

# Behind the USAMCO Case: Some Difficult Questions

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ANY ATTEMPT to write an exact and final recapitulation of "the USAMCO affair"—the meteoric rise and equally meteoric decline of United States Automatic Merchandising Co., of Redondo Beach—clearly must await the outcome of the several law suits now pending in federal and state courts, the official findings of the Securities and Exchange Commission, and inquiries now in progress by two private bodies: the National Assn. of Securities Dealers and the New York Stock Exchange.

As the first eight articles in this series have documented, the creation, growth and activities of USAMCO—and the distribution and price gyrations of its stock—have brought the company and the men surrounding it within the public gaze.

This is not to make judgment upon the company or the men surrounding it, since such judgments necessarily—and properly within the framework of our heritage of Anglo-Saxon law—must be made by officially constituted bodies such as the courts.

IT IS SELF-EVIDENT, however, that "the USAMCO affair" raises some questions profoundly significant to this country's economic system—questions distinct from the sharply defined issues covered by law, or even by the rules of agencies such as the SEC, the NASD or the New York Stock Exchange.

They are questions that may be asked all participants in the American business process: the investing and buying public, the securities profession, the business community itself, and the public at large.

USAMCO, for example, came into the public gaze as a small, new company. Of the more than 1 million corporations in this country today, approximately three-fourths are small companies with fewer than 20 employees and assets of less than \$300,000. And perhaps one out of every 10 is a new company.

Moreover, new corporations are being added to the roster of U.S. business at the rate of perhaps 15,000 a month.

IN RECENT YEARS, these young, untried corporations have been entering the realm of public-held companies at the rate of more than 100 a month. Yet, according to Dun & Bradstreet, 56% of all the businesses that failed last year had been in business less than five years.

Some of these youngsters are built upon important new products or business ideas, have excellent management, and in time perform impressively in terms of their return to investors.

Conversely, some have fared miserably. Their managements have been immature. Their basic product or service has been little short of hare-brained. And both owners and investors have lost their shirts.

All this is one area for pondering brought to mind by the events involving USAMCO.

And it's an area of fundamental importance to the United States and its whole concept of economics.

In the past, one of this nation's shining strengths has been its capacity to receive new ideas, develop new products and services—and to reward the ingenuity of the men and women who helped create and develop them.



THE PROBLEM ARISES in finding some means of encouraging this growth while at the same time finding some means of protecting the investing public—to find some means to alert the public to the risks inherent in new and unproved companies, and seeing that those who put up money for new ventures can afford to take the risk.

The National Assn. of Securities Dealers, for example, reveals its awareness of the problem in its "Rules of Fair Practice"—the rules of ethical conduct expected of every representative of every brokerage firm belonging to the NASD, which is the principal professional organization of over-the-counter firms. Two sections of this code are of special interest here.

Section Two of Article III states: "Recommendations to a customer covering the purchase, sale or exchange of any security must be based upon reasonable grounds for believing that the recommendation is suitable for the customer upon the basis of the facts as to his financial situation and needs."

In brief, a responsible securities dealer will not sell risk stocks to "unsophisticated" investors of only moderate means.

Section 16 of Article III states: "When participating in the primary or secondary distribution of an issue which is not traded on a national securities exchange, no representation may be made that the security is being offered to a customer 'at the market' or at a price related to the market unless there are reasonable grounds to believe that a market for the security exists other than that made or controlled by the member."

THE VOLUMINOUS CODE of the New York Stock Exchange has numerous provisions aimed at the same ends, and its constitution begins, in its second article, with an even broader statement of ethics: the object of the exchange shall be, among other things, "to maintain high standards of commercial honor and integrity among its members and allied members, and to promote and inculcate just and equitable principles of trade and business."

The question in this area suggested by the USAMCO case is not merely whether these rules of ethical conduct were violated or skirted, but more importantly: how can such rules or codes be implemented?

The great body of securities dealers and registered representatives are men and women of both experience and integrity. Their peers within the profession—and the forces of competition—would not let them remain in business long if they weren't.

Yet it has been no secret in recent years that the over-optimism of the Bull Market and the general affluence of Americans resulted in unusual expansion of the securities business—and with it, the employment of many new, and sometimes, inexperienced salesmen.

The problem of old, established firms and veteran branch managers has been—and still is—to maintain some reasonable control over what these salesmen say to the public.

BUT HERE ARISES still one more question: What is the responsibility of the public itself? How far should the individual investor go in delegating to someone else his responsibility to investigate before investing? And if the investor does delegate such investigation,

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to someone else, can he reasonably hold his agent responsible if things go wrong?

In the course of his testimony before the SEC hearing, John B. Dunbar, the Shearson, Hammill partner who was one of USAMCO's directors, called the commission's attention to the point in this way:

"It is amazing that no one ever says to me, 'Why is the market always going up?' But they say, 'Is the market going down?' They don't have a complaint when they have a profit, but they have a complaint when they have a loss."

The long rise of the post-war Bull Market suggests that Witness Dunbar touched a major truth: the investing public had not been particular about investigating the origin of the profits so long as stock prices spiraled up. The public concern was ex-

pressed only when prices began to fall.

Although several aspects of the USAMCO case suggest this particular stock may not have been typical, the USAMCO "peculiarities" do not excuse the investors from the need to make their own inquiry into any issue.

The courts and other agencies are studying whether there had, indeed, been misrepresentation or fraud. But many of the investors concede they bought their stock merely on the say-so of a given brokerage representative, or on the tip of a friend. And according to testimony before the SEC, even some registered representatives who admitted to recommending the stock over the phone conceded they based their recommendations on unsubstantiated reports from USAMCO officials.

Finally, there are the questions centering on the nature of a corporation and its obligations and responsibilities.

Any corporation, in the

eyes of the law, is a unique creature of the law and it can be dissolved only by another act of law.

An unsuccessful corporation often takes on the characteristics of a derelict ship at sea, floating with the currents of the business world — a hazard, as it were, to navigation.

What are the responsibilities of the governmental bodies who authorize the formation of new corporations? To what degree should these bodies pass upon the experience of the men who form the new corporations? Indeed, can statutes be written to assure the competence of corporate leadership? Or put another way, in attempting to minimize the risk to the public, can government really protect the enterprise motive that brings new ideas to the market place — and new

capital into the economic bloodstream?

These are the real issues behind those raised by the unhappy chronicle of United States Automatic Merchandising Co.

No doubt the stock losses of public investors, the decline of the corporation itself, and the legal embroilment of the securities people who sold the stock are specific issues of concern.

But the implications of their difficulties are reason for even more concern. This nation needs new businesses

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to create the employment demanded by a growing population. It needs new capital to get these businesses started. And it needs a public with confidence in the economic system and in the business community, a public willing to enter into the economic life of this country.

Finding the answers isn't simple — and when they are found, they are likely to be seen in blends of gray rather than the sharp contrasts of black and white.

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