Thirteenth Annual Report

of the

Securities and Exchange Commission

Fiscal Year Ended June 30, 1947

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SECURITIES AND EXCHANGE COMMISSION

Central Office
425 Second Street, N. W.
Washington 25, D. C.

COMMISSIONERS

JAMES J. CAFFREY, *Chairman*
ROBERT K. MCCONNAUGHEY
RICHARD B. MCENTIRE
EDMOND M. HANRAHAN
HARRY A. MCDONALD

ORVAL L. DUBOIS, *Secretary*

LETTER OF TRANSMITTAL

SECURITIES AND EXCHANGE COMMISSION,
Washington, D. C., March 2, 1948.

SIR: I have the honor to transmit to you the Thirteenth Annual Report of the Securities and Exchange Commission, in accordance with the provisions of section 23 (b) of the Securities Exchange Act of 1934, approved June 6, 1934; section 23 of the Public Utility Holding Company Act of 1935, approved August 26, 1935; section 46 (a) of the Investment Company Act of 1940, approved August 22, 1940, and section 216 of the Investment Advisers Act of 1940, approved August 22, 1940.

Respectfully,

ROBERT K. MCCONNAUGHEY,
Acting Chairman.

THE PRESIDENT OF THE SENATE,
THE SPEAKER OF THE HOUSE OF REPRESENTATIVES,
Washington, D. C.

[illegible]

[illegible] 1938.

[illegible] Holding Company Act of 1935 [illegible] August 26, [illegible]

[illegible]

Yours truly,

[illegible]

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FOREWORD

This report is submitted pursuant to law to inform the Congress about the work of the Commission. Of necessity, it is only a summary and cannot do more than highlight the more prominent phases of the Commission's activities under the various statutes which it administers. Equally significant are the many aspects of the Commission's day to day activities which play such a large part in the carrying on of its functions. Space does not permit an adequate presentation of such matters, but in considering the totality of the Commission's activities they should not be forgotten. The Commission is always ready to give any additional information that may be sought concerning its work, either by the Congress or by members of the public.

The year covered herein was marked by a continuation of high levels of economic activity and of commensurate levels of Commission work. Particularly significant was the fact that the volume of financing during the 1947 fiscal year for new money purposes exceeded even that of 1946—when the total volume of financing was at its highest point.

Further substantial progress has been made toward completion of the program of integration of the nation's electric and gas public utility holding company systems and the simplification of their corporate structures pursuant to the requirements of Section 11 of the Public Utility Holding Company Act of 1935. Thus, not only are the holding company systems being brought into conformity with the pattern set forth by Congress in the Act, but in addition the financing of the industry's present extensive expansion program is greatly facilitated. In the latter connection it is significant that the public utility industry has done more new money financing during the 1947 fiscal year than the aggregate of all such financing for the twelve preceding years.

The continued effort of the Commission to simplify its procedures and forms, and to avoid unnecessary duplication in its disclosure requirements is manifest throughout the report. In this connection, we may note the adoption of rules and forms to facilitate the operations of the International Bank for Reconstruction and Development; the promulgation of rules eliminating unnecessary hearing procedures under the Investment Company Act; and the simplification of basic Securities Act registration forms and the elimination of other forms.

One of the significant activities of the Commission during the past year was its undertaking of a program of study of the operations of the Securities Act of 1933 and the Securities Exchange Act of 1934 with a view to an ultimate recommendation to the Congress of desirable and workable amendments to these statutes. Conferences have been held with representatives of all groups directly concerned with the operations of these statutes. Discussions were had with and comments were solicited from investors, large and small, and representatives of underwriters, dealers, securities exchanges, State regulatory bodies, and professional groups of attorneys and accountants.

The Commission expects that, before the close of the current fiscal year, its offices will have been returned from Philadelphia to Washington. It is hoped that the move will facilitate contact between the Commission and the Congress.

COMMISSIONERS AND STAFF OFFICERS

Commissioners

	Term expires June 5—
JAMES J. CAFFREY, of New York, Chairman [1]	1950
ROBERT K. MCCONNAUGHEY, of Ohio	1949
RICHARD B. MCENTIRE, of Kansas	1948
EDMOND M. HANRAHAN, of New York [2]	1952
HARRY A. MCDONALD, of Michigan [3]	1951

Secretary: ORVAL L. DUBOIS

Staff Officers

BALDWIN B. BANE, Director, Corporation Finance Division. ANDREW JACKSON, Associate Director.
MORTON E. YOHALEM, Director, Public Utilities Division. ROBERT F. KRAUSE, Associate Director.
JAMES A. TREANOR, Director, Trading and Exchange Division.
ROGER S. FOSTER, Solicitor.
EARLE C. KING, Chief Accountant.
HERBERT B. COHN, Director, Opinion Writing Office.
WALTER C. LOUCHHEIM, JR., Adviser on Foreign Investments.
NATHAN D. LOBELL, Adviser to the Commission.
SHERRY T. MCADAM, JR., Assistant to the Chairman.
HASTINGS P. AVERY, Director, Administrative Division.
WILLIAM E. BECKER, Director of Personnel.
JAMES J. RIORDAN, Budget and Fiscal Officer.

REGIONAL AND BRANCH OFFICES

Regional Offices

Zone 1—PETER T. BYRNE, Equitable Building (Room 2006), 120 Broadway, New York 5, N. Y.
Zone 2—PAUL R. ROWEN, Post Office Square Building (Room 501), 79 Milk Street, Boston 9, Mass.
Zone 3—WILLIAM GREEN, Atlanta National Building (Room 322), Whitehall and Alabama Streets, Atlanta 3, Ga.
Zone 4—CHARLES J. ODENWELLER, JR., Standard Building (Room 1608), 1370 Ontario Street, Cleveland 13, Ohio.
Zone 5—THOMAS B. HART, Bankers Building (Room 630), 105 West Adams Street, Chicago 3, Ill.
Zone 6—ORAN H. ALLRED, United States Courthouse (Room 103), 10th and Lamar Streets, Forth Worth 2, Tex.
Zone 7—JOHN L. GERAGHTY, Midland Savings Building (Room 822), 444 Seventeenth Street, Denver 2, Colo.
Zone 8—HOWARD A. JUDY, Appraisers Building (Room 308), 630 Sansome Street, San Francisco 11, Calif.
Zone 9—DAY KARR, 1411 Fourth Avenue Building (Room 810), Seattle 1, Wash.
Zone 10—E. RUSSELL KELLY, O'Sullivan Building (Room 2410), Baltimore 2, Md.

Branch Offices

Federal Building (Room 1074), Detroit 26, Mich.
United States Post Office and Courthouse (Room 1737), 312 North Spring Street, Los Angeles 12, Calif.
Pioneer Building (Room 500), Fourth and Roberts Streets, St. Paul 1, Minn.
Drew Building (Room 202), Third and Boston Streets, Tulsa 3, Okla.
United States Courthouse and Custom House (Room 1006), 1114 Market Street, St. Louis 1, Mo.

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[1] Elected chairman on July 23, 1946, resigned December 31, 1947.
[2] Appointed July 5, 1946, to the vacancy created by the resignation of GANSON PURCELL.
[3] Appointed March 18, 1947, to succeed the late ROBERT E. HEALY.

COMMISSIONERS APPOINTED DURING FISCAL YEAR

EDMOND M. HANRAHAN

Mr. Hanrahan was born in the city of Cortland, N. Y., August 14, 1905. He was graduated from Cortland High School, attended Fordham University, graduated from Fordham University Law School in 1928 with an LL. B. degree and was admitted to the Bar of the State of New York in 1929.

In 1933 Mr. Hanrahan became a partner in the firm of Sullivan, Donovan & Heenehan and practiced law with that firm until his appointment to the Commission.

Mr. Hanrahan served for 4 years as a member of the committee on State legislation of the Association of the Bar of the City of New York and has been special counsel to the superintendent of banks of the State of New York. On July 5, 1946, he was appointed to the Securities and Exchange Commission for a term of office ending June 5, 1947, and has since been reappointed for a full 5-year term.

HARRY A. MCDONALD

Mr. McDonald was born in Cherokee, Iowa, June 17, 1894. He attended public schools in Cherokee County, graduated from high school in Cedar Falls, Iowa, attended Iowa State Teachers College for 3 years and received a Ph. B. degree from the University of Chicago in 1917.

Mr. McDonald served in the United States Navy from 1917 to 1919 and then entered business in Cleveland, Ohio. In 1923 he moved to Detroit, Mich., and was actively engaged in the dairy industry until 1932. In 1932 he formed McDonald, Moore & Hayes, Inc., an investment firm which became McDonald, Moore & Co. in 1936. He resigned from that firm to accept his present appointment.

Mr. McDonald served as chairman of the Michigan Unemployment Compensation Commission for 3 years and was a member of the Michigan State Fair Board for 6 years, 1 as chairman. On March 18, 1947, he was appointed to the Securities and Exchange Commission for a 5-year term of office ending June 5, 1951.

PART I

ADMINISTRATION OF THE SECURITIES ACT OF 1933

The primary purpose of the Securities Act of 1933 is to prevent fraud in the sale of securities. To accomplish this purpose the act requires the fair disclosure of information about securities by means of the registration statement and prospectus before the securities are publicly offered for sale to the investor. In addition, certain practices in connection with the sale of securities are defined as fraudulent and made unlawful. The requirements as to the registration of a security and the use of a prospectus are designed to provide the investor with sufficient facts about the security to enable him to make an informed judgment of the merits of the investment before he buys the security offered to him. The provisions defining and prohibiting certain fraudulent practices are aimed at the prevention and punishment of active fraud, misrepresentation, and deceit. The Commission neither makes any determinations as to the merits of any security nor passes upon the value of any investment. The act does not aim at the elimination of risk in investment, but only at the disclosure of sufficient information to enable the investor to measure the risk.

THE REGISTRATION PROCESS

The Registration Statement and Prospectus

The principle of full and fair disclosure of material facts about a security is applied in practice by means of the registration statement and the prospectus. The registration statement is filed with the Commission and must become effective before the security being registered may be publicly offered for sale in interstate commerce or by use of the mails. The registration statement becomes a public document when filed (except where the act provides for confidential treatment) and is available for inspection by the public. Financial houses, financial writers, the investment services, and newspapers make major use of the registration statement as a source of information and publicize the facts which it contains.

The prospectus serves to bring pertinent information contained in the registration statement directly to the attention of the investor. It is unlawful to offer a registered security for sale by means of a prospectus unless the prospectus contains the information required by the act.

The act sets forth the information required to be contained in the registration statement and prospectus. This includes, for example, information about officers and directors of the issuer of the security; the nature, size, and degree of success of the business; the issuer's capitalization; the purpose of the financing and the use to which the proceeds will be put; the compensation which the under-

writer is to receive; options outstanding against securities of the issuer; bonus and profit-sharing agreements; and pending or threatened legal proceedings against the issuer. In addition, certified financial statements are a part of every registration statement.

Effective Date of Registration Statement

In order to permit the information contained in a registration statement to become known to the investing public, the act provides a 20-day waiting period after the filing of the registration statement before the registration statement becomes effective and the security may be offered for sale. If the registration statement is amended after it is filed but before it has become effective, the 20-day waiting period starts anew from the time of the amendment, unless the amendment is filed with the consent of or by order of the Commission.

The Commission is empowered at its discretion to accelerate the effective date of a registration statement, in cases where the facts justify such acceleration, so that the full 20-day period need not expire before the securities may be offered for sale. The act directs that, in the exercise of this power, the Commission must give due regard to the adequacy of the information about the security already available to the public, to the complexity of the particular financing, and to the public interest and the protection of investors.[1]

One of the main functions of the Commission under the act is the examination of registration statements to determine compliance with the requirements of the act and its standards of full and fair disclosure. In view of the fact that a registration statement may become effective on the twentieth day after filing, the examination by the staff must be completed with a maximum speed consistent with thoroughness and a full consideration of all the facts. Neither the Commission, the issuer, nor the underwriter desires a statement to become effective unless it fully complies with the act. It is often the case that the staff will ascertain that deficiencies exist in the registration statement, or the issuer or underwriter may wish to amend the statement or delay its effectiveness for business reasons. In such cases, if there is a danger that the registration statement may become effective in defective form or prematurely for the purposes of the issuer or underwriter, it is customary for the issuer to file a minor amendment to the registration statement, thereby starting the 20-day period running anew.

In order to speed the registration process, and at the same time to make available to the registrant the assistance of the Commission's staff of experts, the Commission has adopted the procedures of the prefiling conference and the "letter of comment." The prefiling conference enables the registrant to discuss with the staff, prior to the filing of the registration statement, any special problems involved with respect to the particular registration statement. The letter of comment is an informal device by which the registrant is informed of any deficiencies found to exist in the registration statement as filed. The registrant can therefore make the necessary amendments and

[1] In the 1947 fiscal year, acceleration was requested and granted with respect to 98 percent of the registration statements which became effective in that year.

thereby prevent the registration statement from becoming effective in deficient form.

Time Required for Registration

The Commission, with the cooperation of persons in the securities industry, constantly studies and adopts ways to cut down the elapsed time from the day the registration statement is filed to the day when it is in proper form and becomes effective. The prefiling conference and deficiency letter are two of the results of this continuous study. The Commission's staff has by and large been able to supply the registrant with a deficiency letter before the 20-day waiting period expires. It is rarely possible, however, for the registrant to make corrections within that time. Further, as has been pointed out, the registrant often desires to delay the effective date of the registration statement, particularly in a period of a declining market.

The Commission has recently made two studies to determine the median elapsed time for completion of the registration process. For convenience and simplicity, the elapsed time has been broken down into three periods: (1) the time required after filing for the staff to prepare a deficiency letter; (2) the time consumed by the registrant in filing necessary amendments; and (3) the elapsed time thereafter until the statement became effective. These two studies are described and their results tabulated below.

First Study

This study was based on 665 registration statements, involving offerings of securities aggregating more than $6,600,000,000, which became effective during the 1946 calendar year. The 1946 calendar year covers a period in which there was a considerable volume of public financing. During that year, a total of 803 registration statements were filed for proposed offerings aggregating $7,900,000,000, the largest dollar amount of offerings for any single year since adoption of the Securities Act. The results of the study follow:

Elapsed time	*Median number of days*
From date of filing the registration statement to the staff's first letter of comment	15
From date of letter of comment to date of final amendment by the registrant	13
From date of last amendment to date when registration statement became effective	1
Total median elapsed time	29

Second Study

The second study was made, in somewhat different detail, for each of the 10 months from August 1946 to and including June 1947. It covers 423 registration statements which became effective during the period. The elapsed periods of time shown in the table below are given in days and are for the median registration statement. In examining the results of this study, it is to be recalled that there was a precipitous decline in the stock market beginning in September 1946. This re-

sulted in the voluntary delay of effectiveness of registration statements by many registrants.

	1946					1947					
	Aug.	Sept.	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.	May	June
Total registration statements effective during month	54	29	29	43	38	30	29	50	44	32	45
Elapsed time (median number of days):											
From date of filing registration statement to first letter of comment	16	15	15	13	12	12	10	10	10	11	10
From date of letter of comment to first amendment by registrant	10	10	14	8	17	15	8	8	7	11	9
From date of first amendment to the effective date of registration	7	9	11	7	13	7	6	5	6	7	6
Total median elapsed time	33	34	40	28	42	34	24	23	23	29	25

THE VOLUME OF SECURITIES REGISTERED

Volume of All Securities Registered in Fiscal Year

	1947	*1946*
Total registered	$6,732,447,000	$7,073,280,000

The amount of securities effectively registered during the 1947 fiscal year was 5 percent less than the amount registered in the 1946 fiscal year, which was the peak year.

The volume registered in the 1947 fiscal year was distributed over 493 [2] registration statements covering 686 issues, as compared with 661 statements covering 1,015 issues for the 1946 fiscal year.

Volume of Securities Registered for Cash Sale

A. ALL SECURITIES

	1947		*1946*	
Registered for cash sale for accounts of issuers	$4,874,141,000		$5,423,593,000	
Registered for cash sale for accounts of others than issuers	397,029,000		472,247,000	
Total registered for cash sale		$5,271,170,000		$5,895,840,000
Total registered for other than cash sale		1,461,277,000		1,177,440,000
Total of all registered securities		$6,732,447,000		$7,073,280,000

[2] This figure differs from the 489 shown in the table on p. 8 due to difference in the classification as to the time of effectiveness of registration statements. See footnote 2 to appendix table 1 for details.

B. STOCKS AND BONDS REGISTERED FOR CASH SALE FOR THE ACCOUNTS OF ISSUERS

	1947		1946	
Equity securities other than preferred stocks	$1,150,330,000		$1,330,625,000	
Preferred stocks	786,866,000		990,699,000	
Total all stocks		$1,937,196,000		$2,321,324,000
All bonds		2,936,945,000		3,102,269,000
Total		$4,874,141,000		$5,423,593,000

The volume of bonds registered for cash sale for the accounts of issuers in the 1947 fiscal year was only slightly less than the volume for the prior year. There was a more substantial decrease in the volume of stocks registered in the 1947 fiscal year for cash sale for the accounts of issuers. But this volume was half again as great as the next highest volume of stocks registered for cash sale for the accounts of issuers registered in the 1937 fiscal year.

From September 1934 through June 1946, new money purposes represented 20.67 percent of the net proceeds expected from the sale of issues registered for the accounts of the issuers. In the 1947 fiscal year, new money purposes were 54.48 percent of the expected net proceeds for the year—large enough to raise the 13-year average over five points to 25.84 percent.[3]

C. ALL SECURITIES REGISTERED FOR CASH SALE FOR THE ACCOUNTS OF ISSUERS—BY TYPE OF ISSUER

Type of issuer	1947	1946
Manufacturing companies	$1,266,055,000	$1,749,852,000
Electric, gas and water companies	1,214,346,000	1,661,274,000
Transportation and communication companies [1]	1,190,814,000	800,381,000
Financial and investment companies	714,529,000	902,344,000
Foreign governments	247,105,000	30,212,000
Merchandising companies	201,373,000	174,511,000
Service companies	16,109,000	24,705,000
Extractive companies	15,685,000	72,082,000
Construction and real estate companies	8,125,000	8,232,000
Total	$4,874,141,000	$5,423,593,000

[1] Does not include companies subject to regulation by the Interstate Commerce Commission and therefore exempted from registration. The transportation group no longer includes wholesale gas pipeline companies, now classified in the electric, gas, and water group. An adjustment of $164,414,000 has been made in the respective figures for 1946 to compensate for this change in classification.

Registrations for cash sale by transportation and communication companies in the 1947 fiscal year established a record, exceeding by almost 50 percent the previous high established in the 1946 fiscal year. The amount of such registrations by manufacturing companies was 28 percent less than that for the 1946 fiscal year, but was the second largest amount in any fiscal year. Foreign governments registered over eight times the amount registered in the 1946 fiscal year and ex-

[3] See also appendix table 1, part 3, and tables 39 and 40.

ceeded the previous peak of $229,005,000 established in the 1937 fiscal year. Merchandising companies exceeded by 6 percent the previous peak of $190,104,000 established in the 1937 fiscal year.

D. USE OF INVESTMENT BANKERS AS TO SECURITIES REGISTERED FOR CASH SALE FOR THE ACCOUNTS OF ISSUERS

	1947		1946	
Amount registered to be sold through investment bankers:				
Under agreements to purchase for resale	$3,333,621,000		$4,445,915,000	
Under agreements to use "best efforts" to sell	697,123,000		749,952,000	
Total registered to be sold through investment bankers		$4,030,744,000		$5,195,867,000
Total registered to be sold directly to investors by issuers		843,397,000		227,726,000
Total		$4,874,141,000		$5,423,593,000

In the 1947 fiscal year, investment bankers were used for the sale of 83 percent of the total securities registered for cash sale for the accounts of issuers, as compared with 96 percent in the 1946 fiscal year. Commitments by investment bankers to purchase for resale involved 68 percent of the total registered for cash sale for the accounts of issuers, as compared with 82 percent in the 1946 fiscal year.[4]

E. COST OF FLOTATION OF SECURITIES REGISTERED FOR CASH SALE FOR THE ACCOUNTS OF ISSUERS

The cost of flotation of securities registered for primary cash distribution, as reported in the registration statements for such securities, amounted to 5.5 percent of the aggregate dollar volume of such securities. A further breakdown of this 5.5 percent indicates that 5.0 percent was to be paid as commissions and discounts and 0.5 percent for all other expenses incidental to the flotation of the securities, including all costs relative to registration. A study of the portion of aggregate gross proceeds paid as commissions and discounts to investment bankers on securities registered for sale to the general public through such bankers reveals a downward trend in recent years, as may be noted from the table below:[5]

[4] See appendix tables 1 through 4 for a more detailed breakdown of the dollar volume of Securities Act registrations.

[5] This table does not include investment trust issues, whose costs are not reported on a basis comparable to that of other issues.

Compensation—Percent of gross proceeds

Year ended June 30	Bonds	Preferred stock	Common stock
1939	2.0	6.4	16.9
1940	1.9	7.2	16.4
1941	1.8	4.1	14.4
1942	1.5	4.1	10.1
1943	1.7	3.6	9.7
1944	1.5	3.1	8.1
1945	1.3	3.1	9.3
1946	.9	3.1	8.0
1947	.9	2.8	9.3

A trend similar to that noted in the table may be noted with respect to bonds, subdivided on the basis of the investment risk involved.[6]

THE VOLUME OF UNREGISTERED SECURITIES

Total of Unregistered Corporate Issues

Some $2,370,000,000 of unregistered new corporate securities are known to have been offered for cash sale by issuers in the 1947 fiscal year, as compared with $2,696,000,000 in the 1946 fiscal year.[7] The basis for exemption of these securities from registration is broken down as follows:[8]

Basis for exemption from registration	*1947*	*1946*
Privately placed issues	$1,899,000,000	$1,189,000,000
Issues under the jurisdiction of the Interstate Commerce Commission	292,000,000	1,317,000,000
Issues of bank securities	27,000,000	74,000,000
Intrastate offerings	9,000,000	4,000,000
Offerings under regulation A [1]	143,000,000	112,000,000
Total	$2,370,000,000	$2,696,000,000

[1] Includes only offerings between $100,000 and $300,000 in size. See p. 19 for a more detailed discussion of regulation A offers.

Total of Unregistered Governmental and Eleemosynary Issues

The total of unregistered governmental and eleemosynary securities offered for cash sale in the United States was $812,385,000,000, as compared with $28,795,000,000 in the 1946 fiscal year. These totals consist of the following:[9]

Issuer	*1947*	*1946*
United States Government	$10,264,000,000	$27,258,000,000
Federal agencies	140,000,000	608,000,000
States and municipalities	1,975,000,000	928,000,000
Miscellaneous nonprofit organizations	6,000,000	—[1]
Total	12,385,000,000	28,795,000,000

[1] Less than $1,000,000.

Volume of All Unregistered Issues Offered for Cash Sale

	1947	*1946*
Corporate issues	$2,370,000,000	$2,696,000,000
Noncorporate issues	12,385,000,000	28,795,000,000
Total	$14,755,000,000	$31,491,000,000

[6] Compare part 2 of the appendix table 2 with the same table in the Twelfth, Eleventh, and Ninth Annual Reports.

[7] This does not include offers of securities of $100,000 or less.

[8] Where a security may have been exempted from registration for more than one reason, the security was counted only once.

[9] See appendix table 3 for a more detailed statistical break-down of the volume of all securities offered for cash sale in the United States.

PAUL GONSON
SECURITIES AND EXCHANGE COMM'N
WASHINGTON, DC 20549

THE VOLUME OF ALL SECURITIES OFFERED FOR CASH SALE [10]

Total of Registered and Unregistered Securities Offered for Cash Sale:

	1947	1946
Registered securities:		
Corporate (excluding investment cos.)	$3,833,000,000	$4,626,000,000
Noncorporate (foreign government)	247,000,000	30,000,000
Total registered securities	$4,080,000,000	$4,656,000,000
Unregistered securities:		
Corporate	$2,370,000,000	$2,696,000,000
Noncorporate	12,385,000,000	28,795,000,000
Total unregistered securities	$14,755,000,000	$31,491,000,000
Total all securities	$18,835,000,000	$36,147,000,000

New Capital and Refinancing

Proceeds from corporate securities flotations, both registered and unregistered, applicable to expansion of fixed and working capital amounted to $3,965,000,000 compared with the peaks of $1,617,000,000 in the 1946 fiscal year and $1,196,000,000 in the 1937 fiscal year. While entirely comparable figures for the years prior to 1934, the date when this statistical series began, are not available, it appears that the new money volume in the 1947 fiscal year was as large as the high levels reached in the twenties. Industrial and miscellaneous firms accounted for 58 percent of the new money financing, public utility companies (including telephone companies) for 37 percent and railroad companies for 5 percent. The volume of refinancing through new issues of securities declined to $2,011,000,000 compared with the 1946 record high of $5,297,000,000.[11]

STATISTICS OF SECURITIES REGISTERED UNDER THE ACT

The aggregate dollar amount involved in registration statements filed in the 1947 fiscal year exceeds that for any fiscal year except the preceding year 1946. As shown in the table below there were 567 statements filed in the 1947 fiscal year covering proposed offerings in the aggregate amount of $6,934,388,303, as compared with the amount of $7,401,260,809 for the 1946 fiscal year.

Number and disposition of registration statements filed

	Prior to July 1, 1946	July 1, 1946, to June 30, 1947	Total as of June 30, 1947
Registration statements:			
Filed	6,572	567	7,139
Effective—net	[1] 5,339	[2] 489	[3] 5,825
Under stop or refusal order—net	182	1	[4] 181
Withdrawn	913	123	1,036
Pending at June 30, 1946	[1] 138		
Pending at June 30, 1947			97
Aggregate dollar amount:			
As filed	$39,754,139,439	$6,934,388,303	$46,688,527,742
As effective	$35,643,256,162	$6,732,446,684	$42,375,702,846

[1] Adjusted figure. (Previously published figures were 5,341 and 136, respectively.)
[2] Excludes 10 registration statements which became effective and were subsequently withdrawn.
[3] Three registration statements which became effective prior to July 1, 1946, were withdrawn during the year and are counted in the number withdrawn.
[4] Two registration statements which were under stop order prior to July 1, 1946, were withdrawn during the year and are counted in the number of withdrawn statements.

[10] The figures given in this section exclude securities of investment companies because complete data on cash sales of these securities are not available. See footnote 1 to appendix table 3 for a complete description of the securities included in these figures.
[11] See appendix tables 4, 39, and 40 for statistics in greater detail as to the use of net proceeds from the sale of securities.

Additional documents filed in the 1947 fiscal year under the act

Nature of document:	Number
Material amendments to registration statements filed before the effective date of registration	1,106
Formal amendments filed before the effective date of registration for the purpose of delaying the effective date	2,030
Material amendments filed after the effective date of registration	555
Total amendments to registration statements	3,691
Supplemental prospectus material, not classified as amendments to registration statements	1,231
Reports filed under section 15 (d) of the Securities Exchange Act of 1934 pursuant to undertakings contained in registration statements under the Securities Act of 1933:	
Annual reports	601
Current reports	296

EXEMPTION FROM REGISTRATION UNDER THE ACT

The Commission is empowered under section 3 (b) of the act to exempt from registration, subject to such terms and conditions as it might prescribe by rule and regulation, issues of securities not exceeding an aggregate offering price to the public of $300,000. Five regulations have been adopted pursuant to this authority: regulation A, a general exemption for small issues; regulation A-R, a special exemption for notes and bonds secured by first liens on family dwellings;[12] regulation A-M, a special exemption for assessable shares of stock of mining companies; regulation B, an exemption for fractional undivided interests in oil or gas rights, and regulation B-T, an exemption for interests in oil royalty trusts or similar types of trusts or unincorporated associations.

The availability of an exemption under any of these regulations does not include any exemption from civil liabilities under section 12 or from criminal liabilities for fraud under secton 17. In order to insure the proper enforcement of these sections, the conditions for the availability of the exemptions provided by these regulations, with the exception of regulation A-R, include the requirements that certain minimum information be filed with the Commission and that disclosure of certain information be made in sales literature.

Exempt Offerings Under Regulation A

In the 1947 fiscal year business made greater use of public offerings under the general exemption provided by regulation A than in the prior year. Thus, the number of letters of notification received and examined thereunder rose from a total of 1,348 in the 1946 fiscal year to 1,513 in the 1947 fiscal year; and the aggregate offering price increased at the same time from $181,600,155 to $210,791,114. Included in the 1947 fiscal year's offerings were 68 letters of notification relating to oil and gas leases. Securities of companies engaged in various phases of the oil and gas business totaled an aggregate offering price of $8,660,261.

The distribution of the 1,513 letters of notification by size of offering shows that 761 covered proposed offerings of $100,000 or less; 298 offerings of more than $100,000 but less than $200,000; and 454 in-

[12] Inasmuch as no reports or filings are required under this regulation, no statistical data as to its application and use are available.

volved offerings in excess of $200,000 but not more than the statutory maximum of $300,000.

The regulation makes provision for the filing of the requisite letter of notification at the appropriate regional office of the Commission for the greater convenience of small businesses making use of this regulation. The letters of notification and the related sales literature are examined in the regional office where filed and then reviewed by a staff of experts at the Commission's central office. This review involves a search for pertinent information in the Commission's extensive files and an examination to determine whether the exemption of the regulation is applicable in the particular case and whether the information filed discloses any violations of any of the acts administered by the Commission. The results of this review are made available promptly to the regional office involved. 1,800 letters were written in this connection during the fiscal year. In addition, the Commission cooperates with the proper authorities in the States in which the securities are proposed to be offered by informing them of the fact that the offering is to be made and giving them a summary of pertinent data concerning the proposed offer.

It should be emphasized that, as suggested above, the exemption from registration provided by regulation A, as well as by the other exemptions granted under section 3 (b), does not constitute complete exemption from all provisions of the act. Thus these exemptions are subject to the express provisions of section 12 imposing civil liability on persons who sell securities in interstate commerce or through the mails by means of untrue statements or misleading omissions, and to the provisions of section 17, which makes it unlawful to sell securities by such means or by other types of fraud. By their express terms, each of these sections is applicable whether or not the transactions involve securities which have been exempted under section 3 (b). Accordingly, the principal effect of a section 3 (b) exemption is to permit the sale of securities on the basis of a less complete formal filing than that required by the act in the case of a registered security.

Exempt Offerings Under Regulation A-M

The Commission received and examined during the year a total of three prospectuses covering an aggregate offering price of $150,000 for assessable shares of stock of mining corporations conditionally exempt from registration pursuant to rule 240 of regulation A-M.

Exempt Offerings Under Regulation B

Pursuant to regulation B, which provides for the conditional exemption from registration of fractional undivided interests in oil or gas rights where the aggregate offering price does not exceed $100,000, the Commission last year received and examined 135 offering sheets, and 161 amendments to such offering sheets, with respect to which the following actions were taken:

Various actions on filings under regulation B

Temporary suspension orders (rule 340 (a))	53
Orders terminating proceedings after amendment	41
Orders consenting to withdrawal of offering sheet and terminating proceeding	10
Orders terminating effectiveness of offering sheet (no proceeding pending)	11
Orders consenting to amendment of offering sheet (no proceeding pending)	56
Orders consenting to withdrawal of offering sheet (no preceeding pending)	8
Total orders	179

Confidential written reports of sales under regulation B.—The Commission also received and examined during the year 2,698 confidential written reports required pursuant to rules 320 (a) and 322 (c) and (d) of regulation B concerning sales made by broker-dealers or offerors to investors and by dealers to other dealers. This total consisted of 1,100 reports on Form 1–G and 148 on Form 2–G representing sales in the aggregate of $897,573 and $738,798, respectively. If examination of these reports indicates that a violation of the law may have occurred, the Commission makes appropriate investigations, and, in instances where the facts are deemed to warrant it, appropriate action is taken.

Oil and gas investigations.—Twenty-two investigations involving oil and gas securities were instituted by the Commission during the 1947 fiscal year to determine whether there had been any violations of sections 5 (requiring registration) or 17 (prohibiting fraudulent sales) of the Securities Act or section 15 of the Securities Exchange Act of 1934 (regulating the conduct of brokers and dealers). The total of such investigations current during the year was 161. As part of these investigations, some 1,500 letters were written and approximately 200 personal and telephone conferences were held during the fiscal year by the experts of the Oil and Gas Unit of the Commission's staff. In addition, engineer and geologist members of the staff prepared a number of technical memoranda or valuation estimates and conducted scores of conferences in the oil and gas producing regions and other locations in the field. Thirty-one of these investigations were closed during the year, leaving 130 pending at the end of the year. A summary of these investigations is tabulated below:

Oil and gas investigations

	Preliminary	Informal	Formal	Total
Pending at June 30, 1946	28	81	30	139
Opened July 1, 1946 to June 30, 1947:				
New cases	6	16		22
Transferred from preliminary or informal			4	4
Total number of cases to be accounted for	34	97	34	165
Closed	9	17	5	31
Transferred to informal				
Transferred to formal		4		4
Pending at June 30, 1947	25	76	29	130

During the fiscal year, an investigation was undertaken with respect to a number of letters of notification, filed under regulation A, relating to many oil and gas properties located in the Rangely Field,

Colorado, which was then being actively developed. The investigation showed that practically all of the prospective acreage on the Rangely structure was under lease to major or strong independent companies and that the field was defined in several directions by dry holes or by wells making a considerable quantity of water. A number of companies which had filed letters of notification under regulation A owned leases beyond the indicated productive limits of the field, or held such leases under option. Several of them were circulating highly misleading statements through the mails with reference to the possibilities of finding oil. The results of this investigation have helped to prevent the continued use of sales literature containing misleading statements about the Rangely Field.

As a result of another investigation, George C. Reining was tried at Tampa, Fla., for violation of the mail fraud and conspiracy statutes in connection with the sale of various oil and gas leases in Terrell and Presidio Counties, Tex. He was found guilty on six counts and sentenced to 6 years in the penitentiary.

FORMAL ACTIONS UNDER SECTION 8

The Commission makes every effort to insure that a registration statement shall be complete and comply fully with the requirements of the act before the statement becomes effective. As has been pointed out, where a registration statement is found to be deficient, the registrant is informed in order that proper corrections may be made. It is sometimes necessary, however, for the Commission to invoke its powers under section 8 to prevent a registration statement from becoming effective or to suspend the effectiveness of a registration statement which has already become effective.

Under section 8 (b), the Commission may institute proceedings to determine whether it should issue a stop order to prevent a registration from becoming effective. Such proceedings are authorized if the registration statement as filed is on its face inaccurate or incomplete in any material respect. Under section 8 (d), proceedings may be instituted to determine whether the Commission should issue a stop order to suspend the effectiveness of a registration statement, which has already become effective, if it appears to the Commission that the registration statement includes any untrue statement of a material fact or omits to state any material fact required to be stated or necessary to make the statements included not misleading. Under section 8 (e) the Commission may make an examination to determine whether to issue a stop order under section 8 (d).

The Commission tries to avoid the use of its powers under section 8, and will institute an examination under section 8 (e) or a proceeding under section 8 (d) only where necessary for the protection of investors and to prevent fraud. The 1947 fiscal year was unusual in that the Commission was required to institute seven section 8 (e) examinations and five section 8 (d) proceedings.

Examinations Under Section 8 (e)

Examinations made pursuant to section 8 (e) may be held in public. The Commission, however, to insure that no injury shall be done to a registrant by means of bad publicity if the examination should reveal no violation of the law, makes it a practice to hold such preliminary

examinations in private. Where the facts revealed by the examination warrant the institution of proceedings under section 8 (d), such latter proceedings are held in public. During the 1947 fiscal year, the Commission authorized the conduct of seven examinations under section 8 (e). Six of these were held in private and one in public. Of the six held in private, the records of examination in two cases remained private after completion of the examination and the other four were made public. In two of the five cases in which the records of examination are now public the Commission authorized the institution of proceedings under section 8 (d), and those cases are discussed hereinafter. The nature of and the results in the three remaining cases are:

Consolidated Hotels, Inc.—File No. 2-6668.—This registrant is engaged principally in the operation of hotels and apartment houses. Substantially all its proposed offering covered securities owned by the controlling stockholder, a large part of which had been acquired from the registrant in exchange for certain properties.

It appeared from a preliminary examination of the registration statement that there was a failure to disclose, among other things: (1) The commingling of activities of the registrant with those of the controlling stockholder; (2) that the controlling stockholder was the promoter of the registrant and an underwriter of the securities; (3) the profits to the controlling stockholder as such promoter and underwriter; (4) the effect of a write-up in unrealized values of properties recently acquired from the controlling stockholder; and (5) the absence of arm's length dealings between him and the company.

Since it was impossible to determine from the registration statement the cost to the controlling stockholder of properties transferred by him to the company in return for securities which it was proposed to offer to the public, as well as other material facts as indicated above, it was decided that the true status of the case could be determined only through a section 8 (e) proceeding. Before an opinion was rendered by the Commission in respect of the proceeding, the registrant requested withdrawal of the registration statement on the basis, in part, that "withdrawal is consistent with the public interest and the protection of investors." The application for withdrawal was granted.

Health Institute, Inc.—File No. 2-6864.—This registrant proposed to build and equip hotel and health facilities and to acquire a mineral water supply at a spa in the southwest.

It appeared from preliminary investigation that no serious effort had been made to determine the practicability of the enterprise with respect to cost of construction, demand for proposed facilities, cost of operation or method of financing. In the face of this situation the prospectus nevertheless contained no hint of the hazards involved and implied that the enterprise would be successful and profitable.

A section 8 (e) examination was ordered to determine the true status of the case. After the hearings were conducted, but before any subsequent action was taken by the Commission, the registrant withdrew the registration statement.

Oro Yellowknife Gold Mines, Ltd.—File No. 2-6881.—The registrant, of Toronto, Canada, filed a registration statement covering 2,000,000 shares of common stock which were to be offered for an aggregate of $1,200,000. The company was to receive a net of $900,000.

The Commission authorized a private examination under section 8 (e) to determine whether a stop order should issue under section 8 (d). At the conclusion of the examination, the Commission received a request for the withdrawal of the registration statement, giving as the reason therefor that "the company desires to make further inquiry into the geological facts affecting its properties." The Commission granted the request for withdrawal and made public the record of the examination.

Among the matters considered at the private examination were the adequacy and accuracy of the disclosure in the registration statement concerning the independence of the registrant's consulting engineer and the proposed use of the proceeds of the offering. The engineer stated in his report that he had no direct or indirect interest in the property, that he was "an independent consulting mining engineer," and the registrant made the same representation in the prospectus. According to evidence adduced, however, the engineer was a son of one of the officials of the registrant, he was a brother of another who acted as general manager of the company, and he understood that his services "will be sought" to act as an engineer on a retainer basis for the registrant in the future. These facts were not disclosed in the registration statement.

The registration statement showed that of the $900,000 net proceeds of the proposed offering, $115,000 were to be expended for exploratory work as recommended by the engineer. He also recommended that the financing should include "ultimate monies required to pursue underground development through a standard shaft with modern mining plant, and should make provision finally for construction of a treatment plant." The registration statement did not disclose either that the sampling done on the various geological structures investigated gave gold assay values well below a commercial grade or the bearing of these low values on the probability of requiring more than $115,000 for exploration.

Stop-Order Proceedings Under Section 8 (d)

Two stop-order proceedings were pending at the beginning of the fiscal year. The Commission authorized the institution of five additional proceedings during the year. Two of these five proceedings were instituted after the completion of examination under section 8 (e). The nature of and the results in the seven stop-order proceedings are:

Midas Yellowknife Gold Mines Ltd.—File No. 2-6787.—On October 21, 1946, registrant filed a registration statement covering 1,250,000 shares of common stock, $1 par value, to be offered to the public at $0.60 per share for an aggregate offering price of $750,000. It was stated that the net proceeds to the registrant, estimated at $450,000, were to be utilized in the exploration of some 68 gold-mining claims located in the Yellowknife area of Canada.

The examination under section 8 (e) revealed the following, among other circumstances, none of which had been disclosed in the registration statement: (1) That Gordon Jones, the promoter and dominant stockholder of the registrant, had options on other mining claims located in Canada which he intended to transfer to the registrant and that approximately $790,000 over and above the estimated pro-

ceeds from the contemplated offering would be required to explore such additional claims; (2) that under existing contractual arrangements the stockholders' equity in the various mining claims owned and to be acquired by the registrant could be diluted up to 90 percent; and (3) that Jones had been appointed general manager of the registrant, that he determined in general the entire conduct of its business, and that he had received and was to receive substantial payments as fees and expenses.

Based on the result of this examination the Commission authorized the institution of stop-order proceedings and scheduled a hearing under section 8 (d) at which the prior section 8 (e) record was introduced. The registrant thereupon filed a request for withdrawal of the registration statement, stating that no sales or offering of the securities had been made and that the financing would be undertaken in Canada. Its request was granted by the Commission.

Tucker Corporation.—File No. 2–7057.—The Tucker Corp. filed a registration statement relating to a proposed public offering of 4,000,000 shares of class A common stock, par value $1 per share, to be offered at $5 a share for a total of $20,000,000. The proceeds were to be used to develop and produce a medium-priced automobile, to be known as the "Tucker," featuring a rear engine and other innovations substantially departing from present day conventional design.

Upon examination of the registration statement, the Commission first authorized a private examination under section 8 (e), and later instituted stop-order proceedings under section 8 (d), alleging misstatements and omissions to state material facts in regard to numerous items of required information, financial statements, the accountants' certificate, certain exhibits and the prospectus.

As a result of these hearings, it appeared that the prospectus and registration statement as originally filed had failed to disclose adequately and accurately the names of all promoters and the amount of consideration received directly or indirectly from the company by each promoter, officer, and director; the stage of development of the mechanical features of the proposed automobile; the status of the company's patent position; the application of the proceeds of the proposed offering, and the company's working capital requirements; the business experience of the executive officers; the nature and the extent of the interest of Preston Tucker in Ypsilanti Machine & Tool Co.; the interests of affiliates and other persons in property acquired by the company; material litigation; the scope of the audit and the auditing procedures followed by the certifying accountants; and the failure of the accounts to reflect all liabilities of the company.

During the course of and after the close of the hearings in the section 8 (d) proceedings, the registrant filed material amendments which appeared to correct satisfactorily all material deficiencies previously contained in the registration statement. The Commission thereupon dismissed the proceedings and issued an opinion commenting, in the public interest and for the protection of investors, upon certain facts developed in the proceedings and discussing the Commission's action in this case and the limitation of its jurisdiction.[18] In this opinion the Commission also warned the prospective investor of the danger of

[18] Securities Act Release No. 3236 (1947).

relying upon past judgments based on prior literature concerning the Tucker Corp. inasmuch as there had been grossly misleading and, in many cases, false statements publicized as to the radical features of the proposed automobile, the accomplishments and the performance of such automobile, and the funds invested by the management. The registration statement was permitted to become effective after adequate dissemination of the corrected prospectus had been made and sufficient time had elapsed since the release of the Commission's opinion.

Globe Aircraft Corporation.—File No. 2-6204.—Globe Aircraft Corp. filed a registration statement covering 150,000 shares of 5½ percent cumulative convertible preferred stock and sufficient common shares for conversion purposes. The statement became effective and the company received the entire proceeds from the sale of the securities. It was represented in the prospectus that the net proceeds of $1,275,000 to the company would be used for the payment of a $960,000 loan from the Reconstruction Finance Corporation, for the purchase of a factory building and equipment for $250,000, and the remainder for working capital and expenses of the issue.

In July 1946 the registrant filed a post-effective amendment which stated that the company had been negotiating for a commercial loan, and that the then outstanding RFC loan of approximately $500,000 would be increased to $960,000. The prospectus filed as a part of the amendment stated that since the effective date of the registration statement the company had agreed to purchase a factory from the War Assets Administration for $276,000, and that funds for this purchase were to be borrowed from the RFC.

On December 27, 1946, certain creditors filed an involuntary petition in bankruptcy against the company and on December 31, 1946, the company filed an answer in the form of a petition for reorganization. The latter petition was dismissed on April 15, 1947, with the result that the petition for involuntary bankruptcy was reinstated and receivers were appointed.

The Commission participated in the reorganization proceedings under chapter X of the Bankruptcy Act. During these proceedings information was secured which raised serious questions concerning certain representations made in the registration statement. Stop-order proceedings were initiated on March 25, 1947, pursuant to section 8 (d) of the Securities Act of 1933. The hearing officer in his recommended decision found that the registration statement included untrue statements of material facts and omitted material facts required to be stated therein and material facts necessary to make the statements therein not misleading, in respect of: (1) The company's losses for January 1946; (2) the increase in note liabilities after December 31, 1945; (3) the stated purpose of the financing, in particular the payment of the outstanding RFC loan of $960,000 and the purchase of the factory building and equipment; and (4) the working capital needs of the company.

Exceptions to the recommended decision were taken by counsel for the registrant and by certain other persons granted leave to be heard in the proceedings. Oral argument was heard by the Commission June 25, 1947, on the exceptions. A decision by the Commission had not been rendered by the close of the fiscal year. Investors have

manifested much interest in this case. A civil suit in the nature of a class suit was instituted against the underwriters in April 1947, alleging misrepresentations in the registration statement.

Hayes Manufacturing Corp.—File No. 2-6179.—The company filed a registration statement covering 215,000 shares of its $2 par common stock (later reduced to 185,000 shares). The stock was to be issued first to Eli I. Kleinman, Jennis M. Doroshaw, Johann S. Ackerman and associates in exchange for all the outstanding 432,000 shares of common stock of American Engineering Co. The Commission directed that a public examination be held under section 8 (e) and later instituted stop-order proceedings under section 8 (d), alleging misstatements and omissions of material facts in numerous items, the financial statements, the accountants' certificate, certain exhibits, and the prospectus. By successive material amendments filed after institution of proceedings, the registrant corrected the existence of substantial deficiencies in the registration statement. Inasmuch as the amendments corrected substantially all of the material deficiencies, the Commission determined it was unnecessary to issue a stop order and the registration statement was permitted to become effective.[14]

Kleinman, Doroshaw, and Ackerman and their associates planned to sell the 185,000 shares of Hayes stock to the public and, since they were acquiring securities of the issuer with a view to immediate distribution, they were underwriters as defined by section 2 (11) of the Securities Act of 1933. This fact was not disclosed in the original filing. Furthermore, the costs and profits of these individuals as well as other pertinent items of information were not disclosed. As a result of the proceedings instituted by the Commission, the registration statement was amended to set forth numerous transactions as a result of which Kleinman and his associates were shown to have acquired the 432,000 shares of capital stock of American Engineering for a total of $17,000. Through various transactions between January 1943 and March 1946 they realized gross profits in the amount of approximately $585,000, and the value of the Hayes stock, based on an assigned value of $12 a share, amounted to an additional $2,580,000, reflecting a total of $3,148,000 which they stood to profit by the transactions. With the reduction in the number of shares to be received to 185,000, their total realizable profits were reduced by approximately $360,000.

The registration statement as filed also failed to disclose certain material facts with respect to Federal income tax liabilities of American Engineering and agreements with respect thereto. The original filing moreover did not disclose that American Engineering and its subsidiary would need approximately $1,600,000 within the ensuing 6 months to meet current obligations and provide additional working capital, which funds were to be obtained primarily from Hayes. Information concerning remuneration payments to Clark, president of Hayes, and certain disputes and a settlement relating thereto, as well as the need of Hayes for approximately $2,000,000 of additional working capital for its own operations before the end of 1946, were inadequately set forth in the original registration statement. Besides, that document did not indicate that since the date of the latest profit and loss statements filed both Hayes and American Engineering had

[14] Securities Act Release No. 3151 (1946).

been operating at a loss. It failed to reveal a possible contingent liability of Hayes for the sale of 100,000 shares of its stock in violation of section 5 (b) of the Securities Act. Other deficiencies of lesser importance also existed in the registration statement as originally filed.

Kiwago Gold Mines Limited—File No. 2-6852.—The registration statement filed by Kiwago Gold Mines Limited (a Manitoba corporation) on December 3, 1946, became effective on February 4, 1947, as of January 7, 1947. The 1,000,000 shares of common stock covered by the statement were offered to the public at 70 cents per share through an underwriter (Jack Cohn Co. of New York City) acting as agent for the registrant on a "best efforts" basis. The registrant's capitalization as of October 1, 1946, consisted of an authorized 3,000,000 shares of no par value common stock of which 2,000,000 shares were outstanding.

The registrant is controlled by Transcan Investors Limited (an Ontario corporation) which owns approximately 31 percent of its voting securities. In addition, as of September 28, 1946, C. E. Hepburn & Co. (of which Louis Cadesky is the sole owner) owned beneficially approximately 14 percent of the registrant's voting securities. Messrs. A. J. McLaren, Louis Cadesky, and H. T. Leslie, who comprise a majority of the registrant's board of directors, also promoted Transcan and control it by their ownership of 57.47 percent of that corporation's voting securities, Louis Cadesky being the largest holder with 28.91 percent. Within the preceding 2 years 779,000 shares of the registrant's common stock had been purchased by Transcan at an average price of approximately 12½ cents per share and sold to C. E. Hepburn & Co. at cost.

On April 16, 1947, the Commission's attention was directed to an advertisement in The Northern Miner, a Canadian publication which is circulated in this country, with respect to an offering of shares of the registrant by C. E. Hepburn & Co. The advertisement contained the statement that "1,000,000 shares of Kiwago Gold Mines, Limited have been registered with the SEC in the United States for sale to the American public." No statement was made as to the offering price of the registrant's stock. At the same time the Commission was informed that it was believed that the shares were being offered in Canada at a price substantially below the 70 cents per share offering price in the United States.

As a result of inquiries then made by the Commission, it was ascertained that only two sales of the registered stock had been made in the United States, each involving 1,000 shares at the stated offering price of 70 cents per share, whereas from December 17, 1946, to May 10, 1947, C. E. Hepburn & Co. had sold in Canada 178,000 shares of the registrant's stock at prices ranging from 10 cents to 40 cents per share. It was also noted that between December 3, 1946, the day the statement was originally filed, and February 4, 1947, the date on which it became effective, approximately 40 separate sales involving 70,000 of these shares were made in Canada at prices ranging from 10 cents to 35 cents per share. During this period the registrant apparently had in mind offering the shares in this country at 70 cents per share, since this price was indicated in the original filing.

The prospectus in the registration statement as of its effective date contains no reference to actual or proposed sales of the registrant's stock in Canada by C. E. Hepburn & Co. or by any officer, director or associate of the registrant. Since it appeared that the omission of such information was materially misleading, the Commission instituted stop-order proceedings under section 8 (d).

Red Bank Oil Company—File Nos. 2–5754 and 1–342.—A stop-order proceeding under section 8 (d) relating to the registration statement of Red Bank Oil Co. was consolidated with a proceeding with regard to the termination of exchange listing under section 19 (a) (2) of the Securities Exchange Act of 1934 because of numerous common questions of fact involved. On January 4, 1946, the Commission found that the auditor was not independent and the audits had not been made in accordance with generally accepted auditing standards applicable in the circumstances.[15] The financial statements originally filed were the subject of the Commission's findings and opinion dated January 3, 1947, in which it was found that numerous inaccuracies and omissions were present in financial statements for the years 1940–44.[16] The deficiencies found were principally the failure to disclose transactions between Frank W. Bennett and interests affiliated with him on the one hand, and Red Bank and its subsidiaries on the other; failure to disclose the amounts owing to and from the affiliated Bennett interests; failure to disclose the materiality of pledges and other liens to which assets were subject; and numerous misstatements of income, the most outstanding example occurring for the year 1943, when various inaccuracies produced an apparent consolidated profit of $173,409 although revised statements subsequently filed by amendment showed a net loss of $4,436.

A stop-order was issued by the Commission on February 27, 1947, based upon the financial statements referred to above and upon numerous other omissions, inaccuracies, and inconsistencies in the registration statement and prospectus.[17] The findings and opinion which accompanied the stop-order found that omissions, inaccuracies, and inconsistencies concerned, among other things, control of the company; the business and property of the company and its subsidiaries; the capital stock; the underwriting and distribution of the securities sought to be registered; acquisitions of various properties; remuneration of officers; principal holdings of securities; the interest of affiliates in property acquired; and recent sales of securities. It was concluded that the registration statement as a whole was materially misleading. The stop-order was still in effect at the close of the fiscal year.

Western Tin Mining Corp.—File No. 2–6679.—This case is described below at p. 20 under the heading "Gross Omission of Material Facts."

[15] Securities Act Release No. 3110. Described in the Commission's Twelfth Annual Report, p. 120.
[16] Securities Act Release No. 3184.
[17] Securities Act Release No. 3197.

DISCLOSURES RESULTING FROM EXAMINATION OF REGISTRATION STATEMENTS

The following brief histories are illustrative of disclosures that were made after the staff had examined the registration statements and prospectuses involved.

Profitable Inside Dealings With Affiliated Companies

Two affiliated companies owned a controlling interest in a registrant, a manufacturer of automobiles, and the controlling persons of such affiliated companies were also officers and directors of the registrant. The registration statement disclosed that the registrant had: (1) Entered into an agreement to purchase from one of the affiliated companies all of the stock of a subsidiary of that affiliate, and (2) proposed to purchase certain land and buildings from said affiliate. The staff of the Commission requested that disclosure be made in the registration statement of the contract sale price of the stock, land, and buildings to the registrant, their cost to the affiliate, the date of acquisition by the latter, and the profits to be realized by the affiliate from the transaction. As a result, it was disclosed that the controlling affiliate realized a profit of $2,893,270.17 on an investment of $770,000 allocated cost from the sale of the stock of its wholly owned subsidiary, and $297,082.37 from the sale of the land and buildings.

Gross Omission of Material Facts

Some months prior to the filing of a registration statement by a mining company, the registrant had filed a letter of notification and sales literature under the conditional exemption from registration provided by regulation A for issues of not more than $300,000. The representations in the sales literature were of such character that an investigation was made. The company's engineer testified that no known tin or other ore bodies existed on the property and that a gold assay referred to in the literature was taken from a property other than that belonging to the registrant. Shortly after this testimony was given, the principal promoter of the registrant advised the Commission that he had been misled by the engineer and was discharging him immediately. Despite the foregoing, the registration statement as subsequently filed contained reports by the same engineer and the same failure to make adequate disclosure of the material facts referred to above. Among numerous other discrepancies was a statement to the effect that a certain accountant had gone over the financial schedules submitted. The Commission brought injunction proceedings in this case, and the accountant in question testified that he had not reviewed such schedules. Stop-order proceedings under section 8 (d) were instituted and hearings commenced. The registrant thereafter requested withdrawal of its registration statement.

Importance of Disclosure to Underwriters

In one case the registrant was only in the promotional stage, having no physical plant, no production machinery, and no established commercial acceptance for its proposed products. After allowing 25 percent for discounts or commissions to an underwriter, it proposed to use the funds obtained to erect a plant and equip it with the necessary machinery. The staff's letter of comment resulted in the amend-

ment of the prospectus to disclose, first, that governmental wartime tests of certain of the proposed products cast considerable doubt upon the feasibility of the venture, and, second, that the nature of the underwriting arrangements was such that it was wholly conjectural whether the company would obtain enough funds from the financing to commence business properly. Although the registration statement became effective, the underwriter on the following day informed the Commission's staff in effect that when he became aware of hitherto unknown facts disclosed in the company's final prospectus, he decided to abandon the underwriting. The registration statement was withdrawn. The underwriter stated in a letter to the Commission: "This incident confirms my opinion that the SEC is as much a help to the dealer as it is to the public."

Relative Investment Positions of Public and Promoters

The significance of disclosure is often lost in lengthy and complex presentations of adverse facts. The Commission frequently obtains a sharpening of disclosure by requesting that information be stated simply, summarized, or presented in tabular form. The following table was substituted, at the request of the Commission, for lengthy textual material which tended to conceal the information so clearly brought out in the table:

	Number of shares	Cost per share	Aggregate cost	Percent of stock to be outstanding
Original subscribers (or transferees)	180,000	$0.125	$22,500	44
Public	230,000	4.375	1,006,250	56

Maintenance of Insider Control—Restrictions on Stock Resales

A company manufacturing electrical parts registered 7,500 shares of class A stock to be offered to the public at $101 per share. At the same time it granted the promoters and managers the right to purchase, at $1 per share, a share of class B stock for each share of class A outstanding, up to 20,000 shares. By amendment obtained by the Commission it was pointed out in a prominent part of the prospectus that

by the purchase of shares of Class B Stock under the above conditions, the members of the management of the Corporation will be given at a nominal cost the opportunity (1) to maintain control of the Corporatiton, including the power to sell, lease or exchange all of the property and assets of the Corporation, (2) to share equally in all profits in excess of the dividend requirements of the Class A Stock, and (3) to share equally in all assets in excess of the liquidating preference of the Class A Stock.

In the same case proper prominence was required for disclosure of the fact that the class A stock being offered to the public had a limited transferability. A stockholder wishing to dispose of any such shares would be required first to offer them to the corporation for a 60-day period at the involuntary liquidation value of the stock. If such offer were not accepted, the stockholder could then sell the shares. However, if the shares were not sold within the next 30 days the cycle of first offering the shares to the corporation would have to be repeated. Any purchaser of the stock would become subject to the same restrictions on transfer. The company was required to point out that

the restrictions place a limitation on price appreciation of shares and may prevent a quick sale by a stockholder needing immediate funds.

Speculative Hazards of Stock Issue

At the request of the Commission a registrant manufacturing a food products specialty disclosed the following information under a heading which it labeled "Speculative Nature and Hazards of the Offering": (1) Although founded in 1943 it was seeking working capital for what amounted to a new peacetime enterprise, since substantially all of its sales up to the time it filed its registration statement had been made to agencies of the Government and such sales had terminated; (2) the business was not subject to patent protection and anyone could employ its processes; (3) simultaneously with the offering of shares to raise working capital for the company, its two stockholders were selling to the public for $600,000 one-third of their own holdings (with a book value of $13,803) at a profit of $583,000, and their total profit, including retained stock at the public offering price, would be $1,749,000; (4) solely as a result of the financing, the book value of the stock would be increased from 14 cents a share to $2.72 a share, the increase inuring to the benefit of the selling stockholders with respect to the 200,000 shares of stock to be retained by them; and (5) the two selling stockholders, constituting two of the four directors, also occupied the positions of president and vice president of the company, the latter officer was additionally the president of the underwriting firm which was offering the issue, and the former had entered into a management contract with the registrant.

Speculative Nature of Venture Spelled Out

Factors relating to the speculative nature of the securities of a company proposing to produce and sell a special type of fuel were summarily stated in the registration statement. It was brought out at the instance of the Commission that: (1) The company was in the development stage, that production was not possible until completion of its plant, and that there would be no assurance of the date of completion, particularly inasmuch as the underwriter had not contracted to purchase the entire stock issue but only to use his best efforts to sell it for the company; (2) the company proposed to use a process that had not been demonstrated to be feasible on a commercial basis as applied to the raw material which it would use, and the only other company in the United States using this process was an admitted financial failure; (3) as to the process it would use, the company was nothing more than a nonexclusive licensee of six patents, four of which had expired; (4) the company would be in competition in a limited geographical market with other fuels sold by established companies possessing greater financial resources; (5) the company had net tangible assets of less than $10,000 and no prospect of income at least until the completion of the contemplated construction program, yet it was offering a fixed interest security as well as common stock; (6) the promoters paid $1.25 a share for their common stock shortly before the proposed offering to the public to be made at $3.75 a share; (7) the net tangible asset value of the promoters' stock would be increased, solely as a result of the public financing, from 20 cents per share immediately preceding such financing to $5.09 per share immediately thereafter; and (8) the company had entered into an engi-

neering contract and a 5-year management contract with a firm with which two of the promoters of the company were associated, under which contracts the company agreed to pay $90,000 as a maximum engineering fee and $50,000 as a minimum annual management fee.

Impact of Domestic and Foreign Law on Company's Operations

In order to clarify the more important elements of risk in a proposed offering of securities, the Commission requested a foreign airline corporation to disclose in an introductory section to the prospectus, among other factors, that: (1) A permit to operate in the United States would not be issued until after a determination by the Civil Aeronautics Board that the registrant had met the required standards as to operational ability and percentage of ownership of the registrant's shares by citizens of the foreign country; (2) failure to obtain any of the necessary operating permits would adversely affect the competitive position of the registrant and, in addition, that substantial competition existed or was to be expected in an important segment of the registrant's route; and (3) based on the number of shares being offered and already sold, it would be necessary to sell large additional amounts of the registrant's capital stock in order that the required percentage of its capital should be owned by citizens of the foreign country. In the event that the required percentage was not secured thereby, it would be necessary to curtail sales of capital stock in the United States and Canada with the consequent curtailment of proposed operations.

Liabilities Under Employees' Retirement Plan

A leading oil refining and distributing enterprise filed a registration statement for a public distribution of some 400,000 shares owned by certain of its controlling stockholders. The offer, to be made at the market price, amounted to some $27,000,000. The statement failed to show the inescapable liability already incurred by the company under its employees' "Annuities and Benefits Plan," adopted in 1944, to the extent of about $4,000,000 on account of retired employees, and also omitted any disclosure of an actuarial deficiency in the plan to the even greater extent of about $40,000,000 on account of employees still working for the corporation. The $40,000,000 liability of the company could be avoided only if its employees left their jobs otherwise than by retirement, or through action by the company abolishing the plan. As a result of questions raised by the Commission and conferences held by the staff with representatives of the registrant, it was disclosed by amendment that, as of December 31, 1945, $44,018,153 remained unpaid on account of prior service annuities and that, if payments were continued on the same basis followed since the inception of the plan, this amount would be paid in approximately equal installments through 1953.

CHANGES IN RULES, REGULATIONS, AND FORMS

The necessity that rules, regulations, and forms adopted under the Securities Act be flexible to meet changing business conditions had early been recognized by the Commission. Experience has also shown that any procedure for compliance with a regulatory statute is made

most simple and expedient for those who must comply if each type of situation is recognized and provision made for its particular need.

The Commission, therefore, has adopted many rules under the several acts which it administers, and has adopted numerous forms for compliance with the requirements of these acts. Although these may seem confusing at first glance, it has been amply demonstrated that a specific registrant under the Securities Act, for example, finds that he encounters the least problems and is best able to comply with the registration requirements because his situation has been anticipated and covered by the rules. No one registrant must comply with all the rules or use all the forms.

Rules and forms must be changed, obsolete procedures rescinded and new ones adopted as changing conditions require. Changes may be made as a result of recommendations by the staff, and many changes have been made at the suggestion of persons who must comply with the requirements of a particular statute. No material change is made without a series of conferences with all persons interested or who might be affected by such change. Changes made during the 1947 fiscal year in the rules, regulations, and forms under the Securities Act are described below.

Rule 131—The Red-Herring Prospectus

As has been pointed out, the Securities Act provides a 20-day waiting period before a registration statement becomes effective in order to insure that the information contained in the registration statement will become known to the investing public before the securities are offered for sale. The degree to which this information is circulated is of the utmost importance to the accomplishment of the purposes of the act. It is to be recalled, too, that one of the criteria to be observed before acceleration of the effective date may be granted by the Commission is the adequacy of the information available to the public at the time when acceleration is requested.

This need for the adequate dissemination of information about a security during the waiting period was recognized both by the Commission and the securities industry early in the history of the Securities Act, and a practice developed to make such dissemination of information. The prospectus which is to be used to offer the security for sale is prepared and filed with the registration statement. It cannot be used to offer the security for sale until the registration statement becomes effective, but if adequately prepared is an excellent source of public information about the proposed issue.

The Commission approved this use of the prospectus in advance of effectiveness as a source of information only and not as a method of offering the security for sale. To insure that the nature of the prospectus should not be misunderstood when used in this way, and therefore possibly lead to a violation of the act, a legend was printed across the facing sheet of the prospectus to the effect that the prospectus was being circulated at the time for information purposes only and not to offer the security for sale. This legend was normally printed in red ink, and the prospectus which was so used during the 20-day waiting period became known as the "red-herring" prospectus.

Within the recent past the use of "red-herrings" diminished substantially. Various reasons were ascribed; among others, that the liability of those who used red-herrings was doubtful, notwithstanding

repeated interpretations by the Commission as to the legality of their use.

In order to remove this obstacle, the Commission availed itself of the provisions of section 19 (a). The pertinent part of that section is:

> No provision of [the Securities Act] imposing any liability shall apply to any act done or omitted in good faith in conformity with any rule or regulation of the Commission . . .

The Commission adopted rule 131 under the Securities Act to afford the protection of section 19 to the use of the red-herring prospectus.[18] In substance, the rule provides that the use of a red-herring prospectus shall not constitute an offer to sell the security under the following conditions:

(*1*) The red-herring prospectus must be a copy of the prospectus proposed to be used to offer the security for sale and must have been filed as part of the registration statement;

(*2*) The red-herring prospectus must contain substantially the information required by the Act and the rules and regulations to be contained in a final prospectus except that it may omit certain specified matters not ascertainable at the time the red-herring prospectus is used;

(*3*) The red-herring prospectus must contain, on each page, a statement set forth in the rule to the effect that the red-herring prospectus is for information purposes only, that the registration statement has not yet become effective, and that an offer to sell the security can and would be made only by use of the final prospectus after the effective date of the registration statement.

In its announcement of the adoption of rule 131, the Commission stated that the adequacy of distribution of the red-herring prospectus would be considered in determining whether to grant a request for acceleration of the effective date of the registration statement. At the same time, the Commission reaffirmed its policy to refuse acceleration where a materially deficient or inadequate red-herring prospectus had been distributed until such time as corrected information had been communicated to the persons who had received such red-herring prospectuses.[19]

Forms S–1, A–1, and A–2—Registration of Securities

Form S–1 is the form most generally used in registering securities. It represents a simplification of Forms A–1 and A–2, the forms most generally used prior to the adoption of Form S–1. On January 8, 1947, a further simplified version of Form S–1 was adopted.

Originally, Form S–1 was divided into two parts. Part I called for information required to be included in the prospectus and Part II called for information required to be included in the registration statement but which could, for the most part, be omitted from the prospectus. The revision abolished this division and eliminated from the form proper all items calling for information not required to be set forth in the prospectus. The purpose of this revision was, first, to eliminate a number of requirements which experience had shown did not produce information essential to the prospective investor's appraisal of the security, and second, at the

[18] Securities Act Release No. 3177 (1946). Originally adopted for a 6-month trial period beginning December 6, 1946, the rule was continued in effect shortly after the close of the 1947 fiscal year.

[19] Previously announced in Securities Act Release No. 3061 (1945).

same time to clarify the requirements of the form in certain limited respects.

Some of the principal changes made were:

(1) Elimination of the description of capital securities other than those being registered;

(2) Substitution of limited information as to underwriting contracts for the complete outline theretofore required;

(3) Elimination of information about patents as a separate item;

(4) Consolidation of the items as to information about security holdings;

(5) Elimination of historical financial information from the prospectus, and from the registration statement if the information has previously been filed with the Commission.

With this revision, Forms A–1 and A–2 no longer served any useful function and they were rescinded.

Regulation C—Rules Governing Registration

In the last month of the fiscal year the Commission adopted a revised regulation C, that portion of the General Rules and Regulations under the Securities Act which deals with registration and the registration procedure. This regulation is the complement of the various registration forms under that act. The revision eliminated a great deal of material which had become obsolete and reorganized the remaining rules in a manner intended to facilitate the registration of securities according to the simplified procedure provided by the Commission's recently revised Form S–1. In fact, the revised regulation extended the simplified procedure to registration statements filed on any form under the act, whether the form itself provides such procedure or not. Certain rules which specify the items of information required to be included in a prospectus were transferred from regulation C to the respective forms to which they relate.

Rules Adopted in Connection With the International Bank

The formation of the International Bank for Reconstruction and Development necessitated the adoption of special rules to facilitate its operations and to clarify certain procedures under the several acts administered by the Commission as they apply to the Bank. These new rules are included in the discussion of the Bank which appears on page 141.

Supplement S–T

During the year the Commission adopted various amendments of a minor nature including two relating to Supplement S–T, the document containing special items of information required in the case of securities being registered under the Securities Act which are to be issued under an indenture that must be qualified under the Trust Indenture Act of 1939.

INJUNCTION ACTIONS INSTITUTED UNDER THE ACT

Under the Securities Act the Commission's enforcement activity is concerned generally with the obtaining of full disclosure, by means of the registration process, of all pertinent data concerning securities

publicly offered for sale, and with the prevention of fraud in the sale of securities. Section 5 of the act, with certain exceptions,[20] requires registration with the Commission of all securities publicly offered for sale, and section 17 makes it unlawful by use of the mails or instrumentalities of interstate commerce to employ any fraudulent scheme or device, to make any misrepresentation, or to omit to state any material fact in connection with the sale of any security. During the past year the Commission has instituted civil litigation in a number of cases to prevent violations of the requirements of these provisions of the act.

A great part of the Commission's civil litigation has arisen through the enforcement of these sections. In *S. E. C.* v. *Slocan Charleston Mining Co. Ltd.*,[21] *S. E. C.* v. *Sterling, Inc.*,[22] *S. E. C.* v. *Vindicator Silver Lead Mining Co.*,[23] *S. E. C.* v. *Nevada Wabash Mining Co.*,[24] *S. E. C.* v. *J. Stacy Henderson, Mid-Continent Development Co.*,[25] and *S. E. C.* v. *Bennett S. Dennison and W. W. Patty*,[26] the Commission obtained final judgments restraining the defendants from further violations of the registration provisions of section 5. In the cases of *S. E. C.* v. *Sandy Boy Mines and Lena M. Little*[27] and *S. E. C.* v. *Carroll I. Mitchell, Rangely Petroleum, Inc.*,[28] the Commission obtained final judgments restraining the defendants from further violations of the fraud provisions of section 17.

In addition to the foregoing, in the cases of *S. E. C.* v. *Walter J. Porteous*,[29] *S. E. C.* v. *Edward J. Stoll*,[30] and *S. E. C.* v. *Western Tin Mining Corporation and Marion Allen*,[31] the Commission obtained final judgments restraining the defendants from further violations of both the registration provisions (section 5) and the fraud provisions (section 17) of the Securities Act.

When consideration is given to the number and scope of the acts administered by the Commission it is not surprising to discover that some of its civil litigation concerns itself with more than one of such acts. For example, in the cases of *S. E. C.* v. *Joseph J. LeDone*[32] and *S. E. C.* v. *Standard Oil Company of Kansas and Charles B. Wrightsman*,[33] both the Securities Act of 1933 and the Securities Exchange Act of 1934 were involved. In the *LeDone* case, the defendant was a broker-dealer in securities and was duly registered with the Commission as such under the Securities Exchange Act of 1934. LeDone's principal business consisted of the sale of oil royalties. It was developed that the price to purchasers exceeded the amount of the then current value of the estimated recoverable oil by 50 percent, so that

[20] Secs. 3 and 4 contain the exceptions.
[21] U. S. D. C., Seattle, June 7, 1947.
[22] U. S. D. C., S. D. N. Y., Apr. 11, 1947.
[23] U. S. D. C., Washington, Apr. 19, 1947.
[24] U. S. D. C., N. D. California, Jan. 20, 1947.
[25] U. S. D. C., E. D. Michigan, Feb. 14, 1947.
[26] U. S. D. C., Nevada, Sept. 11, 1946.
[27] U. S. D. C., Colorado, Jan. 31, 1947. False and misleading statements regarding quality and quantity of ore, past and future profits, size of shipments already made, and scale of operations.
[28] U. S. D. C., Colorado, Oct. 3, 1946. False and misleading statements that oil wells would be drilled in proven area, concerning geological structure and ownership of acreage.
[29] U. S. D. C., S. D. N. Y., Feb. 14, 1947. False and misleading statements concerning ownership of patents in a "coal carburetor."
[30] U. S. D. C., Iowa, Oct. 2, 1946. False and misleading statements that the companies whose securities were being sold were producing ore in profitable quantities, that the companies' ore was worth $48,000,000 and that timber standing on mining claims was worth $100,000. It was not disclosed that the companies did not own the timber.
[31] U. S. D. C., Va., July 8, 1946. False and misleading statements regarding the development possibilities of a mine, profits to stockholders, and reports of engineers.
[32] U. S. D. C., S. D. N. Y., Mar. 26, 1947.
[33] U. S. D. C., Texas, Feb. 26, 1947. This case is discussed in detail in part II of this report.

in no event could the purchaser reasonably expect to recover even the amount of the purchase price. The evidence disclosed that LeDone had represented that these investments would return a sum substantially greater than the purchase price. Based on this evidence the Commission sought to enjoin LeDone from further violation of the fraud provisions of both the Securities Act and the Securities Exchange Act,[34] inasmuch as he was a registered broker-dealer under the latter act.

During the past year litigation was concluded in *Penfield* v. *S.E.C.*[35] and in *S.E.C.* v. *Vacuum Can Co.*,[36] which arose out of requests by the Commission for enforcement of its subpenas. In the *Penfield* case, the defendant refused to comply with the Commission's subpena even after a district court had directed compliance, a circuit court had affirmed the district court's order, and the Supreme Court had denied *certiorari*.[37] On an appeal in contempt proceedings instituted by the Commission, the Supreme Court held that the Commission was entitled to such a decree holding the defendant in contempt as would coerce the production of the records sought to be examined. In the *Vacuum Can* case the Circuit Court of Appeals for the Seventh Circuit dismissed an appeal from a district court order directing the production of certain books and records in compliance with a subpena issued by the Commission. The appeal was grounded upon an asserted constitutional right in the corporate defendant to refrain from producing certain records whose relevancy to the investigation being conducted by the Commission was questioned. The court held that the appeal was so clearly without merit that it must have been taken for the purpose of delay.

The appellate courts were also petitioned in *Crooker* v. *S.E.C.*[38] to review a so-called order of the Commission consenting to the filing of amendments to a registration statement as of an earlier date and thus, by the automatic operation of section 8 (a) of the Securities Act, accelerating the effective date of the registration statement. The Circuit Court of Appeals for the First Circuit dismissed the petition for review on the grounds that: (1) The petitioner was not a "person aggrieved" since he appeared in the proceedings as attorney for an undisclosed principal and declined to advance any substantial basis for not revealing the name of his client; and (2) the action of the Commission was not reviewable.

Data concerning civil cases and appellate proceedings instituted under this act as well as under the Securities Exchange Act of 1934, together with a brief discussion of all civil proceedings commenced or pending during the past fiscal year and their status at the close of the year, are included in appendix tables 26 and 28.

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[34] Section 15 (c) (1) of the Securities Exchange Act, in effect, makes it unlawful for a broker-dealer to use the mails or means of interstate commerce to effect a security transaction by means of fraud.
[35] 157 F. (2d) 65 (C. C. A. 9, 1946), affirmed 330 U. S. 585.
[36] 157 F. (2d) 530 (C. C. A. 7, 1946), cert. den. 330 U. S. 820.
[37] See Twelfth Annual Report, p. 104–105.
[38] 161 F. (2d) 944 (C. C. A. 1, 1947).

PART II

ADMINISTRATION OF THE SECURITIES EXCHANGE ACT OF 1934

The Securities Exchange Act of 1934 is designed to eliminate fraud, manipulation, and other abuses in the trading of securities both on the organized exchanges and in the over-the-counter markets, which together constitute the Nation's facilities for trading in securities; to make available to the public information regarding the condition of corporations whose securities are listed on any national securities exchange; and to regulate the use of the Nation's credit in securities trading. The authority to issue rules on the use of credit in securities transactions is lodged in the Board of Governors of the Federal Reserve System, but the administration of these rules and of the other provisions of the Act is vested in the Commission.

The act provides for the registration of national securities exchanges, brokers and dealers in securities, and associations of brokers and dealers.

REGULATION OF EXCHANGES AND EXCHANGE TRADING

Registration of Exchanges

Each securities exchange in the United States is required by section 5 of the act to register with the Commission as a national securities exchange or to apply for exemption from such registration. Under this section, exemption from registration is available to exchanges which have such a limited volume of transactions effected thereon that, in the opinion of the Commission, it is unnecessary and impracticable to require their registration. During the fiscal year the number of exchanges registered as national securities exchanges remained at 19 and the number of exchanges granted exemption from such registration remained at 5.

The registration or exemption statement of each exchange contains information pertinent to its organization, rules of procedure, membership and related matters. In order to keep this information up to date, the 24 exchanges filed a total of 90 amendments to their statements reflecting changes which had occurred therein during the year. Each of these amendments was reviewed to ascertain that the change involved was not adverse to the public interest and that it was in compliance with the relevant regulatory provisions of the act. The nature of the changes effected by the exchanges in their constitutions, rules and trading practices varied considerably. Some of the more significant of these changes are briefly outlined below:

Philadelphia Stock Exchange adopted a more comprehensive form of financial questionnaire to be filed by its member firms doing business with the public. It amended its rules to include a requirement that

the answers to this questionnaire be prepared by an independent public accountant based upon the results of an annual audit of its affairs made by such an accountant, and that the annual audit be made on a date selected by the accountant and without prior notice to the member firm.

At the suggestion of the Commission, Boston Stock Exchange, Philadelphia Stock Exchange, and San Francisco Mining Exchange each adopted a rule requiring members and member firms to report to the exchange information regarding substantial options relating to securities dealt in on their respective exchanges. This action brought to a total of ten the number of exchanges which have such a rule in effect.

New York Stock Exchange revised its requirements for listing shares of companies organized under the laws of countries other than the United States. The revised requirements incorporate many suggestions which had been received from investment banking, legal, and accounting firms. This exchange also revised its schedule of listing fees by eliminating the optional lump-sum method of paying for new stock issues, and by a reduction of the fee for issues over 2,000,000 shares. Under the revised fee schedule, issuers are charged a small initial fee and an annual continuing fee for 15 years. During the year the exchange's board of governors took under consideration a proposal to permit corporations to become members of the exchange. This was submitted for membership vote and was rejected on November 20, 1947. The constitution of this exchange was amended to permit a group of members by petition to present a desired constitutional amendment to the exchange's board of governors and whereby such amendment, within a stated period of time, would be referred to the membership for vote regardless of whether it had the board's approval. In connection with its efforts to keep holders of securities and the investing public informed as to the status of listed companies, this exchange initiated the practice of having the letter "Q" printed preceding the ticker symbols for securities of companies reported to the exchange as being in receivership or bankruptcy proceedings. The recommendation of a special committee of the Association of Stock Exchange Firms for higher rates of commission was under consideration by the board of governors of this exchange at the close of the fiscal year. This recommendation was contained in a report of the results of a survey of costs and revenues of a group of New York Stock Exchange member firms which had been prepared by the special committee and submitted to the board of governors of the exchange by the Association of Stock Exchange Firms.

New York Curb Exchange's committee on listing modified its policy in considering applications for the listing of stock issues from the viewpoint of voting rights. Under this modified policy this committee will not, in broad principle, view favorably applications for the listing of common stocks which are nonvoting or which have unduly restricted voting rights, and nonvoting preferred stocks which do not acquire voting rights upon specified defaults in the payment of fixed dividend requirements. This exchange also revised its requirements for listing shares of companies organized under the laws of countries other than the United States or the Dominion of Canada, following similar action taken by New York Stock Exchange as mentioned above.

San Francisco Stock Exchange revised its rules to permit members to effect on the exchange principal transactions wherein the member or member firm may buy a security from or sell a security to a customer, provided the price is consistent with the exchange market and that a member of the floor trading committee approves the transaction. Previouly, if a member were offering stock for his account or for a partner of the firm and an order was received from one of his customers, the exchange did not allow this transaction to be executed and recorded on the exchange.

New York Stock Exchange and New York Curb Exchange, following consultations with the Commission, effected modifications in the rules designed to regulate floor trading on these exchanges.

Standard Stock Exchange of Spokane changed its name to Spokane Stock Exchange. This change did not effect its status as a registered exchange.

Disciplinary Actions by Exchanges Against Members

Pursuant to a request of the Commission, each national securities exchange reports to the Commission whenever it takes action of a disciplinary nature against one of its members or an employee of a member for violation of the Securities Exchange Act, any rule or regulation thereunder, or of any exchange rule. Five exchanges reported having taken such action against a total of 46 members, member firms, and partners or employees of member firms during the year.

In a number of these cases the disciplinary action involved merely censuring an individual or firm for an infraction of the rules and issuing a warning that a further infraction would be dealt with more severely. The more important of the other actions taken included fines ranging from $25 to $2,500 in 22 cases, with total fines imposed aggregating $19,875; the cancelation of the registration of a specialist; the cancelation of the registration of a registered representative of a member firm; and the temporary suspension of a partner of a member firm. These disciplinary actions resulted from violations of various exchange rules, principally those pertaining to margin trading, floor trading, handling of orders, partnership agreements, capital requirements, registered employees and specialists.

Market Value and Volume of Exchange Trading

The market value of total sales on national securities exchanges for the 1947 fiscal year, as shown in appendix table 7, amounted to $14,790,928,000, a decrease of 27.4 percent from the market value of total sales for the 1946 fiscal year. Of this total, stock sales had a market value of $13,733,163,000 (excluding sales of rights and warrants), a decrease of 27.5 percent from 1946, and bond sales that of $973,725,000, a decrease of 28.3 percent from 1946. The market value of sales of rights and warrants totaled $84,040,000, involving 44,203,000 units.

The volume of stock sales, excluding right and warrant sales, for the 1947 fiscal year totaled 552,774,000 shares, a decrease of 33.1 percent from 1946. Total principal amount of bond sales was $1,350,158,000, a decrease of 24.3 percent from 1946.

The market value of total sales on all exempted exchanges for the 1947 fiscal year amounted to $11,437,000, a decrease of 22.6 percent from 1946. Further details are given in appendix table 7.

Special Offerings on Exchanges

Under rule X–10B–2, special offerings of blocks of securities are permitted to be effected on national securities exchanges pursuant to plans filed with and declared effective by the Commission. Briefly stated, these plans provide that a special offering may be made when it has been determined that the auction market on the floor of the exchange cannot absorb a particular block of a security within a reasonable period of time without undue disturbance to the current price of the security. A special offering of a security is made at a fixed price consistent with the existing auction market price of the security and members acting as brokers for public buyers are paid a special commission by the seller. Buyers are not charged a commission on their purchases and obtain the securities at the net price of the offering. There were no new special offering plans filed or declared effective during the year. The plans of 7 exchanges, which had previously been declared effective, remained in effect throughout the year.[1]

During the year a total of eight special offerings were effected, all on the New York Stock Exchange and the Chicago Stock Exchange. These offerings involved the sale of 104,814 shares of stock with an aggregate market value of $2,852,000; $68,000 in special commissions were paid to brokers participating in the offerings. During the preceding fiscal year, 49 special offerings involving 622,629 shares of stock were effected on 4 exchanges. The aggregate market value of offerings in the preceding year was $21,673,000 and special commissions paid totaled $340,000. Further details are given in appendix table 8.

REGISTRATION OF SECURITIES ON EXCHANGES

Purpose and Nature of Registration of Securities on Exchanges

Section 12 of the Securities Exchange Act forbids trading in any security on a national securities exchange unless the security is registered or exempt from registration. The purpose of this provision is to make available to investors reliable and comprehensive information regarding the affairs of the issuing company by requiring an issuer to file with the Commission and the exchange an application for registration disclosing pertinent information regarding the issuer and its securities. A companion provision contained in section 13 of the act requires the filing of annual, quarterly, and other periodic reports to keep this information up-to-date. These applications and reports must be filed on forms prescribed by the Commission as appropriate to the class of issuer or security involved.

Examination of Applications and Reports

All applications and reports filed pursuant to sections 12 and 13 are examined by the staff to determine whether accurate and adequate disclosure has been made of the specific types of information required

[1] These exchanges are: Chicago Stock Exchange, Cincinnati Stock Exchange, Detroit Stock Exchange, New York Curb Exchange, New York Stock Exchange, Philadelphia Stock Exchange, and San Francisco Stock Exchange.

by the act and the rules and regulations promulgated thereunder. The examination under the Securities Exchange Act, like that under the Securities Act of 1933, does not involve an appraisal and is not concerned with the merits of the registrant's securities. When examination of an application or a report discloses that material information has been omitted, or that sound principles have not been followed in the preparation and presentation of accompanying financial data, the examining staff follows much the same procedure as that developed in its work under the Securities Act in sending to the registrant a letter of comment, or in holding a conference with its attorneys or accountants or other representatives, pointing out any inadequacies in the information filed in order that necessary correcting amendments may be obtained. Here again, amendments are examined in the same manner as the original documents. Where a particular inadequacy is not material, the registrant is notified by letter pointing out the defect and suggesting the proper procedure to be followed in the preparation and filing of future reports, without insistence upon the filing of an amendment to the particular document in question.

Statistics of Securities Registered on Exchanges

At the close of the fiscal year, 2,215 issuers had 3,560 security issues listed and registered on national securities exchanges. These securities consisted of 2,562 stock issues aggregating 2,655,064,350 shares, and 998 bond issues aggregating $18,426,753,851 principal amount.

During the past year 88 new issuers registered securities under the act on national securities exchanges, while the registration of all registered securities of 61 issuers was terminated. Thus there was a net increase of 27 in the number of issuers having securities registered under the act during the year.

The following applications and reports were filed in connection with the listing and registration of securities on national securities exchanges during the past year:

Applications for registration of securities	527
Applications for "when issued" trading	73
Exemption statements for short-term warrants	73
Annual reports	2,189
Current reports	9,134
Amendments to applications and reports	1,663

Appendix tables 7 through 18 contain a considerable amount of detailed statistics concerning securities registered on exchanges.

TEMPORARY EXEMPTION OF SUBSTITUTED OR ADDITIONAL SECURITIES

Rule X-12A–5 provides a temporary exemption from the registration requirements of section 12 (a) of the act to securities issued in substitution for, or in addition to, securities previously listed or admitted to unlisted trading privileges on a national securities exchange. The purpose of this exemption is to enable transactions to be lawfully effected on an exchange in such substituted or additional securities pending their registration or admission to unlisted trading privileges on an exchange.

The exchanges filed notifications of the admission to trading under this rule with respect to 151 issues during the year. The same issue

was admitted to trading on more than one exchange in some instances, so that the total admissions to such trading, including duplications, numbered 177.

Proceedings Under Section 19 (a) (2)

Section 19 (a) (2) of the Securities Exchange Act authorizes the Commission to deny, suspend the effective date of, suspend for a period not exceeding 12 months, or to withdraw the registration of a security if the Commission finds, after appropriate notice and opportunity for hearing, that the issuer of such security has failed to comply with any provision of the act or the rules and regulations thereunder.

Three proceedings were pending under this section at the beginning of the year. During the year one additional proceeding was instituted. The registration of the securities of one issuer was ordered suspended, and the proceedings in three cases were dismissed during the year, so that there were no proceedings pending at the close of the year.

UNLISTED TRADING PRIVILEGES ON EXCHANGES [2]

The early stock exchanges permitted trading in whatever securities were available. Any member could have any security added to those traded on the exchange merely by requesting its inclusion among the issues which in those days were called out one at a time for bids and offers. With the development of the exchanges as important securities markets, the rules for adding stocks and bonds to the list became more stringent, reaching the point where formal listing agreements and considerable financial information were required of the corporations whose issues were being listed. The practice continued, however, of permitting securities to be traded at the request of exchange members without the desire or agreement of the issuers. Such trading became known as "unlisted trading." None of it occurs on New York Stock Exchange. Most of the unlisted trading in issues which are nowhere listed occurs on New York Curb Exchange. Most of the regional exchanges confine their unlisted trading to issues listed on other exchanges plus a few of the leading unlisted New York Curb Exchange stocks. The Securities Exchange Act of 1934 prohibits the admission of any additional securities to unlisted trading on a stock exchange unless they are already listed on some registered exchange or unless investors have, respecting such securities, protections equivalent for those provided for in the act regarding listed securities.

Unlisted Trading on Registered Exchanges

At the close of the fiscal year, 541 listed stock issues aggregating 1,431,484,853 shares were admitted to unlisted trading on one or more exchanges other than those on which they were listed and 366 stock issues aggregating 362,908,213 shares, not listed on any registered exchanges, were admitted to unlisted trading.

The number of listed stock issues traded unlisted on other exchanges is about the same as it was 10 years ago, when it stood at 554, but the dispersion among exchanges is considerably greater. For example, one stock listed on 2 exchanges has been admitted to unlisted trading on 10 other exchanges, 5 of them since 1937.

[2] For comprehensive data with respect to the status of issues on exchanges, see appendix tables 12 through 19.

The number of stock issues not listed on any exchange which were nevertheless admitted to unlisted trading has decreased over 50 percent during the decade, from the 737 shown on p. 25 of our Third Annual Report to the current 366. The principal causes of this decrease were the listing of previously unlisted issues, retirement of New York Real Estate Exchange and Chicago Curb Exchange, retirement of preferred stocks, expiration of warrants, and sundry liquidations of companies.

Of the 366 stock issues (including 4 warrant issues) admitted only to unlisted trading, 291 were on New York Curb Exchange only, 13 were on that exchange and one or more exchanges outside New York, and 62 were on the latter (or "regional") exchanges only. Domestic corporations accounted for 271 of the issues, Canadian corporations for 65, and 30 were American depositary receipts for shares of foreign issues. Reported trading volume in the 366 issues for the 1946 calendar year was 53,481,177 shares, warrants, and depositary receipts. This consisted of 29,658,957 shares and 12,921,580 warrants in domestic issues; 7,961,740 shares in Canadian issues; and 2,938,900 American depositary receipts. The 4 warrant issues and 30 American depositary receipts were exclusively on New York Curb Exchange. Of the 2,938,900 reported trading volume in American depositary receipts, 2,360,100, or 80 percent, were of 1 issue, Burma Corp., Ltd. The 362,908,213 shares comprising the 366 issues were about 12 percent of the entire 3,031,265,525 shares admitted to trading on the registered exchanges.

The decrease in bonds admitted to unlisted trading on the exchanges over the last decade has been from 42 to 14 issues in the "also listed" category and from 550 to 97 issues in the "unlisted only" group. The total of 111 current issues aggregate somewhat less than $1,500,000,000 face value, and 102 of these issues are on New York Curb Exchange.

Applications for Unlisted Trading Privileges

Section 12 (f) (2) of the act provides that, upon application to and approval by the Commission, a national securities exchange may extend unlisted trading privileges to a security which is listed and registered on another national securities exchange. Pursuant to this section, and in accordance with the procedure prescribed by rule X-12F-1, applications were granted extending unlisted trading privileges to Boston Stock Exchange with respect to 9 stock issues; Cincinnati Stock Exchange, 21 stock issues; Detroit Stock Exchange, 27 stock issues; Philadelphia Stock Exchange, 6 stock issues; and San Francisco Stock Exchange, 8 stock issues and 1 bond issue. Three of these exchanges were permitted to withdraw applications involving five stock issues upon being advised that the applications did not meet the requirements prescribed by the rule. No applications were filed during the year under section 12 (f) (3).

During the year the Commission put into effect a simplified procedure to eliminate hearings on applications for unlisted trading privileges in cases where none of the interested parties or public investors desire a hearing. Upon the filing of an application the Commission now issues a notice which is served on the issuer and the exchanges concerned, published in the Federal Register, and released to the press for the information of the public. The notice states that

the Commission will hold a hearing on the matter only if requested by any interested party. The notice further provides that, if no one requests a hearing, the application will be determined by the Commission on the basis of the facts stated in the application and on other information contained in the Commission's files.

Changes in Securities Admitted to Unlisted Trading Privileges

During the year the exchanges filed numerous notifications pursuant to rule X-12F–2 (a) of changes in the title, maturity, interest rate, par value, dividend rate, or amount authorized or outstanding of securities admitted to unlisted trading privileges. Where changes of this nature only are effected in an unlisted security, the altered security is deemed to be the security previously admitted to unlisted trading privileges and such privileges are automatically extended to the altered security. However, when changes more comprehensive than these are effected in an unlisted security, the exchange is required to file an application with the Commission, pursuant to rule X-12F–2 (b), seeking a determination that the altered security is substantially equivalent to the security previously admitted to unlisted trading privileges. Applications filed pursuant to this rule were granted by the Commission with respect to one stock issue on Baltimore Stock Exchange, three stock issues on Boston Stock Exchange, six stock issues on New York Curb Exchange, and one stock issue on Philadelphia Stock Exchange. The Philadelphia Stock Exchange was permitted to withdraw an application involving one stock issue upon being advised by the Commission that the application would be denied.

DELISTING OF SECURITIES FROM EXCHANGES

Securities Delisted by Application

Section 12 (d) of the act provides that upon application by the issuer or the exchange to the Commission, a security may be removed from listing and registration on a national securities exchange in accordance with the rules of the exchange and subject to such terms as the Commission deems necessary for the protection of investors. In accordance with the procedure prescribed by rule X-12D2–1 (b), 18 issues were removed from listing and registration on exchanges during the year. Of these, 4 issues were removed upon application of their issuers and the remaining 14 upon application of exchanges. In each of these instances the application was granted without the imposition of any terms by the Commission.

Of the four issues removed upon application of their issuers, one had never been actively traded on the exchange involved and the holders of substantially all of the outstanding shares had assented to the delisting; the issuer of one had been inactive since 1935, a large percentage of the outstanding shares was held by an officer of the company, and no exchange transactions had occurred in the issue for over 4 years; the remaining two issues had become very closely held and the small number of shares outstanding in public hands did not justify the continuance of an exchange market.

The removal of the 14 issues upon application of exchanges was occasioned by various events which had the effect of practically terminating public interest in the issues involved. These included situations where the issuer was in the process of liquidation, where the issue was greatly reduced in the amount outstanding, or where no

provision had been made for the issue under a plan of reorganization. In one instance the issue had been approved for listing by the exchange on the condition of submission of evidence of its satisfactory distribution. However, the distribution was not effected and the exchange never admitted the issue to trading.

Another exchange application was that of the New York Curb Exchange to strike from listing the $1 par value capital stock of Standard Silver-Lead Mining Co. This security had been listed and traded on the exchange since 1911. While small dividends had been paid as recently as 1937, the company's principal mines had been closed down and new ventures which it had undertaken had not been successful, with the result that the corporation had operated at a loss for the years 1938 to 1945, inclusive. Despite the absence of any favorable prospects for future earnings or dividends and although the stock had sold at prices below $1 a share during all the years from 1929 to 1944, it became the subject of wide speculation in 1945 and 1946 and reached a price of $4.25 per share. Since the corporation was practically dormant and had current liabilities greatly exceeding its current assets, the exchange felt that it was not in the public interest to continue the exchange market. The application to strike this security from listing and registration was granted.

The simplified procedure on unlisted trading applications, described in the preceding section, is being followed also in suitable delisting cases.

Securities Delisted by Certification

Securities which have been paid at maturity, redeemed, or retired in full, or which have become exchangeable for other securities in substitution therefor, may be removed from listing and registration on a national securities exchange upon the exchange's filing with the Commission a certification to the effect that such retirement has occurred. The removal of the security becomes effective automatically after the interval of time prescribed by rule X-12D2–2 (a). The exchanges filed certifications under this rule effecting the removal of 313 separate issues. In some instances the same issue was removed from more than one exchange, so that the total number of removals, including duplications, was 343. Successor issues to those removed became listed and registered on exchanges in many instances.

In accordance with the provisions of rule X-12D2–1 (d), New York Curb Exchange removed eight issues from listing and registration when they became listed and registered on New York Stock Exchange. This rule permits a national securities exchange to remove a security from listing and registration in the event trading therein has been terminated pursuant to a rule of the exchange which requires such termination due to the security's becoming listed and registered and admitted to trading on another exchange. Removal under this rule is automatic, the exchange being required merely to notify the Commission of the removal.

Securities Removed From Listing on Exempted Exchanges

A security may be removed from listing on an exempted exchange upon the filing by such exchange of an appropriate amendment to its exemption statement setting forth a brief statement of the reasons for the removal.

During the year two exchanges removed five issues from listing thereon. Three of these issues had been called for redemption and two had become exchangeable for new securities under plans of recapitalization.

Exempted Securities Removed From Exchange Trading

During the year New York Stock Exchange removed from trading two issues which had been temporarily exempted from the registration requirements of section 12 (a) of the act pursuant to rule X-12A-2. One of these issues had become exchangeable for cash and other securities under a plan of reorganization and the other issue had been paid at maturity.

MANIPULATION AND STABILIZATION

Manipulation

In its administration of the provisions of the Securities Exchange Act relating to the manipulation of securities markets, the Commission's policy is to attempt to detect manipulative practices at their inception, before the public has been harmed. At the same time, it seeks to avoid interfering with the legitimate functioning of the securities markets. In brief, the Commission's investigations in this area take two forms. The "flying quiz," or preliminary investigation, is designed to detect and discourage incipient manipulation by a prompt determination of the reason for unusual market behavior. If a legitimate reason for the activity is uncovered, the case is closed. If more extended investigation seems required, a formal order is sought of the Commission under which members of the staff are empowered to subpena pertinent material and take testimony under oath. These formal investigations often cover substantial periods of time, and trading operations involving large quantities of shares are carefully scrutinized.

The Commission keeps confidential the fact that any security is under investigation so that the market in the security may not be unduly affected or reflections be unfairly cast upon individuals or firms whose activities are being investigated. As a result, the Commission occasionally receives criticism for failing to investigate situations when, in fact, it is actually engaged in an intensive investigation of those very matters.

A tabular summary with respect to the Commission's trading investigation follows:

Trading investigations

	Flying quizzes	*Formal investigations*
Pending June 30, 1946	245	31
Initiated July 1, 1946 to June 30, 1947	66	5
Total to be accounted for	311	36
Changed to formal investigations	4	--
Closed or completed [1]	216	2
Total disposed of	220	2
Pending June 30, 1947	91	34

[1] Includes reference of cases to the Department of Justice or to a national securities exchange for their action.

Stabilization

During the 1947 fiscal year the Commission continued the administration of rules X-17A–2 and X-9A6–1. Rule X-17A–2 requires the filing of detailed reports of all transactions incident to offerings in respect of which a registration statement has been filed under the Securities Act of 1933 where any stabilizing operation is undertaken to facilitate the offering. Rule X-9A6–1 governs stabilizing transactions in securities registered on national securities exchanges, effected to facilitate offerings of securities so registered, in which the offering prices are represented to be "at the market" or at prices related to market prices.

Of the 567 registration statements filed during the 1947 fiscal year, 317 contained a statement of intention to stabilize to facilitate the offerings covered by such registration statements. Because a registration statement sometimes covers more than one class of security, there were 362 offerings of securities in respect of which a statement was made as required by rule 827 under the Securities Act to the effect that a stabilizing operation was contemplated. Stabilizing operations were actually conducted to facilitate 83 of these offerings. In the case of bonds, public offerings of $160,942,300 principal amount were stabilized. Offerings of stock issues aggregating 11,870,892 shares and having an estimated aggregate public offering price of $418,243,102 were also stabilized. In connection with these stabilizing operations 12,103 stabilizing reports were filed with the Commission during the fiscal year. Each of these reports has been analyzed to determine whether the stabilizing activities were lawful.

To facilitate compliance with the Commission's rules on stabilizing and to assist issuers and underwriters to avoid violation of the statutory provisions dealing with manipulation and fraud, many conferences were held with representatives of such issuers and underwriters, and many written and telephone requests were answered. A total of 1,531 letters and memoranda of such conference and telephone requests and memoranda to the regional offices of the Commission were written in connection with the administration and enforcement of the stabilization and manipulation statutory provisions and regulations.

SECURITY TRANSACTIONS OF CORPORATION INSIDERS

Sections 16 (a) of the Securities Exchange Act of 1934, 17 (a) of the Public Utility Holding Company Act of 1935, and 30 (f) of the Investment Company Act of 1940 require that corporation "insiders" file reports of certain transactions in the securities of their companies. These reports are required to be filed by every beneficial owner of more than 10 percent of any equity security listed on a national securities exchange and by every officer and director of the issuer of any equity security so listed; every officer or director of a registered public utility holding company; and every officer, director, beneficial owner of more than 10 percent of any class of security (other than short-term paper), member of an advisory board, investment adviser or affiliated person of an investment adviser of a registered closed-end investment company. There must be filed an initial report showing beneficial ownership, both direct and indirect, of the company's securities when one

of these relationships is assumed and a report must be filed for each month thereafter in which any purchase or sale, or other change in such ownership occurs, setting forth in detail each such change, on or before the tenth day following the month in which it occurs.

The staff examines all reports filed to determine whether they comply with applicable requirements. Where inaccuracies or omissions appear amended reports are requested. The reports are available for public inspection from the time they are filed. However, it is manifestly not possible for many interested persons to inspect these reports at the Commission's central office, or at the exchanges where additional copies of section 16 (a) reports are also filed. The Commission therefor publishes a monthly official summary of security transactions and holdings which is widely distributed among individual investors, brokers and dealers, newspaper correspondents, press services and other interested persons. Files of this summary are maintained at each of the Commission's regional offices and at the offices of the various exchanges. The nature and value of these summaries is indicated by the fact that during the past 13 years 41,327 persons have filed 272,450 reports with the Commission.

Preventing Unfair Use of Inside Information

For the further purpose of preventing the unfair use of information which may have been obtained by the corporation insider by reason of his confidential relationship to his company, section 16 (b) of the Securities Exchange Act provides that any profit he realizes from any purchase and sale, or any sale and purchase, of any equity security of the company within any period of less than 6 months shall be recoverable by the issuer, or by any security holder acting in its behalf if the issuer fails or refuses to bring suit for recovery within 60 days after request or fails diligently to prosecute the suit after it is instituted. Corresponding provisions are contained in section 17 (b) of the Public Utility Holding Company Act of 1935 and section 30 (f) of the Investment Company Act of 1940. The Commission is not charged with the enforcement of the civil remedies created by these various provisions, but has filed briefs as amicus curiae in several suits brought by private persons.

Ownership reporting provisions of these acts have enabled issuers and public stockholders in some instances to recover substantial profits which had been realized by insiders in short-term trading. In a number of other cases, the Commisison has been informed of the voluntary payment to the companies of short-term profits realized by insiders. Such repayments were often brought about by the necessity to report short-term transactions.

Statistics of Ownership Reports

The number of ownership reports filed with and examined by the Commission during the past fiscal year is set forth below.

Of the total number of reports filed during the year approximately 18,500 reports were filed under the Securities Exchange Act, 1,000 with respect to investment companies, and 500 identified with utility companies—or in the proportions of about 92, 5 and 3 percent respectively.

Number of ownership reports of officers, directors, principal security holders, and certain other affiliated persons filed and examined during the fiscal year ended June 30, 1947

Description of report [1]	Original reports	Amended reports	Total
Securities Exchange Act of 1934:			
Form 4	14,842	725	15,567
Form 5	787	18	805
Form 6	2,197	51	2,248
Public Utility Holding Company Act of 1935:			
Form U-17-1	75	1	76
Form U-17-2	456	21	477
Investment Comapny Act of 1940:			
Form N-30F-1	109		109
Form N-30F-2	761	46	807
Total	19,227	862	20,089

[1] Form 4 is used to report changes in ownership; form 5, to report ownership at the time any equity securities of an issuer are first listed and registered on a national securities exchange; and Form 6, to report ownership of persons who subsequently become officers, directors, or principal stockholders of such an issuer, under section 16 (a) of the Securities Exchange Act of 1934; form U-17-1 is used for initial reports and form U-17-2 for reports of changes in ownership of securities, under section 17 (a) of the Public Utility Holding Company Act of 1935; and form N-30F-1 is used for initial reports and form N-30F-2 for reports of changes in ownership of securities under section 30 (f) of the Investment Company Act of 1940.

SOLICITATION OF PROXIES, CONSENTS, AND AUTHORIZATIONS

Under three of the acts it administers—sections 14 (a) of the Securities Exchange Act of 1934, 12 (a) of the Public Utility Holding Company Act of 1935 and 20 (a) of the Investment Company Act of 1940—the Commission is authorized to prescribe rules and regulations concerning the solicitation of proxies, consents, and authorizations in connection with securities of the companies subject to those acts. Pursuant to this authority, the Commission has adopted regulation X–14, which is designed to protect investors by requiring the disclosure of certain information to them and by affording them an opportunity for active participation in the affairs of their company. Essentially, this regulation makes unlawful any solicitation of any proxy, consent or authorization which is false or misleading as to any material fact or which omits to state any material fact necessary to make the statements already made not false or misleading. Under the regulation it is necessary, in general, that each person solicited be furnished such information as will enable him to act intelligently upon each separate matter in respect of which his vote or consent is sought. The proxy rules set forth in this regulation also contain provisions which enable security holders who are not allied with the management to communicate with other security holders when the management is soliciting proxies.

During the past fiscal year the Commission received and examined under regulation X–14 both the preliminary and definitive material required with respect to 1,677 such solicitations as well as "follow up" material employed in 303 instances.

This proxy examination work is seasonal. Approximately 72 percent of all proxy statements filed during any year are for stockholder meetings held in the 3-month period from March to May; about 10 percent are for meetings in the fourth week of April; and about 5 percent, or one in every 20, are for meetings held on one particular day, the fourth Tuesday in March.

According to a study recently made by the staff of the proxy statements filed under regulation X–14 during the calendar years 1943, 1944, 1945, and 1946, the prinicpal items of business for which stockholder action was sought were as follows:

	Year ended December 31—			
	1943	1944	1945	1946
Proxy statements filed by management	1,467	1,523	1,570	1,664
Proxy statements filed by others than management	31	27	24	21
Total proxy statements filed	1,498	1,550	1,594	1,685
For meetings at which the election of directors was one of the items of business	1,368	1,350	1,350	1,407
For meetings not involving the election of directors	109	172	213	244
For assents and authorizations not involving a meeting or the election of directors	21	28	31	34
Total proxy statements filed	1,498	1,550	1,594	1,685

The items of business other than that of election of directors were distributed among specific proposals of action as follows:

	Year ended December 31—			
	1943	1944	1945	1946
Mergers, consolidations, acquisition of businesses, and purchase and sale of property	47	59	40	65
Issuance of new securities, modification of existing securities, recapitalization plans other than merger or consolidation	95	144	227	249
Employees pension plans	46	105	94	75
Bonus and profit-sharing plans, including stock options	51	58	51	52
Indemnification of officers and directors	137	31	25	36
Change in date of annual meeting	54	33	33	28
Other miscellaneous amendments to bylaws, and miscellaneous other matters (renegotiation, investment policy, V and V–T loans)	131	141	217	309
Stockholder approval of independent auditors	307	310	296	304
Number of management's proxy statements containing stockholder proposals under rule X–14A–7	27	20	14	19
Number of such stockholder proposals	66	38	34	34
Net number of stockholders whose proposals were included in management's proxy statements under rule X–14A–7 (each stockholder is counted only once in each year regardless of the number of his proposals or the number of companies that included his proposals in proxy statements)	19	17	17	9

It might be helpful to describe by way of illustration the disclosure resulting from examination of the proxy solicitation material intended to be used in a particular case. In connection with the solicitation of proxies by a cement producing company, the change in the position of preferred stockholders which would result from a proposed recapitalization was not clearly set forth in the first instance. As originally drafted the proposed plan, which would have forced preferred stockholders to give up substantial rights to the benefit of common stockholders, including members of the management group, was not clearly or adequately described.

Following the Commission's insistence that complete disclosure be made in the proxy soliciting material of the effect of the plan—particularly with respect to the prior position of the preferred as to assets and earnings and as to the earnings record of the company which would show that dividends on the preferred stock had been earned in many years but not paid, while substantial sums were being

used to purchase the preferred at depressed prices—the company elected to modify the plan so as to offer more favorable terms to the preferred stockholders. Hence, as a result of the disclosure demanded, the preferred stockholder received a plan much more equitable to his interest.

REGULATION OF BROKERS AND DEALERS IN OVER-THE-COUNTER MARKETS

Registration

Brokers and dealers using the mails or other instrumentalities of interstate commerce to effect transactions in securities on over-the-counter markets are required to be registered with the Commission pursuant to section 15 (a) of the Securities Exchange Act, except for those brokers and dealers whose business is exclusively intrastate or exclusively in exempt securities. The following table contains pertinent data with respect to the registration of brokers and dealers during the 1947 fiscal year:

Registration of brokers and dealers under section 15 (b) of the Securities Exchange Act for the 1947 fiscal year

Effective registrations at close of preceding fiscal year	4132
Effective registrations carried as inactive	[1] 80
Registrations placed under suspension during preceding fiscal year	0
Applications pending at close of preceding fiscal year	43
Applications filed during fiscal year	482
Total	4737
Applications withdrawn during year	10
Registrations withdrawn during year	537
Registrations canceled during year	53
Registrations denied during year	1
Registrations suspended during year	0
Registrations revoked during year	11
Registrations effective at end of year	4011
Registrations effective at end of year carried as inactive	[1] 74
Applications pending at end of year	40
Total	4737

[1] These are carried as inactive because of the inability to locate the registrants despite careful inquiry. Six such registrations were canceled, withdrawn, or restored to active status during the year.

Broker-Dealer Inspections

During the 1947 fiscal year a total of 587 broker-dealer inspection reports were received from the Commission's regional offices. These inspections are undertaken pursuant to section 17 of the Securities Exchange Act for the purpose of determining whether registrants are in compliance with the requirements of law.

Ninty-four inspections reflected unsatisfactory financial conditions requiring immediate corrective action or continued surveillance. The high ratio of inspections in which unsatisfactory financial conditions were revealed is due largely to the fact that a substantial number of special inspections were undertaken to test financial condition following the September 1946 break in the market. In 131 inspections the reports disclosed transactions at prices so different from prevailing market prices as to raise some question as to the fair treatment of

customers. In 133 inspections the reports contained information indicating noncompliance with provisions of regulation T relating to the extension of credit. In 13 inspections questions were raised concerning improper hypothecation and commingling of customers' securities. In nine inspections it was discovered that firms took secret profits in agency transaction by misrepresenting prices at which customers' orders had been executed.

As has been explained in previous annual reports, efforts are made to determine whether infractions are the result of carelessness or represent a policy of indifference or willfulness on the part of responsible management. It is the Commission's established policy to call minor infractions to the attention of the firm at the time of the inspection so that corrective measures may be taken immediately. This of course necessitates a subsequent check-up in order to determine whether the promised corrections have been effected. However, when acts and practices are discovered which represent such substantial harm to customers that action by the Commission may be appropriate, inquiry or investigation beyond the scope of the inspection is undertaken. During the 1947 fiscal year, 43 inspections resulted in such inquiry or investigation.

Administrative Proceedings

A summary of the administrative proceedings instituted by the Commission during the 1947 fiscal year with respect to brokers and dealers is given below.

Record of broker-dealer proceedings and proceedings to suspend or expel from membership in a national securities association instituted pursuant to sec. 15 of the Securities Exchange Act of 1934

Proceedings on revocation of registration pending at beginning of fiscal year	2
Proceedings on revocation of registration and suspension or expulsion from NASD pending at beginning of fiscal year	4
Proceedings on denial of registration pending at beginning of fiscal year	2
Proceedings on question of terms and conditions on withdrawal of registration pending at beginning of fiscal year	1
Proceedings ordered during year on revocation of registration	15
Proceedings ordered during year on revocation of registration and suspension or expulsion from NASD	3
Proceedings ordered during year on denial of registration	2
Total	29

Revocation proceedings dismissed, withdrawal of registration being permitted or registration canceled	5
Revocation proceedings dismissed, registration continued in effect	1
Denial proceedings dismissed, withdrawal of application being permitted	1
Denial proceedings resulting in registration under terms and conditions	1
Proceedings discontinued on question of imposing terms and conditions on withdrawal, withdrawal being permitted	1
Registration denied	1
Registration revoked	10
Registration revoked and firm expelled from NASD	1
Firms suspended from membership in NASD	1
Revocation proceedings pending at end of fiscal year	4
Revocation proceedings and proceedings to expel or suspend from NASD pending at end of fiscal year	2
Denial proceedings pending at end of fiscal year	1
Total	29

In proceedings against Ira Haupt & Co., the Commission held that the brokerage exemption provided by section 4 (2) of the Securities Act of 1933 was inapplicable to a distribution on an exchange by an underwriter acting for a controlling person.[3] The proceeding was instituted to determine whether the firm had willfully violated section 5 (a) of the Securities Act. The violation arose out of the firm's sale for the account of the "Schulte interests" (consisting of David A. Schulte, a corporation controlled by Schulte, and the David A. Schulte Trust) of approximately 93,000 shares of the common stock of Park & Tilford, Inc., from November 1, 1942, to June 1, 1944. The securities so offered were not registered under the Securities Act.

The firm contended that its transactions in the Park & Tilford stock for the account of the Schulte interests did not constitute a violation of section 5 (a) because of the applicability to such transactions of certain exemptions provided by sections 3 (a) (1), 4 (1) and 4 (2) of the Securities Act. In its opinion, the Commission rejected these claims to exemption and found that the firm was an underwriter within the meaning of section 2 (11) of the Securities Act since, upon the stipulated facts, the firm had effected a public distribution of the common stock of Park & Tilford for the Schulte interests, which concededly controlled 90 percent of the Park & Tilford outstanding common stock. The Commission cited the legislative history of the act to show that it was the intention of Congress to require registration in connection with secondary distributions through underwriters by controlling stockholders. It pointed out that while "distribution" is not defined in the act, it has been held to comprise "the entire process by which in the course of a public offering a block of securities is dispersed and ultimately comes to rest in the hands of the investing public." Having found that the firm acted as an underwriter in connection with the distribution of the Park & Tilford stock to the public, the Commission concluded that the distribution of a controlling block of stock is a new offering and that the exemptions of section 3 (a) (1) and the third clause of section 4 (1) were not applicable to such transactions.

The Commission further found that the brokerage exemption provided by section 4 (2) is not available to an underwriter who effects a distribution of an issue for the account of a controlling stockholder through the mechanism of a stock exchange. It pointed out the distinction between "trading" and "distribution." The opinion holds that section 4 (2) permits individuals to sell their securities through a broker in an ordinary brokerage transaction but that the process of distribution itself, however carried out, is subject to section 5.

While concluding that the firm's violations were willful, the Commission did not find that revocation of registration or expulsion from the exchange was necessary in the public interest, but held that it was appropriate in the public interest to suspend the firm from membership in the National Association of Securities Dealers, Inc., for a period of 20 days.

The revocation proceedings against Behel, Johnsen & Company, Inc., Chicago, Ill., involved a pattern of trading which the Commission, in its opinion and findings, described as "churning."[4] Three

[3] Securities Exchange Act Release No. 3845 (1946).
[4] Securities Exchange Act Release No. 3967 (1947).

women customers, who opened their accounts with registrant in May and June 1942, owned securities with an aggregate market value of $54,008. These securities and subsequent cash contributions made their total net investment $61,731. The pattern followed in these accounts was one of simultaneous sale and purchase of securities at short intervals. Registrant used the proceeds from the sale of the customers' securities to purchase, purportably for its own account, securities which it had recommended to the customers, and then sold such securities to the customers at a profit, confirming as a "principal" in the transaction.

As a result of this course of dealing, from May 18, 1942, to May 7, 1945, the three women were induced to sell, in a series of 130 transactions, securities with a market value of $266,727 and to "purchase from" the registrant, in a series of 143 transactions, securities that had cost the firm $274,451. Approximately 61 percent of the securities sold by the registrant to these customers were held by them for less than 6 months and 86 percent were held for less than 1 year. Over the course of the 3-year period, the capital in these three accounts, as measured by the average of the market value of the opening and closing of the portfolio plus the additional cash invested, was turned over approximately four and one-half times. From the trading activity deliberately created in these three accounts, registrant realized gross profits of $18,879, representing more than one-third of its total gross profit during the period under consideration, while on the other hand the customers benefited only to the extent of an increase of $2,400 in the aggregate market value of their security holdings at the end of the period over the value of those held at the beginning of the period.

Noting that the three women customers were all uninformed as to securities, relying completely on registrant's advice in determining the course of their transactions, and that the registrant's position was one of trust, its undertaking and obligation being to treat these accounts as investment accounts, the Commission reprehended as a vicious and fraudulent course of conduct registrant's practice of "churning" the accounts by inducing a great number of transactions and successive turn-overs of the portfolio solely for the purpose of its own gain and to the substantial detriment of the customers. The Commission pointed out that the registrant's practice of confirming "as principal" where orders given by customers were filled by means of purchases purportably made for the firm's own account facilitated perpetration of the type of fraud represented in this proceeding. By confirming "as principal," the firm made no disclosure of either the commission or profit derived from the operations effected in the customer's account. The Commission found on the foregoing admitted facts that registrant had willfully violated section 17 (a) of the Securities Act of 1933 and sections 10 (b) and 15 (c) (1) of the Securities Exchange Act and rules X-10B–5 and X-15C1–2 (a) and (b) adopted thereunder. The Commission concluded that it was in the public interest to revoke the registration of registrant and to expel it from membership in the NASD.

During the current year, the Commission instituted revocation proceedings against nine registered broker-dealers who had failed to submit yearly reports of their financial condition to the Commission as

required by rule X-17A–5 promulgated under section 17 (a) of the Securities Exchange Act.[5] These cases are of interest because they were the first in which the Commission has sought to revoke registration solely for the violation of this rule. The Commission noted in its opinions in these proceedings that the promulgation of rule X-17A–5 was announced by publication in the Federal Register, by releases to the public press, and by distribution to the persons on its mailing list, which included these nine registrants. In addition, letters were sent to these registrants reminding them of the necessity for filing reports of financial condition as required by the rule.

As to whether the violation commonly involved in these proceedings was willful, the Commission observed that had these registrants acquired knowledge of the requirement, their failure to comply with it could hardly be otherwise than willful; that under the circumstances, ignorance of the requirements of the rule would appear to have been the result of deliberate indifference to obligations imposed upon them by their status as registered broker-dealers; and that their conduct in placing themselves out of reach of communication from the Commission amounted to such a disregard of the duty inherent in their licensed status to keep informed of the legal requirements attached to that status as to make their violation of rule X-17A–5 "willful" within the meaning of that term as used in section 15 (b) of the Securities Exchange Act.

In four of these cases, namely, Wayne Lloyd Morgan, Julius Guttag, Henry Leach, and Sylvan Perry Spies, the Commission, finding that the public interest and the protection of investors would be adequately served by withdrawal rather than revocation, permitted such registrants to withdraw their registrations. The Commission, however, found that it was necessary in the public interest to revoke the registrations of Ray Murphy, David Heffler, Robert Charles Johnson, Earl P. Corley, and Charles Fletcher Baxter.

The proceedings which the Commission instituted against M. S. Wien & Co. were based upon charges of manipulation of the market, fraudulent misrepresentations, and nondisclosure of material facts in connection with certain purchases and sales in the over-the-counter market of the 5 percent income debentures of 1968 of the Phoenix Silk Corporation.[6]

Under consideration of an extensive record the Commission concluded that the firm had made misrepresentations and material omissions in connection with these transactions, thereby willfully violating sections 10 (b) and 15 (c) (1) of the Securities Exchange Act and rules X-10B–5 and X-15C1–2 thereunder. Holding that the firm must be held responsible for the violations, the Commission found that it was in the public interest that its broker-dealer registration be revoked and that it be expelled from membership in the NASD. The

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[5] *Wayne Lloyd Morgan, d/b/a W. L. Morgan.* Proceedings to revoke registration instituted July 10, 1946. Order dismissing proceedings and permitting withdrawal, July 23, 1946.
See the following Securities Exchange Act Releases:
Ray Murphy, No. 3857 (1946);
Julius Guttag, d/b/a Guttag Bros., No. 3893 (1946);
David Heffler, d/b/a D. Heffler Company, No. 3879 (1946);
Robert Charles Johnson, d/b/a H. C. Johnson Company, No. 3878 (1946);
Henry Leach, No. 3877 (1946);
Sylvan Perry Spies, d/b/a Sylvan Perry Co., No. 3900 (1947);
Earl P. Corley, No. 3880 (1946);
Charles Fletcher Baxter, d/b/a Charles F. Baxter and Associates, No. 3901 (1947).

[6] Securities Exchange Act Release No. 3855 (1946).

opinion, however, noted that the culpability rested chiefly on Lann, one of the partners who was personally in charge of the trading and made all the representations respecting the debentures. Finding further that there was nothing in the record to show that the other partners knew of or acquiesced in any of the misrepresentations or omissions made by Lann in connection with the activities in the debentures, the Commission provided in its order that the revocation of the firm's registration should be without prejudice to the right to reapply for registration after 30 days from the effective date of the order if by that time Lann should have withdrawn from the firm and become disassociated from its business. Lann, as an aggrieved person, filed a petition on December 30, 1946, with the Circuit Court of Appeals for the District of Columbia Circuit, for review of the Commission's order, and the review was still pending at the close of the fiscal year.

When Lawrence R. Leeby, who proposed to do business as a sole proprietor under the name of Lawrence R. Leeby & Co., applied for registration as an over-the-counter broker, proceedings were instituted to determine whether it was in the public interest to deny such registration.[7] Leeby's registration as a broker and dealer had been revoked by the Commission in 1943 for violation of section 17 (a) of the Securities Act of 1933 upon a finding by the Commission that he had sold numerous oil royalties to two customers at exceedingly high mark-ups over contemporaneous wholesale costs, the sales being confirmed to the customers as principal transactions although the evidence showed that Leeby was charged with the high fiduciary duties of an agent. The Commission found that in these circumstances he violated his fiduciary duties in taking secret profits. Moreover, viewed even as principal transactions, the Commission found the mark-ups taken in such transactions were excessive and fraudulent.

Leeby's application for registration stated that he intended to engage in business only as a broker and at the hearing in the denial proceedings he testified that he proposed to charge commissions previously agreed upon with his customers and comparable to those charged in similar transactions by members of exchanges. It was the opinion of the Commission that such proposed plan of operation afforded a promise that there would be no repetition of the taking of excessive profits and the failure to reveal such profits which resulted in the earlier revocation of Leeby's registration. Leeby further testified that he proposed to amend his application to indicate that he would engage in transactions as a dealer in investment trust shares, which transactions would be limited to securities registered with the Commission which he would purchase from the underwriters and sell through the use of the prospectus filed with the Commission. In considering this amendment to his application, the Commission noted that in such transactions Leeby would be limited to the dealer discount set forth in the prospectus and that the disclosure of such discount would tend to prevent recurrence of the improper practices engaged in by Leeby in the sale of oil royalties.

Upon further findings that Leeby had been employed as a salesman by several firms since his revocation as a registered broker and dealer, that the schedule of his transactions as a salesman for one firm by

[7] Securities Exchange Act Release No. 3863 (1946). The proceedings by Leeby for admission to membership in the NASD are discussed at p. 54.

which he had been employed for a considerable period disclosed that the dealer transactions in over-the-counter securities had been effected by him for the firm at prices not unreasonably related to the current market quotations, and that letters had been supplied by brokerage firms and individuals testifying to his good reputation and standing, the Commission concluded that it was not necessary in the public interest to deny Leeby's application for registration as a broker and, after appropriate amendment of his application, as a dealer in investment company shares. The Commission made it clear, however, that it was permitting his registration to become effective subject to the condition that his activities were limited to those in which he represented he would engage and that a finding that he had departed from such limitations would subject his registration to revocation.

Special Financial Reports of Brokers and Dealers

On September 30, 1946, the Commission issued a call upon registered brokers and dealers and members of national securities exchanges to file an abbreviated financial report as of September 30.[8] A total of 3,595 notices were sent out and 2,930 reports were received. An analysis of the reports disclosed that in the main the net capital of brokerage firms appeared to be adequate and in compliance with rule X-15C3–1 as of September 30. Less than 3 percent disclosed financial conditions requiring prompt correction. A number of the firms whose financial condition was unsatisfactory reduced their inventories, reduced their indebtedness, or introduced new capital to meet the requirements of the rule. There were other circumstances in which firms divested themselves of customers' cash and securities and transferred them to other accounts in which credit was extended, thereby becoming exempt from the rule. While the staff of the Commission indicated that the industry withstood the September market break remarkably well, its analysis of the September 30 financial reports has raised some question as to the adequacy of the protection which the rule in its present form provides.

SUPERVISION OF NASD ACTIVITY

Membership

Membership in the National Association of Securities Dealers, Inc. (NASD), the only national securities dealers association registered with the Commission, increased during the year by 100 to stand at 2,614 on June 30, 1947. On that date, 25,573 individuals connected with member firms in capacities which involved doing business directly with the public were registered with the association as registered representatives. These include partners, officers, traders and salesmen.

Disciplinary Actions

The NASD reported to the Commission in the 1947 fiscal year final action on eight disciplinary cases in which formal complaints had been filed against members. In five of these cases the appropriate district business conduct committee found the firms in violation of the NASD rules of fair practice and imposed fines, in amounts ranging

[8] The New York Stock Exchange had already issued a call upon its members to file September 30 reports with the Exchange and had agreed to make these reports available to the Commission. Consequently New York Stock Exchange firms were exempted from the Commission's call.

from $200 to $1,100, aggregating $2,135. In another case, a firm employee, who had been cited as a respondent in a complaint together with his employing firm, had his registration as a registered representative revoked on a finding that he had misappropriated customers' funds and securities.[9] Restitution in full was effected. The complaint was dismissed as to the employing firm on a finding that it had no knowledge of the employee's improper activities. In the two remaining formal complaints the board of governors, in a review capacity, reversed findings of violations by the district business conduct committee of original jurisdiction and dismissed the complaints against the firms involved.

The Commission continued its practice of referring to the NASD, for appropriate action by the NASD, facts concerning the business practices of members where there was some indication of a possible violation of the NASD rules of fair practice. Seven such references were made during the 1947 fiscal year and seven other cases were pending at the start of the year. By June 30, 1947, the NASD reported the disposition of 13 of these 14 cases. Three resulted in formal complaint procedures, as reported above, in which violations were found and fines imposed on the members concerned. In 9 other instances, the district business conduct committees held informal discussions with the members involved, but took no formal action. In the remaining case, the firm cited retired from business at about the time the reference was made and the NASD permitted the resignation to become effective.

Commission Review of Disciplinary Action and of Denial of Membership

By the provisions of section 15 A (g) of the Securities Exchange Act, any disciplinary action by the NASD against a member or denial of membership to any applicant is subject to review by the Commission on application by an aggrieved party. Three such cases were decided by the Commission during the year.

As indicated in the Twelfth Annual Report there was before the Commission at the close of the 1946 fiscal year an appeal proceeding to review disciplinary action by the NASD against the Washington, D. C., office of Herrick, Waddell & Co., Inc. The NASD district business conduct committee, after the filing of a complaint and a hearing, concluded that prices charged customers by the firm were not reasonably related to the market and that the firm's conduct in these transactions was in violation of the NASD rules of fair practice. As a penalty, the firm was censured and directed to pay costs in the amount of $250. This decision was appealed by the firm to the board of governors where, by a tie vote, it was affirmed.

The issue before the Commission was whether there had been a violation of the NASD's interpretations governing the amount of mark-up over market which a member firm may charge in the sale of a security to a customer. The basic facts were not in dispute and no claim was made that, if a violation had occurred, the penalty was excessive. There was no charge of fraud involved in the case. The NASD findings were based in part on an exhibit showing that the gross profit received by Herrick, Waddell & Co., Inc., in 39 transactions ranged from 4.2 percent to 11.4 percent over cost price. In most pur-

[9] This is the first disciplinary case in which a complaint was directed against a registered representative under the procedure adopted effective January 15, 1946.

chases by customers, the firm purported to act as principal, executing customers' purchase orders in so-called riskless transactions, in which the firm purchased the security only after it had received the order from the customer and then billed the security to the customer at a stated mark-up over cost.

Evidence was introduced that it was general practice for the firm's salesman to inform the customer at the time the customer's order was accepted that the firm would act as principal and that the cost to the customer would include a mark-up over cost to the firm stated in points to the nearest one-eighth of a point. These disclosures, according to the evidence, were also made in writing by means of a confirmation sent to customers immediately after the firm's purchase for its own account and its concurrent sale to the customer. The firm contended that the relevant NASD rule was no broader than a prohibition against fraud which, it claimed, was obviated by the oral and written disclosures made to the customer.

The NASD argued and the Commission found that the NASD rules go beyond fraud, but the Commission concluded that the NASD findings were not supported by the evidence, and that the NASD had not properly applied its interpretations governing mark-ups.[10] The NASD had relied heavily upon evidence comparing the firm's mark-up policy with the practices of other firms in the District of Columbia. The Commission, however, held that this evidence did not provide a standard sufficiently clear to constitute a proper basis for a finding that the firm's mark-ups were unreasonable in their relationship to the market. The Commission also held that the NASD had not given proper weight to various other circumstances, including particularly the oral and written disclosures of the firm as to its capacity and amount of mark-up. The Commission disagreed with the NASD view that these disclosures were immaterial and emphasized that they are pertinent to the question of ethical conduct. The Commission remanded the record to the NASD for reconsideration consistent with the Commission's opinion. Subsequently the matter was reconsidered by the board of governors, which dismissed the complaint.

A case involving the "denial of membership" was decided on the issue whether Foelber-Patterson, Inc. was disqualified from membership in the NASD as a result of a Commission order issued in 1942 [11] revoking the registration of a broker-dealer firm in which Foelber and Patterson were officers, directors and shareholders. The Commission had granted Foelber-Patterson, Inc., registration as a broker-dealer in 1945, but subsequently, on application to the NASD for membership, the NASD denied admission on the grounds that Foelber and Patterson had been causes of the Commisison's order revoking the registration of Central Securities Corp., and that, notwithstanding the subsequent registration of Foelber-Patterson, Inc., the applicant was disqualified from membership and could be admitted only with the approval or at the direction of the Commission. The firm then filed with the Commission a petition for review of that action. The Commission held that when a broker-dealer whose registration has been revoked is subsequently permitted by the Commission to become registered, the disqualification is removed in that he is no longer subject

[10] Securities Exchange Act Release No. 3935 (1947).
[11] *Central Securities Corporation*, 11 S. E. C., 98.

to an order of revocation and, looking behind the corporate veil, held that the firm was not disqualified.[12] The Commission accordingly set aside the action of the NASD and required applicant's admission to membership.

Another "denial of membership" case arose on a petition filed by Republic Investment Co. requesting the Commission to review an NASD order denying applicant's admission to membership. The NASD had concluded that Republic Investment Co. was disqualified from membership because its president, A. Morris Krensky, had been a cause of the expulsion of Lowell Niebuhr & Co., Inc., by and from the NASD for violations of its rules of fair practice. Accordingly, Republic Investment Co. could be admitted only with the approval or at the direction of the Commission. The Commission, in its opinion, declared that it was unable to find any evidence in the record to support the conclusion that Krensky had knowledge of, or in any way participated in, the acts which led to the expulsion of Lowell Niebuhr & Co., Inc., or that he was a cause thereof within the meaning of section 15A (b) (4) of the Securities Exchange Act and the identical section 2 of article I of the NASD bylaws. The Commission further stated that "at the time those acts occurred, the record indicates that he (Krensky) actually had withdrawn from the firm." The Commission concluded that the applicant was not disqualified from membership and, by order, set aside the action of the NASD and required applicant's admission to membership.[13]

Commission Action on Petitions for Approval of or Continuation in Membership

In addition to the review of cases such as those cited above, a petition can be brought before the Commission under the provisions of section 15A (b) (4) of the Securities Exchange Act by or on behalf of a member of the NASD for the continuance of its membership when it proposes to take in a partner, officer, director or an employee who is himself disqualified from membership. In this type of action, the question before the Commission is whether it is in the public interest, in spite of the existence of valid disqualification, to approve the continuance of membership. Applications are directed in the first instance to the NASD. If the NASD acts favorably to the applicant, it so advises the Commission and becomes the petitioner. Under this circumstance, the Commission considers "approval" of the petition for admission to or continuance in membership. If the NASD rejects the application, the applicant may petition the Commission for an order "directing" the NASD to continue the petitioner in membership. In the last year, three "approval" petitions were filed by the NASD on behalf of members. Action was taken by the Commission as to two of these petitions and the third, which was pending at June 30, 1947, was subsequently withdrawn.

At the close of the 1946 fiscal year there was before the Commission a petition filed by the NASD on behalf of Greene & Co. applying for Commission approval of the continuance of Greene & Co. in membership with W. F. Thompson acting as a partner or as an employee of the firm. Thompson had been one of two partners of W. F. Thompson & Co., which, in 1942, had been found by the NASD to

[12] Securities Exchange Act Release No. 3847 (1946).
[13] Securities Exchange Act Release No. 3866 (1946).

have violated certain of its rules and to have been guilty of conduct inconsistent with just and equitable principles of trade. The firm was expelled from the NASD and fined $1,200. Subsequently, Thompson was employed by Greene & Co. The NASD acted favorably on the firm's application for continuance of membership and the petition before the Commission was filed by the NASD on behalf of the firm. After hearings were held the Commission approved the petition.[14] A significant fact developed at the hearings was that, apart from the above-mentioned NASD proceedings, Thompson had never been subject to any disciplinary action, law suit or complaint growing out of his securities business.

As mentioned earlier, Lowell Niebuhr & Co., Inc. had been expelled by and from the NASD in 1942 for violation of the NASD rules in two respects—conducting a securities business while its liquid assets were considerably less than its obligations and filing balance sheets with the NASD in which its financial condition was misrepresented. Subsequently, the Commission found willful violations of its statutes on somewhat the same facts,[15] but on a showing that, among other things, the firm had met its obligations in full, the Commission permitted withdrawal of registration and dismissed the revocation proceedings. The NASD was favorably inclined to Niebuhr's reemployment by Leason & Co., Inc., a member firm, and recommended that the Commission approve the firm's continuation in membership. On an independent review of the record before the NASD, the Commission concluded that it was appropriate in the public interest to approve the application.[16]

Edward E. Trost was under a disqualification from membership as a result of a Commission order revoking the broker-dealer registration of Trost & Co., Inc. and expelling the firm from membership in the NASD.[17] Trost was subsequently employed by a member firm of the NASD, which made application for continuance of membership. For the first time, the unique procedure was employed in which the firm making application was permitted to do so without publicly disclosing its identity. This procedure was permitted, and will be permitted where feasible in future cases, on advice that the publicity attendant upon a Commission proceeding had discouraged some members from taking the necessary legal steps to obtain approval of the employment of persons under some disqualification but who, with due regard to the public interest, may be employed under appropriate supervision by an NASD member.

The board of governors of the NASD found, after a review of the Commission's opinion which gave rise to the disqualification and of Trost's subsequent activity and general reputation, that he should be permitted to engage in the securities business as an employee and registered representative. Its findings included the facts that he was subject to supervision by responsible partners of the firm employing him and that, while so employed, there was no record of exorbitant profits such as had formed the basis for the Commissions' prior disciplinary action. Upon a review of the record the Commission con-

[14] Securities Exchange Act Release No. 3836 (1946).
[15] Securities Exchange Act Releases Nos. 3668 (1945) and 3707 (1945).
[16] Securities Exchange Act Release No. 3937 (1947).
[17] *Trost & Co., Inc.*, 12 S. E. C. 531 (1942)

cluded that it was appropriate in the public interest to approve the application.[18]

The first case in which the Commission directed the NASD to admit an applicant to membership after the NASD had disapproved the application arose on the petition of Lawrence R. Leeby to be admitted to membership. Leeby was under a disqualification from membership as a result of his expulsion from and by the NASD in 1942 and the revocation of his broker-dealer registration by the Commission in 1943.[19] The Commission, in 1946, granted Leeby registration as a broker in over-the-counter securities and as a dealer in investment trust shares.[20] Leeby's application for membership was thereafter approved by the appropriate district business conduct committee of the NASD but was disapproved by the board of governors, without explanation or findings, solely because of the disability arising out of his previous expulsion.

The Commission had to consider whether it was appropriate in the public interest to direct Leeby's admission to membership. In its opinion, the Commission pointed out that the limited registration as a broker-dealer already granted to Leeby should tend to prevent a recurrence of the practices which had led to his expulsion and to the revocation of his registration as a broker-dealer. The Commission emphasized that it was incumbent upon the NASD, under the circumstances, if its action of disapproval were to be sustained, to present adequate reasons for barring Leeby from membership and that none had been advanced. In the absence of such findings, the Commission was forced to make its decision without the benefit which would, and should, be derived from a statement of the NASD views. The Commission, by order, directed the NASD to admit Leeby to membership.[21]

CHANGES IN RULES AND FORMS

Rule X-11D1–1—Extensions of Credit by Broker-Dealers

In general, section 11 (d) (1) of the act makes it unlawful for a broker-dealer to extend or maintain credit on any security which was part of a new issue in whose distribution he participated during the preceding 6 months. By an amendment to rule X-11D1–1 adopted during the year an exemption is afforded which permits broker-dealers who would otherwise be subject to section 11 (d) (1) to extend credit to their customers upon securities received on the exercise of certain short-term rights or warrants.[22] The exemption is available only where the right has been issued to the customer as a stockholder of the corporation issuing the security upon which credit is to be extended, or as a stockholder of a company distributing such security pursuant to section 11 of the Public Utility Holding Company Act of 1935.

This amendment removes the absolute prohibition of section 11 (d) (1) but does not, of course, remove the exempted transactions from the scope of regulation T or any applicable stock exchange rules on margin. Regulation T, the margin regulation promulgated by the board of governors of the Federal Reserve System under section 7 of the act,

[18] Securities Exchange Act Release No. 3955 (1947).
[19] 13 S. E. C. 499.
[20] See p. 48.
[21] Securities Exchange Act Release No. 3898 (1947).
[22] Securities Exchange Act Release No. 3899 (1946).

had been amended to permit extensions of credit in these cases on specified conditions.

Rule X-12D2–1—Reports by Exchanges

By an amendment to this rule the Commission eliminated the requirement that an exchange which had suspended a security from trading file a statement every 2 months setting forth the reasons for the continuance of the suspension.[23] The amended provision requires an exchange merely to notify the Commission of any change in the reasons for the suspension and of the effective date on which the suspended security is restored to trading.

Rule X-12D2–2—Delisting of Retired Securities

Paragraph (*a*) of rule X-12D2–2 permits an exchange, upon certification of certain facts to the Commission, to remove from listing and registration securities which have been "retired." Paragraph (*a*) was amended to make it clear that securities shall be deemed to be retired within the meaning of the rule where all rights pertaining to such securities have been extinguished.[24]

Rule X-13A–6B—Quarterly Reports

On July 12, 1946, the Commission announced an amendment to rule X-13A–6B, which requires quarterly reports of sales volume from most issuers having securities registered on a national securities exchange. The amendment exempts from the rule companies primarily engaged in the production of raw cane sugar or other seasonal, single crop agricultural commodities, since such producers will ordinarily have no sales in two or more of their fiscal quarters.

Rule X-15A–2—Shares in Cooperative Dwellings.

This new rule exempts shares of cooperative corporations, representing ownership or a right to possession and occupancy of specific apartment units in property owned by such corporations, from the operation of section 15 (a).[25] Section 15 (a), in substance, requires the registration of brokers or dealers who effect transactions in securities over the counter. Shares of the type covered by the rule are invariably distributed through the usual real estate channels and not through securities brokers.

The Commission determined that the public interest did not require that real estate brokers who are duly licensed by the appropriate State or local authorities and subject to their supervision be subjected to the additional registration requirements of section 15, solely by reason of their participation in the sale of such securities. The rule is applicable, however, only if the securities are sold by or through such duly licensed real estate brokers. The registration requirements of the Securities Act of 1933 and the antifraud provisions of both the Securities Act and the Securities Exchange Act remain applicable, of course, to such securities.

Rules X-16B–2 and X-16C–2—Exemption from Sections 16 (b) and 16 (c)

These rules conditionally exempt underwriting transactions from sections 16 (b) and 16 (c) of the act.[26] Section 16 (b) provides

[23] Securities Exchange Act Release No. 3921 (1947).
[24] Securities Exchange Act Release No. 3861 (1946).
[25] Securities Exchange Act Release No. 3963 (1947).
[26] Securities Exchange Act Release No. 3907 (1947).

that "short-swing" profits by certain corporate insiders shall inure to their corporation. Section 16 (c) prohibits short sales of such equity securities by such persons. The two rules exempt bona fide underwriting transactions by dealers who fall within one of the three classes of insiders specified in section 16, or by dealer firms with which such persons are connected. However, in order to prevent such insiders or insider firms from acquiring a preferential position when they participate in a distribution, the exemptions afforded by the two rules are subject to the condition that noninsiders or noninsider firms shall have participated in the distribution "on terms at least as favorable" as those on which the insiders have participated and "to an extent at least equal to the aggregate participation" of all insiders.

The purpose of the amendments was to make it clear that the mere receipt of a fee by an insider as manager of an underwriting syndicate should not in itself be deemed to place the insider in a preferential position within the meaning of the rule and thereby make the exemption unavailable.

Rule X-16B–4—Exemption of Registered Holding Companies

This rule provides that any transactions by a holding company registered under the Public Utility Holding Company Act of 1935 or by a subsidiary of such a company, where both the purchase and the sale have been approved or permitted by the Commission under that act, shall be exempt from the civil liability provisions of section 16 (b) or the Securities Exchange Act.[27] (These liabilities are described in the preceding subsection.)

Form 10 for Corporations

On June 19, 1947, the Commission announced an amendment to the Instruction Book for Form 10 for Corporations. Form 10 is the basic general form prescribed for use by corporations in filing applications for registration of securities on a national securities exchange. The amendment deleted from the instruction book certain temporary instructions, which had become obsolete, as to the financial statements to be filed with an application. The amendment also deleted the instruction as to the form and content of financial statements and schedules, inasmuch as the form and content of financial statements and schedules required to be filed with an application on Form 10 are now governed by the provisions contained in regulation S–X, the Commission's general accounting regulation.

Forms 10–K and 1–MD—Annual Report Forms

On January 29, 1947, the Commission announced amendments to the instructions for Form 10–K, the basic annual report form for most issuers having securities listed and registered on a national securities exchange. The amendments operate to simplify the requirements for financial statements by permitting a registrant to file either consolidated or individual statements where registrants own assets and revenues comprising more than 85 percent of those shown in the consolidated statement. Heretofore both individual and consolidated statements were required. The amendments bring to this form certain

[27] Securities Exchange Act Release No. 3848 (1946).

of the changes adopted, as discussed elsewhere in this report, in the recently revised Form S–1 under the Securities Act of 1933.

The amendments to the Instructions to Form 10–K operate to effect a corresponding simplification in the requirements of Form 1–MD, since that form requires registrants to file the same statements as those required of registrants on Form 10–K. Form 1–MD is the basic annual report form for issuers which have registered securities under the Securities Act of 1933 and are required to file annual reports by section 15 (d) of the Securities Exchange Act.

Forms 12–K and 12–AK—Annual Report Forms

On April 8, 1947, the Commission adopted minor amendments to its annual report Forms 12–K and 12–AK. Companies which report to the Interstate Commerce Commission on its Form A are permitted, in connection with reports to the Securities and Exchange Commission, to file certain selected schedules from Form A in lieu of the complete Form A report. The purpose of the amendments is to revise the list of selected schedules to conform to certain changes made in Form A by the Interstate Commerce Commission for the year ended December 31, 1946.

LITIGATION UNDER THE SECURITIES EXCHANGE ACT

The Commission's litigation activities under the act during the 1947 fiscal year included: (1) Injunction actions in the district courts to restrain broker-dealers and others from violating those provisions of the act and the Commission's rules designed to protect security holders and the customers of broker-dealers; (2) appellate court actions on petitions to review orders of the Commission; and (3) actions between private parties in which the Commission participated as amicus curiae.

Injunction and Appellate Proceedings Involving Broker-Dealers

The large majority of injunction actions was against broker-dealers. In *S. E. C.* v. *Patrick A. Trapp* a permanent injunction was entered which, for the first time in any contested civil action, judicially established two theories of fraud advanced by the Commission in connection with sales of oil royalties.[28] The first is that it is fraudulent for a dealer to sell oil royalties at prices in excess of the probable returns to purchasers, as computed on the basis of reasonable estimates of the recoverable oil underlying the tracts covered by the royalties.[29] The court's holding to this effect was based on expert evidence that, as of the purchase dates, the probable returns based on such estimates ranged from only 65 to 80 percent of the cost of the royalties to the buyers. The second new judicial principle, which the Commission had followed in an earlier administrative proceeding, is that it is fraudulent for a dealer to sell oil royalties at prices bearing no reasonable relationship to his contemporaneous cost. These fraudulent practices were held to have violated section 15 (c) (1) of the Securities Exchange Act, as well as section 17 (a) (2) and (3) of the Securities Act of 1933.

[28] Civil No. 1288, N. Dak., June 4, 1947.

[29] This theory was also the basis of the complaint in *S. E. C.* v. *Joseph J. LeDone*, Civil No. 40–347, S. D. N. Y., Mar. 26, 1947, in which a permanent injunction by consent was entered. In this case investors had been charged $416,078 for oil royalties worth at the time of the sales (on the basis of the then current value of the recoverable oil) not more than $272,890, or approximately $143,188 less than the total paid by the investors.

Trapp's registration as a dealer had been revoked by the Commission several years before and he was therefore engaged in business as a dealer without being registered as required by section 15 (a) of the act. The court found also that he had made false representations to purchasers about his ownership of the oil royalties being sold to them. The defendant joined a lodge and then represented to a number of his brother members that he was liquidating his oil royalty holdings in order to raise funds for a mining venture. In fact, his practice was first to make sales of oil royalties which he did not own and then to use the customers' money to acquire the royalties from another dealer.

In *S. E. C.* v. *Fiscal Service Corp. and Otto F. Herald* the defendants consented to the entry of a judgment permanently enjoining them on all counts of the Commission's complaint.[30] The Commission had alleged that, while unlawfully engaged in business as a broker and dealer in securities without being registered under section 15 (a) of the act, the defendant firm had violated the antifraud and confirmation rules of the Commission in reporting to its customers that it was acting as agent, when in fact it was buying and selling for its own account, and in taking secret profits in those transactions. In addition the complaint had alleged violations of the credit provisions of regulation T (the margin rules) and of the Commission's hypothecation and bookkeeping rules. In all, the complaint alleged violations of sections 7 (c), 8 (c), 10 (b), 15 (a), 15 (c) (1), 15 (c) (2), 17 (a), and 20 (b) of the act.

During the fiscal year the Commission was engaged in two court actions involving broker-dealers who were charged with violating the fraud provisions of the act by doing business while insolvent. In both *S. E. C.* v. *Raymond, Bliss, Inc.* and *S. E. C.* v. *York* the Commission filed complaints charging that the defendants had accepted money and securities from customers without advising them of the defendants' insolvent condition, and had hypothecated customers' securities without their knowledge or consent. In the *Raymond, Bliss* case a preliminary injunction was granted notwithstanding the facts that the firm had ceased doing business and that Bliss' family had made an assignment for the benefit of creditors. So long as the firm continued to be registered, the court stated, it could not be said that there was no risk of further violations. Because of the assignment, which was made after the filing of the Commission's complaint, the request for the appointment of a receiver was for the time being denied.[31] The request for a final injunction was still pending at the close of the fiscal year.

In the *York* case a temporary restraining order was entered. The defendant then filed a voluntary petition in bankruptcy and a receiver was appointed. The defendant agreed not to engage in the securities business pending final determination of the bankruptcy proceedings and the Commission then stipulated to the dismissal of its application for a preliminary injunction and the appointment of a receiver. However, the defendant shortly thereafter was shot and killed by his principal creditor and the court action was discontinued.[32] An administrative proceeding for revocation of York's registration as a

[30] Civil No. 47C408, N. D. Ill., Mar. 5, 1947.
[31] Civil No. 5999, Mass., Sept. 25, 1946.
[32] Civil No. 894, W. D. Texas, July 31, 1947.

broker-dealer, which had been instituted by the Commission, was also discontinued.[33]

Three companion cases based on regulation T, the first of their kind, were pending at the beginning of the fiscal year in the United States District Court at Cleveland.[34] That regulation, adopted by the board of governors of the Federal Reserve System under section 7 (c) of the Securities Exchange Act and enforced by the Commission, governs the extension of credit by members of national securities exchanges and brokers or dealers transacting a business through the medium of such members. In these three cases the Commission charged that Butler, Wick & Co., of Youngstown, Ohio, Hirsch & Co., of New York and Cleveland (both members of the New York Stock Exchange), and The S. T. Jackson & Co., Inc., an over-the-counter firm of Youngstown, had repeatedly violated regulation T by overextensions of credit to Richard C. Brown, of Youngstown, and First Mahoning Co., an investment company controlled by him; that A. E. Masten & Co., a member house in Pittsburgh, had overextended credit directly to the Jackson firm, its over-the-counter correspondent, and indirectly through the Jackson firm to Brown and his investment company, customers of the Jackson firm; and that Brown and his investment company had aided and abetted all of these violations. For the most part, these violations involved the "special cash account" provisions of regulation T. During the 1945 fiscal year the court had entered a final injunction by default against the Jackson firm. During the current year final injunctions were entered by default against Brown and First Mahoning Co., who had been named as defendants in all three cases.[35]

The three cases were disposed of after the close of the year by the entry of consent judgments against the remaining defendants, Hirsch & Co., Butler, Wick & Co., and A. E. Masten & Co. Each contained a finding that the defendant firm had violated section 7 (c) (1) of the Securities Exchange Act and regulation T, but that the violations had not been committed intentionally. The Commission agreed that this was the fact as to these defendant firms. The Commission, however, had not charged these firms with violating regulation T intentionally. It had taken the position that the presence or absence of actual intent to violate the regulation was irrelevant in an action to enjoin further violations, and each of the judgments specified that the finding of lack of intent to violate was made without determining the legal question whether intent was an element of the offense under section 7 (c) (1) of the act or regulation T. In view of the defendants' admission and the court's adjudication that all three firms had violated regulation T, and under all the facts and circumstances surrounding the actions (among which was the fact that these cases were the first of their kind), the Commission agreed to their disposition without the formal entry of injunctions.

In *S. E. C.* v. *Schultz*, another regulation T case instituted in the same court, the Commission obtained final judgments against the partners of L. J. Schultz & Co. (by consent) and against Josiah Kirby (by default).[36] The Commission's complaint alleged viola-

[33] Securities Exchange Act Release No. 3965 (1947).
[34] *S. E. C.* v. *Hirsch*, Civil No. 23474; *S. E. C.* v. *Butler*, Civil No. 23475; *S. E. C.* v. *Young*, Civil No. 23476.
[35] Civil No. 23476, N. D. Ohio, Oct. 21, 1946.
[36] Civil No. 24198, N. D. Ohio, Sept. 4, 1946.

tions of the "special cash account" provision of regulation T similar to those in the three preceding cases. The Commission's affidavit alleged that in a 20-month period the Schultz firm had executed 350 transactions for Kirby, 160 of which had been in violation of regulation T.

S. E. C. v. *Nevada Oil Co.*, pending from the preceding year, was an action for a mandatory injunction to require the defendant, a registered dealer, to permit an examination of its books and records required under section 17 (a) and the Commission's bookkeeping rules. The court granted a motion by the Commission for summary judgment, ordering the defendant to permit the examination. The summary judgment, however, was subject to a condition which the Commission sought to remove by a motion to amend, and at the same time the corporation filed a motion for a rehearing. Pending action on these motions, the corporation permitted the Commission to make the examination, which demonstrated that it was not doing business as a broker or dealer. The Commission therefore stipulated with the defendant to the vacation of the summary judgment and the dismissal of the action, and permitted the company to withdraw its registration with the Commission.[37]

During the fiscal year the Commission was in court on two manipulation cases, both involving broker-dealers. In the first, *S. E. C.* v. *Bennett and the Federal Corp.*, the Commission alleged the violation of section 9 (a) (2) of the Act by the manipulation of a stock listed on the New York Curb Exchange. The complaint alleged that Federal, controlled by Bennett, had manipulated the market for the common stock of Red Bank Oil Co., also controlled by Bennett, in order to facilitate a pending offer of a substantial block of that stock which was then in process of registration under the Securities Act of 1933. After a preliminary injunction had been denied during the preceding fiscal year on the ground that there was insufficient proof of a manipulation,[38] Federal consented to the entry of a permanent injunction. However, the complaint was dismissed with the Commission's concurrence insofar as it related to Bennett individually.[39] Thereafter Federal's registration as a broker-dealer was revoked by the Commission pursuant to section 15 (b) of the Act on the basis of the court's injunction.[40]

The second manipulation case, *Lann* v. *S. E. C.*,[41] is a petition to review the order of the Commission in M. S. Wien and Co., discussed above at p. 47. This case, one of two circuit court appeals under the act during the 1947 fiscal year, represents the first court review of a Commission finding of manipulation in the over-the-counter market in violation of section 10 (b) and 15 (c) (1) of the act and rules X-10B–5 and X-15C1–2 thereunder. Lann, a partner of Wien & Co., was found by the Commission to have been primarily responsible for the manipulation and fraud upon which the order revoking the Wien firm's registration as a broker-dealer was based. The basis of the appeal was that the Commission, in finding that the petitioner had violated the antifraud provisions of the Federal securities laws, had

[37] Civil No. 1142, N. D. Tex., Feb. 25, 1947.
[38] 62 F. Supp. 609 (S. D. N. Y. 1945).
[39] Civil No. 32–104, S. D. N. Y., Dec. 30, 1946.
[40] Securities Exchange Act Release No. 3909 (1947).
[41] Civil No. 9640, App. D. C.

gone beyond ordinary standards of fraud and improperly applied to his over-the-counter activity specific statutory provisions applicable solely to exchange markets. The appeal was pending at the close of the fiscal year.

The final court action involving a broker-dealer is *Norris & Hirschberg, Inc.* v. *S. E. C.* (previously discussed at pages 35–36 and 41 of the Twelfth Annual Report). On January 22, 1946, after prolonged proceedings, the Commission had issued its findings and opinion in this matter and ordered the revocation of the registration of Norris & Hirschberg, Inc., as a broker-dealer. The Commission had found that in fixing prices which were unaffected by the operation of a free, open, and competitive market without disclosing the nature of its market, in dealing as a principal with uninformed customers and customers who had given it powers of attorney, and in trading excessively for accounts as to which it had discretionary powers, this firm had engaged in activities which were fraudulent and illegal under section 17 (a) of the Securities Act of 1933 and sections 10 (b) and 15 (c) (1) of the Securities Exchange Act of 1934. A petition for review of the Commission's order was filed on April 29, 1946, in the Court of Appeals for the District of Columbia. This appeal has not yet been argued on its merits.

After the filing of the petition for review the court entered an order on stipulation staying the Commission's order of revocation pending further action by the court. The court conditioned this stay upon conformance by the firm with its stipulation and agreement with the Commission not to engage during the pendency of the review in acts or practices violating the above-mentioned provisions of the statutes. On June 8, 1946, the Commission filed a transcript of the record in the court of appeals. This transcript was attacked by Norris & Hirshberg, Inc. on several grounds. The court has upheld these objections in part, remanding the case to the Commission and physically returning the certified transcript and additional material tendered.

Injunction Actions Against Persons Other Than Broker-Dealers

The second category of injunction cases consists of actions against persons other than broker-dealers for violations of those sections of the act and the Commission's rules designed to protect security holders in general. One of these is rule X-10B–5, which contains a general prohibition against fraud in the purchase or sale of securities in interstate channels. An action based both on this rule and on section 17 of the Securities Act of 1933, which prohibits fraud only in the sale of securities, was *S. E. C.* v. *Standard Oil Company of Kansas.*[42] The Commission's complaint charged that the corporation and its president, Charles B. Wrightsman, by whom the corporation was controlled, had defrauded the corporation's minority stockholders in connection with a scheme to acquire the common stock of the corporation from them. The complaint alleged further that Wrightsman, in connection with the purchases from minority stockholders, had circulated to them balance sheets representing Standard's properties to be worth less than $4,000,000 when qualified engineers had appraised

[42] Civil No. 2552, S. D. Texas, Feb. 26, 1947.

its oil reserves alone to be worth $16,000,000 to $20,000,000. These appraisals had been relied upon by banks in making loans to the company, which for the most part were used in the purchases of stock from the minority holders.

The Commission charged also that Standard and Wrightsman, as a result of their program of purchasing and retiring the common stock, had controlled the market on the New York Stock Exchange and over-the-counter with the result that stockholders wishing to sell had no practical choice except to sell to the defendants at their price. The complaint alleged in addition that the defendants had devised a merger scheme for the company in a further attempt to acquire stock at depressed prices and to eliminate the minority stock ownership. The defendants filed an answer denying the allegations of the complaint but thereafter consented to the entry of a final judgment.

Two actions during the year were based on regulation X–14, which comprises the Commission's proxy rules. The first is *S. E. C.* v. *McQuistion.* The Commission's complaint charged that the defendant had solicited proxies of the voting security holders of Third Avenue Transit Corp. for its annual meeting without furnishing them with a proxy statement containing the information specified in the proxy rules, and had mailed proxy soliciting material prior to the expiration of 10 days following the filing of preliminary copies of the proxy statement and form of proxy. A preliminary injunction was entered before the close of the fiscal year.[43] The second is *S. E. C.* v. *Transamerica Corp.*, pending from the preceding year. In that action the Commission sought to restrain the defendants from using proxy material obtained as a result of solicitations which did not include proposals which a minority stockholder, pursuant to rule X–14A–7, desired to bring before the annual meeting. The district court sustained the right of the minority stockholder with respect to one of four proposals in question, denied a defense motion to dismiss, and enjoined the defendants from violating section 14 (a) of the act and rules X-14A–2 and X-14A–7 thereunder.[44] Cross appeals from this judgment to the Circuit Court of Appeals for the Third Circuit were pending at the end of the fiscal year.

S. E. C. v. *Metropolitan Mines Corp., Ltd.*, was instituted just before the close of the fiscal year. The Commission charged the defendants with violating sections 13 (a), 14 (a), 16 (a) and 20 (c) of the Securities Exchange Act and section 5 (a) of the Securities Act of 1933. The complaint alleged: (1) That the defendant corporation from 1943 to 1946 had failed to file annual reports with the Spokane Stock Exchange and with the Commission as required by section 13 (a) of the Securities Exchange Act; (2) that Roy H. Kingsbury, the secretary-treasurer and managing director of the corporation, had made purchases and sales of its equity securities without reporting his changes of ownership with the exchange and the Commission as required by section 16 (a) of the act; (3) that the defendants had violated section 5 (a) of the Securities Act in selling 100,000 shares of the corporation's common stock without a registration statement being in effect with the Commission; and (4) that the defendants had solicited prox-

[43] Civil No. 41–47, S. D. N. Y., May 16, 1947.
[44] 67 F. Supp. 326 (Del. 1946).

ies from stockholders without filing proxy statements as required by section 14 (a) of the Securities Exchange Act.[45]

Participation by the Commission in Private Actions

The private actions in which the Commission participated as amicus curiae during the fiscal year for the purpose of assisting the courts in construing the act and the Commission's rules fall into three categories: (1) A number involving sections 9 and 10 (b), two of the antifraud sections of the act; (2) two based on regulation X–14, which contains the Commission's proxy rules; and (3) several based on section 16 (b), which provides for private actions to recover "short-swing" profits by corporate insiders.

The first of the fraud cases is *Kardon* v. *National Gypsum Co.*, a private action for damages based on section 10 (b) of the act and rule X-10B–5 thereunder. All the stock of Western Board & Paper Co. had been owned in equal amounts by two individuals named Kardon and two named Slavin. While all four were officers and directors of the company, its affairs were managed by the Slavins. The Kardons claimed that they were defrauded because the Slavins induced them to sell their stock to the Slavins without the latter disclosing their negotiations (1) for the sale of certain assets of Western to the defendant National Gypsum Co. and (2) for the execution of certain contracts between the Slavins and National Gypsum Co. The defendants filed a motion to dismiss which, among other things, raised the following two questions: (1) Whether an individual right of action exists for damages resulting from a violation of section 10 (b) and rule X-10B–5; (2) whether section 10 (b) of the act was intended to apply to the securities of a closely held corporation.

The Commission filed a brief as amicus curiae on these two points. On the first it argued that an individual may maintain such an action either (*a*) by application of the general common law rule that members of a class for whose protection a statutory duty is created may sue for injuries resulting from its breach and that the common law will supply a remedy if the statute gives none, or (*b*) under section 29 (b) of the act, which provides that contracts in violation of any provision of the act shall be void. On the second point, the Commission argued that, while the primary concern of Congress was undoubtedly with corporations having widely distributed securities, the statute was intended to apply also to the securities of closely held corporations. The court denied the defense motion to dismiss, relying on the position taken by the Commission on both points.[46]

The *Kardon* decision was followed in *Slavin* v. *Germantown Fire Insurance Co.*,[47] in *Fifty Third Union Trust Co.* v. *Block*[48] and in *Fry* v. *Schumaker*.[49] The Commission participated as amicus curiae in all these cases.

Another fraud case is *Speed* v. *Transamerica Corp.*, which was still pending at the close of the year.[50] There the Commission appeared before the district court to urge that, when a corporate "insider" (in

[45] Subsequent to the close of the fiscal year a consent decree of mandatory injunction on all counts of the Commission's complaint was entered. Civil No. 664, E. D. Wash., July 18, 1947.
[46] 69 F. Supp. 512 (E. D. Pa. 1946).
[47] Civil No. 6564, E. D. Pa., Dec. 5, 1946.
[48] Civil No. 1507, S. D. Ohio, Dec. 11, 1946.
[49] Civil No. 6418, E. D. Pa., Jan. 10, 1947.
[50] 71 F. Supp. 457 (D. Del. 1947).

this case the controlling stockholder) buys stock from minority holders without disclosing to them material facts coming to his attention by virtue of his position, there is a violation of section 10 (b) of the act and rule X-10B–5. A second point in the Commission's brief in the *Speed* case was based on the principle established a few months before in the *Kardon* case—that a private person may maintain an action on his own behalf for damages claimed to arise from a violation of section 10 (b) and rule X-10B–5. A defense motion for summary judgment was sustained on one count, but was dismissed on the counts as to which the Commission participated.

The final two fraud actions in which the Commission participated as amicus curiae were *Acker* v. *David A. Schulte* and *Schmolka* v. *David A. Schulte*. These were separate actions by individual stockholders of Park & Tilford, Inc. against the company, its former president, and various other individuals for damages resulting from the alleged manipulation of the stock of the company on the New York Stock Exchange in violation of sections 9 and 10 (b) of the Securities Exchange Act of 1934. Section 9 (e), which creates a civil right of action for persons who suffer damages as a result of a violation of the anti-manipulation provisions of section 9, provides that the court, in its discretion, may require an undertaking for the payment of costs from either party. The defendants filed motions demanding security for costs on the ground that the suits had not been brought in good faith. The Commission filed a brief in opposition to these motions, arguing that section 9 (e) was designed to afford public investors a more effective remedy for recovering damages than existed at common law and that, in order to preclude the statutory provision from operating as a barrier to suits under section 9 (e), the party seeking security for costs should be required to show by clear evidence that the suit had been brought in bad faith. The court, following this theory, denied the defense motions. In view of this ruling, the court found it unnecessary to consider whether security could be ordered under section 9 (e) where the action is brought also under section 10, which does not contain a provision authorizing the requiring of security for costs.[51]

The first of the proxy cases in which the Commission intervened as amicus curiae during the year was *Doyle* v. *Milton*. This was an action by a stockholder of the Equity Corp., a registered investment company, designed primarily to restrain the use of proxy soliciting material alleged to be false and misleading and therefore in violation of rule X-14A–5. The question presented was whether a proxy statement is false or misleading if it fails to state all possible alternatives to a course of action for which the management seeks approval. Upon the request of the court the Commission filed a memorandum taking a position in the negative. This position was sustained.[52]

The second proxy case was *Tate* v. *Sonotone*, also based on allegedly false and misleading proxy material. The Commission was requested by the district court for advice on whether the court had jurisdiction to entertain a suit by a private party under section 14 (a), upon which the proxy rules are based. A member of the Commission's staff appeared and orally advised the court in the affirmative. The court so held.[53]

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[51] —— F. Supp. —— (S. D. N. Y., May 26, 1947).
[52] 73 F. Supp. 281 (S. D. N. Y. 1947).
[53] Civil No. 41–39, S. D. N. Y. April 15, 1946.

Under section 16 (b) of the act, if a corporation has an equity security registered on a national securities exchange, any profit realized by its officers, directors or principal stockholders on purchases and sales of any of the corporation's equity securities within any 6-month period may be recovered by the corporation or by any security holder in its behalf. Two of these private section 16 (b) actions in which the Commission participated as amicus curiae were *Kogan* v. *David A. Schulte*,[54] and *Park & Tilford, Inc.* v. *Arthur D. Schulte*,[55] both of which arose from the same series of transactions as formed the basis of *Acker* v. *David A. Schulte* and *Schmolka* v. *David A. Schulte*, the fraud actions discussed above. In the preceding fiscal year the district court had held that the conversion of preferred stock into common by a controlling stockholder within 6 months prior to a sale of common by him was a purchase of the common within the meaning of section 16 (b).

This holding was affirmed by the Circuit Court of Appeals in the *Park & Tilford* case during the current year.[56] The circuit court's ruling also (1) reversed the district court holding denying Kogan, a minority stockholder, the right to intervene in the *Park & Tilford* case, and (2) increased the measure of recovery awarded by the district court. On the intervention question, the circuit court held that the defendants and their father were so dominant in the affairs of the plaintiff corporation that it was proper to permit Kogan's intervention in order to assure adequate representation of the interests of the minority stockholders. On the question of damages, the amount recoverable by the corporation under the statute is the proceeds of the sale of the stock minus the purchase price. The district court computed this to be $302,145. This figure was arrived at by taking the market value of the common into which the preferred had been converted as the "purchase" price, and deducting that gross figure from the proceeds of the sale. The circuit court recomputed the recoverable profit to be $418,128 on the ground that the "purchase" price was not the market value of the common acquired on conversion, but rather the lower market value of the preferred on the conversion date. A petition for rehearing based solely on the increase in the amount of the judgment was denied, one judge dissenting.[57]

Another section 16 (b) action in which the Commission had filed a brief as amicus curiae during the preceding fiscal year was *Gratz* v. *Claughton*, in which the defendant contested the venue of the action. The Commission expressed the view that the statute should be construed to provide as many alternative choices of venue as could reasonably be implied from the language of the act in order to accomplish the legislative purpose. Otherwise, the Commission argued, a stockholder might be faced with the burden of bringing his suit in a court distant from the place where the significant acts occurred. In line with this construction the Commission took the position that it was proper to lay the venue in the place where the transactions occurred. This position was sustained by the court.[58]

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[54] 61 F. Supp. 604 (S. D. N. Y. 1945).
[55] 160 F. (2d) 989 (C.C. A. 2, 1947).
[56] 160 F. (2d) 984 (C. C. A. 2, 1947).
[57] 160 F. (2d) 989 (C. C. A. 2, 1947). A petition for a writ of *certiorari* was filed by the defendants after the close of the fiscal year.
[58] —— F. Supp. —— (S. D. N. Y. Apr. 2, 1947).

A similar ruling was made in *Grossman* v. *Young*, in which the Commission also participated.[59] Two additional issues, however, were involved in the *Grossman* case. The first related to the 2-year limitation on actions provided in section 16 (b). The defendant had been delinquent in filing the reports of changes in ownership of stock required by section 16 (a), and the Commission took the position that the time during which he had failed to make these disclosures required by the statute should not be included in the 2-year period. The second point was the construction of the provision of section 16 (b) which gives a security holder the right to bring a suit for the recovery of "short-swing" profits on behalf of his corporation only if the corporation itself fails to bring the suit within 60 days after request. The Commission argued that, where the right of action might be jeopardized by waiting the full 60-day period or where the corporation has indicated that it does not intend to institute the action, there is no need for an individual security holder to wait until the expiration of the full 60-day period before instituting the action on behalf of the corporation.[60]

In *Berkey & Gay Furniture Co.* v. *Wigmore*[61] the Commission participated as amicus curiae on the question of the right of an individual stockholder to intervene in a section 16 (b) action where the corporation itself has already instituted suit. The case was still pending at the end of the fiscal year.

There were in addition several section 16 (b) actions over which the Commission maintained close observation during the course of the year, as is its practice, but in which no active participation was necessary since no question of statutory construction arose.[62]

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[59] 70 F. Supp. 970 (S. D. N. Y. 1947).

[60] The Commission's construction on both issues was followed by the court in an opinion shortly after the close of the year which overruled a defense motion to dismiss. —— F. Supp. —— (S. D. N. Y., July 3, 1947).

[61] Civil No. 40–147, S. D. N. Y.

[62] *Dottenheim* v. *Emerson Electric Manufacturing Co.*, —— F. Supp. —— (E. D. N. Y., Jan. 29, 1947); *Twentieth Century—Fox Film Corp.* v. *Jenkins*, —— F. Supp. —— (S. D. N. Y., Feb. 19, 1947); *Pottish* v. *Divak, et al.*, 71 F Supp. 737 (S. D. N. Y. 1947).

PART III

ADMINISTRATION OF THE PUBLIC UTILITY HOLDING COMPANY ACT OF 1935

The Public Utility Holding Company Act of 1935 was enacted for the purpose of eliminating certain evils and abuses which the Congress found to exist in connection with the activities of holding companies having subsidiaries which are electric utility companies, or which are engaged in the retail distribution of natural or manufactured gas. It was particularly designed to eliminate holding companies serving no useful purpose and thus to afford to the operating companies the advantages of localized management and to strengthen local regulation. This objective finds its most direct expression in section 11 of the act. Section 11 (b) (1) requires the operations of holding company systems to be limited to one or more integrated systems and to such additional businesses as are reasonably incidental or economically necessary or appropriate to the operation of the integrated systems. Section 11 (b) (2) requires elimination of undue complexities in corporate structures of holding company systems and the redistribution of voting power among their security holders on a fair and equitable basis. The act provides also for the registration of holding companies (sec. 5); regulation of security transactions of holding companies and their subsidiaries (secs. 6 and 7); regulation of acquisitions of securities and utility assets by holding companies and their subsidiaries (secs. 9 and 10); regulation of sales of public utility securities or assets, payment of dividends, solicitation of proxies, intercompany loans and other intrasystem transactions (sec. 12); control of services, sales, and construction contracts (sec. 13); and the control of accounting practices (sec. 15).

Following the pattern of recent years, activity under the Holding Company Act has centered largely around plans for integration and reorganization filed under section 11 and the issuance of securities under sections 6 and 7.

INTEGRATION AND CORPORATE SIMPLIFICATION UNDER SECTION 11

Litigation Arising Under the Act

In November 1946 the Supreme Court upheld the constitutionality of section 11 (b) (2) in proceedings involving Commission orders requiring the dissolution of American Power & Light Co. and Electric Power & Light Co.[1] This section requires registered holding companies and their subsidiaries to eliminate unnecessary corporate complexities and any unfair or inequitable distribution of voting power among their security holders. The court held that section 11 (b) (2) was a reasonable exercise of congressional power under the commerce clause of the Constitution; that it did not embody an unconstitutional

[1] 329 U. S. 90.

delegation of legislative authority; that the due process clause of the fifth amendment was not violated; and that the Commission's findings were amply supported by the record. In March 1946 the Supreme Court had sustained the constitutionality of section 11 (b) (1) of the act.[2]

A list of all instances in which the Commission appeared in the Federal courts during the fiscal year in connection with proceedings under the Holding Company Act, either as a party or as amicus curiae, and the status of these cases at the end of the year is set forth in the appendix.

In the following cases, decided by the courts during the fiscal year, the courts discussed various aspects of the adminstration of the Holding Company Act.

American Power & Light Company v. *S. E. C.*[3]—American Power & Light Co. petitioned for review of an order of the Commission requiring Florida Power & Light Co., a subsidiary of American, to amortize certain items classified as plant acquisition adjustments (account 100.5) aggregating approximately $10,500,000, and to classify as plant adjustments (account 107) and charge to earned surplus approximately $1,800,000. As more fully set out in the section dealing with regulation of utility accounts, the court upheld the power of the Commission to regulate the accounting practices of an intrastate public utility subsidiary of a registered holding company, and held that the Commission's order was amply supported by its findings and by the facts in the record.

In re Blatchley, *Blatchley* v. *S. E. C.*, and *Goldfine* v. *S. E. C.*[4]—The Commission approved a plan of New England Public Service Co. under section 11 (e) of the act under which the company proposed to sell certain nonutility assets, and filed an application for enforcement in the District Court of the United States for the District of Maine. In the district court proceedings all security holder representatives urged approval of the plan. Enforcement was opposed by one Goldfine who desired to bid for the properties to be sold. The district court entered an enforcement order and thereafter Goldfine and one Blatchley, a preferred stockholder who had not appeared in the Commission or district court proceedings, filed in the Circuit Court of Appeals for the First Circuit petitions for review of the Commission's order under section 24 (a) of the act, appealed from the district court enforcement order, and filed certain other petitions and motions in the district court and in the Circuit Court of Appeals. The Circuit Court of Appeals dismissed the petitions to review the Commission's order for lack of jurisdiction, in view of the enforcement proceedings in the district court. The appeals from the district court enforcement order were dismissed upon the ground that Goldfine, not a stockholder but a prospective bidder, and Blatchley, a stockholder who did not appear below, had no standing to appeal from such orders.

S. E. C. v. *Chenery Corporation*.[5]—In connection with the reorganization of Federal Water & Gas Corp., the Commission had required that Chenery Corp., and certain individual defendants, who had acquired securities of Federal during the reorganization proceedings,

[2] *North American Company* v. *S. E. C.*, 327 U. S. 686.
[3] 158 F. (2d) 771 (C. C. A. 1, Dec. 1946), certiorari denied 331 U. S. 827.
[4] 157 F. (2d) 894, 898, 899, 900, 901 (C. C. A. 1, 1946), rehearing denied, Dec. 18, 1946.
[5] 67 S. Ct. 1575.

be limited, in substance, to the cost of such securities. In *S. E. C.* v. *Chenery Corporation*, 318 U. S. 80, the Supreme Court had held that the Commission's order could not be sustained on the judicial grounds stated in its findings and opinion, and had directed that the case be remanded to the Commission for further proceedings. On remand, the Commission reexamined the problem in the light of the Supreme Court opinion and reached the same result. The Commission's decision was reversed by the United States Court of Appeals for the District of Columbia. In June 1947 the Supreme Court reversed the Court of Appeals and upheld the decision of the Commission. The Supreme Court held that the Commission, which had not previously been confronted with the problem of management trading during reorganization, had the power to deal with the problem on a case-to-case basis. The court found that the Commission had made a thorough examination of the problem, utilizing statutory standards and its own accumulated experience with reorganization matters; that it had considered properly the subtle factors involved in the marketing of utility company securities, and the dangers of abuse of corporate position, influence and access to information involved in the management purchases; and that the Commision's action had been based upon substantial evidence and was consistent with the authority granted by Congress. Mr. Justice Frankfurter and Mr. Justice Jackson dissented in an opinion anounced in October 1947.

In re Community Gas and Power Company and *American Gas and Power Company*.[6]—By orders issued in February 1946 and in January 1947, the Commission approved a plan which provided, among other things, for the reorganization of American Gas & Power Co. and for the allocation, to the holders of its secured debentures, common stock and warrants to purchase common stock, of shares of a new common stock to be issued under the plan. Certain representatives of debenture holders objected to court enforcement of the plan primarily upon the ground that the Commission had no power to approve a plan for the satisfaction of secured debentures in common stock. Following *In re Standard Gas and Electric Company*,[7] the district court held that a plan for distribution in kind to secured debenture holders may be approved by the Commission, and that in the particular case it was an appropriate and fair method for effecting compliance with the act. Appeals from this decision were taken to the Circuit Court of Appeals for the Third Circuit and are pending there. Consummation of the plan was stayed by the Circuit Court of Appeals pending determination of the appeals.

In re Electric Bond and Share Company.[8]—In September 1946 the Commission issued an order under section 11 (e) of the act approving a plan (plan II–A) for the retirement of the preferred stock of Electric Bond & Share Co., and an order under section 11 (b) (2) of the act requiring Bond & Share to eliminate preferred stock from its capital structure. Enforcement proceedings in the United States District Court for the Southern District of New York, which had been instituted in connection with a prior plan for partial payment of the preferred stock, were reopened on the Commission's supplemental ap-

[6] 71 F. Supp. 171 (Del. 1947).
[7] 151 F. (2d) 326 (C. C. A. 3, 1945), certiorari denied 327 U. S. 796.
[8] Unreported (D. C. S. D. N. Y., Dec. 1946), affirmed *Okin* v. *S. E. C.*, 161 F. (2d) 978 (C. C. A. 2, 1947).

plication. Objections to enforcement of plan II–A by common and preferred stockholders of Bond & Share were overruled by the district court. The exclusion of a common stockholder from personal participation in the Commission hearing was held to be supported by the record showing obstructive conduct; since he had the right to be represented by counsel, to submit his own views in writing and to attend the proceedings as a spectator so long as he behaved himself, the court held that he had been accorded his full constitutional and statutory rights to a fair hearing. The court further held that in a section 11 (e) enforcement proceeding, the district court acts as a reviewing authority and may not add to the record made before the Commission on the question whether the plan is fair and equitable and appropriate. Absent a specific offer of proof, together with a showing that the new evidence proferred is material to the issue, that reasonable grounds exist for failure to adduce it at the Commission hearing, and that its consideration by the Commission would be advisable, there is no basis for referring the matter to the Commission for further consideration. The court after considering all objections held that the plan was fair and equitable and appropriate to effectuate the provisions of section 11 in providing for the retirement of the preferred stock, with immediate payment to preferred stockholders of their liquidation preference and issuance to them of certificates evidencing a contingent right to receive additional amounts, and for the sale by Bond & Share of certain portfolio securities, with rights offerings to common stockholders, in order to raise cash required for such payments.

Appeals taken and petitions for review of the Commission orders filed by the common stockholder were dismissed by the Circuit Court of Appeals as being without merit.

In re Engineers Public Service Company.[9]—The Commission had approved a plan for the liquidation of Engineers Public Service Co., which provided among other things for payment in cash to preferred stockholders of amounts equal to the call price of their shares. Certain holders of common stock of Engineers opposed court enforcement of this aspect of the plan. The district court held that the plan was unfair in providing for payment to the preferred stockholders of more than their involuntary liquidation preference. The district court made its own independent examination of the preferred stock, with particular emphasis on its issue price and market history. Accepting the Commission's conclusions that the present investment value of the preferred stock was at least equal to the call price, the court held that this was not a controlling factor, but that participation should be accorded to the various security holders in accordance with a standard of "colloquial equity."

Except in this respect the dissolution plan was approved, and pursuant to the court order Engineers has paid to its preferred stock-

[9] 71 F. Supp. 797 (Del. 1947).

holders amounts equal to the involuntary liquidation preference of their shares and has set aside in escrow additional amounts to cover the maximum payable in the event that the district court's decision is reversed. Appeals were taken to the Circuit Court of Appeals for the Third Circuit by the Commission and by certain preferred stockholders, and are now pending.

Ladd v. *Brickley*.[10]—In March 1946 the Commission approved a plan proposed by Brickley, trustee for International Hydroelectric System appointed pursuant to section 11 (d) of the Holding Company Act, for the settlement of claims of International Hydro against International Paper Co. The settlement was approved in June 1946 by the United States District Court for the District of Massachusetts. Certain junior security holders of International Hydro appealed on the ground that the settlement was inadequate. The Circuit Court of Appeals noted that the settlement had been approved by the Commission, by the district judge, and by the majority of those interested in the company. The court's opinion reviewed the claims asserted by International Hydro against International Paper, the defenses to those claims, and the investigation of them by the Commission and the trustee. The court held that the district judge was not required to estimate separately the probable success of each claim and defense, and that findings of ultimate fact that the compromise is for the best interests of the estate, that the consideration payable thereunder was fair, reasonable and adequate, and that adequate notice and opportunity to be heard had been given to all persons interested, were adequate to support the district court's order.

Lahti v. *New England Power Association*.[11]—Pursuant to section 11 (e) the Commission approved, and the United States District Court for the District of Massachusetts approved and enforced, a plan for the reorganization of New England Power Association and its five subholding companies. A number of security holders of the companies affected challenged on appeal the fairness and equity of the allocations proposed in the plan. The Circuit Court of Appeals held that the findings of fairness by the Commission and the district court could not be upset by the Circuit Court of Appeals unless they were shown to be without rational basis in fact or to be predicated on a clear-cut error of law. In determining the equitable equivalent of the rights surrendered, the court stated that consideration must be given to the entire set of rights and limitations of the security to be surrendered in the business context of the issuer, apart from the impact of section 11, and that a comparison of earnings prospects is the primary factor to be considered in making the determination. The court reviewed the comparisons made and law applied by the Commission, and accepted the judgment of the Commission and the district court that the

[10] 158 F. (2d) 212 (C. C. A. 1, 1946) certiorari denied 330 U. S. 819.
[11] 160 F. (2d) 845 (C. C. A. 1, 1947).

plan accorded fair and equitable treatment to holders of the securities represented by objectants.

In re United Gas Corporation.[12]—In November 1944 the United States District Court for the District of Delaware had approved and enforced a plan for the reorganization of United Gas Corp., a public utility subsidiary of Electric Bond & Share Co. and Electric Power & Light Corp.[13] A minority common stockholder of Bond & Share appealed from the injunctive provisions of the district court's enforcement order, enjoining any action interfering with the plan, including the prosecution of proceedings in other tribunals. The Circuit Court of Appeals held that the injunction met the requirements of the Holding Company Act and of the judicial code, and was appropriate to avoid a multiplicity of law suits and to permit the prompt, unimpeded execution of the plan of reorganization, objectives plainly within the purview of the relevant statutes.

Divestments Under Section 11

During the year holding companies divested themselves of 31 subsidiaries with assets of $1,978,000,000. This brings the total of such divestments since December 1, 1935, to $8,051,000,000. Of this amount, $5,450,000,000 is no longer subject to the act.

The tables below summarize divestments of electric, gas, and nonutility companies by registered public utility holding companies for the 1947 fiscal year and for the period December 1, 1935, to June 30, 1947:

July 1, 1946, to June 30, 1947

	Number of companies				Assets of companies divested ($000,000 omitted)			
	Electric	Gas	Nonutility	Total	Electric	Gas	Nonutility	Total
Divested by exchange or distribution of securities to security holders:								
No longer subject to Holding Company Act	2	2	1	5	$172	$16	$27	$215
Still subject to Holding Company Act [1]	3			3	354			354
Divested by sale of property or securities: [2]								
No longer subject to Holding Company Act [3]	[4] 9	4	5	18	[4] 620	15	20	655
Still subject to Holding Company Act [1]	5			5	754			754
Total divested	19	6	6	31	1,900	31	47	1,978
	Number of companies making such sales				Sale price ($000,000 omitted)			
Partial sales of property not included in above totals:								
Assets sold no longer subject, to the act	3	3	4	10	$2	$1	$3	$6
Assets sold still subject to the act								
Totals	3	3	4	10	2	1	3	6

See footnotes at end of table.

[12] 162 F. 2d 409 (C. C. A. 3, 1947).
[13] 58 F. Supp. 501.

December 1, 1935, to June 30, 1947

	Number of companies				Assets of companies divested ($000,000 omitted)			
	Electric	Gas	Non-utility	Total	Electric	Gas	Non-utility	Total
Divested by exchange or distribution of securities to security holders:								
No longer subject to Holding Company Act	14	10	3	27	$1,336	$434	$31	$1,801
Still subject to Holding Company Act [1]	11	[5] —	—	11	1,580	[5] —	—	1,580
Divested by sale of property or securities: [2]								
No longer subject to Holding Company Act [3]	131	90	118	339	2,894	365	390	3,649
Still subject to Holding Company Act [1]	37	[5] 13	3	53	976	[5] 25	20	1,021
Total divested	193	113	124	430	6,786	824	441	8,051
	Number of companies making such sales				Sale price ($000,000 omitted)			
Partial sales of property not included in above totals:								
Assets sold no longer subject to the act	54	16	30	100	$80	$8	$30	$118
Assets sold still subject to the act	11	5	1	17	11	4	1	16
Totals	65	21	31	117	91	12	31	134

[1] By reason of their relationship to other registered holding companies.
[2] Includes all cases where total divestment was effected by sales of entire property to one or more than one buyer.
[3] In the case of sales to more than one buyer, the company was classified in accordance with the disposition of the majority of the assets sold.
[4] Reflects divestment of Pennsylvania Power & Light Co. by Electric Bond & Share Co. The divestment of Pennsylvania Power & Light Co. by National Power & Light Co. is not included in the above summary table figures.
[5] Northern Natural Gas Co., which was a subsidiary in three different company systems and itself a registered holding company having consolidated assets of $63,178,222, was not included in the above summary; Lone Star Gas Corp. distributed its common stock investment therein to its own stockholders and United Light & Power Co. sold its holdings for $10,533,612.

With less favorable market conditions prevailing during most of the past year than in 1946, divestments were carried out less frequently by sales in the open market and greater reliance was placed upon distribution plans. Outright distributions or warrant offerings of portfolio common stocks were made in the following instances:

A—Outright distributions:

Allied Gas Co. by Great Lakes Utilities Co.
Birmingham Electric Co. by National Power & Light Co.
Carolina Power & Light Co. by National Power & Light Co.
Central and South West Corp. by Middle West Corp.
Northern Indiana Public Service Co. by Midland Realization Co.
Pennsylvania Power & Light Co. by National Power & Light Co.
South Carolina Electric & Gas Co. by General Public Utilities Corp.

B—Purchase warrants issued to common stockholders of parent:

American Gas & Electric Co. by Electric Bond & Share Co.
Cincinnati Gas & Electric Co. by Columbia Gas & Electric Corp.
Cleveland Electric Illuminating Co. by The North American Co.
Gulf States Utilities Co. by Engineers Public Service Co.
Pennsylvania Power & Light Co. by Electric Bond & Share Co.

The common stocks of five small utility subsidiaries were sold to the public through underwriters. Two additional divestments were brought about by reorganization which removed the subsidiary from the control of the parent. The remaining divestments were carried out by private sales to individuals, public bodies or other utility companies.

Noteworthy progress has also been witnessed in the simplification of corporate structures and redistribution of voting power of holding company systems under section 11 (b) (2). Because of the fact that in many cases dissolution of unnecessary holding companies cannot take place until a series of involved transactions has been consummated, it is difficult to provide a precise statistical measure of the over-all simplification which has been achieved. The following table, however, covering the period from June 15, 1938, to June 30, 1946, indicates the sharp reduction which has taken place in the total number of holding companies, and utility and nonutility subsidiary companies subject to the Holding Company Act. This reflects the simplification which has occurred as a result of compliance with both the geographic integration requirements of section 11 (b) (1) and the corporate simplification requirements of section 11 (b) (2).

	Total companies subject to act during period	Eliminations			Other disposals [1]	Total	Companies subject to act as of June 30, 1947
		Absorbed by merger or consolidation	Sales, dissolutions and other divestments	Exemption by rule or order			
Holding companies	207	23	56	30	9	118	89
Electric and/or gas companies	903	126	335	59	47	567	336
Nonutilities plus utilities other than electric and/or gas companies	1,007	96	360	58	84	598	409
Total companies	2,117	245	751	147	140	1,283	834

[1] Principally small or nonutility subsidiaries, with little or no public interest, disposed of by various means.

Notable progress in meeting the requirements of section 11 has been made by holding company systems, both large and small, during the past year. A brief summary of the year's activity under section 11 with respect to a number of major holding-company systems follows. Earlier developments in the section 11 proceedings concerning these and other systems have been outlined in the Twelfth Annual Report and in the reports for earlier years.

STATUS OF INTEGRATION PROGRAMS—MAJOR SYSTEMS

American Water Works & Electric Co., Inc.

Findings and opinions were issued by the Commission on December 23, 1946 and February 17, 1947 with respect to two plans filed under section 11 (e) by American Water Works & Electric Co., Inc. (American) and certain of its subsidiaries.[14] An order was issued on March 19, 1947 by the district court finding these plans fair and equitable and appropriate to effectuate the provisions of section 11 (b) of the act.

[14] Holding Company Act releases Nos. 7091 and 7208.

Plan I is concerned primarily with the creation of a new water works holding company to be known as American Water Works Co., Inc. Two subholding companies, Community Water Service Co. and Ohio Cities Water Corp., will be dissolved and the new holding company will then own directly or indirectly substantially all of the water works properties in the American system. Ten-year serial debentures of the new company in the amount of $15,000,000 are to be sold to John Hancock Mutual Life Insurance Co. and approximately 2,500,000 shares of common stock are to be sold at competitive bidding.[15]

Plan II, which is to be undertaken after the consummation of plan I, proposes the liquidation of American. Thus, after segregation of the water companies in a new system, the remaining subsidiaries will be controlled by the West Penn Electric Co., now a subholding company in the American system. Under plan II American will pay off in cash its bank loan notes and preferred stock and will distribute its residual assets to its common stockholders. The question as to whether the preferred stock shall be retired at its liquidation price of $100 per share or at some greater amount has not been determined. The plan provides that certificates of contingent interest in any such additional payment shall be distributed to preferred stockholders if final determination of this question has not been made at the time plan II becomes effective.

Community and Ohio Cities have outstanding preferred stocks with substantial dividend arrearages, and the Commission has determined that the equitable equivalent of such shares is $180 per share and $159 per share respectively, plus, in each case, an allowance for accrued dividends from October 31, 1945 to the effective date of the plan. Holders of these preferred stocks are to be given the option of receiving the amounts due them in cash or in new common stock of American Water Works Co., Inc., on the basis of the initial public offering price.

Cities Service Co.

In November 1946 Cities Service Co. (Cities) filed a plan for the simplification of its corporate structure pursuant to section 11 (e). Extended hearings and conferences were held and during the course of the proceeedings Cities amended its plan to meet objections and proposals for modification. On April 24, 1947, the Commission approved the amended plan[16] and on May 27, 1947, the district court issued an order enforcing it. The amended plan has since been consummated.

Briefly, the plan provided for the issuance by Cities of new debentures to the holders of its outstanding preferred and preference stocks in a principal amount equivalent to their respective redemption prices and in discharge of all the rights and claims of such security holders, including their claim for dividend arrears. The plan also provided for the immediate retirement of approximately 40 percent of outstanding long-term debt and contemplated the applications of anticipated proceeds from the sale of certain subsidiary utility companies to the retirement of the remaining outstanding long-term debt and to the reduction of the outstanding amount of new debentures.

[15] The sale of these shares was carried out after the close of the fiscal year.
[16] Holding Company Act release No. 7368 (1947).

Pursuant to section 11 (b) (1) orders of the Commission, Cities has made further progress in the divestment of its direct and indirect interest in nonretainable utility companies. On August 29, 1946, the Commission approved the liquidation and dissolution of Cities Service Power & Light Co., a holding company subsidiary of Cities, and the transfer of its 5 remaining subsidiaries to Cities. These subsidiaries are expected to be divested promptly in accordance with the plan of corporate simplification noted above. Since the original order of divestment was issued in May 1944, Cities has disposed of 5 direct and 40 indirect subsidiaries and has been engaged in a program of refinancing certain subsidiaries preparatory to divestment. Elimination of other subsidiaries is planned through a series of mergers and consolidations.

Federal Light & Traction Co. (Federal), formerly a subsidiary holding company of Cities Service Power & Light Co. and now a direct subsidiary of Cities, has filed a section 11 (e) plan proposing its liquidation and dissolution. Under the plan of liquidation presently pending before the Commission, Federal proposes, among other things (1) the immediate cash payment to preferred stockholders of their liquidating preferences ($100 per share plus accrued unpaid dividends), (2) the deposit in escrow of the call premium of $10 per share pending determination of the additional amounts, if any, to which the preferred stockholders are entitled, and (3) the pro rata distribution to common stockholders of its investment in its two remaining subsidiaries plus $11 per share in cash.

In addition to the pending divestments referred to above, the disposition of three direct subsidiaries and an indirectly owned gas distribution system of Cities is required in order to comply fully with Commission orders. However, Cities has indicated that it intends to apply for an exemption order permitting the company to retain its interest in these remaining companies.

The Commonwealth & Southern Corp.

During the year under review Commonwealth & Southern carried out a number of transactions in furtherance of a general program for compliance with section 11 (b) (1) and 11 (b) (2) of the act. This general program was set forth in a plan dated March 25, 1946 submitted by Commonwealth.[17] That plan, in brief, had as its objectives: (a) That the northern operating subsidiaries become independent operating companies whose common stocks would be held by the public; (b) that the common stocks of the southern operating subsidiaries be transferred to a new holding company, the Southern Co., which would thereafter continue to own and hold such securities; and (c) that Commonwealth thereafter liquidate and dissolve by making distributions of its assets to holders of its preferred stock and common stock. Although this plan has been superseded by a new plan filed July 30, 1947, the general objectives of Commonwealth are substantially unchanged.

While the plan filed in March 1946 set forth the pattern proposed by Commonwealth for compliance with section 11, the company stated that it proposed to carry out the various transactions incidental thereto by filing separate plans or applications. Among the transactions

[17] Holding Company Act release No. 5825 (1945).

were the issuance and sale at competitive bidding of additional common stock by Ohio Edison Co. in June 1946 and by Consumers Power Co. in November 1946, primarily to provide funds for construction and also to establish public markets in these common stocks to facilitate the over-all plan. Another incidental step was the repurchase and retirement by Commonwealth of 40,753 shares of its preferred stock during the period October to December 1946 through use of approximately $5,000,000 of treasury funds.

Another plan filed by Commonwealth as part of its over-all program provided for the transfer of its interests in Alabama Power Co., Georgia Power Co., Gulf Power Co., Mississippi Power Co., and a nonutility subsidiary, Savannah River Electric Co., to the Southern Co. In connection with this plan Commonwealth and the Southern Co., agreed, subject to the Commission's approval of the plan and its finding that the electric properties of the four southern operating companies constitute a single integrated public utility system retainable under common control: (*a*) That Commonwealth will dispose of its direct or indirect interests in all subsidiaries other than the four operating companies and Savannah River Electric Co. to be transferred to the Southern Co.; (*b*) that Commonwealth and the Southern Co. will cause the disposition of their direct or indirect interests in the gas and transportation properties of Alabama Power, Georgia Power, and Gulf Power; and (*c*) that Commonwealth will dispose of any remaining interest in Southern as soon as possible after retiring the Commonwealth preferred stock.

On August 1, 1947, the Commission approved this plan subject to certain conditions, and in its findings concluded, among other things, that the electric properties of Alabama Power, Georgia Power, Gulf Power, and Mississippi Power constitute a single integrated public utility system retainable under common control.[18]

Still another section 11 plan was filed by Commonwealth which provided for a voluntary exchange of a portion of the portfolio common stocks held by Commonwealth for a maximum of 400,000 shares of its preferred stock. This plan was approved by the Commission on April 11, 1947,[19] and the common stocks of Consumers Power Co., Ohio Edison Co. and Southern Indiana Gas and Electric Co. were thereupon offered in exchange for preferred stock of Commonwealth. However, Commonwealth subsequently stated that the response to this offer had not been satisfactory and that this voluntary plan had been abandoned.

On July 30, 1947 Commonwealth submitted a new plan under section 11 (e) which provides, in brief: (a) That the common stocks of two northern operating companies, Consumers Power Co. and Central Illinois Light Co., will be distributed in full discharge of all of Commonwealth's preferred stock; (b) that the preferred stock will also receive a specified cash payment on account of dividend arrearages; (c) that the common stock of the Southern Co. and Ohio Edison Co. will be distributed to holders of Commonwealth's common stock; and (d) that Commonwealth will liquidate and dissolve. Commonwealth has stated that this new plan supersedes the plan dated March 25, 1946, earlier mentioned.

[18] Holding Company Act release No. 7615 (1947).
[19] Holding Company Act release No. 7347 (1947).

Electric Bond & Share Co.

When the parent of this system, Electric Bond & Share Co. (Bond & Share), registered under the act in 1938, it controlled 121 domestic subsidiaries including 5 major subholding companies: American Power & Light Co. (American); American & Foreign Power Co., Inc. (Foreign Power); American Gas & Electric Co. (American Gas); Electric Power & Light Corp. (Electric); and National Power & Light Co. (National). Of these, the American Gas system ceased to be a subsidiary of Bond & Share during the past year, and National disposed of substantially all of its interests in electric and gas utility companies. By June 30, 1947 Bond & Share had divested itself of 78 direct and indirect subsidiaries having assets of $1,650,000,000 and had filed plans calling for the retirement of its preferred stocks and the divestment of all its remaining public utility investments in the United States [20] in order to become, prospectively, an investment company.

Pursuant to plans approved by the Commission and by the district court, Bond & Share has paid an aggregate of $100 per share to the holders of its $5 and $6 preferred stocks and in addition delivered to each of such holders a certificate evidencing his right to receive any additional amounts which the Commission or the courts may approve or direct.[21] Funds for these payments were derived from a bank loan and from disposition of all of its holdings of the common stock of Pennsylvania Power & Light Co. and substantially all of its holdings of American Gas common stock, principally by means of rights offered to Bond & Share's common stockholders. As a result of such disposition Bond & Share ceased to be a holding company with respect to both Pennsylvania and American Gas. In addition, the company proposes to dispose of its holdings of Carolina Power & Light Co. and Birmingham Electric Co., the proceeds from such disposition to be used to retire its bank loan. The Commission has already authorized the sale of Carolina Power & Light Co. common stock.[22]

On November 25, 1946, the Supreme Court upheld the constitutionality of section 11 (b) (2) of the act [23] and affirmed the Commission's order of August 22, 1942, which directed the dissolution of American and Electric.[24] During the year American and its subsidiaries took the following major steps toward compliance with section 11:

On September 6, 1946, American, joined by Bond & Share, filed a plan providing for the retirement of American's $5 and $6 preferred stocks either through an exchange for portfolio securities or for cash.[25] The plan also provides for the compromise and settlement of certain claims between American and its subsidiaries and Bond & Share and certain of its subsidiaries. Under the plan American would dispose of all of its interest in Texas Utilities Co. as required by the Commission's order permitting the creation of that company.[26] Beginning on October 22, 1946, hearings on the plan were held from time to time and concluded as to all major issues on March 11, 1947. A common

[20] Holding Company Act release No. 5970 (1945).
[21] On April 7, 1947, Bond & Share filed plan II–B, in which it proposed to make no further payments to the holders of these certificates. Hearings on this matter were in process after the close of the fiscal year.
[22] Holding Company Act release No. 7383 (1947).
[23] 329 U. S. 90 (1946).
[24] Holding Company Act release No. 3750 (1942).
[25] Holding Company Act release No. 6902 (1946).
[26] Holding Company Act release No. 6158 (1945).

stockholders' committee opposed the company's plan and submitted a plan proposing the allocation of American's portfolio securities among the company's preferred and common stockholders. Briefs were exchanged and on May 27, 1947, the two plans were argued before the Commission.

On April 24, 1947, the Commission authorized the merger of Northwestern Electric Co. into Pacific Power & Light Co. and the retirement of the two companies' preferred stocks through a new preferred stock issue by Pacific, the survivor.[27] Subsequently, Pacific refunded its debt and the debt of Northwestern which has been assumed under the merger agreement.[28]

The compromise section 11 (e) plan filed by Electric Power & Light Corp. and Bond & Share, described in the last annual report, was pending before the Commission at the end of the fiscal year.[29] Hearings have been completed and the plan has been briefed and argued.

American Gas has divested itself of all holdings in companies held to be unretainable under section 11 with the exception of the common stock of Atlantic City Electric Co. The Commission has approved a plan for the disposition of Atlantic City whereby American Gas will divest itself of all interest in that company by December 31, 1948.[30] The Commission also approved the acquisition by American Gas of the common stock of Indiana Service Corp., holding that the latter company might properly be considered a part of the Central System approved by the Commission during 1946.[31]

The plan of reorganization filed by Foreign Power under section 11 (e) of the act on October 26, 1944, in which Bond & Share joined,[32] was amended by a plan of reorganization filed on May 22, 1947, in which Bond & Share also joined.[33] The proceedings were reconvened and hearings on the amended plan began on June 24, 1947. On July 16, 1947, the record in the proceedings was closed on all matters except as to certain fees and expenses, and counsel for parties and participants agreed on a program for submission of briefs and for oral argument.

Engineers Public Service Co.

This system at the time of its registration in February 1938 had included 20 subsidiaries with consolidated assets of $370,000,000. Operations were conducted in 13 States. During the past year the Commission approved a plan for the sale and distribution of nearly all the assets of Engineers and for its dissolution. A certificate of dissolution was filed and recorded on June 30, 1947, and Engineers' only remaining asset consists of about 5 percent of the common stock of Virginia Electric & Power Co.

The plan originally filed by Engineers in this matter provided for the retirement of its preferred stocks at their voluntary liquidating price of $100 plus accrued dividends. Funds to retire the preferred were expected to come from treasury cash, from proceeds of an offering of rights to Gulf States Utilities Co. common stock to the

[27] Holding Company Act release No. 7369 (1947).
[28] Holding Company Act release No. 7564 (1947).
[29] Holding Company Act release No. 6768 (1946).
[30] Holding Company Act release No. 7335 (1947).
[31] Holding Company Act release No. 7054 (1946).
[32] Holding Company Act release No. 5388 (1944).
[33] Holding Company Act release No. 7450 (1947).

common stockholders of Engineers, and from a bank loan of $3,000,000. The bank loan was to be repaid over a 3-year period, and it was proposed that the common stock of Virginia Electric & Power Co. be retained by the liquidating trustees of Engineers as security for such loan. The common stock of El Paso Electric Co. (Texas) was to be distributed to Engineers' common stockholders as a part of the plan.

The Commission issued its findings and opinion regarding this plan on December 5, 1946.[34] Approval of the bank loan was withheld on the grounds that funds could readily be obtained from other sources which would not prolong for 3 years the control of the $65,000,000 assets of Virginia Electric & Power Co. The Commission also found that the impact of section 11 was responsible for the dissolution of Engineers and that the charter provisions for retirement of its preferred stock thus did not apply. An examination was accordingly made of the investment value of such stock. It was found that this value was at least equal to the respective call prices of the various series of preferred stock, and Engineers' proposal to retire these shares at $100 plus accrued dividends was denied approval.

Engineers subsequently filed an amended plan eliminating the bank loan and providing for distribution to its common stockholders of the common stock of Virginia as well as that of El Paso. The amended plan also provided for retirement of the preferred stock at the respective call prices. The plan as amended was approved by the Commission on January 8, 1947,[35] and an application was filed in the district court to enforce and carry out the plan. On May 15, 1947, the court disapproved that part of the plan calling for the payment of the full voluntary redemption prices, but permitted consummation of the plan by the payment of $100 plus accrued dividends to the preferred stocks and the escrowing of an amount sufficient to cover the difference between the involuntary liquidation price and the voluntary redemption prices in the event that it should be determined, on appeal, that the preferred stockholders were entitled to the larger amounts. The amount escrowed also made provision for interest on the escrowed premiums and for fees and other expenses connected with the plan.[36] As indicated earlier, the Commision and others have appealed from the decree of the court, and these appeals are now pending in the Circuit Court of Appeals for the Third Circuit.

General Public Utilities Corp. (Formerly Associated Gas & Electric Corp.)

At the time the Associated Gas & Electric system registered under the act in March 1938, its consolidated assets were stated at over $1,150,000,000. The system included 170 subsidiary companies, operating in 29 States and the Philippine Islands, as well as numerous other affiliated companies. In contrast, the present system of General Public Utilities (GPU) consists of 26 subsidiaries with consolidated assets of $660,000,000 and operating in only 3 States and the Philippines. The Commission has not yet determined which of these remaining properties may be retained by GPU under section 11 (b) (1).

[34] Holding Company Act release No. 7041.
[35] Holding Company Act release No. 7119.
[36] *In re Engineers Public Service Company*, 71 F. Supp. 797 (Del.).

During the past fiscal year four former subholding companies in the system were dissolved: Associated Utilities Co., Gas & Electric Associates, General Gas & Electric Corp. and NY PA NJ Utilities Co.

A recapitalization plan pursuant to section 11 (b) (2) was consummated by New England Gas & Electric Association (NEGAS) which resolved complex claims and counterclaims between NEGAS and various companies in the Associated system. As indicated in the Twelfth Annual Report of the Commission, an amended plan was developed through discussion by all interested parties which was approved by the Commission and the appropriate district court. The plan called for the public sale of debentures and common stock, the latter at not less than $11 per share or, at the option of GPU, whose claims were affected by such price, at not less than $10 per share. When it developed that even the lesser amount could not be realized for the NEGAS common, an alternate plan was filed providing for the issuance of collateral trust bonds, convertible preferred stock and common stock. This alternate plan was likewise the result of discussions among all interested parties, including protective committees. In its findings and opinion the Commission indicated that the use of preferred stock could be considered appropriate only in the light of the imminent maturities of the outstanding NEGAS debentures and the fact that the earlier amended plan was no longer feasible.[37] The plan was consummated during April 1947. After the close of the fiscal year GPU sold at competitive bidding its holdings of NEGAS common which had been received under the plan.

International Hydro-Electric System

This company (IHES) is under a Commission order to liquidate and dissolve. However, litigation has been in process over claims asserted by IHES against its former parent, International Paper Co., delaying such liquidation and dissolution. A settlement of these claims was approved by the district court in December 1945 and an appeal was taken by a stockholder and a director of IHES. On November 14, 1946, the Circuit Court of Appeals for the First Circuit affirmed the decree of the district court.[38] Appellants filed a petition for a writ of *certiorari* in the Supreme Court of the United States, which was denied on February 10, 1947.[39] A petition for rehearing was filed which was denied by the Supreme Court on March 10, 1947,[40] and payment in the amount of $10,000,000 was thereupon made in accordance with the settlement provisions.

A further step toward the dissolution of IHES was taken in the acquisition and merger by Eastern New York Power Corp. of Hudson River Power Corp. and System Properties, Inc., all subsidiaries of IHES. As a result of this merger the assets of these companies and the capital structure of the surviving company were better adapted to subsequent divestment by IHES. The plan was approved by the Commission on December 14, 1946.[41]

As indicated in the Twelfth Annual Report, the Commission approved a plan under section 11 (b) (2) for the simplification of the

[37] Holding Company Act release No. 7181 (1947).
[38] *Ladd* v. *Brickley*, 158 F. (2d) 212.
[39] 67 S. Ct. 675.
[40] 67 S. Ct. 964.
[41] Holding Company Act release No. 7042.

New England Power Association (NEPA) system. The order of the district court approving this plan was affirmed on appeal [42] and the plan was consummated in June 1947. As a result of this plan four subholding companies were merged with NEPA to form a new holding company, New England Electric System (NEES). A fifth subholding company was dissolved. The securities of NEES now consist of $85,000,000 of funded debt and 6,695,075 shares of common stock, as compared with the 18 classes of holding company securities previously outstanding in the system.

Prior to consummation of the above plan, IHES owned 88 percent of the NEPA common stock representing 51.5 percent of the voting power. IHES interest in NEES amounts to less than 8 percent of the total voting power as a result of the redistribution provided for in the plan.

The Middle West Corporation

Pursuant to a section 11 (b) (1) order of the Commission, the Middle West Corp. (Middle West) was directed to divest itself of its interest in all companies except Central Illinois Public Service Co., Kentucky Utilities Co., and Public Service Co. of Indiana, Inc.[43] Hearings were held from time to time regarding the retainability by Middle West of these latter three subsidiaries and raising issues as to the continued existence of Middle West. In May 1947 the management of Middle West deemed it advisable for the benefit of the stockholders to dissolve the corporation and is presenting an appropriate resolution to its stockholders for approval. If such resolution is approved, it is Middle West's intention to distribute or sell its remaining investments and assets.

During the prior fiscal year the Commission approved and the district court ordered enforcement of a plan of merger of Central & South West Utilities Co. and its subsidiary, American Public Service Co., both subsidiaries of Middle West. The plan was consummated in February 1947 and the surviving company, Central & South West Corp. (Central), controls a group of operating companies whose electric properties have been held to be an integrated system. Divestment of certain nonutility properties remains to be carried out. Central is no longer a subsidiary of Middle West by virtue of the distribution by Middle West to its stockholders of the stock of Central received by it under the plan.

An amended plan under section 11 (e) was filed by North West Utilities Co. (North West) in February 1947 proposing to distribute to its preference stockholders the common stock of Wisconsin Power & Light Co. held by North West and to terminate the corporate existence of North West. Hearings were concluded in June 1947 and briefs were filed and oral argument heard after the close of the fiscal year.

New England Public Service Co.

On November 23, 1946, New England Public Service Co. (NEPSCO) filed an amended plan for corporate simplification by retirement of its prior lien preferred stock and a further amended plan was filed on March 10, 1947.

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[42] *Lahti* v. *New England Power Association*, 16 F. (2d) 845 (C. C. A. 1, 1947).
[43] Holding Company Act releases Nos. 4846 (1944) and 6010 (1945).

At the close of 1946, the $7 prior lien preferred stock of NEPSCO had dividend arrears of $71.31 per share and the $6 prior lien stock had arrearages of $61.12 per share. In addition, NEPSCO had $6 and $7 series of so-called "plain preferred" with respective arrearages of $88.25 and $102.95 per share. The plan in question called for the retirement of the prior lien shares by cash payments at the call price plus accrued dividends. It was also proposed that the prior lien stockholders have the option of taking common stock of Public Service Co. of New Hampshire in lieu of cash. NEPSCO was not bound by the plan to provide this option, however, if market or other conditions made disposition of the New Hampshire stock seem inadvisable.

NEPSCO had realized substantial capital gains from sale of its industrial properties, as indicated in the Twelfth Annual Report, and was entitled to the benefits under supplement R of the Internal Revenue Code only if such funds were used for certain specified purposes within a 24-month period.

One of the major objectives of the above plan was the utilization of such funds in retirement of the prior lien stock by October 30, 1947, in order that NEPSCO would not incur a capital gains tax estimated at $3,200,000. Thus in approving the plan on June 27, 1947,[44] the Commission sought to minimize the possibilities of delay in its consummation by requiring that payment to prior lien stockholders be limited to $100 per share plus accrued dividends and that an amount corresponding to the aggregate call premium, the payment of which was controversial, be placed in escrow.

The North American Co.

On January 6, 1947, the North American Co. (North American) submitted new plans,[45] designated as plans I, II, and III, pursuant to section 11 (e) of the act, withdrawing plans previously submitted and proposing: (*a*) the settlement of all system claims and counterclaims affecting Illinois Power Co. and the liquidation and dissolution of North American Light & Power Co. (Light & Power); (*b*) to obtain funds to pay off bank loans and to make advances to enable Light & Power to complete its liquidation; and (*c*) to effect the divestment by North American of its entire public utility holding company system. The portion of plan I pertaining to the settlement of the Illinois Power Co. claims has been approved by the Commission [46] and has been consummated. The remaining portion of plan I, as amended, pertaining to the dissolution of Light & Power has been approved by the Commission [47] and is presently under consideration by a court upon application for judicial enforcement.[48]

During the year North American has disposed of its interests in Cleveland Electric Illuminating Co. through the issuance of purchase warrants to holders of North American common stock [49] and the sale of the residual shares on the open market. Its interest in St. Louis County Gas Co. was sold at competitive bidding [50] and North

[44] Holding Company Act release No. 7511.
[45] Holding Company Act release No. 7124 (1947).
[46] Holding Company Act release No. 7238 (1947).
[47] Holding Company Act release No. 7514 (1947).
[48] D. C. Del., Civil Action No. 1033 (1947).
[49] Holding Company Act release No. 7526 (1947).
[50] Holding Company Act release No. 7236 (1947).

American has made the first of several proposed distributions to its stockholders of the common stock of Wisconsin Electric Power Co.[51]

Washington Railway & Electric Co. submitted a plan pursuant to section 11 (e) of the act which, as amended, has been approved by the Commission [52] and the District Court for the District of Columbia.[53] Upon consummation, the plan will result in the dissolution of Washington Railway & Electric Co. and the consolidation of its electric utility assets in Potomac Electric Power Co. Of its other assets, the common stock of Capital Transit Co. has been made the subject of a rights offering to Washington Railway's common stockholders,[54] while Great Falls Power Co. (a land company) has been acquired by Potomac Electric Power Co. and will be held temporarily subject to an order requiring its divestment.

Standard Power & Light Corp.—Standard Gas & Electric Co.

During the past year Standard Gas & Electric Co. (Standard Gas) disposed of its interests in Mountain States Power Co.[55] and California-Oregon Power Co.[56] thus reducing the area in which its system renders electric or gas service to 7 States as compared to 19 at the time of its registration in 1938.

An amended dissolution plan was filed under section 11 (e) by Louisville Gas & Electric Co. (Delaware), a subholding company, enlarging the participation of its class A stock in the distribution of its assets prior to dissolution. All of the class A stock is publicly held. The company also proposed to invest substantially all its net current assets in additional stock of its subsidiary, Louisville Gas & Electric Co. (Kentucky). Such shares plus its present holdings would then be distributed to its class A and class B stockholders. Hearings have been held, the record closed, and oral argument scheduled.

Proceedings pursuant to section 11 (b) (2) of the act were instituted with respect to Philadelphia Co., a subholding company controlling 15 direct and 40 indirect subsidiaries.[57] Such proceedings were consolidated with those under section 11 (b) (1) previously instituted against Standard Gas and its subsidiary companies. Hearings in the consolidated proceedings have been held and the record closed. Briefs and requested findings are being prepared and oral argument has been requested.

The United Corp.

On June 12, 1946, the Commission instituted proceedings under sections 11 (b) (1) and 11 (b) (2) with respect to Public Service Corp. of New Jersey (Public Service), a holding company subsidiary of United. In September 1946, Public Service filed an application, pursuant to section 11 (e), for approval of a plan calling for its dissolution. The plan provides that the dividend preference stock of Public Service Electric & Gas Co. (Electric & Gas), the principal sub-

[51] Holding Company Act release No. 7461 (1947).
[52] Holding Company Act release No. 7410 (1947).
[53] D. C. Dist. of Col., Civil Action No. 2076–47 (1947).
[54] The North American Co. agreed to purchase any unsubscribed shares and did, in fact, acquire a total of 106,446 shares of which 12,791 shares represented the unsubscribed portion of the offering.
[55] Holding Company Act release No. 7061 (1946).
[56] Holding Company Act release No. 6707 (1946).
[57] Holding Company Act release No. 7025 (1946).

sidiary of Public Service, be exchanged for the latter's noncallable preferred stock in the hands of the public, that debentures of Electric & Gas be exchanged for the perpetual certificates of Public Service and that the common stock of Electric & Gas and of South Jersey Gas Co. (a subsidiary of Public Service) be distributed to Public Service's common stockholders. As a part of the plan, the ownership of Public Service Coordinated Transport, now a subsidiary of Public Service, will be transferred to Electric & Gas, and County Gas Co., also a subsidiary of Public Service, will be disposed of after a recapitalization has been effected.[58]

During the fiscal year, the Commission permitted declarations to become effective providing for open-market purchases by United of its preferred stock in an amount not to exceed $5,000,000. Further retirement of its preferred was provided for in two plans filed during the year. In January 1947 United proposed to offer in exchange for each share of its preference stock, to the extent of 200,000 such shares, (*a*) four shares of common stock of Columbia Gas & Electric Corp., a subsidiary of United, and (*b*) $2 in cash. The Commission permitted the withdrawal of this application and in June 1947 United filed a new plan providing for the retirement of all of its preferred stock in exchange for a package of securities and cash, the character and amount of which were to be disclosed by further amendment. This amendment was filed in July and provided that for each share of the preference stock of United there would be exchanged (*a*) one share of the common stock of Public Service Electric & Gas Co. and (*b*) one-tenth of a share of the common stock of South Jersey Gas Co., provided the amended plan in the matter of Public Service Corp. of New Jersey and its subsidiary companies should, in the interim, have become effective; otherwise, (*a*) one share of the common stock of Public Service Corp. of New Jersey, (*b*) one share of the common stock of Columbia Gas & Electric Corp., (*c*) one-fourth share of the common stock of the Cincinnati Gas & Electric Co., and (*d*) $6 in cash.[59]

The United Light & Railways Co.

Since its registration in February 1938, this system has divested itself of 38 of its 56 subsidiary companies and has reduced its area of operation from 13 States to 7. These subsidiaries are grouped under two subholding companies, one of which, American Light & Traction Co. (American), filed a plan for its dissolution in 1945. As indicated in the Twelfth Annual Report, the Commission withheld approval of this plan on the grounds that it inadequately compensated the holders of American's 6 percent cumulative noncallable preferred stock. Reargument has been heard on this question.

On September 20, 1946, the Commission approved an application which involved the investment by American of $310,000 in the common stock of Michigan-Wisconsin Pipe Line Co., its subsidiary, to finance that company in securing authority from the Federal Power Commission to construct a natural gas pipe line from the Hugoton Gas fields in Oklahoma to Michigan. In approving the application,

[58] Holding Company Act releases Nos. 6883 (1946), 7336 (1947) and 7478 (1947).
[59] Holding Company Act releases Nos. 7496 and 7557 (1947).

the Commission stated that this financing should not permit any delay in the liquidation of American.[60]

On June 26, 1947, Railways and American filed a plan under section 11 (e) which, in general, provides for (1) continuance, without change in its capital stock structure, of American as a registered holding company owning a gas utility system consisting of the properties of Michigan Consolidated Gas Co., Milwaukee Gas Light Co., Milwaukee Solvay Coke Co., Michigan-Wisconsin Pipe Line Co., Austin Field Pipe Line Co., and such additional properties as hereafter may be acquired by American or its subsidiaries with the approval of State and Federal regulatory bodies having jurisdiction over such acquisition; (2) the disposition by American through distribution to its stockholders and/or by sale to the public of its holdings of the common stock of the Detroit Edison Co. and Madison Gas & Electric Co.; and (3) disposition by Railways of its interests, direct or indirect, in, and its holdings of stock of, American and its subsidiaries, including Madison Gas and Detroit Edison, through distribution to Railways' common stockholders in dividends and through sale to the public.

REGULATION OF SECURITY ISSUES

Volume of Financing

The past fiscal year witnessed a continuation of the high level of activity in security issues under sections 6 (b) and 7 of the act. The Commission declared effective 191 such applications and declarations [61] as against 197 during the previous year, representing a level nearly twice as high as the average for the period 1935–45. The dollar amount of securities covered by effective applications and declarations, however, declined from $2,374,865,967 in the year ended June 30, 1946, to $1,148,696,608 in fiscal 1947.

This decline was due largely to the shift in emphasis from refunding issues to those sold for new money purposes, the latter type of issue being ordinarily smaller than a refunding operation of the same company. While refunding issues accounted for about half of the entire volume of effective applications and declarations during this past year, their volume was only a fourth as large as that for fiscal 1946. It was to be expected that refundings would diminish in this way, partly because most companies had already refinanced and partly because of firming tendencies in money rates. Moreover, the refunding process became more expensive with the termination of excess profits taxes, as unamortized debt discount and expense, as well as call premiums on the refunded issues, had been deductible in computing such taxes.

There is shown below the break-down, by type and purpose of issue, of the securities covered by effective filings during each of the past 2 years and for the period November 1, 1935 to June 30, 1947:

[60] Holding Company Act release No. 6905 (1946).

[61] At the beginning of the 1947 fiscal year, 106 applications and declarations under sections 6 and 7 were pending and 228 were filed during the year. Of these, 234 were declared effective, 4 were withdrawn, leaving 96 pending at the close of the fiscal year. Of the 234 effective declarations and applications, 191 pertained to security issuance, 35 to alteration of rights, and 8 to assumption of liability.

Summary of effective security issues under sections 6 (b) and 7 of the Public Utility Holding Company Act of 1935 [1]

	July 1, 1946, to June 30, 1947			July 1, 1945, to June 30, 1946			Nov. 1, 1935, to June 30, 1947	
	Amount	Number of issues	Percent	Amount	Number of issues	Percent	Amount	Percent
Type of issue:								
Bonds	$262,556,000	31	22.9	$1,063,197,000	43	44.8	$5,481,059,778	50.5
Debentures	302,446,950	6	26.3	36,000,000	2	1.5	618,899,750	5.7
Notes	223,155,000	61	19.4	438,277,000	46	18.5	1,501,030,325	13.8
Preferred stock	143,544,000	17	12.5	418,185,000	37	17.6	1,369,380,038	12.6
Common stock	216,994,658	60	18.9	419,206,967	49	17.6	1,872,883,146	17.4
Total	1,148,696,608	175	100.0	2,374,865,967	177	100.0	10,843,253,037	100.0
Purpose of issue:								
Refunding and refinancing	557,192,662	-------	48.5	2,007,929,190	-------	84.6	7,773,996,536	71.7
Reorganization	271,309,262	-------	23.6	216,853,555	-------	9.1	1,817,003,137	16.8
Acquisition of property or other assets	33,578,884	-------	2.9	148,186,016	-------	6.2	675,241,954	6.2
New financing	286,615,800	-------	25.0	1,897,206	-------	0.1	568,611,130	5.2
Miscellaneous	0	-------	—	0	-------	—	8,400,280	.1
Total	1,148,696,608	-------	100.0	2,374,865,967	-------	100.0	10,843,253,037	100.0

[1] These figures do not include outstanding issues whose rights were altered under sections 6 (a) (2) and 7 (e), nor do they include the guarantee of other issues.

New Financing

New financing has assumed greater importance over the past year than in any year since the effective date of the act. The heavy construction program now under way, which by responsible estimates will increase the generating capacity of the electric utility industry by 30 to 40 percent within the next 5 years, gives promise that new financing will increase still further in volume over this period. During the past fiscal year new financing under sections 6 (b) and 7 was made up as follows:

New financing under sections 6 (b) and 7 (fiscal year July 1, 1946 to June 30, 1947)

	Amount	Number of issues	Percent
Bonds	$31,013,001	[1] 15	10.8
Debentures	10,477,360	[1] 3	3.7
Notes	109,471,000	38	38.2
Preferred stock	17,303,400	[1] 7	6.0
Common stock	118,351,039	30	41.3
Total	286,615,800	93	100.0

[1] Includes issues whose proceeds were used both for new financing and refunding purposes.

As indicated by the above table, notes and common stock were the vehicles principally employed to raise new money. Of the note issues, 32 were placed with banks and insurance companies in an aggregate amount of $88,821,000. The remaining 6 issues, amounting to $20,650,000, represented loans from the parent company. With respect to common stock money, funds of parent companies bulked even larger.

Twenty-five issues of common stock amounting to $88,002,566 were purchased by parent companies leaving only 5 issues totaling $30,348,473 for sale to the public.

Although a large part of the funds needed for construction purposes has thus far been derived from parent companies and from internal sources such as depreciation reserves, it must be anticipated that an increasing proportion of these needs will have to be met by public financing. Such financing can, of course, alter materially the existing capitalization ratios of an expanding company, and the increased volume of new money issues thus places upon the Commission an enlarged responsibility for maintaining sound capital structures in companies under its jurisdiction. Particularly if the market for junior securities is dull, the combined efforts of the industry, the Commission, and other regulatory agencies will be required to keep the issuance of debt securities within prudent bounds.

PROTECTIVE PROVISIONS FOR SENIOR SECURITIES

During recent years the Commission has evolved comprehensive protective provisions relating to bonds and preferred stocks. These provisions have been written into bond indentures or corporate charters, as the case may be, with respect to issues approved under sections 6 (b) and 7 and have given new and wider protection to investors. The extensive refunding program of the last few years has accelerated the pace at which these provisions have been put into effect. However, because many operating companies are being removed, under section 11, from the jurisdiction of this Commission, much of the prospective new financing for construction purposes will not contain these provisions unless they are accorded the support of other regulatory bodies as well.

These protective provisions cannot be set down in final, definitive form, since they must retain the elasticity necessary for successful adaptation to many different companies. Moreover, these provisions and particularly the technicalities of legal phrasing in which they find expression in the indenture are subject to continuous reexamination by the Commission. In outline, however, typical provisions and some of the purposes which they are designed to serve are as follows:

Provisions Relating to Bond Issues

Issuance of additional bonds.—The issuance of additional bonds is limited to 60 percent of the cost or fair value of net bondable additions to fixed property. While the Commission endeavors to limit the amount of debt initially outstanding to 50 percent of new fixed property, the standard of 60 percent with reference to additional bonds is designed to give the issuer sufficient flexibility to meet future exigencies while at the same time requiring it to provide a reasonable proportion of junior capital in meeting its growth requirements. Issuance of additional bonds is also conditioned upon the adequacy of the earnings coverage for the entire amount of bonds to be outstanding. This coverage is computed on the basis of earnings before income taxes and a coverage of at least two times is usually required.

"Net additions" are carefully defined to exclude from gross property additions any property or cash certified or delivered to the trustee in satisfaction of any other provisions of the mortgage, such as require-

ments of the maintenance and depreciation fund or the sinking fund. Also excluded is the amount, if any, by which retirements exceed the depreciation requirement of the maintenance and depreciation fund. Property previously used as a basis for the issuance of additional bonds is likewise deducted in arriving at "net additions."

Maintenance and depreciation fund.—The purpose of creating a maintenance and depreciation fund is to assure, as certainly as possible, that the net value of the property securing the mortgage will not decrease materially. The issuer is required to set aside for this fund each year either a fixed precentage (frequently 15 percent) of gross operating revenues or a percentage of its fixed property. This amount is annually accounted for to the trustee in terms of—

(*a*) Cash expended for maintenance.
(*b*) The cost or fair value of property used to replace property retired from service.
(*c*) The cost or fair value of property additions.
(*d*) Bonds secured by the mortgage and surrendered for cancelation.
(*e*) Cash deposited with the trustee.

Property used in accounting to the trustee under (*b*) and (*c*) above may not be used for any other purpose under the indenture.

Sinking funds.—The primary function of a sinking fund is to improve the ratio between debt and net property. Thus it is particularly necessary where, for one reason or another, a satisfactory ratio cannot be obtained at the time securities are issued. The Commission ordinarily requires a sinking fund of 1 percent of the largest principal amount of the issue at any time outstanding; where the initial ratio is unfavorable, this percentage is increased. If the issuer is faced with heavy serial payments on unsecured debt, the operation of the sinking fund on the bonded debt is ordinarily postponed until a date subsequent to that of the final serial maturity.

Since most utility companies are and have been under the necessity of increasing their facilities and thus in constant need of cash for such purposes, the Commission has seldom required that sinking funds be operated on a cash basis. Instead, a company may certify property additions, which may not then be used for any other purpose under the mortgage. The amount of certified property necessary to meet the sinking fund requirements is made equivalent to that necessary for the issuance of additional bonds, i. e., under the typical 60-percent provision, $1,666.67 of property must be certified in lieu of each $1,000 in cash or surrendered bonds.

Dividend restrictions.—Dividends on the common stock, with the frequent exception of 1 year's dividend requirements, may be paid only out of earned surplus accumulated subsequent to the date of the mortgage in order to prevent dissipation of the existing equity by excessive dividend payments. If operating expense for a given year has been charged with maintenance and depreciation in an amount less than a stipulated percentage of gross revenues or of fixed property, earned surplus is further restricted by the amount of such deficiency. In some cases the dividend restriction is based upon the company's net income available for dividends, as defined in the indenture, rather than upon earned surplus. Ordinarily, these restrictions apply only to common-stock dividends, but may be made applicable to preferred as well.

Provisions Relating to Preferred Stock Issues

Default in dividend payments.—Upon defaults aggregating 1 year's dividends, the preferred stock as a class is given the right to elect a majority of the board of directors. Since preferred dividend arrearages bear no interest and since the disadvantages they bring upon the common stockholder are not always sufficiently acute to insure maximum efforts in clearing such arrearages, the transfer of control upon default is an essential minimum protection for preferred stockholders. This provision becomes operative no later than the annual stockholders' meeting following the default and an earlier special meeting may be called in some instances. When all dividend arrearages on the preferred have been paid, control is returned to the common stockholders.

Issuance of unsecured debt.—A majority vote of the preferred stock is required as to the issuance of unsecured debt in excess of 10 percent of the aggregate secured debt, capital, and surplus of the company. This limitation is designed to protect the preferred from imposition of excessive prior ranking debt while leaving to the management reasonable latitude in temporary financing. A vote is not required, however, if the unsecured debt is to be used for the retirement of preferred stock. Neither is the preferred given a vote with reference to any issuance of secured debt, since the latter is circumscribed by indenture provisions which serve to protect the stockholder as well as the creditor.

Issuance of prior ranking preferred stock.—A two-thirds vote of the preferred stock is required before any prior ranking preferred may be authorized.

Issuance of equally ranking preferred stock.—A two-thirds vote of the preferred stock is necessary to authorize the issuance of additional preferred of equal rank unless earnings coverage and common stock equity meet certain standards after giving effect to the proposed issuance. These standards are—

1. Interest on long-term debt and dividend requirements on both the present and the new preferred must be covered at least 1½ times.
2. Common stock and surplus must at least equal the combined involuntary liquidating value of the present and the new preferred.

Merger or consolidation.—Since the position of a preferred stockholder may be prejudiced by merger with a financially unsound company, a majority vote of the preferred stock is required to authorize a merger or consolidation.

Restriction on common stock dividends.—If common stock equity is or becomes less than 25 percent of total capitalization and surplus, a dividend restriction on the common stock automatically becomes operative. This restriction is an important protection of the preferred stockholder's equity cushion. Dividends are restricted as follows:

1. If common equity is at least 20 percent but less than 25 percent, common dividends may not exceed 75 percent of net income otherwise available for such dividends.
2. If common equity is under 20 percent, common dividends are limited to 50 percent of net income otherwise available for such dividends.
3. Except to the extent permitted in (1) and (2) above, no common dividend may be paid which would reduce common equity to less than 25 percent of total capitalization and surplus.

Amendment of the articles of incorporation.—A two-thirds vote of the preferred stock is required to change the terms and conditions of such stock, the above protective provisions being examples, in any manner substantially prejudicial to the preferred stockholder.

COMPETITIVE BIDDING

The past year has seen the first extended period in which the Commission's competitive bidding rule has been called upon to function in a falling market. It has been recognized from the outset, of course, that the competitive bidding procedure is not necessarily adapted to all securities and all market conditions, and exemption provisions were thus made an integral part of rule U-50. However, it has been necessary to grant exemptions in only a few cases even under the relatively unfavorable market conditions of the year just past.

Although the volume of offerings under rule U-50 dropped sharply from the previous year, the total of $466,265,349 for the 12 months ended June 30, 1947 was exceeded only in the 1945 and 1946 fiscal years, when refunding operations were at their height.[62] From the standpoint of equity securities alone, the 1947 volume was surpassed only by that of 1946.

EXEMPTIONS FROM THE PROVISIONS OF THE ACT

During the fiscal year the commission approved five applications for exemption from the provisions of the act pursuant to sections 2 and 3.[63] In addition, five orders were issued pursuant to section 5 (d) of the act declaring that the registrations of certain holding companies had been terminated.[64]

Twenty-eight holding companies filed statements during the year claiming exemption under rule U-2 as being predominantly operating or intrastate companies. Ten banks claimed exemption pursuant to rule U-3, and 21 small holding companies claimed exemption under rule U-9.

REGULATION OF UTILITY ACCOUNTS

During the past year the Commission set up an original cost section in its Public Utilities Division. The duty of this section is to examine and review the filings which have been made pursuant to rule U-27. This rule states that companies not required by the Federal Power Commission or a State regulatory body to conform to a classification of accounts must keep accounts according to systems prescribed by this Commission. Among other things the prescribed systems of accounts require that plant, property, and equipment be set forth on an original

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[62] Securities sold under rule U-50 from May 7, 1941, its effective date, to June 30, 1947, total $3,952,705,349, comprising 222 issues.

[63] *Cincinnati Milling Machine Co.; The Factory Power Co.*, file No. 31–538; *Preston-Shaffer Milling Co.*, file No. 31–542; *Great Northern Gas Co., Ltd.*, file No. 31–439; *American Gas & Electric Co.*, file No. 31–425; *Industrial Electrica Mexicana, S. A.*, file No. 31–544.

[64] *Texas Public Service Co., formerly Peoples Light & Power Co.*, file No. 30–88; *Estate of Midland Utilities Co., successor Trustees*, file No. 30–54; *Eastern New York Power Corp.*, file No. 30–22; *Northeastern Water Co., formerly Northeastern Water & Electric Corp.*, file No. 30–118; *Arkansas-Missouri Power Corp.*, file No. 30–89.

cost basis. Extensive field investigations and examinations have been made of the original cost reports submitted by some of the companies subject to rule U-27. The results are nearing completion.

Long-standing orders of the Commission involving Florida Power & Light Co.[65] with respect to certain accounting requirements were affirmed on review by the circuit court.[66] Florida is a subsidiary of American Power & Light Co. and Electric Bond & Share Co. The Commission had ordered that, pending final determination under rule U-27 of the total and the disposition to be made of the amounts in utility plant acquisition adjustment account (account 100.5), Florida should begin to appropriate out of earned surplus to a contingency reserve at least $700,000 per year, and should classify in account 107 and eliminate from the plant account by charge to earned surplus not later than December 31, 1944, an amount of $1,815,655 consisting of capitalized intrasystem profits paid to affiliated companies as construction and engineering fees. These orders were attacked as being beyond the powers of the Commission, based on sections of the act alleged to be unconstitutional, unwarranted by the evidence, and contrary to generally accepted accounting principles. The court first disposed of the issue of constitutionality and found that the accounting provisions of sections 15 and 20 of the act were designed to prevent the evils set out in section 1 of the act and were constitutional. The reasoning and decisions of the Supreme Court in *Electric Bond and Share Company* v. *S. E. C.*[67] and *The North American Company* v. *S. E. C.*[68] were cited to support the validity of the regulatory power of the Commission. The court then proceeded to find that sections 15 and 20 of the act were sufficiently inclusive to permit the adoption by the Commission of an "original cost" system of accounts and sustained the Commission's order requiring a contingency reserve to be accumulated to offset probable write-offs upon completion of the original cost study now being conducted pursuant to rule U-27.

COOPERATION WITH STATE COMMISSIONS

It has been the long established policy of the Commission to work for effective cooperation with the State commissions in all matters where their respective jurisdictions interlock and in all additional matters where such cooperation is desirable and appropriate in the case under consideration. The Commission has found that the State commissions are equally interested in the interchange and harmonization of views on mutual problems. During the past year there have been many cases in which this cooperative approach has been helpful.

A number of State commissions have availed themselves of the provision of section 19 of the act which requires the admission "as a party (of) any interested State, State commission, State securities commission, municipality, or other political subdivision of a State" in proceedings before the Commission. One example of this type of cooperation concerned the formation of the Southern Co. to hold the southern properties of the Commonwealth & Southern Corp. Requests to intervene in these proceedings were made by the attorney general

[65] Holding Company Act releases Nos. 4719 (1943), 4824 and 4825 (1944).
[66] 158 F. (2d) 771 (C. C. A. 1, 1946), petition for rehearing denied Jan. 8, 1947, certiorari denied 67 S. Ct. 1348 (1947).
[67] 303 U. S. 419 (1938).
[68] 327 U. S. 686 (1946).

of the State of Alabama, the Public Service Commission of the State of Georgia, and the Public Service Commission of South Carolina. A representative of the Georgia commission conferred with the staff of this Commission and with representatives of the management and also testified as an expert at the hearings. The South Carolina Commission requested postponement of the hearings to enable it to consider the proposal, and subsequently conferred with the staff of this Commission and the management. As a result of these conferences the plan was changed in certain respects and has been approved by the Commission.

In the case of the reorganization of Kings County Lighting Co. the opinion of the Commission differed from that of the New York Public Service Commission. In August 1945, Kings County Lighting Co. simultaneously filed a plan of recapitalization with the Commission and with the New York commission and hearings were held thereon before each commission. On February 5, 1946, the New York commission issued an opinion in which it criticized the plan in certain respects. It recommended, among other things, that (1) the proposed capital structure be modified and that (2) all the new preferred and new common stock be issued to the existing preferred shareholders, except possibly for a nominal amount to the holders of the existing common stock.

In April 1946 the company filed an amended plan with both commissions in which the proposed capital structure was changed to conform more closely to the views of the New York commission. The amended plan provided for the issuance of all the new preferred stock and 90 percent of the new common stock to the existing preferred shareholders and the remaining 10 percent of the new common stock to the existing common shareholders. The New York commission determined that the proposed allocation to present common shareholders was excessive and that such stockholders were entitled to no more than a nominal participation upon the basis of the book values of the assets of the company. This Commission in a series of letters and conferences pointed out that, under the decisions of the United States Supreme Court which were binding upon it, primary weight in determining the fairness of the allocation must be accorded earnings rather than book asset values. This Commission, in its findings and opinion, adopted the view of the New York commission with respect to the capital structure of the company, but concluded that, on the basis of indicated earnings, the existing preferred shareholders should receive all the new preferred stock and 92½ percent of the new common stock and that the balance of the new common stock should be allocated to the existing common shareholders. This allocation was acceptable to all security holders, both preferred and common. A draft of the Commission's findings and opinion was submitted to the New York commission for comment and subsequently several conferences were held in an effort to reconcile the opposing views. The Commission subsequently issued its findings and opinion[69] and, as provided by section 11 (e) of the act, applied to the district court for enforcement of the plan. The New York commission entered its order disapproving the plan and appeared at the hearing in the district court to oppose enforcement of the Commission's order. The matter was under advisement by the court at the close of the fiscal year.

[69] Holding Company Act releases Nos. 7060 (1946) and 7122 (1947).

The Commission endeavors to obtain the view of the State commissions with respect to any transactions proposed by registered holding companies or their subsidiaries where it appears that the local authorities may have jurisdiction over or an interest in the proposed transactions. This practice has been very helpful. It was employed in passing upon the plan of American Gas & Electric Co. to acquire the common stock of Columbus & Southern Ohio Electric Co. and in considering the proposal to merge Kansas City Gas Co. and the Wyandotte County Gas Co. into the Gas Service Co. Similarly, when Iowa-Illinois Gas & Electric Co. presented a plan under which it proposed to issue $22,000,000 of bonds to the public and to sell $3,500,000 of additional common stock to its parent, the Commission deferred action pending disposition by the State commission. In the application of the Central Illinois Light Co. for permission to reclassify its common stock and transfer a portion of its earned surplus to common capital stock account, the Illinois Commerce Commission was requested to state its views prior to our final determination.[70]

[70] Holding Company Act release No. 7459 (1947).

PART IV

PARTICIPATION OF THE COMMISSION IN CORPORATE REORGANIZATIONS UNDER CHAPTER X OF THE BANKRUPTCY ACT, AS AMENDED

Chapter X of the Bankruptcy Act, as amended in 1938, in setting up appropriate machinery for the reorganization of corporations (other than railroads) in the Federal courts provides for participation by the Commission in proceedings thereunder at the request of or with the approval of the court for the purpose of providing independent expert assistance to the court and to investors and for the preparation by the Commission of formal advisory reports on plans of reorganization submitted to it by the courts in such proceedings. The Commission's functions in chapter X proceedings are of a purely advisory character. The Commission has no authority to veto or to require adoption of a plan of reorganization or to render a decision on any other issue in the proceedings. It has no right of appeal in such proceedings, although it may participate in appeals taken by others and has, as a matter of fact, participated in many appeals as a party or as amicus curiae.

SUMMARY OF ACTIVITIES

The Commission actively participated during the year in 98 reorganization proceedings involving the reorganization of 124 companies (98 principal debtor corporations and 26 subsidiary debtors).[1] The aggregate stated assets of these 124 companies amounted to $1,933,599,000 and their aggregate indebtedness was $1,274,131,000.[2] During the year the Commission filed its notice of appearance in nine new proceedings under chapter X, two of which were filed at the request of the judge and the remaining seven upon approval by the judge of the Commission's motion to participate. These nine new proceedings involved 14 companies (9 principal and 5 subsidiary debtors) with aggregate stated assets of $15,457,000 and aggregate stated indebtedness of $13,135,000. Proceedings involving 24 principal debtor corporations and 6 subsidiary debtors were closed during the year.

At the close of the year, the Commission was actively participating in 74 reorganization proceedings involving 94 companies (74 principal and 20 subsidiary debtors), with aggregate stated assets of $1,716,189,000 and aggregate stated indebtedness of $1,097,928,000.

[1] Appendix table 24 contains a complete list of reorganization proceedings in which the Commission participated during the fiscal year ended June 30, 1947.

[2] Appendix table 24, pts. 1 and 2, classify these debtors according to industry and size of indebtedness.

COMMISSION'S FUNCTIONS UNDER CHAPTER X

A detailed discussion of the Commission's duties and policies in connection with its functions under chapter X appeared in the Twelfth Annual Report (pp. 81 to 93). The Commission maintains expert staffs of lawyers, accountants, and analysts in various regional offices where they keep in close touch with hearings, issues, and parties and are readily available to the courts. Some of the legal and financial questions encountered in typical bankruptcy and reorganization proceedings in which the Commission participated during the past fiscal year are described in the following paragraphs.

Problems in the Administration of the Estate

It is recognized that the trustee has the responsibility not only to examine into the debtors' past operations to ascertain the reasons for its financial difficulties but also to determine whether any causes of action exist against the old management or other persons and, if so, to prosecute them diligently. In view of that principle, during the past fiscal year the Commission has on various occasions supported requests that the trustee be authorized to bring suit on such corporate causes of action.

Where a fair offer of compromise was made, the Commission has, of course, supported the settlement of such suits, but not otherwise. In one case, the trustee had proposed, several years ago, a compromise of certain claims filed against the debtor for alleged services and advances by the promoter of the debtor.[3] The Commission had opposed the proposed compromise on the ground that evidence justified the disallowance of the claims in their entirety and indicated the possibility of causes of action by the estate against the promoter. Disapproval of the compromise was recommended by the special master. During the past fiscal year, however, the trustee submitted the proposed compromise to the court. In the meantime, an audit of the debtor's books urged by the Commission revealed, in the Commission's view, startling misconduct on the part of the promoter during the time he was in control of the debtor. The Commission thereupon, after prior notice to the trustee, filed a petition with the court asking that the trustee be instructed to withdraw his request for approval of the compromise and to prosecute all causes of action against the promoter. The matter has not yet been heard by the court.

In a significant case involving a suit for $39,000,000 by chapter X trustees against directors, officers, and the controlling stockholder of the debtor, the Commission appeared as amicus curiae and vigorously supported the trustees' contention that the Federal court had jurisdiction over the suit although it was not the court where the reorganization proceedings were pending and although no diversity of citizenship was alleged. The Commission urged that the Congress intended in chapter X cases to remove the restrictions contained in the Bankruptcy Act which might otherwise bar access to the Federal courts in suits brought by a reorganization trustee. It was the Commission's view that the Bankruptcy Act had been purposely modified so as to afford the reorganization trustee a wider choice of forum than the bankruptcy trustee, having in mind the typical suit involving diversion

[3] *International Mining & Milling Company*, District of Nevada.

of assets and related wrongs by insiders in large corporations with a national public interest. The district court did not agree with this contention and granted the defendants' motion to dismiss for want of jurisdiction.[4] On appeal, however, the Circuit Court for the Second Circuit reversed [5] and the Supreme Court affirmed this decision.[6]

In administering the debtor's estate, it is the trustee's function to recommend to the court the assumption or rejection of executory contracts of the debtor, including leases. In the reorganization proceedings involving Mount Gaines Mining Co., the question arose as to the applicability of section 70 (b) of the Bankruptcy Act which provides for a 60-day period for the assumption or rejection of the contracts of a bankrupt, including leases. On the theory that this time limitation is inconsistent with the provisions and purpose of chapter X, the Commission urged that it was not applicable. The difference between the purpose of bankruptcy to liquidate the estate and of chapter X to rehabilitate and preserve the enterprise was pointed out and the impracticability of applying the short limitation period in reorganization was emphasized. The district court adopted this view and, on appeal, the Circuit Court for the Ninth Circuit affirmed.[7]

Responsibilities of Fiduciaries

Trading in securities of a debtor in reorganization by trustees, directors, attorneys, committee members, or other fiduciaries is a practice which has generally been condemned by the courts and which has always been decried by the Commission in its opinions and reports. The access to inside information and, frequently, the control or influence over the course of reorganization which are possessed by these "insiders" are urgent considerations for enforcing judicial sanctions against them strictly. One such sanction which has been availed of during the past fiscal year in several cases in which the Commission participated is the prohibition against payment of any fees or reimbursement of any expenses where a fiduciary bought or sold securities of the debtor. These cases will be mentioned below. Another sanction is the prevention of any profiting by such a fiduciary through the limitation of his securities to the cost thereof or requiring him to account for any profits from securities sold by him.

In the reorganization proceedings involving National Realty Trust and Federal Facilities Realty Trust objections were filed to the final accounts of a former trustee of these debtors based in part upon the doctrine underlying limitation to cost. In these proceedings, the former trustee had permitted certain employees of his, with his knowledge and consent, to trade in the securities of the debtors and their subsidiaries. These employees, the promoter of the enterprise and his associate, had active supervision of the affairs of the debtors and their subsidiaries entrusted to them by the former trustee. In many instances, they purchased bonds from members of the public and sold them to the former trustee at a profit. After extensive hearings the matter has been presented to the special master for report. The Commission has urged that the former trustee should be surcharged to the extent of the profits he permitted his employees to make on the

[4] *Austrian* v. *Williams*, 67 F. Supp. 223 (S. D. N. Y. 1946).
[5] 159 F. (2d) 67 (C. C. A. 2, 1946).
[6] Decided June 16, 1947.
[7] *Title Insurance and Guaranty Co.* v. *Hart*, 160 F. (2d) 961 (C. C. A. 9, 1947).

ground that he had completely ignored and breached his trust obligations and he or his associates should not profit by his culpable conduct.

In the proceedings in reorganization involving Pittsburgh Railways Co., the Commission actively supported the trustee's request for authority to investigate possible grounds for subordinating or limiting to cost various claims of the parent company, Philadelphia Co. Philadelphia Co., after unsuccessfully attempting to prevent the inquiry into its management of the debtor, endeavored to extend the scope of the investigation to public security holders who may have purchased the debtor's securities at less than par. In opposing this contention, the Commission pointed out that, apart from special cases, security holders are treated equally regardless of when or at what price their securities were purchased. Unless this were the general rule reorganization securities would become unmarketable since no one would purchase securities at a price which would be the maximum he could obtain in distribution. It was urged by the Commission that the possibility of subordinating or limiting Philadelphia Co. was in no way relevant to the treatment to be accorded security holders buying at a discount—public holders should not recover less merely because a fiduciary who has committed wrongful acts recovers less. The district court upheld the Commission's position and denied Philadelphia Co.'s request. On appeal, the Circuit Court for the Third Circuit affirmed the order of the district court.[8] An application for certiorari, opposed by the Commission, was denied by the Supreme Court on May 5, 1947.

Activities with Respect to Allowances

In a proceeding involving Midland United Co., the Commission urged that an attorney who bought and sold preferred stocks and bonds of subsidiaries of a public utility holding company in reorganization while representing a protective committee for debenture holders should be barred from any compensation. The Commission pointed out that, as a fiduciary, the attorney owed an obligation not to acquire interests adverse to those he purported to represent nor to use information acquired in a trustee capacity to personal advantage. The Commission argued that these principles applied equally to a situation where the securities acquired, or sold, were those of a subsidiary, particularly where, as in this case, the subsidiary had substantial claims against the parent company and where other adverse interests existed. The Commission also took the position that the prohibition against trading by a fiduciary is equally applicable to his near relatives and business partners. The district court sustained the Commission's position and denied compensation to the applicant.[9] On appeal to the Circuit Court for the Third Circuit, the district court decision was affirmed.[10] The circuit court held that the specific prohibitions of section 249 were intended to augment and not limit the jurisdiction of the court and that, under general equitable principles, trading in the stock of a subsidiary where a conflict of interest existed barred the applicant from compensation. The court also pointed out that since the subsidiary had claims against the parent debtor, the attorney had in fact purchased an indirect interest in a claim against

[8] *In re Pittsburgh Railways Co.*, 159 F. (2d) 630 (C. C. A. 3, 1946).
[9] *In re Midland United Co.*, 64 F. Supp. 399 (Del. 1946).
[10] *In re Midland United Company*, 159 F. (2d) 340 (C. C. A. 3, 1947).

the debtor specifically barred by section 249. The court also held that the rule applied to the wife of the applicant who engaged in the transactions with his approval and knowledge, even though she used her own funds.

Another problem under section 249 with respect to allowances arose in the proceeding involving Inland Power & Light Corp. In this case, an investment banking house, the original underwriter of the debtor's bonds, traded in these bonds for several years during the section 77B reorganization proceeding, prior to the enactment of chapter X. The investment banking house had organized a bondholders' committee and installed an employee as secretary of the committee. Subsequently other employees assumed the office of secretary. The last one in office filed an application for compensation for services rendered by himself and his predecessors but it was conceded that any award of compensation would be turned over to the investment house. Pointing out the strategic position of secretary to a committee and his ability to acquire inside information, the Commission urged the denial of any indirect award to the banking house which in a real sense occupied the secretarial office. The Commision contended that either under section 249, which was applicable to the section 77B proceeding, or under the equitable principles it codified, compensation should be denied. Upon the special master's recommendation, the district court disallowed the application. The applicant sought leave to appeal from the Circuit Court for the Seventh Circuit, which was opposed by the Commission. After briefs and argument, the court entered an order denying the petition for leave to appeal.

INSTITUTION OF CHAPTER X PROCEEDINGS AND JURISDICTION OF THE COURT

The Commission has striven for a liberal interpretation of the provisions of the Bankruptcy Act so that the benefits of Chapter X may be made fully available to security holders in accordance with the spirit and intent of the statute. In accordance with this policy, the Commission has participated in various cases involving the question of "good faith" in the filing of a petition. The Commission's view in these cases was that the pendency of a prior State court proceeding was not a bar to a chapter X proceeding since the prior proceedings in those cases did not contain safeguards for investors comparable with those in chapter X. The contentions of the Commission generally have not been upheld by the courts.

During the past fiscal year, the Commission participated in another case involving the "good faith" of the filing of the petition, the proceeding for the reorganization of Midwest Athletic Club. Also involved in the case was the objection to the jurisdiction of the court based on the contention that the debtor was a nonprofit corporation which had been dissolved pursuant to State law in 1938. The district court approved the petition as having been properly filed and in good faith. In supporting the decision on appeal, the Commission argued that the debtor had conducted a business enterprise for many years and that while the corporation as such had been dissolved, the remaining entity was an "unincorporated association" under the Bankruptcy Act and, hence,

a proper subject for reorganization. The Commission also argued that the petition for reorganization met the "good faith" requirements of chapter X. The Circuit Court for the Seventh Circuit, however, reversed the lower court, holding that the enterprise was not an "unincorporated company" within the meaning of chapter X which could be reorganized. The court emphasized the fact that no stockholders or members of the company had operated the enterprise after its dissolution, but that a State court receiver, as a mere custodial officer of the court, had conducted its business and could not be considered as continuing the corporate entity or its corporate affairs. Therefore, the court concluded that there was no corporation to be reorganized.

PLANS OF REORGANIZATION UNDER CHAPTER X

The ultimate objective of a reorganization is the formulation and consummation of a fair and feasible plan of reorganization. Accordingly, the most important function of the Commission under chapter X is to aid the courts in achieving this objective.

Fairness and Feasibility

A proceeding involving the fairness of a proposed plan of reorganization based on established principles of priorities of securities and valuation of the debtor's estate was that of Chicago Railways Co., Chicago City Railway Co., and Calumet & South Chicago Ry., known collectively as the Chicago Surface Lines, in which the Commission rendered an advisory report and supplemental advisory report during the previous fiscal year. In those reports, the Commission concluded that the proposed plan involving a minimum upset price of $75,000,000 for the Surface Lines' properties to be offered by the Chicago Transit Authority was fair, after certain suggested amendments had been made. Its conclusions were based primarily upon a valuation of the properties reached by capitalizing reasonably prospective earnings. The proposed price was considered to be within a reasonable range of the Commission's valuation. Since the proceeds of the sale together with excess cash were insufficient to pay in full the claims of senior security holders, it was also concluded that certain junior security holders could not participate in the plan. The plan as amended was approved by the court, accepted by security holders entitled to participate, and confirmed. Appeals were taken to the Circuit Court for the Seventh Circuit by certain junior security holders who were excluded from sharing in the estate by the orders of approval and confirmation.

Among their contentions, the junior security holders relied upon the rate base valuation of the properties, upon a price fixed by formula in the original franchises of the companies in 1907, upon book values of the companies and upon a hypothetical figure that might be awarded in a condemnation proceeding. All of these amounts were substantially higher than the proposed purchase price and the valuation estimated by the Commission. The Commission, in its brief, replied to these contentions, arguing that reorganization values are dependent upon probable future earnings, and that on the basis of the record and the applicable priority rules, the junior securities had no right to such earnings and were properly denied participation in the estate. The circuit court affirmed the lower court's approval of the plan, holding that a valuation of the enterprise, if it is to be freed from

the heavy hand of past errors, miscalculations or disaster, requires consideration of past earnings, factors affecting earnings, probable future earnings and an appropriate rate of capitalization.[11] The circuit court stated that the district court had clearly considered every proper factor suggested by the parties and in addition had the benefit of the expert and disinterested advice of the Commission in its advisory report in reaching its findings. Application for certiorari, opposed by the Commission, was denied by the Supreme Court on April 14, 1947.

In the reorganization proceedings involving Childs Co., the Commission had occasion to invoke the general equitable rule enforced in ordinary bankruptcy that, where full payment is made, prior distributions are to be applied first to accrued interest and then to principal. This view has been adopted by the trustee and approved by the district court.

Following its policy of according to senior creditors all their rights before permitting participation in the estate by junior creditors, the Commission supported the claim of first mortgage bondholders to interest on overdue interest as provided for under the terms of the indenture in the proceedings involving Inland Gas Corp. The Supreme Court, however, in *Vanston Bondholders Protective Committee* v. *Green*, 329 U. S. 156 (1946) held that interest on interest under the circumstances of the case would not be equitable. The court pointed out that the failure to make interest payments promptly when due was a result of judicial action and that bondholders should not receive added compensation or a penalty, by way of interest on interest, by reason of the court's supervision of the estate and its prohibition against payment of interest on the due date.[12]

MODIFICATION OF PLAN

In the proceedings involving Equitable Office Building, a plan of reorganization had been confirmed under which debenture holders were to receive new convertible debentures for a portion of their claim and old common stockholders were to receive a small amount of the new common stock. Just before this plan was to be consummated by transfer of the property to the new reorganized company and by distribution of the new securities, two common stockholders appeared with a financing proposal under which stockholders would receive an option to buy the stock of the new company, an underwriter would buy all unsubscribed shares, and the proceeds would be used to pay the old debentures in full, principal and interest. Thus, under the new proposal, the stockholders would be afforded an opportunity to pay off the debenture holders and retain their equity in the property. The marked improvement in the real-estate field since the date of confirmation made possible the underwriting pro-

[11] *In re Chicago Railways Company*, 160 F. (2d) 59 (C. C. A. 7, 1947).

[12] It may be observed that the Commission's brief before the Supreme Court contained the following statement in a note:

"The validity, as a matter of public policy, of a covenant for interest on interest, as applied to interest accruing since the date of a Federal equity receivership or bankruptcy proceedings, might conceivably be regarded as a proper subject for independent decision by the Federal court, even in the absence of direct legislation. The consequence of such a holding would be to afford greater uniformity and certainty in dealing with a problem which appears to be arising with increasing frequency in reorganization proceedings and occasionally in the State courts. We recognize, however, that there is no precedent for such a rule. The closest analogy would appear to be those cases holding that the equitable status of certain claims is a matter of bankruptcy law."

posal. Stockholders not exercising their rights to subscribe would receive the same stock interest as in the confirmed plan and, in addition, would have the privilege of selling their rights.

The debenture holders vigorously opposed this proposal, since the market price of the debentures had risen far above the amount of principal and interest. This rise in price, of course, reflected the market's appraisal of the value of the new stock to be issued under the confirmed plan. The Commission took the position that the district court should have a full hearing on the merits of the proposed modification, since it now appeared that there was an equity in the property for common stockholders which they could salvage; that debenture holders had no vested interest in the confirmed plan; and that payment to them of principal and interest in full would satisfy the debtor's obligation to them.

The district court refused to consider the stockholders' proposal, holding in effect that it was too late to modify the confirmed plan. After some appellate litigation regarding a stay of proceedings, which was finally granted, until the issue could be heard on its merits, the Circuit Court for the Second Circuit considered the matter. In upholding the Commission's views as set forth in its brief and argument before the court, it was held that the plan could be modified even after confirmation, that the debenture holders had as yet no legally protected interest beyond principal and accrued interest and had no right to rely upon sharing in an equity in the property above that amount and deprive stockholders of whatever chance might remain of realizing upon their property.[13] The circuit court stated that the long delay in effectuating a plan was not a good reason, so long as the rights of creditors were fully preserved, to deny stockholders a reasonable chance to protect their own interests.

ADVISORY REPORTS

During the fiscal year the Commission prepared a formal advisory report and two supplemental advisory reports with respect to proposed plans of reorganization in proceedings involving Childs Co., which owns and operates a large chain of restaurants. The advisory report concluded that certain aspects of the trustee's plan were unfair and unfeasible. The plan was said to be unfair to debenture holders and other unsecured creditors in failing to compute their claims on a proper basis and unfair to common stockholders in allocating too much of the new common stock to preferred stockholders. In proposing an all-common stock plan for the reorganized company, the trustee was held to have provided a sound capital structure for this enterprise, but the Commission opposed the issuance of long-term option warrants to common stockholders and considered unnecessary a proposed bank loan.

Plans and amendments proposed by common and preferred stockholders were also considered but the Commission found them unfair principally because of their unfair allocation of new stock. A plan suggested by a debenture holders' committee was viewed as unfair because of a proposed offering of new common stock to debenture holders at too low a price as well as unfair in its allocation of new

[13] *Knight* v. *Wertheim*, 158 F. (2d) 838 (C. C. A. 2, 1946).

stock between common and preferred stockholders and in its use of long-term warrants.

The Commission's report dealt with the complicated questions of valuation of the enterprise, the company's working capital position, its rehabilitation program, the question of the need for a bank loan, the unsoundness of issuing long-term option warrants and the treatment of creditors and stockholders under the trustee's plan and the various other proposals. The method of computing interest on creditors' claims was questioned. First, the Commission was of the opinion that all debenture holders should be treated equally on a 6 percent interest basis in that those who had voluntarily agreed to accept new debentures at 5 percent had done so on condition that in any judicial proceeding they would receive no worse treatment than those who had not accepted a reduction in interest. Second, it was felt that interest should be paid to the date of payment on the aggregate claim of principal and accrued interest at the time of commencement of the proceeding as in the *Realty Associates Securities* case. Third, it was the Commission's view, as indicated in a previous paragraph, that prior, partial payments to creditors be applied first to interest and then to principal.

Another important question dealt with in the report involved the basis of the preferred stockholders' claim. The Commission differentiated their claim in a chapter X proceeding from the preferred stockholders' position in a reorganization under the Public Utility Holding Company Act and concluded that the liquidating preference of preferred stock is the controlling factor in measuring the extent of its claim under chapter X. In considering the allocation of new stock to the preferred and common shareholders, the Commission pointed out what it considered to be a reasonable range—on the basis of all common stock and on the basis of a new preferred stock and common stock.

In its first supplemental report, the Commission considered amendments to the trustee's plan and two plans submitted by a security holder. While the trustee's amendments were held to cure several of the Commission's objections, the plan was still considered deficient in several major respects. The security holders' plans were viewed as fair and feasible since they embodied the Commission's suggestions.

In its second supplemental report, additional plan amendments by the trustee were reviewed by the Commission. These amendments adopted fully the Commission's views as to the rights of creditors. They also eliminated the long-term option warrant feature and revised the allocation of new common shares. As to such allocation, the Commission felt it was not so far outside the range suggested by the Commission as to require disapproval.

Subsequently the plan was approved by the court and submitted to security holders. The preferred stockholders accepted the plan but the required percentage of common stockholders was not obtained. Thereafter the trustee filed a new plan which has been submitted to the Commission for its advisory report.

PART V

ADMINISTRATION OF THE TRUST INDENTURE ACT OF 1939

SCOPE OF ACT

The Trust Indenture Act of 1939 outlaws the exculpatory clauses used in the past in trust indentures underlying corporate debt securities. Many of these clauses eliminated liability of the trustee for misconduct to such an extent that the word "trustee" was meaningless as applied to indenture trustees. The act is designed to insure that the trustee will act in the interest of the bond or debenture owners and to insure his complete independence of the issuer and the underwriters. To secure its objectives, the act requires that bonds, notes, debentures, and similar debt securities publicly offered for sale, sold, or delivered after sale through the mails or in interstate commerce, except as specifically exempted by the act, be issued under an indenture which meets the requirements of the act and has been duly qualified with the Commission. The provisions of the Securities Act of 1933 and the Trust Indenture Act are so integrated that registration pursuant to the Securities Act of 1933 of securities to be issued under a trust indenture is not permitted to become effective unless the indenture conforms to the requirements expressed in the Trust Indenture Act of 1939, and such an indenture is automatically "qualified" when registration becomes effective as to the securities themselves. An application for qualification of an indenture covering securities not required to be registered under the Securities Act of 1933, which is filed with the Commission under the Trust Indenture Act, is processed substantially as though such application were a registration statement filed pursuant to the Securities Act of 1933.

STATISTICS OF INDENTURES QUALIFIED

The number of indentures filed with the Commission during the year for qualification under the Trust Indenture Act of 1939, together with the disposition thereof and the amounts of indenture securities involved, are shown in tables I and II below and the totals in table III.

TABLE I.—*Indentures filed in connection with registration statements under the Securities Act of 1933*

	Number	*Aggregate Amount*
Indentures pending at June 30, 1946	13	$274,205,300
Indentures filed during the fiscal year	96	2,544,712,200
Total	109	$2,818,917,500
Disposition during fiscal year:		
Indentures qualified	84	$2,517,412,700
Amount reduced by amendment	--	27,769,600
Indentures deleted by amendment or withdrawn	10	43,730,400
Indentures pending at June 30, 1947	15	230,004,800
Total	109	$2,818,917,500

TABLE II.—*Indentures filed for securities not required to be registered under the Securities Act of 1933*

	Number	Aggregate Amount
Indentures pending at June 30, 1946	—	None
Indentures filed during the fiscal year	12	$147,258,661
Disposition during fiscal year:		
Indentures qualified	12	$147,258,661
Indenture pending at June 30, 1947	—	None

TABLE III.—*Total number of indentures filed under the Trust Indenture Act of 1939 (table III is the sum of tables I and II)*

	Number	Aggregate Amount
Indentures pending at June 30, 1946	13	$274,205,300
Indentures filed during the fiscal year	108	2,691,970,861
Total	121	$2,966,176,161
Disposition during fiscal year:		
Indentures qualified	96	$2,664,671,361
Amount reduced by amendment	—	27,769,600
Indentures deleted by amendment or withdrawn	10	43,730,400
Indentures pending at June 30, 1947	15	230,004,800
Total	121	$2,966,176,161

During the fiscal year the following additional material relating to trust indentures was filed and examined for compliance with the appropriate standards and requirements:

Five indentures as to which the Commission, under its authority granted by the Public Utility Holding Company Act of 1935, applies the standards of the Trust Indenture Act of 1939 although such indentures are exempted from the Trust Indenture Act;

One hundred thirty-four statements of eligibility and qualification under the Trust Indenture Act;

Twenty-one amendments to trustee statements of eligibility and qualifications;

Ninety-three Supplements S-T, covering special items of information concerning indenture securities registered under the Securities Act of 1933;

Thirty-five amendments to Supplements S-T;

Twenty-six applications for findings by the Commission relating to exemptions from special provisions of the Trust Indenture Act of 1939; and

Three hundred sixty annual reports of indenture trustees pursuant to section 313 of the Trust Indenture Act of 1939.

PROBLEMS ENCOUNTERED IN ADMINISTRATION OF ACT

Although the Trust Indenture Act is designed as an adjunct to the Securities Act of 1933, it presents problems of administration which are peculiar to itself. These problems arise from the fact that the primary purpose of safeguarding investors pursuant to the Trust Indenture Act is sought by assuring that all indentures qualified thereunder shall contain specified protective provisions and only incidentally by resort to disclosure requirements as such.

The exemptive provisions of the act incorporate most but not all of the exemptions contained in the Securities Act and several exemptions in addition thereto. Thus, some offerings exempt from registration under the Securities Act (exchanges with existing security holders exempt under section 3 (a) (9) and securities issued in reorganizations exempt under section 3 (a) (10)) must be qualified under the Trust Indenture Act and information contained in the application for qualification must be examined to determine whether

Securities Act registration is required. Conversely, Securities Act registration statements will include debt securities which are not to be issued under an indenture qualified under the Trust Indenture Act, and it is necessary then to determine whether there is an exemption from qualification under one of the exemptions specified in section 304 of the Trust Indenture Act, including:

(1) Nondebt securities;
(2) An investment contract;
(3) A mortgage insured under the National Housing Act;
(4) Foreign government issues;
(5) Any guarantee of an exempted security;
(6) An aggregate of $250,000 principal amount of security issued not under an indenture, within a period of 12 consecutive months;
(7) An indenture limiting the amount outstanding thereunder to $1,000,000 or less; not more than $1,000,000 to be issued thereunder in 36 consecutive months;
(8) Secondary offerings by controlling persons.

EXAMINATION PROCEDURE

In examining a registration statement or application including an indenture to be qualified, it is necessary to examine the document for the purpose of determining (1) whether the indenture contains the required provisions in proper form, that permissive provisions are in proper form, and that there are no inconsistent provisions; (2) that the disclosure requirements specified in section 305 (a) (2) of the act are complied with in the prospectus or application; and (3) that the trustee is eligible and qualified. Any inadequacies found upon examination customarily are corrected after the staff sends the applicant a letter of comment, or holds conferences with counsel for the applicant, and only in rare cases has it been necessary to institute remedial proceedings. (See secs. 305 (b), 307 (c), 321 (a), and 322 (b)). This examination procedure may be briefly explained for convenience in the numerical order listed above.

(1) The examination of the indenture requires a careful reading. For example, variations in statutory language are sometimes injected. If such variations appear to be in derogation of statutory objectives, it is necessary to insist that the statutory language be more closely followed. The Commission finds that as time goes on injections of this character tend to diminish. On the other hand, because of the great variety of provisions and purposes of indenture agreements, considerable latitude has been exercised with respect to the insertion of some statutory language (*e. g.*, sec. 314 (d) certificates of fair value), although such latitude is not extended to provisions relating to the trustee's qualifications and standards of conduct. Here again experience has permitted the working out of indenture provisions which in the ordinary case have become more or less standardized.

In instances where the requirements of the act would appear to work a hardship, the Commission may grant exemptions from onerous provisions as to indentures having securities outstanding issued prior to the effective date of the act and indentures of foreign issuers (secs. 304 (c) and (d)). Applications for such exemptions generally relate to section 316 (a) of the act, which permits the holders of not less than a majority of outstanding bonds to direct the trustee in the exercise of his trusts or powers (many old indentures according this power to holders of less than a majority).

(2) The disclosure requirements of the act relate to defaults, the authentication of bonds, the release of property, satisfaction and discharge, and evidence of compliance with the requirements of the indenture to be furnised to the trustee. No particular problems have arisen in the examination and analysis of material filed under these requirements.

(3) Information with respect to the eligibility and qualifications of the trustee, required under section 310 of the act, is provided for primarily in the Commission's Forms T–1 and T–2, which must be prepared and filed by the trustee or trustees. A number of difficult problems as to conflicts of interest proscribed by section 310 (b) of the act have arisen. However, for the most part they have been resolved by administrative interpretation. Section 310 (b) (1) provides for administrative proceedings by the Commission to permit the trustee to act under more than one indenture of the same obligor. Usually applications for such permission are of routine nature. Besides, the Commission's Rule T–10B–3 provides machinery for a prior determination of conflicts of interest arising from affiliations between the trustee and an underwriter for the issuer.

Significance of Commission's Examination

Particular care must be taken with respect to the original examination into these situations because once the indenture is qualified its enforcement becomes a matter of contract between the parties. The Commission may not enforce its provisions (see sec. 309 (e)). However, trustees are required to report annually to their bondholders as to certain matters specified in sections 313 (a) and (b) of the act and copies of their reports are required under section 313 (d) to be filed with the Commission, which calls the attention of the trustees to any material discrepancies which the staff finds upon examination thereof.

PART VI

ADMINISTRATION OF THE INVESTMENT COMPANY ACT OF 1940

SCOPE OF ACT

The Investment Company Act of 1940 requires the registration and provides for the regulation of investment companies, which are, generally, companies engaged primarily in the business of investing, reinvesting, owning, holding, or trading in securities. Among other things, the act requires disclosure of the finances and of the investment policies of these companies to afford investors full and complete information with respect to their activities; prohibits such companies from changing the nature of their business or their investment policies without the approval of the stockholders; bars persons guilty of security frauds from serving as officers and directors of such companies; prevents underwriters, investment bankers, and brokers from constituting more than a minority of the directors of such companies; requires management contracts in the first instance to be submitted to security holders for their approval; prohibits transactions between such companies and their officers and directors and other insiders except on the approval of the Commission; forbids the issuance of senior securities of such companies except in specified instances; prohibits pyramiding of such companies and cross ownership of their securities; and requires face-amount certificate companies to maintain reserves adequate to meet maturity payments upon their certificates.

ADVISORY REPORTS UPON PLANS OF REORGANIZATION

One of the functions of the Commission under the Investment Company Act arises from its authority to prepare advisory reports for the benefit of security holders upon plans of reorganization of registered investment companies. Such reports may be rendered upon request of the company or of the holders of 25 percent of any class of its outstanding securities. In addition, the Commission is authorized to institute proceedings to enjoin reorganization plans if they are grossly unfair. Last year the Commission prepared such an advisory report covering a plan of reorganization of an investment company upon the request of stockholders, following a refusal of the management of the company itself to request the report at their instance. That part of the Commission's report dealing with the effect of the plan on the shareholders called attention to the more important factors which the stockholders should evaluate in order to form a sound investment judgment as to whether they would assent to the plan. It included, for example, a discussion of the pro forma earnings of a new company which was to result from a proposed consolidation, and called particular attention to the effect of the recent war on sales, costs of operations, and profit margins of the iron-ore producing business of the corporation with which it was proposed to consolidate the investment company; the cyclical nature of operations not only for the iron-ore business but also of the steel industry in which the investment company was heavily invested; and the element of leverage inherent in the capital structure of the new company by virtue of its uncommonly high proportion of senior securities.

NEW RULES ADOPTED UNDER THE ACT

The Commission last year accomplished certain further simplification of its rules and regulations under this act.

Rule N–5—Procedure With Respect to Applications

On May 23, 1947, the Commission adopted rule N–5, which provided a simplified general procedure designed to expedite the disposition of proceedings initiated by application or upon the Commission's own motion pursuant to any section of the act or any rule or regulation thereunder. The rule does not apply, however, in a very limited number of cases where a more appropriate procedure is provided. The purpose of the rule is to provide for the expeditious disposition of proceedings which are not contested by any interested person. The rule makes provision for the publication in the Federal Register of the initiation of such proceeding and affords ample opportunity for any interested persons to request a hearing.

Rule N–17A–2—Exemption of Transactions by Banks

On December 3, 1946, the Commission adopted rule N–17A–2 to exempt certain commercial transactions occurring in the usual course of business between banks and persons engaged principally in the business of installment financing. It is believed that these exemptions are consistent with the protection of investors. Interest and discount rates will probably be set competitively and not exceed the rate permitted locally. The adoption of the rule was intended to preclude the multiplicity of proceedings arising from individual applications for exemptions which were burdensome both to the parties involved and to the Commission with no compensating public interest involved.

Rule N–17A–3—Exemption of Transactions With Subsidiaries

On May 23, 1947, the Commission adopted rule N–17A–3, which provides an automatic exemption from section 17 (a) under the act for transactions with or between fully owned subsidiaries of registered investment companies. The rule was adopted to provide an automatic exemption for such transaction since such subsidiaries are completely owned by the registered investment company and there is no public or investor interest involved in transactions within the group. The rule eliminates the necessity of filing an application with the Commission for the exemption of such transaction.

Rule N–17D–1—Bonus, Profit-Sharing, and Pension Plans

On May 23, 1947, the Commission amended rule N–17D–1 regarding bonus, profit-sharing, and pension plans and arrangements. The amendment to this rule eliminated the special procedure for the handling of applications thereunder and thereby makes the procedure provided by the new rule N–5 applicable thereto.

STATISTICS RELATING TO REGISTERED INVESTMENT COMPANIES

As of June 30, 1947, there were 352 companies registered under the Investment Company Act of 1940. During the fiscal year 12 companies registered under the act, and the registration of 21 companies was terminated. The assets of the 352 registered investment companies aggregated approximately $3,600,000,000. These companies are classified under the act as follows:

Management open-end	125
Management closed-end	115
Unit	96
Face amount	16
Total	352

The 12 companies that registered during the fiscal year are classified under the act as follows:

Management open-end	9
Management closed-end	2
Unit	1
Total	12

The 21 companies whose registrations were terminated during the fiscal year were classified under the act as follows:

Management open-end	5
Management closed-end	13
Unit	3
Total	21

During the fiscal year 91 applications were filed under various provisions of the act, 74 of these for orders of the Commission relating to exemptions from requirements of the act and the remaining 17 for a determination of the Commission that the applicant has ceased to be an investment company within the meaning of the act. At the beginning of the fiscal year, 60 applications were pending. These applications, together with the 91 filed during the year, totaled 151 applications pending before the Commission during the year; 101 of these applications were disposed of during the year and 50 were pending at June 30, 1947. The various sections of the act under which these applications were filed, and the disposition of the applications during the fiscal year, are shown in the following table (since an application may involve more than one section of the act, the numbers are not totaled):

Section of the act under which application was filed	Number pending at June 30, 1946	Filed during year	Disposed of during year	Number pending at June 30, 1947
2 (a) (9) Determination of question of control.	1	4	1 withdrawn	4
3 (b) (2) Determination that applicant is not an investment company.	7	4	2 granted	9
6 (b) Employees' security company exemptions.	2	2	1 granted; 2 withdrawn.	1
6 (c) Various exemptions not specifically provided for by other sections of the act.	16	20	19 granted; 4 withdrawn.	13
6 (d) Exemption for small closed-end companies offering securities in intrastate commerce.	1	----------	----------	1
8 (f) Determination that a registered investment company has ceased to be an investment company.	8	17	20 granted	5
9 (b) Exemption of ineligible persons to serve as officers, directors, etc.	13	----------	----------	13
10 (f) Exemption of certain underwriting transactions.	1	2	3 granted	----------
11 (a) Approval of terms of proposed security exchange offers.	1	1	2 granted	----------
17 (b) Exemption for proposed transactions between investment company and affiliates.	16	30	29 granted; 2 denied; 5 withdrawn.	10
17 (d) Approval of certain bonus and profit-sharing plans.	2	16	15 granted	3
23 (c) (3) Terms under which closed-end investment company may purchase its outstanding securities.	1	3	1 granted; 1 withdrawn.	2
25 (b) Request for advisory report on proposed plan of reorganization.	----------	2	1 report made; 1 withdrawn.	----------

Figures as to the number of documents filed under the act by registered investment companies, together with other related statistics, during the fiscal years ended June 30, 1946 and 1947, are given in the following table:

	Fiscal year ended June 30—	
	1947	1946
Number of registered investment companies:		
Beginning of year	361	36(
Registered during year	12	1
Terminations of registration during year	21	1
Number of companies registered at end of year	352	361
Notifications of registrations	12	1
Registration statements	12	1
Amendments to registration statements	18	3
Annual reports	226	21
Amendments to annual reports	20	2(
Quarterly reports	790	78(
Periodic reports, containing financial statements, to stockholders	718	71(
Reports of repurchases of securities by closed end management companies	102	11(
Proxy statements	162	15
Copies of sales literature	1,935	1,75
Applications for exemption from various provisions of the act	74	7
Applications for determination that registered investment company has ceased to be an investment company	17	1
Amendments to applications	50	4
Total applications:		
Beginning of year	60	7(
Filed during year	91	9(
Disposed of during year	101	10(
Pending at end of year	50	6(

PART VII

ADMINISTRATION OF THE INVESTMENT ADVISERS ACT OF 1940

The Investment Advisers Act of 1940 requires the registration of investment advisers: persons engaged for compensation in the business of advising others with respect to securities. The Commission is empowered to deny registration to or revoke registration of such advisers if they have been convicted or enjoined because of misconduct in respect of security transactions or have made false statments in their applications for registration. The act also makes it unlawful for investment advisers to engage in practices which constitute fraud or deceit; requires investment advisers to disclose the nature of their interest in transactions executed for their clients; prohibits profit-sharing arrangements; and, in effect, prevents assignment of investment advisory contracts without the client's consent.

Investment advisers' registration statistics, 1947 fiscal year

Effective registrations at close of preceding fiscal year	853
Applications pending at close of preceding fiscal year	12
Applications filed during fiscal year	188
Total	1,053
Registrations canceled or withdrawn during year	81
Registrations denied or revoked during year	0
Applications withdrawn during year	1
Registrations effective at end of year	952
Applications pending at end of year	19
Total	1,053

LITIGATION UNDER THE ACT

The single court action under the act during the fiscal year was S. E. C. v. *Todd*, in which the Commission sought an injunction to restrain alleged frauds on the defendant's investment advisory clients.[1] The complaint alleged that the defendant had three classes of clients: those who subscribed to his weekly investment advisory letter, those who for an additional fee obtained more personalized advice, and those for whom he managed discretionary accounts. It was alleged that the defendant would first purchase some inactive security for his discretionary accounts, at the same time orally recommending its purchase to the clients receiving the personalized advice, and then several days later would recommend its purchase to the subscribers of the weekly letter. Since the security was inactive, the market would be raised by the subscribers' purchases and the defend-

[1] Civil No. 6149, Mass., Nov. 14, 1946.

ant would then sell the security in his discretionary accounts, meanwhile continuing to recomemnd its purchase in the weekly letter. The Commission alleged that this constituted a practice or course of business which operated as a fraud or deceit upon his clients within the meaning of section 206 (2). A final judgment was entered with the consent of the defendant. The judgment was thereafter vacated at the defendant's request to be permitted to proceed with a trial of the case on the merits. The matter was pending at the close of the year.