15*th* ANNUAL REPORT

Securities and Exchange Commission

1949

FISCAL YEAR ENDED JUNE 30

Fifteenth Annual Report

of the

Securities and Exchange Commission

Fiscal Year Ended June 30, 1949

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SECURITIES AND EXCHANGE COMMISSION

Central Office
425 Second Street NW.
Washington 25, D. C.

COMMISSIONERS

HARRY A. MCDONALD, *Chairman*
RICHARD B. MCENTIRE
PAUL R. ROWEN
DONALD C. COOK
EDWARD T. MCCORMICK

ORVAL L. DUBOIS, *Secretary*

LETTER OF TRANSMITTAL

SECURITIES AND EXCHANGE COMMISSION,
Washington, D. C., February —, 1950.

SIR: I have the honor to transmit to you the Fifteenth 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,

HARRY A. MCDONALD,
Chairman.

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

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FOREWORD

This is a report of the activities of the Securities and Exchange Commission during the fifteenth fiscal year of its existence. While the report is in no sense as ambitious a survey of the Commission's work and its problems as was undertaken in its Tenth Annual Report, some trends are noted herein for the five preceding years.

The statutes entrusted to the Commission give it a wide range of responsibility for protection of the investor. We have frequently stressed the fact that the generally applicable legislation administered by the Commission places its main emphasis on disclosure. That legislation is based on the theory that business, on the one hand, and the investor on the other, should retain a full range of individual responsibility for financial and investment decisions.

However, the statutes go further. For example, in regulating the conduct of securities professionals who do business with investors the statute imposes certain minimum capital requirements and provides that customers shall not be unduly prejudiced by practices in regard to the hypothecation of securities by professionals for their own borrowings. Since, in the ordinary course of business many firms handle cash and securities belonging to customers it is important for the Commission to help prevent loss to investors occurring as a result of violation of such restrictions. Further, many of the rules evolved under antifraud standards applying to such professionals have the effect of requiring obedience to certain business practices; an example is the doctrine, announced by the Commission and judicially affirmed, that dealers in the over-the-counter market may not, without disclosure, charge a customer a price not reasonably related to current market prices. While adequate disclosure and consent of the customer may avoid the charge of fraud when a firm has exacted high markups in its sales, the fact is that most firms obey the limitation on pricing inherent in the doctrine without regard to disclosure.

We have tried to show further in this report the importance, when dealing with securities frauds and manipulation, of prompt and preventative action. It is of little comfort to an investor to suffer loss through a firm which is, in effect, judgment proof. The best protection of the investor is to prevent the harm before it occurs.

For these reasons it is fallacious to think of the Commission as merely an information clearing house. It has duties which, in order to be fully borne, must carry the Commission's work into the books, records, practices, and financial conditions of thousands of securities firms scattered all over the country.

The "passive" activity of the Commission—the receipt and processing of filings—is activity over which the Commission has no control. It must be performed as the demand for the work arises. The Commission cannot, for example, delay work on a registration statement covering an issue of securities under the Securities Act of

1933 without either subjecting investors to the risk that an inadequate statement has been filed or unduly interfering with financing programs. On the other hand while the enforcement or "active" work in the examination of the records of securities firms by the Commission can be rationed according to available manpower and facilities it is no less significant to millions of investors than is the work of a superintendent of banks to depositors.

The Commission has long felt that its enforcement activities need to be strengthened. We are now considering streamlined procedures of examination to increase the number of inspections, and we hope that with additional funds we will be able to devote more manpower to this work.

An additional development worth commenting upon is the recent introduction by Senator Frear of S. 2408, a proposal to safeguard investors in securities not listed on national securities exchanges. The Securities Exchange Act contains several cardinal provisions whose purpose it is to change blind trading into informed investment by requiring corporate management to meet certain standards in its relations with investors. As a condition of listing its securities on a national securities exchange the law provides that each issuer must register and file initial and periodic information about the company and its financial affairs; it subjects those who solicit securityholders' proxies to the requirement that information be disclosed sufficient to permit an intelligent exercise of the vote; it contains provisions requiring disclosure by insiders—officers, directors and large holders of equity securities—of their holdings of equity securities of the corporation and contains provisions designed to prevent such persons from using inside information to profit from short term trading in equity securities of their companies. With limited exceptions these requirements do not exist with respect to securities not registered with the Commission under the Securities Exchange Act although many of their issuers are of substantial size and have substantial numbers of securityholders among the public.

S. 2408 would extend to certain large companies not now registered under the Securities Exchange Act the standards of that act relating to filing of information, the solicitation of proxies, and trading by corporate insiders. Not all companies would be so covered, but only those having assets of 3 million dollars or more and 300 or more securityholders—size limits selected because they indicate the existence of sufficient public interest in the company to warrant the extension of these standards.

This proposal was first contained in a report to the Congress by the Commission submitted in 1946 and entitled "A Proposal to Safeguard Investors in Unregistered Securities." That report showed how freedom from regulation permitted unregistered companies with large public stockholder interests to withhold from their securityholders the minimum information necessary for intelligent understanding of the investors' position and informed exercise of the investors' rights. The President endorsed this proposal and commended it to the Congress. Soon after the introduction, on August 8, 1949, of S. 2408, the Commission undertook to bring its 1946 report up to date. Such a revision should be ready soon.

The bill represents no departure from the basic philosophy of the existing law—that the securityholder who risks his money, who is the ultimate owner of the enterprise, is entitled to have a proper accounting from management of its stewardship of the company's affairs—but simply seeks to fill gaps left by piecemeal adoption of legislation affecting securities in 1934, 1935, 1936, 1938, 1939, and 1940. The bill would avoid the anomaly whereby the disposition of management's fiduciary duties depends, not upon the extent of public interest in a given company, but upon the accident that its management at one time listed the company's securities for trading on the exchange and registered them under the Securities Exchange Act.

Administration of the geographical integration and corporate simplification requirements of the Public Utility Holding Company Act of 1935 has continued at a rapid pace. During the fiscal year covered by this report 44 companies with assets of $1,748,878,827 were divested by registered holding companies through compliance with these standards. All of these companies thereby ceased to be subject to the Holding Company Act. Divestments since December 1, 1935, resulting in complete divorcement from jurisdiction under the Act were thus increased to 661 companies with assets of $7,964,764,537. Of the 2,152 companies subject at one time or another to the act, 1,510 have been eliminated through divestment, dissolution, mergers, and other means.

In addition 206 companies with assets of $3,781,000,000 have been divested by one or more holding companies, but remain subject to the statute by reason of their relationship to a registered holding company. One hundred forty-three of these companies with assets of approximately $3,355,000,000 are expected to continue under the Commission's jurisdiction indefinitely as members of systems which will become fully integrated. It is estimated that these integrated systems will control from 6 to 7 billion dollars of assets.

A great deal has been accomplished under the Holding Company Act. However, despite serious attrition in personnel the case workload today in the important categories is actually greater than it was in 1941. Average employment in the Division of Public Utilities had dropped from 234 in 1941 to 150 at the end of the 1949 fiscal year. Yet, at the end of the 1941 fiscal year we had only 37 voluntary and involuntary reorganization proceedings pending—at the end of the 1949 fiscal year we had 138. Total proceedings regarding reorganization and the acquisition and sale of properties and portfolio securities pending at the end of 1941 was 163—at the end of 1949 it was 265. In 1941 we disposed of 192 applications and declarations concerning financing out of 257 current for the year. During 1949 we disposed of 317 out of 434 current during the year. At the end of 1949 we had 117 of such proceedings pending, whereas at the end of 1941 we had 65.

This report is intended to inform the Congress of the activities of the Commission. The Commission's facilities are always available to supply further information about its work.

COMMISSIONERS AND STAFF OFFICERS

(as of December 31, 1949)

Commissioners	*Term expires June 5—*
HARRY A. MCDONALD, of Michigan, Chairman [1]	1951
RICHARD B. MCENTIRE	1953
PAUL R. ROWEN, of Massachusetts	1950
DONALD C. COOK, of Michigan [2]	1954
EDWARD T. MCCORMICK, of Arizona [3]	1952

Secretary: ORVAL L. DUBOIS

Staff Officers

BALDWIN B. BANE, Director, Division of Corporation Finance. ANDREW JACKSON, Associate Director.

MORTON E. YOHALEM, Director, Division of Public Utilities. SIDNEY E. WILLNER, Associate Director.

ANTHON H. LUND, Director, Division of Trading and Exchanges.[4] SHERRY T. MCADAM, Jr., Associate Director.

ROGER S. FOSTER, General Counsel. LOUIS LOSS, Associate General Counsel.

EARLE C. KING, Chief Accountant.

MICHAEL E. MOONEY, Director, Division of Opinion Writing.

NATHAN D. LOBELL, Executive Adviser to the Commission.

HASTINGS P. AVERY, Director, Division of Administrative Services.

WILLIAM E. BECKER, Director, Division of Personnel.

JAMES J. RIORDAN, Director, Division of Budget and Finance.

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[1] Elected Chairman on November 4, 1949.
[2] Appointed October 27, 1949 to fill the vacancy created by the resignation of Robert L. McConnaughey.
[3] Appointed November 2, 1949 to fill the vacancy created by the resignation of Edmond M. Hanrahan.
[4] Appointed to succeed the late Edward H. Cashion.

REGIONAL AND BRANCH OFFICES

Regional Administrators

Zone 1—PETER T. BYRNE, Equitable Building (Room 2006), 120 Broadway, New York 5, N. Y.
Zone 2—PHILIP E. KENDRICK, 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, Fort 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—JAMES E. NEWTON, 1411 Fourth Avenue Building (Room 810) Seattle 1, Wash.[1]
Zone 10—E. RUSSEL KELLY, 425 Second Street NW., Washington 25, D. C.

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 400), Fourth and Roberts Streets, St. Paul 1, Minn.
Wright Building (Room 327), Tulsa 3, Okla.
United States Courthouse and Customhouse (Room 1006), 1114 Market Street, St. Louis 1, Mo.

[1] Appointed to fill the vacancy created by the retirement of Day Karr.

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PART I

ADMINISTRATION OF THE SECURITIES ACT OF 1933

The purpose of the Securities Act of 1933 is to provide full and fair disclosure and to prevent fraud in the sale of securities in interstate and foreign commerce and through the mails. To this end, the act requires that issuers of securities to be offered for such public sale must file with the Commission registration statements setting forth prescribed information about the securities; that investors must be furnished, at or before delivery of the security purchased, a copy of a required prospectus containing the more significant items of such information; and civil and criminal penalties are provided for securities frauds. The act does not authorize the Commission to pass on the investment merits of securities and it makes representations to the contrary unlawful.

THE REGISTRATION PROCESS

Purpose of Registration

Unless exempted from the Securities Act, securities offered for sale in interstate commerce or by the use of the mails must be registered. Securities for which such exemption is provided consist, in general, of government and municipal securities and the issues of banks, railroads, cooperatives and other organizations and associations specified in section 3 (a) of the act or covered by exemptions in rules and regulations adopted by the Commission, as discussed elsewhere in this report, pursuant to section 3 (b) of the act. In addition, while the act contains no exemption for securities of governmental or other foreign issuers as such, Public Law 142, 81st Congress, approved by President Truman on June 29, 1949, extended a specific exemption to securities issued or guaranteed by the International Bank for Reconstruction and Development from the registration requirements of both the Securities Act of 1933 and the Securities Exchange Act of 1934.[1]

An integral part of each registration statement is the prospectus, which sets forth the more pertinent information about the security offering. As a basic method of direct disclosure to investors, the prospectus plays a vital role in carrying out the purpose of the act.

The registration statement as a whole discloses material facts dealing, among other things, with the character, size, and profitableness of the business, its capital structure, the uses to which the company intends to put the proceeds realized from the sale of the securities, options outstanding against securities of the issuer, remuneration of officers and directors, bonus and profit-sharing arrangements, underwriters' commissions, and pending and threatened legal proceedings. There must also be included in this document certified financial statements of the business enterprise.

[1] For comments of the Commission made upon the proposal to exempt issues of the World Bank, see letter from Chairman Hanrahan incorporated in Senate Report No. 504 and House Report No. 708, to accompany S. 1664 and H. R. 4332, respectively, 81st Cong., 1st sess., calling attention to the fact that the provisions of these acts prohibiting outright fraud are applicable to "exempted securities," and under this enactment would continue to be applicable to securities issued or guaranteed by the World Bank.

The information contained in registration statements filed with the Commission is not only made available immediately for public inspection at the offices of the Commission but also forms the basis of widespread publicity released by financial news services, financial writers, and newspapers throughout the nation, which further accelerates the process of getting this information rapidly before a greatly enlarged field of potential investors.

Recently, there has been a marked trend, encouraged by the Commission, toward use of smaller prospectuses than had commonly been customary. As a result, in place of the cumbersome and somewhat formidable document, printed on a heavy stock of legal-size paper, which was commonly furnished to prospective investors during the early years of the administration of the act, in recent years many registrants used smaller and simpler prospectuses furnishing the lay investor with a more convenient and more readable document than heretofore.

Examination Procedures

One of the Commission's most important undertakings has been its development of procedures and techniques, which are constantly undergoing improvements as dictated by experience, for the fast and thorough examination of registration statements to determine compliance with the disclosure requirements of the act. The need for speed in the examination process arises not only from the statutory prescription of an effective date of the registration statement, in the ordinary case on the twentieth day after its filing, but also from the Commission's desire to avoid unnecessary interference with financing plans.

Where examination shows the registration statement to be inaccurate or incomplete in disclosure of material information, the Commission may resort to its power under section 8 of the act and issue an order preventing or suspending the effectiveness of the registration statement. However, the Commission has, during the past five years, continued its policy of exercising this power sparingly. Instead, it has relied for enforcement mainly upon the long-standing practice of securing an amendment to the registration statement. Accordingly, registrants are informally advised, as promptly as possible after the statements are filed, of any material misrepresentations or omissions found upon examination and they are afforded an opportunity to file correcting amendments before the statements become effective. This advice is furnished by means of an informal "letter of comment" which indicates what information should be corrected or supplemented to meet the disclosure standards.

Another informal procedure that has proved effective in speeding the registration process is the "pre-filing conference" between staff members and representatives of registrants and underwriters. In this manner registrants are encouraged to discuss problems in connection with the proposed filing for the purpose of determining in advance what types or methods of disclosure may be necessary under the circumstances of the particular case. Considerable use is made of this procedure, which has contributed to the marked reduction in the number of instances where the Commission has found it necessary to resort to stop-order proceedings or other formal action under section 8.

Neither the Commission, the issuer, nor the underwriter desires a statement to become effective unless it complies with the act. Often, the staff will ascertain that deficiencies exist in the registration statement as filed, or the issuer or underwriter may wish either to amend the statement or simply to delay its effectiveness because of changes in the securities market or for other 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 registrant to file a minor amendment, called a "delaying amendment," which starts the 20-day waiting period running anew.

Effective Date of Registration Statement

The 20-day waiting period was provided by the Congress in order to permit widespread publicity among investors of the information contained in the registration statement before it becomes effective. The Commission is, however, empowered at its discretion to accelerate the effective date where the facts justify such action so that the full 20-day period need not elapse before the registration statement can become effective. In the exercise of this power, the Commission must have 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.

Time Required to Complete Registration Process

The Commission seeks to accomplish completion of the registration process within the statutory 20-day waiting period, and to that end it has enlisted the cooperation of representatives of the securities business. Studies of the amount of time required to complete the registration process in all cases during the past three years show that the median elapsed time has been shortened from 30½ days in 1947 to 24½ days in 1948 and to 22¼ days in the 1949 fiscal year.

Time elapsed in registration process—1949 fiscal year

	1948						1949					
	July	Aug.	Sept.	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.	May	June
Total registration statements effective during month (number)	26	27	31	34	40	27	26	38	43	59	32	38
Elapsed time (median number of days):												
From date of filing registration statement to first letter of comment	10	10	10	10	10	10	10	10	10	10	10	10
From date of letter of comment to first amendment by registrant	7	9	7	8	7	9	10	7	7	6	6	6
From date of first amendment to the effective date of registration	6	6	6	5	6	6	4	4	3	4	4	4
Total median elapsed time (days)	23	25	23	23	23	25	24	21	20	20	20	20

The table covers all statements processed, including those where voluntary delays were sought for reasons extrinsic to the examination process. The detailed figures for each month of the year show that no more than 20 days in total elapsed time has been required to obtain effectiveness of the typical registration statement during each of the last four months of the year.

It will be noted from the table that the Commission has maintained a median of 10 days between receipt of filings and staff comment on the registration statement. Variations in time for the total registration process are due in large part to variations in the time taken for corrections by those who file statements and to the lapse between corrections and effectiveness. Many factors enter into the duration of the latter period; among them are the necessity for further corrections and variations in the time necessary for analyzing supplementally filed amendments.

THE VOLUME OF SECURITIES REGISTERED

Volume Of All Securities Registered in Fiscal Year

	1949	1948
Total registered	$5, 333, 362, 000	$6, 404, 633, 000

The amount of securities effectively registered during the 1949 fiscal year was 17 percent less than the amount registered in the 1948 period. For the five-year period ending with the 1949 fiscal period [2] the amount was $28,768,306,000, 226 percent greater than the $8,819,-902,000 for the 5-year period ended June 30, 1944, and 82 percent greater than the $15,280,021,000 for the 4-year and 10-month period ended June 30, 1939 adjusted to a 5-year period.

The volume registered in the 1949 fiscal year was distributed over 429 [3] effective registrations covering 588 issues, as compared with 435 statements covering 559 issues for the 1948 fiscal year.

Securities Registered for Cash Sale

A. ALL SECURITIES

	1949	1948
Registered for cash sale for accounts of issuers	$4, 204, 008, 000	$5, 032, 199, 000
Registered for cash sale for accounts of others than issuers	193, 870, 000	209, 102, 000
Total registered for cash sale	4, 397, 878, 000	5, 241, 301, 000
Total registered for other than cash sale	935, 484, 000	1, 163, 332, 000
Total of all registered securities	5, 333, 362, 000	6, 404, 633, 000

[2] For 5-year summary see appendix table 1, pts. 4, 5 and 6.
[3] This figure differs from the 415 shown in the table on p. 9 due to difference in the classification as to the time of effectiveness of registration statements. See appendix table 1, footnote 2 for details.

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

	1949	1948
Equity securities other than preferred stock	$1, 083, 117, 000	$1, 678, 127, 000
Preferred stock	325, 854, 000	536, 942, 000
Total all stock	1, 408, 971, 000	2, 215, 069, 000
All bonds	2, 795, 036, 000	2, 817, 130, 000
Total	4, 204, 008, 000	5, 032, 199, 000

It should be noted that while the volume of bonds registered by issuers for cash sale decreased only slightly in the 1949 fiscal year, stock so registered showed a marked decrease.

From September 1934 through June 1948 new money purposes represented 33 per cent of the net proceeds expected from the sale of issues registered for the accounts of issuers. In the 1949 fiscal year new money purposes represented 76 percent of the expected net proceeds for the year—large enough to raise the 15-year average by 4 points to 37 percent.[5]

The table below shows the amount of each type of security registered for cash sale for the accounts of the issuers in each of the fiscal years 1935 through 1949 as well as the three 5-year totals. In addition to the totals of the new issues for cash sale, all registrations are shown for the same periods.

(Millions of dollars)[1]

Fiscal year ended June 30	All registrations	Cash sale for account of issuers			
		Total	Bonds and face-amount certificates	Preferred stock	Common stock and certificates of participation
1935 [2]	913	686	490	28	168
1936	4, 835	3, 936	3, 153	252	531
1937	4, 851	3, 635	2, 426	406	802
1938	2, 101	1, 349	666	209	474
1939	2, 579	2, 020	1, 593	109	318
1935-39	15, 280	11, 626	8, 328	1, 003	2, 293
1940	1, 787	1, 433	1, 112	110	210
1941	2, 611	2, 081	1, 721	164	196
1942	2, 003	1, 465	1, 041	162	263
1943	659	486	316	32	137
1944	1, 760	1, 347	732	343	272
1940-44	8, 820	6, 812	4, 922	812	1, 078
1945	3, 225	2, 715	1, 851	407	456
1946	7, 073	5, 424	3, 102	991	1, 331
1947	6, 732	4, 874	2, 937	787	1, 150
1948	6, 405	5, 032	2, 817	537	1, 678
1949	5, 333	4, 204	2, 795	326	1, 083
1945-49	28, 768	22, 249	13, 502	3, 047	5, 698

[1] Dollar amounts are rounded to millions and will not necessarily add to totals.
[2] For 10 months ended June 30, 1935.

[5] See also appendix table 1, pts. 3 and

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

Type of issuer	1949	1948
Electric, gas, and water companies	$1,796,709,000	$1,606,551,000
Transportation and communication companies [1]	989,911,000	1,674,528,000
Financial and investment companies	680,600,000	780,542,000
Manufacturing companies	679,447,000	872,471,000
Extractive companies	33,495,000	26,238,000
Merchandising companies	14,675,000	51,333,000
Service companies	9,171,000	20,498,000
Construction and real estate companies	0	39,000
Total	4,204,008,000	5,032,199,000

[1] Does not include companies subject to regulation by the Interstate Commerce Commission and therefore exempt from registration.

Registrations of securities for cash sale by electric, gas, and water companies in the 1949 fiscal year established a new high for the group, exceeding by 8 percent the previous high established in the 1946 fiscal year and by 12 percent the amount for the 1948 fiscal year. They accounted for two-fifths of the total for the year. Transportation and communication companies, with 24 percent of the total, registered 41 percent less than in the 1948 fiscal year, which represents their peak year for the 15 years. Companies classified as financial and investment companies and manufacturing companies registered almost equal amounts of securities, 16 percent of the total each, decreases of 13 and 22 percent, respectively, from the amounts for the 1948 fiscal year. No registration statements were filed by foreign governments for cash sale during the 1949 and 1948 fiscal years.

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

	1949	1948
Amount registered to be sold through investment bankers:		
Under agreements to purchase for resale	$2,758,454,000	$3,016,544,000
Under agreements to use "best efforts" to sell	557,361,000	759,791,000
Total registered to be sold through investment bankers	3,315,814,000	3,776,335,000
Total registered to be sold directly to investors by issuers	888,194,000	1,255,865,000
Total	4,204,008,000	5,032,199,000

In the 1949 fiscal year, investment bankers were used for the sale of 79 percent of the total securities registered for cash sale for the accounts of issuers as compared with 75 percent in the 1948 fiscal year. Commitments by investment bankers to purchase for resale involved 66 percent of the total registered for cash sale for the accounts of issuers, as compared with 60 percent in the 1948 fiscal year.[6]

[6] See also appendix table 1, pts. 2 and 5.

During the five fiscal years ended June 30, 1949, investment bankers underwrote for cash sale or exchange 1,821 registered issues amounting to $17,325,874,000. Of this amount, $10,957,543,000 represented bonds, $3,706,520,000 represented preferred stock, and $2,661,812,000 represented common stock.

That part of cost of flotation represented by commissions and discounts to investment bankers, but excluding other expenses, is shown for each type of security for each of the past 10 fiscal years. The table below covers securities effectively registered for cash sale through investment bankers to the general public for the accounts of the registrants, but does not include securities sold to existing security holders of the issuers, securities sold to special groups, and securities of investment companies.

Commissions and discounts to investment bankers

[Percent of gross proceeds]

Year ended June 30—	Bonds	Preferred stock	Common stock
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
1948	.6	4.5	10.2
1949	.8	3.8	7.1

ALL NEW SECURITIES OFFERED FOR CASH SALE[7]

Registered Securities

Securities effectively registered under the Securities Act of 1933 and actually offered for cash sale during the 1949 fiscal year still were at a high level, although lower than in any of the postwar years which have been characterized by a record volume of new capital issues. The amounts of such offerings, valued at actual offering prices, are as follows:[8]

	1949	*1948*
Corporate (excluding investment companies)	$3, 443, 000, 000	$3, 758, 000, 000
Noncorporate (International Bank)	0	249, 000, 000
Total registered securities offered	3, 443, 000, 000	4, 007, 000, 000

Unregistered Securities

CORPORATE

Some $3,436,000,000 of unregistered corporate securities are known to have been offered for cash sale by issuers in the 1949 fiscal year as

[7] See appendix table 3 for a detailed statistical breakdown of the volume of all securities offered for cash sale in the United States. Footnote 1 of that table gives a description of the statistical series.

[8] The figures given in this section exclude securities sold through continuous offering, such as issues of open-end investment companies and securities sold through employee purchase plans, because complete data are not currently available.

compared with $3,644,000,000 in the 1948 fiscal year. The basis for exemption of these securities from registration is as follows:[9]

Basis for exemption from registration:	1949	1948
Privately placed issues	$2, 657, 000, 000	$3, 006, 000, 000
Railroads and other common carriers	621, 000, 000	452, 000, 000
Commercial bank issues	25, 000, 000	25, 000, 000
Intrastate offerings	2, 000, 000	9, 000, 000
Offerings under regulation A [1]	121, 000, 000	141, 000, 000
Other exemptions	10, 000, 000	11, 000, 000
Total	3, 436, 000, 000	3, 644, 000, 000

[1] Includes only offerings between $100,000 and $300,000 in size. See p. 11 for a more detailed discussion of regulation A offerings.

NONCORPORATE

The total of unregistered governmental and eleemosynary securities offered for cash sale in the United States during the 1949 fiscal year was $13,823,000,000 as compared with $11,879,000,000 in the 1948 fiscal year. These totals consist of the following:

Issuer:	1949	1948
United States Government	$11, 135, 000, 000	$9, 349, 000, 000
State and local governments	2, 513, 000, 000	2, 526, 000, 000
Foreign governments	166, 000, 000	0
Miscellaneous nonprofit organizations	8, 000, 000	4, 000, 000
Total	13, 823, 000, 000	11, 879, 000, 000

Total Registered and Unregistered Securities

The volume of all corporate securities offered for cash sale amounted to $6,879,000,000 in the 1949 fiscal year, somewhat lower than the 1948 figure. Offerings in the noncorporate category were moderately higher than in the preceding fiscal year, reflecting increased sales of United States savings bonds and notes and a large offering in this country of Canadian Government bonds. Comparable figures for the 1949 and 1948 fiscal years are:

	1949	1948
Corporate	$6, 879, 000, 000	$7, 402, 000, 000
Noncorporate	13, 823, 000, 000	12, 128, 000, 000
Total securities	20, 702, 000, 000	19, 530, 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 $5,779,000,000. This may be compared with the $5,887,000,000 in the 1948 fiscal year, which was estimated to be the largest amount of money ever raised in the securities markets for new capital purposes. As between money allocated to fixed and working capital purposes in the 1949 fiscal year, there was an increase of $200 million in the amount for new plant and equipment expenditures, offset by a decline of 300 million dollars in proceeds for working capital purposes. Public utility companies (including telephone) accounted for 52 percent of the new money financing, industrial and miscellaneous firms for 38 percent, and railroad companies for 10

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

percent. The volume of refinancing through new issues of securities declined further to $777,000,000, compared with $1,136,000,000 in the 1948 fiscal year and a peak volume of $5,310,000,000 for the 1946 fiscal year.[10] Refunding of outstanding bonds fell to $151,000,000, the lowest amount for this purpose since the beginning of the series in 1934. However, funds used for repayment of other debt, principally bank loans, increased and amounted to $600,000,000 as compared with $360,000,000 in the preceding fiscal year.

REGISTRATION STATEMENTS FILED

Four hundred and fifty-five registration statements were filed in the 1949 fiscal year covering proposed offerings in the aggregate amount of $5,124,439,119.

Number and disposition of registration statements filed

	Prior to July 1, 1948	July 1, 1948, to June 30, 1949	Total as of June 30, 1949
Registration statements:			
Filed	7,588	455	8,043
Effective—net	6,258	[1] 415	[2] 6,663
Under stop or refusal order—net	182	0	182
Withdrawn	1,093	52	1,145
Pending June 30, 1948	55	----	----
Pending June 30, 1949	----	----	53
Aggregate dollar amount:			
As filed	$52,838,232,030	$5,124,439,119	$57,962,671,149
As effective	$48,780,336,063	$5,333,362,000	$54,113,698,063

[1] Excludes 13 registration statements which became effective and were subsequently withdrawn.
[2] 10 registration statements which became effective prior to July 1, 1948, were withdrawn during the year and are counted in the number withdrawn.

A long-range comparison shows that during the 5 years ended June 30, 1949, 2,623 registration statements were filed covering proposed financing in the aggregate amount of $29,792,518,627, or an amount three times greater than that for the preceding 5 years, as shown below:

Registration statements filed 1940–49

Fiscal year—	Number	Amount
1940	338	$1,956,841,248
1941	337	3,412,087,877
1942	235	1,825,433,469
1943	150	959,326,793
1944	245	1,774,316,982
5 years ended June 30, 1944	1,305	9,928,006,369
1945	400	4,182,726,108
1946	752	7,401,260,809
1947	567	6,934,388,303
1948	449	6,149,704,288
1949	455	5,124,439,119
5 years ended June 30, 1949	2,623	29,792,518,627

[10] See appendix table 4 for statistics in greater detail as to the use of net proceeds from the sale of securities.

Additional documents filed in the 1949 fiscal year related to Securities Act registrations

Nature of document:	*Number*
Material amendments to registration statements filed before the effective date of registration	706
Formal amendments filed before the effective date of registration for the purpose of delaying the effective date	754
Material amendments filed after the effective date of registration	542
Total amendments to registration statements	2,002
Supplemental prospectus material, not classified as amendments to registration statements	1,063
Reports filed under sec. 15 (d) of the Securities Exchange Act of 1934 pursuant to undertakings contained in registration statements under the Securities Act of 1933:	
Annual reports	744
Current reports	1,013
Total filings	4,822

EXEMPTION FROM REGISTRATION UNDER THE ACT

The Commission is authorized under section 3 (b) of the act to provide, by rules and regulations, exemption from the registration requirements for issues of securities whose aggregate offering price to the public does not exceed $300,000.

The Commission has adopted five regulations 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; 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 act originally imposed a maximum limit of $100,000 upon the amount of an offering which the Commission was thus empowered to exempt from registration until by amendment of the statute effective May 15, 1945, this limit was raised to $300,000. Following this amendment of the law, the Commission revised its regulation A insofar as it applies to issuers (as distinguished from controlling stockholders) so as to extend the general exemption from the registration requirements provided thereby up to the ceiling of $300,000.

Small offerings of securities may be made and sold to the public pursuant to a section 3 (b) exemption on the basis of a less complete disclosure than that required by the act in the case of a registered security. For example, regulation A provides for the filing of a simple letter of notification, containing limited information about the issuer and the offering, with the appropriate regional office of the Commission, and provides further that the offering may be made five business days thereafter.

It should be emphasized, however, that any exemption from registration permitted under section 3 (b) carries no exemption from civil liabilities under section 12 for misstatements or omissions, or from the criminal liabilities for fraud under section 17. For the proper enforcement of these sections, the conditions for the availability of the exemptions provided under section 3 (b) include, with the exception of regulation A–R, the requirement that certain minimum information be filed with the Commission and that disclosure of certain information

be made in sales literature, if any sales literature is used. While no prospectus need be used, selling literature must be filed in advance of its use.

Exempt Offerings Under Regulation A

There has been a marked increase in the amount of small financing by means of offerings made under regulation A since the maximum permissible amount of such an offering was tripled to $300,000 in May, 1945. The striking character of this increase in offerings can be noted in the following table:

Fiscal year—	Number of letters of notification filed	Aggregate offering price
1945	578	$38,845,893
1946	1,348	181,600,155
1947	1,513	210,791,114
1948	1,610	209,485,794
1949	1,392	186,782,661

The figures for the 1949 fiscal year include 127 letters of notification covering offerings aggregating $18,355,308 of securities of companies engaged in some phase of the oil and gas business. This represents an increase of about 25 percent in the number and 50 percent in the dollar amount of these particular offerings over the 1948 year.

Of 1,389 letters of notification filed in the 1949 fiscal year (omitting three that were incomplete and subsequently withdrawn), 726 covered proposed offerings of $100,000 or less; 276 covered offerings of more than $100,000 and less than $200,000; and 387 covered offerings of an amount between $200,000 and $300,000. Issuing companies made 1,238 of these offerings, stockholders made 142, and both issuers and stockholders made the remaining 9. Commercial underwriters were employed to handle 396 of the offerings, officers and directors or other persons not regularly engaged in the underwriting business marketed 195, and no underwriter was used in connection with the remaining 798.

The Commission's procedure for making an exempt offering under regulation A is simple. All that is necessary is to file the prescribed letter of notification and such sales literature as the offeror intends to employ with the appropriate regional office of the Commission five business days before the offering is to be made. In processing by the Commission this material is examined in the field and reviewed by the staff at the Commission's headquarters. This review involves a search for pertinent information in the Commission's extensive files and an examination to determine whether the exemption provided by the regulation is applicable to the particular case and whether the information filed discloses any violation of any of the acts administered by the Commission. The results of this review are made available promptly to the regional office. The Commission also follows the practice of cooperating with the proper local authorities in the states in which the securities are proposed to be offered by furnishing them significant data about the proposed offering.

Exempt Offerings Under Regulation A–M

During the 1949 fiscal year the Commission received and examined four prospectuses covering an aggregate offering price of $375,000 for

assessable shares of stock of mining corporations exempt from registration under this regulation.

Exempt Offerings Under Regulation B—Oil and Gas Securities

To help deal with the special problems arising in oil and gas financing the Commission maintains a specialized unit in its central office. This unit not only administers regulation B but also gives technical help and advice with regard to offerings of oil and gas securities under other provisions and rules of the Securities Act. Where oil and gas securities are significant in the portfolio of broker-dealers undergoing inspection by the staff of the Commission, inspection reports are submitted to this unit for advisory assistance. Last year, in addition to its examination of 85 offering sheets filed under regulation B, this unit was called upon to render technical advisory assistance in connection with the examination of 127 letters of notification filed under regulation A covering securities of companies engaged in various phases of the oil and gas business; 54 registration statements and 58 amendments thereto; and 33 broker-dealer inspection reports. It assisted also in the examination of 7 applications for registration of securities on exchanges, 3 filings of proxy soliciting material, and 1 annual report on Form 1–MD, under the Securities Exchange Act of 1934, all raising some technical problem concerning oil and gas securities.

As a further means of coordinating its work dealing with the sale of oil and gas securities, the Commission maintains a petroleum geologist in Tulsa, Okla. This field officer is a source of up-to-date information on wells and tracts located in the Mid-Continent and Coastal regions. He not only makes examinations of actual tracts involved in specific investigations conducted by the central or various of the regional offices of the Commission, but also conducts a considerable amount of research pertaining to oil and gas production and development for use of the staff charged with examining offering sheets filed under regulation B and sales literature filed for the information of the Commission under regulation A.

The oil and gas unit maintains an extensive reservoir of pertinent information about various companies and wells now consisting of between 30,000 and 40,000 catalogued items. This information comes generally from all the oil-producing states in the United States, Canada, and Mexico and, in as yet a more limited way, from other oil-producing countries throughout the world.

The Commission's examination and investigative procedures are designed to protect investors in oil and gas securities, while saving needless time, effort and expense for all parties concerned, by avoiding insofar as possible any necessity to resort to legal proceeding. Most problems are disposed of directly and informally in the field before they would mature into litigation.

During the past 5 years the Commission has participated in only 17 oil and gas investigations which have led ultimately to court convictions or injunctions; and there have been only 204 preliminary, informal, and formal oil and gas investigations during this period.

As we have noted, examination of letters of notification and related sales literature filed under regulation A is concerned with aiding the Commission in the enforcement of section 17 of the act. Often the information needed for such examination does not require the expense

of a field trip but merely a reference to the technical files already catalogued by the Commission's oil and gas unit, or consultation with experts in other agencies of the Government. In a typical case, the Tulsa representative of the Commission, through his personal local contacts in the industry and expert information on most producing areas in the Mid-Continent and Rocky Mountain fields, is able to take any action indicated before the expiration of the five business days of waiting provided under the regulation before the securities may be sold. Where, for example, sales literature filed with the Denver regional office appears to be misleading, that office sends a copy immediately to the Tulsa office. If the material is found to be untrue or misleading, a report to that effect is communicated to the originating office before the waiting period has expired, so that the offerors may be informed and thus enabled to correct their sales literature before it is distributed to the public. Since sales campaigns of many of the regulation A issues extend over a period of many months, with new sales appeals being prepared for such issuance under the regulation sometimes as often as once every week or 10 days, these technical examinations and reports have become increasingly numerous and continuous. As evidence of the growth in this particular work, it may be noted that in the 1948 fiscal year the Tulsa Office prepared a total of 89 technical memoranda and investigative reports, of which 20 related to sales literature filed under regulation A, whereas last year the corresponding total had increased to 136, of which a very much larger number, 84, related to such sales data.

The exemption from registration provided by regulation B for fractional undivided interests in oil or gas rights is limited to a maximum aggregate offering price of $100,000. Regulation B requires that an offering sheet be filed with the Commission summarizing pertinent information regarding the security being offered. In the 1949 fiscal year a total of 85 such offering sheets, and 76 amendments thereto, were received and examined by the Commission. The following actions were taken on these filings:

Various actions on filings under regulation B:

Temporary suspension orders (rule 340 (a))	28
Orders terminating proceedings after amendment	17
Orders consenting to withdrawal of offering sheet and terminating proceeding	2
Orders terminating effectiveness of offering sheet (no proceeding pending)	1
Orders accepting amendment of offering sheet (no proceeding pending)	30
Orders consenting to withdrawal of offering sheet (no proceeding pending)	1
Total orders	79

Confidential written reports of sales under regulation B.—The Commission also received and examined during the 1949 fiscal year 1,262 confidential written reports of actual sales made under regulation B and filed on Forms 1–G and 2–G, in the aggregate amount of $460,935. The reports are required pursuant to rules 320 (a) and 322 (c) and (d) of regulation B concerning sales made by broker-dealers to investors and by dealers to other dealers. Where examination of these reports indicates that a violation of the law may have occurred, the Commission makes an investigation or takes such other action as may be deemed appropriate.

During the past 5 years the proportion of nonproducing interests offered for sale under regulation B has more than doubled. These

nonproducing interests accounted for 22 percent of total regulation B filings in the 1945 fiscal year and for 55 percent of the total filed last year in the 1949 fiscal year.

Oil and gas investigations.—Nineteen new investigations involving oil and gas securities were instituted by the Commission in the 1949 fiscal year and 25 such cases closed. This brought the total current during the year to 150 and the number pending at the close of the year to 125. Most of these investigations, conducted by the regional offices and reviewed by the technical staff of the central office, arise out of complaints from investors to the Commission. They are undertaken primarily to determine whether the transactions in question were effected in violation of section 5, which requires registration, and of section 17, which prohibits fraud in securities transactions.

As a result of the evidence developed in some of these oil and gas investigations the Commission has filed complaints in the courts seeking injunctions restraining violations of the law, and has cooperated with the Department of Justice in undertaking criminal prosecutions where the facts warrant such action. During the 1949 year two persons were enjoined from violations of the registration provisions of the Securities Act and another was enjoined from further violations of the antifraud provisions of the act in the sale of oil and gas securities. In the same period indictments were secured in two cases developed by the staff, charging violations of these antifraud provisions, and one defendant whose transactions had previously led to his indictment for such offense was last year sentenced to imprisonment for 2 years.

FORMAL ACTIONS UNDER SECTION 8

The purpose of the Commission's informal procedures in processing registration statements is to get registration statements which comply with the requirements of the act before the statements become effective. In almost all cases conference and comment by letter are sufficient both for the needs of the registrant and for the adequate protection of investors. It is sometimes necessary, however, for the Commission to exercise its powers under section 8 in order to prevent a registration statement from becoming effective in deficient or misleading form 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 an order to prevent a registration statement 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 at any time to determine whether the Commission should issue a stop-order to suspend the effectiveness of a registration statement 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 otherwise 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).

Examinations under section 8 (e) may be held in public, or the record may be made public after the close of the hearing. 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, the Commission makes it a practice to hold such examinations preliminarily in private. On the other hand, all stop-order proceedings under section 8 (d) are held in public.

Examinations under Section 8 (e)

At the beginning of the past year one private examination under section 8 (e) was pending and three were authorized during the year. The examinations were discontinued and the registration statements withdrawn in two cases and stop-order proceedings were authorized in a third case. The registration statement was withdrawn and the record of examination was made public in the fourth case, described below:

The First Guardian Securities Corporation—File No. 2-7554.—The company filed a registration statement proposing the sale of nearly $2,000,000 of preferred and common stocks. The information contained in the registration statement indicated a willful attempt to distort descriptions of both the business of the company and the background of the company's promoters, who were also its principal officers and stockholders.

The prospectus stated: (1) That the company would deal in securities for the purpose of investment and trading and that funds not so used would, up to 50 percent of the company's assets, be used for making collateral or factoring loans or for any other types of profitable opportunities; (2) that during its period of operations the company had invested its money principally in collateral loans and had, in one case, charged the borrower a factoring rate of 2 percent a month, implying that this was the maximum rate; (3) that the management planned to operate the company in such manner as to enable it to qualify under section 361 of the United States Internal Revenue Code as a regulated investment company, which would entitle it to certain tax benefits; (4) that the company intended to pay a dividend on Common Stock of 20 cents per quarter and that initially the dividend would be paid from capital surplus; and (5) that the company did not intend to invest in real estate.

The prospectus also sought to convey the impression that the promoters had extensive business experience. In describing their experience the prospectus stated that "after successfully accumulating sufficient capital" they "organized a distributing agency for soft beverages during 1929;" that "they subsequently organized" a company "for the manufacture of textiles and integrated products from the raw yarn through a nationwide retail distribution;" and that "during 1943 and 1944 they liquidated their operations in the textile field and principally engaged in trading and investing in stocks, bonds and debentures for their own account and for the account of the members of their immediate family."

Investigation disclosed that the registration statement was in fact false and misleading. For example, the investigation disclosed that, contrary to the statements contained in the prospectus: (1) The policy of the registrant would be to place its monies primarily in collateral loans, which would be generally secured by non-liquid collateral such

as second mortgages on real estate, personal endorsements, chattel mortgages and shares of stock of privately owned corporations, and that the promoters had little experience in making such loans; (2) the company received fees and interest on collateral loans at rates as high as 12 percent a month; (3) the normal operations of the company would be such that it could not claim the tax benefits made available by section 361 of the Internal Revenue Code; (4) assuming that it sold all of the shares of stock offered, the company could not meet its stated dividend policy of 20 cents a quarter on the common stock payable out of earnings unless gross earnings were at least 15 percent on its capital, and that by reason of the asset coverage required with respect to the preferred stock by provisions of the Investment Company Act it could not pay such dividend out of capital surplus for more than 2 years at the most; and (5) the company did in fact intend to invest in real estate. Furthermore, the investigation disclosed that the financial statements included in the registration statement were certified by an accountant who owned shares of stock of the company during part of the period covered by the audit. The independence of the accountant was questioned for this reason.

Regarding the experience of the promoters, the investigation disclosed that the beverage business in which they had engaged consisted of the sale of soft drinks to factory workers when they were still no more than 13 years of age. The company which was engaged in the business of "manufacturing textiles and integrated products from the raw yarn through a nationwide retail distribution" was in fact a small enterprise engaged for the most part in the business of selling ladies' blouses. The reference to their trading in securities was no less misleading. It sought to convey the impression that they had experience in trading in securities but did not show the results of their experience. The investigation disclosed that during the period referred to in the prospectus the promoters traded extensively in securities and suffered a net loss as a result of their operations.

Subsequent to the investigation the Commission granted the company's request to withdraw the registration statement. At the same time the Commission ordered that the investigation pursuant to section 8 (e) be made public.

Stop-Order Proceedings under Section 8 (d)

Three stop-order proceedings were authorized in the 1949 fiscal year and public hearings were held in the cases during the year. In one case the registration statement was withdrawn and the proceedings dismissed. The remaining two cases were pending as of the close of the year.

American Oil Explorers Inc.—File No. 2-7886.—This company, newly organized for the purpose of engaging in speculative oil exploration, filed a registration statement on March 17, 1949, covering 5,000,000 shares of its 1-cent par value common stock to be offered to the public at a purported price of $1 per share, for an aggregate of $5,000,000. At the time the registration statement was filed the company's entire capital amounted to $1,000. Each purchaser of stock was to receive a paid-up life insurance policy in an amount equal to the price of the total number of shares purchased by each shareholder, but not less than $250 nor more than $2,000 for any one investor.

Such policy was to be purchased by the company from a specified insurance company for a single stated premium, the amount of which would vary with the age of the particular investor.

On April 5, 1949, the Commission ordered the institution of stop-order proceedings under section 8(d), alleging misstatements and omissions to state material facts in regard to numerous items of required information. Issue was taken, among other things, with the misleading nature of the proposed offering which combined life insurance and a speculative stock in one package. The company represented in the prospectus that by applying a major part of the proceeds from the sale of the issue to the purchase of fully paid-up life insurance having a face amount equal to the sum paid by investors, the scheme would provide investors with long-range protection against loss of the capital invested in the speculative program of oil exploration. The Commission attacked this deliberate attempt to imply the absence of risk in an investment in this highly speculative venture, since life insurance alone could have been bought elsewhere for the same or a lower premium without the need of subjecting a substantial amount of additional money to the hazards of the promoters' enterprise.

A second issue raised was the legality of a combined offering of life insurance with stock under pertinent State law. Additional issues included: (1) The accuracy and adequacy of the disclosures regarding the insurance company; (2) the failure to disclose properly the relationship between the registrant and another company, controlled by the registrant's promoters, which was to provide management advisory services; (3) the nature of the emoluments the promoters would receive through such arrangement; and (4) the failure to state that the price of the shares would vary as between investors by reason of the fact that a portion of the amount paid in, variable with the age of each investor, was to be invested in life insurance, and the resulting balance, representing the actual price of the stock, would differ materially for different purchasers.

After the Commission's order for a public hearing was issued, the registrant filed a request for withdrawal of its registration statement and no sale or offering of the securities was made. The request was granted by the Commission on April 19, 1949.

DEFICIENCIES DISCOVERED IN EXAMINATION OF REGISTRATION STATEMENTS

The examination of registration statements during the waiting period brings to light many deficiencies in the registration statements which would, if undiscovered, be published and furnished to investors. These are sometimes corrected; often they are of such material character that the statements are withdrawn on discovery of the deficiency. The following are examples of deficiencies discovered in examination of registration statements.

Failure to Disclose Interest of Parent Company

A company operating a chain of restaurants filed a registration statement for 120,000 shares of convertible preferred stock, $1 par value. Thirty-two thousand two hundred and fourteen of the shares

were to have been offered, by way of exchange, to the holders of the company's then outstanding $6 cumulative preferred stock, on a share-for-share basis, and the remaining 87,786 shares were to have been offered to the company's stockholders and to the public at $15 per share. The old preferred had a $100 liquidating preference and carried, as indicated, a $6 cumulative dividend rate. Dividend arrearages amounted to $95 per share. The new preferred stock to have been offered in the share-for-share exchange had a par value of $1 per share, a $30 liquidating preference and a cumulative dividend rate of $1.50. The registration statement failed to disclose adequately the rights which the old preferred stockholders would give up and the rights which they would receive if they accepted the exchange offer.

Although there was no equity for the common stock of the company the exchange of old preferred stock for the new preferred stock would create an equity for the common stock through the reduction in the liquidating preference and the elimination of dividend arrearages. No disclosure was made in the registration statement as to the benefits which would thereby accrue to the company's parent, which held 45 percent of the common stock.

In conferences with counsel for the company the staff pointed out these inadequacies of the registration statement. It developed in these conferences that the fair or current value of the company's property, plant and equipment, carried on the books of the company at a depreciated value of $3,478,301, was very substantially less than the books indicated, and that if the land, buildings, and equipment were offered for sale, these assets would probably yield less than $1,000,000. Shortly after these conferences the company withdrew the registration statement upon the grounds that the company's restaurants had been leased to another company and that the plan of financing was no longer necessary.

Expenses Paid by Company to Accommodate Selling Stockholders

A manufacturer of metal roofing filed a registration statement covering an offering of 30,000 issued shares of the company's $1 par value common stock to be sold to employees at $10 per share. Although the stock was owned by and to be offered in behalf of three of the company's principal officers, who were also directors and controlling stockholders of the company, the entire cost of financing purchases under this employee stock purchase plan was to be borne by the company as an accommodation to these selling stockholders. Thus it was disclosed in the registration statement as originally filed that purchases would be financed with loans from two local banks, and that the company would not only pay interest charges on the installment notes securing such loans but also the cost of insuring the loans, while providing in addition a special cash deposit in the banks for the purpose of guaranteeing all loans made. This participation by the company assured immediate payment to the selling stockholders.

This method of financing prompted serious questions on the part of the Commission's examining staff concerning not only the legality of the banks' participation therein but also whether the assumption of such expenses and guarantees by the company would constitute *ultra vires* acts as to which issues no disclosure was made in the regis-

tration statement. Subsequently, the registration statement was amended to indicate that the banks had entirely withdrawn from participation in the offering, that the company's participation therein was limited to periodic pay-roll deductions for payment of the shares purchased by the employees, and that the company's expenses in connection with the offering were confined to the cost of stock certificates and transfer fees.

Failure to Disclose Cease and Desist Orders

A company, owning a gold-mining property which had been developed by a predecessor, filed with its registration statement a prospectus in which it was represented that the property was then in condition for operation except for minor installations of mill equipment. An estimate of ore reserves in excess of 400,000 tons, as set forth in the prospectus, served to round out the registrant's picture of a mine about ready for productive operations. The ore reserve estimate rested on a three-page report by the company's mine manager. It was readily apparent upon examination, however, that this report gave no evidence that its ore estimate was based on an adequate sampling of the mine. On the contrary, it indicated an insufficient sampling. The prospectus omitted all discussion of this vitally important question of sufficiency of the sampling as a basis for the ore reserve estimate. It failed to show the following significant facts: (1) The predecessor company, after having finished substantially all development work done at the property and after a thorough sampling of the mine, concluded it had no ore reserves in its mine and that the mine did not justify any further expenditures; and (2) an extensive program of check-sampling by the company filing the registration statement gave results mainly consistent with those of the predecessor. After the deficient character of the registration statement was called to the attention of the company, a conference was arranged during which the inadequacies of the statement were discussed by the examining staff with a representative of the company. Thereafter the company elected to abandon its proposed public offering and withdrew its registration statement.

While the process of examination was under way, the Commission's staff discovered from sources of information independent of the registration statement that numerous cease and desist orders forbidding the sale of the registrant's securities were then in effect in several States, and it was pointed out to the registrant that disclosure of the existence of these orders would need to be included in the registration statement in order to make it not misleading to the public. The registrant's request for withdrawal was stated to have been made in view of the existence of these orders.

Preferred Position of Insiders

A company filed a registration statement covering the public offering of stock of the company. Some of the stock was to be offered by the company and the balance by company insiders—officers of the company and persons closely associated with them. Some of the stock to be offered by the insiders had been acquired through the exercise of options. These options had been obtained by an individual closely associated with the company management.

When the registration statement was filed it was examined by the staff in the ordinary course. Such examination disclosed the necessity for ascertaining further facts concerning the acquisition of the options. Upon inquiry, it was discovered that in acquiring the options financial statements were used which did not reflect then current earnings, which had substantially improved over those shown. The last purchases of options were made shortly before the close of the company's 1948 fiscal year, when new financial statements would have become available disclosing that earnings for that year had increased to about three times over earnings for the prior year. The stock obtained through exercise of the options was to be resold to the public at a price greatly in excess of the option price paid.

The company thereafter elected to withdraw its registration statement, giving as its reason the then condition of the securities market.

Liability for Pensions not Disclosed

A registration statement was filed by a gas company which, with its subsidiaries, had guaranteed annuities for life to certain former employees who had retired and to others who were eligible to retire. Annual payments to those retired were charged to profit and loss only when made. However, the issuer did not carry any liability in its balance sheet for the estimated amount of the cost of future payments of annuities for past services in the financial statements originally filed in connection with its public offering of securities. Following discussions held between the Commission's staff, representatives of the issuer, and the certifying accountants in the course of the examination of this registration statement, an actuarial study was made to ascertain the estimated liability representing the cost of these annuities. This cost was found to approximate $1,500,000 and was consequently so recorded on the balance sheet as a liability, with a corresponding reduction of earned surplus.

Overstatement of Inventories and Understatement of Losses

A registration statement filed by an aircraft producer preparatory to a public offering of debentures contained financial statements which indicated that the operating loss for the accounting period covered amounted to $783,000. As a result of inquiry, it was found by the staff that materials and parts inventories and work in process inventories were greatly overstated. At the same time it was discovered that realizable values from the sales of goods in the regular course of business were, on the other hand, substantially less than the actual cost of materials and other expenses of manufacture. The staff also ascertained that manufacturing costs used in determining operating results were based on standard costs which had not been properly adjusted to reflect substantially higher actual costs. Under the circumstances, appropriate adjustments were required to be made in the financial statements in order that they would not be misleading, as a result of which the amount of operating losses, originally reported as $783,000, was shown to be $2,000,000, and carrying values of inventories shown on the balance sheet were commensurately reduced. Subsequently the registration statement was withdrawn.

Write-up of Fixed Assets

A company engaged in the construction business filed a registration statement which included a consolidated balance sheet reflecting fixed assets in a gross carrying amount of approximately $11,000,000 and showing a net worth of $2,180,000. In the course of the staff's examination of the financial statements conferences were held with representatives of the issuer and it was ascertained that during 1928 certain land had been acquired in an arm's-length transaction and reflected on the books of a subsidiary at cost. The issuer constructed a building on this land which was completed in the early part of 1929. Shortly after the completion of the building negotiations were entered into with underwriters for the sale of securities and the underwriters, in negotiating the price and amount of the public offering, assigned a value to the land and buildings which was $4,507,000 in excess of cost. The issuer wrote up the fixed assets and assigned the entire amount of the write-up to land.

At the suggestion of the Commission's staff, a pro-forma consolidated balance sheet was included reflecting the consolidated financial condition of the company based on cost of fixed assets, which the Commission considers to be the proper accounting basis for carrying fixed assets. This accounting adjustment brought about while the registration statement was in process of examination resulted in a reduction of the asset value of land from $7,400,000 to $3,000,000, and the substitution of a deficit of $2,900,000 for a previously shown surplus of $1,600,000.

The original prospectus included a representation that the net book value of the common stock was $4.36 per share. This representation was revised to indicate further that the common stock had no net book value on the basis of using cost in accounting for fixed assets.

Effect of Additional Depreciation and Taxes on Earning Power

One company filed a registration statement in connection with the proposed sale of equity securities, the principal purpose of which was to acquire certain assets of a partnership and certain real estate from the partners. The amount to be paid for the partnership assets exceeded the amount at which they were carried on the partnership books, the excess being related to depreciable property.

The prospectus included a summary of earnings of the partnership for the 10½ years ended June 30, 1947. The staff pointed out that the summary of partnership income did not properly show the earning power of the assets to be acquired as recognition was not given to the additional depreciation charge resulting from the excess payment for property, nor to income taxes which would have been incurred had the partnership been operated as a corporation. As amended, the summary of earnings showed for each period the effect of additional depreciation and of income taxes computed on a pro-forma basis of rates ap plicable to corporations.

The significance of the added information thus disclosed may be appraised in the light of the following differences: The highest net income of the partnership during the 10½ years covered in the summary was $171,067.06 in 1943. Additional depreciation of $45,000 and corporate Federal income taxes of $46,000 would have reduced such

income to $80,067.06. Further, in 4 years in which there were profits on the partnership basis there would have been losses on the pro-forma basis. In respect of the latest period, the 6 months ended June 30, 1947, profits shown for the partnership of $111,648.92 become $55,148.92 on the corporation basis, a reduction of approximately 50 percent.

Good Will Amortized

An issuer, engaged primarily in the manufacture and sale of milk products, acquired, through merger, the facilities and business of another company engaged in a like business. The purchase price substantially exceeded the net assets as reflected on the acquired company's books. This excess, together with certain other transactions, gave rise to an item of approximately $1,300,000 in the consolidated balance sheet which was shown as good will. It was indicated, in a prospectus filed by the issuer in connection with a public offering of equity securities, that the good will balance was not being amortized. It was pointed out to representatives of the issuer that this good will appeared to represent, in effect, the cost of additional earnings which should be amortized against the realization of such earnings in order to make future statements of earnings meaningful. The issuer revised its prospectus to reflect the adoption of an amortization policy for its item of good will over a period of 15 years.

Sale of Stock at Different Prices

A foreign gold mining company filed a registration statement for 500,000 shares of common stock, $1 par value, to be offered at $1 per share. This company and its three predecessors (all controlled by the same promoter) despite sporadic efforts over a period of 30 years had been unsuccessful in their efforts to find a commercial body of ore. Following the filing of the statement a conference was had with the company's promoter and his counsel. At this conference the staff was informed that the stock was currently obtainable and had been sold in the foreign country at 50 cents per share, a fact not disclosed in the registration statement. It was also learned that the company's immediate predecessor had been denied the right to sell securities by a large number of States in this country and that the promoter had been refused a broker's license by the appropriate authorities in his own country. The registration statement was silent as to these matters.

The information given with respect to the development of the mining property and its prospects was inadequate and misleading. For example, it was stated in the prospectus that in 1918 a "* * * kidney of concentrated free gold * * *" was found on the property which was said to be "two feet long, ten inches wide, and about two feet deep" and to be "practically solid gold." This gold would have had a value of over $1,000,000 at the gold price prevailing in 1918. Since governmental reports of gold production for the area in which the property is located showed no gold production for the year 1918 or for a number of succeeding years, inquiry was made as to the issuer's basis for the representation. No supporting evidence was presented.[11]

[11] This representation about the gold kidney does not appear in a new registration statement filed by the company recently which was under examination at the close of the 1949 fiscal year.

Upon being advised of the serious nature and extent of the deficiencies existing in the registration statement, the company withdrew the statement.

Promoter's Profit in Cooperative

A cooperative apartment corporation filed a registration statement in connection with an offering of common stock wholly owned by the sponsor of the enterprise, the stock to be purchased in conjunction with the issuance to each purchaser of a proprietary lease on an apartment. The estimated profit accruing to the sponsor was not disclosed in the registration statement originally filed. At the suggestion of the Commission the prospectus was amended to reveal that the cost of the building and related charges was estimated at $550,000, for which the purchasers were paying $700,000 ($400,000 in stock and $300,000 first mortgage) resulting in a profit to the sponsor of $150,000.

Disclosure of Financial Position

An electrical products manufacturing corporation filed a registration statement covering 270,000 shares of its common stock. Some time prior to the date of filing the company reported to its stockholders a net loss of $724,000 for the 6-month period ended October 31, 1948. However, the certified financial data included in the proposed form of prospectus pursuant to the requirements of the Securities Act indicated a net loss of $3,108,000 for that period. The greater loss disclosed in the prospectus was due to additional inventory write-downs and reserves of $1,765,000, a further reserve of $396,000 against possible loss on an investment in an affiliated company, and other audit adjustments of $223,000.

The principal deficiency in respect of the financial statements related to inventories, which at October 31, 1948, after deducting a reserve of $2,200,000, represented over 42 percent of total assets and 64 percent of total current assets.

The prospectus and the report of a management consultant retained by the corporation showed that the corporation was carrying excess inventories, the discontinuance of certain product lines, and reflected absolescence and faults in products. Further, the prospectus stated there was general inefficiency in purchasing, production, shipping, and warehousing.

The amounts stated in the balance sheet for inventories were based upon book records. The accountants in their certificates stated: "* * * such continuous records of quantities as are maintained by the Corporation with respect to certain portions of the inventories are not integrated in monetary amounts with the general accounting records. * * *" They also stated: "Assuming use and realization of the inventories in the regular course of business, we have no reason to believe that the inventory amounts at October 31, 1948, have not been fairly stated." Inventories had been written down by $1,268,700 during the year ended April 30, 1948, and by $1,700,967 during the 6 months ended October 31, 1948.

The Commission's letter of comment set forth that, in view of the statements in the prospectus and elsewhere in respect of the inventories, it did not appear that reliable and dependable financial statements could be prepared in the absence of a physical inventory as of the balance sheet date and questioned whether the accountants had

followed generally accepted auditing procedures under the circumstances. This failure to take a physical inventory raised the serious question of whether the amount of inventories, and of the write-downs made therein, had been properly determined.

During the pendency of the registration statement the Federal Government attached the company's property because of a default in the payment of income taxes. Also the Reconstruction Finance Corporation imposed conditions with regard to a proposed mortgage-loan to which the company could not agree. The registration statement was subsequently withdrawn after the negotiation of an agreement for the sale of the company to another company.

The filing of the registration statement, which was immediately made public by the Commission pursuant to the statute, instantly gave rise to widespread publicity released by financial news services, financial writers and newspapers generally. The loss for the accounting period, as disclosed in the registration statement, was a matter of public record the moment it was filed, and it was immediately reported in the public press and in the various financial news services. Trading in the stock was suspended for 1 hour by the authorities of the exchange on which the security was listed so as to give investors an opportunity to consider a statement by the company's president concerning the revised figures shown in the prospectus.

Comparative Investment Positions of Public and Promoters

In order to disclose clearly certain essential features of a proposed offering, particularly the contributions made and benefits received by promoters, the staff of the Commission requested that certain information be presented in tabular form by a registrant engaged in the manufacture and sale of an electrical product. The relative amounts of cash contributed by the public and by the promoters and their respective voting power and shares in the dividends were set forth in the prospectus, pursuant to this request, in a simple table.

This table disclosed that, assuming all the stock were sold, the promotors would have 50 percent of the voting power for an investment of $2,500—less than 1 percent of the total capital investment in the company—whereas the price to the public of a similar 50 percent of the voting power would be $480,000. In addition, in case the registrant should be able to pay dividends of $80,000 or more a year, public investors could get a maximum of only $16,000 a year more than the promoters.

The registration statement was subsequently withdrawn, and the company elected to make an offering of a reduced number of shares under the exemption from registration provided by regulation A. However, disclosure similar in form to that described above, adjusted principally to the smaller amount of offering involved, was continued in the company's offering circular filed under regulation A.

In addition, the relative position of this company's class A stockholders was greatly improved by a change in their dividend rights effected while the registration statement as originally filed was undergoing examination. The original filing covered a proposed offering of class A stock. At that time the registrant had outstanding class B stock, all of which was owned by promoters. The class A stock was stated to have a noncumulative dividend preference of 30 cents

per share. After the payment of 30 cents on the class A stock the class B stock was entitled to 20 cents per share, and thereafter the two classes were to share equally in dividends. The registrant was requested to point out in the prospectus that because of the noncumulative feature of the class A stock and the promoters' ownership of class B stock it was within the latters' power and interest to withhold dividends on the class A stock until such time as earnings had accumulated to the point the registrant could pay 20 cents a share on the class B stock as well as 30 cents a share on the class A stock. By amendment then filed the registrant disclosed it had changed its class A stock to make it cumulative.

CHANGES IN RULES, REGULATIONS AND FORMS

During the past 5 years the Commission has continued its long-established policy of revising its rules, regulations, and forms whenever it has appeared that such action was necessary for the protection of investors or to meet changing business conditions. This flexibility is intended to simplify compliance with the statute in the most practicable manner for different classes of issuers and securities with distinctive problems peculiar to the class. Changes may be made as a result of recommendations by the staff, or at the suggestion of persons who must comply with the requirements of the statute. In either case, no material change is made without a series of conferences with persons interested or who may be affected by such change. Some outstanding changes made during the past 5 years in the rules, regulations, and forms under the Securities Act of 1933 are summarized below.

Rules Relating to Exemptions

For a summary review of changes in sizes of offerings exempted from registration by Commission rules see discussion, above, of exemptions under section 3 (b) of the Securities Act.

Amendment of Rules Relating to Registration

Rule 131—The Red-Herring Prospectus.—Rule 131 was adopted by the Commission on December 5, 1946. Its purpose is to facilitate the dissemination of information about a security before the registration statement for such security becomes effective. It provides that the sending or giving to any person before a registration statement becomes effective of a copy of the proposed form of prospectus filed as a part of the registration statement shall not, in itself, constitute an "offer to sell," "offer for sale," "attempt or offer to dispose of," or "solicitation of an offer to buy," within the meaning of section 2 (3) of the act, if the proposed form of prospectus contains substantially the information required by the act and the rules and regulations thereunder to be included in a prospectus for registered securities, or substantially that information with certain specified exceptions. The rule was adopted for a trial period of 6 months and the Commission later announced that it would be continued in effect indefinitely. The copy of the prospectus so distributed is the so-called red-herring prospectus.

Regulation C.—On June 9, 1947, the Commission adopted a complete revision of regulation C, which contains general requirements

governing the preparation, form, contents, and filing of registration statements and prospectuses. The purpose of the revision was to simplify the registration procedure and conform the requirements of the rule to present day needs.

On November 10, 1948, the Commission added rule 431 to regulation C. This rule, designed to avoid the necessity of dual prospectuses in certain cases, provides that in sales of securities by an issuer to its existing stockholders a prospectus may consist of a copy of the proposed form of prospectus meeting the requirements of rule 131 plus a document containing such additional information that both together contain all of the information required to be included in a prospectus for registered securities. Under this rule most of the information required to be included in a prospectus may be sent to stockholders prior to the effective date of the registration statement. Upon the effectiveness of the registration statement the document is sent to stockholders incorporating the previous information by reference and containing such additional information as to price and related matters as is necessary to constitute a statutory prospectus.

Amendment of Forms for Registration

Revision of Form S–1.—The most important of the Commission's forms for registration of securities under the Securities Act of 1933 is Form S–1. On January 8, 1947, a revised and simplified Form S–1 was adopted and two predecessor forms, A–1 and A–2, were rescinded. Another predecessor form, Form E–1, was later rescinded. Further items of Form S–1 calling for information about remuneration of company officials were further amended on December 17, 1948, to reduce the number of persons whose individual remuneration must be disclosed.

Revision of Form S–2.—Form S–2 is used for the registration of securities of certain newly organized companies and other companies which are still in the promotional or development stage. It was revised so as to simplify considerably the requirements of the form. At the same time it superseded Form S–12, which was concurrently rescinded.

Forms S–4 and S–5.—Minor amendments to these forms were adopted recently on March 1, 1949. These amendments merely corrected certain references which required clarification because of other changes in the rules and regulations.

Form S–7.—With the organization of the International Bank for Reconstruction and Development (the so-called World Bank) it became necessary to adopt a form for the registration of security issues offered by the bank. Accordingly, Form S–7 was adopted for this purpose on July 8, 1947. This form followed the pattern of Form S–1 and other forms adopted under the act except that the requirements were adapted to the particular organization and functions of the bank. The Eighty-first Congress amended the Bretton Woods Agreements Act so as to exempt securities issued and securities guaranteed as to both principal and interest by the bank from the registration provisions of the act. Therefore, registration by the bank of such securities is no longer required. However, this amendment to the Bretton Woods Agreements Act requires the bank to file with the Commission such annual and other reports with regard to such securities as

the Commission shall determine to be appropriate in view of the special character of the bank and its operations and necessary in the public interest or for the protection of investors.

Form S–11.—When regulation A–M was adopted on March 24, 1945, the Commission concurrently adopted Form S–11 for the registration of shares of exploratory mining corporations. This form is for the use of mining corporations that are not engaged in active ore production and have no mining property developed beyond the exploratory stage. Its use is limited to corporations that have not been involved in recent successions and are without important subsidiaries. It dispenses with the requirement for the certification of financial statements by independent accountants since the type of corporation eligible to use the form will generally have had few financial transactions.

LITIGATION UNDER THE SECURITIES ACT

Whenever it appears that any person has violated or is about to violate any of the provisions of the Securities Act of 1933, the Commission is authorized to bring an action to enjoin such violations. Such injunction actions, which are prophylactic in character, constituted the major portion of the litigation arising under the act during the past 5 years. A very considerable part of the injunctions which have been issued were directed against violations of sections 5 and 17. Section 5 requires all securities offered to the public other than those specifically exempted by the statute to be registered with the Commission. Section 17 makes unlawful the use of fraud in the sale of securities.

The attempts to circumvent those sections assume many forms, some of which are patterned upon schemes recurring in substantially the same form year after year,[12] and some of which involve new devices. One of the most ingenious sought to capitalize upon the public's general familiarity, as a result of the war bond drives, with the soundness and safety of government bonds as an investment. This familiarity was used by promoters of some highly speculative enterprises to obtain capital for their ventures without a full disclosure of the risks involved. Thus, investors were told that their investment would be guaranteed by the government and 75 percent of the funds involved were actually used to purchase government bonds, which would at maturity have a face value equal to 100 percent of the stockholder's investment, thereby "insuring" this investment. The promoters would then use the other 25 percent of the investment for the particular speculation in mind—without disclosing this fact. The Commission was successful in obtaining injunctions against such practices.[13]

In order to avoid the scrutiny which accompanies registration under the act, the promoters of some companies have disregarded the requirement of registration. Accordingly, actions instituted by the Commission to enforce the act in the sale of securities often involve violations of both sections 5 and 17. The industries in which fraud

[12] Of these, the so-called "Ponzi" scheme, is perhaps the most common. Under it, the promoter pays fabulous returns to investors by using the principal fund to pay interest. See *S. E. C.* v. *May* (Civil No. 613, S. D. Tex. 1949).

[13] See *S. E. C.* v. *Haynes* (Civil No. 8066, E. D. Pa. 1948); *S. E. C.* v. *Derryberry* (Civil No. 2382, W. D. La.).

is attempted in the sale of securities vary. A substantial proportion of injunctions under the act have related to the sale of mining securities.[14]

Other actions instituted by the Commission have forced compliance with sections 5 and 17 of the act primarily with respect to the financing of oil wells,[15] gas wells,[16] and various alleged inventions or patents.[17] Although unscrupulous persons may practice fraud in the sale of securities of almost any business, these types of enterprises are often selected. The misrepresentations may include exaggeration of the prospects of the company being exploited, false claims of recommendations by Government agencies,[18] and omissions to state material facts concerning the portion of the proceeds of each sale which is to be used for the private purposes of a promoter.[19]

An injunction was granted by the district court in almost every action under the act in which the Commission sought injunction relief during the past 5 years. In one case, *S. E. C.* v. *W. J. Howey Co.*,[20] the district court refused to grant the injunction, was sustained by the Court of Appeals, and the Supreme Court granted *certiorari*. The Commission took the position that the sale of acreage which was part of a large citrus grove, when coupled with the offer of a contract to harvest and sell the fruit, constituted the sale of a security within the meaning of section 2 of the act. The Supreme Court so held, reversing the lower courts.

This decision approved the position consistently taken by the Commission that whenever a purchaser has no intention of assuming any control of the property purchased, but is really buying only an interest in a business enterprise and looks solely to the efforts of the promoter to earn a profit for him, there is involved the purchase of a security. Misrepresentations or fraudulent conduct in the course of such purchase, or the failure to register the security being sold when registration is necessary, furnish the basis for an injunction. The success achieved by the Commission in these cases is due, to some extent, to the care with which complaints are investigated.

The Securities Act, like the other statutes administered by the Commission, authorizes the Commission, pursuant either to a complaint or on its own initiative, to conduct investigations for the purpose of determining whether any provision of the act has been or is about to be violated. For the purpose of such investigations the Commission, or any officer designed by it, is empowered to administer oaths, subpena witnesses, or to require the production of records deemed relevant or material to the inquiry. Information disclosed in such investigations often serves as the basis for formal hearings conducted by the Commission, for injunction actions, or for references to the Department of Justice to institute criminal proceedings.

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[14] *S. E. C.* v. *Great Western Gold & Silvermine Corp.* (Civil No. 1602, D. Colo. 1946; *S. E. C.* v. *Blakesley* (Civil No. 1279, N. D. Ill. 1945); *S. E. C.* v. *Slocan Charleston Mining Co.* (Civil No. 1822, D. Wash., 1947); *S. E. C.* v. *Vindicator Silver Lead Mining Co.* (Civil No. 1766, D. Wash. 1947); *S. E. C.* v. *Nevada Wabash Mining Co.* (Civil No. 26695, N. D. Calif. 1947); *S. E. C.* v. *Sandy Boy Mines* (Civil No. 2085, D. Colo. 1947).

[15] *S. E. C.* v. *LeDone* (Civil No. 40-347, S. D. N. Y., 1947); *S. E. C.* v. *Ellenburger Exploration Enterprises* (Civil No. 1828, N. D. Tex. 1949).

[16] *S. E. C.* v. *John White, Mon Dakota Development Co.* (Civil No. 309, D. Mont. 1945).

[17] See *S. E. C.* v. *Fyre-Mist* (Civil No. 25178, D. Ohio 1947) involving a company organized for the purported purpose of manufacturing and selling a device for the burning of oil and water to produce enormous heat.

[18] See *S. E. C.* v. *Edmond Michel* (Civil No. 831, N. D. Ill. 1948).

[19] See *S. E. C.* v. *Aloha Oil Co.* (Civil No. 4463, W. D. Okla., 1949).

[20] 60 F. Supp. 440 (D. Fla. 1945), affirmed 151 F. 2d 714 (C. A. 5 1945), reversed 328 U. S. 293.

Considerable litigation has arisen out of refusals to appear in response to Commission subpenas. Usually, opposition to the subpena is short-lived,[21] for it is now well established that compliance should be prompt, and an appeal taken for purposes of delay will be dismissed.[22] Moreover, where the defendant continues his refusal to comply with the subpena in spite of a court order, the court is required to enter a decree that will coerce the production of the material named in the subpena. In the *Penfield* case, where a district court order obtained by the Commission enforcing a subpena *duces tecum* was ignored the Commission initiated contempt proceedings. The district court then merely ordered defendant to "pay a fine of $50, and stand committed until paid." Since this order did not enable the Commission to obtain access to the documents it had sought to subpena, an appeal was taken. The Court of Appeals reversed, ordering the entry of a coercive decree, and the Supreme Court affirmed the action of the Court of Appeals.[23]

In only one case during the past 5 years has a petition been filed for review of a Commission order entered pursuant to the Securities Act. In that case, petitioner sought 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 act, accelerating the effective date of the registration statement. The Court of Appeals for the First Circuit dismissed the petition for review on the ground, *inter alia*, that the action of the Commission was not reviewable.[24]

Current data concerning civil cases and appellate proceedings instituted under this act are included in appendix tables 26 and 28–32.

[21] Upon proof of materiality and relevance of the inquiry or documents sought enforcement is ordered by the court.
[22] *S. E. C.* v. *Vacuum Can Co.*, 157 F. 2d 530 (C. A. 7, 1946) *cert. den.*, 330 U. S. 820.
[23] *Penfield* v. *S. E. C.*, 157 F. 2d 65 (C. A. 9, 1946) affirmed, 330 U. S. 585.
[24] *Crooker* v. *S. E. C.*, 161 F. 2d 944 (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

Section 5 of the act requires each securities exchange within or subject to the jurisdiction of the United States to register with the Commission as a national securities exchange or to apply for exemption from such registration. 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 not necessary or appropriate in the public interest or for the protection of investors to require their registration.

At the close of the 1949 fiscal year the following 18 exchanges were registered as national securities exchanges:

Boston Stock Exchange.
Chicago Board of Trade.
Chicago Stock Exchange.
Cincinnati Stock Exchange.
Cleveland Stock Exchange.
Detroit Stock Exchange.
Los Angeles Stock Exchange.
New Orleans Stock Exchange.
New York Curb Exchange.
New York Stock Exchange.
Philadelphia-Baltimore Stock Exchange.
Pittsburgh Stock Exchange.
St. Louis Stock Exchange.
Salt Lake Stock Exchange.
San Francisco Mining Exchange.
San Francisco Stock Exchange.
Spokane Stock Exchange.
Washington Stock Exchange.

Five exchanges were exempted from registration at the close of the 1949 fiscal year. These are:

Colorado Springs Stock Exchange.
Honolulu Stock Exchange.
Minneapolis-St. Paul Stock Exchange.
Richmond Stock Exchange.
Wheeling Stock Exchange.

The registration or exemption statement of each exchange contains information pertinent to the organization, rules of procedure, trading practices, membership, and related matters, and the exchanges are required to keep such information up to date by filing appropriate amendments. During the year the exchanges filed a total of 84 such

amendments, bringing the number of amendments filed during the past 5 years to 488. Many of these amendments contained only periodic information required by the rules, such as membership lists, names of officers and directors, financial statements of the exchanges, etc. However, changes which were effected by the exchanges in their constitutions, rules and trading practices were also reported. Each amendment was reviewed to ascertain whether the change was adverse to the public interest and complied with the Act. The nature of the changes in the exchanges' rules and trading practices varied considerably. Some of the more significant which occurred during the 1949 fiscal year are briefly outlined below:

New York Stock Exchange and New York Curb Exchange, effective December 15, 1948, each modified its rules to permit members trading for their own account on the floor of the exchange to purchase for their own account, under certain conditions, long stock at a price higher than the last sale. Previously, floor traders could not purchase for their own account any stock at a price higher than the last sale.

New York Curb Exchange, following action taken by New York Stock Exchange and others during the previous fiscal year, adopted, effective February 1, 1949, a revised schedule of commission rates on stocks selling at 50 cents or above per share. Its new commission rates are, as in the past, computed on a rate-per-share basis. Salt Lake and Spokane Stock Exchanges also revised their schedule of commission rates upward effective June 1 and 2, 1949, respectively.

New York Stock Exchange and New York Curb Exchange, on February 15, 1949, each amended its rules respecting equity in margin accounts to securities having a market value at or below $5 per share, for the purpose of new securities transactions or commitments or withdrawals of cash or securities. These two exchanges, on June 6, 1949, and June 15, 1949, respectively, also amended their rules by lowering the initial margin and minimum equity requirements from $1,000 to $500.

New York Curb Exchange adopted new standards to be followed in approving odd-lot differentials assigned to securities dealt in on the exchange. These new standards became effective June 1, 1949, and resulted in the revision on that date of the odd-lot differentials for 255 stocks.

Cincinnati Stock Exchange changed the method of trading on the exchange from a call system to one of continuous trading with a posted market. This change in trading procedure was patterned after the methods of Cleveland Stock Exchange and became effective on September 13, 1948. Under the old system of trading, all trading, except odd-lot trading in securities for which odd-lot books were operated by odd-lot dealers, was on call; i. e., members on the floor of the exchange engaged in competitive bids and offers for each security as it was called from the rostrum. The new system of continuous trading provides for all bids and offers to be posted upon a blackboard which is used as a trading post. Bids and offers are posted in order as to price and time received and the highest bidder and lowest offerer have preference over other bids and offers.

Cincinnati Stock Exchange also amended its rules and regulations to permit delivery through a designated Cincinnati bank or trust company of securities having no transfer office in the city of Cincinnati.

Philadelphia Stock Exchange changed its name to Philadelphia-Baltimore Stock Exchange effective March 7, 1949, as a result of the merger of that exchange with Baltimore Stock Exchange. Upon consummation of the merger, the activities of Baltimore Stock Exchange were terminated and Philadelphia-Baltimore Stock Exchange opened an office in the city of Baltimore. A private wire is maintained between that office and the trading floor of the exchange in the city of Philadelphia for the use of its members in placing orders. In addition, an office of Stock Clearing Corporation of Philadelphia, a wholly owned subsidiary of Philadelphia-Baltimore Stock Exchange, was established in Baltimore for the purpose of facilitating the transfer of securities in that city. A majority of the issuers of securities listed and registered on Baltimore Stock Exchange prior to the merger transferred their listing and registration to Philadelphia-Baltimore Stock Exchange. The two exchanges believed that merger of their activities would result in benefits to issuers of securities traded on the exchanges as well as to the public, due, among other things, to the wider spread membership of the merged exchanges and consolidation of the trading areas involved.

San Francisco Stock Exchange and New York Curb Exchange each adopted an amendment to its rules governing trading by members while acting as brokers. The rule involved, which was contained in the list of rules originally adopted by the exchanges upon recommendation of the Commission in 1935, prohibited members from competing with public orders at all times. The amendment to the rule relaxed this restriction to the extent that a specialist-odd-lot dealer may now compete with public orders to offset positions previously acquired or to offset odd-lot orders to be executed.

Floor Trading

The term "floor trading" designates the use of the facilities of the floor of an exchange for trading by members for their own account as distinguished from transactions for customers' accounts.

On January 15, 1945, the Division of Trading and Exchanges recommended the adoption of a rule, pursuant to section 11 (a) (1) of the Securities Exchange Act of 1934, which would prohibit floor trading in stocks on New York Stock Exchange and New York Curb Exchange. This recommendation was accompanied by a report which outlined the legislative background of the Commission's powers with respect to floor trading and described the nature and effects of such trading in considerable detail. A public conference was held on May 16, 1945, to consider the merits of the proposal. Subsequent to the public conference, representatives of the Commission and of New York Stock Exchange met for additional discussions. Finally, at the request of New York Stock Exchange, the Commission agreed to permit the exchanges to adopt certain rules restricting floor trading. The Division of Trading and Exchanges has kept constant watch on the activity of floor traders and their effect on the market. At the request of New York Stock Exchange and after conferences by the Commission with the staff and with exchange officials, the rules were

revised in February 1947 and again in December 1948. Although these revisions permit wider flexibility of action by floor traders, the general policy of the exchanges restrains floor traders from many of the practices which were condemned in the division's report of 1945.

Disciplinary Actions by Exchanges Against Members

Pursuant to a request of the Commission, each national securities exchange reports to the Commission any action of a disciplinary nature taken by it against any of its members or against any partner or employee of a member for violation of the Securities Exchange Act, any rule or regulation thereunder, or of any exchange rule. During the year 5 exchanges reported having taken disciplinary action against a total of 46 members, member firms, and partners of member firms.

The nature of the actions taken included fines ranging from $50 to $2,500 in 15 cases, with total fines aggregating $18,275; expulsion of an individual from exchange membership; suspension of an individual and of 3 firms from exchange membership; revocation of the registration of a specialist for a period of 60 days; and censure of individuals or firms for infractions of the rules and warnings against further violation. The disciplinary actions resulted from violations of various exchange rules, principally those pertaining to partnership agreements, capital requirements, handling of customers' accounts, specialists, and conduct inconsistent with just and equitable principles of trade.

REGISTRATION OF SECURITIES ON EXCHANGES

Purpose and Nature of Registration

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 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 1949 fiscal year 2,194 issuers had 3,645 security issues listed and registered on national securities exchanges. These securities consisted of 2,570 stock issues aggregating 2,965;371,336 shares; and 1,075 bond issues aggregating $21,625,697,083 principal amount. This represents increases of 127,874,694 shares and $1,472,-803,350 principal amount, respectively, over the aggregate amounts of securities listed and registered on national securities exchanges at the close of the 1948 fiscal year.

During the year 37 issuers not previously having securities registered under the act on national securities exchanges effected such registration and the registration of all securities of 52 issuers was terminated, principally by reason of retirement and redemption and through mergers and consolidations. Included in these 52 issuers are 8 issuers whose securities were removed from registration by reason of the termination of the registration of the Baltimore Stock Exchange on March 5, 1949, such issuers having determined not to transfer the registration of their securities to the Philadelphia-Baltimore Stock Exchange.

The following table shows the number of applications and reports filed during the fiscal year in connection with the registration of securities on national securities exchanges:

Applications for registration of securities on national securities exchanges	425
Applications for registration of unissued securities for "when issued" dealing on national securities exchanges	74
Exemption statements for trading short-term warrants on national securities exchanges	62
Annual reports	2,139
Current reports	8,766
Amendments to applications and reports	1,103

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 admission to trading under this rule with respect to 108 issues during the year. The same issue was

admitted to trading on more than 1 exchange in some instances, so that the total admissions to such trading, including duplications, numbered 139.

SECURITIES TRADED ON EXCHANGES

Market Value and Volume of Exchange Trading

Stock sales on all registered stock exchanges in the past five fiscal years, ended June 30, have been as follows:

Fiscal year—	Number of shares traded	Value of sales
1945	595, 132, 582	$13, 142, 289, 881
1946	826, 779, 793	18, 935, 182, 748
1947	553, 180, 698	13, 747, 185, 467
1948	536, 832, 816	12, 901, 422, 308
1949	443, 740, 828	10, 322, 019, 935

Such stock sales averaged about 591,133,000 shares per year, as compared with an annual average in the preceding 5 years of approximately 372,028,000 shares. Dollar value of sales showed an annual average of about $13,809,620,000 for the latest period, as against $7,846,981,000 for the 5 years ended June 30, 1944.

Share volume and dollar value of all transactions on all stock exchanges for the 1949 fiscal year are shown in appendix table 8.

Share volume and dollar value of stock transactions on the principal exchanges for the calendar years 1935 through 1948 are shown in appendix table 9.

Special Offerings on Exchanges

Rule X–10B–2 permits special offerings of large blocks of securities to be made on national securities exchanges provided such offerings are effected pursuant to a plan which has been filed with and approved by the Commission. Briefly stated, a security may be the subject of a special offering 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 which ordinarily exceeds the regular brokerage commission. Buyers of the security are not charged any commission on their purchases and obtain the security at the net price of the offering.

Since February 6, 1942, the date on which rule X–10B–2 was amended to permit special offerings, the Commission has declared effective special offering plans of the following nine exchanges on the date shown opposite each:

New York Stock Exchange	Feb. 14, 1942
San Francisco Stock Exchange	Apr. 17, 1942
New York Curb Exchange	May 15, 1942
Phila.-Balto. Stock Exchange	Sept. 23, 1943
Detroit Stock Exchange	Nov. 18, 1943

Chicago Stock Exchange	Mar. 27, 1944
Cincinnati Stock Exchange	June 26, 1944
Los Angeles Stock Exchange	May 28, 1948
Boston Stock Exchange	Sept. 15, 1948

Each exchange with a special-offering plan in effect has been requested to report detailed information to the Commission on each offering effected on the exchange under the plan. Such reports were received from the Chicago, San Francisco, and New York Stock Exchanges and New York Curb Exchange during the year with respect to a total of 25 offerings. These offerings involved the sale of 263,700 shares of stock with an aggregate market value of $5,750,000 and ranging in market value from $49,500 to $570,900. Special commissions paid to brokers participating in these 25 offerings totaled $161,000. Further details of special offerings during the year are given in appendix table 13.

The first special offering was effected on New York Stock Exchange on February 19, 1942, and from that time through June 30, 1949, a total of 406 offerings have been effected on 4 of the 9 exchanges having special-offering plans. These offerings totaled 4,915,900 shares with a market value of $144,335,000 and brokers were paid special commissions totaling $2,815,800.

Secondary Distributions Approved by Exchanges

A "secondary distribution," as the term is used in this section, is a distribution over the counter by a dealer or group of dealers of a comparatively large block of a previously issued and outstanding security listed or admitted to trading on an exchange. Such distributions take place when it has been determined that it would not be in the best interest of the various parties involved to sell the shares on the exchange in the regular way or by special offering. The distributions generally take place after the close of exchange trading. As in the case of special offerings, buyers obtain the security from the dealer at the net price of the offering, which usually is at or below the most recent price registered on the exchange. It is generally the practice of exchanges to require members to obtain the approval of the exchange before participating in such secondary distributions. Registration of such distributions under the Securities Act of 1933 may also be necessary.

During the 5-year period ending June 30, 1949, 7 exchanges reported having approved a total of 510 secondary distributions under which 31,920,000 shares of stock with a market value of $845,656,000 were sold. Of these, 97 distributions involving the sale of 4,481,000 shares with a market value of $129,014,000 were approved by 4 exchanges during the fiscal year ended June 30, 1949. Further details of secondary distributions of exchange stocks are given in appendix table 14.

Securities Traded on Exchanges—Comparative Data

The unduplicated total at the close of 1948 of all securities admitted to trading on 1 or more of the 24 stock exchanges of the United States was $214,616,000,000, composed as follows:

STOCKS

Exchange	Number of issues	Market value
New York Stock Exchange	1,419	$67,048,000,000
New York Curb Exchange	819	11,884,000,000
Regional exchanges only	814	3,040,000,000
Total	3,052	81,973,000,000

BONDS

New York Stock Exchange	911	$131,306,000,000
New York Curb Exchange	110	1,082,000,000
Regional exchanges only	50	255,000,000
Total	1,071	132,643,000,000

Nearly half of the 1,419 stock issues traded on New York Stock Exchange and over one-quarter of the 819 stock issues traded on New York Curb Exchange were also traded on various regional exchanges, and the principal dollar volumes of the leading regional exchanges are in these dually traded stocks. Six of the regional exchanges accounted for over 90 percent of the dollar volume of stock transactions on all 22 such exchanges during 1948. These 6 exchanges—Boston, Chicago, Detroit, Los Angeles, Philadelphia, and San Francisco—reported an aggregate 1948 dollar volume of $858,600,000 in stocks, of which about $750,000,000 was in the issues also traded on New York Stock Exchange or Curb. Only the smaller regional exchanges still accomplish most of their trading in local issues.

No duplication of either stock or bond issues exists between New York Stock Exchange and New York Curb Exchange, and very little duplication of bond issues exists between the New York and regional exchanges, bond trading on the latter having shrunk to negligible proportions since 1929–30. Bonds traded on New York Stock Exchange included $114,572,000,000 United States Government, State, and municipal issues.

TERMINATION OF REGISTRATION UNDER SECTION 19 (a) (2)

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

During the past year the Commission instituted formal proceedings under section 19 (a) (2) involving four issuers to determine whether to suspend or withdraw the registration of their securities for failure to comply with the reporting requirements of section 13 of the act and the rules and regulations thereunder. Specifically, in three of such cases the issuers had failed to file their annual report for 1947, and in the other case, the Commission alleged the failure to correct serious accounting deficiencies appearing for 3 years in succession in financial statements filed under the act despite repeated efforts of the Commission to obtain correction thereof. Two of these proceedings were dismissed, after the hearings, when the issuers filed their

required annual reports; registration was ordered withdrawn in one case; and the proceedings in the fourth case, instituted in June 1949, were still pending at the close of the fiscal year.

The case in which registration was ordered withdrawn was that of the Assessable Common Capital Stock Ten Cents Par Value of Reorganized Carrie Silver-Lead Mines Corp. listed and registered on the San Francisco Mining Exchange. The brief language of the syllabus of the Commission's findings and opinion in this case, published February 21, 1949,[1] is sufficient to show why this registration was terminated: "Where an issuer having securities listed and registered on a national securities exchange has failed to comply with the Securities Exchange Act of 1934 in that it has generally failed to file its annual reports within the time prescribed for filing said reports; has failed to submit with the annual report for 1946 required financial statements and has failed to file the annual report for 1947 up to the present time, and where, in addition, the company is largely inactive and has practically no assets *held* the securities of such issuer will be withdrawn from registration."

Assertions of more serious violations of the law appear in the case pending at the close of the 1949 fiscal year, involving the registration of Barnhart-Morrow Consolidated Common Capital Stock $1 Par Value. A full statement of issues involved was published by the Commission in its order scheduling a hearing to be held shortly after the close of the year.[2] As set forth therein, the Commission's Division of Corporation Finance asserts, among other things, that the issuer, in its annual reports filed for the years 1945, 1946, and 1947, willfully and knowingly made a false and misleading statement with respect to its assets and net worth. More specifically, the examining staff had discovered that, at about the time the issuer was organized in 1926, capital stock in the amount of $219,120.50 was issued to the two organizers for alleged services and for a lease interest; that such lease interest acquired from the organizers was abandoned and quit-claimed by the issuer to the lessor in the fall of 1927; and that the issuer went into receivership on March 19, 1931, and continued in receivership until November 24, 1936. Nevertheless, the alleged services and lease interest above-mentioned are reflected as "Intangible Assets" in the amount of $219,120.50 under the description "Capital Stock issued for services and leases" in the balance sheets of the financial statements contained in the issuer's annual reports filed on Form 10–K for the fiscal years ended December 31, 1945, 1946, and 1947. In the same balance sheets the net worth of the issuer is reflected as $278,247.88, $395,031 and $396,765.96, respectively.

UNLISTED TRADING PRIVILEGES ON EXCHANGES

Securities traded on exchanges on an unlisted basis are of two principal varieties. Some are listed and registered on an exchange but are traded unlisted on one or more other exchanges. As to these securities, the public enjoys the protections afforded by the listing and registration under the Securities Exchange Act. A great majority of the issues in this category are listed on New York Stock Exchange and admitted to unlisted trading on various exchanges in other cities.

[1] Securities Exchange Act release No. 4214.
[2] Securities Exchange Act release No. 4264 (1949).

The other category consists of issues not listed or registered on any registered exchange. Most of such issues are admitted to unlisted trading on New York Curb Exchange alone. In their case the public is not protected by any listing agreement with the issuer nor by the financial reporting requirements of section 13, the proxy rules under section 14, and the "trading by insider" reporting and penalty clauses of section 16 of the Securities Exchange Act, except to the extent that the issuers or issues may be registered under other acts administered by the Commission containing similar requirements.

Exchange trading in issues admitted to unlisted trading prior to March 1934 is permitted to continue under section 12 (f) (1) of the Securities Exchange Act. The further admission of issues to unlisted trading, however, has been prohibited except to the extent permitted under section 12 (f) (2) in the case of issues already listed and registered on some registered exchange,[3] and under section 12 (f) (3) in the case of issues not so listed and registered, as more specifically outlined under the next subheading, "Applications for Unlisted Trading Privileges."[4]

Twelve years ago, on June 30, 1937, the status of unlisted issues on the registered exchanges was as follows:

Status	Stocks	Bonds
Listed on some other registered exchange	554	42
Not listed on any registered exchange	737	550
Total	1,291	592
Total all stocks and bonds, 1,883 issues.		

These issues were practically all in the section 12 (f) (1) category of securities which had been admitted to unlisted trading prior to March 1, 1934.

Since the first grant in April 1937 of an application by an exchange under section 12 (f) (2) for unlisted trading in stocks listed on some other registered exchange, there have been 562 admissions of such stocks to the various exchanges. The number of actual issues involved is less than this figure because many issues have been admitted to unlisted trading on 2, 3, or more exchanges. These admissions of stocks under section 12 (f) (2) have, however, barely maintained the number of listed stocks traded unlisted on other exchanges, which has fallen from 554 in 1937 to 539 in 1949. The grants have tended to make the same stocks available on numerous exchanges and to substitute currently active stocks in offset to the many retirements of issues originally admitted to unlisted trading under section 12 (f) (1). Annual trading on the various exchanges in these unlisted issues is shown in appendix table 21.

Only nine stock issues have been admitted to unlisted trading on an exchange (two of them on two exchanges) under section 12 (f) (3). Two of these issues have been removed from this unlisted status on New York Curb Exchange by reason of listing on New York Stock Exchange. One of the issues continues on New York Curb Exchange but has become listed on Philadelphia-Baltimore Stock Exchange.

[3] "Registered exchanges" and "national securities exchanges" are used synonymously in this section.
[4] The subject is treated at length in the Tenth Annual Report under "Unlisted Trading Privileges on Securities Exchanges."

Admissions of bonds under sections 12 (f) (2) and 12 (f) (3) have totaled 52, but retirements have exceeded admissions, and only 23 of the issues are still outstanding. It has become unusual to apply for bond admissions under these sections, except in case of very large and, particularly, convertible issues.

The status of unlisted issues on the registered exchanges as of June 30, 1949 was:

Status	Stocks	Bonds
Listed on some other registered exchange	539	7
Not listed on any registered exchange	344	84
Total	883	91
Total all stocks and bonds, 974 issues.		

There has been a great diminution of issues, in all except the first category, under the 1937 level. The principal shrinkage has been in stocks and bonds not listed on any registered exchange, and this, as has been frequently stated in these reports, was the expectation of Congress when it authorized continuance of such privileges in 1936.

The 344 stocks admitted to unlisted trading without being listed on any registered exchange aggregated 353,595,077 shares, warrants, and receipts as of June 30, 1949. The reported volume of trading in these stocks for the calendar year 1948 was 23,762,256 units, including 15,882,748 domestic shares, 3,913,708 Canadian shares, 2,598,000 warrants, and 1,367,800 American depository receipts. The 353,595,077 unlisted shares were about 10½ percent of the total of 3,375,691,673 shares admitted to trading on the registered exchanges, and the 23,762,256 reported volume was 4½ percent of the total volume of 540,487,546 shares and warrants on the registered exchanges for the calendar year 1948. Of the 23,762,256 reported volume of trading in units of unlisted securities for 1948, 21,850,060 (92 percent) were on New York Curb Exchange, 1,578,999 (6.6 percent) were on San Francisco Stock Exchange, and 337,197 (1.4 percent) were scattered among 6 other regional stock exchanges. All but 1 of the 84 bond issues admitted to unlisted trading without registration were on New York Curb Exchange.

The single bond issue and all but 1 of the 36 stocks admitted only to unlisted trading on the exempted exchanges were on Honolulu Stock Exchange.

Comprehensive figures with respect to issues and volumes on exchanges will be found in appendix tables 8 to 21, inclusive.

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, applications were granted during the year extending unlisted trading privileges to Boston Stock Exchange with respect to 5 stock issues; Chicago Stock Exchange, 3 stock issues; Cleveland Stock Exchange, 6 stock issues; Los Angeles Stock Exchange, 4 stock issues; Philadelphia-Baltimore Stock Exchange, 5 stock issues; Pittsburgh Stock Exchange, 11 stock issues; St. Louis Stock Exchange, 1 stock

issue; San Francisco Stock Exchange, 2 stock issues; and Washington Stock Exchange, 1 stock issue.

Section 12 (f) (3) of the act permits the Commission to grant an exchange's application for the extension of unlisted trading privileges to a security which is not listed and registered on another national securities exchange if investors have, respecting such a security, protections equivalent to those provided for in the act regarding listed securities. Applications were granted under this section, during the year, extending unlisted trading privileges to New York Curb Exchange with respect to three bond issues and two stock issues, one of which (Northern States Power Co. common stock) was later removed upon listing on New York Stock Exchange, while the other (Utah Power & Light Co. common stock) was also admitted to unlisted trading under this section on Salt Lake Stock Exchange.

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 may 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. The Commission denied one such application by New York Curb Exchange,[5] and granted two other applications of that Exchange with respect to one of the two securities each involved, denying them with respect to the others.[6] Other applications filed pursuant to this rule were granted by the Commission with respect to four stock issues and one debenture escrow certificate issue on New York Curb Exchange, three stock issues on Philadelphia-Baltimore Stock Exchange, and two stock issues on Boston Stock Exchange.

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 withdrawn or stricken 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 this procedure 18 securities (3 of which were listed on 2 exchanges each) were stricken from listing and registration as a result of various events which had the effect of practically terminating public interest in the issues involved. These included situations where the issuers were in the process of liquidation and where the issues were greatly reduced in the amount outstanding. In the case of three securities listed and registered on several national

[5] Securities Exchange Act release No. 4172.
[6] Securities Exchange Act releases Nos. 4171 and 4172.

securities exchanges, the issuers applied to have them withdrawn from listing and registration on one of the exchanges, which applications were granted; but they remained listed and registered on the other exchange. An application by an issuer to withdraw one stock issue from listing and registration was granted by the Commission, on the ground that the number of shares remaining in the hands of the public had become reduced to a very small number.

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 if the exchange files a certification with the Commission 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 111 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 132. 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 five 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 if the security becomes 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 if such exchange files an appropriate amendment to its exemption statement setting forth a brief statement of the reasons for the removal. Three exempted exchanges removed three issues from listing thereon during the year.

MANIPULATION AND STABILIZATION

Sections 9, 10, and 15 of the Securities Exchange Act prohibit manipulation of securities. The Commission is empowered to define and regulate manipulative and other fraudulent devices. Section 9 forbids certain specifically described forms of manipulative activity. Transactions which create actual or apparent trading activity or which raise or lower prices are declared to be unlawful if they are effected for the purpose of inducing others to buy or to sell. Certain practices designated as "wash sales" and "matched orders" effected for the purpose of creating a false or misleading appearance of active trading or a false or misleading appearance with respect to the market for a security are declared to be illegal. Persons selling or offering securities for sale are prohibited from disseminating false information to the effect that the price of a security will, or is likely to, rise or fall because of market operations conducted for the purpose of raising or depressing

the price of a security. Persons selling or buying securities are forbidden to make false or misleading statements of material facts, with knowledge of their falsity, or willfully to omit material information regarding such securities for the purpose of inducing purchases or sales. Sections 10 and 15 (the latter applying to the conduct of over-the-counter securities brokers and dealers) empower the Commission to adopt rules and regulations to define and prohibit manipulative practices.

Pursuant to its statutory authority, the Commission has adopted rules and regulations to aid it in carrying out the expressed will of Congress. Sections 9, 10, and 15, as augmented by the Commission's rules and regulations, are aimed at freeing our securities markets from artificial influence, to help maintain fair and honest markets where prices are established by supply and demand and uninfluenced by manipulative activity.

Manipulation

A principal reason for the adoption of the Securities Exchange Act was the manipulation of securities prices which, prior to 1934, took millions of dollars annually from the public. In the early years of the Commission's existence some large-scale manipulations were detected and as a result various penalties were imposed upon certain market operators, including expulsions from exchanges, jail sentences, and fines.

As a result of the act and its administration manipulation is no longer an appreciable factor in our markets. However, efforts to raise or depress artificially the prices of securities are still encountered. During the past 5 years several notable cases of the type set forth below were detected.

Thornton & Co., a broker-dealer located in New York City, was found to have manipulated the stocks of Lindsay Light & Chemical Co. on the Chicago Stock Exchange and of Northwest Utilities Co. over-the-counter. The registration of Thornton & Co. as a broker-dealer was revoked. The Federal Corp. was enjoined from attempting to manipulate the stock of Red Bank Oil Co. at a time when the company was attempting to register 990,000 shares of stock for sale to the public. Albert B. Windt was sentenced to 6 months in fail and fined $1,000, and the broker-dealer registration of Aurelius F. DeFelice was revoked for their manipulation of the stock of Tonopah Gipsy Queen Mining Co. on the San Francisco Mining Exchange. Serge Rubinstein and Frank Bliss were indicted on February 7, 1949, on charges of fraud and market manipulation in connection with their distribution of Rubinstein's holdings of Panhandle Producing & Refining Co., resulting in an alleged unlawful profit of $3,000,000 to Rubinstein. The *Rubinstein* case was the only one of those enumerated where the public suffered a substantial loss. The above cases, detected by the methods set forth in the next few paragraphs, were investigated by the appropriate regional offices of the Commission. In the cases involving criminal prosecution the results of Commission investigation were referred to the Department of Justice for punitive action.

In administering the anti-manipulation requirements there is a premium on prompt action to prevent harm before it occurs and on

the avoidance of interference with the legitimate functioning of the markets. To accomplish this the Commission has continuously modified and sought to improve its procedures for the systematic surveillance of trading in securities. Methods used to detect manipulation have necessarily been elastic and fluid in character, since techniques employed by manipulators change constantly, increasing in subtlety and complexity.

The staff scrutinizes price movements in approximately 8,500 securities, including 3,500 issues traded on exchanges and 5,000 which have the most active markets over-the-counter. Information maintained concerning these securities includes not only data reflecting the market action of such securities but also includes news items, earnings figures, dividends, options, and other facts which might explain price and volume changes. In addition, periodic observations are made of the price movements of the thousands of other issues which occasionally change hands in our public markets. The markets for securities about to be sold to the public are watched very closely. In this connection, 800 securities were kept under special observation during the 1949 fiscal year for periods ranging from 14 to 90 days.

When no apparent explanation can be found for an unusual movement in a security or for an unusual volume of trading, the matter may be referred to one of the regional offices of the Commission for a field investigation. For reasons of policy the Commission keeps confidential the fact that trading in a given security is under investigation, for it has found that knowledge of the existence of such investigations may unduly affect the market or reflect unfairly upon individuals whose activities are being investigated. As a result, the Commission occasionally receives criticism for failing to investigate in cases when, in fact, it is actually engaged in an intensive investigation.

The Commission's investigations of unusual market activity 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. Often the results of a flying quiz point to a legitimate reason for the activity under review and the case is closed. Frequently facts are uncovered which require more extended investigation; and in these cases formal orders of investigation are issued by the Commission. In a formal investigation, members of the Commission's staff are empowered to subpena pertinent material and to take testimony under oath. In the course of such investigation data on purchases and sales over substantial periods of time are often compiled and trading operations involving considerable quantities of securities are scrutinized.

The Commission operates on the premise that manipulation should be suppressed at its inception. Many of the cases investigated never come to the attention of the public because the promptness of the Commission's investigation, through the flying quiz technique, stops the manipulation before it is fully developed. Public losses are seldom recoverable even though the perpetrator of a fraud is brought to justice. Therefore it is believed that these investigatory methods afford more protection to the public than allowing market operations

to continue until it appeared that sufficient evidence for a successful prosecution would be obtainable.

A 5-year tabular summary of the Commission's trading investigations follows:

Trading investigations

	Fiscal year—				
	1945	1946	1947	1948	1949
Flying quizzes:					
Pending at start of fiscal year	59	163	245	91	138
Initiated during year	308	287	66	147	92
Total to be accounted for	367	450	311	238	230
Changed to formal investigation	17	11	4	2	4
Closed or completed [1]	187	194	216	98	89
Total disposed of	204	205	220	100	93
Pending at end of fiscal year	163	245	91	138	137
Formal investigations:					
Pending at start of fiscal year	19	28	31	34	27
Initiated during year [2]	14	11	5	2	4
Total to be accounted for	33	39	36	36	31
Closed or completed [1]	5	8	2	9	13
Pending at end of fiscal year	28	31	34	27	18

[1] Includes referrals to the Department of Justice and others for punitive action.
[2] Several quizzes may be consolidated into 1 formal investigation or formal investigations may be initiated directly.

Stabilization

During the 1949 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 effected to facilitate offerings of securities registered on national securities exchanges, in which the offering prices are represented to be "at the market" or at prices related to market prices.

Of the 455 registration statements filed during the 1949 fiscal year, 188 contained a statement of intention to stabilize to facilitate the offerings covered by such registration statements. Each of the latter filings was examined critically as to the propriety of the proposed method of distribution and market support and the full disclosure thereof. Because a registration statement sometimes covers more than one class of security, there were 209 offerings of securities in respect of which a statement was made, as required by rule 426 under the Securities Act, to the effect that a stabilizing operation was contemplated. Stabilizing operations were actually conducted to facilitate 66 of these offerings, principally the stock offerings. In the case of bonds, public offerings of 2 issues aggregating $86,300,000 in principal amount were stabilized. Offerings of stock issues aggregating 12,186,838 shares with an estimated aggregate public offering price of $297,659,921 were stabilized. In connection with these stabilizing

operations, 9,454 reports were filed with the Commission during the fiscal year. Each of these reports has been analyzed to determine whether the stabilizing activities were within permissible limits.

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. It is the Commission's experience that such issuers and underwriters place great value on the immediate service which the Commission is able to render them by being at all times available to give them responsible advice as to problems dealing with proper stabilizing techniques in the offering of securities.

SECURITY TRANSACTIONS OF CORPORATION INSIDERS

A corporation "insider," by virtue of his position, may have knowledge of his company's condition and prospects which is not available to the general public. Accordingly, any transactions effected by him in the company's securities are of particular interest to other stockholders and investors. For the purpose of providing information with respect to such transactions, 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. The Commission requires the filing of an initial report showing beneficial ownership, both direct and indirect, of the company's securities when one of these relationships is assumed and subsequent reports 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 therefore 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.

Preventing Unfair Use of Inside Information

For the purpose of preventing unfair use of information which may have been obtained by an insider by reason of his relationship to the issuer, section 16(b) of the Securities Exchange Act provides that any profit realized by an officer, director or principal stockholder from short-term transactions (any sale and purchase or any purchase and sale of any equity security of the issuer within any period of less than 6 months) shall be recoverable by the issuer. If necessary, suit for the recovery of such profits may be instituted by the issuer or by any stockholder of the issuer if it fails or refuses to act within 60 days after request. Similar provisions are contained in sections 17(b) of the Public Utility Holding Company Act and 30(f) of the Investment Company Act. Voluntary payments of short-term profits have been made in a number of instances, and others have been made upon request by the issuer based upon information disclosed in ownership reports filed with the Commission by the insider involved. Further substantial amounts have been recovered through court action. One of the first of such suits under section 16(b) was decided for the plaintiff in 1942, and since that time, particularly during the past 5 years, a growing number of similar actions have been brought in the courts. The Commission has participated as *amicus curiae* in several of these cases.

Statistics of Ownership Reports

During the 5-year period ended June 30, 1949, 93,396 security ownership reports were filed with the Commission, compared with 87,000 reports filed during the previous 5-year period. Since these various regulations were put into effect, 309,494 reports have been filed by 45,179 insiders of 2,733 issuers of listed equity securities, of 225 registered public-utility holding companies, and of 234 registered closed-end investment companies. The following table shows the number of reports filed during the past fiscal year:

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, 1949

Description of report [1]	Original reports	Amended reports	Total
Securities Exchange Act of 1934:			
Form 4	14,619	709	15,328
Form 5	384	23	407
Form 6	2,187	54	2,241
Total	17,190	786	17,976
Public Utility Holding Company Act of 1935:			
Form U-17-1	95	3	98
Form U-17-2	548	29	577
Total	643	32	675
Investment Company Act of 1940:			
Form N-30F-1	131	1	132
Form N-30F-2	559	11	570
	690	12	702
Grand total	18,523	830	19,353

[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 issuer, under sec. 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 sec. 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 sec. 30 (f) of the Investment Company Act of 1940.

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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.

Statistics of Proxy Statements

During the 5-year period from July 1, 1944, to June 30, 1949, the Commission received and examined both the preliminary and definitive material with respect to 8,356 solicitations under regulation X–14, as well as "follow-up" material employed in 1,376 instances.

During the 1949 fiscal year the Commission received and examined both the preliminary and definitive material with respect to 1,702 solicitations under regulation X–14 as well as "follow-up" material used in 191 instances.

The number of proxy statements filed by management and by others than management, and the principal items of business for which stockholders' action was sought in these solicitations, is shown below for each of the past five calendar years:

	Year ended Dec. 31—				
	1944	1945	1946	1947	1948
Proxy statements filed by management	1,523	1,570	1,664	1,613	1,648
Proxy statements filed by others than management	27	24	21	32	29
Total number of proxy statements filed	1,550	1,594	1,685	1,645	1,677
For meetings at which the election of directors was one of the items of business	1,350	1,350	1,407	1,461	1,534
For meetings not involving the election of directors	172	213	244	149	115
For assents and authorizations not involving a meeting or the election of directors	28	31	34	35	28
Total number of proxy statements filed	1,550	1,594	1,685	1,645	1,677

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

	Year ended Dec. 31—				
	1944	1945	1946	1947	1948
Mergers, consolidations, acquisition of businesses, and purchase and sale of property	59	40	65	69	46
Issuance of new securities, modification of existing securities, recapitalization plans other than mergers or consolidations	144	227	249	223	154
Employees pension plans	105	94	75	66	59
Bonus and profit-sharing plans, including stock options	58	51	52	60	32
Indemnification of officers and directors	31	25	36	22	21
Change in date of annual meeting	33	33	28	27	24
Other miscellaneous amendments to bylaws, and miscellaneous other matters	141	217	309	207	215
Stockholder approval of independent auditors	310	296	304	312	365
Number of management's proxy statements containing stockholder proposals	20	14	19	15	38
Number of such stockholder proposals	38	34	34	29	57
Net number of stockholders whose proposals were included in management's proxy statements (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)	17	17	9	13	18

Examination of Proxies

The problems which arise in the Commission's administration of regulation X–14 may be shown by reference to a few actual cases examined by the staff during the 1949 fiscal year.

In a proxy contest in the spring of 1948, a group in opposition to the management of an aircraft company proposed the election of a majority of the board of directors. The first proxy form which was used by the opposition group authorized the proxies named to vote shares at the annual meeting of the company to be held April 21, 1948, and at all adjournments thereof. Just before the annual meeting the opposition group made a resolicitation of proxies. The second proxy form attempted to seek authority to vote "at the annual meeting to be held on April 21, 1948, and all adjournments thereof, and any meeting, regular or special, held up to and including the 1949 annual meeting to be held on or about April 20, 1949, and all adjournments thereof. * * *" Upon objection by the Commission to such indefinite duration of a proxy, the opposition group agreed that proxies received as a result of the latter solicitation would not be used at any stockholders' meeting other than that of April 21, 1948, and any adjournment of this particular meeting. In order to prevent the premature solicitation of proxies and in order to clarify the rule in this respect, amendments to the proxy rules were adopted on November 5, 1948, especially providing that no proxy shall confer authority to vote at any annual meeting other than the next annual meeting (or any adjournment thereof) which is to be held after the date on which the solicitation is made.

In most cases no such proxy contest is involved. Nevertheless, a wide variety of problems may be presented to the examining staff in any particular case. One example illustrates how a public utility company's inadequacy of reserves for its fixed assets was made clear to the investing public as a result of a proxy examination made by the staff. This company filed preliminary copies of proxy solicitation

material to be used in obtaining stockholder approval for an increase in authorized long-term debt, and with such material included certified financial statements. As originally filed, the accountants' certificate contained the qualification: "subject to the adequacy of the reserve for property retirements." To the Commission's examiners this reservation presented some doubt as to whether the accountants had excluded the reserve from the purview of their audit or whether they were of the opinion that the reserve was inadequate. Following informal discussions with the accountants their certificate was revised to state clearly that the reserve was materially inadequate and that they took exception to the financial statements because of such inadequacy. Their resultant certificate, as revised, read in part as follows:

> The company uses the retirement-reserve method of providing for property retirements, the purpose of which is to equalize the burden of retirement losses from year to year. As stated in Note 5 of the notes to the balance sheet, the ratio between the expired life * * * is materially in excess of the ratio between the related retirement reserve and the estimated original cost of such property, and a straight-line depreciation reserve would materially exceed such retirement reserve. * * *

The certificate as revised was used together with the financial statements in a prospectus covering a public offering of securities made shortly thereafter by the issuer under the Securities Act of 1933.

While it is unusual for the Commission to find it necessary to resort to the courts for the enforcement of its proxy regulations, it has been engaged in such litigation during the past year in a case involving the solicitation of proxies by John A. Topping from the stockholders of Certain-Teed Products Corp. The Commission's attention was called to a letter of April 1, 1949, sent by Mr. Topping to stockholders. The Commission in its complaint filed with the court alleged that the letter was not filed as required by the proxy rules and that certain statements contained therein were false and misleading. The Commission therefore sought an injunction prohibiting Mr. Topping from sending further letters of this nature in contravention of these rules. On June 1, 1949, the court denied the defendant's motion to dismiss the Commission's complaint; denied the temporary injunction requested by this Commission without prejudice, on the theory that since the annual meeting had been held no immediate danger existed of further violations of law; and retained jurisdiction in the case. This litigation is still pending and awaiting a ruling by the court on the defendant's motion for summary judgment.

Illustrating the proxy cases which give rise primarily to one or more of a wide variety of accounting problems was that of a chemical manufacturer which filed preliminary proxy material covering a proposed merger between the company and one of its subsidiaries for the purpose of effecting a recapitalization of the parent company. The notes to the financial statements contained in the proxy material revealed that the accumulated unpaid dividends on 213,052.15 shares of preferred stock amounted to $83.50 per share or a total of $17,789,854.53. The surplus shown on the balance sheet amounted to $11,477,570.43.

The company proposed that new first preferred and second preferred stock would be issued in exchange for its outstanding preferred stock,

the effect of which would be to satisfy all dividend arrearages. It proposed also to carry forward its surplus intact without reflecting any deduction arising out of the satisfaction of dividend arrearages. After discussions between the staff and representatives of the company of the results sought to be obtained by the proposed merger, the main purpose of which was to eliminate preferred dividend arrearages, and of the accounting procedure proper under the circumstances, the company's financial statements were revised to indicate that the entire surplus of $11,477,570.43 remaining, after routine adjustments, would be eliminated and treated as capital upon consummation of the merger.

The method used by a company in the valuation of its inventories becomes significant to stockholders in many cases, as may be illustrated by still another actual proxy examination conducted by the staff. An oil company submitted copies of proxy solicitation material with respect to a proposed merger with another oil company. This proxy material contained financial statements of both companies. In reviewing the financial statements, the staff noted that the companies used different methods of valuing their principal inventories; e. g., last-in, first-out method; first-in, first-out method; and the average-cost method. Both companies used the last-in, first-out method for valuing inventories of crude oil and of crude oil content of refined and semirefined products at refineries, which constituted a substantial portion of total inventories.

It should be noted that in the determination of net income, the last-in, first-out method of valuing inventories has the effect of deducting from sales the cost of recent products purchased, instead of the cost of such products on hand at the beginning of the year (based on the first-in, first-out or average cost methods) plus purchases during the year. Therefore, generally, in a period of rising prices the effect of the last-in, first-out method is to show earnings and inventories in the balance sheet substantially lower than they otherwise would have been if other generally recognized methods had been used. In a period of declining prices, earnings would normally be greater on the last-in, first-out basis. It was deemed particularly pertinent in this case, as frequently occurs in many other instances, that the financial statements should disclose to stockholders the valuation on a current cost basis of inventories carried on the last-in, first-out basis. These financial statements were amended to indicate that with respect to one company's inventories valued on the last-in, first-out method ($3,067,611.03) the approximate current cost aggregated $6,000,000, and with respect to the other company's inventories stated on the last-in, first-out method ($1,999,756) the approximate current cost aggregated $3,750,000. This disclosure, obtained for the benefit of stockholders, enabled them more adequately to appraise their respective equities.

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 of 1934; exemption, however, is granted to those brokers and dealers whose business is exclusively intrastate or exclusively in exempt securities. The following tabulation reflects certain data with respect to registration of brokers and dealers during the fiscal year ended June 30, 1949:

Registration of brokers and dealers under section 15 (b) of the Securities Exchange Act—fiscal year ending June 30, 1949

Effective registrations at close of preceding fiscal year	4,006
Effective registrations carried as inactive	[1] 72
Registrations placed under suspension during preceding fiscal year	0
Applications pending at close of preceding fiscal year	29
Applications filed during fiscal year	429
Total	4,536
Applications withdrawn during year	19
Applications cancelled during year	0
Registrations withdrawn during year	443
Registrations cancelled during year	41
Registrations denied during year	0
Registrations suspended during year	0
Registrations revoked during year	16
Registrations effective at end of year	3,924
Registrations effective at end of year carried as inactive	[1] 70
Applications pending at end of year	23
Total	4,536

[1] Registrations on inactive status because of inability to locate registrant despite careful inquiry. Two such registrations were cancelled, withdrawn, or restored to active status during the year.

Administrative Proceedings

Section 15 (b) of the act provides that registration may be denied for specific types of misconduct on the part of an applicant, and that, once allowed, registration may be revoked for such misconduct if the Commission finds after an appropriate record has been made that such denial or revocation is necessary in the public interest. The Commission's staff, therefore, examines all applications for registration and numerous other available sources of information to determine whether the applicant has engaged in any violations of law which would constitute a statutory basis for challenging the propriety of giving him the privilege incident to registration. When indications of such misconduct are discovered, the Commission orders proceedings to establish the facts and to afford the applicant full opportunity to be heard on the specified charges so that an appropriate determination may be made. Similar procedures are followed in revocation proceedings against registered brokers and dealers and in proceedings to determine whether to suspend or expel a broker or dealer from membership in a national securities exchange or association. The following tabulation reflects the number of proceedings instituted under sections 15 (b) and 15A during the 5-year period ending June 30, 1949, and the disposition thereof.

Cumulative record of broker-dealer registration proceedings and proceedings to suspend or expel from membership in a national securities association instituted pursuant to section 15 of the Securities Exchange Act for each of the fiscal years 1945–49

	1945	1946	1947	1948	1949	Total (5-year period)
Proceedings pending at start of fiscal year to—						
Revoke registration	4	2	2	4	10	4
Revoke registration and suspend or expel from NASD [1]	11	5	4	2	9	11
Deny registration to applicants			2	1		
Total proceedings pending	15	7	8	7	19	15
Proceedings instituted during fiscal year to—						
Revoke registration	6	6	15	13	10	50
Revoke registration and suspend or expel from NASD	2	4	3	9	6	24
Deny registration to applicants	5	5	2	6	7	25
Total proceedings instituted	13	15	20	28	23	99
Total proceedings current during fiscal year	28	22	28	35	42	114
DISPOSITION OF PROCEEDINGS						
Proceedings to revoke registration:						
Dismissed on withdrawal or cancellation of registration	1		4	0	3	8
Dismissed—registration continued in effect	1		1	0	2	4
Registration revoked	6	6	8	7	10	37
Total	8	6	13	7	15	49
Proceedings to revoke registration and suspend or expel from NASD:						
Dismissed on withdrawal or cancellation of registration	0	0	1	0	1	2
Dismissed—registration and membership continued	1	1	0	0	0	2
Registration revoked and firm expelled from NASD	0	1	1	0	6	8
Firm suspended from membership in NASD	4	1	1	0	0	6
Registration revoked—no action taken on NASD membership	3	2	2	2	0	9
Total	8	5	5	2	7	27
Proceedings to deny registration to applicants:						
Dismissed on withdrawal of application	1	2	1	3	2	9
Dismissed—registration permitted	2		1	2	4	9
Registration denied	2	1	1	2	0	6
Total	5	3	3	7	6	24
Total proceedings disposed of	21	14	21	16	28	100
Proceedings pending at end of fiscal year to—						
Revoke registration	2	2	4	10	5	5
Revoke registration and suspend or expel from NASD	5	4	2	9	8	8
Deny registration to applicants		2	1		1	1
Total proceedings pending at end of fiscal year	7	8	7	19	14	14
Total proceedings accounted for	28	22	28	35	42	114

[1] The National Association of Securities Dealers, Inc., is the only national securities association registered with the Commission.

As shown in the foregoing tabulation, seven proceedings involving the denial of registration as an over-the-counter broker or dealer were ordered during the 1949 fiscal year. Two applications were withdrawn after the Commission had given notice of hearing thereon. Four were granted registration. One proceeding was pending at the end of the year. Of the 16 revocation proceedings against registered

brokers and dealers ordered during the fiscal year and the 19 proceedings pending at the beginning of the year,[7] the Commission disposed of 22 as follows:

Registration revoked	[1] 10
Registration revoked and firm expelled from NASD	[1] 6
Proceedings dismissed and registration cancelled or withdrawn	4
Proceedings dismissed and registration continued in effect	2

[1] Registrations revoked (* indicates expulsion from NASD was also ordered):

Firm	*Securites Exchange Act Release No.*
Thornton & Co.*	4115
Hammill & Co	4189
Southeastern Securities Corp	4274
Meyer & Ewell Co. Inc	4156
J. Omer Hebert	4126
Edward R. Parker Co. Inc.*	4157
Morris T. Sitkoff	4155
Roy Culp	4203
William Monroe Layton	4204
Harold G. Wise*	4270
Aurelius F. De Felice	4272
Lewis Ankeny & Co	4265
Carter H. Corbrey & Co. (not incorporated)*	4244
Strouse, Thomas and Whelan, Inc	4248
J. S. Lockaby, & Co.*	4237
American Canadian Enterprises, Ltd.*	4273

Most of the proceedings brought against brokers and dealers stem at least indirectly from the Commission's routine fraud detection procedures designed to detect and prevent violations of law.

During the last five fiscal years revocation proceedings have been instituted against seven brokers and dealers for manipulation of the market in particular securities. Two proceedings of this nature were decided during the 1949 fiscal year and the registrations of Aurelius F. De Felice and Thornton & Co. were revoked on findings that they had manipulated the market in willful violation of law.

In the first case, De Felice and one Windt undertook a manipulation of the market which raised the price of the common stock of Tonopah Gipsey Queen Mining Co. from 40 cents on March 15, 1946, to 75 cents on March 26, 1946, at which level it was maintained until April 10, 1946. This was accomplished by artificial trading generated by De Felice and Windt and by their contraction of the available trading supply in the security.

By obtaining option agreements from one Christiansen, who owned 1,091,191 of the 1,243,715 shares of Tonopah's outstanding stock (in connection with which Christiansen agreed to deposit 750,190 of his shares in escrow until November 1, 1947), Windt removed from the market all except 41,001 of Christiansen's shares, thus removing an overhang from the market and facilitating the manipulation. Despite the fact that DeFelice was informed by the board of governors of the San Francisco Mining Exchange that it would be necessary for Christiansen to make available a sufficient amount of stock to prevent an unduly narrow market, DeFelice effectively removed from trading 20,000 of the 40,000 shares offered by Christiansen by placing such shares with a customer off the exchange. The Commission found that DeFelice had followed a course of conduct for the manifest purpose of raising the price of the stock in order to induce the purchase of the stock by others, and that he aided and abetted Windt,

[7] Some of these proceedings included the question of suspension or explusion from the NASD.

who he had reason to believe was effecting like transactions with a similar purpose. DeFelice thereby violated section 9 (a) (2) of the Securities Exchange Act.

In the second case, Charles J. Thornton was the active and controlling partner in Thornton & Co. Thornton entered matched orders and effected wash transactions on the Chicago Stock Exchange in the common stock of Lindsay Light & Chemical Co. from June 1, 1946, to July 31, 1946, and in the 7 percent cumulative preferred $100 par value stock of Northwest Utilities Co. from February 9, 1946, to July 2, 1946, for the purpose of creating a false and misleading appearance of active trading in these securities. This raised the price of the Lindsay common from approximately $32 to $35.50 per share and the price of the Northwest preferred from approximately $152 to approximately $184 per share and was done for the purpose of inducing the purchase of these securities by others.

In the course of the manipulation of the market in each of these securities Thornton made sales to the public both on the Exchange and over-the-counter markets within the range of the fictitious prices it had created directly and at levels achieved in public transactions which followed Thornton's substantial participation in the market. To screen his operations Thornton placed buy and sell orders with numerous brokers, none of whom was ever on both sides of a transaction. Thornton admitted that he had entered large numbers of matched orders and consummated a substantial volume of wash transactions, 116 in all. He contended, however, that they were not for the purpose prescribed by statute but rather to delay payment for securities which he had purchased and could not finance, in other words a "kiting" of securities. He further contended that he was endeavoring to accumulate an inventory in such securities.

The Commission found that his public sales and the mechanics of his trading were not only inconsistent with his assertions, but also that, granting the truth of his contentions, the asserted financing objective was in any event accompanied by a manipulative purpose. Thornton's activities on the Chicago Stock Exchange in the two securities were found to violate section 9 (a) (1) and (2) of the Securities Exchange Act. Since he had sold such securities over-the-counter as well without disclosing to the purchasers that the prices charged were determined by prices established by a manipulated market on the Exchange, the Commission found also that Thornton had violated sections 10 (b) and 15 (c) (1) of the act and rules X-10B-5 and X-15C1-2 (a) and (b) thereunder. On a petition for review filed by Thornton, the Commission's order was affirmed by the United States Court of Appeals and *certiorari* was denied by the United States Supreme Court. Litigation aspects of the case are discussed later in the report of litigation activities.

Ten other proceedings which resulted in revocation of registration pertained to the more common types of fraudulent practices involving other people's money, such as violation of fiduciary obligations, misrepresentations, and misappropriation of customers' funds and securities. Two of them, Southeastern Securities Corp. and Hammill & Co., involved shocking abuse of the trust and confidence reposed by certain customers of these firms.

The proceedings against Hammill & Co. concerned the utter betrayal of the trust and confidence reposed in Albert L. Hammill, the controlling partner of the firm, by a customer, Mrs. G., a widow without business experience. At a time when the financial condition of his firm was precarious, Hammill advised and induced Mrs. G. to sell certain securities on the representation that the proceeds would be reinvested in another security which would be of greater advantage to her. Hammill, however, did not reinvest the proceeds, aggregating $4,534.69, in such security but persuaded Mrs. G. to accept his personal promissory note in the amount of $4,000. The Commission, pointing out the confidential relationship that existed between Hammill and Mrs. G., observed that, at a minimum, Hammill was under an obligation to disclose to this customer all pertinent information, including the particulars of his own financial condition and the fact that by accepting his note for her claim against the firm she could assert her claim only against Hammill and not against Hammill and his partner. Later, Hammill's partner withdrew from the firm because of its distressed financial condition. In order to return the securities which this partner had invested in the firm and which were pledged as collateral for a bank loan, it was necessary for Hammill to substitute new securities. On the promise that she would receive 4-percent interest on her money and that her securities would be deposited with a bank where they would be safe, Hammill induced Mrs. G. to invest all of her securities, aggregating about $15,000, in a new partnership in which he and Mrs. G. would be the partners. Six months thereafter the business collapsed.

The Commission based its order revoking registration on findings that Hammill had willfully violated section 17 (a) of the Securities Act and sections 10 (b) and 15 (c) (3) and rules X–10B–5 and X–15 (c) (3)–1 of the Securities Exchange Act.

The facts in the proceedings against Southeastern Securities Corp. were similar in some respects to the facts in the Hammill proceedings. Here there were three women customers into whose trust and confidence Luck, president and controlling stockholder, had insinuated himself and whose trust and confidence he betrayed. His conduct of the affairs of one of these customers, a patient bedridden at a nursing institution, was especially shocking and reprehensible. Luck maintained that this customer had executed a power of attorney authorizing him to trade for her account, but a handwriting expert of the Federal Bureau of Investigation testified that in his opinion the customer's signature on the power of attorney was a forgery. It is the first instance in any administrative proceeding against brokers and dealers in which the Commission has introduced expert testimony to challenge handwriting.

Another aspect of these proceedings related to the financial condition of the company. The evidence disclosed that the company and Luck had made false entries on Southeastern's books purporting to remove certain liabilities for the purpose of giving the appearance of solvency, when in fact the company was insolvent. Thus it was found, in part, that entries were made on Southeastern's books debiting certain accounts of directors and customers with the amounts of their credit balances and crediting the capital surplus account of Southeastern in those amounts. On one day there were thus elim-

inated credit balances aggregating more than $145,800 and the same amount was added to surplus. The evidence adduced at the hearing clearly established that certain of the creditors whose balances were thus transferred expected the money to be repaid. The device of false and fictitious entries was employed by Luck to enable the company to continue in business while it was actually insolvent.

The Commission found on the foregoing facts that Southeastern and Luck willfully violated section 10 (b) and rule X–10B–5 of the act, that Southeastern, aided and abetted by Luck, violated section 15 (c) (1) of the act and rule X–15C1–2 (a) and (b) thereunder, and that Southeastern violated section 17 (a) of the act and rule X–17A–3 thereunder.

Of the remaining revocations several involved different types of violations. Three were based on findings of willful failure to file financial reports and one was based on the filing of a false financial report and on the willful violation of rule X–15C3–1, which requires brokers and dealers to maintain net capital of not less than 5 percent of their aggregate indebtedness.

Broker-Dealer Inspections

The broker-dealer inspection program, initiated by the Commission in 1940 under section 17 (a) of the Securities Exchange Act, which authorizes the Commission to make periodic, special and other examination of the books and records of brokers and dealers, is one of the Commission's important implements in the detection and prevention of violations of law by broker-dealers. These inspections are conducted by the staff of the Commission's regional offices. They are sometimes limited to a particular phase of a firm's operations, such as its financial condition or its method of handling particular accounts, but generally they involve full scale examination of all characteristic activities, culminating in a report on the extent to which its operations are in compliance with the standards established by the act and rules. During the last 5 years a total of 3,621 broker-dealer inspections were made:

Fiscal year—	*Number of inspections*
1945	825
1946	603
1947	587
1948	841
1949	765
Total	3,621

Irregularities of varying degrees of seriousness [8] were reported in 399 [9] of the 772 inspections made during the 1949 fiscal year. Noncompliance with regulation T (relating to margins) continues to be reflected in a large number of examinations, this year in a total of 214. Improper hypothecation of customers' securities was reported in 62 inspections and secret profits in 11. Questions of compliance with the rule relating to the capital of registered firms (rule X–15C3–1) and in some instances even more serious matters relating to financial

[8] Not including infractions of rule X–17A–3, which requires brokers to make and keep current certain books and records.

[9] Three hundred and thirty of these were inspections of members of National Association of Securities Dealers, Inc., an association of over-the-counter firms registered with the Commission under sec. 15A of the Securities Exchange Act. A total of 540 inspections were of members of that association.

condition were reported in 33 inspections. Investigations of 18 firms were undertaken as a result of information obtained during these examinations. Two of these have gone out of business, the registrations of 2 others have been revoked, and 1 has been enjoined from engaging in certain fraudulent practices and ordered by the court to establish and maintain the books and records required by rule X–17A–3.

In addition to inquiry into the various matters referred to above, the inspection procedures call for a test check to determine whether the firm inspected deals fairly with customers at prices reasonably related to the current market. These tests checks have a dual purpose—first to enforce the principle, judicially established in *Charles E. Hughes & Co., Inc.* v. *S. E. C.*, that it is fraudulent for a dealer to sell securities to customers, or buy from them, at prices not reasonably related to the market unless he discloses the variation from the market,[10] and second to determine the effectiveness of the rules of the NASD relating to fair prices and fair and equitable principles of trade.[11]

The following tabulation reflects information obtained in inspections made during the year with respect to pricing practices in sales to customers:

	NASD members	Others
Number of inspections	540	225
Number of inspections reporting sales to customers in which the customer paid more than 5 percent above the current market [1]	235	28
Number of sales reported	15,746	1,323
Number of sales analyzed [2]	12,999	1,176
Number of sales in which the customer paid more than 5 percent above the current market	1,658	304

[1] For test purposes in the case of unlisted securities the high offer on the professional market as of the date of the sale is employed; on exchange securities the high sale on the date of sale, or if there was no sale, the asked price, as reported by the exchange on which the security is traded.

[2] Market prices as of the date of sale are not readily available in all instances. This is often true of securities inactively traded and generally true of securities having only a local market. There were 1,738 transactions reported in these inspections on which no market prices were readily available.

A further break-down of the last item in the above tabulation shows substantial concentration of the 1,962 sales made at more than 5 percent mark-up. As noted in the table, 263 firms made such sales. One hundred and forty-eight of these firms made a total of 500 such remaining 115 firms, and the number of sales at above the 5 percent sales out of 7,831 of their sales analyzed. The concentration was in the mark-up made by each of these firms represented over 10 percent of their analyzed sales, as indicated below:

	NASD members	Others
Number of inspections in which the sales to customers at mark-up of more than 5 percent over the current market represented more than 10 percent of the sales analyzed	96	19
Number of sales analyzed in such inspections	5,547	807
Number of such sales made at mark-up of more than 5 percent over the current market	1,250	282

[10] 139 F. 2d 434 (C. C. A. 2, 1943), *cert. den.* 321 U. S. 786 (1944).

[11] On November 25, 1944, the board of governors of the NASD adopted an interpretation of sec. 1 of art. III of its Rules of Fair Practice holding that transactions by dealers at prices not reasonably related to the market constitute conduct inconsistent with just and equitable principles of trade.

During the 5 years prior to the decision in *Charles E. Hughes & Co., Inc.* v. *S. E. C.* in 1944 the Commission revoked the registrations of nearly a score of brokers and dealers for fraudulent transactions in securities at prices not reasonably related to the current market. While the number of such proceedings has diminished there are still some indications of overreaching and some evidence that it has taken a new form. The NASD is vitally interested in the problem and the Commission is encouraged to believe that with the association's continued cooperation a practical and effective solution will be found.

Inspections of Broker-Dealers in Hawaii

The Commission has received occasional complaints over the years from citizens residing in Hawaii, alleging securities frauds and sales of securities without registration. Recently the complaints have increased in volume and acerbity, and at the request of the Territorial Government of Hawaii, the Better Business Bureau, and other organizations and individuals, the Commission sent two staff members to investigate these charges. An attorney and an accountant arrived early in 1949 and promptly found evidences of fraud in the sale of securities, and sales of securities without registration, by a score of persons and organizations. The attorney then returned to Washington to report on the situation, and the accountant remained to follow up additional leads and to inspect broker-dealers whose activities had not been checked in the 15 years' existence of the Commission.

The accountant's investigations disclosed that several broker-dealers were engaged in business without registration. In a number of instances complete audits were made of registered broker-dealers and necessary changes were effected to meet the requirements of the securities laws. The accountant was also instrumental in causing several organizations to increase their capital for the safety of investors.

The Commission's representatives were able to aid in the tightening of Hawaiian securities laws by assisting in the preparation of amendments to the existing laws. It is hoped that the amendments enacted will increase the protection of the Hawaiian public with respect to securities matters.

The survey in Hawaii indicates a need for the establishment of an office or, in the alternative, occasional trips by staff members from the mainland in order to enforce compliance with the securities laws. The Commission has appealed for funds in order to protect the citizens of Hawaii adequately against fraudulent securities practices and sales of unregistered issues.

Financial Reports

Brokers and dealers are required by rule X–17A–5 to file reports of financial condition during each calendar year. During the 1949 fiscal year a total of 3,659 financial reports were filed. Each report is examined to determine, among other things, whether there has been any violation of rule X–15C3–1, which provides that the aggregate indebtedness of a broker or dealer shall not exceed 20 times his net capital. When deficiencies are found steps are taken immediately to secure compliance. This is an important phase of the Commission's activities in affording protection to customers.

Failure to file the reports as required is an infraction of the rule and may lead to disciplinary proceedings. Frequently, small firms doing relatively little or no business fail to file reports on time. These are handled by a procedure for cancellation of registration when the registrant's inactivity is established. Informal procedures are frequently used to procure filing by those who do not furnish reports on time. In some instances action becomes necessary to revoke registration.

SUPERVISION OF NASD ACTIVITY

Membership

National Association of Securities Dealers, Inc. (NASD) has been the only securities association registered as such with the Commission under section 15A of the Securities Exchange Act. In the 5-year period ended June 30, 1949, membership in the NASD increased by 502, as shown below:

As of June 30—	Membership	Gain
1945	2,281	88
1946	2,514	233
1947	2,614	100
1948	2,677	63
1949	2,695	18

The gain of 18 members in the last fiscal year was the balance of 177 terminations of membership and the admission of 195 new members.

Disciplinary Actions

During the 1949 fiscal year the Commission received from the NASD reports of final action in seven disciplinary cases involving formal complaints against members, in addition to various interim reports or reports of informal action. In six of these seven cases the NASD committee having jurisdiction had found violations of rules of fair practice and imposed various penalties on the firms, and in one instance on a registered representative also named in the complaint. In the remaining case the committee had found that no violations had occurred and dismissed the complaint. The penalties included expulsion in two cases; two firms were each fined $500, one of which was also censured; two firms were censured and a registered representative of one of them was fined $100. Such disciplinary decisions are subject to review by the Commission, on its own motion or upon application by any aggrieved person, but no such review was undertaken in any of these cases in the 1949 fiscal year nor was any such matter pending before the Commission at the year's end.[12]

Comparative data on the number and outcome of disciplinary cases, final decisions on which were received by the Commission in each of the last five fiscal years, appear below in tabular form:

[12] As recited in some detail in the annual reports identified below, the Commission, within the last five fiscal years, reviewed three disciplinary decisions by the Association: *National Association of Securities Dealers, Inc.*, Securities Exchange release No. 3700 and Tenth and Eleventh Annual Reports; *Thomas Arthur Stewart*, Securities Exchange Act release No. 3720 and Eleventh and Twelfth Annual Reports; and *Herrick Waddell & Company, Inc.*, Securities Exchange Act release No. 3935 and Twelfth and Thirteenth Annual Reports.

Fiscal year	Final decisions received	Complaints dismissed or withdrawn	Violations found and penalties imposed			
			Expelled	Fined	Censured	Miscellaneous
1945	21	6	2	9	3	[1] 1
1946	19	6	0	9	4	0
1947	8	3	0	5	0	0
1948	10	3	0	2	3	[2] 2
1949	7	1	2	3	1	0
Total	65	19	4	28	11	3

[1] In 1 case the committee accepted in settlement a statement from the firm named in the complaint pledging future compliance with, and observation of, the rules of fair practice.
[2] Includes suspension for 30 days in 1 instance; in another, a complaint was dismissed as to a member firm but the registration of a registered representative, also named as a party to the complaint, was revoked.

The Commission continued its practice of referring to the NASD facts disclosed in the course of its broker-dealer inspection program which would indicate a possible violation of the NASD rules of fair practice. Occasionally, independent investigations by the NASD result in the filing of formal complaints against members. More often, such matters are settled by informal means, such as a critical discussion with the firm involved and the receipt of assurance that the business practices of the firm would be altered to comply with NASD and Commission requirements. In other instances additional investigation indicates that no disciplinary action is appropriate. Data on the number and disposition of references in the past five years appear below:

	Fiscal year				
	1945	1946	1947	1948	1949
Pending at beginning of fiscal year	0	3	7	1	2
Referred during year	6	11	7	7	3
Total	6	14	14	8	5
Dispositions received during years:					
By formal complaint	2	1	3	2	0
By informal means	1	6	10	4	4
Pending at end of fiscal year	3	7	1	2	1
Total	6	14	14	8	5

Registered Representative Rule

The NASD adopted rules, effective January 15, 1946, which in effect require the registration with the NASD as "registered representatives" of all partners, officers, and other employees of broker-dealer firms who, generally, do business directly with the public.[13] The broad purpose of these rules was to bind all registered represent-

[13] Although the amendments were approved by the board of governors and by the affirmative vote of the requisite majority of the NASD membership, the program was attacked by individuals and groups in the securities industry as inconsistent with the language of the Securities Exchange Act and on the ground that it would create a form of substandard membership in which the obligations, but not the benefits of membership, were forced on persons who had no voice in the NASD. After public hearing, the Commission held the proposed amendments to be consistent with the statutory requirements and announced that it would not disapprove them. In so acting, the Commission took the position that when it failed to exercise its veto power over proposed amendments to NASD rules, the statute did not require the issuance of a reviewable order, a position sustained by the courts in subsequent litigation. *National Association of Securities Dealers, Inc.*, Securities Exchange Act release No. 3734.

atives by the articles of incorporation, bylaws and rules of the NASD and duly authorized rules, orders, directions, decisions and penalties.

Data on "registered representatives" since the effective date of the rules follow:

	Number registered		*Number registered*
Jan. 15, 1946	21, 351	June 30, 1948	26, 228
June 30, 1946	23, 374	June 30, 1949	27, 249
June 30, 1947	25, 573		

The increase of 1,021 registrations in the 1949 fiscal year was the balance of 3,599 terminations of registration, 1,634 re-registrations, and 2,986 initial registrations.

Commission Review of Actions on Membership

The qualifications for registered representative status under NASD rules are identical with the statutory qualifications for membership. Both provide that a petition for admission to or continuation in membership can be brought before the Commission by or on behalf of any NASD applicant or member who controls or is controlled by a disqualified partner, officer, or employee. Such a petition may raise the question whether it is in the public interest for the Commission to approve, or direct, admission to or continuation in membership notwithstanding control of the petitioner of or by a disqualified person. In the 1949 fiscal year six such "approval or direction" cases were decided by the Commission.[14] Five cases, involving six individuals, were decided on findings by the Commission that each person was validly disqualified because he had been the "cause" of an order of revocation of broker-dealer registration by the Commission, but that the individuals need not be permanently excluded from the securities business due to the nature of their proposed employment and the degree of supervision to be exercised over them. On this basis the Commission, by order, approved the continuation in membership of the member firms even though they employed the disqualified persons.[15]

The sixth case concerned J. A. Sisto & Co. The controlling partner, Joseph A. Sisto, was disqualified from membership because of expulsion from the New York Stock Exchange in 1938 for conduct inconsistent with just and equitable principles of trade.[16] A petition was filed on

[14] Other cases on similar or related questions decided within the last five fiscal years and discussed in the respective annual reports include:

Case	*Securities Exchange Act release No.*
John L. Godley	3823
Greene Co	3836
Foelber-Patterson, Inc	3847
Republic Investment Co	3866
L. R. Leeby & Co	3898
Leason & Co	3937
E. E. Trost	3955
Minnesota Securities Corp	4033
John J. Bell	4034
Dewitt Investment Co	4076
W. L. Johnson	4116
H. L. Ruppert and J. H. Lynch	4117
G. M. Peterson	4118
Joseph Loeb	4119
H. L. Brocksmith	4120

[15] Two earlier petitions filed directly by J. A. Sisto & Co., without NASD sponsorship or approval, had requested the Commission to direct the NASD to admit the firm to membership. *J. A. Sisto & Co.*, 7 S. E. C. 647, 1102 (1940); and Securities Exchange Act release No. 3614.

behalf of the firm by the NASD, together with its affirmative recommendation that the Commission approve the firm's admission to membership. In considering the petition the Commission noted the period of time which had elapsed since the earlier petitions and that neither Sisto nor his firm had been involved in any proceedings respecting their conduct in the securities business in the interim period. Under these circumstances, and having given weight to the findings and recommendation of the NASD, the Commission approved the admission of the firm to membership.[17]

CHANGES IN RULES, REGULATIONS, AND FORMS

During the 5 years since July 1, 1944, the Commission has amended and revised various rules, regulations, and forms under the Securities Exchange Act of 1934 as changing circumstances have required. The principal changes made during this period or now under consideration are summarized below:

Changes Made During the 1949 Fiscal Year

Revision of registration and reporting rules.—A thoroughgoing revision of the rules governing the preparation, form, content and filing of applications for registration and annual and other reports under the Act was published on December 17, 1948. These rules are applicable to registration and reporting by issuers having securities listed on a national securities exchange and also to reporting by registrants under the Securities Act of 1933 which are subject to the reporting requirements of the Securities Exchange Act of 1934. The revision clarified and brought up to date all of the rules pertaining to registration and reporting. The revision also abolished certain obsolete rules and integrated into the General Rules and Regulations certain general requirements previously contained in the several forms with respect to the preparation, form, content, and filing of applications for registration and annual and other reports.

Prior to the revision of these rules registrants under the Securities Act of 1933 which were subject to reporting requirements were required to file only annual reports if they had no securities listed and registered on a national securities exchange.[18] The revised rules put such registrants on the same reporting basis as issuers having securities listed and registered on an exchange, so that such registrants now file in addition to annual reports the same current and quarterly reports as are filed by listed companies.

Rule X–16B–3.—On March 6, 1949, the Commission published an amended rule X–16B–3 which provides an exemption from section 16 (b) of the act with respect to the acquisition of certain equity securities issued to directors and officers as a part of their remuneration.

Section 16 (b) of the act provides, in general, that where any director or officer of the issuer of a registered equity security, or any beneficial owner of more than 10 percent of such security, has realized a profit from any purchase and sale, or sale and purchase, of any equity security of the issuer within any period of less than six months such profits may be recovered by the issuer.

[17] *J. A. Sisto & Co.*, Securities Exchange Act release No. 4142.

[18] Under sec. 15 (d) of the Securities Exchange Act, the Commission has the power to require that annual and other reports be filed by certain registrants under the Securities Act of 1933.

The exemption provided by the amended rule is subject to several conditions designed to limit it to bona fide bonus, profit-sharing and similar remuneration plans. These conditions are, briefly, that the plan must have been approved by security holders; that the security must have been acquired solely in consideration of services; that the amount of securities acquired by each director or officer must have been determined by an independent committee of three or more persons or by the board of directors; and finally, that the exemption is not available unless the amount of funds or securities distributed or set aside for a fiscal year pursuant to the plan is related to the net profits of the issuer and its subsidiaries for such fiscal year.

Changes Made During the 1945–48 Fiscal Years

A summary of the more significant rule changes in the 1945–48 fiscal years follows.

Adoption of Rule X–16B–4.—Another exemption from section 16 (b) of the act is provided by rule X–16B–4, which was published by the Commission on August 28, 1946. This rule exempts certain transactions by public utility holding companies and their subsidiaries from the civil liability provisions of section 16 (b). The new rule exempts from section 16 (b) any transaction by a holding company registered under the Public Utility Holding Company Act of 1935 or by any subsidiary of such a company where both the purchase and sale have been approved or permitted by the Commission under that act.

Adoption of Rule X–16C–2.—An exemption from section 16 (c) of the act was adopted by the Commission on March 20, 1946. This section makes it unlawful under certain circumstances for any beneficial owner of more than 10 percent of any class of any equity security which is registered on a national securities exchange, or for any director or officer of the issuer of any such security, to sell any equity security of that issuer if he does not own the security sold or owns the security but does not deliver it against the sale within a specified time. The new rule is designed to exclude from the prohibition of section 16 (c) certain technical short positions which arise purely as an incident to participation by one of the specified classes of persons (or some dealer firm with which such a person is connected) in either a primary or secondary distribution by a person in a control relationship with the issuer.

Revision of Proxy Rules.—On December 17, 1947, the Commission published a completely revised edition of its proxy rules under section 14 (a) of the act and of regulation X–14. These rules are applicable to the solicitation of proxies, authorizations, and consents with respect to any security listed and registered on a national securities exchange. They also apply to the solicitation of proxies by public utility holding companies registered under the Public Utility Holding Company Act of 1935 and their subsidiaries and to investment companies registered under the Investment Company Act of 1940. The purpose of the revision was to clarify and simplify the rules and to make certain changes in the requirements which the Commission's experience in administration had shown to be desirable without making any fundamental departure from the principles of the rules as previously in effect.

Certain further amendments to these rules, adopted on November 5, 1948, effected principally a reduction in the amount of information

called for with respect to the remuneration of directors and officers of issuers subject to the rules.

Quarterly Reports.—On July 23, 1945, the Commission adopted a new rule which required listed companies whose war business amounted to more than 25 percent of total sales in the last preceding fiscal year to file a quarterly report on Form 8–K disclosing the total volume of unfilled orders at the beginning and end of each fiscal quarter, and the total amount of sales during the quarter showing separately sales made pursuant to war contracts. This rule was intended primarily to inform the public of the effect upon listed companies of declining war business.

By 1946 the rule had served its purpose as a temporary postwar measure. It was then replaced, on March 28, 1946, by a new rule which required all listed companies to file regular quarterly reports of their gross sales and operating revenues. These requirements were extended on December 17, 1948, to registrants under the Securities Act of 1933 who are required to file annual and other reports pursuant to section 15 (d) of the Securities Exchange Act of 1934. This extension of the requirement was made in connection with the general revision, referred to above, of the rules governing the preparation, form, content and filing of applications for registration and annual and other reports.

Proposed Revision of Registration and Reporting Forms

The Commission presently has under consideration a broad program for the revision of all of its forms for registration and reporting under the act. The purpose of this revision is to bring the requirements of the various forms up to date and to abolish a number of forms which are no longer necessary in the administration of the act. Several of these forms were published in preliminary draft form on March 11, 1949, for the purpose of obtaining informed comments and suggestions thereon. The comments and suggestions received are now being studied.

LITIGATION UNDER THE SECURITIES EXCHANGE ACT

The issues involved in the Commission's court activities during the last five years were somewhat different from those which had predominated during the first ten years of its existence. Some of the early problems were solved by court determinations which crystallized the application of the statutes to various activities. New issues were presented by rules adopted by the Commission; primarily by rule X–10B–5, which defines the scope of the anti-fraud provision of section 10 of the act, and regulation X–14, establishing standards relating to the solicitation of proxies under section 14 (a) of the act.

Court actions during this period included: (1) Injunction actions brought by the Commission in the Federal district courts to restrain broker-dealers and others from violating those provisions of the act and the Commission's rules designed to protect securityholders and the customers of broker-dealers; (2) appellate court actions on petitions to review orders of the Commission; and (3) actions between private parties involving the acts administered by the Commission in which the Commission participated as *amicus curiae* to express its views on questions of construction. The substantive problems in-

volved are discussed below under the following headings: (1) The regulation of broker-dealers; (2) section 16 (b), the recovery of insiders' short-swing profits; (3) rule X-10B-5, the antifraud provision; and (4) regulation X-14, the proxy rules. In addition there is reported separately below the Commission's investigation of an offering of Kaiser-Frazer stock and litigation with Otis & Co. which arose therefrom.

Broker-Dealer Cases

As a result of the Commission's broad regulatory duties with respect to approximately 4,000 registered broker-dealers the largest single category of judicial proceedings under the act involved breaches of obligations to customers by such persons and by others who engaged in business as brokers and dealers without being registered as required by the statute.

A number of injunction actions were obtained against broker-dealers who were doing buiness while insolvent, thereby jeopardizing customers' funds and securities.[19] Wherever feasible, in insolvency cases, the Commission has sought the appointment of a receiver in order to preserve assets for customers.[20] In one such case the family of the broker, who had died, made an assignment of $30,000 for the benefit of creditors.[21]

Other cases in which the Commission obtained injunctions involved secret profits made by a broker-dealer professing to act as agent for his customers;[22] charging prices which bore no reasonable relationship to the current market prices;[23] wrongfully hypothecating or converting customers' securities;[24] making misrepresentations to customers or omitting to state material facts in connection with purchases and sales of securities;[25] and failing to keep required books and records,[26] or refusing to permit them to be examined by the Commission's representatives.[27] The Commission has also obtained judgments against a number of persons to enjoin them from engaging in business as brokers or dealers without being registered.[28]

A very important case from the standpoint of the relationship of the securities dealer and his customer was *Arleen W. Hughes* v. *S. E. C.*

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[19] See *S. E. C.* v. *Greene & Co.*, Civil No. 44C1252, N. D. Ill. Nov. 11, 1944; *S. E. C.* v. *Financial Service, Inc.*, Civil No. 253, S. D. Ind., Aug. 28, 1945; *S. E. C.* v. *Raymond, Bliss, Inc.*, Civil No. 5999, D. Mass., Sept. 12, 1947; and *S. E. C.* v. *H. P. Carver Corp.*, Civil No. 7860, D. Mass., Sept. 27, 1948, *Cf. S. E. C.* v. *Light, Wofsey & Benesch, Inc.*, Civil No. 3645, D. Md., April 7, 1948, where an injunction was entered for violation of the Commission's rule X-15C3-1, which prohibits a broker-dealer from permitting his aggregate indebtedness to exceed his net capital by more than 20 times.

[20] See *S. E. C.* v. *Greene & Co.*, supra; *S. E. C.* v. *Financial Service, Inc.*, supra; *S. E. C.* v. *Raymond, Bliss, Inc.*, supra; and *S. E. C.* v. *H. P. Carver Corp.*, supra.

[21] *S. E. C.* v. *Raymond, Bliss, Inc.*, supra.

[22] See *S. E. C.* v. *Bates*, Civil No. 213, N. D. Iowa, Mar. 7, 1946; *S. E. C.* v. *Atlas Investment Co.*, Civil No. 469, W. D. Mo., June 24, 1948. *S. E. C.* v. *Financial Service, Inc.*, supra; and *S. E. C.* v. *Fiscal Service Corp.*, Civil No. 47C408, N. D. Ill., Mar. 5, 1947.

[23] See *S. E. C.* v. *Rose*, Civil No. 1866, S. D. Ind., Apr. 13, 1949; *S. E. C.* v. *Greene & Co.*, supra; and *S. E. C.* v. *Bates*, supra.

[24] See *S. E. C.* v. *Walters & Co.*, Civil No. 1231, D. Del., July 6, 1949; *S. E. C.* v. *Greening*, Civil No. 1271, W. D. Wash., June 30, 1945; *S. E. C.* v. *Greene & Co.*, supra; *S. E. C.* v. *Fiscal Service Corp.*, supra; and *S. E. C.* v. *Raymond, Bliss, Inc.*, supra.

[25] See *S. E. C.* v. *Trapp*, Civil No. 1288, D. N. Dak., June 4, 1947; *S. E. C.* v. *Rose*, supra; *S. E. C.* v. *Bates*, supra; *S. E. C.* v. *Greene & Co.*, supra; *S. E. C.* v. *Fiscal Service Corp.*, supra; *S. E. C.* v. *Financial Service, Inc.*, supra; *S. E. C.* v. *Greening*, supra; and *S. E. C.* v. *Atlas Investment Co.*, supra.

[26] See *S. E. C.* v. *Sharkey*, Civil No. 1378, W. D. Wash., 1945; *S. E. C.* v. *Walters & Co.*, supra; and *S. E. C.* v. *Atlas Investment Co.*, supra.

[27] See *S. E. C.* v. *Nevada Oil Co.*, Civil No. 1142, N. D. Tex., Oct. 5, 1946 and Feb. 25, 1947; *S. E. C.* v. *Sharkey*, supra.

[28] See *S. E. C.* v. *Burmeister & Co., Inc.*, M. D. Tenn., June 27, 1947; *S. E. C.* v. *Kirby*, Civil No. 25742, N. D. Ohio, Apr. 28, 1949; *S. E. C.* v. *Bates*, supra; *S. E. C.* v. *Trapp*, supra; *S. E. C.* v. *Greening*, supra; *S. E. C.* v. *Fiscal Service Corp.*, supra; and *S. E. C.* v. *Atlas Investment Co.*, supra.

This case arose on a petition to the Court of Appeals for the District of Columbia to review an order of the Commission revoking the petitioner's registration as a broker-dealer. The Commission had held that it was fraud for Mrs. Hughes, who was registered both as a broker-dealer under the Securities Exchange Act of 1934 and as an investment adviser under the Investment Advisers Act of 1940, to sell her own securities to her investment advisory clients without fully disclosing that her interests were in some respects adverse to their interests. This disclosure, the Commission held, should have included the capacity in which she acted, i. e., whether as principal (dealer) or agent (broker), the cost of the securities to her, and the current market price of such securities. Another point raised on the appeal was whether it was lawful for the Commission to impose greater duties of disclosure on a broker-dealer who is also a registered investment adviser than would otherwise be the case. The Commission withheld the entry of its order of revocation for a reasonable time to permit Mrs. Hughes to correct her methods of doing business. Changes which she thereupon proposed were deemed inadequate as a matter of law, however, and the order of revocation was entered, from which the appeal was taken. The court of appeals sustained the Commission on all the points involved.[29]

Another case related to the revocation of the broker-dealer registration of Norris and Hirshberg, Inc., of Atlanta, Ga. The Commission found that the firm had engaged in activities which were illegal under the antifraud provisions of both the Securities Act of 1933 and the Securities Exchange Act of 1934. The firm had fixed prices for a group of securities whose market it controlled without disclosing that fact to customers, had dealt as a principal with uninformed customers and customers who had given it powers of attorney, and had traded excessively for accounts for which it had discretionary powers. The firm appealed the Commission's action to the Court of Appeals for the District of Columbia in 1946. Various procedural matters were litigated at length before the Court reached the case on its merits. The most significant of the procedural questions was an attempt by the petitioner to compel the Commission to include in the transcript of record a summary of the evidence which, it alleged, the Commission's independent staff of opinion writers had prepared for the use of the individual commissioners. The petitioners sought also to inquire into the decisional processes of the Commission to determine how various items in the record to which it objected had been treated by the Commission. The Court of Appeals denied these requests and an application by the petitioner to the Supreme Court for a writ of *certiorari* was also denied.[30] After hearing argument on the merits, the court affirmed the decision of the Commission, and pointed out that the statutes involved were not designed to require the Commission, in disciplining broker-dealers for fraudulent activities, to find every element of common law fraud.[31] This case was also the first court review of a Commission finding of manipulation

[29] 174 F. 2d 969 (C. A. D. C., May 9, 1949).
[30] *Norris & Hirshberg, Inc.* v. *S. E. C.*, 163 F. 2d 689 (C. A. D. C. 1947), *cert. den.*, 333 U. S. 867 (1948).
[31] *Ibid.*, 177 F. 2d 228 (C. A. D. C., September 6, 1949).

in the over-the-counter market as distinguished from the markets on the national securities exchanges.[32]

Two other cases initiated by the Commission during the past 5 years involved the manipulation of prices on securities exchanges. In *Thornton & Co.* v. *S. E. C.* the Commission revoked the firm's broker-dealer registration upon finding that it had violated the anti-manipulation provisions of section 9 (a) of the act in effecting "wash sales" in two stocks traded on the Chicago Stock Exchange, raising their prices and creating apparent trading activity, which was followed by sales of the stocks in the over-the-counter market at prices based on the false exchange market prices in violation of sections 10 (b) and 15 (c) (1) of the act. The Court of Appeals for the Second Circuit, on a petition for review, affirmed the Commission's order during the 1949 fiscal year.[33] In *S. E. C.* v. *Bennett and Federal Corp.* the Commission sought an injunction to restrain the defendants from manipulating the exchange market for a security while a registration statement was pending under the Securities Act of 1933 with respect to a proposed offering of a large block of the stock "at the market." [34] A preliminary injunction was denied, but Bennett thereafter consented to a permanent injunction against Federal Corporation (which he controlled) and the Commission concurred in the dismissal of the complaint against Bennett individually.

Acker v. *Schulte* and *Schmolka* v. *Schulte*, which did not involve broker-dealers, were actions under section 9 (a) of the act instituted by stockholders of Park and Tilford, Inc. against its former president for damages resulting from the alleged manipulation of the stock of the company on the New York Stock Exchange. These cases resulted in the first judicial construction of that clause of section 9 (e) which provides that the court may require an undertaking for the payment of costs from either party in a civil action by a person damaged as a result of a violation of section 9. The Commission, in its brief, argued as *amicus curiae* that in order to preclude the statutory provision from operating as a barrier to suits under section 9, 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 adopted this position.[35]

Another new development in the broker-dealer field during the past 5 years was a series of actions brought by the Commission alleging violation of regulation T, the regulation promulgated by the Board of Governors of the Federal Reserve System under section 7 (c) of the act for the purpose of preventing excessive use of credit in purchasing or carrying securities. The first cases of this category were three companion actions filed by the Commission in the United States District Court at Cleveland which involved firms in Youngstown and Cleveland, Ohio, Pittsburgh, and New York City, and several individuals and an investment company. Final judgments were entered against all the defendants.[36]

A significant case during the last 5 years in the field of oil and gas

[32] An appeal from a broker-dealer registration based on over-the-counter manipulation was also taken in *Lann* v *S. E. C.*, No. 9460, C. A. D. C., November 15, 1947, discussed at p. 63 of the 14th Annual Report. After the expiration of a year from the date of the revocation order the Commission permitted Lann to become registered in consideration of his record. The action was then dismissed by stipulation.

[33] 171 F. 2d 703 (C. A. 2, 1948).

[34] 62 F. Supp. 609 (S. D. N. Y. 1945) and S. D. N. Y., December 30, 1946.

[35] 74 F. Supp. 683 (S. D. N. Y. May 26, 1947). See 13 SEC Ann. Rep. 64 (1947).

[36] See 13 SEC Ann. Rep. 59 (1947) and *S. E. C.* v. *Schultz* at p. 60.

securities was *S. E. C.* v. *Trapp*, an injunction action brought against an individual who was selling oil royalties after the Commission had revoked his broker-dealer registration. In that case the district court in North Dakota entered an injunction which judicially established: (1) 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; and (2) that, as the Commission had held in an earlier administrative proceeding, it is fraudulent for a dealer to sell oil royalties at prices bearing no reasonable relationship to his contemporaneous cost. Such practices were held to be in violation of section 15 (c) (1) of the Securities Exchange Act and sections 17 (a) (2) and (3) of the Securities Act of 1933.[37]

Among the frauds uncovered in the course of the Commission's routine inspection of broker-dealers' books and records was that enjoined in *S. E. C.* v. *Caplan, Junger, Anderson & Co.*[38] The following scheme was employed by the defendants: The securities trader for a large investment company would advise accomplices in brokerage offices in advance when the company was about to make substantial purchases and sales of securities. On purchases, the accomplices would use dummy accounts to buy up the securities in question and as a result would be in a position to resell them to the investment company at higher prices when it sought to make its purchases; on sales, reverse steps were taken. Through this scheme, which was operated without the knowledge of the investment company, the individuals involved profited to the extent of approximately $300,000 from trading profits and commissions.

Cases Based on Section 16 (b) of the Act

The past 5 years have seen the emergence of section 16 (b) of the Securities Exchange Act as an important protection to the small stockholder against trading abuses by corporate insiders. Under that section a stockholder of a corporation may sue in its behalf to recover profits made by insiders as a result of short-term trading in that corporation's equity securities. Until the decision in *Smolowe* v. *Delendo Corporation*[39] the constitutionality of section 16 (b) was undetermined. That case not only upheld the constitutionality of the section but provided as a touchstone for the solution of problems of construction of the section the determination whether all "tendency to evil" would be removed. Most of the litigation arising under section 16 (b) has been resolved in accordance with that criterion.

Although the Commission is not responsible for the enforcement of section 16 (b), it has participated as *amicus curiae*, either at the request of the court or on its own initiative, in actions involving important questions of interpretation of the section. Thus, in *Park & Tilford, Inc.* v. *Schulte*[40] it urged upon the court the necessity for construing the act to prevent holders of convertible preferred stock from profiting from inside information by converting their stock into

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[37] Civil No. 1288, D. N. Dak., June 4, 1947, *Cf. S. E. C.* v. *LeDone*, Civil No. 40-347, S. D. N. Y., March 26, 1947. A criminal action based on these theories of fraud is *U. S.* v. *Grayson*, discussed herein under "Criminal Proceedings."

[38] Civil No. 49-138, S. D. N. Y., May 3, 10, and 17, 1949.

[39] 136 F. 2d 231 (C. A. 2, 1943), *cert. den.*, 320 U. S. 751.

[40] 160 F. 2d 984 (C. A. 2, 1947), *cert. den.*, 332 U. S. 761.

common stock prior to an expected rise in the market and thereafter selling the common stock after the anticipated rise took place. The question before the court was phrased in terms of whether the conversion of preferred stock into common stock by a controlling stockholder was a "purchase" within the meaning of section 16 (b). The court held that it was a purchase, and over $400,000 was paid to the corporation as profits realized from the trading.

In one case the court asked the Commission whether it considered stock disposed of by gift to constitute a "sale" within the meaning of section 16 (b). The Commission, in a letter, expressed the view that Congress did intend to include gifts within the scope of section 16 (b), but that no profit would be recoverable unless the stock were subsequently sold by the donee at a price higher than that which the donor had paid for the stock. The court did not adopt the reasoning of the Commission and held that the gift was not a sale.[41]

On several occasions, participation by the Commission in actions under section 16 (b) has been necessary in order to clarify the construction of other sections of the act challenged by one of the parties in the action. Thus, it has urged that section 27 of the act should be construed to give the federal courts exclusive jurisdiction over all actions arising under the Securities Exchange Act and to urge that the venue provisions be broadly construed, permitting section 16 (b) actions to be brought wherever the transactions occurred. In these respects the construction advanced by the Commission has been adopted by the courts.[42]

The information upon which private actions under section 16 (b) are based as a rule comes from the reports of changes in ownership which corporate insiders are required to file with the Commission under section 16 (a). During the last 5 years the Commission for the first time had to resort to its authority under section 21 (f) to obtain mandatory injunctions to enforce compliance with the reporting requirements of section 16 (a).[43] These cases also constituted the first actions brought to enjoin violations of section 20 (c), which section makes it unlawful for corporate insiders to hinder the corporations' filing of reports regarding changes in their holdings.

The Commission has also appeared in a section 16 (b) action, where section 16 (a) reports had not been filed within the specified time, to support the right of a stockholder to sue more than 2 years after the profits were realized by the insider even though the statute provides that the cause of action is barred after 2 years. The Commission successfully contended that the Congress did not intend that the statute of limitations begin to run until the insider has disclosed his profits, and, since the suit was brought within 2 years after the disclosure had been made in that case, that the action had been instituted in time.[44]

[41] *Truncale* v. *Blumberg*, 80 F. Supp. 387 (S. D. N. Y. 1948).

[42] *American Distilling Co.* v. *Brown*, 184 Misc. 431, 51 N. Y. S. (2d) 614 (Sup. Ct. 1944); *Grossman* v. *Young*, 70 F. Supp. 970 (S. D. N. Y. 1947); *Gratz* v. *Claughton*, CCH Fed. Sec. L. Rep. Par. 90,373 (S. D. N. Y. 1947).

[43] *S. E. C.* v. *L. A. Young, et al.*, E. D. Mich., February 26, 1945; *S. E. C.* v. *Metropolitan Mines Corp., Ltd.*, Civil No. 664, E. D. Wash., July 18, 1947.

[44] *Grossman* v. *Young*, 72 F. Supp. 375 (S. D. N. Y. 1947).

Cases Based on the Anti-fraud Provisions of Rule X–10B–5

In 1942 the Commission adopted rule X–10B–5, which implements section 10 of the Securities Exchange Act by prohibiting fraud in the purchase or sale of securities. During the past 5 years this rule has been the subject of frequent construction by the courts both in actions instituted by the Commission and in private civil actions, in a number of which the Commission participated as *amicus curiae*. The most frequent situation in which the rule has been invoked has been that in which controlling stockholders or the management of an issuer sought to take advantage of smaller stockholders by purchasing their securities from them while suppressing pertinent information concerning the corporation's business, the market value of its securities, or other vital information.

Wherever feasible the Commission has sought to restrain such fraudulent transactions before full consummation, to curtail injury to minority stockholders, and in some instances this has resulted in agreement by the wrongdoing insiders to rescind the transactions.[45] Nevertheless, in many cases the transactions are consummated before discovery by the Commission.[46]

One injunction obtained by the Commission during the 1949 fiscal year involved an unusual scheme which operated as a fraud on brokers and dealers.[47] The defendant entered orders for purchases and sales with various brokers and dealers with no intention either to pay for the securities ordered to be purchased or to deliver the securities ordered to be sold. If, on purchase orders, the securities increased in value before the settlement date he would order them sold and demand the profit; otherwise he would default. On sale orders, he would do the opposite. As a result, losses were incurred by the brokers and dealers on the defaulted transactions.

A significant private action during the period involving rule X–10B–5 was that of *Kardon* v. *National Gypsum Co.*, in which the Commission participated as *amicus curiae*.[48] The Commission filed a brief in which it argued that there is an individual right of action for damages resulting from a violation of rule X–10B–5, (1) on the basis of the general common law rule that members of a class for whose protection a statutory duty is created may sue for injury resulting from its breach and that the common law will supply a remedy if the statute gives none, or, (2) under section 29 (b) of the act, which provides that contracts in violation of the act shall be void. The Commission argued also that Congress intended that section 10 of the act apply to the securities of a small, closely held corporation, as well as to those of large corporations whose securities are widely held. The district court

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[45] See *S. E. C.* v. *Mueller*, Civil No. 2022, E. D. Wis., April 20, 1945; *S. E. C.* v. *Oils and Industries, Inc.* Civil No. 27–450, S. D. N. Y., April 4, 1945; and *S. E. C.* v. *Greenfield*, Civil No. 5361, E. D. Pa., April 2, 1946.

[46] See *S. E. C.* v. *Boyd Transfer & Storage Co.*, Civil No. 1548, D. Minn., December 5, 1945; *S. E. C.* v. *Gentile*, Civil No. 34–700, S. D. N. Y., January 30, 1946; *S. E. C.* v. *Cohen*, Civil No. 5461, E. D. Pa., December 11, 1945; *S. E. C.* v. *Mitchell*, Civil No. 23097, N. D. Ohio, August 6, 1945; and *S. E. C.* v. *Standard Oil of Kansas*, Civil No. 2552, S. D. Tex., February 26, 1947.

[47] *S. E. C.* v. *Landberg*, S. D. N. Y., February 4, 1949.

[48] 69 F. Supp. 512 (E. D. Pa. 1946) and 73 F. Supp. 798 (E. D. Pa. 1947).

adopted the positions taken by the Commission, and the *Kardon* decision has since been followed in a number of private actions.[49]

Another private fraud action based on this rule is the pending case of *Speed* v. *Transamerica Corp.*[50] In connection with a motion for summary judgment the Commission urged that there is a violation of the rule when a controlling stockholder buys stock from minority holders without disclosing to them material facts affecting the value of the stock (here the greatly augmented value of the corporation's principal asset, its tobacco inventory).

Cases Based on Regulation X-14—The Proxy Rules

The second substantial group of cases based on rules of the Commission are those involving regulation X-14, which prescribes rules concerning the solicitation of proxies, consents, and authorizations in connection with securities of companies subject either to the Securities Exchange Act, the Investment Company Act of 1940, or the Public Utility Holding Company Act of 1935. While several questions of construction of the regulations were brought to the courts before the period under review, a number of important questions have been adjudicated during the past few years. One was the principle established in *Okin* v. *S. E. C.*[51] that the proxy rules apply to a letter which is written as the first step in a plan ending in a solicitation and which prepares the way for its success, even though the letter itself does not request proxies. This principle was also applied during the current year in *S. E. C. v. Topping.*[52] In another case the principle was established that the Commission can obtain an injunction to restrain the use of proxies obtained in violation of the proxy rules.[53]

An especially significant proxy case during the period was that of *S. E. C.* v. *Transamerica Corp.*, an action brought by the Commission to compel the defendant corporation to resolicit proxies originally obtained as a result of solicitations which failed to include proposals which a minority stockholder sought to have brought before the annual meeting. It was ultimately held by the Court of Appeals for the Third Circuit that the management's attempt to block the stockholder's proposals by declining to include them in the notice of meeting was contrary to the purpose of Congress in the Securities Exchange Act to prevent the control of corporations by a very few persons.[54]

The question whether a stockholder, rather than the Commission, may bring an action for an injunction based on violation of the proxy rules was raised in *Phillips* v. *The United Corporation.* The Commission filed a brief as *amicus curiae* taking the position that the court had jurisdiction to entertain such an action founded upon alleged violations of the Commission's proxy rules promulgated under the

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[49] *Slavin* v. *Germantown Fire Insurance Co.*, Civil No. 6564, E. D. Pa., December 5, 1946; *Fifty Third Union Trust Co.* v. *Block*, Civil No. 1507, S. D. Ohio, December 11, 1946; and *Fry* v. *Schumacher*, Civil No. 6418, E. D. Pa., January 10, 1947; *Montague* v. *Electronic Corporation of America*, S. D. N. Y., February 14, 1948; *Rosenberg* v. *Globe Aircraft Corp.*, E. D. Pa., January 17, 1948 *Osborne* v. *Mallory*, S. D. N. Y., July 13, 1949; *Hawkins* v. *Clayton Securities Corp.*, 81 F. Supp. 1014 (D. Mass., 1949); *Appel* v. *Levine*, S. D. N. Y., November 11, 1948; *Acker* v. *Schulte*, 74 F. Supp. 683 (S. D. N. Y. 1947); *Speed* v. *Transamerica*, 67 F. Supp. 326 (D. Del. 1946); and *Grand Lodge of International Association of Machinists* v. *Highfield*, Civil No. 3661-48, January 24, 1949.

[50] 71 F. Supp. 457 (D. Del. 1947).

[51] 132 F. 2d 784, 786 (C. A. 2, 1943).

[52] 85 F. Supp. 63 (S. D. N. Y., May 24, 1949).

[53] *S. E. C.* v. *Okin*, 58 Fed. Supp. 20 (S. D. N. Y. 1944). *Cf. S. E. C.* v. *McQuistion*, Civil No. 41-47, S. D. N. Y., May 16, 1947; and *S. E. C.* v. *Metropolitan Mines Corp., Ltd.*, Civil No. 664, E. D. Wash., July 18, 1947.

[54] 163 F. 2d 511 (C. A. 3, 1947), *cert. den.* 332 U. S. 847 (1948). See 14 SEC Ann. Rep. 53-4 (1948).

Public Utility Holding Company Act of 1935, but that in the light of the Commission's primary responsibility for the enforcement of its rules any injunction action it might bring should take precedence and an injunction action by a stockholder should not be entertained unless he had exhausted his administrative remedy by first bringing his complaint to the Commission. The court accepted this construction of the act.[55] Another action involving the Commission's proxy rules under the Public Utility Holding Company Act of 1935, *North American Utility Securities Corporation* v. *Posen,* is discussed elsewhere in this report in the section on litigation under that statute.

The position of the Commission was sustained in a number of additional actions on the proxy rules during the last 5 years. In one of these the Commission argued that a proxy statement is not false or misleading simply because it fails to state all possible alternatives to a course of action for which the management seeks approval.[56] In another, the New York Supreme Court sustained the Commission's contention that a proxy solicitation was defective when it did not disclose that the directors elected had agreed prior to the solicitation to resign in favor of another slate of candidates.[57]

THE KAISER-FRAZER INVESTIGATION AND THE LITIGATION WITH OTIS & CO.

One of the most extensive litigations in the history of the Commission, from the standpoint of sheer number of court proceedings involved, has been the litigation with Otis & Co. arising out of an investigation of a stock offering of Kaiser-Fraser Corp.

During February of 1948, a public offering of some 1,500,000 shares of common stock of Kaiser-Frazer Corp. was withdrawn after Kaiser-Frazer had expended about $2,500,000 in an unsuccessful effort to stabilize the market. By the terms of the underwriting contract, the 3 underwriters who were participants in the offering had agreed to take 900,000 of the shares outright and the rest on a "best efforts" basis. One of the conditions of the contract was that there should be no material litigation pending against Kaiser-Frazer as of 10 a. m. on February 9, which was the settlement date under the contract. Shortly before 10 a. m. on February 9—several days after the withdrawal of the offering—one James F. Masterson, a Kaiser-Frazer stockholder and Philadelphia attorney, filed a lawsuit in Detroit charging mismanagement on the part of the officers and directors of Kaiser-Frazer and demanding, among other things, an injunction against the sale of the stock. On the basis, at least in part, of this lawsuit, two of the underwriters—Otis & Co. and First California Corp.—refused to go through with the contract.

Thereafter the Commission instituted a private investigation, and soon a public investigation, into the general subject of the Kaiser-Frazer stock offering. The purpose of the public investigation, as set forth in the Commission's order, was to determine whether there had been any violations of the securities acts and whether there was any basis for the formulation of new rules by the Commission or for the recommendation of new legislation to the Congress. During the

[55] See 14 SEC Ann. Rep. 55 (1948).
[56] *Doyle* v. *Milton,* 73 F. Supp. 281 (S. D. N. Y. 1947).
[57] *Wyatt* v. *Armstrong,* 59 N. Y. S. (2d) 502 (N. Y. Sup. Ct., 1945).

spring and summer of 1948 hearings were held in various cities during which some 5,000 pages of testimony were taken and numerous exhibits introduced.

One of the first lawsuits filed was instituted in the United States District Court for the Southern District of Ohio by Portsmouth Steel Corp. (the chairman of the board of this corporation is Cyrus S. Eaton, who is also controlling stockholder of Otis & Co.) in an attempt to enjoin The Ohio Consolidated Telephone Co. from complying with a Commission subpoena directing the production of certain long-distance telephone slips. The Commission intervened, and after the service of an amended subpoena the complaint was dismissed.[58]

Another action was instituted at about the same time, this one by the Commission, when two Cleveland attorneys named Harrison and Hull, who were shown during the investigation to have inquired about the Masterson suit at the courthouse in Detroit before the suit was filed refused to identify their client on the ground of the attorney-client privilege. When the United States District Court for the Eastern District of Michigan indicated it would enter an order against the attorneys unless they testified,[59] they revealed that their client was Eaton.

In subsequent hearings in Washington, however, Harrison and Hull declined to divulge their actual communications with Eaton, again on the ground of the attorney-client privilege. The Commission instructed its presiding officer at the investigation to rule that the privilege was unavailable because the evidence theretofore adduced during the investigation showed *prima facie* that the attorneys had been retained for a fraudulent purpose. Upon the continued refusal of Harrison and Hull to testify, the Commission applied to the United States District Court for the District of Columbia for an order compelling their testimony. The entire record of the investigation to date was introduced as an exhibit. Otis & Co. and Eaton intervened in this proceeding, without objection by the Commission, and filed a counterclaim in which they demanded that the Commission be enjoined from continuing with its public investigation. Judge Morris of the District Court dismissed the counterclaim, but also denied the enforcement order sought by the Commission on the ground that the record of the investigation did not show *prima facie* that the Masterson suit had been inspired by Eaton.[60] In his opinion Judge Morris emphasized that, in the absence of cross-examination in the record of the investigation, he had subjected the record "to the strictest scrutiny for possible ambiguity and equivocation."[61] No appeal from this decision was taken by either side.

On August 11, 1948, while Judge Morris still had the subpoena case under consideration, the Commission instituted a proceeding under sections 15 (b) and 15A (l) (2) of the Securities Exchange Act to determine whether the registration of Otis & Co. as a broker-dealer should be revoked and whether the firm should be suspended or expelled from the National Association of Securities Dealers for possible violations of the securities acts. Thereupon Otis & Co., arguing that the Commission proceeding would interfere with the

[58] *Portsmouth Steel Corporation* v. *Ohio Consolidated Telephone Company* (No. 1892, S. D. Ohio, 1948).
[59] *SEC* v. *Harrison* (No. 7332, E. D. Mich., 1948).
[60] *SEC* v. *Harrison*, 80 F. Supp. 226 (D. D. C., 1948).
[61] *Ibid.*, at p. 232.

jurisdiction of the District Court in the pending subpoena action, obtained from Judge Letts of the United States District Court for the District of Columbia a temporary injunction restraining the Commission from conducting the revocation proceeding pending Judge Morris' decision in the subpoena case.[62]

When Judge Morris refused to compel Harrison and Hull to testify, the Commission decided to pursue the revocation proceeding—in which its final order, if adverse to Otis & Co., would be subject to judicial review in an appropriate court of appeals—rather than to appeal Judge Morris' ruling. Thereupon Otis & Co. and Eaton instituted a new action in the District Court for the District of Columbia to enjoin the holding of this proceeding to the extent that it might be concerned with the filing of the Masterson suit, on the ground that the decision in the subpoena case was *res judicata* on this question. This new action also came before Judge Morris, who, on November 12, 1948, dismissed the complaint from the bench.[63] On the same day Otis & Co. appealed to the Court of Appeals for the District of Columbia Circuit and obtained from that court an injunction against the Commission's proceeding pending the outcome of the appeal.

On June 1, 1949, the Court of Appeals held that, because the complaint alleged that the Commission had no evidence that had not already been considered by Judge Morris, and because this allegation was admitted for purposes of the Commission's motion to dismiss the complaint, the doctrine of *res judicata* was applicable. Accordingly, the case was remanded with instructions that the injunction be granted unless the Commission should deny the allegation that no new evidence would be introduced at the hearing.[64] On August 9, 1949, the Solicitor General, on behalf of the Commission, filed a petition for a writ of *certiorari* in the Supreme Court, and Otis & Co. filed a brief in opposition in due course. On October 17, 1949, the Supreme Court took the unusual step of rendering a *per curiam* decision [65] in which it granted the petition for a writ of *certiorari* and at the same time reversed the judgment of the Court of Appeals, on the authority of *Myers* v. *Bethlehem Shipbuilding Corporation*, 303 U. S. 41 (1938), and similar cases.

Concurrently there had been in progress considerable litigation in which the Commission and the National Association of Securities Dealers, Inc. (NASD) had been joined as defendants. The NASD is an association of securities dealers registered under provisions of the Securities Exchange Act designed to promote just and equitable principles of trade in the securities industry. The Cleveland District Business Conduct Committee of the association, of which Otis & Co. is a member, had instituted its own investigation of the circumstances surrounding the Kaiser-Frazer stock offering shortly after the failure of the offering, and had demanded that Otis & Co. and Eaton disclose the communications between Eaton and his attorneys concerning the Masterson suit.

[62] *SEC* v. *Harrison* (No. 2617-48, D. D. C., 1948). The Commission appealed this injunction to the United States Court of Appeals for the District of Columbia Circuit, but Judge Morris' decision in the subpoena case of a few weeks later rendered the appeal moot. A motion by the Commission that the judgment of the District Court be vacated as moot has been resisted by the appellees and has not yet been passed upon by the Court. *SEC* v. *Harrison* (No. 10,043, C. A. D. C.).

[63] *Otis & Co.* v. *SEC* (No. 4613-48, D. D. C.).

[64] *Otis & Co.* v. *S. E. C.*, 176 F. 2d 34 (C. A. D. C.).

[65] — U. S. — (No. 244, October Term, 1949).

After this demand was refused, the NASD's district issued a complaint charging Otis & Co., Eaton and William R. Daley, president of Otis & Co. (the individual respondents in their capacity as representatives of Otis & Co. registered with the NASD) with violation of a rule of the NASD which provides that refusal of a member or registered representative to submit any required reports with regard to a matter under investigation shall of itself be sufficient cause for suspending or cancelling membership.

At this point Otis & Co. and Eaton, instead of filing an answer to this complaint, went to the United States District Court for the District of Columbia, where the Commission's subpena-enforcing action was pending before Judge Morris, and obtained from Judge Keech and Judge Letts of that court, respectively, a restraining order and a preliminary injunction making the NASD a party to the subpena action for the purpose of restraining it from attempting to obtain such communication. The subsequent decision of Judge Morris automatically terminated this injunction. A hearing on the complaint followed, after which the district committee ordered the respondents suspended for a period of 2 years, unless they should furnish the desired information sooner.

Otis & Co., Eaton, and Daley thereupon instituted a new action in the District Court for the District of Columbia, the third in that court. In this action they sought to compel vacation of the district committee's suspension order and to enjoin the NASD and the Commission from taking any action to compel the disclosure of the communications in question, again on the ground that the decision of Judge Morris in the subpena action had rendered the subject matter *res judicata*. The Commission was joined as a defendant on the theory that it had conspired with the NASD. The Commission and the NASD separately moved to dismiss this new complaint on the ground that the plaintiffs had not followed the procedure for review of NASD disciplinary proceedings which is specifically set forth in the Securities Exchange Act and in the NASD rules adopted thereunder. Under the act and the NASD rules any person disciplined by a district committee of the NASD may appeal to the board of governors of the NASD, thence to the Commission, and thence to the appropriate court of appeals. There are provisions for automatic stays of the district committee's action pending review by the board of governors and the Commission and a further stay may be sought from the court of appeals pending judicial review of the Commission's final order, if any. Thus, the Commission and the NASD contended, the plaintiffs would remain in good standing in the NASD pending a final determination by the proper court of appeals, but they could not short-circuit the statutory method of review by seeking an injunction in the district court.

The plaintiffs obtained postponement of the argument on the motion to dismiss, and in the meantime took depositions on the merits of the case over the opposition of the Commission and the NASD and obtained a temporary restraining order against certain alleged "publicity" on the part of the NASD.[66] The motion to

[66] *Otis & Co.* v. *NASD* (No. 329-49, D D. C., 1949).

dismiss finally came before Judge Morris, who granted it on June 6, 1949 (distinguishing the earlier opinion of the court of appeals in *Otis & Co.* v. *SEC*),[67] and reaffirmed his decision after reargument on July 11, 1949.[68] The plaintiffs appealed to the Court of Appeals for the District of Columbia Circuit and sought an injunction pending the outcome of this appeal, which was denied from the bench, one judge dissenting, on September 7, 1949.[69] Subsequently, a motion for reargument was denied and the court ordered that the argument on the merits be expedited. It was at this juncture that the Supreme Court rendered its decision in *S. E. C.* v. *Otis & Co.*, discussed above.

An aftermath of the failure of the Kaiser-Frazer stock offering was the institution of an action for damages by Kaiser-Frazer Corp. against Otis & Co.,[70] as well as the filing of a number of stockholders' derivative actions against the officers and directors of Kaiser-Frazer Corp. on the basis of alleged improprieties in connection with the attempted market stabilization and on other charges of misconduct.[71] In one of these cases the Commission submitted its views as *amicus curiae* on the construction of various provisions of the Securities Exchange Act, including the provisions relating to manipulation and stabilization.[72]

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[67] *Otis & Co.* v. *NASD*, 84 F. Supp. 395.
[68] *Otis & Co.* v. *NASD* (No. 329-49, D. D. C.).
[69] *Otis & Co.* v. *NASD* (No. 10,397, C. A. D. C.).
[70] *Kaiser-Frazer Corporation* v. *Otis & Co.* (Civil No. 45-564, S. D. N. Y.). Otis & Co. also filed counterclaims and cross-claims in the Masterson suit, which has been removed to the United States District Court for the Eastern District of Michigan.
[71] *Stella* v. *Kaiser* (Civil No. 45-750, S. D. N. Y.); *Pergament* v. *Frazer* (Civil No. 7354, E. D. Mich); *Fleming* v. *Kaiser* (No. 377,779, Calif. Super. Ct.).
[72] See *Stella* v. *Kaiser*, 82 F. Supp. 301 (S. D. N. Y. 1948).

PART III

ADMINISTRATION OF THE PUBLIC UTILITY HOLDING COMPANY ACT OF 1935

The Public Utility Holding Company Act of 1935 was passed by the Seventy-fourth Congress following an investigation by the Federal Trade Commission. The Federal Trade Commission's investigation, considered by many one of the most extensive ever made, disclosed a variety of abuses in public-utility holding company finance and operations. The more significant of these abuses are enumerated in section 1 (b) of the act: (1) Inadequate disclosure to investors of the information necessary to appraise the financial position and earning power of the companies whose securities they purchase; (2) the issuance of securities against fictitious and unsound values; (3) the over-loading of the operating companies with debt and fixed charges thus tending to prevent voluntary rate reductions; (4) the imposition of excessive charges upon operating companies for various services such as management, supervision of construction and the purchase of supplies and equipment; (5) the control by holding companies of the accounting practices and rate, dividend and other policies of their operating subsidiaries so as to complicate or obstruct State regulation; (6) the control of subsidiary holding companies and operating companies through disproportionately small investment; (7) the extension of holding company systems without relation to economy of operations or to the integration and coordination of related properties.

The jurisdiction of the statute embraces public-utility holding company systems which are engaged in the electric utility business or in the retail distribution of natural or manufactured gas. Fundamentally the regulatory provisions of the act fall into two basic categories. The first deals with supervision of the financing and operations of holding company systems. These regulations, however, are carefully designed not to conflict with, but to supplement and strengthen local regulation. Thus, the jurisdiction of the act does not extend to local rate making and does not authorize the Commission to prescribe accounting systems for operating subsidiaries, except in a comparatively few instances where there are neither State nor other Federal laws prescribing such accounting systems. The second area of regulatory jurisdiction under the act provides for the geographical integration and corporate simplification of holding company systems.

THE PUBLIC UTILITY INDUSTRY UNDER THE ACT

The properties subject to the statute at this time represent an important segment of the electric and gas industry of the United States, despite the divestment under section 11 of several hundred companies during the past 14 years. On June 30, 1949, there were registered with the Commission 46 holding company systems with aggregate consolidated system assets of approximately $14,263,000,000. These systems included 46 top holding companies, 26 subholding

companies, 274 electric and gas utility companies and 296 nonutility companies. This made a total of 642 companies subject to the statute on that date. At the close of the preceding fiscal year there were 46 registered public-utility holding company systems comprising 46 top holding companies, 27 holding companies, 309 electric and gas utility companies and 323 nonutility companies or a total of 705 companies with total system assets of $14,680,000,000.[1] The decrease in assets of some $417,000,000 represents for the most part the difference between additions, due primarily to plant expansion, on the one hand, and the divestment during the year of nonretainable companies and properties, on the other. Viewed from the standpoint of the electric utility industry alone, it may be noted that of the 315 class A and class B electric utility companies [2] in operation on December 31, 1948, with aggregate assets of $17,347,000,000, 146 companies with assets of $7,106,000,000 are presently subject to the Holding Company Act. Ninety-eight companies with assets of $6,188,000,000 were formerly subject to the Holding Company Act, but are no longer under the Commission's jurisdiction as a result of divestment under section 11. Seventy-one of the 315 companies with assets aggregating $4,053,000,000 have never been subject to the Holding Company Act.

REGULATION OF FINANCING AND OPERATIONS OF HOLDING COMPANY SYSTEMS

Fourteen of the 33 sections of the act deal specifically with the regulation of finances and operations of the holding company systems. These provisions cover a wide range of activities and they are geared to correction of the abuses enumerated by the Congress in section 1 (b) of the act.

Registration of Holding Companies

Sections 4 and 5 require that holding company systems register with the Commission and file periodic reports containing detailed data with respect to their organization, financial structure, and operations. This provides a background of necessary information for supervision of specific transactions under other sections of the act and enables the Commission to keep abreast of significant trends and developments in that segment of the utility industry which is subject to the act. When a holding company registers with the Commission it files a basic "registration statement." Each year thereafter "annual supplements" are filed setting forth important changes during the year. In the twelve months ended June 30, 1949, 91 "annual supplements" were filed and examined by the staff of the Commission.

It is necessary to take appropriate steps for registration of a holding company under section 5 before jurisdiction can be exercised over the company under other sections of the act.

Exemption from the Act

Holding companies and subsidiaries which are able to comply with certain standards of the act may be released from the Commission's jurisdiction. Under section 3 if a holding company system is pre-

[1] The data on assets subject to the act as represented in previous annual reports have been revised during the past year. The figures shown above are on a comparable basis.
[2] As classified by the Federal Power Commission.

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dominantly intrastate in character, it may be exempted from the obligations of the statute. The same applies to systems where the holding company itself is predominantly an intrastate operating utility company, or is only incidently or only temporarily a holding company. Likewise, a holding company which derives no material part of its income from sources within the United States may be exempted from the statute. In section 2 the mechanics are established whereby the Commission, upon application, may declare that a company is not an "electric utility company" under section 3 (a) (3), not a "gas utility company" under section 3 (a) (4), not a "holding company" under section 3 (a) (7) or not a subsidiary of a holding company under section 3 (a) (8). Actions under these sections are in the nature of declarations of status and have the effect of releasing the applicant companies from the obligations of the act. Under section 5 (d) a company registered as a holding company with the Commission may, after it ceases in fact to be a holding company, have its registration terminated by order of the Commission.

During the 14 years of the Commission's administration of the statute, 637 applications for exemption under section 3, declarations for status under section 2 and applications for termination of registration under section 5 (d) have been filed with the Commission. Of this number 200 have been granted, 349 have been withdrawn or dismissed and 53 have been denied. As of June 30, 1949, 35 cases were pending. Beginning about 1940 a substantial number of these applications were allowed to continue in pending status for indefinite periods awaiting the outcome of reorganization plans under section 11, the consummation of which subsequently operated to render the exemption questions moot. Sections 2 and 3 expressly provide that the applicant shall be exempt from the obligations of the act during pendency of the application before the Commission. This policy resulted in substantial savings of expense on the part of both the Commission and the applicant companies, and accounts for the comparatively large number of applications withdrawn or dismissed during the period.

Acquisitions

Under sections 9 and 10 the acquisition of securities and utility assets by holding companies and their subsidiaries may not be authorized by the Commission unless the following standards are met: (1) the acquisition must not tend toward interlocking relations or concentration of control to an extent detrimental to the public interest or the interest of investors or consumers; (2) any consideration paid for the acquisition, including fees, commissions, and other remuneration, must not be unreasonable; (3) the acquisition must not complicate the capital structure or holding company system; (4) the acquisition must not be otherwise detrimental to the public interest or the interest of investors or consumers, or to the proper functioning of the holding company system; (5) the acquisition must tend toward the economic and efficient development of an integrated public-utility system.

The bulk of operations under sections 9 and 10 are represented by determination of questions arising under clauses (1), (2), and (3) of section 10 (a). During the 14 years of the Commission's adminis-

tration of the act 1,625 questions under this section have been determined. Applications were granted with respect to 1,452 of the matters presented, 159 were withdrawn or dismissed and 14 denied. During the fiscal year applications raising 203 questions under this section were filed. Applications with respect to 160 were approved and 73 matters were still pending determination on June 30, 1949. For the most part these transactions are represented by holding company acquisitions of the securities of their subsidiaries in connection with financing and reorganizations.

Transactions within Holding Company Systems

Section 12 of the act extends Commission jurisdiction to a wide variety of activities. It covers regulation of dividend payments, intercompany loans and the solicitation of proxies, authorizations, and consents. It also covers sales by one company of its holdings of the securities of other companies, sales of utility assets, capital contributions, the acquisitions by companies of their own securities and various transactions between affiliates. In this section "upstream" loans from subsidiaries to their parents and "upstream" or "cross-stream" loans from public utility companies to any holding company in the same holding company system are expressly forbidden. Prior to passage of the act these loans and other intrasystem transactions resulted in widespread abuses in holding company systems. Activities of this character, moreover, were entirely beyond the scope of local and State regulation.

Since passage of the act 3,825 questions under paragraphs (b), (c), (d), and (f) of section 12 have been determined. Of this number 3,537 were decided in favor of the declarant companies, 247 were withdrawn or dismissed and 41 were denied. During the past fiscal year 388 questions of this character were presented in declarations filed with the Commission. Declarations raising 294 questions were approved, 4 dismissed and 1 denied. Two hundred and seventeen matters under these sections were pending June 30, 1949.

Servicing Operations

As noted above one of the principal abuses of holding company systems which is expressly described in section 1 (b) of the act was the loading of excessive service charges by holding companies, or their controlled service companies, upon the operating utility subsidiaries. Prior to passage of the act this problem imposed a very burdensome task upon state commissions in their endeavors to analyze the operating expenses of local utilities in rate-making proceedings. The solution of this question was specifically provided in section 13. The act expressly forbids holding companies to render services to their subsidiaries for a charge, and it requires that all services performed for any company in a holding company system by a mutual or subsidiary service company in that system be rendered at cost fairly and equitably allocated.

During the 14-year span of the administration of the act 77 proposals for servicing arrangements in holding company systems pursuant to section 13 have been presented to the Commission for consideration. Fifty-two were approved, 1 was denied, 12 were either withdrawn or dismissed and 12 were pending on June 30, 1949. Actions upon proposals for servicing arrangements, however, constitute only a

part of the mechanism for regulation of service charges. Every servicing company in a registered holding company system must file with the Commission a comprehensive annual report of activities. These reports are examined by the Commission's staff in order to detect any irregularities. During the past fiscal year 49 of these reports were filed. This device plus the statutory power of the Commission to reopen any proceeding in which servicing arrangements were approved has been successful in preventing a recurrence of the abuses described in section 1 (b) of the act.

Issues of Securities, Assumptions of Liability, and Alterations of Rights

The issue and sale of securities by holding companies and their subsidiaries are regulated under sections 6 and 7 of the act. Assumptions of liability on securities and alterations of rights of security holders are covered by section 7. The tests which a proposed security issue, assumption of liability or alteration of rights must meet are set forth in section 7: (1) The security must be reasonably adapted to the security structure of the issuer and of other companies in the same holding company system; (2) the security must be reasonably adapted to the earning power of the company; (3) the proposed issue must be necessary and appropriate to the economical and efficient operation of the company's business; (4) the fees, commissions and other remuneration paid in connection with the issue must not be unreasonable; (5) the terms and conditions of the issue or sale of the security must not be detrimental to the public interest or the interest of investors or consumers.

During the fiscal year 372 applications and declarations covering issues of securities under sections 6 and 7 and assumptions of liability and alterations of rights under section 7 were filed with the Commission. Action was completed in 317 cases, all of which were approved. From the date of passage of the act to June 30, 1949, 2,260 applications were approved, 150 withdrawn or dismissed and 16 denied. These actions dealt both with securities issued for financing purposes and with securities issued in connection with reorganizations of holding company systems under section 11.

The most important aspect of the administration of sections 6 and 7 in recent years has been the financing of an unprecedented expansion program for the electric and gas utility industries. It is estimated that construction expenditures approached $2,300,000,000 during the past fiscal year, exclusive of natural gas pipe lines. Of this total, more than 80 percent is represented by growth of the electric utilities. The rate of increase in electric energy sales in 1949 has slowed down somewhat, although that output has remained consistently above the levels of 1948, which suggests that construction expenditures are likely to continue at a very high level for many months to come. To provide the necessary funds for this tremendous expansion the industry maintained the heavy financing program in evidence last year. This is demonstrated by the following tabulation showing security sales for cash plus exchanges for refunding purposes for the fiscal years 1948 and 1949.

Total security issues sold for cash and issued in exchange for refunding purposes by electric and gas utilities [1]—fiscal years 1948 and 1949 (includes all issues subject to provisions of the Public Utility Holding Company Act of 1935 and to registration requirements under the Securities Act of 1933)

	July 1, 1947, to June 30, 1948	July 1, 1948, to June 30, 1949
Bonds	$1,087,266,075	$899,434,729
Debentures	146,307,321	241,238,500
Preferred stock	229,443,828	192,779,280
Common stock	226,439,063	364,016,666
Total [2]	1,689,456,287	1,697,469,175

[1] As defined in secs. 2 (a) (3) and 2 (a) (4) of the act.
[2] In addition, companies subject to the Holding Company Act sold notes with maturities of 5 years or more in the amounts of $79,200,000 in fiscal year 1948 and $62,090,000 in 1949. Comparable data for companies not subject to the Holding Company Act are not available.

This table embraces a high proportion of the total financing within the industry. It will be noted that during the 2-year period financing volume has continued unabated at the annual rate of approximately $1,700,000,000. In addition, securities of companies not subject to the Public Utility Holding Company Act, which were privately placed and hence do not become a matter of record with the Commission, would probably increase this figure by approximately $200,000,000.

Data for the fiscal year 1948 reflect the fact that approximately 25 percent of funds derived through security sales was employed for refunding purposes. In contrast, during the fiscal year just closed, refunding took only 5 percent of net proceeds, with the balance employed for construction purposes. Thus the general industry program for refunding debt and preferred stock issues with lower coupon issues which had reached very large proportions in the early post war period seems to be approaching termination and the period from July 1, 1948, to June 30, 1949, saw financing geared almost exclusively to new money needs. With this growth problem in the fore, management has been faced with the basic problem of maintaining a proportion of equity capital sufficient to safeguard the financial strength of the industry. Figures for the latest fiscal year provide an encouraging answer to this responsibility, for while the aggregate of bond and debenture financing declined about $93,000,000 as compared with fiscal year 1948, common stock sales advanced by more than $135,000,000.

Although the proportion of security sales falling within the orbit of the Public Utility Holding Company Act is steadily diminishing as integration under section 11 proceeds, the volume of issues approved remains a substantial segment of total security sales in the industry. The following two tables set forth in summary form security sales approved under sections 6(b) and 7 of the act for the fiscal years 1949 and 1948. Information is provided with respect to electric and gas utilities, registered holding companies and nonutility subsidiaries of registered holding companies. These totals include all cash sales and refundings accomplished by direct exchanges. Excluded from these figures are sales from portfolios and issues offered as part of a reorganization under section 11.

Sales of securities and application of net proceeds approved under the Public Utility Holding Company Act of 1935 during the fiscal year July 1, 1948, to June 30, 1949 [1]

	Number of issues	Total security sales [2]	Application of net proceeds [2]		
			New money purposes	Refinancing of short-term bank loans [3]	Refunding
Sales by electric and gas utilities:					
Bonds	56	$368,209,514	$246,174,609	$95,620,052	$17,955,072
Debentures	5	106,551,165	46,615,225	41,358,800	17,303,000
Notes [4]	31	62,090,000	44,793,050	14,850,000	2,100,000
Preferred stock	17	74,859,040	43,062,350	26,254,700	4,000,000
Common stock	74	197,610,057	146,218,297	30,713,805	18,730,750
Total	183	809,319,776	526,863,531	208,797,357	60,088,822
Sales by holding companies:					
Debentures	2	33,878,815	20,646,890		12,850,000
Notes [4]	6	18,272,500	3,272,500		15,000,000
Common stock	8	69,893,184	68,546,045		
Total	16	122,044,499	92,465,435		27,850,000
Sales by nonutility companies:					
Bonds	4	49,295,080	43,807,210	5,000,000	
Common stock	8	9,875,000	9,279,301		575,000
Total	12	59,170,080	53,086,511	5,000,000	575,000

[1] Data limited to sales by issuing companies; offerings from portfolio are not included.
[2] Difference between total security sales and total proceeds is represented by flotation costs to the issuing companies.
[3] Bank loans of less than 5 years maturity for construction purposes.
[4] With maturities of not less than 5 years.

Sales of securities and application of net proceeds approved under the Public Utility Holding Company Act of 1935 during the fiscal year July 1, 1947, to June 30, 1948 [1]

	Number of issues	Total security sales [2]	Application of net proceeds [2]		
			New money purposes	Refinancing of short-term bank loans [3]	Refunding
Sales by electric and gas utilities:					
Bonds	66	$786,791,945	$389,312,601	$107,067,524	$282,005,752
Debentures	8	70,749,427	41,736,919	15,809,564	12,208,313
Notes [4]	33	79,200,000	52,647,766	9,895,289	16,587,465
Preferred stock	14	94,818,311	59,178,977	10,480,143	22,156,037
Common stock	69	154,109,294	121,997,179	12,948,447	17,566,053
Total	190	1,185,668,977	664,873,442	156,200,967	350,613,620
Sales by registered holding companies:					
Bonds (collateral trust)	1	5,225,000	5,204,000		
Debentures	3	80,830,514	75,209,739	561,000	4,231,000
Notes [4]	2	13,500,000			13,500,000
Common stock	1	692,854	583,354	77,000	
Total	7	100,248,368	80,997,093	638,000	17,731,000
Sales by nonutility subsidiaries:					
Bonds	4	34,804,500	29,436,706		5,280,000
Notes [4]	1	150,000			148,000
Common stock	3	1,583,000	1,196,938	380,629	
Total	8	36,537,500	30,633,644	380,629	5,428,000

[1] Data limited to sales by issuing companies; offerings from portfolio are not included.
[2] Difference between total security sales and total proceeds is represented by flotation costs to the issuing companies.
[3] Bank loans of less than 5 years maturity for construction purposes.
[4] With maturities of not less than 5 years.

A comparison of the totals for fiscal years 1948 and 1949 shows that security sales by electric and gas utilities subject to the act declined from $1,186,000,000 to $809,000,000. In view of the fact that total industry financing has varied little in size during the 2-year period, the contraction in the amount of approved financing is considered attributable principally to the continuing divestment of operating utilities. Total number of issues approved, including holding company and nonutility offerings showed, much less of a percentage decline, however, the number being 211 in 1948 and 205 in 1949.

Of considerable significance is the noticeable change in the proportions of financing media as between the two periods. The prior period, July 1, 1947, to June 30, 1948, reflected utility company sales of bonds, debentures and long-term notes in the amount of $936,000,000 or 79.0 percent of total utility offerings. However, in the period ended June 30, 1949, sales of these types of securities declined to $536,000,000 or 66.3 percent of the total. On the other hand, common stock sales were sharply increased from 13.0 percent of the total in the earlier period to 24.4 percent in the fiscal year just closed. There is some indication that the high point of bond financing related to earlier urgent needs for capacity has now been passed. The increase in common stock financing is in direct accord with the policy of the Commission which has consistently urged operating companies under its jurisdiction to pace their bond offerings with a sufficient amount of equity financing to preserve financial stability and a sound capitalization to assure adequate facilities for financing in future years.

A significant feature of utility financing during the fiscal year has been the extensive employment of the rights offering procedure in the marketing of common stocks. The practice has been followed most frequently by companies which are now free from holding company control and must turn to their public stockholders for equity capital. Companies which are still holding company subsidiaries sold most of their common stock directly to their respective parents for cash without resort to public offering. However, from July 1, 1948, to June 30, 1949, electric and gas utilities under jurisdiction of the Holding Company Act did make 15 public rights offerings involving an amount in excess of $63,000,000. In addition, registered holding companies employed the rights procedure in 5 offerings aggregating approximately $48,000,000. Ability of the utility industry to go back to its stockholders for an important segment of its capital requirements is, in a sense, a tribute to the financial strength and investor confidence which it now enjoys.

Registered holding companies have played the major role in the common stock financing of electric and gas utilities under the act; they purchased shares to the extent of $135,000,000 in the fiscal year 1948 and $150,000,000 in the past year. By thus increasing the equity of its operating utility subsidiaries a holding company performs one of the important functions contemplated by the statute. In part, funds employed by holding companies for investment in their subsidiaries have been derived from the sale of portfolio securities found by the Commission to be nonretainable under section 11. Additional funds have been obtained by holding companies through the offering of their own securities to the public. These offerings

totaled $122,000,000 during the past fiscal year. Of this amount 57 percent was represented by common stock and most of the balance by debentures.

The following table sets forth purchases of subsidiary common stocks and capital donations or contributions by holding companies to their subsidiaries during the period from March 1, 1937, to March 15, 1946:

Cash purchases of common stock of subsidiaries by parent holding companies	$47,673,171
Purchases by parent holding companies of additional common stock of subsidiaries with assets other than cash	1,358,300
Aggregate purchases of subsidiaries' common stocks by holding companies	49,031,471
Cash donations by parent holding companies to their subsidiaries	128,500,743
Donations of subsidiaries' senior securities by parent holding companies to their subsidiaries	114,218,996
Conversions by parent holding companies of subsidiaries' senior securities held by the parent into subsidiaries' common stock	48,118,982
Donations of other securities and assets by parent holding companies to their subsidiaries	19,381,823
Forgiveness by parent holding companies of preferred dividend arrearages on preferred stocks of subsidiaries held by the parent	2,405,613
Total capital contributions and donations by holding companies	312,626,157
Total common stock purchases and capital donations	361,657,628

In addition to the foregoing, capital contributions were made by registered holding companies to their subsidiaries in the following amounts:

1947	$15,000,000
1948	67,100,000

Historical records covering transactions between holding companies and their subsidiaries prior to enactment of the statute are incomplete but the available data presents a sharp contrast between the practices of recent years and the methods employed by holding companies in the financing of their subsidiaries prior to enactment of the statute. During the period from 1924 to 1930, inclusive, public utility holding companies sold approximately $4,856,000,000 of their securities to the public. The funds received from this financing were devoted almost entirely to the purchase of already outstanding corporate securities. Only a negligible portion went into the construction of plant and equipment of operating utility subsidiaries.[3] For a period of many years up to 1928, it was the general practice of holding companies to furnish capital to their subsidiaries through the mechanism of demand notes or open-account advances. Interest was often charged on these short-term loans at rates ranging from 6 to 8 percent and in some large systems the holding companies followed the regular practice of compounding interest monthly.[4]

In its investigation the Federal Trade Commission found that in many instances the book value of holding companies' investments in common stocks of their subsidiaries represented highly inflationary

[3] S. Rep. No. 621, 74th Cong., 1st sess., p. 15.
[4] S. Doc. 92, 70th Cong., 1st sess., pt. 72-A, chs. 5 and 6, S. Doc. 92, 70th Cong., 1st sess., pts. 23 and 24, pp. 218 *et seq.*

valuations. This condition stemmed both from the "write-ups" in the investment book values on the books of holding companies and large scale "write-ups" in the property accounts of underlying subsidiaries. During the 14 years of its administration of the Holding Company Act, the Commission, working jointly with the Federal Power Commission and state and local regulatory bodies, in proceedings arising under sections 6, 7, and 11 (b) (2) has aided in the removal from the plant accounts of subidiaries of registered holding companies' "write-ups" aggregating approximately $1,423,000,000.

Under the terms of rule U–27, adopted April 21, 1941, every registered holding company and subsidiary thereof, which was a public utility company and which was not required by either the Federal Power Commission or a state commission to conform to a classification of accounts has been required by the Commission to keep its accounts in accordance with the designated systems adopted by this Commission for electric and/or gas utilities. These systems specifically provide that plant and property accounts shall be stated at original cost.

While some field examinations were undertaken in 1945, it was not until the latter part of 1946 that a section of original cost studies was organized and the review of the field studies, including field examinations, was undertaken on an intensive scale. At June 30, 1949, field examinations had been completed with respect to 10 companies, 6 of which were located in the State of Texas, and 1 in each of the States of New York, Delaware, Mississippi, and Florida. Definitive orders of the Commission approving disposition of adjustment items have already been issued for the following companies:

Texas Power & Light Co.	Mississippi Power & Light Co.
Texas Electric Service Co.	Delaware Power & Light Co.

The adjustments to the accounts of the remaining companies are now being processed. Field examinations with respect to 6 additional companies, located in the States of Texas, Iowa, Nebraska, and Minnesota are either pending or are now being conducted.

Completed field studies for the 10 companies which have already been examined disclose that the total properties, prior to reclassification, were recorded on their books at $372,159,252. The original cost of such properties was determined to be only $245,672,325, leaving a balance of $126,486,927 subject to adjustment. Of this latter amount it was determined that $101,116,546 should be classified to Account 107—Plant Adjustments—and required to be written off the books of account. The balance of $25,370,381 was classified in Account 100.5—Plant Acquisition Adjustments—and is thus subject to amortization over a period of years. These eliminations of items not representing original cost are included in the total of $1,400,000,000 set forth above.

In section 1 (b) of the act the Congress found that "* * * investors cannot obtain the information necessary to appraise the financial position or earning power of the issuers, because of the absence of uniform standard accounts; * * *," that "* * * such securities are issued upon the basis of fictitious or unsound asset values having no fair relation to the sums invested in or the earning capacity of the properties and upon the basis of paper profits from intercom-

pany transactions * * *," and that "such securities are issued by a subsidiary public-utility company under circumstances which subject such company to the burden of supporting an overcapitalized structure and tend to prevent voluntary rate reductions; * * *."

The strengthening of capital structures of operating companies and holding companies, the restoration of subsidiary companies' equities through capital contributions by holding companies and the elimination of "write-ups" from the plant accounts of utility subsidiaries, as accomplished through the administration of sections 6, 7, and 11 (b) (2), all have operated to bring about the effective correction of these abuses.

Competitive Bidding

Sales of securities under these two sections and sales by holding companies under section 12 of securities held in their investment portfolios are generally required to be offered at competitive bidding. This requirement is embodied in rule U–50, which was promulgated in 1941 as a means of meeting the Commission's statutory responsibility for passing upon the reasonableness of fees and expenses and the maintenance of competitive conditions. The events and considerations which led to the adoption of the rule were set forth in some detail in the Seventh Annual Report.

To June 30, 1949, more than $5,320,000,000 of securities had been sold pursuant to rule U–50, $4,360,000,000 of which were sold within the past five fiscal years. Further analysis of this latter amount indicates that all types of securities have been sold in substantial volume and upon many occasions:

Competitive sales under rule U–50—1944–49

	Amount	Number of issues
Bonds	$2,962,509,000	183
Debentures and notes	433,688,000	27
Preferred stock	565,464,700	56
Common stock	399,881,744	42
Total	4,361,543,444	308

It was anticipated that the use of competitive bidding would bring about a reduction in underwriting costs or "spreads," and this expectation has been amply fulfilled. A study of underwriting spreads prevailing during the 5-year period ended January 1, 1940, revealed that slightly over one-half of the 159 utility mortgage bond issues studied had been sold on the basis of a 2-point spread; in only four cases was a smaller spread found. The average spread for these 159 issues, which had been sold by traditional methods of private negotiation, was 2.49 points; i. e., $2.49 per $100 face amount of bonds. The sharply contrasting picture under competitive bidding is shown in the following compilation of spreads on bond issues during the past 5 years:

Spread per $100 of bonds	Number of issues	Aggregate amount
Under $0.25	7	$51,500,000
$0.25 to $0.50	58	683,379,000
$0.50 to $0.75	69	1,480,701,000
$0.75 to $1	21	208,411,000
$1 to $1.25	16	421,380,000
$1.25 and over	8	90,400,000
Total	[1] 179	[1] 2,935,771,000

[1] Exclusive of 4 issues reported in the preceding tabulation for which an insurance company bid successfully, retaining the security in portfolio.

Spreads on competitively sold preferred issues have averaged just under two points while those on common stocks have averaged 5.4 percent of the public offering price.

A primary consideration in the adoption of rule U–50 was the necessity of overcoming the influence of traditional relationships between particular investment banking houses and public utility companies. These relationships seriously hindered arms-length bargaining and led, as noted above, to relatively standardized underwriting costs on a high level. The extent to which the competitive bidding procedure has diversified the management of security offerings is therefore a matter of considerable importance. The table shown below covers 24 companies whose securities have been marketed at competitive bidding on at least 4 occasions during the past 5 fiscal years and shows the number of managing underwriters who have been successful in purchasing the securities of these companies.

	Number of companies which, during fiscal years 1945 to 1949, inclusive, sold—			
	4 issues	5 issues	6 issues	7 issues
All issues purchased by same manager	1			
Issues purchased by 2 managers		1		
Issues purchased by 3 managers	7	3	1	
Issues purchased by 4 managers	6	3	1	1
Total number of companies	14	7	2	1

It will be noted that in only one instance was a single manager able to win all securities offered by a particular company over this 5-year period. This manager had not been the traditional banker of the company in question, and numerous other bids were submitted for each of the issues. In only one other of the 24 companies studied was any manager successful in purchasing as many as half of the issues offered. Examination of the membership lists of underwriting syndicates reveals also that individual banking firms participate in offerings under widely diverse leadership. Over a period of time, nearly all such firms have been in competition with each other.

Rule U–50 is kept flexible by the various provisions for exemption written into its terms. Some of these are automatic exemptions,

such as those covering security issues not exceeding $1,000,000 or certain debt issues of less than 10 years' maturity. In addition, the Commission may exempt any particular issuance of securities by order at its discretion. The great bulk of cases granted exemption on this latter basis have involved non-underwritten sales to other companies, individuals, stockholders, or institutional investors. There were 69 security sales in this category. During the past 5 years only 28 underwritten sales have been exempted; 23 of these were issues of common and preferred stock.

Acceptance of competitive bidding for public utility securities has become considerably more widespread during the period since rule U–50 was adopted. Competitive bidding is now regularly required by the Interstate Commerce Commission and by 15 State regulatory commissions. It has been employed, moreover, by a number of utility companies under no regulatory compulsion to do so. It has been tested under widely varying conditions and, although there are sometimes circumstances which make other methods of sale advisable, it has been demonstrated to be highly effective in general application.

INTEGRATION AND SIMPLIFICATION OF HOLDING COMPANY SYSTEMS

The physical integration and corporate simplification provisions of the act are embodied principally in section 11. Section 11 (b) (1) requires that the operations of a holding company group be limited to one or more "integrated utility systems" and to such additional businesses as are reasonably incidental or economically necessary or appropriate to the operations of such systems. In section 2 (a) (29) an "integrated utility system" is defined as one capable of economic operation as a single coordinated system confined to a single area or region in one or more States and not so large as to impair the advantages of localized management, efficient operation, and effectiveness of regulation. These, in substance, are the principal statutory requirements of physical integration. The standards covering corporate simplification are found in section 11 (b) (2), which requires action to insure that the corporate structure or continued existence of any company in a holding company group does not unduly or unnecessarily complicate the structure or unfairly or inequitably distribute voting power among security holders of such holding company system. Several years ago the Commission instituted proceedings with respect to all of the major holding companies subject to its jurisdiction. The orders and tentative conclusions handed down in connection with these proceedings set forth in general terms the changes necessary to meet the requirements of sections 11 (b) (1) and 11 (b) (2).

The mechanics necessary to effectuate compliance with these standards are contained in sections 11 (d), (e), and (f). Under section 11 (d) the Commission may apply to a court for an order compelling compliance, in which case the court may, to the extent neces-

sary, take exclusive jurisdiction and possession of the company. Where a holding company is under the control of the courts in proceedings in bankruptcy or receivership, the debtor's plan for reorganization is required to be approved by the Commission under section 11 (f) before action is taken thereon by the court. A holding company may comply with the act on a voluntary basis under section 11 (e), which requires that the Commission approve a voluntary reorganization plan submitted pursuant to this section if it finds that the plan is (1) necessary to effectuate the provisions of section 11 (b), and (2) fair and equitable to the persons affected thereby. Nearly all of the reorganizations passed upon by the Commission have been voluntary plans filed under section 11 (e). The more drastic procedure provided by section 11 (d) has been employed in the instance of only one holding company and, in that case, such action was requested by the company. A few cases have been processed under section 11 (f).

Prior to enactment of the statute an overwhelming majority of the electric and gas utility companies in the United States were enmeshed in one or more holding company systems. The independents included a few large metropolitan companies, certain long-established utilities in New York and New England, and the barest scattering over the rest of the Nation. Through holding company control the electric and gas utility companies became affiliated with an almost limitless variety of unrelated business activities. Among these were water, telephone, ice, street railway, coal, oil, real estate, and investment companies. There were manufacturers of brick and tile, iron fence, wood products, and paper. There were companies operating farms, quarries, gas stations, parking lots, theaters, and amusement parks. There was one coal-storage plant in Alaska and the New Orleans Baseball Co., Inc. Furthermore, most of the electric and gas utility companies of these holding company systems were widely scattered among many States with little or no functional relationship with one another. This problem of scatteration and unrelated businesses constituted one of the major abuses enumerated by the Congress in section 1 (b) of the act, which states "* * * the growth and extension of holding companies bears no relationship to the economy of management and operation or the integration and coordination of related operating properties; * * *"

During the period from June 15, 1938, to June 30, 1949, 2,152 companies at one time or another have been subject to the jurisdiction of the Commission under the Holding Company Act. Of this number 210 were holding companies, 918 were electric and gas utility companies and 1,024 were nonutility companies. Reflecting primarily the divestment of nonretainable properties under section 11, but also mergers, consolidations, and exemptions from the act, there were subject to the statute on June 30, 1949, only 642 companies. Of this number 72 were holding companies, 274 were electric and gas utilities, and 296 were nonutility companies. These changes, to-

gether with the eliminations which have taken place in each of the fiscal years 1948 and 1949, are set forth in the following tabulations:

FISCAL YEAR ENDED JUNE 30, 1949

	Total companies subject to act during period [1]	Eliminations					Companies subject to act as of June 30, 1949
		Absorbed by merger or consolidation	Sales, dissolutions and other divestments	Exemption by rule or order	Other disposals	Total	
Holding companies	78		3	3		6	72
Electric and/or gas companies	315	9	31		1	41	274
Nonutilities plus utilities other than electric and/or gas companies	328	3	19	5	5	32	296
Total companies	721	12	53	8	6	79	642

FISCAL YEAR ENDED JUNE 30, 1948

Holding companies	87		13	1		14	73
Electric and/or gas companies	345	1	33	1	1	36	309
Nonutilities plus utilities other than electric and/or [gas] companies	421	3	92		3	98	323
Total companies	853	4	138	2	4	148	705

FOR PERIOD JUNE 15, 1938, TO JUNE 30, 1949

Holding companies	210	23	72	34	9	138	72
Electric and/or gas companies	918	136	399	60	49	644	274
Nonutilities plus utilities other than electric and/or gas companies	1,024	102	471	63	92	728	296
Total companies	[2] 2,152	261	942	157	150	1,510	642

[1] Reflects company additions and classification adjustments during the fiscal year.
[2] A few companies have been subject and not subject to the Public Utility Holding Company Act at various times during the period. These instances contribute some duplication to the reported company totals.

In response to the physical integration standards of section 11 (b) (1) and the corporate simplification requirements of section 11 (b) (2), holding companies divested themselves of 44 companies having assets of $1,749,000,000 during the past fiscal year. These companies are no longer subject to the provisions of the act. In the previous year 111 companies, with assets of $1,244,000,000, were divested by registered holding companies. The substantial decrease in the number of companies divested in 1949 as compared with the number divested in the preceding fiscal year, without corresponding change in aggregate assets divested, reflects for the most part the divestment in October 1947 of 77 water subsidiaries of the American Water Works & Electric Co. system. Since December 31, 1935, 661 companies, with assets of $7,965,000,000, have been removed from the jurisdiction of the act through divestment. The following tables present a complete record of all companies and partial segments of utility properties which have been divested during the period December 1, 1935, to June 30, 1949, and which, as of June 30, 1949, were not subject to the Holding Company Act.

Electric, gas, and nonutility companies divested under the Public Utility Holding Company Act of 1935 (no longer subject to act as of June 30, 1949)

	Dec. 1, 1935, to June 30, 1949		July 1, 1948, to June 30, 1949		July 1, 1947, to June 30, 1948	
	Number of companies	Assets [1]	Number of companies	Assets [1]	Number of companies	Assets [1]
Companies:						
Electric utility	213	$6,534,845,360	22	$1,545,671,312	22	$989,933,810
Gas utility	134	558,168,598	10	106,024,850	5	51,864,622
Nonutility	314	[2] 871,750,579	12	[2] 97,182,665	84	201,929,731
Total	661	7,964,764,537	44	1,748,878,827	111	1,243,728,163

[1] Assets as of divestment date or year end next preceding date of divestment.
[2] A small percent of the assets of nonutility companies were included in the consolidated assets of the electric and/or gas utilities.

Divestments by sales of partial segments of properties under the Public Utility Holding Company Act of 1935 (no longer subject to act as of June 30, 1949)

	Dec. 1, 1935, to June 30, 1949		July 1, 1948, to June 30, 1949		July 1, 1947, to June 30, 1948	
	Number of companies involved	Consideration received	Number of companies involved	Consideration received	Number of companies involved	Consideration received
Electric	57	$89,130,744	1	$430,000	2	$6,367,500
Gas	19	11,140,516	4	3,112,356	2	2,085,000
Nonutilities	31	27,808,355				
Total	107	128,079,615	5	3,542,356	4	8,452,500

NOTE.—It will be observed that the divestments in the "no longer subject" category for the fiscal year ended June 30, 1948, differ substantially from the data covering the same period appearing at p. 58 of the Commission's fourteenth annual report. This difference reflects primarily 2 major revisions in the method of reporting "no longer subject" divestments:
(*a*) A small amount of duplication has been eliminated;
(*b*) Under the method of reporting shown in the fourteenth annual report a company with 10 subsidiaries with consolidated assets of $12,000,000 divested in 1 operation would appear in the table as 1 company with assets at time of divestment of $12,000,000. Under the revised method of reporting, set forth above, this divestment would be reported as 11 companies with assets of $12,000,000. The divestment example cited above to illustrate the change in method of compilation is hypothetical.

These data represent for the most part the severance from holding company systems of companies and properties found by the Commission to be non-retainable under the standards contained in section 11 (b) (1) of the act.

Aside from the "no longer subject" divestments, 206 companies with assets of $3,781,000,000 have been divested by one or more holding companies, but remain subject to the statute by reason of their relationship to another registered holding company. One hundred and forty-three of these companies with assets of approximately $3,355,000,000 are expected to remain under the Commission's jurisdiction indefinitely as systems which, it is presently anticipated, will ultimately complete compliance as fully integrated holding company systems under the standards of section 11 (b). Some $28,000,000 of assets representing partial segments of utility properties formerly owned by nine companies likewise are expected to remain under the Holding Company Act as parts of integrated systems. The following tables summarize these "still subject" divestments.

Companies and assets divested from holding companies Dec. 1, 1935, to June 30, 1949, still subject to Public Utility Holding Company Act of 1935 as of June 30, 1949

Estimated future status of companies and assets under act	Companies divested				Assets divested			
	Electric	Gas	Non-utility	Total	Electric	Gas	Nonutility	Total
A. Companies continuing in existence:								
1. Companies and assets expected to remain under act	97	32	14	143	$2,285,394,429	$970,265,671	$99,114,950	$3,354,775,050
2. Companies and assets expected to be released from jurisdiction of act	7	9	9	25	161,771,337	109,224,015	32,434,996	303,430,348
3. Future status of companies and assets under act cannot be estimated at this time	1		20	21	168,466		71,286,165	71,454,631
Total companies still under act	105	41	43	189				
B. Companies dissolved or expected to dissolve assets sold to other companies:								
1. Assets expected to remain under act	7	1	1	9	27,030,552	415,000	339,162	27,784,714
2. Assets expected to be released from jurisdiction of act	4	2		6	9,686,172	1,667,194		11,353,366
3. Future status of assets under act cannot be estimated at this time	2			2	12,516,195			12,516,195
Total companies	118	44	44	206	2,496,567,151	1,081,571,880	203,175,273	3,781,314,304
Summary—total assets divested still subject to act:								
1. Total assets expected to remain under act					2,312,424,981	970,680,671	99,454,112	3,382,559,764
2. Total assets expected to be released from jurisdiction of act					171,457,509	110,891,209	32,434,996	314,783,714
3. Total assets—Future status under act cannot be estimated at this time					12,684,661		71,286,165	83,970,826
Grand total					2,496,567,151	1,081,571,880	203,175,273	3,781,314,304

Partial divestments of electric and gas utility properties by companies still subject to the Public Utility Holding Company Act of 1935 as of June 30, 1949

	Companies whose properties were sold			Consideration received by selling companies		
	Electric	Gas	Total	Electric	Gas	Total
DEC. 1, 1935, TO JUNE 30, 1949						
Companies:						
In	[1] 5	4	9	$2,185,407	$1,411,323	$3,596,730
Out	1	2	3	317,969	638,000	955,969
Undetermined	2	2	4	2,407,899	2,237,500	4,645,399
Total	8	8	16	4,911,275	4,286,823	9,198,098
JULY 1, 1948, TO JUNE 30, 1949						
Companies:						
In		1	1		1,500	1,500
Out		1	1		573,000	573,000
Undetermined						
Total		2	2		574,500	574,500
JULY 1, 1947, TO JUNE 30, 1948						
Companies:						
In						
Out						
Undetermined						
Total						

[1] Central States Power & Light Corp. sold 2 distribution systems for $29,500 and $95,238 respectively the first to a company no longer subject to the act and the latter to a company subject to the act.

GENERAL NOTE.—Attention is invited to the fact that the data for "still subject" divestments appearing in the above table have been compiled on a substantially different basis from the data appearing in the fourteenth annual report at pp. 58 and 59. The revised method of reporting eliminates certain substantial duplications and is basically designed to show only the present status as to jurisdiction of the statute for companies or systems which have undergone one or more complete divestment operation in the past. In this table only the most recent divestment operation is reflected. Data in the fourteenth annual report included all complete divestment operations affecting a company or system.

Contrary to popular conception, the Holding Company Act does not contemplate the elimination of all holding companies. Sections 2 (a) (29) and 11 (b) (1) prescribe standards for the continued operation of compact and well-integrated public-utility holding company systems subject to regulation by the Commission under other sections of the act, as more fully described in the preceding sections of this report, after they have completed compliance with the provisions of the statute.

While it is too early to determine precisely which companies or even which systems will remain subject to the Commission's continuing jurisdiction, it is estimated that some 6 or 7 billion dollars of assets (including electric, gas, and retainable nonutility assets) may remain subject to the act after integration proceedings have been completed. Present indications are that the following systems, among others, are likely to continue under the act in this manner:

American Gas & Electric Co.
American Natural Gas Co.
Allegheny Gas Co.
Central & South West Corp.
Columbia Gas System, Inc.
Consolidated Natural Gas Co.
Delaware Power & Light Co.
Derby Gas & Electric Corp.
Interstate Power Co.
Middle South Utilities, Inc.
National Fuel Gas Co.
New England Electric System.
Northern States Power Co.
North American Co. (or Union Electric Co. of Missouri).
Ohio Edison Co.

Philadelphia Electric Power Co.
The Southern Co.
Utah Power & Light Co.
West Penn Electric Co.
Wisconsin Electric Power Co.

As noted above, many companies have been eliminated from holding company systems as a result of proceedings designed to meet the corporate simplification standards. These standards have also required simplification of the security structures of many holding companies. Some of the most complex, prolonged and bitterly contested cases before the Commission have been those in which senior securities, particularly those of holding companies were replaced, with common stock of a new holding company or of one or more subsidiary companies. In these cases the rights of each class of security holder must be carefully evaluated and the equitable equivalent of such rights must be allotted to them in cash or in new stock. Many outstanding examples of corporate simplification have already been brought to completion; a number of these are discussed in the following sections of this report in connection with the narratives relating to individual systems.

STATUS OF HOLDING COMPANY SYSTEMS

The over-all impact of both the geographical integration provisions of section 11(b)(1) and the corporate simplification provisions of section 11(b)(2) upon the major holding company systems is illustrated by the following reports tracing developments in the individual holding company groups listed below.

Cities Service Co.
The Commonwealth & Southern Corp.
Electric Bond & Share Co.
Engineers Public Service Co.
General Public Utilities Corp.
International Hydro-Electric System-New England Electric System.
Midland United Co.-Midland Utilities Co.
The Middle West Corp.
New England Gas & Electric Association.
New England Public Service Co.
The North American Co.
Northern States Power Co.
Ogden Corp.
Standard Power & Light Corp. and Standard Gas & Electric Co.
The United Light & Railways Co.
United Corp.
West Penn Electric Co.

Cities Service Company

Cities Service Co. at the time of its registration in 1941 was the top holding company in a system containing 125 companies, of which 49 were electric and gas utility companies, with consolidated assets of approximately $1,000,000,000. This system owned or operated properties in each of the 48 States and in several foreign countries. Utility properties were held by three subholding companies, Cities Service Power & Light Co., Federal Light & Traction Co., and Arkansas Natural Gas Corp., each controlling one or more utility systems.

In proceedings under section 11(b) of the act, the Commission found that Cities should be limited in its operations to those of a single integrated gas utility system and required Cities to dispose of its other interests.[5] However, Cities expressed a desire to retain instead its nonutility businesses and accordingly the Commission modified its 11(b)(1) order so as to permit Cities to effect compliance by disposing of all of its utility interests.[6]

[5] Holding Company Act releases Nos. 4489 and 4551.
[6] Holding Company Act release No. 5350.

Cities Service Power & Light Co., pursuant to a plan approved on March 14, 1944,[7] simplified its corporate structure by eliminating its debentures and preferred stock. In August 1946, Power & Light liquidated and dissolved, transferring to Cities its portfolio holdings.[8] These consisted of an interest of approximately 65 percent in Federal Light & Traction Co., the common stocks of Ohio Public Service Co., Spokane Gas & Fuel Co., The Toledo Edison Co., Doniphan County Light & Power Co. (all operating utility companies) and other miscellaneous holdings.

Federal Light & Traction Co. has likewise completed liquidation proceedings. A number of its smaller properties were sold to individuals or other private purchasers and the stock of Tucson Gas, Electric Light & Power Co. was sold to underwriters for public distribution. Federal also merged four of its subsidiaries to form Public Service Co. of New Mexico and the stock of this company was distributed to Federal's common stockholders in the course of the liquidation. Federal distributed to its preferred stockholders $100 per share plus accrued and unpaid dividends and deposited in escrow an amount equivalent to the full premium of $10 per share plus interest for a period of approximately 3 years on the aggregate premium pending the determination of whether or not the preferred stockholders are entitled to receive more than par plus accrued dividends.

Arkansas Natural Gas Corp. has filed an application to comply with the Commission's outstanding order under section 11(b)(1) providing for the disposition of the gas distribution properties of its only gas utility subsidiary, Arkansas Louisiana Gas Co.[9] This application, filed in May 1948, is still pending and has since been consolidated with a proceeding instituted by the Commission to determine what action, if any, is required to be taken by Arkansas Natural Gas Corp. to comply with the requirements of section 11(b)(2).

On April 24, 1947, the Commission approved a section 11(e) plan filed by Cities Service Co. for the simplification of its corporate structure which provided for the issuance of approximately $115,000,000 principal amount of new debentures to the holders of Cities' outstanding preferred and preference stocks representing a principal amount equivalent to the redemption prices of the three series of preferred and preference stocks plus accumulated dividend arrears of approximately $50,000,000.[10] In addition, provision was made for the immediate retirement of approximately $40,000,000 of the company's outstanding long term debt and for the application of anticipated proceeds from the disposition of utility subsidiary companies to the retirement of the remaining long term debt and toward the reduction in the amount of the new debentures. Since the consummation of that plan in June 1947, Cities has disposed of its interest in the common stock of Public Service Co. of New Mexcio (acquired through liquidation of Federal Light & Traction Co.) and used the proceeds together with cash to retire approximately $9,000,000 of its outstanding debt. On April 12, 1949, Cities disposed of a portion of its interest in Ohio Public Service Co., an electric utility subsidiary. These

[7] Holding Company Act release No. 4944.
[8] Holding Company Act release No. 6865.
[9] File No. 70-1704.
[10] Holding Company Act release No. 7368, plan approved and enforced 71 F. Supp. 1003 (Del. 1947).

proceeds are likewise required to be applied toward reduction of Cities' debt.

The Commonwealth & Southern Corporation.

At the time of its registration as a public utility holding company in March 1938 The Commonwealth & Southern Corp. controlled a holding company system consisting of some 43 companies. Its principal subsidiaries were 11 public utility comapnies, all of which rendred electric service and some of which also furnished gas, transportation, and other services. These companies conducted their operations in 5 northern and 6 southern States. Although some of the electric properties in the South were interconnected, the northern electric properties for the most part were situated in separate and distinct areas. The publicly-held securities of the subsidiaries, consisting primarily of bonds and preferred stocks, aggregated about $711,000,000, while Commonwealth's own debt securities and preferred stock totaled about $52,000,000 and $150,000,000, respectively. Thus the system had outstanding an extremely large amount of senior securities ranking ahead of Commonwealth's common stock. Dividends on this common stock had not been paid since March 1932 and dividends on the cumulative preferred stock had been paid at a reduced rate for several years, resulting in dividend arrearages of about $18,000,000.

Since 1938 all of the transportation companies and nearly all of the small nonutility companies have been eliminated from the holding company system. Commonwealth also has sold its interests in three former public utility subsidiaries which conducted operations in Tennessee, South Carolina, and Indiana. A section 11(e) plan approved by this Commission on August 1, 1947,[11] resulted in the creation of The Southern Co. as a public utility holding company, and the transfer to it of Commonwealth's investments in the utility subsidiaries which conduct integrated electric utility operations in Georiga, Alabama, Florida, and Mississippi. In its order approving that plan, the Commission, among other things, ordered Commonwealth to dispose of its interest in all the northern subsidiary companies.

Another section 11 plan of Commonwealth, dated July 30, 1947, provides for the retirement of Commonwealth's preferred stock by exchanging for it the common stocks of Consumers Power Co. and Central Illinois Light Co. together with $1 per share in cash. This plan also provides that Commonwealth's remaining assets, chiefly consisting of the common stocks of The Southern Co. and a substantial portion of the common stock of Ohio Edison Co., be distributed to Commonwealth's common stockholders and that Commonwealth be dissolved. The last-mentioned plan was approved by this Commission [12] and by the District Court of the United States for the District of Delaware which directed that the plan be consummated.[13] Commonwealth has indicated its intention to make the initial distribution under this plan on or about October 1, 1949.

Upon the consummation of this plan, Commonwealth will have disposed of all its investments in subsidiary companies and will have been dissolved. As contrasted with its holding company system of 43

[11] Holding Company Act release No. 7615.
[12] Holding Company Act release No. 8633.
[13] Unreported (D. Del. No. 1175, 7-15-49).

companies in 1938, there will remain a number of independent companies and two nonaffiliated holding company systems: one consisting of Ohio Edison Co. with Pennsylvania Power Co. as its subsidiary; the other consisting of The Southern Co. with five subsidiary companies.

Electric Bond & Share Co.

The Electric Bond & Share Co. ("Bond and Share") system is the largest which has registered under the Holding Company Act. At the time of its registration under the act in 1938, it controlled 121 domestic subsidiaries including 5 major subholding companies with combined assets of nearly 3½ billion dollars. These subholding companies were American & Foreign Power Co., Inc. (Foreign Power), American Gas & Electric Co. (American Gas), American Power & Light Co. (American), Electric Power & Light Corp. (Electric), and National Power & Light Co. (National). Of these, American Gas ceased to be a subsidiary of Bond and Share in March 1947, National has disposed of substantially all of its interest in electric and gas utility subsidiaries and Electric as of the end of the 1949 fiscal year was in the process of dissolution pursuant to a plan approved by the Commission. In addition, Bond and Share has filed plans providing for the retirement of its preferred stocks and the divestment of all of its public utility investments in the United States in order to become, prospectively, an investment company.

Pursuant to plans filed in 1945 and 1946 and approved by the Commission and by the district court, Bond and Share has paid $100 per share, or an aggregate amount of $104,328,000, to the holders of its $5 and $6 preferred stocks and in addition has delivered to each of such holders a certificate evidencing the right to receive any additional amounts which the Commission or the courts may approve or direct.[14] On April 7, 1947, Bond and Share filed plan II–B in which it proposed that no further payment be made to holders of the preferred stock certificates.[15] Hearings on this plan have been completed, the matter has been briefed and argued and is presently before the Commission for decision. A portion of the funds required for the payments to preferred stockholders was derived from the disposition by Bond and Share of its holdings in American Gas and in Pennsylvania Power & Light Co. Both of these companies thereupon ceased to be subsidiaries of Bond and Share. In the latter part of 1948, Bond and Share also disposed of its holdings of the common stock of Carolina Power & Light Co., through a sale to the public and distribution to its common stockholders.[16]

National Power & Light Co.

On August 23, 1941, pursuant to proceedings instituted by the Commission, National was ordered to dissolve because it constituted an undue and unnecessary complexity in the Bond and Share system.[17] At the time of the issuance of this order, National had 27 subsidiaries, 9 of which were public utility companies. Substantial progress has been made in bringing about National's dissolution. All of its long-term debt has been retired through the use of treasury cash and its

[14] Holding Company Act releases Nos. 6121 and 6879–1, plan approved and enforced, 73 F. Supp. 426 (S. D. N. Y., 1946).
[15] Holding Company Act release No. 6768.
[16] Holding Company Act release No. 8694.
[17] 9 S. E. C. 978.

preferred stock was retired at $100 per share, partly through a voluntary exchange for common stock of Houston Lighting & Power Co. and in part by cash derived from sale of the Houston stock.[18] In May 1946, the Commission approved a plan for the settlement of all suits and claims against Bond and Share by or on behalf of National, its subsidiaries and certain former subsidiaries through payment of $750,000 by Bond and Share.[19] This settlement was subsequently approved by the United States district court and in August 1946 National distributed the common stocks of Pennsylvania Power & Light Co., Carolina Power & Light Co., and Birmingham Electric Co., its remaining principal subsidiaries, pro rata to its common stockholders. Thus Bond and Share, which owned 46 percent of National's common stock, received 46 percent of the stocks distributed. In preparation for these distributions Pennsylvania, Carolina, and Birmingham were reorganized to conform their accounts and structures to the requirements of the act. After the distribution of these companies, National's only remaining subsidiaries were Lehigh Valley Transit Co., The Memphis Street Railway Co. (Memphis) and Memphis Generating Co. (Memphis Generating). On August 17, 1948, the Commission approved a plan for the reorganization of Lehigh Valley,[20] which was subsequently approved by the United States district court.[21] Under the plan, Lehigh Valley's debt was retired by the payment of its principal amount and its capital stocks were reclassified into a new common stock. On March 22, 1949, the Commission approved a plan for the reorganization of Memphis,[22] which was subsequently approved by the United States district court.[23] Under this plan, National was paid approximately $327,000 for its interest in the common stock and Memphis' preferred stock was reclassified into a new class of common stock. A plan for the reorganization and disposition of Memphis Generating is pending.

American Power & Light Co.

On August 22, 1942, American and Electric were ordered to dissolve on grounds similar to those set forth with respect to National.[24] The Commission order was appealed by both American and Electric and subsequently affirmed by the United States Circuit Court of Appeals for the First Circuit on May 17, 1944, and by the United States Supreme Court on November 25, 1946.

At the time of the issuance of the dissolution order, American controlled directly or indirectly 35 subsidiaries, 16 of which were public utility companies. American's capital structure consisted of long-term debt, 2 classes of cumulative preferred stock with dividend arrearages of more than $35,000,000, and common stock. Considerable progress has also been made in resolving American's problems under section 11. All of American's long-term debt has been retired. In addition, American has disposed of its interest in Nebraska Power Co., Central Arizona Light & Power Co. and New Mexico Electric Service Co. plus certain minor properties. Plans for the sale in

[18] Holding Company Act release No. 4811.
[19] Holding Company Act release No. 6663, plan approved and enforced, 80 F. Supp. 795 (S. D. N. Y., 1948).
[20] Holding Company Act releases Nos. 8445 and 8467.
[21] Unreported (E. D. Pa., No. 8812, 9-28-48).
[22] Holding Company Act release No. 8942.
[23] Unreported (N. D. Tenn., No. 1559, 4-22-49).
[24] 11 S. E. C. 1146.

July 1949 of all of American's interest in Kansas Gas & Electric Co. were completed at the close of the fiscal year. Its remaining subsidiaries, with the sole exception of Portland Gas & Coke Co., have been recapitalized to conform their accounts and structures to the requirements of the act in order to be ready for disposition. In October 1945, the Commission approved the formation by American of a new Texas holding company which acquired from American its interest in Texas Electric Service Co. and Texas Power & Light Co. and, from Electric, the latter's interest in Dallas Power & Light Co.[25] On April 24, 1947, the Commission authorized the merger of two of American's subsidiaries; namely, Northwestern Electric Co. and Pacific Power & Light Co. and the retirement of the two companies' preferred stocks through a new preferred stock issue by Pacific, the survivor.[26] Subsequently Pacific refunded its debt and the debt of Northwestern which had been assumed under the merger agreement.[27]

American and Bond and Share have filed a joint plan providing for the reorganization of American.[28] This plan is in substitution for an earlier plan which was withdrawn because of a change in market conditions. The present plan, in summary, provides for the settlement of all suits and claims against Bond and Share by and on behalf of American, its subsidiaries and certain former subsidiaries for a cash payment of $2,500,000 and the allocation of American's assets among its preferred and common stockholders in the ratio of 82 percent to the preferred and 18 percent to the common. The division of assets is proposed to be effected, under the plan, through the direct distribution of the common stocks of four of American's direct subsidiaries and the reclassification of American's present stocks into a single class of common stock. Hearings on this plan have been completed and the plan, as of the end of the fiscal year, was under consideration by the Commission. The plan had the support of all representatives of American stockholders who participated in the proceedings.

Electric Power & Light Corp.

At the time of the issuance of the Commission's dissolution order, Electric controlled directly or indirectly 24 subsidiary companies, 10 of which were public utility companies under the act. Electric's capital structure consisted of long-term debt, three classes of cumulative preferred stock with aggregate arrearages in excess of $53,000,000, common stock and option warrants entitling the holders, without limitation as to time, to purchase shares of common stock at $25 a share. The resolution of Electric's problems under section 11 has been substantially completed. Electric has disposed of its holdings in Idaho Power Co.[29] and Dallas Railway & Terminal Co.[30] through sales to the public and its holdings in Dallas Power & Light Co. were sold to the new Texas holding company organized by American. Its holdings in Utah Power & Light Co. were disposed of pursuant to a plan of reorganization of the latter company which provided, in part, for the reclassification of Utah's preferred and common stocks into

[25] Holding Company Act release No. 6158.
[26] Holding Company Act release No. 7369.
[27] Holding Company Act release No. 7564.
[28] File No. 54-168.
[29] 14 S. E. C. 167.
[30] Holding Company Act releases Nos. 6363 and 6377.

a new common stock.[31] United Gas Corp., Electric's principal subsidiary, was reorganized under section 11 in a proceeding which resolved all claims of United and Electric against Bond and Share arising out of the formation and financing of United.[32] In 1945 Electric retired its outstanding long-term debt with the proceeds derived from the disposition of properties described above and from retained earnings. In addition, the accounts and structures of Electric's remaining subsidiaries have been brought into compliance with the requirements of the act.

On March 2, 1949, the Commission approved a plan of dissolution filed by Electric.[33] This plan was filed in substitution for a joint plan filed by Electric and Bond and Share in July 1946 and subsequently withdrawn because of changed market conditions. The present plan provides in summary for the creation of a new holding company to acquire and hold the common stocks of the electric utility subsidiaries of Electric, subject to a reservation of jurisdiction under section 11 (b) (1) as to what properties of the subsidiaries may ultimately be retainable; the settlement of all suits and claims against Bond and Share by and on behalf of Electric, its subsidiaries, and certain former subsidiaries for a cash payment of $2,200,000; the distribution of Electric's assets among its security holders; and the dissolution of Electric. This plan was approved by the United States District Court for the Southern District of New York and is in the process of consummation.

American Gas & Electric Co.

At the time American Gas registered under the act its properties were divided, generally speaking, into three groups; namely, the Central System, operating in Indiana, Kentucky, Michigan, Ohio, Tennessee, Virginia, and West Virginia, the South Jersey System and the Northeast Pennsylvania System. Proceedings on an application filed by American Gas requesting approval of the continuance of its Central System together with the South Jersey and Northeast Pennsylvania Systems were consolidated with proceedings instituted by the Commission under section 11 (b) (1) in 1939. On December 28, 1945, the Commission concluded that the properties comprising the Central System formed an integrated electric system and were retainable under the act but that other properties must be divested if the Central System were to be retained.[34] Accordingly, in April 1946 American Gas sold to the public its holdings of the common stock of Scranton Electric Co.[35] and subsequently disposed of its holdings of the common stock of Atlantic City Electric Co., partly through a sale to the public and partly through dividend distributions to its common stockholders.[36] As a result of these dispositions, American Gas has fully complied with the Commission's order. The Commission has approved the acquisition by American Gas of the common stock of Indiana Service Co.[37] and, in August 1948, the acquisition of

[31] Holding Company Act release No. 6212, plan approved and enforced, unreported (D. Utah, No. 901, 1-14-46).
[32] Holding Company Act release No. 5271, plan approved and enforced, 58 F. Supp. 501 (Del. 1944).
[33] Holding Company Act releases Nos. 8889 and 8906, plan approved and enforced (S. D. N. Y., No. 49,547, April 22, 1949), appeal pending in United States Court of Appeals for Second Circuit.
[34] Holding Company Act release No. 6333.
[35] Holding Company Act release No. 6565.
[36] Holding Company Act release No. 7335.
[37] Holding Company Act release No. 7054.

all of the outstanding securities of Citizens Heat, Light & Power Co.[38] The Commission held that the electric properties of both companies might properly be considered a part of the Central System. In 1946 American Gas was denied authority to enter a bid for Continental Gas & Electric Corp.'s holdings of 99.17 percent of the common stock of Columbus & Southern Ohio Electric Co. The stock was sold to the public shortly thereafter for $39,900,000. The Commission concluded that the holding company system of American Gas would exceed the limits of "bigness" permitted by sections 10 and 11 if the proposed acquisition of Columbus and Southern was approved.

American & Foreign Power Co., Inc.

Foreign Power controls a mutual service company and 70 subsidiary companies located in Central and South America, Cuba, Mexico, China, and India. Since the operations of all Foreign Power's subsidiaries are in foreign countries, the Commission's principal concern is with respect to the simplification of the company's corporate structure and its relationship to Bond and Share. Foreign Power's capital structure at December 31, 1948, consisted of debentures, serial notes, three classes of preferred stock with dividend arrearages of some $390,000,000, common stock, and option warrants. Bond and Share holds all the serial notes and substantial blocks of the junior securities.

On October 24, 1944, Foreign Power and Bond and Share filed a plan for the reorganization of Foreign Power. After extensive hearings, this plan was amended by the two companies and on November 19, 1947, the Commission approved such amended plan after the filing of certain additional modifications.[39] The plan, as approved by the Commission, was subsequently approved by the United States District Court for the District of Maine.[40] However, because the company could not effectuate the financing necessary to consummate the plan, both the district court and the Commission vacated their orders approving it. On May 2, 1949, the Commission issued an order pursuant to section 11(b)(2) of the act requiring Bond and Share and Foreign Power to take steps to reorganize Foreign Power in such a manner that its resulting capital structure will consist only of common stock plus such amount of debt as will meet the applicable standards of the act.[41]

At the end of the fiscal year there was pending before the Commission an application by Foreign Power and Bond and Share in which it was proposed that Bond and Share would transfer to Foreign Power $19,500,000 principal amount of past due 6 percent debentures of Cuban Electric Co., a subsidiary of Foreign Power, in exchange for a $19,500,000 note of Foreign Power to bear interest at the rate of 6 percent per annum.[42] The stated purpose of the application is to facilitate the carrying out of a reorganization plan for foreign Power's Cuban subsidiaries and to provide Foreign Power with marketable securities which it could sell to obtain cash to meet the needs of its subsidiaries.

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[38] Holding Company Act release No. 8453.
[39] Holding Company Act releases Nos. 7815 and 7849.
[40] 80 F. Supp. 514 (Me., 1947).
[41] Holding Company Act release No. 9044.
[42] File No. 54-111.

Engineers Public Service Company

Events in the current fiscal year have brought substantially to a close the problems confronting this major public-utility holding company system. At the time of registration, Engineers Public Service Co. was a conspicuous example of geographical scatteration. Through its 20 subsidiaries, including 2 intermediate holding companies, it carried on operations in the States of Virginia, North Carolina, Georgia, Florida, Louisiana, Texas, New Mexico, Wyoming, South Dakota, Nebraska, Kansas, Missouri, Iowa, and Washington, and in Canada and Mexico. Operations included not only the electric and gas businesses but also such nonutility businesses as transportation, ice, steam and telephone. Proceedings were instituted under section 11(b)(1) of the act and the Commission directed, after hearings, that Engineers retain only one of its subsidiaries, Virginia Electric & Power Co., or, if the company elected, Gulf States Utilities Co.[43] Engineers contested the Commission's order in the courts but, while review proceedings were pending, proceeded to divest itself by sale of many of its properties. One major operating subsidiary, Puget Sound Power & Light Co., was reorganized and Engineers' remaining interest therein was sold. The two sub-holding companies were eliminated. A portion of the proceeds of these sales was used by Engineers to acquire Virginia Public Service Co. which adjoined and was interconnected with the properties of Virginia Electric & Power Co., its largest subsidiary. The properties so acquired were merged into the latter company.

By 1945 the Engineers system had been reduced to three operating companies, each soundly financed and capable of standing upon its own feet. These companies were Virginia Electric & Power Co. operating in Virginia, West Virginia, and North Carolina, Gulf States Utilities Co., in Louisiana and Texas, and El Paso Electric Co., in Texas and New Mexico. In that year, Engineers filed a voluntary plan under section 11(e) of the act which provided that Engineers' preferred stock should be retired by the payment of cash and that the remaining assets should be distributed to its common stockholders, after which Engineers would liquidate and dissolve. The El Paso stock was distributed to the common stockholders of Engineers, as was the major portion of the stock of Virginia Electric & Power Co. The stock of Gulf States Utilities Co. was offered to common stockholders of Engineers on a subscription basis.

The principal question which arose in connection with the plan involved the amount of cash to be paid to preferred stockholders of Engineers. The company originally proposed that the preferred stock be retired by the payment of an amount equal to the involuntary liquidation price, $100 per share plus accrued dividends. Certain preferred stockholders contended that the preferred stock should receive amounts equal to the call prices, which were $105 for the $5 preferred and $110 for the $5.50 and $6 series. The latter position was sustained by the Commission, which held that while the charter provisions did not control, the fair investment value of the preferred stock was not less than the respective call prices.[44] Engineers ac-

[43] 12 S. E. C. 41.
[44] Holding Company Act releases Nos. 7041 and 7119.

cordingly amended its plan to provide for the retirement of the preferred by the payments of amounts equivalent to the call prices. After litigation which reached the Supreme Court, Commission approval of the plan was upheld.[45]

The balance of the stock of Virginia Electric & Power Co. retained by Engineers is now being sold, leaving Engineers with no substantial asset other than cash. This cash will be distributed to the common stockholders upon dissolution of the company.

General Public Utilities Corp.

This company is the top holding company emerging from reorganization of the former Associated Gas & Electric System. Associated Gas & Electric Co. and its immediate subsidiary Associated Gas & Electric Corp. registered as holding companies on March 28, 1938. At that time the system consisted of 164 companies, including 11 subholding companies, and was unequalled for the complexity of its corporate structure. Four of the utility companies were as many as 6 tiers of companies removed from the top holding company. The system was engaged in business in 26 States scattered from Maine to Arizona and in the Philippine Islands; the businesses included such diverse activities as electric, gas, water, ice, street railway, bus, heating, hotel, insurance, real estate, engineering, marine towing, toll bridge, coal mining, and ferry operations. Associated Gas & Electric Co. itself had outstanding 10 different kinds of fixed-interest debt obligations, several series of income debentures, a number of securities variously known as convertible debenture certificates, convertible certificates, and convertible obligations, two different classes of preferred stock, a class A stock, a class B stock, a common stock and warrants to purchase common stock. Most of Associated's subsidiaries also had senior securities outstanding in the hands of the public. The consolidated assets of the system were stated at a little over $1,000,000,000 and the corporate assets of Associated Gas & Electric itself were stated at approximately $450,000,000.

In 1940, Associated Gas & Electric Co. and Associated Gas & Electric Corp. filed petitions for reorganization pursuant to chapter X of the Bankruptcy Act. In 1942, pursuant to the provisions of section 11 (b) (1) of the act, the trustees of Associated Gas & Electric Corp. were ordered to divest themselves of all their interests in some 114 companies located primarily outside the 3 States of New York, Pennsylvania, and New Jersey, no determination being made at that time of the status of the majority of the properties in these States.[46] Of these 114 companies 111 have been divested. Included in the 3 remaining companies are 2 operating in the Philippine Islands as to which our divestment order has been temporarily suspended.[47] Just prior to the close of the fiscal year the Commission ordered the section 11 (b) (1) proceedings reconvened for the purpose of determining what properties located in Pennsylvania and New Jersey, and incidental businesses related thereto, may be retained under the standards of the act.[48] All but 3 New York properties have already been divested and preparations are being made for the disposition of these 3 as well.

[45] 17 L. W. 4601 (1949).
[46] 11 S. E. C. 1115.
[47] Holding Company Act release No. 5601.
[48] Holding Company Act release No. 9182.

As at January 1, 1946, a comprehensive plan of reorganization of Associated Gas & Electric Co. and Associated Gas & Electric Corp. was consummated pursuant to chapter X of the Bankruptcy Act and section 11 (f) of the Holding Company Act. In place of the two companies and their many securities there was substituted a single company, General Public Utilities Corp. (GPU), which had a security structure consisting of 10 year convertible debentures, bank loans, and common stock. The debentures were redeemed in 1947, however, and at June 30, 1949, GPU had outstanding only $3,950,000 of notes payable to banks, all due within approximately 6 years, and common stock having a book equity of approximately $122,000,000.

After consummation of the plan of reorganization, GPU's assets consisted primarily of securities of three subholding companies which in turn had outstanding in the hands of the public approximately $80,000,000 of senior securities. These publicly held securities have been reduced to $32,000,000 through the dissolution of two of these companies and the retirement of substantial amounts of senior securities by the third. Plans are presently pending which should result in the retirement of the remaining subholding company's senior securities and make possible the dissolution of the company if such action should be deemed necessary or advisable at that time.

The operating subsidiaries of General Public Utilities have all restated their accounts to eliminate inflationary items and have been refinanced in a manner which enables them to raise new money for construction purposes on a sound and economic basis.

International Hydro-Electric System—New England Electric System

At the time of registration, International Hydro-Electric System (IHES), a Massachusetts voluntary association, owned directly Gatineau Power Co., a Canadian public utility company, and two wholesale electric utilities operating in the United States. It also owned the equity in New England Power Association, which since its reorganization is known as New England Electric System (NEES). NEES was a holding company in its own right and while the managements of the two companies were interrelated they functioned separately. Accordingly the reorganizations of the two companies were handled in separate proceedings.

Originally, IHES had outstanding debentures due in 1944, preferred stock, class A stock, class B stock, and common stock. The company was in a precarious financial position, having a huge earned surplus deficit. Operationally it performed no functions for its subsidiaries. Voting control was vested in the stock junior to the preferred stock. Moreover, NEES, its subsidiary holding company, had two layers of intermediate holding companies beneath it, with the result that the corporate structures of both IHES and NEES violated the "great-grandfather clause" of section 11 (b) (2) of the act.

The Commission initiated proceedings under section 11 (b) (2) with respect to IHES. The first important step in these proceedings was to cause the cancellation of the class B and common stock. Subsequently, in 1942, the Commission directed IHES to liquidate and dissolve.[49] However, many system problems had to be resolved before the portfolio of IHES could be distributed. Among these were litiga-

[49] 11 S. E. C. 888.

tion of claims on behalf of IHES against its former parent, International Paper Co., the reorganization of NEES, and the merger of IHES's two New York subsidiaries into a single company. These matters were not fully disposed of until 1947, when the reorganization of NEES was completed and the sum of $10,000,000, together with other considerations, was finally paid to IHES in settlement of the claims against International Paper Co. The separate reorganization of NEES was itself a major operation. NEES had five subholding companies, in two tiers, over its operating subsidiaries. Under a voluntary plan filed under section 11 (e) of the act the subholding companies were eliminated by the retirement of their securities in exchange for cash or new common stock of NEES.[50] NEES emerged from the reorganization with a single issue of debt and common stock, which replaced 18 classes of old securities. IHES now owns only 8 percent of the common stock of NEES, and is no longer a holding company with respect to it.

It is contemplated that NEES will continue indefinitely as a registered holding company. During the current fiscal year the Commission has entertained numerous applications by NEES and its subsidiaries relating principally to the financing problems of the NEES system. Also, Green Mountain Power Corp., a subsidiary of NEES operating in Vermont, has itself filed a voluntary plan of reorganization.

Meanwhile, hearings on various plans for the liquidation and dissolution of IHES are going forward. An application has been made by a class A stockholder of IHES seeking to have the Commission modify its dissolution order of 1942 in order to permit IHES to continue as a corporate entity rather than to dissolve.

The Middle West Corp.

The Middle West Corp. (Middle West), successor in bankruptcy to Middle West Utilities Co., registered under the Holding Company Act in December 1935. At that time it had 152 subsidiaries, including 62 electric or gas utility companies and fifteen subholding companies. Sixteen of the 152 subsidiaries were themselves in process of reorganization under the Bankruptcy Act, and these in turn controlled an additional 74 of the system companies.

As a result of proceedings under section 11 (b) (1) of the act, Middle West was ordered to sever its relations with all properties, operations and companies except Central Illinois Public Service Co. and its subsidiaries and Kentucky Utilities Co. and its subsidiaries, jurisdiction being reserved to consider the retainability of these companies.[51]

In 1947, however, the management of Middle West decided to dissolve the corporation and a resolution was presented to stockholders, who voted in favor of the dissolution. Pursuant to this decision, Middle West distributed to its stockholders its principal assets, consisting of the common stocks of Central Illinois Public Service Co., Kentucky Utilities Co., Public Service Co. of Indiana and Wisconsin Power & Light Co.[52] Many of its smaller properties were sold or merged into other companies in the system. Middle West has now

[50] Holding Company Act release No. 6470.
[51] 14 S. E. C. 309.
[52] Holding Company Act releases Nos. 8642 and 8788.

disposed of substantially all of its assets. Declarations are pending before the Commission covering the disposition of its holdings of common stock of Upper Peninsula Power Co. and of its interest in four service companies.

In April 1946, the Commission approved the creation of the Central & South West Corp. system,[53] which is comprised of four electric utility companies of substantial size. The new system was formed by merging two subholding companies which between them had four outstanding issues of 6 and 7 percent preferred stock with dividend arrearages totaling about $16,000,000. These shares were retired at the redemption price plus accrued dividends. The merger also resulted in increasing combined common equity from 9.5 percent of total capitalization and surplus to 29.5 percent. The new Central & South West Corp. continues to be subject to the act as a registered holding company controlling an integrated electric system.

Midland United Co. and Midland Utilities Co.

Midland United Co. and its subsidiary, Midland Utilities Co., which had been part of the Insull utility empire, filed voluntary petitions for reorganization pursuant to section 77B of the Bankruptcy Act on June 9, 1934. The trustees of the respective estates registered as holding companies under the Public Utility Holding Company Act of 1935 on December 1, 1935. At that time the Midland United System was comprised of 27 companies and Midland Utilities Co., in turn, had an additional 18 subsidiaries.

At the time of the filing of the bankruptcy petitions, Midland United had outstanding secured demand notes, two classes of preferred stock, both in arrears as to dividends, and common stock. Midland Utilities had outstanding both secured and unsecured demand notes, debentures on which there was accumulated unpaid interest, two classes of preferred stock, both in arrears as to dividends, and common stock. In addition, there were intercompany claims between the two companies as well as claims against the estates by various affiliated and nonaffiliated interests.

Various plans were considered by the reorganization court and by this Commission and numerous hearings with respect to such plans were held. The final plan of reorganization was approved by this Commission in late 1944, and was confirmed by the reorganization court on April 7, 1945. This plan, which was thereafter consummated, proposed the recapitalization of both companies on a one-stock basis with complete liquidation to follow within five years. The liquidation of both companies has now been completed.

New England Gas & Electric Association

New England Gas & Electric Association, a Massachusetts trust, registered as a holding company in 1938 and in 1941 was made the subject of proceedings under section 11 (b) (2) of the act. At that time the company's capitalization consisted of five debenture issues, four of which matured in the years 1947 to 1950, two classes of preferred shares with large dividend arrearages, and common shares. There was little or no equity for the second preferred and common stock of New England. Furthermore, under the terms of its declara-

[53] Holding Company Act release No. 6606.

tion of trust its shares were all nonvoting and vested in the holders no right or power to elect or remove its trustees, directors, or officers or to control them in the management of its affairs. The trustees were self-perpetuating and they in turn appointed or removed officers and directors.

The system consisted of 10 electric utilities, 7 gas utilities, 2 gas and electric utilities, a steam-heating company and 2 service companies. The utility subsidiaries rendered service in the States of Massachusetts, New Hampshire, and Maine. New England's investments in its subsidiaries were carried at approximately double the related net assets of the subsidiaries at the dates of their acquisition.

Subsequent to the institution of section 11 (b) (2) proceedings the trustees of Associated Gas & Electric Co. and Associated Gas & Electric Corp. asserted claims in the amount of approximately $30,000,000 against New England arising from various transactions between the two systems. It appeared to the Commission that before a determination could be made with respect to the recapitalization of New England the validity and rank of the asserted claims would have to be resolved, and the proceedings under section 11 (b) (2) were broadened accordingly.

After conclusion of very lengthy hearings, but before a decision of the Commission with respect to the claims, numerous discussions were held by the parties looking toward a recapitalization plan which would resolve the section 11 (b) (2) problems and also the complex claims and counterclaims between New England and the Associated system. A plan of recapitalization acceptable to the various parties in the proceeding was then filed and approved by the Commission [54] and by the United States District Court for the District of Massachusetts.[55] Due to adverse market conditions, however, this plan was not consummated. In the following year an alternate plan was approved by the Commission [56] and was consummated during April 1947.

The alternate plan substituted for the complex capitalization of New England a capital structure consisting of collateral trust bonds, preferred stock and common stock. It corrected the lack of voting power by extending to the proposed shares full voting rights, including the right to elect trustees annually. The plan also provided for a settlement of the enormous contingent debt liabilities resulting from the claims litigation and restated the carrying value of New England's investments in its subsidiaries at approximately $50,000,000, representing related net asset value as shown by the books of the subsidiary companies.

New England Public Service Co.

This company at the time of its registration had five major operating subsidiaries, of which two operated in Maine, one in New Hampshire and two in New Hampshire and Vermont. It also owned, through an industrial subsidiary, five textile mills, a paper company, and a forest products manufacturing company. The company was heavily overcapitalized, having outstanding two classes of prior lien preferred stock and, junior thereto, four classes of preferred stock. All these

[54] Holding Company Act release No. 6729.
[55] Unreported (D. Mass., No. 5636, 7-17-46, 3-10-47).
[56] Holding Company Act release No. 7181.

preferred issues had substantial dividend arrearages. As a result of simplification proceedings instituted by the Commission under section 11 (b) (2) of the act, the company was directed, in 1941, to reorganize on a one-stock basis, or, in the alternative at its election, to liquidate and dissolve.[57] The company did not appeal this decision and has elected to dissolve. It has merged Cumberland County Power & Light Co. into Central Maine Power Co. and has caused Public Service Co. of New Hampshire to acquire the New Hampshire properties of Twin State Gas & Electric Co. and Central Vermont Public Service Corp. to acquire the Vermont properties of that company. The industrial companies were sold for cash.

A plan filed by the company under section 11 (e) of the act provided for the retirement of the prior lien stock by the payment of amounts equal to the voluntary redemption prices, $120 per share for the $7 series and $110 per share for the $6 series, in each case with accrued dividends. A portion of the cash required was derived from the sale of the company's interest in its nonutility properties and the balance from a bank loan. Due to the pendency in the courts of the *Engineers Public Service Co.* case, the Commission approved the retirement of the preferred by the payment for each share of prior lien of $100 per share and the deposit of the difference in escrow, reserving for future determination what additional amounts, if any, should be paid on the prior lien stock.[58] This plan was approved by the district court.[59]

Superimposed on New England Public Service Co. is Northern New England Co., a voluntary association, which owns approximately one-third of the former company's common stock. During the current fiscal year the Commission approved a plan for the partial liquidation of this company by distribution of cash to its shareholders.[60] At the same time it directed that the company liquidate and dissolve.

The North American Co.

At its registration in 1937, the North American Co. was the top holding company in a system which through several subholding companies controlled 36 utility and 46 nonutility subsidiaries. Electric utility operations were conducted by system companies in 10 States and the District of Columbia; gas utility operations were conducted in 9 States. The consolidated balance sheet of North American and its subsidiaries showed assets of over $900,000,000, and through the direct and indirect ownership of securities North American controlled an empire whose aggregate value was stated to be approximately $2,200,000,000.

During the last 5 years, North American has taken substantial steps toward compliance with the Commission's section 11 (b) (1) order, which was issued in 1942.[61] By a number of means, including dividend payments in portfolio securities, outright distribution, issuance of purchase warrants to its stockholders and sale at competitive bidding, North American has disposed of nearly all of its assets except Union Electric Co. of Missouri, Missouri Power & Light Co., and several minor nonutility subsidiaries.

[57] 9 S. E. C. 239.
[58] Holding Company Act releases Nos. 7511 and 7713.
[59] 73 F. Supp. 452 (S. D. Me., 1947).
[60] Holding Company Act release No. 8401.
[61] 11 S. E. C. 194 (1942), aff'd *sub nom. The North American Co.* v. *S. E. C.*, 133 F. 2d 148 (C. A. 2, 1943), aff'd 327 U. S. 686 (1946).

Among major interests which have been divested are those in Pacific Gas & Electric Co., Cleveland Electric Illuminating Co., Wisconsin Electric Power Co., Potomac Electric Power Co., Detroit Edison Co., Illinois Power Co., St. Louis County Gas Co., Northern Natural Gas Co., Des Moines Electric Light Co., and Illinois Terminal Co. Since the close of the fiscal year, the Commission has approved divestments of West Kentucky Coal Co. and Kansas Power & Light Co.[62] The Commission has before it a plan for the liquidation and dissolution of North American Utility Securities Corp., a proposed sale by North American of its holdings in Capital Transit Co., and the proposed transfer of Missouri Power & Light Co. to Union Electric Co. of Missouri.

Concurrently with its divestments, North American has eliminated all of its debt and preferred stock and presently has an all common stock structure.

Northern States Power Co.

Northern States Power Co., a Delaware corporation, had as its only substantial asset the common stock of Northern States Power Co., a Minnesota corporation. The Delaware company had been organized prior to the passage of the Holding Company Act, largely for the purpose of avoiding a provision for double stockholders' liability then contained in the Minnesota corporation law. This provision was later repealed and for many years the Delaware company performed no function other than to hold the Minnesota company stock.

The Minnesota company, on the other hand, is a substantial holding-operating company, engaged, either directly or through subsidiaries, in the gas and electric business in the States of Minnesota, Wisconsin, North Dakota, and South Dakota, and, to a minor extent, in Illinois.

The Delaware company filed various plans for its liquidation and dissolution. The principal question arose as to the proportions in which its principal asset, the common stock of the Minnesota company, should be distributed among its four classes of security holders. During the past fiscal year, the Commission approved a plan giving to the 7 percent preferred 41.05 percent, to the 6 percent preferred 36.94 percent, to the class A common stock 18.82 percent and to the class B common stock 3.19 precent.[63] The United States District Court for Minnesota approved this plan and ordered it carried out.[64] Distribution has now been made.

Ogden Corp.

This company is the successor in reorganization to the former Utilities Power & Light Corp. At the time of its registration as a holding company in 1936, Utilities Power & Light Corp. had total consolidated book assets of over $300,000,000, and 48 subsidiaries, including 27 public utility companies. The utility subsidiaries were located in far-flung areas—including 12 States of the United States and 2 provinces of Canada.[65] Its other subsidiaries were engaged in a

[62] Holding Company Act releases No. 9237 and 9213.
[63] Holding Company Act releases Nos. 7950 and 7976.
[64] 80 F. Supp. 193 (Minn., 1948).
[65] Just prior to its registration as a holding company Utilities Power, through its subsidiary Utilities Power & Light Corp., Ltd., had disposed of its interests in 57 British utility subsidiaries.

great variety of nonutility businesses, including such nonrelated enterprises as machinery manufacturing, motion picture theater, wood products manufacturing, railroad transportation, coal production, and oil production. As a result of its top-heavy capital structure—consisting of two series of debentures, preferred stock (with large dividend arrearages) and three classes of common stock—Utilities Power went into bankruptcy in 1937. In 1938, the Commission instituted proceedings against the Utilities Power system under the integration provisions of section 11 (b) (1) of the act—the first of such proceedings to be instituted by the Commission.

Emerging as Utilities Power's successor pursuant to a plan of reorganization approved by the Commission and by the district court, Ogden Corp. was committed to a program of divestment of its interests in utility properties, so that it would cease to be a public utility holding company under the act.[66] Ogden's initial outstanding securities, which were distributed among the creditors and preferred stockholders of Utilities Power in the latter's bankruptcy reorganization, consisted of debentures, preferred stock and common stock. With the proceeds from the sale or other disposition of public utility investments, Ogden, as early as 1940, redeemed for cash its entire outstanding debentures and preferred stocks and has since made substantial cash distributions to holders of its common stock.

Ogden also caused the reorganization of certain of its utility subsidiaries so as to simplify their capital structures, eliminate dividend arrearages, and place them on a sound financial basis. Thus, Derby Gas & Electric Corporation was reorganized in 1942;[67] The Laclede Gas Light Co. was reorganized in 1945;[68] and Interstate Power Co. was reorganized in 1948.[69] In addition, Central States Power & Light Corp. disposed of all its physical utility properties and its liquid assets have been distributed to its security holders and to certain security holders of its parent company, Central States Utilities Corp., pursuant to a plan of liquidation and dissolution of both companies approved by the Commission in July 1947.[70]

Since its inception in 1940 Ogden has divested itself of direct or indirect public utility interests with book assets of over $150,000,000. Among the principal divestments were the sale of Ogden's investment in Indianapolis Power & Light Corp., its interest in the reorganized Derby company, and of the reorganized Laclede company. In addition, Ogden disposed of investments in numerous nonutility subsidiaries through outright sale or dissolution of such subsidiaries.

Following the reorganization of Interstate, referred to above, certain shares of new common stock of Interstate, together with cash, were placed in escrow pending resolution of subordination questions regarding Ogden's former holdings in Interstate, under the principles of the *Deep Rock* case.[71] In June 1949 the Commission approved a plan for resolution of the "Deep Rock" issues which provided for distribution

[66] 5 S. E. C. 483 (1939).
[67] 9 S. E. C. 686 (1941).
[68] Holding Company Act releases Nos. 5062 and 5071, plan approved and enforced, 57 F. Supp. 997 (ED Mo. 1944).
[69] Holding Company Act release No. 7955, plan approved and enforced, unreported (Del., No. 1003, January 7, 1948).
[70] Holding Company Act releases Nos. 7568 and 7610, plan approved and enforced, 74 F. Supp. 360 (Del. 1947).
[71] For a discussion of the *Deep Rock* case and the underlying principles thereby established, see the Commission's Tenth Annual Report, p. 94.

of the escrowed stock and cash to public holders of Interstate's old debentures and preferred stocks and to Ogden.[72] The matter is pending in the District Court of the United States for the District of Delaware. Pursuant to the plan, Ogden is committed to disposition of its holdings in Interstate's new common stock within a year from the effective date of the plan.

Ogden having disposed of all its interests in public utility properties (with the single exception of its interest in Interstate which, as noted above, is destined for early disposition) the Commission, in August 1948, granted an application pursuant to section 5 (d) of the act declaring Ogden to be no longer a registered holding company, subject to certain conditions and reservations.[73] Shortly thereafter, Ogden registered with the Commission as an investment company under the Investment Company Act of 1940.

Of the entire former Utilities Power system, only Derby Gas & Electric Corp. (with present total consolidated assets of approximately $15,800,000) and Interstate Power Co. (with present total consolidated assets of approximately $49,000,000) remain subject to the act as registered holding companies.

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

The Standard holding company system presented in extreme degree the evils of corporate pyramiding and scatteration of properties which the integration and simplification provisions of the act were designed to eliminate. Standard Power, through its subsidiary, Standard Gas, controlled at that time 104 active subsidiaries whose operations were conducted in 20 different States and Mexico, and the system contained 9 registered holding companies. At June 30, 1949, the number of active subsidiaries had been reduced to 66 companies (including 43 street railway companies) operating in 8 States, and the number of registered holding companies to 3. The system presently comprises Philadelphia Co. and its subsidiaries, Wisconsin Public Service Corp., Oklahoma Gas & Electric Co., Louisville Gas & Electric Co., and Market Street Railway Co., an inactive company in process of dissolution. Substantially all of the proceeds from divestments together with undistributed earnings of Standard Gas were applied to the reduction of Standard Gas' indebtedness from some $71,000,000 in 1940 to $9,800,000 as of June 30, 1949. On December 31, 1948, the Commission entered an order requiring either the liquidation of Standard Gas or its recapitalization on an all-common stock structure.[74]

In 1947, extensive hearings were held on the status under section 11 of Standard Gas' principal subsidiary, Philadelphia Co. That company is a holding company whose principal subsidiaries are engaged in serving the Pittsburgh area with electricity (Duquesne Light Co.), natural gas (Equitable Gas Co.) and street railway and bus transportation (Pittsburgh Railways Co. and its underliers). In June 1948, the Commission ordered Philadelphia Co. to dispose of its interests in the natural gas utility and the transportation businesses and thereafter to liquidate and dissolve.[75] Standard and Philadelphia Co. filed petitions for review of that order with the United States Court of

[72] Holding Company Act releases Nos. 9139 and 9202.
[73] Holding Company Act release No. 8402.
[74] Holding Compay Act release No. 8773.
[75] Holding Company Act release No. 8242; rehearing denied, Holding Company Act release No. 8320.

Appeals for the District of Columbia. Briefs were filed and oral argument was had on May 19, 1949. As of the end of the fiscal year the matter was pending decision by the court.

In late 1948, Standard Gas filed a voluntary plan for the simplification of the capital structure of Philadelphia Co., providing for the retirement of Philadelphia Co.'s $36,000,000 of funded debt and $40,000,000 of preferred stocks. Hearings on that plan were commenced in April 1949 and have been adjourned to October 1949 to permit Standard to prepare and file amendments.

An important development in the compliance by Standard Gas & Electric Co. with section 11 occurred in May 1949, when a compromise plan for the reorganization of Pittsburgh Railways Co., which has been in bankruptcy since 1938, was announced.[76] The transit system in Pittsburgh is operated by Pittsburgh Railways Co. under complex lease and operating agreements. It is owned by 55 separate corporations which have 42 security issues outstanding in the hands of the public and some 80 other security issues held by Philadelphia Company and its subsidiaries. Philadelphia Co. and Pittsburgh Railways, in addition, have guaranteed or are otherwise obligated to pay rentals, bond interest, taxes and other obligations of some of the underlying companies. Under the plan, a single company would be formed which would replace all of the existing companies, and would have a simple capital structure consisting of common stock and not to exceed $6,000,000 of bonds. During the last fiscal year two major voluntary simplification plans of subholding companies in the Standard System—Louisville Gas & Electric Co. and Northern States Power Co., both Delaware holding companies superimposed upon operating utilities having the same names—were consummated, marking the culmination of extensive hearings and lengthy court proceedings. Those companies are now in the process of liquidation.

Perhaps the most significant recent development in the system, from the point of view of stockholders, was the resumption in early 1949 of regular quarterly dividends on the senior preferred stocks of Standard Gas for the first time since 1934, made possible by the substantial improvement in the system's earnings in recent years and the refunding of Standard Gas' bank loan. This, in turn, made possible the resumption, for the first time since 1935, of regular quarterly dividends on the preferred stock of Standard Power.

The United Light & Railways Co.

On February 18, 1938, The United Light & Power Co. registered as a holding company with a system comprised of 10 holding companies, 7 of which were registered holding companies, 21 electric and gas utility subsidiaries, 20 nonutility subsidiaries, and a service company. In 1941 the Commission directed the dissolution of United Light & Power Co. and United American Co., a subholding company.[77] By a subsequent order the Commission directed the divestment of the interests of United Light & Power Co. and the subholding companies in 22 subsidiaries in order to comply with the standards of section 11 of the act.[78]

[76] File No. 52-28.
[77] 8 S. E. C. 837.
[78] 9 S. E. C. 833.

After a series of transactions designed to enable Light and Power to comply with the outstanding order of dissolution, the Commission approved a plan which provided, in substance, for the distribution of Light and Power's remaining investment, the common stock of United Light & Railways Co., to its common stockholders.[79] The residual net assets of Light and Power were transferred to Railways, and Light and Power was dissolved. Thus, Railways became the system's top holding company with two principal subholding company systems, Continental Gas & Electric Corp. and American Light & Traction Co.

In June 1947 Railways and Light & Traction filed a plan which provided, among other things, for the divestment by Railways of its entire interest in Light & Traction and the continuation of the latter as a registered holding company holding an integrated gas utility system. Light & Traction had, in the interim, embarked on a program to finance and construct a large interstate natural gas pipe line from the operating areas of its natural gas subsidiaries to fields in the Hugoton area. Other more important provisions of the plan provided for the divestment of the common stock of Detroit Edison Co. held by Light & Traction and Railways and the retirement of the preferred stocks of the two holding companies.

On February 17, 1949, Railways and Continental publicly announced their intention to liquidate and dissolve and a plan under section 11 (e) was accordingly filed with the Commission on May 31, 1949.[80] The liquidation and dissolution of the two companies will be accomplished, after retirement of their debt, by the distribution of the common stocks of subsidiary companies to common stockholders of Railways and to a small minority interest holding common stock of Continental. If the proposed dissolutions are consummated, there will remain of the complex holding and subholding company system of The United Light & Power Co. only an integrated gas utility system held by Light and Traction, which has changed its name to American Natural Gas Co.

United Corp.

The United Corp. registered as a holding company in March 1938, at which time its portfolio was largely comprised of the common stock of four holding company subsidiaries. These subsidiaries, with the percentage of voting control held by United, were as follows: The United Gas Improvement Co., 26.2 percent; Public Service Corp. of New Jersey, 13.9 percent; Niagara Hudson Power Corp., 23.4 percent; and Columbia Gas & Electric Corp. (now the Columbia Gas System, Inc.), 19.6 percent.

In June 1941, the Commission instituted proceedings with respect to United under sections 11 (b) (1) and 11 (b) (2) of the act. At that time the 125 companies in the United System operated in 22 States and in Canada. Their combined total assets approximated $2,765,000,000. Subsequently, the Commission ordered that United change its existing capitalization, which consisted of preferred and common stocks, to one class of stock and that it cease to be a holding company.[81] United has since retired all of its preference stock by exchanging for it portfolio

[79] Holding Company Act release No. 3242 and 10 S. E. C. 945.
[80] File No. 54-178.
[81] Holding Company Act release No. 4478.

securities and cash. Its principal investments now consist of common stocks of the following companies:

Company	Percent of voting control
Niagara Hudson Power Corp	28
South Jersey Gas Co	28. 5
The Columbia Gas System, Inc	6. 8
Public Service Electric & Gas Co	3. 5
The United Gas Improvement Co	7. 7

There is pending before the Commission a plan for the distribution to United's common stockholders of approximately 50 percent of its holdings of Niagara Hudson common stock.[82]

Niagara Hudson Power Corp.

In 1942 the Commission instituted proceedings under section 11 (b) (2) with respect to Niagara Hudson, its subholding company, Buffalo Niagara and Eastern Power Corp. (BNE), and their 18 subsidiary companies. Subsequently, a plan was filed pursuant to section 11 (e) of the act providing, among other things, for the consolidation of BNE and its 3 principal public-utility subsidiaries, the dissolution of Niagara Hudson and the payment of accrued and unpaid preferred dividends. This plan, however, was disapproved by the Public Service Commission of the State of New York. Thereafter the Commission issued an order requiring BNE to recapitalize on a one stock basis.[83]

BNE and Niagara Hudson then filed plans providing for the consolidation of BNE and certain of its subsidiaries into Buffalo Niagara Electric Corp. as a surviving company.[84] To accomplish the reorganization Niagara Hudson used approximately $63,000,000 in retiring the publicly held second preferred stock of BNE at its call price plus accrued dividends. These funds were obtained from bank loans, treasury cash and proceeds from the sale of certain of Niagara Hudson's portfolio securities.

At the end of the 1949 fiscal year there were pending before the Commission plans providing, among other things, for the consolidation into a single operating company of Niagara Hudson's principal subsidiaries; namely, the new Buffalo Niagara Electric Corp., Central New York Power Corp., and New York Power & Light Corp.; the reclassification of the common stock of the new operating company into class A and common stocks; the exchange of class A stock for the outstanding preferred stocks of Niagara Hudson; the offering of the common stock of the new operating company to Niagara Hudson's own common stockholders on a subscription basis; and the eventual dissolution of Niagara Hudson. [85]

The Columbia Gas System, Inc.

Columbia registered as a holding company in January 1938. There were approximately 50 companies in the system at that time, including one subholding company, 4 electric utilities, 21 gas utilities and three electric and gas utilities.

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[82] File No. 54-167.
[83] Holding Company Act release No. 5115.
[84] Holding Company Act release No. 6083.
[85] File Nos. 54-170 and 54-172.

In 1941, the Commission instituted proceedings with regard to Columbia and several of its subsidiaries, including Columbia Oil & Gasoline Corp. The plan involved, among other things, the sale by Columbia Oil & Gasoline Corp. of its interest in Panhandle Eastern Pipe Line Co., the transfer of its five oil and gasoline subsidiaries to Columbia, and its subsequent liquidation. The Commission approved this plan [86] and consummation thereof had the effect of divorcing Panhandle Eastern from the Columbia System, a step which the Commission had found to be necessary under section 11 (b) (1).[87] The plan also extricated some of the companies and other interested parties from the problems which they faced under the antitrust laws, and terminated a complex tangle of private litigation.

After further proceedings under sections 11 (b) (1) and 11 (b) (2) with regard to Columbia and its remaining subsidiaries, the Commission found that Columbia could retain the distribution operations of the Charleston, Pittsburgh and Columbus groups of gas properties, as well as the production and transmission properties owned and operated by the companies within each group.[88] The Commission further found that certain other properties, including the properties owned by the Cincinnati Gas & Electric Co. and the Dayton Power & Light Co. were not retainable by Columbia and should be divested. Columbia has fully complied with this order and anticipates continued existence as a holding company controlling an integrated gas system. Since 1946, Columbia has issued and sold $78,000,000 principal amount of debentures in order to obtain funds for construction purposes and has raised new equity money through the issue and sale to its stockholders of 2,568,300 shares of additional common stock at $10 per share.

The United Gas Improvement Co.

United Gas Improvement Company (UGI) registered as a holding company in March 1938 with approximately 50 subsidiary companies engaged in the electric, gas, and miscellaneous businesses. After section 11 (b) (1) proceedings, the Commission defined its integrated system as the electric properties in the Pennsylvania, Delaware, and Maryland area, and orders of divestment were issued on the basis of this interpretation.[89] Thereafter voluntary plans under section 11 (e) were filed by UGI and its subsidiary, Philadelphia Electric Co., for the purpose of enabling the UGI system to effect partial compliance with section 11 (b). Pursuant to this plan, which was approved by the Commission,[90] UGI distributed to its preferred and common stockholders $30,600,000 in cash and substantially all its stockholdings in Philadelphia Electric and in Public Service Corp. of New Jersey. The consummation of this plan and the retirement of UGI's preferred stock made possible the further distribution of investments and cash to its common stockholders. It also made possible an exchange of properties between UGI and nonaffiliated holding company systems, out of which evolved the present holding company system of Delaware Power & Light Co.

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[86] 12 S. E. C. 218 and Holding Company Act releases Nos. 3829, 3950, and 4319.
[87] 11 S. E. C. 80.
[88] Holding Company Act release No. 5455.
[89] 9 S. E. C. 52 and 11 S. E. C. 338.
[90] 12 S. E. C. 1080, Holding Company Act release No. 4205, and 15 S. E. C. 131.

UGI later distributed to its stockholders its holdings of Delaware Power & Light Co. and exchanged for approximately 750,000 shares of its outstanding capital stock its portfolio holdings of securities of 4 public utility holding companies; namely, American Water Works & Electric Co., Inc., The Commonwealth & Southern Corp., Niagara Hudson Power Corp. and Public Service Corp. of New Jersey.

As of December 31, 1948, the UGI system consisted of five gas utility companies, one gas and electric company and five nonutility companies.

Public Service Corp. of New Jersey

Public Service Corp. of New Jersey for more than 40 years had been a holding company with respect to numerous electric, gas, and transportation subsidiaries operating primarily in the State of New Jersey. While it had been subject to the provisions of the act as a subsidiary of United Corp., it was, until 1946, exempted by rule from registration as a holding company. On June 12, 1946, the Commission revoked the exemption and instituted proceedings under sections 11 (b) (1) and 11 (b) (2) with respect to the system;[91] shortly thereafter Public Service registered as a holding company. At that time Public Service had four utility subsidiaries, chief of which were Public Service Electric & Gas Co. (PEG), and a transportation subsidiary, Public Service Coordinated Transport (Transport) which in turn had four nonutility subsidiaries.

At December 31, 1946, Public Service had outstanding $19,087,455 face amount of 6 percent perpetual interest-bearing certificates secured primarily by noncallable preferred stocks of PEG and Transport with an aggregate par or stated value of more than twice the face value of the perpetuals. At the same date Public Service also had outstanding $160,000,000 aggregate par or stated value of noncallable preferred stocks bearing dividend rates of $8, $7, $6, and 5 percent as well as $112,000,000 stated value of common stock. In addition to these high cost, noncallable and perpetual securities which constituted an unparalleled stranglehold on system growth and expansion, numerous other classes and series of securities were held within the system.

As a result of a plan consummated on July 1, 1948, Public Service was dissolved and its security holders received securities of PEG, the principal operating company, in exchange for those of Public Service.[92] Substantially all perpetual and noncallable securities were eliminated, thus clearing the way for future system financing on an economical basis. Inflationary items in the accounts of the subsidiaries were either eliminated or subjected to a program of amortization. Several subsidiary companies were recapitalized, one was sold, and two were merged, the stock of the merged company being distributed to the Public Service common stockholders. PEG and its transportation subsidiaries are no longer subject to the provisions of the act.

West Penn Electric Co.

West Penn Electric Co. is the surviving holding company emerging from reorganization of American Water Works & Electric Co., Inc.

[91] Holding Company Act release No. 6693

[92] Holding Company Act releases Nos. 7964 and 8002; plan approved and enforced, unreported (D. N. J. No. 11105,1 -19-48)

The system of American Water Works & Electric Co., Inc. was comprised, at the date of registration, of 14 subholding companies (including 4 which were also operating companies), 14 electric or gas utility companies and 122 nonutility companies, most of which were water companies.

In 1947 American was liquidated and dissolved, resulting in the payment and discharge of $13,850,000 principal amount of corporate indebtedness of American, and of $19,986,800 aggregate par value of corporate preferred stocks. There is still pending for the decision of the Commission the treatment to be accorded the holders of certificates issued to the preferred stock in lieu of any additional payment over voluntary liquidation price of $100 per share. The redemption premium applicable to this preferred stock was $10 per share. (Holding Company Act releases Nos. 7091 and 7208.).

This liquidation also resulted in the divestment of 70 water companies and the payment and discharge of preferred stocks plus arrears of a subsidiary aggregating in excess of $4,000,000. West Penn Electric Co. is now the top holding company in the system and controls 20 direct and indirect subsidiary companies engaged in electric, gas, transportation, and certain minor businesses in sections of Pennsylvania, West Virginia, Maryland, Virginia, and Ohio. The major operating utility operations of West Penn Electric have been consolidated in three companies, Monongahela Power Co., West Penn Power Co., and the Potomac Edison Co.

COOPERATION WITH STATE AND LOCAL REGULATORY AUTHORITIES

It is the established policy of the Commission to seek effective cooperation with State commissions in all matters where their respective jurisdictions complement each other and in all other cases where such cooperation is desirable and appropriate.

Because the work of holding company simplification and integration is progressing at a good pace, large numbers of electric and gas utility operating companies have been divested and accordingly have passed from the jurisdiction of the Commission under the Holding Company Act. However, mutual problems of regulation continue to arise and in these instances, every effort is made to encourage exchange of ideas and information in furtherance of the policy of cooperation so clearly reflected in various sections of the Holding Company Act.

Most instances of cooperation during the past year have involved questions related to the capital structures of particular companies. The Commission has consistently stood for conservative capitalization and adequate common equity. In the recent case involving Wisconsin Public Service Corp., the assistance of the State commission has been particularly helpful in this respect. Application was made by the company in April 1949 for the issuance of $3,000,000 bank loans, one-half for immediate issuance with the balance to be sold in August. The application also reflected the eventual need for $8,000,000 of permanent financing but offered no indication as to how such financing would be accomplished. Because of the marginal equity ratio of Wisconsin, the staff expressed concern to the company over the absence of any indicated common stock financing in the near

future. It also advised a staff member of the Wisconsin Public Service Commission regarding the particular application and related aspects of the capitalization picture. Final scheduling of the financial program for Wisconsin Public Service Corp. has not yet been accomplished but the two commissions have a common objective in seeking an improved equity ratio for the company and further conferences are in prospect. In this connection it should be noted that over the past several years the staff of this Commission has worked closely with the staff of the Wisconsin Commission on the problems of a number of Wisconsin companies.

The matter of appropriate financial structure was also discussed in February 1949 between the staff of this Commission and members of the Vermont Public Service Commission in respect to Green Mountain Power Corp., a subsidiary of New England Electric System. Arrearages had accumulated on the preferred stock in amount sufficient to give that stock voting control and the company was in need of financial reorganization. Another problem was the presence of substantial amounts of excess over original cost in the property accounts. These and other features were considered in conference and it was indicated that no final action would be taken by the Commission until the views of the Vermont Commission had been presented.

The staff of the Commission also had the benefit of discussion in October 1948 with representatives of the Public Service Commission of Indiana on matters relating to the acquisition by Ohio Valley Gas Co. of three gas companies from United Public Utilities Corp. and the resultant financial structure of Ohio Valley. As a result of these conferences joint recommendations for changes in the proposal were agreed upon as a condition precedent to its approval. The changes were designed to achieve an objective of the Indiana Commission's representatives, who wished to see the transactions result in the purchasing company owning the properties of the three gas companies rather than their securities. It was also expected that these revisions would conserve cash for construction. The joint recommendations were then discussed with representatives of the purchasing company who altered their proposal in such manner as to make it acceptable to both commissions. Changes made in the proposed bond indenture aided the company in securing a more flexible instrument and a lowered cost of its debt money.

Another instance of cooperative effort involves the application by Appalachian Electric Power Co. for approval of a proposal to establish a line of credit with four banks amounting to $18,000,000. In setting this matter down for hearing the Commission set forth, as among the issues to be considered, the future financing plans of Appalachian and its parent company, American Gas & Electric Co., and the extent to which the proposed construction program will be financed by equity capital. Since this matter is of considerable interest to local authorities, the commissions in each of the States in which American Gas operates were served with notice of the hearing and the Virginia State Corporation Commission indicated that it intended to have an observer present at the proceedings.

Other instances of cooperation during the past year were related to problems involved in the Commission's administration of section 11 and other provisions of the Holding Company Act. For example,

there has been pending before this Commission since late 1947 a proposal by American Power & Light Co. to contribute to the Washington Water Power Co. its holdings of all of the common stock of Pacific Power & Light Co.

Simultaneously with the application made to the Commission for authority to acquire the Pacific stock, a similar application was made by Washington to the Washington Department of Public Utilities (now Public Service Commission). In a decision dated March 9, 1948, the Washington Commission refused to permit the acquisition, holding that approval would have created a holding company relationship which in the opinion of that commission constituted an unnecessary corporate complexity. On April 8, 1948, American filed with the Commission a plan which, among other things, called for a further application to the Washington department by Washington for permission to acquire the common stock of Pacific. In the alternative the plan proposed that American be continued in existence to hold the common stocks of Pacific and Washington. This, of course, raises a question of modification of the Commission's order of August 22, 1942, which directed the dissolution of American. Since the proposal vitally affected utilities operating in both Washington and Oregon, the Washington department, through its attorney general, was upon application made a party to the proceeding and while no representative of the attorney general appeared, a letter from him was read into the record indicating the Washington department's deep concern with that part of the plan relating to Washington. His letter was also made available to counsel for each of the parties and participants.

In September of 1948 all of the exhibits received during the proceeding, numbering in the aggregate over 100, were sent to the attorney general at his request, together with copies of those parts of the transcript containing testimony relating to the Washington company. Subsequently, the chairman of the new Washington Public Service Commission and the Oregon Commissioner of Public Utilities jointly wired the Commission setting forth their views as to those parts of the plan which touched on the relinquishment by American of control over Washington and Pacific. Throughout this period a number of conferences have been held between members of the Commission staff and representatives of the Oregon Commissioner and the Washington Commission, pertaining to this problem and related matters affecting the Washington and Pacific companies.

The Commission also had discussions with the Public Service Commission of Utah during March 1949. The Utah commission, acting in collaboration with local Rural Electrification Administration cooperatives, requested this Commission to defer for 2 months proceedings in the United States District Court for the Southern District of New York for approval of a plan involving the reorganization of Washington Gas & Electric Co. The additional time was requested in order to enable the cooperatives to make studies preparatory to submission of a bid for the acquisition of Washington's sole subsidiary, Southern Utah Power Co. Discussions between the staffs of the two Commissions served to satisfy the Utah commission that the procedures contemplated would assure the cooperative organizations the desired amount of time.

In October 1948 the Commission received communications from the

common counsel of Detroit, Mich., and from the city manager of Madison, Wis., with respect to a proposal of Michigan-Wisconsin Pipeline Co. to sell $66,000,000 of its first-mortgage bonds. Though it was found necessary to exempt this sale of bonds from its usual competitive bidding requirements, the petitions of these city governments in favor of the bidding procedure were carefully weighed in the findings and opinion of the Commission. Corporation counsel for the city of Detroit also appeared as a party in these proceedings.

LITIGATION ARISING UNDER THE ACT

Toward the end of the fiscal year the Supreme Court sustained the Commission on major issues of law governing the consideration and enforcement of plans submitted pursuant to section 11 (e) of the Holding Company Act. In a case posing fundamental questions concerning the Commission's valuation technique and the scope of review by the district courts which had been the subject of differing opinions within the Commission and strong attack from outside, the Supreme Court directed enforcement of a section 11 (e) plan as approved by the Commission, reversing the court of appeals and the district court.[93] Because of the far-reaching importance of this case, it is discussed below in relation to the development of the principles adopted by the Supreme Court.

During the year district courts of the United States entered orders enforcing voluntary plans approved by the Commission under section 11 (e) of the act in 14 cases. In 12 of these cases the plans were declared effective and were consummated during the course of the year, or were in process of being consummated at the close of the year. In one case the order of the court was vacated at the instance of the Commission, where changed circumstances had rendered the plan not feasible. Appeals were taken from four of the enforcement orders. In two of these cases motions were made for a stay of the district court's orders, and in each case the motion was denied. At the close of the fiscal year one of the appeals had been dismissed on stipulation, and the others were pending.

In three cases, petitions were filed with the courts of appeals pursuant to section 24 (a) of the act to review orders entered by the Commission. In one such case, the Philadelphia Co. petitioned for review of the Commission's order under section 11 (b) of the act directing the company to divest itself of its interests in gas and transportation operations and to dissolve.[94] Stay of the Commission's order was granted pending determination of the appeal, which had not been decided at the close of the fiscal year. Thereafter the Commission's order was affirmed.[95] A second petition, to review an order of the Commission denying a committee's request for authority to solicit funds from stockholders,[96] had not been perfected at the end of the fiscal year. The third petition involved the propriety of the Commission's determination that preferred stockholders of a holding company subsidiary merged into an affiliated company were entitled

[93] *S. E. C.* v. *Central-Illinois Securities Corp.*, 338 U. S. 96.
[94] Holding Company Act release No. 8242.
[95] *Philadelphia Co.* v. *S. E. C.*, — F. 2d — (C. A. D. C., October 10, 1949).
[96] *Halsted, et al.*, Holding Company Act release No. 8965.

to receive more than the liquidation preferences of their stock. After the end of the fiscal year the Commission's order was affirmed.[97]

During the fiscal year two appeals from orders of the United States district courts approving section 11 (e) plans, pending at the commencement of the year, were disposed of, in the one case by affirmance of the district court order,[98] and in the other by dismissal on stipulation.

At the commencement of the fiscal year there were pending before the court of appeals six petitions for review of Commission orders under the act. In three such cases the orders were affirmed, in one the petition was dismissed, in another a Commission motion to dismiss was pending at the end of year, and in the sixth the Commission's order was reversed. In that case the court of appeals held that the Commission had denied the Philadelphia Co. procedural due process in that the company had not been afforded an opportunity to adduce evidence in opposition to a proposed amendment to rule U–49 (c) of the Commission's General Rules of Practice under the Public Utility Holding Company Act.[99] The Supreme Court granted *certiorari*, but prior to hearing, the decision of the Court of Appeals was vacated on joint motion of counsel, the company having submitted to the amended rule and the matter having become moot.[1]

A list of all cases in which administration of the Holding Company act was an issue and the status of those cases at June 30, 1949, is set forth in the appendix. The following section discusses the Commission's record in the courts in proceedings for the enforcement of section 11 (e) plans, in relation to the Supreme Court decision mentioned above.

ENFORCEMENT PROCEEDINGS UNDER SECTION 11 (E) OF THE ACT

In enacting the Holding Company Act, Congress recognized that the problems in holding company systems were so extensive and the task of simplification so complicated that legislative action alone without administrative supervision would not effectively meet the situation. The enforcement of the act, therefore, was entrusted to the Commission. Thus section 11 (b) directs the Commission to determine what action should be taken by registered holding companies to meet the standards of the act. The Commission may, under section 11 (d), apply to a court to enforce an order issued by the Commission under section 11 (b), and in such cases the court is given power over the company and its assets to enforce the order of the Commission in accordance with a plan which shall have been approved by it.

Congress recognized, however, that it was desirable to encourage voluntary compliance with the act by the various holding company systems. Under section 11 (e) registered holding companies and their subsidiaries are permitted to file voluntary plans designed to meet the requirement of section 11 (b), and it is this voluntary cooperative route to effectuate compliance which has been followed in most cases.

[97] *In re Pennsylvania Edison Company*, — F. 2d — (C. A. 3, August 31, 1949).
[98] *In re North American Light & Power Company*, 170 F. 2d 924 (C. A. 3, 1948), affirming *In re Illinois Power Company*, 74 F. Supp. 137 (D. Del., 1947).
[99] *Philadelphia Company v. S. E. C.*, — F. 2d —.
[1] *S. E. C.* v. *Philadelphia Company*, — U. S. —, 93 L. Ed., *adv. op.* 896.

Section 11 (e) of the act provides that if after notice and opportunity for hearing the Commission finds a plan, as submitted or as modified, necessary to effectuate the provisions of section 11 (b) and fair and equitable to the persons affected by the plan, the Commission shall make an order approving the plan and at the request of the company may apply to a district court of the United States to enforce and carry out the provisions of the plan. If the court, upon such application and after notice of opportunity for hearing, approves the plan as fair and equitable and appropriate to effectuate the provisions of section 11, the court then enters an order enforcing and carrying out the plan.

Whether a plan satisfies the standards of the act in respect of "necessity" is a question primarily for Commission determination.[2] To be necessary within the meaning of section 11 (e) of the act a plan need not by itself effectuate complete compliance with the requirements of section 11. It is sufficient if the plan provides a suitable and expeditious means for achieving results necessary under section 11 (b), although different means might have been chosen and further steps may be necessary.[3]

In *Electric Power & Light Corporation*,[4] a plan was found necessary wherein it was proposed, *inter alia*, that a new holding company be organized which would, *prima facie*, meet the integration standards of the act, even though objecting stockholders urged other methods of effectuating compliance with the Commission's prior order directing the holding company to dissolve.

In cases arising under the Bankruptcy Act the Supreme Court held, as urged by the Commission, that in order to be "fair and equitable" a plan must satisfy the "absolute priority" standard; that is, the full priority of senior securities must be compensated before junior security holders may participate in the reorganization.[5] In the application of the absolute priority standard to the requirement that a plan under section 11 (e) of the act must be fair and equitable, the Commission has evolved what has come to be known as the "investment value" doctrine. In brief, this holds that the measure of equitable equivalence for purposes of simplification proceedings compelled by the Holding Company Act is the value of the securities on the basis of a going business and not as though a liquidation were taking place,[6] except as it appears that liquidation could and would have taken place apart from the compulsion of section 11.[7]

Since the passage of the act, the Commission has filed applications with United States district courts for the enforcement of 80 such voluntary plans, of which 3 were pending as of June 30, 1949. In 75 cases the plans were approved by the district court. In the 2 cases where approval was refused by the district court the court was reversed, in 1 case by the court of appeals,[8] and in the other by the Supreme Court.[9] Appeals from enforcement orders of district courts were taken in 16

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[2] *American Power & Light Corporation* v. *S. E. C.*, 329 U. S. 90; *In re Standard Gas and Electric Co.*, 151 F. 2d 326 (C. A. 3, 1945), *cert. den.* 327 U. S. 796.
[3] *Lahti* v. *New England Power Association*, 160 F. 2d 845 (C. A. 1, 1947).
[4] Unreported, S. D. N. Y. April 14, 1949, affirmed after close of fiscal year — F. 2d — (D. A. 2, 1949).
[5] *Case* v. *Los Angeles Lumber Products Co.*, 308 U. S. 106; *Consolidated Rock Products Co.* v. *DuBois*, 312 U. S. 510; *Group of Investors* v. *Chicago, M., St. P. & P. R. Co.*, 318 U. S. 523; *Ecker* v. *Western Pacific R. Corp.*, 318 U. S. 448.
[6] *S. E. C.* v. *Central-Illinois Securities Corp.*, supra; *Otis & Co.* v. *S. E. C.*, 323 U. S. 624.
[7] See *In re Pennsylvania Edison Company*, supra.
[8] *In re Standard Gas and Electric Company*, supra.
[9] *S. E. C.* v. *Central Illinois Securities Corp.*, supra.

cases, of which 6 were dismissed or discontinued, 8 were affirmed, and as of June 30, 1949, 2 were pending.[10] In 5 cases petitions for writs of *certiorari* were filed to seek review of decisions of courts of appeals affirming enforcement orders of the district courts. In 4 cases the petitions were denied and, in the fifth, the decision of the court of appeals was affirmed. Thus, every case heretofore decided on the Commission's applications for court enforcement of section 11 (e) plans has resulted in court approval of the plan.

Before it may issue an enforcement order, the district court must find that the plan is fair and equitable to the persons affected and appropriate to effectuate section 11 of the act. Accordingly, the court orders a hearing on these issues and directs that notice be given of such hearing to the security holders affected by the plan. The enforcement proceeding is based upon the record made before the Commission, containing all the evidence relating to the plan. Until the decision of the Court of Appeals for the Third Circuit in the *Engineers* case, the courts had consistently held that an enforcement proceeding under section 11 (e) did not constitute a trial *de novo*. The doubts raised by the *Engineers* case as to the scope of review by the enforcement court, and the nature of the hearing in the enforcement court, were resolved by the decision of the Supreme Court reversing the Court of Appeals for the Third Circuit. The Supreme Court held that the scope of review of the district court in enforcement proceedings under section 11 (e) of the act is identical with the review process prescribed in section 24 (a) of the act, relating to petitions to a court of appeals to review orders of the Commission; that is, the decision of the Commission is to be sustained if supported by substantial evidence and not contrary to law.

The determination of what constitutes fair and equitable treatment under the standards of section 11 (e) often involves review of intercorporate transactions to ascertain whether there has been such wrongdoing on the part of the parent as to require subordination of its claims to those of other security holders under the doctrine of *Taylor* v. *Standard Gas and Electric Company*.[11] These "Deep Rock" matters have formed an integral part of many plans filed under section 11 (e) of the act.[12] The jurisdiction of the Commission to approve claims settlements in the context of a section 11 (e) plan even though such settlements are not the result of arm's-length bargaining was affirmed during the year by the Court of Appeals for the Third Circuit.[13] The courts during the year also upheld the Commission's approval of two plans embodying similar settlements of claims and involving other problems of allocations of assets.[14] In all three cases court actions had been instituted based on the alleged wrongdoing by the parent company; consummation of the plans would in effect dispose of that litigation. After the decision in the *North American* case the district court held that dividends paid by *Illinois Power*

[10] After the close of the fiscal year the district court's enforcement order was affirmed in one of these cases. *In Re Electric Power & Light Corporation*, — F. 2d — (C. A. 2, 1949).

[11] 306 U. S. 307.

[12] Comparable problems of fairness and equity may arise out of management purchases of securities of a corporation during proceedings for its reorganization. See *S. E. C.* v. *Chenery Corporation*, 318 U. S. 80, 332 U. S. 194, rehearing denied 332 U. S. 783.

[13] *In re North American Light & Power Company*, 170 F. 2d, 924 (C. A. 3, 1948).

[14] *In re American & Foreign Power Company, Inc.*, 80 F. Supp. 514 (D. Me., 1948), order vacated January 4, 1949; In Re *Electric Power & Light Corporation*, unreported (S. D. N. Y., April 14, 1949), stay denied C. A. 2, May 5, 1949, stay denied 337 U. S. 903, affirmed — F. 2d — (C. A. 2, August 9, 1949).

Company on the shares of its common stock allocated to public stockholders of *North American Light & Power Company* should be distributed to such stockholders along with the *Illinois Power Company* stock.[15]

In two other contested decisions decided during the fiscal year the courts enforced plans, approved by the Commission, providing for the retirement of holding company preferred stocks by distributions of common shares of subsidiary companies.[16] *In re National Power & Light Company* [17] the district court upheld the Commission's determination with respect to the amount of the fee payable by the company to counsel representing a security holder in a reorganization involving primarily settlement of claims and upheld the exclusive jurisdiction of the Commission to pass on such fees.

In the above cases involving allocations of new or portfolio securities to the security holders of holding companies, as in the *Otis* case, application of the investment value doctrine required determination of equitable equivalence between the rights surrendered and the securities given in compensation therefor, involving primarily comparisons of the amount and quality of earnings applicable to the securities retired by the plans with the amount and quality of earnings applicable to the securities to be distributed under the plans. In such cases it is held that a dollar valuation need not be placed upon either the old or the new securities. The valuation problem was presented in somewhat different form in plans providing for the retirement of senior securities by payments in cash.

In such cases the Commission held, with court approval, that redemption premiums as such are not payable, and that where the investment value of the securities being surrendered is not in excess of the involuntary liquidation preference or face amount, payment of that or a lesser amount is fair and equitable.[18] In *American Power & Light Company* [19] the Commission held that application of the investment value theory called for the payment of an amount equal to the voluntary call price of callable debentures being retired pursuant to section 11 (e) plan, where the investment value of the debentures was at least equal to the call price, and for payment of a somewhat greater amount with respect to debentures which would not be callable until some time after the effective date of the plan. In a subsequent case [20] the Commission held unfair a plan calling for the retirement of a noncallable preferred stock by payment in cash at the liquidation preference. In the *Engineers* case the Commission approved a plan calling for the retirement of preferred stocks at an amount equal to the call price, where it found that the investment value of those

[15] F. Supp. (D. Del. 1949), appeal pending.
[16] *In re Northern States Power Company*, 80 F. Supp. 193 (D. Minn., 1948); *In re United Corporation*, F. Supp. (D. Del. February 15, 1949).
[17] — F. Supp. — (S. D. N. Y. 1949), appeal pending.
[18] The cases are cited in the Appendix to *S. E. C.* v. *Central-Illinois Securities Corp., supra.*
[19] Holding Company Act release No. 7176, enforced (unreported) S. D. N. Y. December 21, 1945 (No. 33-583).
[20] *The United Light & Power Company*, Holding Company Act release No. 6603. Thereafter a rehearing was granted, and while decision was pending a substitute plan was proposed by the company and approved by the Commission. Holding Company Act release No. 7951.

stocks was at least equal to that amount. The district court, on the Commission's application for enforcement, found the plan unfair in that regard, and held that no more than the involuntary liquidation preference might be paid. The district court in its decision considered as controlling certain factors which it grouped under the term "colloquial equities." The Court of Appeals for the Third Circuit held that the district court had no power to amend the plan, but approved the district court's rejection of the investment value doctrine as applied by the Commission. The Supreme Court, on June 27, 1949, reversed the court of appeals and held that investment value was the proper basis for evaluating the prior claim of preferred stockholders in a liquidation compelled by the Holding Company Act.

Other Court Decisions during the Fiscal Year

In *South Carolina Public Service Authority* v. *S. E. C.*[21] the court of appeals affirmed an order of the Commission which granted exemption from its competitive bidding rule to The Commonwealth & Southern Company with respect to the sale of all the common stock of South Carolina Power Company. Assuming without deciding that petitioner, a public authority, was a "party aggrieved" by the Commission's order, the court of appeals found that a higher offer of the petitioner for the stock afforded no justification for upsetting that order, in view of a decision of the South Carolina Supreme Court that the petitioner had no power to make a purchase of this character.

In *North American Utility Securities Corporation* v. *Posen*[22] the company sought an injunction against the individual defendants to prevent their solicitation of authorizations from its stockholders to represent them in connection with a plan of reorganization pending before the Commission, claiming that such solicitation would violate Section 11 (g) of the act. The Commission, which had authorized the solicitation, intervened as a party defendant and moved for dismissal of the complaint. The district court dismissed the complaint on the merits, and on appeal the order was affirmed.

SUMMARY OF LITIGATION UNDER THE HOLDING COMPANY ACT

The over-all impact of court litigation upon the administration of the Public Utility Holding Company Act during the 14 years of its existence may also be summarized by statistical measurement. A total of 246 civil and criminal proceedings, exclusive of Bankruptcy Act proceedings, in which the validity or enforcement of the statute was in issue, have been initiated in the courts. Litigation has been completed with respect to 234 of these proceedings; the remaining 12 were pending on June 30, 1949.

Petitions to Review Orders of the Commission

Seventy of the 246 proceedings initiated were petitions to United States courts of appeals to review orders of the Commission as provided

[21] 170 F. 2d 948 (C. C. A. 4, 1948).
[22] 82 F. Supp. 16 (S. D. N. Y., 1948), affirmed after close of year 176 F. 2d 194 (C. A. 2, 1949).

by section 24(a) of the act. The disposition of these proceedings may be summarized as follows:[23]

Petitions dismissed or denied	36
Commission orders affirmed	26
Commission order reversed	1
Petition withdrawn	1
Proceedings remanded to Commission	1
Proceedings vacated as moot	2
Total disposed of	67
Pending June 30, 1949	3
Total	70

In the proceeding remanded to the Commission, the Commission in effect reaffirmed its previous order upon different grounds, and was ultimately upheld by the United States Supreme Court.[24] One of the two proceedings vacated as moot involved an order of the court of appeals which had disapproved action of the Commission in amending a rule;[25] in the other proceeding the court of appeals had affirmed in part and reversed in part an order of the Commission.[26] In both instances the companies concerned undertook to comply with the Commission action under review while the proceedings were pending in the Supreme Court.

The one Commission order ultimately reversed[27] had exempted International Paper & Power Co., from certain provisions of the act in respect of certain specific transactions to be consummated during the pendency of, and after Commission decision on, the company's pending application for a general exemption. Thereafter the Commission disposed of the pending application by entry of an order declaring International not to be a holding company.[28]

Enforcement of Reorganization Plans under Section 11

Eighty-six of the 246 proceedings were initiated by applications by the Commission to United States district courts for orders enforcing plans of reorganization under sections 11(d) and (e) of the act. One of the 86 proceedings was based upon an application of the Commission, filed at the request of a registered holding company, to enforce an order directing dissolution of the company. The district court took possession of the company and appointed a trustee. Disposition

[23] In each case only the ultimate decision is considered and intermediate decisions are disregarded. In two of the cases where the Commission's order was ultimately affirmed [*Okin* v. *S. E. C.*, 154 F. 2d 27 (C. A. 2, 1946), and *American Power & Light Co.* v. *S. E. C.*, 158 F. 2d 771 (C. A. 1, 1946), reh. den. 1-8-47] the Commission had lost an earlier round in the Supreme Court which had decided, contrary to the Commission's contention, that the petitioners were "persons or parties aggrieved" within the meaning of section 24 (a) of the act. Similarly in one of the cases where the proceedings were vacated as moot, the court of appeals had refused to dismiss the petition to review, rejecting the Commission's contention that no reviewable "order" within the meaning of section 24(a) of the act was involved [*Philadelphia Co.* v. *S. E. C.*, 164 F. 2d 889 (C. A. DC, 1947)] and the Supreme Court refused to review this determination. (333 U. S. 828).

Where several parties have petitioned to review the same order, the review is treated as only one proceeding unless the petitions were filed in different circuits. Two proceedings are considered to be involved where petitions to review the same order were filed in two circuits, even though ultimately determined in the same circuit, unless the petitions were consolidated.

[24] *S. E. C.* v. *Chenery Corp.*, 332 U. S. 194 (1947), rehearing denied 332 U. S. 783 (1947).

[25] *Philadelphia Co.* v. *S. E. C.*, 175 F. 2d 808 (C. A. D. C., 1949).

[26] *Engineers Public Service Co.* v. *S. E. C.*, 138 F. 2d 936 (C. A. D. C., 1943).

[27] *Lawless* v. *S. E. C.*, 105 F. 2d 574 (C. A. 1, 1939), rehearing denied 6-26-39.

[28] *International Paper and Power Company*, 4 S. E. C. 873 (1939).

of the other 85 proceedings for enforcement of section 11(e) plans may be summarized as follows: [29]

Application to district court withdrawn upon request of Commission	1
Applications granted by district courts, not appealed	[1] 61
Applications granted by district courts, affirmed by courts of appeals	8
Applications granted by district courts, appeals dismissed by courts of appeals or discontinued	7
Applications denied by district courts, approved on appeal	2
Total	79
Applications granted by district courts from which appeals were pending on June 30, 1949	4
Applications pending in district courts on June 30, 1949	[1] 2
Total	85

[1] On 1 application for enforcement, not included among applications granted, the court entered an order enforcing certain uncontested provisions of the plan during the fiscal year; the proceeding was pending on June 30, 1949, with respect to a contested provision of the plan.

In five of the eight cases where district court orders were affirmed by the courts of appeals, review was sought in the United States Supreme Court, but in four cases the petitions were denied; in the fifth case the order of the court of appeals was affirmed.[30] One of the enforcement orders was subsequently vacated at the request of the Commission and others, upon a showing of material changes in circumstances during the course of the litigation.[31] Notice of appeal from the remand was filed but the appeal had not been perfected prior to June 30, 1949. Another enforcement order was vacated at the request of the Commission and upon approval by the district court of an alternate plan.[32]

In one of the two proceedings in which the district court denied an application of the Commission for an order of enforcement, the court of appeals reversed the order of the district court, and review was denied by the United States Supreme Court.[33] Upon a showing of material changes in circumstances during the pendency of this litigation, the district court, with the concurrence of the Commission, subsequently remanded the plan to the Commission for further consideration. An appeal from the remand order was dismissed by the court of appeals. In the second proceeding involving denial of the Commission's application, the district court disapproved an important aspect of the plan but ordered enforcement of the plan as modified.[34] On appeal from that portion of the order disapproving part of the plan, the court of appeals upheld the district court in that regard, but reversed on the ground that the district court should have remanded the plan to the Commission.[35] The United States Supreme Court reversed the order of the court of appeals, and directed enforcement of the entire plan as approved by the Commission.[36]

The application withdrawn upon motion of the Commission was withdrawn because of substantial changes in circumstances affecting

[29] Every application for court enforcement involving a plan separately disposed of by the court is treated separately, even where more than one application involves a single company.
[30] *Otis & Co.* v. *S. E. C.*, 323 U. S. 624 (1945), rehearing denied 323 U. S. 887.
[31] *In re American & Foreign Power Co.*, 80 F. Supp. 514 (D. Me., 1948), order vacated and plan remanded to Commission, January 4, 1949.
[32] *In re New England Gas & Electric Assn.*, unreported (D. Mass., July 17, 1946 and March 10, 1947).
[33] *In re Standard Gas & Electric Co.*, 151 F. 2d 326 (C. A. 3, 1945), *cert. den.* 327 U. S. 796.
[34] *In re Engineers Public Service Co.*, 71 F. Supp. 797 (D. Del. 1947).
[35] *In re Engineers Public Service Co.*, 168 F. 2d 772 (C. A. 3, 1948).
[36] *S. E. C.* v. *Central-Illinois Securities Corp.*, 338 U. S. 96 (1949).

the reorganization plan at issue;[37] a plan subsequently approved by the Commission was approved and enforced by the district court.[38]

Injunctive Proceedings Initiated by the Commission

Fourteen of the 246 proceedings were initiated by the Commission to restrain violations, or to enjoin interference with the enforcement, of the act. The disposition of these proceedings may be summarized as follows:

Permanent injunctions granted	7
Proceedings dismissed or discontinued	6
Defendant adjudged guilty of contempt in violating preliminary injunction [1]	1
Total	14

[1] *S. E. C.* v. *Okin*, 48 F. Supp. 928 (S. D. N. Y., 1943).

In one of the seven cases in which permanent injunctions were granted, an appeal was taken and the injunction was finally affirmed by the United States Supreme Court.[39] In a second of these cases, an order of the district court granting a temporary injunction was affirmed by the court of appeals prior to the granting of a final injunction by the district court.[40] In a third case, the court of appeals affirmed the order of the district court with modifications.[41]

In all of the proceedings dismissed or discontinued, that action was taken upon the motion, or with the consent or acquiescence, of the Commission. One such proceeding revolved around an order of the Commission revoking an exemption previously granted to a holding company. The court of appeals affirmed an order of the district court denying an injunction to prevent consummation of a plan of reorganization which had been put into effect while the revocation proceeding was pending.[42] The courts enjoined the company from carrying out the reorganization plan pending final disposition of the case. The company registered with the Commission while the matter was under consideration by the Supreme Court and, upon unopposed motion of counsel for the Commission, the judgment of the court of appeals was vacated and the proceeding remanded to the district court with instructions to dismiss the complaint as moot.[43]

Two proceedings were dismissed following entry of a temporary restraining order or preliminary injunction; in each case the Commission decided the results it sought had been accomplished. Three proceedings were dismissed after they had become moot, one before any action had been taken by the court, one after denial of a temporary injunction, and the other after the court of appeals had reversed a district court order refusing injunctive relief.[44]

Actions Initiated by Others than the Commission

Seventy-one proceedings in which the Commission was a defendant or an intervenor, or appeared as *amicus curiae*, were instituted to

[37] *In re Northern States Power Co. (Del.)*, unreported (D. Minn. November 22, 1946).
[38] *In re Northern States Power Co. (Del.)*, 80 F. Supp. 193 (D. Minn., 1948).
[39] *Electric Bond & Share Co.* v. *S. E. C.*, 303 U. S. 419 (1938).
[40] *S. E. C.* v. *Associated Gas & Electric Co.*, 99 F. 2d 795 (C. A. 2, 1938).
[41] *Okin* v. *S. E. C.*, 139 F. 2d 87 (C. A. 2, 1943).
[42] *S. E. C.* v. *Long Island Lighting Co.*, 148 F. 2d 252 (C. A. 2, 1945).
[43] *S. E. C.* v. *Long Island Lighting Co.*, 325 U. S. 833 (1945).
[44] *S. E. C.* v. *Okin*, 132 F. 2d 784 (C. A. 2, 1943).

prevent or delay enforcement of the act by the Commission, to prevent action by other persons pursuant to orders of the Commission, or to seek relief against corporate management for alleged misconduct. The nature and disposition of these proceedings are as follows:

Complaints for judgments declaring act to be unconstitutional:		
Commission dismissed as party on its own motion	22	
Proceedings dismissed or discontinued	26	
Declaratory judgment issued; reversed on appeal	1	
Act held inapplicable to plaintiffs; constitutionality not determined	3	
	—	52
Complaints for injunctions against the Commission, dismissed		3
Petition for writ of mandamus against the Commission, denied		1
Complaints for injunctions against other persons:		
Dismissed	5	
Determined consistently with Commission order	1	
	—	6
Actions seeking relief for corporate mismanagement:		
Settlements approved	2	
Proceedings dismissed	3	
Dismissal of complaint reversed	[1] 1	
Pending June 30, 1949	1	
	—	7
Actions relating to defendants' sec. 11 (e) plans, pending		2
Total		71
Less: Pending, June 30, 1949		3
Total disposed of		68

[1] *Goldstein* v. *Grosbeck*, 142 F. 2d 422 (C. A. 2, 1944), reversing 42 F. Supp. 419 (S. D. N. Y. 1941), *cert. den.* 323 U. S. 737.

The three proceedings for declaratory judgments in which the act was held inapplicable involved companies in reorganization under the Bankruptcy Act when the Holding Company Act became law. The district court order holding that the act was unconstitutional [45] was reversed by the court of appeals; the Supreme Court denied review.[46]

Plaintiffs appealed from the dismissal of one of the injunction actions against the Commission, and from two of the injunction actions against other persons in which the Commission intervened as a party defendant. In each case (two of them decided before and one after the end of the fiscal year) the court of appeals affirmed the decision of the district court.[47]

The Commission appeared as *amicus curiae* or as intervenor in the listed cases where relief was sought for corporate mismanagement and supported the two settlements;[48] the Commission took no position on the merits in the other cases but appeared in order to avoid conflicts between the court proceedings and related proceedings pending before the Commission.

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[45] *In re American States Public Service Co.*, 12 F. Supp. 667 (D. Md., 1935).
[46] *Burco, Inc.* v. *Whitworth*, 81 F. 2d 721 (C. A. 4, 1935), *cert. den.* 297 U. S. 724.
[47] *Okin* v. *S.E.C.*, 130 F. 2d 903 (C. A. 2, 1942), *cert. den.* 317 U. S. 701; *Phillips* v. *The United Corp.* 171 F. 2d 180 (C. A. 2, 1948) rehearing denied 1-11-49; *North American Utility Securities Corp.* v. *Posen*, 176 F. 2d 194 (C. A. 2, 1949) affirming 82 F. Supp. 16 (S. D. N. Y. 1948).
[48] *Ladd* v. *Brickley*, 158 F. 2d 212 (C. A. 1, 1946), *cert. den.* 330 U. S. 819, rehearing denied 330 U. S. 855; *Illinois-Iowa Power Co.* v. *North American Light & Power Co.*, 74 F. Supp. 317 (D. Del. 1947).

Criminal Prosecutions

Five of the 246 proceedings were prosecutions of three corporate and four individual defendants for criminal acts in connection with the enforcement of the act. There are summarized as follows:

Indictments charging conspiracy to violate and violations of the act	2
Indictments charging perjury before officer of the Commission, defendants convicted	3
Total	5

In one of the cases charging conspiracy to violate and violations of the act, the two defendants (a corporation and an individual) were found guilty and the judgment was affirmed on appeal;[49] in the other the two defendants (corporations) pleaded guilty. Of the three cases charging perjury before an officer of the Commission, one resulted in a conviction affirmed on appeal,[50] one in a plea of guilty, and one in a plea of *nolo contendere* (no contest).

[49] *Egan* v. *United States*, 137 F. 2d 369 (C. A. 8, 1943), rehearing denied 9-9-43.
[50] *Boehm* v. *United States*, 123 F. 2d 791 (C. A. 8, 1941), rehearing denied 11-26-41.