affairs of a particular company, such as new products, earnings or dividend actions.

In the 1965 Texas Gulf Sulphur case, officers, directors and employees who bought stock or gave tips on learning of a major "copper strike" in Canada were considered "insiders" who could be asked to make restitution to the sellers.

In 1968, the SEC extended this to Merrill Lynch, Pierce, Fenner & Smith, Inc., for informing a favored few customers of a drop in earnings of Douglas Aircraft before it became public knowledge. It also used 10b-5 against those customers who sold the stock on the basis of that information.

Now the SEC widens the periphery to "inside knowledge" about the market itself. It contends that Campbell Sr. had advance information about the probable market action of stocks about which he would write. Therefore, he and others who knew this were obliged to disclose it to persons from whom they bought and to whom they sold.

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A CASE OF A SIMILAR nature came before the Supreme Court in 1963 under the Investment Advisers Act. The Capital Gains Research Bureau published a report for which subscribers paid \$18 a year. Before recommending some stocks, Harry P. Schwarzmann, president and principal stockholder, would purchase shares. Then, after the report reached subscribers and the stocks advanced, he'd sell.

The SEC accused him of "scalping" at his clients' expense but lost the case both in the Federal District Court and the U.S. Court of Appeals. The defense argued that "the motives were honest." The stocks would have been recommended even if they had not first been purchased.

In a landmark seven-to-one decision, the Supreme Court reversed the lower courts. Supreme Court Justice Arthur Goldberg wrote: "The high standards of business morality . . . do not permit an investment adviser to trade on the market effect of his own recommendations without fully and fairly revealing his personal interests in these recommendations to his clients."

If an investment adviser has fiduciary responsibilities to clients who pay a fee, does a writer have a lesser responsibility to readers of the newspapers, magazines, or publications that pay him for his product?

SEC Chairman William J. Casey answered this question when he said to me:

"There is a good general rule for all persons who can influence the market price of securities to follow: Do not do anything you would be unwilling to see in the newspapers. This applies to writers as well as investment counsel and brokers. Anyone who trades in securities with the intention of writing an article which will influence the price has an obligation to publicly reveal this."