NOTES ON STOCK PRICE MANIPULATION

Stock price manipulation is typically defined to be a "planned effort by an individual or group of individuals to make the market price of a security behave in some manner in which it would not behave if left to adjust itself to uncontrolled or uninspired supply and demand" (Twentieth Century Fund (1935) p. 444). There are two types of manipulation that have been attempted. The first is a "bear raid" where investors plan to initially force down the price of the stock by selling and then buy back at a lower price. The second is a "bull raid" where the sequence of transactions is reversed so that buying precedes selling. When a group of individuals forms a syndicate to manipulate prices this is usually referred to as a "pool."

There is evidence that individuals and groups attempted to manipulate stock prices as early as the beginning of the seventeenth century. Sobel (1965; p. 6) reports that

In the beginning of the seventeenth century some brokers began to realize that concentrated selling over a relatively short period of time might cause the less wary to offer their shares at low prices, in this way spreading and intensifying the decline. If prices could be beaten down artificially at first, frightened investors could be counted upon to join in and push prices still lower. Those who realized what was happening could then step in and buy shares at bargain prices. "Bear raids" of this nature were soon common in Amsterdam.

It was not long before some brokers developed a technique that further multiplied their profits: they sold shares they did not own just before depressing prices. After the market had collapsed, they bought the shares needed for delivery at prices lower than were specified in the first contract. Of course if a broker had not actually delivered the shares he had sold, but had waited until the price had declined, he would have made this profit without having committed his capital. This method, known as the short sale, became a powerful weapon in the hands of the bears. It appeared later on every financial market, and was used extensively by Wall Street bears during and after the nineteenth century.
The work of De la Vega (1688) suggests that by the latter part of the seventeenth century manipulation by individuals and groups was common in the Amsterdam market. Bull pools are mentioned from time to time and he describes the techniques used by bear pools as follows (Twentieth Century Fund (1935) p. 449):

Ten or twelve persons combine to form a consortium on the Bourse, which as already mentioned is called a "Cabala." Do they consider it appropriate to sell stocks, means are devised for the astute execution of this plan. They enter into the venture only when they can foresee the outcome, barring unfortunate accidents.

They, the bear pool, make the first attack with short sales in that they reserve spot (cash) sales for the period of greatest pressure. They sell 50,000 pounds on various terms, an operation through which quotations must fall. The tendency toward weakness spreads. The bears receive aid from other quarters, and one may add that with such wide-spread participation the end must be attained.

Since there are so many people who cannot resist following the prevailing stream, I do not wonder that a small group soon grows into an army. They think only to do what others are doing and to follow their example.

The purposes of the Cabala are fostered through this fear or belief, for when not only the Cabala but others are also selling, there can be no doubt but that the attack will meet with success. When the bears recognize that the mine has caught fire, they throw in the shares which they possess or hold as collateral against loans. They renew the sales until the booty seems assured. But in the face of opposition, they resort to a number of tricks, that only sly and astute speculators invent and introduce.

De la Vega then outlines some of the tricks that are used and, in particular, mentions the circulation of rumors and reports.

John Francis (1850) reports that the manipulation of stock prices also occurred in London in the late seventeenth and early eighteenth centuries during the Napoleonic wars using similar techniques. In this case the press was used to spread rumors and reports (p. 147):

The newspapers were the vehicles generally employed to spread false intelligence; and an almost invariable success attended those who made use of the press to promulgate in bold language "bloody engagements," "rumored invasion," or "great victory," to assist their city operations.
Such attempts to manipulate stock prices were illegal under English common law. A group of persons were in fact tried for a conspiracy to manipulate the prices of public securities and funds during the Napoleonic wars by spreading false rumors about the peace between England and France and the death of Napoleon. Flynn (1934; p. 213) quotes Lord Eliebrough's opinion as follows:

The purpose of such a conspiracy is itself mischievous, as it strikes at the price of a vendible commodity in the market, and if it gives a fictitious price by means of false rumors, it is a fraud leveled against all the public, being against all such as might have anything to do with the funds on that particular day.

Similar manipulative practices were also adopted during the nineteenth century in the U.S. (Twentieth Century Fund (1935) pp. 449-450). For example, Jacob Little was nicknamed the "Great Bear of Wall Street" for the bear raids that he conducted during the mid-nineteenth century. Sobel (1965; p. 41) recounts his activities as follows:

He favored the "manipulated short sale" - he would sell shares he didn't have for delivery in sixty days. He would then sell more shares in different brokerages, plant rumors as to the insolvency of the company, and thus force its shares down. Just before the time limit had expired, he would buy shares at depressed prices for delivery. These tactics were not always successful, and Little knew bankruptcy several times. He carried off enough raids, however, to be considered the uncrowned King of Wall Street, a title he held for a generation - until he lost a fortune and died poor.

Another illustration of the importance of manipulation in the nineteenth century is the fact that the 1817 Constitution of the New York Stock and Exchange Board (the forerunner of the current New York Stock Exchange) explicitly outlawed "wash sales" where a person sold a stock to himself and which were used to give the impression that a transaction had taken
place at a particular price when in fact none had done so.

In the early part of the twentieth century and particularly in the 1920's manipulation of stock prices by what were by that time called "trading pools" (Twentieth Century Fund (1935) p. 464) was also frequent. Sobel (1965; pp. 248-249) gives a number of examples:

John J. Levinson, a free-lance trader who managed pools in Celotex, Borg-Warner, and Pitney-Bowes among others, made profits of over one million dollars a year. He was on close terms with Raleigh T. Curtis, who wrote a column entitled "The Trader" for the New York Daily News. Levinson would buy a stock, Curtis would speak highly of it in his column, the stock would rise, Levinson would sell, and the two friends would share the profit. Each time the procedure was repeated, it was easier, for as Curtis' readers bought on his recommendations, they made them come true, and the next time they trusted him all the more. David Lion, a market manipulator, and William J. McMahon, president of the McMahon Institute of Economic Research and for a while, a widely followed radio commentator on stock market affairs, worked a similar dodge. Lion would buy or sell stocks, and then McMahon would speak enthusiastically or disparagingly of them in next week's broadcast or market bulletin.

Not all trading pools relied on bribing the press. In many cases they aided the operations of trading pools by publicizing their activities in the normal course of reporting the news. A good example is provided by the Radio Corporation of America pool of March 7-30, 1929 (Twentieth Century Fund (1935) pp. 475-483).

Of all the securities listed on the New York Stock Exchange at that time, perhaps the common stock of the Radio Corporation of America was the most appropriate medium for a large scale pool operation. ... between, the date of its organisation and the time of the listing of its shares on the New York Stock Exchange, the enterprise had grown in spectacular fashion. ...

Other characteristics of the company and its position in American industry doubtless likewise commended its common stock to the operators of this pool. It was active in a field new not only to business, but to science, a field imperfectly explored, and therefore leaving the imagination free play in devising possibly miraculous developments. The company had but recently completed its arrangements for merging with the Victor Talking Machine Company, an important rival, and owner of important patent rights. The combination seemed to offer great
possibilities in the manufacture and sale of combination radio and
talking machine sets. Moreover, rumors for which the pool may have been
responsible but which more probably had other sources and possibly some
foundation, had been current for some time that further mergers with
important communications companies, were in prospect. Financial pages
of the newspapers and magazines for weeks had been filled with exciting,
though vague and not always wellfounded, discussions of the industry and
company. The stage was almost perfectly set for a pool operation.

The pool was organized on March 7, 1929 by M. J. Meehan and Company
in cooperation with W. E. Hutton and Company and Block Maloney Company.
The syndicate agreement expired on March 30. Its active operations
began on March 11 and most of its trading was concluded by the end of
the day on March 15, although further transactions occurred during the
succeeding days in March 1929. ... The participants numbered 70 and
included a long list of names well known in industrial and financial
circles. Cash deposits of $12,683,000 were made by participants with
the firm of M. J. Meehan and Company.

... On the afternoon of March 6, the New York Evening Journal informed
its readers that M. J. Meehan was back from a Florida holiday, and that
his return was expected to set off more fireworks in Radio. Meehan, it
was indicated, was the moving force in a pool with almost unlimited
capital which was expected, according to this newspaper to push Radio up
to breath-taking levels. ... For an even longer period before the
operations of the pool began, practically every newspaper in the city
had been featuring the company, its stock, its doings, its plans, its
prospects ... As a result, the volume of daily transactions in the stock
increased three- or four-fold before the pool ever purchased a share.
The stock which sold on the first day of the month at from 81 to 84(1/4)
rose after a brief decline, to 90(3/8)-93(1/2) by March 9, the last
business day before the pool began its operations. On Saturday, March
9, nearly 400,000 shares changed hands. This was approximately 20 per
cent of all the trading on the floor that day.

... Monday, March 11, the pool began its operations by purchasing
392,600 shares and selling 246,000 shares. ... These operations left the
pool long 146,600 shares at the close of the day. Prices fluctuated
widely in the course of the session but at the high were 2(1/2) points
above the high of the previous session. ... During the next two days ,
the group bought 175,900 shares and sold 295,200 shares thus reducing
its holdings by 119,300 to 27,300 shares. ... on the next day, March 14,
it bought 209,400 shares and at the same time sold 186,000 shares, thus
adding to its holding in the amount of 23,400 shares. Prices on that
day ranged from 95(1/2) to 100(7/8), as compared to with the range on
the previous day of 91(1/2) to 94.

... The next day, March 15, with prices ruling firm throughout , they
purchased only 210,500 and sold 449,100 shares. That is to say, they
disposed of all their long holdings at a profit and went short in the
amount of 189,700 shares. Unfortunately the record goes no further.
Prices rose violently the next day to a high of 109(3/4), remained at
such levels for the day and then began to rapidly decline. Before the
end of the month, when the syndicate contract expired, the stock had
touched a low of 82.

At what prices the pool covered its short position is not revealed
in the records, but it is stated there that the profits of the venture amounted to slightly less than $5 million.

... striking fact is the extent to which the pool was aided by the press. No evidence has been discovered to warrant the assertion that the pool managers bought publicity as has been established in sundry other pool operations.

Not all trading pools were organized to artificially manipulate the stock price, some "legitimate" pools were formed to seek out undervalued securities and buy them before telling the public the truth about its excellence. Examples of these are rare (Twentieth Century Fund (1935) p. 505). However, Hickernell (1932; pp. 104-105) gives the following illustration of the Maxwell-Chrysler pool as an example of a beneficial pool:

The large holders of the stock - Brady, Chrysler and Bache - were faced with an ideal situation for pool manipulation. The Chrysler Corporation was organized to take over the stock of the Maxwell Motors Company. The old Maxwell Motors B Common stock moved up from 10(1/8) in April, 1924, to 75(1/2) in April, 1925. The mere fact that the name was being changed to Chrysler did not seem to justify an extensive advance in the stock. Consequently a great many investors sold short before they understood that the new Chrysler car had caught the fancy of the public and before they knew that the net income would increase from $4,000,000 to $17,000,000 in one year. The year 1925 was one of the best automobile years in the past generation from the standpoint of expansion, and the profits were equivalent to over $22 per share on the old Maxwell B stock. After the new Chrysler Common was exchanged for Maxwell B stock in April, 1925, a new crop of shorts was trapped every week as Chrysler rose from 75(1/2) in April to 253 in November, 1925. In nineteen months the old Maxwell B had risen from 10(1/8) to 253. Messrs. Brady, Chrysler and Bache were able to divide up handsome pool profits every month in the summer of 1925.

This pool operation was beneficial to investors in Maxwell and Chrysler. They were able to benefit immediately from the improvement in the operations of their company.

In the manipulative practices described above, trading pools were formed to buy and sell equal amounts of the stock so that the net trade was zero. In addition, there were also what were known as "option pools" (Twentieth Century Fund (1935) p. 463). The purpose of these
pools was to sell a large block of stock to the public. Typically, management or a large holder of the stock would grant a call option on the stock to the manipulators in the hope that they could sell it at a higher price than the option exercise price. Sobel (1965; p. 249) gives the following account of a manipulator that engaged in this type of operation:

George Breen, a master speculator, was in the practice of buying options on stocks that he planned to "move." He then would plant rumors along the Street of mergers, higher earnings, or new managements, which would shoot the price up and add millions to his bank account. In this way he was able to salvage a small fortune for the majority stockholders of many a firm. In a typical example, Kolster Radio, a company which had earned 87 cents a share in 1927 and 20.5 cents the following year, called Breen in and told him that the firm would earn nothing in 1929. Breen was given free options on Kolster stock which enabled him to buy a given number of shares at the market closing of that day. Breen took Kolster Radio in hand, and within a month had bullied it from 70 to 95. He then sold out, making a profit of $1.3 million on no investment at all. Within another month, Kolster sold for 3.

Allowing managers or shareholders to sell large blocks of stock was not the only purpose of option pools. On occasion they were also used to make seasoned issues of stock. The pool in effect took the place of underwriters and kept the price high while the stock was being issued. An example of this type is provided by the American Commercial Alcohol pool of 1933 (Twentieth Century Fund (1935) pp. 489-499).

The American Commercial Alcohol syndicate was organized in the spring of 1933 and completed its operations by the end of July of that year. ... It was conducted through the firm of W. E. Hutton and Company ... Its manager was Thomas E. Bragg ... The first transaction occurred on May 3, 1933 and the final trade took place on July 31, 1933. ...

The operation was based on an option granted by Russell B. Brown, Chairman of the Board ... to Bragg upon 25,000 shares ... The price at which the stock could be taken up under the option was $18 per share.

The explanations of the underlying purposes of the pool as given to the Senate Committee on Banking and Currency by Brown are most interesting. ... The American Commercial Alcohol Corporation in the spring of 1933 found itself with extraordinarily heavy bank loans secured for the most part by raw materials, the inventory value of which
shrunk greatly as a result of declines in the market price of molasses. In addition, the leaders of the alcohol industry chose this time to make changes in their marketing practices which would postpone the sales of important quantities of commercial alcohol. This naturally tended to "freeze" the loans the banks had made to the company. The banks were bringing pressure upon the company which was in desperate need of further working capital. ... Brown testified that, after careful enquiry, responsible executives of the Corporation abandoned the idea of undertaking a public offering of additional stock for the reason that they did not believe it possible to have it underwritten. Meanwhile Brown ... evolved a plan. ... This plan was nothing if not extraordinary and ingenious. Through a dummy, Knox B. Phagan, an accountant, Brown organized a corporation in the state of Maryland known as Maister Laboratories, Inc. He then caused this corporation to issue 10,000 shares of common stock to Phagan against Phagan's note in the sum of $180,000. He caused the corporation to simultaneously enter into a contract with Dr. Maister, a chemist in the laboratories of American Commercial Alcohol Corporation, under which the corporation acquired rights to a secret, unpatented and untried process for the manufacture of certain products. The consideration to Maister is not altogether clear, but apparently consisted of prospective royalties. The next step was to arrange with Phagan to exchange his 10,000 shares of Maister Laboratories, Inc. for the same number of shares of the American Commercial Alcohol Corporation to be issued to him by the Corporation. After this was carried out, the Maister Laboratories, Inc. was a fully owned subsidiary of the American Commercial Alcohol Corporation. It had as assets a vaguely described "secret process" and Phagan's note for $180,000. Now, the 10,000 shares of the common stock of the American Commercial Alcohol Corporation which Phagan had received in exchange for his stock of the Maister Laboratories, Inc. directly or indirectly supplied Bragg with 10,000 of the 25,000 shares of American Commercial Alcohol common that he had under option from Brown at $18 per share. These 10,000 shares were duly taken by Bragg at that price since his operations in the stock market enabled him to sell them at higher figures to the public; and the $180,000 Phagan thus received from Bragg he used to pay his note held by the Maister Laboratories, Inc. The latter corporation then delivered these funds to its parent corporation, the American Commercial Alcohol Corporation, which used them to reduce its current indebtedness.

A similar scheme was used to provide shares for the remaining 15,000 under Bragg's option. This pool obtained notoriety because of the rapid escalation in the firm's stock price during the operation of the pool and its dramatic collapse when the pool ceased operation.

According to the Twentieth Century Fund (1935; Table 80 pp. 494-496) it went from 21 on May 3 when the pool started operations to a peak of
89(7/8) on July 18, a low of 29(1/8) on July 21 and 22 before rising to 44(7/8) on July 28 and 29. Although the pool achieved its aim of raising capital for the firm it did so at a high cost to the firm. The Twentieth Century Fund (1935; pp. 500-501) gives the following account:

When the complicated process through which the company or its directors went is brushed aside, the company received $450,000 for 25,000 shares of its stock, or $18 per share. Yet the public that took stock from the pool apparently paid on the average $28 per share, or a total of about $700,000 for the 25,000 shares in question. This spread of $10 per share, or more than 35 per cent of the price paid by the public for the stock represents approximately the profit to the pool which is out of all proportion to the underwriting profit when financing is done by customary methods.

On the other hand without the manipulation it is not clear that such a high price could have been obtained. It may well be that even though the firm paid such a large amount it was better off than it would have been had it raised money through a conventional underwriting.

In addition to call options, put options were also used in manipulative schemes to encourage others outside the pool to participate. Flynn (1934; pp. 202-203) describes the use of puts in this way:

The object of the pool manager at the beginning and during the pool is to get the price of the stock up and keep it up. For this purpose he does a certain amount of buying himself. However, he will help the situation if he can induce outsiders to buy. Therefore, the pool manager will call up some speculators, perhaps a floor trader or two or three or more and urge him to buy .... shares at the market and give him a put to protect him. Thus he induces a number of persons to add their buying weight to the market without taking very much risk. It is a process, as Mr. Cutten conceded "whereby persons might be induced to buy the stock because they are insured of being protected against loss."

So far the discussion has focused on both bear and bull manipulations. One interesting fact is that during its long investigations into manipulations that occurred in the 1920's and early
1930's the Senate Committee only found examples where pools attempted to raise prices (Twentieth Century Fund (1935) p. 504). In this context one important difference between bull and bear raids should perhaps be noted. In a bear raid, manipulators that engage in short selling a stock open themselves up to the possibility of a corner. The reason is that short sale contracts allow the lender of the stock to call for the return of the stock at any time; in order to satisfy his end of the contract the short seller must then deliver that stock, he cannot satisfy the contract by, for example, delivering cash. However, if somebody has cornered the market in the stock then it will not be possible to obtain the stock itself to satisfy the contract except on terms dictated by the owner of the stock. In bull raids there is no counterpart to this risk of being cornered since there the equivalent of selling short is buying on margin and margin contracts are settled in cash which cannot be cornered. An example of the problems that can be encountered in bear raids is provided by three attempted bear raids in the 1860's on the stock of the Harlem Railway which was controlled by Commodore Cornelius Vanderbilt at that time. Eiteman, Dice and Eiteman (1966; p. 562) describe the first incident as follows (the other two incidents followed a similar pattern).

The Commodore had been operating steamboats most of his life and had made a lot of money. In 1863 as an investment he bought some Harlem Railway stock around 8 and 9. He became interested in the enterprise and began to develop the property. The stock soon climbed to 30 and then to 50. Traders began to suspect manipulation. In April 1863, an ordinance granting Vanderbilt the right to build a streetcar line the length of Broadway was passed by the New York City Council. Since such a grant meant much to the railway, the stock soon advanced to 75. The council now conspired to make large profits by selling Harlem Railway short and then repealing the ordinance passed in April. The council members tipped off their friends, and total short sales amounted to much over the 110,000 shares outstanding. The great bear operator, Daniel Drew, had a share in the attempted raid. The ordinance was appealed on schedule but, instead of a decline in price of 20 to 30 points as expected, the decline amounted to only 3 points. Vanderbilt had learned
of the conspiracy and had bought up all the stock. When the members of
the council and their friends became frightened because the price did
not decline and began to cover, they had to buy from the Commodore. The
price was bid up rapidly. The council settled at 179, while the
Commodore profited to the amount of $5 million or more.

In addition to trading and option pools, another type of
manipulation was also practiced which is sometimes regarded as more
desirable. This was the "pegging" of a stock price by an underwriting
syndicate of investment banks during the primary distribution of a
security. In this case the syndicate prevents the price of the security
from deviating from the "peg" by the appropriate use of buy and sell
orders until the syndicate agreement expires. The Twentieth Century
Fund (1935; p. 500) summarizes the arguments for and against price
pegging as follows.

There is substantial difference of opinion among informed observers in
respect to the economic justification for the price pegging commonly
undertaken in this country on the occasion of the offering of new
issues. It is often alleged that some such practice is necessary in
this country where security buyers are prone to believe that a moderate
and perhaps temporary, decline in the market price of new issues is a
sign of basic weakness. On the other hand, the sale of a new issue to
investors by temporarily holding prices steady only to have them decline
when the syndicate expires is certainly not an ideal method of
distribution. Moreover, this price pegging practice is susceptible to
considerable misuse, and is at times badly abused. One result is the
sale to ill-advised investors of substantial blocks of securities under
essentially false pretenses. At the same time, complete abolition of
the practice as a practical matter would probably require a fundamental
change in our system of marketing securities, and in the conceptions of
the general public as to the nature of investment. It appears both
reasonable and necessary to assert that discontinuance of price pegging
by underwriting syndicates is a goal toward which the financial
community ought to strive as vigorously as possible.

The large amount of manipulation of stock prices that occurred in
the 1920's and early 1930's lead to calls for reform. In February 1934
the New York Stock Exchange amended its rules to limit manipulative
practices (Twentieth Century Fund (1935) p. 507). However, soon after
this the Securities Exchange Act was passed and it contained provisions
to limit manipulation. Huebner (1934; pp. 414-415) summarizes these
provisions as follows.

A large portion of this Act (Sec. 9) is devoted to "prohibitions
against manipulation of security prices," with respect to any member of
a national securities exchange, as well as "any person, directly or
indirectly." Some of the prohibitions referred to have for years been
enforced by the nation's leading exchanges, such as those relating to
fictitious sales and matched orders. The following acts, prohibited by
this law, however, should be mentioned:

(1) The dissemination to the effect that any registered or
unregistered security "will or is likely to rise or fall because of
market operations of any one or more persons, conducted for the purpose
of raising or depressing the price of such security."

(2) The making of any statement, with respect to any registered or
unregistered security, "which was, in the light of the circumstances
under which it was made, false or misleading with respect to any
material fact, and which he knew or had reasonable ground to believe was
so false or misleading."

(3) The dissemination of information, for a consideration, to the
effect that the price of any registered or unregistered security "will or
is likely to rise or fall because of the market operations of any one or
more persons conducted for the purpose of raising or depressing the
price of such security."

(4) Engagement "in any series of transactions for the purchase and
sale" of any registered or unregistered security, "which has the purpose
of pegging, fixing or stabilizing the price of such security in
contravention of such rules and regulations as the Commission may
prescribe as necessary or appropriate in the public interest or for the
protection of investors or without having prior thereto reported to the
exchange authorities and to the Commission such information regarding
the purpose and nature of such transactions or operations, etc."

Thus the Act essentially compromised on the point of whether or not
to allow manipulation when a security was first issued. The requiremmt
was that this type of manipulation should be registered. By the 1960's
the attitude towards pegging was much more favorable than the above
passage from the Twentieth Century Fund indicates. Eiteman, Dice and
Eiteman (1966; p. 551) write as follows:
There is nothing essentially evil about forcing prices up or down. The harm, if any, results from hiding the manipulative activities with intent to deceive investors. The real question is: Would an investor have purchased or sold the manipulated issue if he had known that the price quoted on the Exchange was an artificial one not derived from the free interplay of the forces of supply and demand?

An example of manipulation that seems quite legitimate is found in the support which an underwriting syndicate gives to a new issue of stock by employing a broker to buy shares if the market price goes below the issue price and to sell shares when the price goes above. Without these operations, the price would drop or rise. Clearly this is an artificial price due to the planned activities of the syndicate.

Section 9A (5) of the Securities Exchange Act makes it unlawful for any person to stabilize the price of a security other than in a manner approved by the Commission. The rules of the Commission require that persons seeking to stabilize a security must send a notice of their intention to stabilize with full particulars to the Commission and to the Exchange upon which it is intended to effect stabilizing transactions. Then they must report all transactions to the Commission. Prior to selling a stabilized security off the Exchange, the stabilizer must give the prospective purchaser a written notice. Thus it will be noted that the law does not prohibit stabilizing a security but requires only that the stabilizer refrain from using stabilized market quotations to deceive investors.

Thus the Act is essentially concerned with preventing manipulation through fraudulent statements of any kind and from stabilizing the price without letting investors know about it. It does not prevent a person from buying a stock and then selling it. If such actions allow a profit because investors deduce the seller may be informed this is not illegal provided no false claims are made to attempt to manipulate the price.
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