

CASE STUDIES

On one day in November 1966, well over a half a million shares of one so-called glamour stock were traded on the New York Stock Exchange. Trading in the issue opened at 126 $\frac{3}{8}$, the high for the day. From that 126 $\frac{3}{8}$ figure the stock skidded down to 105. It closed that day at 106 $\frac{3}{4}$, for a net loss of 19%, a drop of approximately 17 percent during that single day. Mutual funds bought 1,500 shares (about $\frac{1}{4}$ of 1 percent of the day's trading) during that day. But mutual funds sold almost a quarter of a million shares (43.5 percent of the day's trading volume) on that day. Among these sales by the funds was one block of 25 thousand shares sold at 115 $\frac{1}{4}$, another block of 32 thousand shares sold at 114, and a third block of 137 thousand shares sold at 109 $\frac{1}{2}$.

In August 1966, one stock opened at 218. By the end of the next day, it had fallen to 200 $\frac{1}{2}$, for a loss of 17 $\frac{1}{2}$ points in two days. During that two-day decline mutual funds sold about 135 thousand shares of the stock, approximately 45 percent of the trading volume in the issue during the period. Some funds bought some shares as its price was skidding. But those fund purchases amounted in the aggregate to only 50 thousand shares, just about 17 percent of the volume.

In four trading days in early June of 1966 the price of one corporation's shares fell from 85 $\frac{3}{4}$ to 75 $\frac{1}{8}$. During these days mutual funds sold shares equal to about 27 percent of New York Stock Exchange trading volume in the issue during the period. Mutual fund purchases during this period totaled only about 6 percent of the volume. During the ensuing two-week period the funds, as a group, switched to the buy side of the market. Mutual funds bought a total of over 100 thousand shares, more than 23 percent of the volume during the period. Mutual fund sales, on the other hand, amounted to only 65 thousand shares. Bolstered by this buying support from the funds, the price rose 12 $\frac{3}{8}$ points to 87 $\frac{1}{2}$. Later that month, there was a very sharp reversal of the upward movement. On that day the price dropped 8 $\frac{3}{4}$ points on the New York Stock Exchange and an additional 1 $\frac{3}{4}$ on the Pacific Coast Stock Exchange so that all the gains of the previous two weeks were almost entirely erased in that one day of trading. Sales by mutual funds that day accounted for 53 percent of total volume compared to mutual fund purchases of less than one-fifth the amount. During the next two weeks the price skidded another 14 $\frac{1}{4}$ points to 64 $\frac{1}{2}$. During that two weeks of sharp declines three funds that had purchased over 100 thousand shares earlier in the month became heavy sellers. From June 24 to July 8, those three funds sold a total of over 170 thousand shares.

During one week and one-half period in September 1966, the price of the stock of one corporation declined 32 $\frac{1}{2}$ points from 151 $\frac{1}{2}$ to 119, a decline of more than 20 percent in little more than a week. During this decline aggregate mutual fund sales of over 70 thousand shares accounted for 45 percent of the total trading volume. Mutual funds did some buying during this period. They bought 3 thousand shares, less than 2 percent of the total trading volume.

7. Professor Ernest L. Polk III, Professor of Law at the University of North Carolina, has submitted a statement to the Subcommittee strongly supporting the provisions of H.R. 9510 which would require that advisory fees be reasonable. Professor Folk expressed doubt over the provision of the Bill which would place the burden of proving unreasonableness on the party objecting to the fee. He noted that state corporation law often recognizes that a fiduciary is in a better posture to prove the reasonableness or fairness of his action than the challenger to establish the contrary and suggested that the Bill be changed to place the burden of proving reasonableness upon the defendants.

The Commission recognizes that H.R. 9510 would not go as far as many courts have gone in enforcing the fiduciary obligations of those who manage other people's money and it would not object to a change in the Bill to implement Professor Folk's suggestion. The Commission believes that the Bill, as presently drafted, provides for effective enforcement by shareholders. As Professor Folk pointed out, liberal pre-trial discovery procedures provided for in the Federal Rules of Civil Procedure and comparable procedures in many state courts ease the task of a plaintiff in obtaining the information which is within the knowledge and possession of the defendants. In addition, even where a plaintiff has the burden of proving the allegations of his complaint, many courts place the burden on the defendants of moving forward with evidence which is within their exclusive knowledge or control. For these reasons, we do not believe that placing the burden of proof on the plaintiff would create undue obstacles to prosecution of an action to enforce the standard of reasonableness.