22*nd* Annual Report

of the

Securities and Exchange Commission

Fiscal Year Ended June 30, 1956

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SECURITIES AND EXCHANGE COMMISSION

Headquarters Office

425 Second Street NW.

Washington 25, D. C.

COMMISSIONERS

January 3, 1957

J. SINCLAIR ARMSTRONG, *Chairman*
ANDREW DOWNEY ORRICK
HAROLD C. PATTERSON
EARL F. HASTINGS
JAMES C. SARGENT
ORVAL L. DUBOIS, *Secretary*

LETTER OF TRANSMITTAL

SECURITIES AND EXCHANGE COMMISSION,
Washington, D. C., January 3, 1957.

SIR: On behalf of the Securities and Exchange Commission, I have the honor to transmit to you the Twenty-Second Annual Report of the Commission covering the fiscal year July 1, 1955 to June 30, 1956 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; section 216 of the Investment Advisers Act of 1940, approved August 22, 1940; and section 3 of the act of June 29, 1949, amending the Bretton Woods Agreements Act.

Respectfully,

J. SINCLAIR ARMSTRONG,
Chairman.

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

TABLE OF CONTENTS

PART VI

PART VII

PART VIII

PART IX

PART X

PART XI

PART XII

APPENDIX—STATISTICAL TABLES

FOREWORD

The 22d Annual Report of the Securities and Exchange Commission to the Congress for the fiscal year July 1, 1955, to June 30, 1956 (herein called "1956"), describes the work of the Commission during the year in discharging its duties under the Federal securities laws which it was established by the Congress to administer. These include supervision of the registration of securities for sale in interstate commerce to the public, the surveillance of the interstate securities markets, regulation of the activities of brokers and dealers and investment advisers, the regulation of public utility holding company systems and investment companies, and litigation in enforcement of the Federal securities laws in the courts.

The year 1956 has been one of great activity in the regulation and supervision of securities markets by the Commission. The increasing responsibility of the Commission was brought about by the sustained high level of economic activity in the country, and the accompanying stepped-up activity in the Nation's capital markets.

In 1956 new issues of securities registered for public sale totaled $13.1 billion, the largest amount in the Commission's history and more than $2 billion in excess of the amount registered in the preceding year. The value of securities traded on stock exchanges during 1956 was $38 billion, more than double the figure of fiscal 1953. Stockholders in publicly owned American corporations are estimated by the New York Stock Exchange to include about 8.5 million domestic individuals, 2 million more than 5 years ago. About 4,600 brokers and dealers were registered with the Commission as compared with 4,100 3 years ago.

Enforcement activities such as broker-dealer inspections and investigations of fraud and market manipulations have been greatly expanded to meet current needs occasioned by abuses incident to the marketing of certain types of securities of speculative quality. The Commission's Enforcement Program, to assure fair disclosure of material facts in connection with the marketing of corporate securities and for the prevention, detection and punishment of fraud in the sale of securities, has been intensively pursued in the interest of the investing public. Administrative and legal actions taken under the Enforcement Program have exceeded those of any prior year. These include 100 suspensions of offerings for which the small issues exemption was claimed, 8 stop orders of securities for which

registration statements were filed, 45 revocation and denials proceedings against broker-dealers and investment advisors; 33 injunctive and one subpoena enforcement actions and 20 criminal referrals to the Department of Justice.

The Commission has continued its program of strengthening and simplifying its rules, forms and procedures with a view to the more effective dissemination of information to investors, the prevention, detection and punishment of fraud and the elimination of unnecessary complexities and duplications. An intensive study of the problems of small business in marketing securities, particularly for equity capital, was conducted by the Commission in 1956, and shortly after the close of the year our exemptive regulations for issues of $300,000 or less were revised and streamlined so as to provide better protection to the investing public without unnecessary or burdensome compliance requirements on small business enterprises seeking access to the interstate capital markets. There was also established shortly thereafter a Branch of Small Issues in our Division of Corporation Finance in Washington, D. C., to coordinate and facilitate the handling in our nine regional offices throughout the country of the filings for small issues.

During the year, the Commission and its staff have appeared before committees of the Congress on many occasions in connection with proposed legislation dealing with the Commission's work and other subjects of interest to the Congress. Various legislative proposals considered are discussed in this report. This work of the Commission in assisting the Congress is of great importance to the public interest.

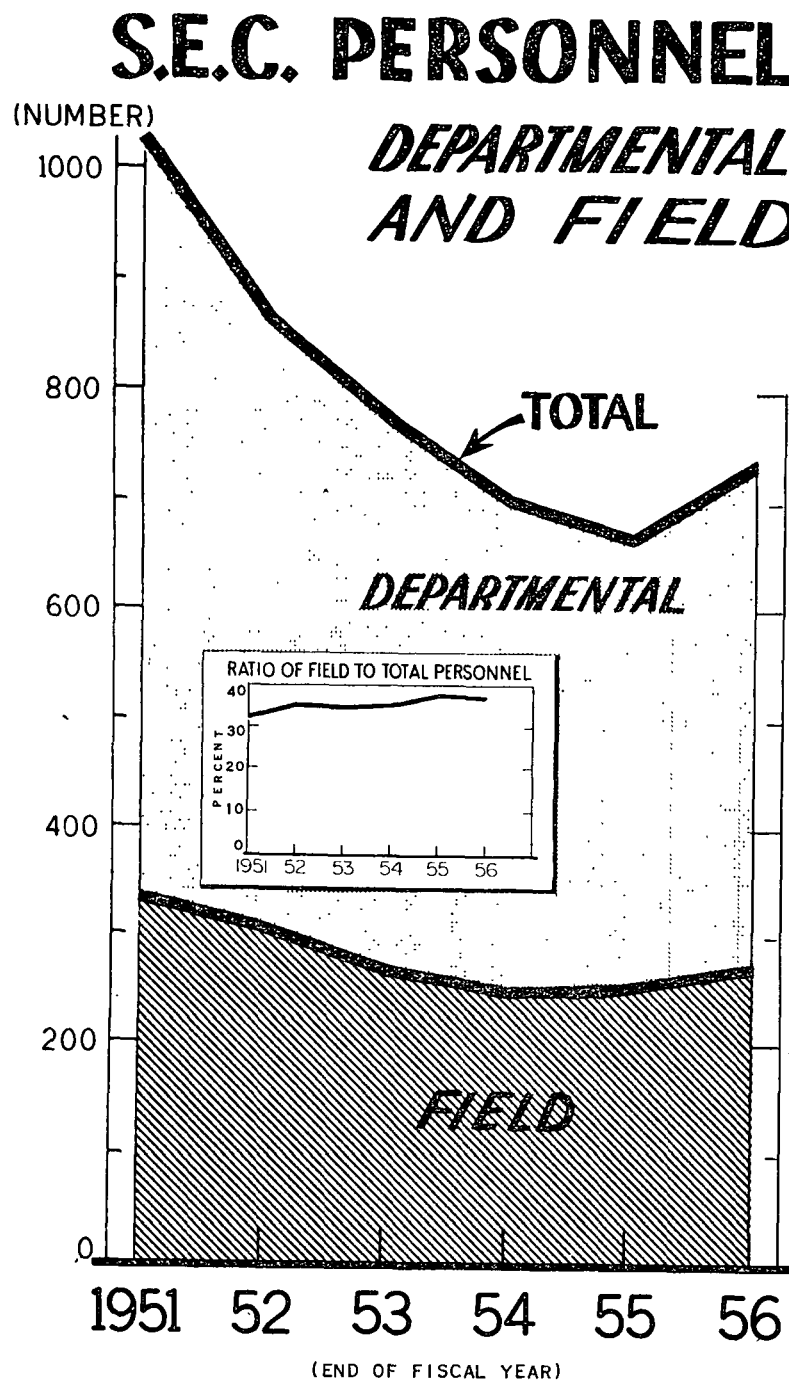
To meet the greatly increased workload in accordance with the recommendation contained in the President's Budget, the Congress granted the Commission an appropriation for an average employment of about 730, in 1956, which represented a small increase from 1955 and, most significant, an end of successive annual curtailments of staff from a high of over 1,700 in 1942 to an all-time low of 666 on June 30, 1955. For 1957, the Congress, recognizing this Commission's request in light of the vastly expanded economy and capital markets, appropriated funds for an average employment of 794.

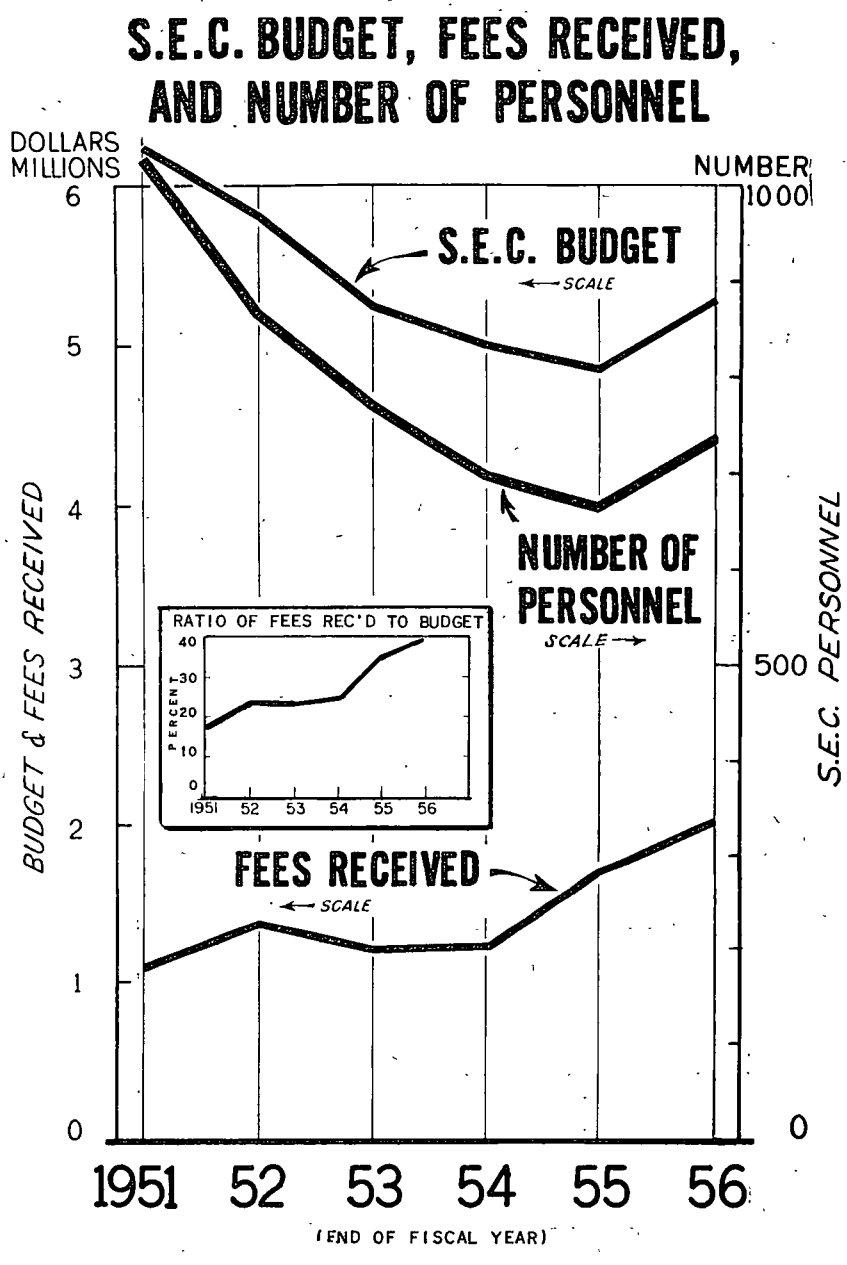
Statutory fees for registration of new issues of securities and trading in issues registered for trading on stock exchanges are imposed by the Federal securities laws. These fees are not available to the Commission for expenditure and are covered into the Treasury as miscellaneous receipts. These fees, however, amounted to 39 percent of the 1956 appropriation for the Commission and therefore represent a reduction in the cost of the Commission which must be provided by the general taxpayer.

During 1956 the Commission has rendered an effective administration at a minimum cost. However, constantly increasing regulatory and supervisory responsibility brought about by the great activity in the securities markets makes it essential that the Congress provide funds for this Commission adequately to fulfill its statutory function of protection of the investor, the consumer and the public in accordance with the acts of Congress which it has the responsibility to administer.

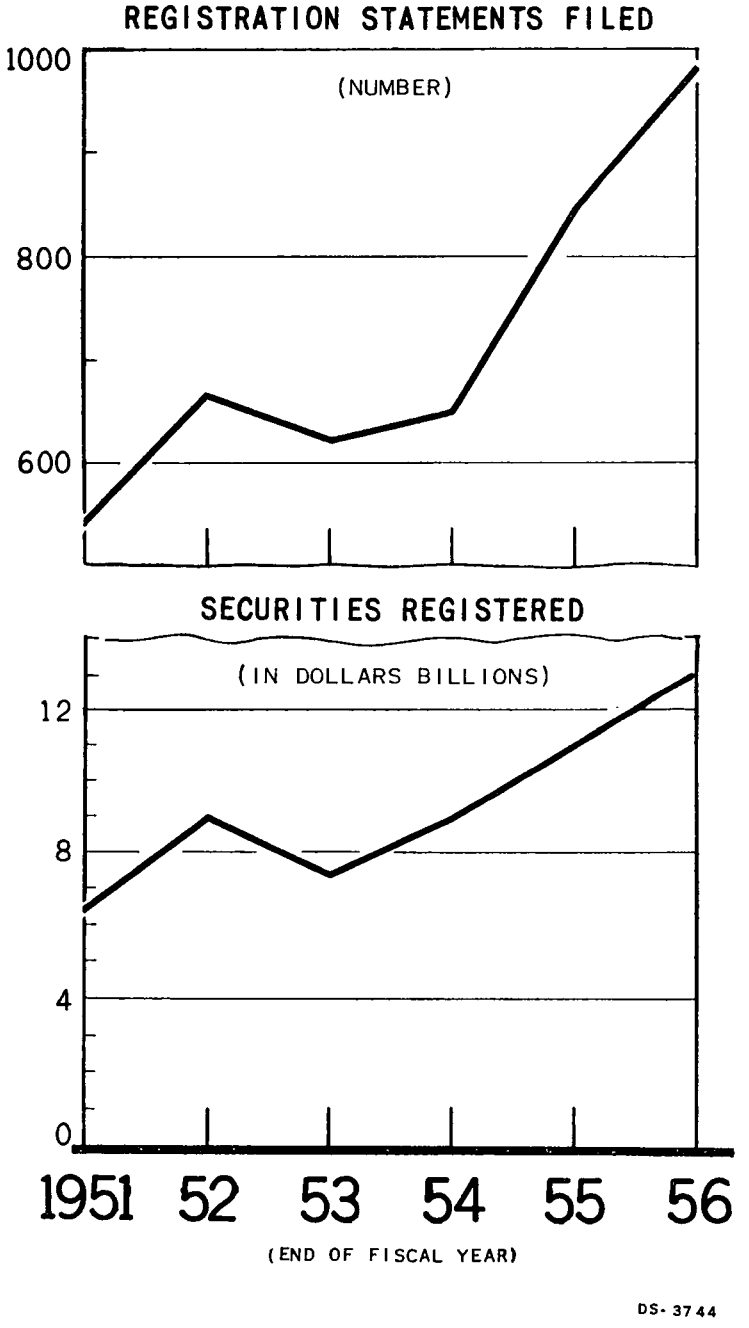
The work of the Securities and Exchange Commission in protecting the investor, the consumer and the public according to the standards established by the Congress in the Federal securities laws is vitally important to the maintenance of confidence in the securities markets which is essential to the preservation of the free enterprise system.

The charts which follow show in graphic form various aspects of the activities and personnel of the Commission relating to its increased workload.

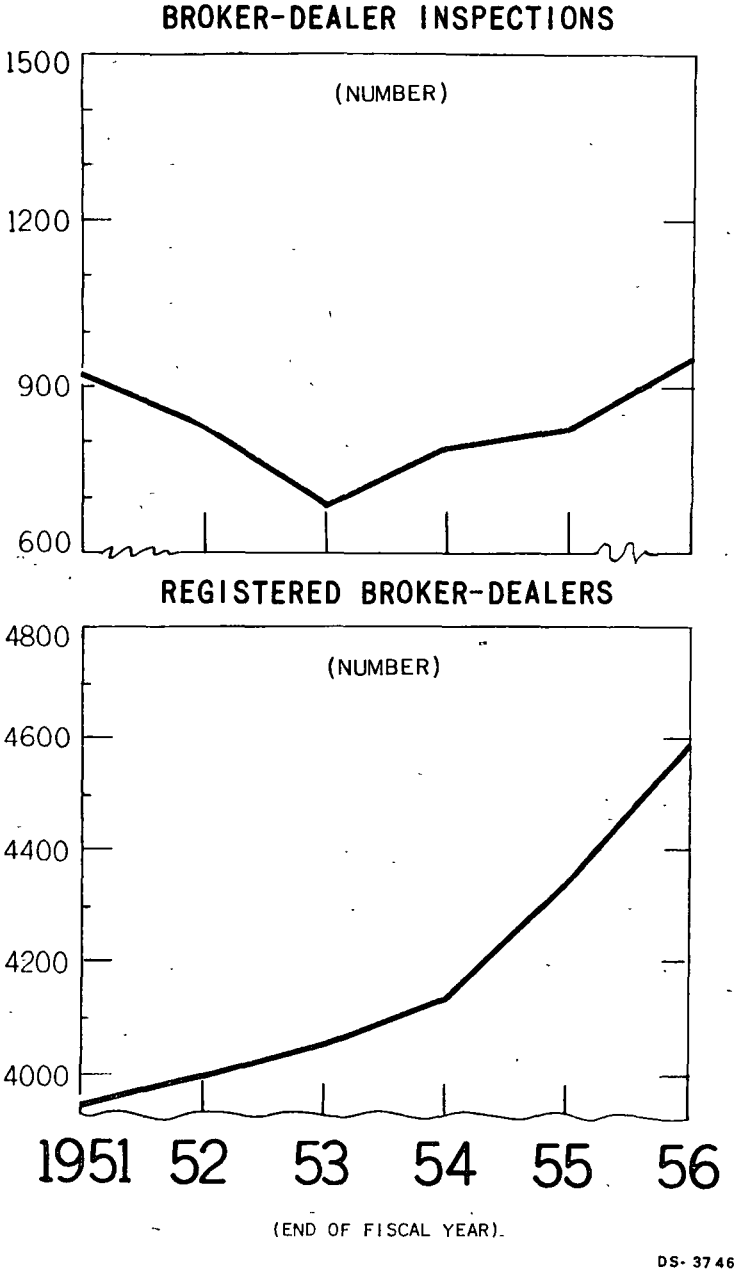

S.E.C. PERSONNEL
(NUMBER)
DEPARTMENTAL AND FIELD
1000
800
600
400
200
0
TOTAL
DEPARTMENTAL
FIELD
RATIO OF FIELD TO TOTAL PERSONNEL
PERCENT
40
30
20
10
0
1951 52 53 54 55 56
1951 52 53 54 55 56
(END OF FISCAL YEAR)
DS-3748


S.E.C. BUDGET, FEES RECEIVED, AND NUMBER OF PERSONNEL
DOLLARS MILLIONS
NUMBER 1000
6
5
4
3
2
1
0
500
0
S.E.C. BUDGET
SCALE
NUMBER OF PERSONNEL
SCALE
RATIO OF FEES REC'D TO BUDGET
PERCENT
40
30
20
10
0
1951 52 53 54 55 56
FEES RECEIVED
SCALE
BUDGET & FEES RECEIVED
S.E.C. PERSONNEL
1951 52 53 54 55 56
(END OF FISCAL YEAR)
DS-3747

SECURITIES REGISTERED WITH S.E.C.



S.E.C. BROKER-DEALER REGISTRATION AND INSPECTION



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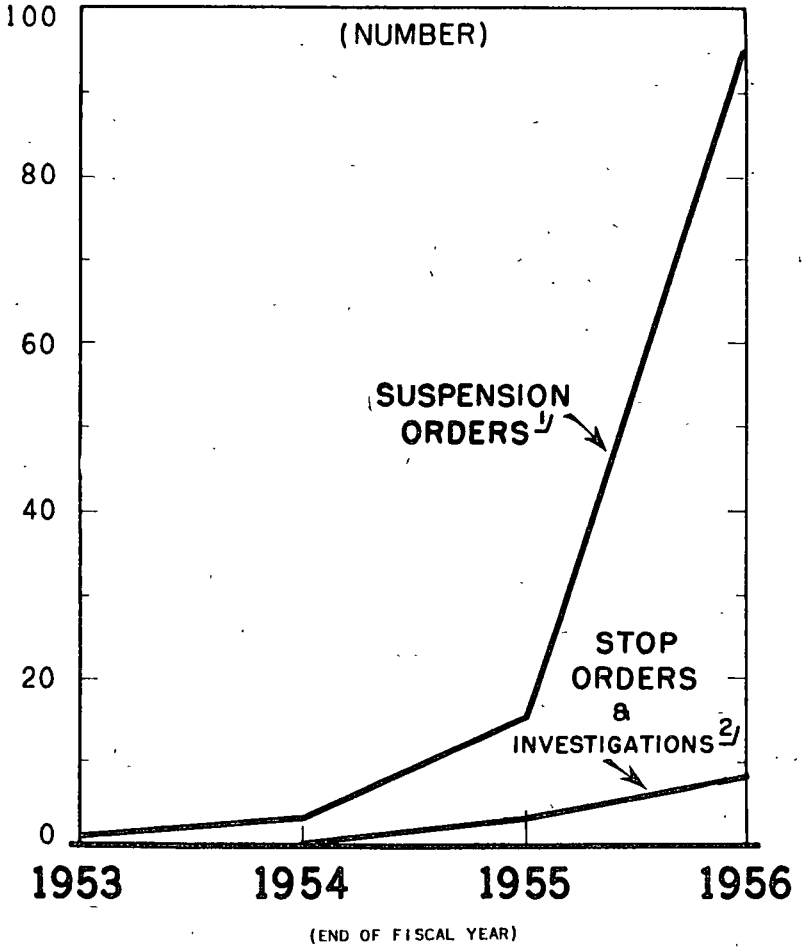
CERTAIN ENFORCEMENT ACTIONS UNDER THE SECURITIES ACT OF 1933



1/ **SUSPENSION ORDERS** - ORDERS DENYING EXEMPTIONS FROM REGISTRATION UNDER REGULATION A.

2/ **STOP ORDERS & INVESTIGATIONS** - NUMBER OF REGISTRATION STATEMENTS ON WHICH ORDERS WERE ISSUED AUTHORIZING STOP ORDERS OR INVESTIGATIONS.

DS-3745

COMMISSIONERS AND STAFF OFFICERS

(As of June 30, 1956)

Commissioners

	Term expires June 5
J. SINCLAIR ARMSTRONG of Illinois, *Chairman*	1958
ANDREW DOWNEY ORRICK of California	1957
HAROLD C. PATTERSON of Virginia	1960
EARL F. HASTINGS of Arizona	1959
JAMES C. SARGENT of New York [1]	1961

Secretary: ORVAL L. DUBOIS

Staff Officers

ALBERT K. SCHEIDENHELM, Executive Director.
F. BOURNE UPHAM, III, Assistant Executive Director.
FRANK G. URIELL, Executive Assistant to the Chairman.
BYRON D. WOODSIDE, Director, Division of Corporation Finance.
GEORGE A. BLACKSTONE, Associate Director.
RAY GARRETT, Jr., Director, Division of Corporate Regulation.[2]
PHILIP A. LOOMIS, Jr., Director, Division of Trading and Exchanges.
THOMAS G. MEEKER, General Counsel.
BRUCE L. CARSON,[3] Associate General Counsel.
EARLE C. KING, Chief Accountant.[4]
LEONARD HELFENSTEIN, Director, Office of Opinion Writing.

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[1] Assumed office June 29, 1956. Succeeded Clarence H. Adams, term of office expired June 5, 1956.

[2] Joseph C. Woodle designated Associate Director, Division of Corporate Regulation, effective November 2, 1956.

[3] Resigned September 21, 1956. Daniel J. McCauley, Jr., designated Associate General Counsel, effective October 5, 1956.

[4] Resigned November 16, 1956. Andrew Barr designated Chief Accountant, effective, November 17, 1956.

REGIONAL AND BRANCH OFFICES

Regional Administrators

Region 1. New York, New Jersey. Daniel J. McCauley, Jr. (Acting),[1] 225 Broadway, New York 7, New York.

Region 2. Massachusetts, Connecticut, Rhode Island, Vermont, New Hampshire, Maine. Philip E. Kendrick, United States Post Office and Courthouse, Post Office Square, Boston 9, Massachusetts.

Region 3. Tennessee, North Carolina, South Carolina, Georgia, Alabama, Mississippi, Florida, and that part of Louisiana lying east of the Atchafalaya River. William Green, Peachtree-Seventh Building (Room 350), Atlanta, 23, Georgia.

Region 4. Illinois, Indiana, Iowa, Kansas City (Kansas), Kentucky, Michigan, Minnesota, Missouri, Ohio, Wisconsin. Thomas B. Hart, Bankers Building (Room 630), 105 West Adams Street, Chicago 3, Illinois.

Region 5. Oklahoma, Arkansas, Texas, that part of Louisiana lying west of the Atchafalaya River, and Kansas (except Kansas City). Oran H. Allred, United States Courthouse (Room 301), 10th and Lamar Streets, Fort Worth 2, Texas.

Region 6. Wyoming, Colorado, New Mexico, Nebraska, North Dakota, South Dakota, Utah. Milton J. Blake, New Customhouse (Room 573), 19th and Stout Streets, Denver 2, Colorado.

Region 7. California, Nevada, Arizona, Hawaii. Arthur E. Pennekamp,[2] Pacific Building (Room 339), Fourth and Market Streets, San Francisco 3, California.

Region 8. Washington, Oregon, Idaho, Montana, Alaska. James E. Newton, 905 Second Avenue Building (Room 304), Seattle 4, Washington.

Region 9. Pennsylvania, Maryland, Virginia, West Virginia, Delaware, District of Columbia. Daniel J. McCauley, Jr.,[3] 425 Second Street NW. (Room 105), Washington 25, D. C.

Branch Offices

Cleveland, Ohio. Standard Building (Room 1628), 1370 Ontario Street.

Detroit, Michigan. Federal Building (Room 1074).

Los Angeles, California. United States Post Office and Courthouse (Room 1737), 312 North Spring Street.

St. Paul, Minnesota. Main Post Office and Courthouse (Room 1027), 180 East Kellogg Boulevard.

Salt Lake City, Utah. Boston Building (Room 201).

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[1] Designated Acting Regional Administrator, June 29, 1956, succeeding James C. Sargent, who was appointed Commissioner, June 29, 1956. Paul Windels, Jr., designated Regional Administrator, August 6, 1956.

[2] Succeeded George A. Blackstone, who was appointed Associate Director, Division of Corporation Finance, March 8, 1956. Mr. Pennekamp designated Regional Administrator, May 7, 1956.

[3] Designated Associate General Counsel, October 5, 1956. James J. Duncan designated Acting Regiona Administrator.

COMMISSIONERS

J. Sinclair Armstrong, Chairman

Chairman Armstrong was born in New York, N. Y., on October 15, 1915. He received an A. B. degree from Harvard College in 1938 and an LL.B. degree from Harvard Law School in 1941. After passing the New York State Bar Examination in 1941 he moved to Chicago, Ill., in July 1941; was admitted to practice in Illinois in that year, and from 1941 to 1945 was associated with the law firm of Isham, Lincoln & Beale. From 1945 to 1946 he was on active duty in the United States Naval Reserve, assigned to the Office of the General Counsel for the Department of the Navy in Washington. In 1946 he returned to Isham, Lincoln & Beale, becoming a partner of the firm in 1950. On July 16, 1953, he took office as a member of the Securities and Exchange Commission for a term of office expiring June 5, 1958, and was designated Chairman of the Commission on May 25, 1955. He has also served as the Commission's delegate as a member of the President's Conference on Administrative Procedure in 1954.

Andrew Downey Orrick

Commissioner Orrick was born in San Francisco, Calif., on October 18, 1917. He received his B. A. degree from Yale College in 1940 and an LL.B. degree from the University of California (Hastings College of Law) in 1947. From 1942 to 1946 he was on active duty with the United States Army as a captain in the Transportation Corps. After being admitted to practice in California in 1947 he was associated with the law firm of Orrick, Dahlquist, Herrington & Sutcliffe, in San Francisco, until February 1954, when he became Regional Administrator of the San Francisco Regional Office of the Securities and Exchange Commission. He served in that capacity until May 24, 1955, when he was appointed a member of the Commission for a term of office expiring June 5, 1957.

Harold C. Patterson

Commissioner Patterson was born in Newport, R. I., on March 12, 1897, and attended public schools in Massachusetts and Maryland. He attended George Washington University after graduating from Randolph Macon Academy. In 1918 he enlisted in the United States Naval Reserve for service in World War I, was commissioned ensign, United States Naval Reserve, in 1918; in June 1919 commissioned ensign United States Navy; and resigned in 1923. Prior to 1954, he had for many years been a partner of Auchincloss, Parker & Redpath,

members of the New York Stock Exchange, in Washington, D. C. He resigned from the firm June 1, 1954. He served as a Board Member of the National Association of Securities Dealers, Inc., and was active over the years in its securities industry policing work. On June 15, 1954, he was appointed Director of the Division of Trading and Exchanges of the Securities and Exchange Commission and served in that capacity until August 5, 1955, when he took office as a member of the Commission for a term of office expiring June 5, 1960.

Earl F. Hastings

Commissioner Hastings was born in Los Angeles, Calif., on April 27, 1908, and resides in Glendale, Ariz. He attended Texas Western University and the University of Denver. He is a registered professional engineer. During the years 1932 to 1941 he served as a consulting engineer with mining and industrial firms. From 1941 to 1942 he worked with Hawaiian constructors on a military installation on Oahu, T. H. From 1942 to 1947 he served in various engineering and managerial capacities. At that time he became a general partner of the firm, Darlington, Hastings & Thorne, which served as industrial consultants and managers. In 1949 he was appointed Director of Securities, Arizona Corporation Commission, Phoenix, and he served in that capacity until March 1, 1956, when he was appointed a member of the Securities and Exchange Commission for a term of office expiring June 5, 1959.

James C. Sargent

Commissioner Sargent was born in New Haven, Conn., on February 26, 1916, and holds degrees of B. A. and LL.B. from the University of Virginia. He was admitted to the New York Bar in 1940 and became associated with the firm of Clark & Baldwin, New York City. From January 1941 to July 1951, except for military service, he was employed as a trial attorney by Consolidated Edison Co. of New York. He enlisted in the United States Army Air Force in 1942 and served in this country as an Air Intelligence school instructor and as a combat and special intelligence officer in the Southwest Pacific. He was separated to inactive duty in January 1946 with the rank of captain and holds that rank in the organized reserve. In the fall of 1948, he served as an Assistant Attorney General of the State of New York in the Election Frauds Bureau in New York City. From July 1951 to August 1954 he was employed as law assistant to the Appellate Division, First Department, Supreme Court, State of New York. He was associated with the firm of Spence & Hotchkiss, New York City, from August 1954 until November 1955. In November 1955 he was appointed Administrator of the Commission's New York Regional Office. He served in that capacity until June 29, 1956, when he was sworn in as a member of the Commission for a term of office expiring June 5, 1961.

PART I

ENFORCEMENT PROGRAM

The most important aspect of the Commission's activities during 1956 has been its Enforcement Program. The aim of the Enforcement Program is to assure fair disclosure of all material facts about corporations offering securities to the public in interstate commerce and to prevent fraud, deceit and manipulation in the sale, purchase and trading of securities, and thus to provide the protection to public investors which is the objective of the Congress expressed in the Federal securities laws. The Enforcement Program, under the day-to-day direction of the Commission, has been carried out by the Commission's operating divisions and offices in Washington, and by its 14 regional and branch offices in principal cities throughout the Nation. The necessity for an increasingly vigorous Enforcement Program has arisen from the tremendous economic activity of the country, which has been reflected in the most active capital markets in our Nation's history. Enforcement problems confronted by the Commission during the relative economic stagnation of the 1930's, the World War II period of market quiescence, and the postwar recovery have been dwarfed by the problems confronting the Commission in the past 2 years of dynamic economic growth and the accompanying requirements for capital.

At no time in the Commission's experience have activities and prices in the securities markets reached such highs. This upsurge has taken place in a relatively short period of time. For example, the dollar amount of securities registered under the Securities Act of 1933 increased by 75 percent from $7.5 billion in the comparatively recent fiscal year 1953 to $13.1 billion in fiscal 1956. During the 1930's, the average dollar amount of securities registered was about $2.5 billion, and in some years was below $1 billion. In the postwar years from 1945 to 1950 it was $4.5 billion a year on the average.

Of the $400 billion gross national product annual rate figure, over $60 billion is applied for capital purposes of industry, that is to say, to provide plant facilities, tools and working capital needed by American industry. Much of the $60 billion amount is supplied from internal sources, such as depreciation accruals and retained earnings. The capital formation process supplies the balance estimated at $7 to $8 billion annually through investments in the capital markets by the American people.

The work of the Commission in sustaining the investors' confidence in the integrity of the capital markets must take into account conditions which if permitted to exist can only result, ultimately, in the destruction of investor confidence and the thwarting of the Congressional objectives set forth in the securities laws. Our free enterprise system will be damaged if these conditions grow and are not stamped out. A few of these problems with which the Commission has been faced and our efforts to cope with them are deserving of consideration by the Congress and the public generally.

1. *The problem of new, inexperienced and, in some cases, dishonest brokers and dealers registering under the Exchange Act.* The activity in the capital markets has attracted many new brokers and dealers to the securities business. The number of registered broker-dealers increased from 3,924 at June 30, 1949, to 4,591 at June 30, 1956. Many of the new broker-dealers are inexperienced and unfamiliar with the obligations owed to their customers. Some have been drawn into the business in the hope of a quick profit rather than the establishment of a sound business reputation built painstakingly upon just and equitable principles of trade.

The aggregate market value of all stock on all stock exchanges, which never exceeded $100 billion before 1946, except briefly in 1929, increased from $111 billion at December 31, 1950, to over $250 billion at June 30, 1956. The Dow Jones Industrial average of stock prices on the New York Stock Exchange reached an all-time high of 521.05 on April 6, 1956. During the years 1933 to 1949 it never exceeded 220. The value of the gross national product broke through the $400 billion annual rate figure in 1956 as compared with $340 billion in 1952.

The dollar value of securities which changed hands on the New York Stock Exchange rose to $32 billion in fiscal 1956, more than double the comparable figures of fiscal 1953, and like increases were registered on the regional exchanges and are believed to have also occurred in the over-the-counter market.

Attending this rapid expansion has been a favorable climate for the marketing of new securities issues, including securities of speculative quality, a marked increase in the number of stockholders (estimated by the New York Stock Exchange to include 8½ million domestic individuals), including many inexperienced investors.

Capital markets such as these, which have no precedent in the Commission's history, have been accompanied by adverse conditions which have required intensified enforcement activities by the Commission so as to assure to the investing public the protection which the Congress intended should be provided by the securities acts. A number of new brokers and dealers either lack adequate financial resources or speculate unwisely, thus getting into financial difficulties which threaten the safety of customers' funds or securities entrusted to them.

The Commission has no authority under the Exchange Act to bar a person from registration (absent proof of earlier violations of law) nor is there any financial or educational requirement. Expanded and more frequent broker-dealer inspections, prompt investigations of irregularities discovered in inspections or complaints received from the public, and prompt and vigorous legal action in the case of violations have been the Commission's program for the protection of investing customers.

2. *The problem of "boiler rooms."* The term "boiler room" is used to refer to a securities sales organization employing high-pressure, fraudulent, and deceptive sales techniques to "tout" highly speculative securities over the telephone. An increasing number of securities of speculative quality have been sold to unsophisticated investors lured by representations of large profits under present market conditions and willing to buy securities on the basis of representations made over the long distance telephone by complete strangers. Prevention and detection of fraud in such sales has been a particularly difficult task necessitating the careful collection of evidence from widely scattered sources.

The Commission's program has been threefold—to bring broker-dealer revocation proceedings against broker-dealers found to be selling or purchasing securities by misrepresentation or fraud, to bring injunction actions in the Federal courts to prevent such transactions, and to prevent broker-dealers from doing business in violation of any of the Exchange Act protective provisions or the Commission's rules, such as the net capital rule, the rule against improper extension of credit (regulation T) and the like, and, where the violation is willful, reference of the case to the Department of Justice for criminal prosecution.

One particularly difficult aspect of the "boiler room" problem is the gullibility of the public. The Commission has had a public information program under which Commissioners have talked at public gatherings, particularly to professional and civic groups, to the press and on radio and television, seeking to acquaint the public with the dangers of stock transactions with unknown persons calling on the long distance phone and holding out promises of riches if the person called will only buy the stock. The public is asked to tell the person calling to put a letter in the mail about the securities (this often ends the call because use of the mails gives Federal jurisdiction under the Exchange Act and the Mail Fraud Act) or to put the official prospectus or offering circular (which in the case of a new issue is required to be filed with, and is examined by, the Commission) in the mail.

The press, radio and television news media have rendered great service to the American people by helping to get this message across.

But, fundamentally, a government agency can do just so much in protecting the public, and in the final analysis the American people must learn to use ordinary care and prudence in investing their money. The Commission needs the help of the investing public which should report to us transactions in which it is believed misrepresentation and fraud have occurred and the public has been bilked. But the public must also learn not to buy the proverbial "gold brick." The tragedy from the standpoint of the public interest is that the widow, the wage earner, the person of small income is often the victim of the "boiler room" salesman. The Commission will welcome every help from the public in reporting to us fraudulent transactions and in using common sense in their securities transactions.

3. *Sales of unregistered securities based on claimed exemptions.* It appears that a substantial but undetermined number of securities have been sold in violation of the registration, prospectus and antifraud provisions of the Securities Act pursuant to claimed exemptions which, in fact, were not available. We believe that these sales have been made in the main under claims of exemption pursuant to the so-called "private offering" exemption [1] and the intrastate exemption.[2] In most of these cases the Commission has no means to discover facts showing the unavailability of a particular exemption until it receives, months after sales have been made, reports or complaints from unwary public investors who have been "taken" for substantial sums. Further complicating the Commission's problems in this area has been the fact that an increasingly large number of securities claimed to have been issued pursuant to these exemptions have been transferred to United States citizens through Canadian, Swiss, Lichtenstein, and other foreign financial institutions, under foreign laws which preclude the Commission from tracing the transactions in which the securities have been publicly sold or the availability or unavailability of the claimed exemption. The Commission has increased its efforts to make factual discoveries of sales made without registration at the earliest opportunity in order to determine the availability or unavailability of these exemptions and thus to take legal action to afford the protection to public investors contemplated by the Securities Act.

4. *The problem of illegal sales from Canada.* The Commission has been concerned about the illegal sale of issues in the securities markets of the United States by issuers and broker-dealers located in Canada. These transactions have appeared to reach public investors in the United States as a result of primary distributions effected on Canadian securities exchanges or through Canadian

[1] Securities Act of 1933, sec. 4 (1)—second clause.
[2] Securities Act of 1933, sec. 3 (a) (11).

brokers and dealers. Although it has not been possible, in many instances to directly reach Canadian issuers or broker-dealers, the Commission has attempted to review more closely the activities of broker-dealer firms in this country suspected of participating in the illegal marketing of Canadian securities or of American securities sold through Canadian sources in order to protect United States public investors more effectively. Efforts are also being made through appropriate diplomatic channels to correct the virtual nullification of the Extradition Treaty between the United States and Canada which, as amended in 1952, provides for the extradition of persons indicted for securities frauds perpetrated in Canada upon persons in the United States. This resulted from a decision of Canadian Extradition judge in 1954,[3] in the first case under the 1952 treaty amendment, denying extradition though conceding the fraud. During the year, continued excellent cooperation on law enforcement matters by Canadian officials, both Federal and Provincial, aided greatly our efforts to detect, thwart and proceed against fraudulent securities sales.

5. *The problem of the "front money" racket.* Under the Commission's exemptive regulation for new issues not in excess of $300,000 in aggregate public offering price (Regulation A) and sometimes under registration, it has been discovered that "rings" have developed through which groups of promoters, dealers, attorneys, and engineers collaborate in the creation of a series of companies primarily employed to "manufacture" securities for public sale in the guise of legitimate promotions. Often these facts have not been developed or discovered until after public investors have bought securities which have little or no actual value. These various transactions frequently have been carefully timed so that it is difficult to relate one issue with another even though a particular issue may have been part of a scheme of the character mentioned. Under the revised regulation A, the Commission now requires disclosure of the names of such individuals in connection with the filing of Form 1–A which will greatly assist its enforcement program.

6. *Evasion of the registration requirements through the "no sale" theory.* By Commission Rule No. 133, certain types of corporate mergers, consolidation, reclassifications of securities and acquisition of assets of another person in conformity with statutory provisions of the state of incorporation, have been deemed not to constitute a "sale" of securities issued in the transactions for purposes of section 5 of the Securities Act. The rule, in effect, exempts such issues from the requirement of registration under that Act. The rule has been used by numerous issuers, domestic and foreign, to distribute securities without registration. As in the case of the "private offering" and "intrastate" exemptions, many transactions ostensibly exempted

[3] See 20th Annual Report, p. 103; 21st Annual Report, p. 113.

under the rule, in fact involve violations of the registration provisions. The Commission recently released a notice of a proposed revision of the rule which is designed to make exemptions unavailable in the cases now exempted under it.[4] If adoption of the proposal results, it will involve a substantial increase in the number of registration statements filed under the Securities Act and in the annual and periodic reports filed under the Securities Exchange Act.

7. *The problem of promotional stocks.* In addition to the problems created by the sale of promotional uranium stocks, the Commission has been concerned with the sale of new insurance company securities in both exempt and registered issues. Many of these new insurance company ventures are located in the South Central, Southwestern and Southeastern parts of the country. A large number of these issues have given the appearance of involving abuses or probable violations of either the Securities Act or of the Securities Exchange Act, necessitating thorough investigation.

8. *Stop order and suspension proceedings for new issues.* For the protection of public investors, the Commission has instituted a substantially increased number of stop-order proceedings and suspension orders. Each of these has been preceded by an investigation, and, in many instances, has required a formal administrative hearing. These actions have involved the establishment of facts and the obtaining of testimony. Securities, which, if sold, would have defrauded the public, have thus been kept off the market.

The effectiveness of the Enforcement Program depends in large measure upon a staff, both in the headquarters and regional offices, adequate to discharge the exacting duties which this program places upon it, and upon the availability of travel funds necessary to give this personnel the mobility necessary to cover the large geographical areas in which the investigative work has to be done. Further, the Enforcement Program has been related to the complex and ever-changing pattern of the securities markets and the securities industry. The facts concerning the business, property, and financing of a security issuer must be ascertained and related to the representations made to investors. Investors must be identified and interviewed. Books and records of brokers, dealers, issuers and others must be examined and analyzed. Frequently, securities must be traced, often through intricate channels, to ascertain whether they have been offered by an issuer or underwriter in violation of the registration and prospectus requirements of the acts. The information thus obtained has had to be then developed in a form which would permit its introduction in evidence in legal proceedings, which is not a simple matter, where complex legal and economic facts and theories are concerned.

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[4] Securities Act Release 3698 (October 2, 1956).

Violations, however, have often been carefully concealed and, under present conditions, frequently have involved elaborate and shrewdly conceived schemes carried out on a large scale. Such activities could be properly dealt with only by assigning a competent team of attorneys, accountants, analysts, and investigators to concentrate on the particular case until it has been completed.

Careful and painstaking work usually over a period of many months has preceded formal enforcement action by the Commission. In some cases the work of the Commission has led to some form of restitution to public investors; in others, the violations have been discovered in time to prevent serious injury to the public; and in others, the violators have been forced out of business or prosecuted.

As a further implementation of the Enforcement Program, and as a means of giving greater protection to public investors, the Commission has undertaken through the media of public speeches made to various civic groups and other organizations, and through adequate coverage in the press and on radio and television, to warn the American people against hasty investments in companies whose financial and background facts have not been disclosed. Such warnings inevitably have had a great deterrent effect and have caused companies which are seeking to raise money in the capital markets to comply with the registration requirements by making the disclosures so necessary to informed investment by the public.

If the confidence and faith of the American public in the capital markets is to be maintained so that the essential supply of capital can be continued at the high rate of demand anticipated by present estimates of industrial production with the resultant high standard of living, it is essential that this agency continue its Enforcement Program by supervising the capital markets in accordance with the standards established by the Congress in the Federal securities laws.

PART II

LEGISLATIVE ACTIVITIES

Statutory Amendments Proposed by the Commission

During 1956 the Commission submitted to the Committee on Banking and Currency of the Senate and the Committee on Interstate and Foreign Commerce of the House of Representatives, which have the duty of exercising watchfulness over the execution of the securities laws pursuant to section 136 of the Legislative Reorganization Act of 1946, a proposal to adopt a number of amendments to these statutes in order to assist the Commission in its enforcement activities. The proposed amendments do not alter the basic provisions and purposes of the statutes. Most of the proposals relate to provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934. They were introduced on May 9, 1956, in the House of Representatives as H. R. 11129, 84th Congress, by the late Representative J. Percy Priest, then chairman of the Committee on Interstate and Foreign Commerce. They were also introduced (by request) in the Senate on May 23, 1956, as S. 3915 by Senator J. William Fulbright, chairman of the Committee on Banking and Currency. No action was taken on these bills during the remainder of the session because there was insufficient time to consider them.

The Commission's amendment proposals were designed to strengthen the jurisdictional provisions of the statutes, to correct certain inadequacies, and to facilitate criminal prosecutions and other enforcement activities. The various proposals would prohibit embezzlement of money or securities of, or entrusted to the care of, a registered broker-dealer; extend criminal liability to false statements in documents filed with the Commission under section 3 (b) of the Securities Act of 1933, in connection with small, exempted securities offerings; enact the antifraud provisions of the Commission's Rule X–10B–5 under the Securities Exchange Act of 1934 in statutory form as an aid to criminal prosecutions; make it clear that a showing of past violations is a sufficient basis for injunctive relief; make it clear that a registration statement under the Securities Act may be withdrawn only with the consent of the Commission; clarify and strengthen the statutory provisions relating to financial responsibility of brokers and dealers; and authorize the Commission, by rule, to regulate the borrowing, holding or lending of customers' securities by a broker or dealer. Many other minor amendments were also proposed. The

Commission expects to request further consideration of these and similar proposals in the 85th Congress.

Registration of Unlisted Securities of Certain Companies Having Large Public Investor Interest

On May 24, 1955, Senator J. W. Fulbright, chairman of the Committee on Banking and Currency, introduced S. 2054, a bill to extend the reporting, proxy and insider-trading provisions of sections 12, 13, 14, and 16 of the Securities Exchange Act to additional corporations. The bill was introduced at the conclusion of the Committee's "Stock Market Study," during which the Commission had testified and had submitted much background material for the information of the committee and for inclusion in the committee's staff report of April 30, 1955, on Factors Affecting the Stock Market. In its final report,[1] a majority of the committee expressed the view that "as a general policy, it is in the public interest that companies whose stocks are traded over the counter be required to comply with the same statutory provisions and the same rules and regulations as companies whose stocks are listed on national securities exchanges." A minority concurred in recommending further study of over-the-counter markets, with the objective of developing specific legislation if needed.

S. 2054 was introduced to carry out the committee's recommendation, by making sections 12, 13, 14 and 16, which now apply only to securities listed and registered on national securities exchanges, applicable also to certain unregistered securities that are traded in the over-the-counter market. A similar bill (H. R. 7845) was introduced in the House on August 2, 1955, by Representative Arthur G. Klein, chairman of the Subcommittee on Commerce and Finance of the Committee on Interstate and Foreign Commerce.

Hearings were held on S. 2054 in June 1955 at which the Commission expressed its support of the broad principles and objectives of the bill, subject to further study.[2] On July 19, 1955, the Commission submitted a preliminary report in which it recommended certain revisions in the bill, but withheld final comment pending a complete factual study.[3] On August 5, 1955, the subcommittee on Securities reported favorably a revised Committee Print of S. 2054, which included some of the changes suggested by the Commission and certain other changes, including a new provision exempting securities of regulated insurance companies from the coverage of the bill. As revised, the bill would be subject to sections 7, 12, 13, 14, and 16 of the Act corporations having 750 or more stockholders, or debt securities

[1] S. Rept. 376, 84th Cong.

[2] Hearings before Subcommittee of Senate Committee on Banking and Currency, 84th Congress, 1st session, on S. 2054, June 27–July 1, 1955, pp. 1037 *et seq.*

[3] Hearings, *supra*, p. 1062 *et seq.*

of $1 million or more outstanding in the hands of the public, and $2 million of assets.

In order to determine the companies which might be affected by this bill, the extent of their present compliance with applicable financial reporting requirements of the Commission, and their practices in soliciting proxies, questionnaires were sent to 1,600 corporations inquiring whether the company had within the past 3 years sent an annual report to its stockholders and requesting a copy. The response received (from approximately 90 percent of those to which requests were sent) indicated that approximately 1,200 corporations would be subject to the bill (of which 617 were presently filing financial statements with the Commission). Such 1,200 corporations have estimated assets in excess of $35 billion. Review of proxy soliciting materials used by these corporations showed that in very few instances were stockholders furnished with information comparable to that required by the Commission's proxy rules and that in most annual meetings for the election of directors stockholders received only a formal notice of the meeting and form of proxy. Examination of the financial statements contained in the stockholders' reports received indicated that approximately 21 percent were deficient by Commission reporting standards. These findings were contained in a report made by the Commission to the Committee on Banking and Currency on May 17, 1956, which report was printed and made available to the public by the committee. In its report, and in hearings subsequently held by the full committee, the Commission endorsed the enactment of the financial reporting, proxy and insider-reporting provisions of the bill, but recommended deferral of any action on the application of section 16 (b) of the Act (providing for recovery of profits from short-swing trading by insiders) to these companies until a further study could be made.

The Commission considers legislation of the character embodied in S. 2054, as demonstrated by the data contained in our report, to be consistent with the standards expressed by the Congress in the Federal securities laws and to be vitally necessary for the protection of public investors in these large widely held corporations.

The committee did not take any final action on S. 2054. However, Senator Fulbright, chairman of the committee, requested the Commission to extend the study it had previously made so as to obtain information about the financial reporting and proxy practices of insurance companies, to provide a basis for further consideration by the committee in the 85th Congress. The Commission had not previously included insurance companies in its study for the reason that the bill as revised by the subcommittee on August 5, 1955, had contained an exemption for such companies. The Commission has initiated the requested study, and, since the end of the fiscal year, has

sent questionnaires to more than 530 insurance companies to obtain the data necessary for making an objective, factual appraisal of such practices of insurance companies.

Proposals To Amend the Exemption for Small Issues

On April 20, 1955, during the previous fiscal year, Representative John B. Bennett of Michigan had introduced a bill (H. R. 5701), to repeal section 3 (b) of the Securities Act of 1933. Section 3 (b) provides that the Securities and Exchange Commission may from time to time by its rules and regulations, and subject to such terms and conditions as may be prescribed, add to the classes of securities exempted in section 3 (a) of the Act (such as securities issued by the United States or other governmental organizations, commercial paper, building and loan association obligations, securities the issuance of which is subject to approval under the Interstate Commerce Act and certain other specifically exempted classes) any class of securities if the Commission finds that enforcement of the registration provisions of the Act with respect to such securities "is not necessary in the public interest and for the protection of investors by reason of the small amount involved or the limited character of the public offering," provided no issue shall be exempted the aggregate offering price of which exceeds $300,000.

Hearings were held on this subject by the Subcommittee on Commerce and Finance, at which the Commission testified, at various dates from July 20, 1955, through May 9, 1956, in Washington, D. C., New York City, Denver and Salt Lake City. The Commission supplied a substantial amount of supplemental information to the committee. The Commission opposed this bill repealing the exemption although these hearings developed a good deal of factual information about the abuses of the public in penny stocks with which the Commission has been attempting to deal by strengthening its filing requirements under the exemptive regulations and by stepping up its enforcement activities in its field offices. The Commission opposed the repeal of the exemption on the ground that it would adversely affect the raising of capital by legitimate small business enterprises.

On February 16, 1956, Representative Bennett introduced another bill (H. R. 9319) which would apply to persons associated with an offering under the exemptive regulations the same strict civil liabilities that pertain to persons associated with an offering under full registration, which are set forth in section 11 of the Act. The Commission likewise opposed this bill on the ground that it would in substance require the equivalent of full registration for small issues and that this would have the indirect effect of repealing the exemption. The Committee on Interstate and Foreign Commerce favorably reported this bill (H. R. Rept. 2513, 84th Cong., 2d sess. (1956)) and, although

it was passed over in the last days of the congressional session, it may be introduced in the 85th Congress (102 Cong. Rec., July 27, 1956, at 13820).

To meet what the Commission considered to be the objectives of this legislation without its drawbacks, Representative Arthur G. Klein of New York on May 17, 1956, introduced a bill (H. R. 11308), which the Securities and Exchange Commission supported. This bill would have enlarged the civil liabilities of persons actually responsible for misstatements or omissions of material facts, or for misrepresentation or fraud, in connection with exempt offerings, but it would not have made the civil liabilities applicable to all persons associated with an offering whether or not they had knowledge or were responsible for misstatements, omissions or misrepresentation or fraud. A minority of three members of the Committee on Interstate and Foreign Commerce of the House of Representatives voted for the Klein bill. The Commission is hopeful such legislation will again be considered by the Congress.

Activities Relating to Amendment of Public Utility Holding Company Act of 1935

Nuclear Reactor Legislation

Several legislative proposals relating to the Public Utility Holding Company Act of 1935 were introduced during the second session of the 84th Congress. Two of these were embodied in S. 2643 and its companion bill, H. R. 6294.[4] Section 4 of this bill would have amended the Public Utility Holding Company Act so as to exclude from the definition of "electric utility company" in section 2 (a) (3) a nuclear reactor company, even though the heat produced by the reactor is used for the generation of electricity. Section 5 of the bill would have amended section 2 (a) (7) of the Act so as to exclude from the definition of "holding company" a company whose subsidiary is a generating company which meets certain requirements including a requirement that all of its stock be owned by electric utility or holding companies which either directly or through operating subsidiaries purchase all of its output.

Section 5 was designed in the first instance to meet the desires of four electric utility companies which operate in the Pacific Northwest

[4] Several bills on this subject were introduced during the session S. 2643, introduced on July 27, 1955, by Senator Potter for himself and Senator Pastore, was substantially identical to H. R. 6294, introduced on May 17, 1955, by Representative Dodd. Two more bills identical to S. 2643 and H. R. 6294 were H. R. 7258, introduced on July 11, 1956, by Representative Ruth Thompson and H. R. 7554 introduced on July 25, 1956, by Representative Hayworth. H. R. 9743 introduced on March 5, 1956, by Representative Cole, differed substantially from S. 2643 in that it related the availability of an exemption to the type of license granted by the Atomic Energy Commission. We submitted written comments, dated June 1, 1956, on H. R. 9743 to the Joint Committee on Atomic Energy at its request. Our comments opposed the bill and attached as exhibits our written statements on S. 2643. We were not asked to testify. When the revised version of S. 2643, or "substitute bill," was approved by the Joint Committee, H. R. 9743 was revised to conform, and this was the bill, as revised, which was reported out to the House.

region and are the parents of Pacific Northwest Power Co., which in turn is seeking permission under the Federal Power Act to construct two hydroelectric projects on the Snake River, known as the "Pleasant Valley" and "Mountain Sheep" projects. An earlier version of this proposal had appeared in H. R. 9043, 83d Congress, but in that form had never reached the floor of the House. The sponsoring companies, the Montana Power Co., Pacific Power & Light Co., Portland General Electric Co., and the Washington Water Power Co., sought the amendment to enable them to construct these projects through a common subsidiary without themselves becoming holding companies required either to register or to qualify for an exemption from the Act.

In our written comments on the bill,[5] and in the testimony of the Chairman and the Director of the Division of Corporate Regulation before the special subcommittee which conducted hearings on the bill,[6] the Commission opposed the enactment of section 5. We took issue with the assertions that the Public Utility Holding Company Act retarded the development of worthy projects and that the Act was not intended to apply to such situations as Pacific Northwest Power Co. and its sponsors and did so only by an accident of definition. We asserted, rather, that Holding Company Act regulation had been wholesome and beneficial in its effects upon companies subject to it, and that the Pacific Northwest situation was clearly within the intent and purposes of the Act. We said, in part:

> Neither the purpose nor the effect of the Public Utility Holding Company Act of 1935 is the impeding of the development of low-cost electric energy in ample and growing supply to meet the needs of consumers. Rather, the act serves to channel such development so as to prevent concomitant evils and abuses which Congress found to exist in the organization, control, and financing of public-utility holding companies and their subsidiary companies. It is corrective but not punitive or merely repressive. Its standards are flexible, and it has been flexibly administered to permit and encourage healthy growth of the utility industry to serve our expanding economy. The Commission believes the act has had the desired result.[7]

Subsequently we submitted a written Supplementary Statement[8] and further testimony[9] in response to points raised and questions asked during the hearings. Our written material undertook to summarize the regulatory jurisdiction of the Commission by demonstrating that the Pacific Northwest Power Co. situation was within the purposes of the Act and that regulation by this Commission would not be merely repetitive of State regulation or that of some other Federal

[5] Hearings on S. 2643 before a Subcommittee of the Senate Committee on Interstate and Foreign Commerce, April 17, 1956, p. 14.

[6] *Ibid.*, p. 12 *et seq.*

[7] Hearing on S. 2643 before a Subcommittee of the Senate Committee on Interstate and Foreign Commerce, April 17, 1956, p. 14.

[8] *Ibid.*, May 24, 1956, p. 376.

[9] *Ibid.*, May 24, 1956, p. 375 *et seq.*

agency. We also examined the sponsors' apparent standing as to qualifications for exemption under any of the subparagraphs of section 3 (a). Certain obvious difficulties appeared with regard to one or more of the sponsors because of foreign incorporation or combined electric and gas operation, although the latter would be more of a problem for a registered company than an obstacle to exemption.

As a principal illustration of an aspect of the Pacific Northwest Power situation upon which the Holding Company Act might come to bear, we analyzed the capital structures of the four sponsors and the adverse effect upon their debt-equity ratios which would result from their announced plans for financing the hydroelectric projects. This was followed by an exposition of the importance of capitalization ratios to sound financing and of the Commission's concern with these ratios.

On May 24, 1956, Senator Pastore, chairman of the Subcommittee of the Senate Committee on Interstate and Foreign Commerce conducting hearings on the bill, announced that he and Senator Potter had agreed to delete section 5 from their bill. This was done, and the amendment proposed in section 5 was not revived.

Whereas section 5 was proposed to meet the desires of the Pacific Northwest Power group, section 4 was designed to satisfy the sponsors of Power Reactor Development Co., sometimes referred to as the Detroit Edison Co. project. The section was substantially revised in the form of a "substitute bill," which was then reported out favorably by the subcommittee, referred by the full committee to the Joint Committee on Atomic Energy, and reported out favorably to both houses as part of a three-unit program to further the development of nuclear energy for peaceful purposes.

The first of these units was a revised version of the Gore bill, which would have directed the Atomic Energy Commission to construct power reactors on its own installations. The second would have provided for government insurance to private owners of licensed power reactors against public liability arising from a major catastrophe. The third unit was the revised section 4 of S. 2643. When the first unit failed to be adopted by the Congress, the other two units failed with it.[10]

The Commission's position toward section 4 of S. 2643 consisted of two elements. First, in commenting upon the proposed granting of an automatic and permanent exemption for nuclear reactor companies and their sponsors, the Commission took the position that the bill went further than any demonstrable need to accomplish the objective of nuclear power development. In our opinion, there was in fact no just need for exemption from the Act's provisions which could not be

[10] See Congressional Record, 84th Cong., 2d sess., July 24, 1956, pp. 12996-13039. The revised Gore bill was S. 4146 and H. R. 12061. The bill providing government insurance for private reactors was S. 3929

met by appropriate Commission action under the present Act. In our written comments we observed:

> No atomic power project has been impeded by the act as it is presently in effect. The only such project to date which has been submitted to the Commission for action has been granted the desired approvals and exemptions by reasonable application of the present statute and the established standards and policies thereunder.[11]

The reference was to *Yankee Atomic Electric Co.*[12] wherein we permitted, under the present statutory standards, joint participation by a large group of utility companies in atomic reactor development on a regional basis.

The Commission recognized, of course, that where a reactor project was sponsored in part by industrial companies and in part by utility companies remote geographically from the reactor site, the approach of *Yankee Atomic Electric Co.* would not be available. In such a situation the Commission believed that, although the substantive effect of exemption would be consistent with the principles of the Act, the exemption should be available only on Commission order, and it should be terminable upon expiration of the research and development phase of the project.

Secondly, the Commission called attention to two other important aspects of the proposed legislation. Since Power Reactor Development Co. is a nonprofit corporation whose approximately 25 sponsors hold 1 membership apiece, with 1 vote, instead of stock, no one company will have 10 percent or more of its voting securities, as required to qualify as a *prima facie* holding company under section 2 (a) (7) (A) of the Act. Accordingly, no member company can be a holding company with regard to Power Reactor unless the Commission first finds actual control or controlling influence after a formal proceeding with full opportunity for hearing and judicial review. It also appeared that the Commission could declare, by rule or order, that a company like Power Reactor is not an electric utility company, pursuant to the last sentence of section 2 (a) (3) of the Act. The Commission proceeded to draft such a rule and published it for public comment on June 15, 1956.[13] After studying the comments submitted and incorporating several of their suggestions in a revised version, the rule was adopted as an amendment to rule U–7 on July 13, 1956.[14]

Despite this demonstration of what could be achieved under the present Act in furthering the development of nuclear energy projects for peaceful purposes, the Detroit Edison group persisted in the view that its reactor project was feasible only if the sponsors had

[11] Hearings on S. 2643 before a subcommittee of the Senate Committee on Interstate and Foreign Commerce, April 17, 1956, p. 15.

[12] Holding Company Act Release No. 13048, November 25, 1955.

[13] Holding Company Act Release No. 13200.

[14] Holding Company Act Release No. 13221. For a description of amended rule U–7 see p. 165, *infra*.

an express exemption from the Act which was not based upon Commission action or discretion. The revised, or substitute, bill, however, as ultimately approved by the Senate Committee on Interstate and Foreign Commerce and the Joint Committee on Atomic Energy, did limit the exemption to a nonprofit corporation and provided for termination of the exemption upon a finding by the Atomic Energy Commission that the project was no longer primarily devoted to research and development.[15] Although the Commission still believes that such legislation is unnecessary, it did not object to its adoption in the revised form. As noted above, however, the proposed legislation failed.

In addition to testifying twice on this matter before Senator Pastore's subcommittee, and submitting three written statements, the Commission also appeared before the Subcommittee on Public Works of the House Committee on Appropriations, to explain its views on the proposed legislation. The Chairman, the General Counsel, and the Director of the Division of Corporate Regulation appeared on behalf of the Commission.

The Commission believes that its opposition to section 5 of S. 2643 in its original form was instrumental in dissuading the Congress from what would have been the first serious encroachment upon the principles and policies embodied in the Public Utility Holding Company Act.[16] We believe that these principles and policies, established by the Congress and administered by the Commission, have been of vital influence in the rehabilitation of the financial condition of large segments of the electric and gas utility industry, thus permitting them to obtain from the investing public the large amounts of new capital needed for their huge expansion programs. We believe that these principles and policies have been beneficial to investors, consumers and the public, and have also served to enhance the effectiveness of the state regulatory agencies. We believe the Congress should be slow to permit departure from these principles and policies and we are certain, so far as any privately sponsored nuclear reactor project that has as yet been brought to our attention, that they do not interfere with the development of nuclear energy for peaceful purposes. Rather, we believe that the Commission has made a significant contribution, consistent with the policies of the Congress expressed both in the Atomic Energy Acts and the Public Utility Holding Company Act, to the development of nuclear power for peaceful purposes in our *Yankee Atomic Electric Co.* decision and in our amendment to rule U–7.

[15] S. Rpt. 2529 to accompany S. 2643, and H. Rpt. 2694 to accompany H. R. 9743.

[16] The Act has never been amended, although the enactment of H. R. 10624, discussed below, is in substance an amendment.

Exemption for General Public Utilities Corp.

H. R. 10624, introduced by Representative Arthur G. Klein, chairman of the Subcommittee on Commerce and Finance of the Committee on Interstate and Foreign Commerce of the House of Representatives provided that no law of the United States shall be held to require the General Public Utilities Corp., a holding company registered under the Public Utility Holding Company Act of 1935, to divest itself of any interest in the Manila Electric Co., a company engaged in the production and distribution of electricity in the Republic of the Philippines. The purpose of the bill was to exempt these companies from section 11 (b) (1) of the Holding Company Act, which requires that each public utility holding company system be geographically integrated. The Philippine Government had expressed apprehension that less favorable management might result from divestment of control of the Manila Electric Co. by the General Public Utilities Corp. and had expressed an interest in a tentative suggestion of GPU for the construction of a nuclear power generating plant in the Philippines by the American Company.

In its memorandum on the bill,[17] the Commission stated:

> The Commission opposes enactment of H. R. 10624 because it will permit General Public Utilities Corp. (GPU) to retain its Philippine subsidiaries in addition to its integrated domestic electric utility system. This would be inconsistent with the principles stated by the Congress in the Public Utility Holding Company Act of 1935 and the Commission has not been presented with any considerations which would justify departing from those principles in this particular situation. It is the Commission's opinion that the reasonable needs of all persons and interests concerned can be well served by divestment from GPU of its Philippine properties in an appropriate manner.

We summarized the history of GPU with respect to its Philippine subsidiaries. Our original order of divestment was entered against the bankruptcy trustees of GPU's predecessors, Associated Gas & Electric Corp. and Associated Gas & Electric Co., in 1942 as a result of the section 11 (b) (1) proceedings commenced the previous year.[18] Later, in 1945, the two Philippine subsidiaries were removed from the list of companies to be divested because of the extensive war damage to the physical properties and the urgent need for rehabilitation.[19] In 1951 the Commission reopened the proceedings and reinstated the divestment order.[20] Under the provisions of section 11 (c) of the Act, GPU was required to comply with the divestment order within 1 year from December 28, 1951, but it had not done so.

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[17] House Rpt. 2477, to accompany H. R. 10624, dated June 26, 1956, p. 6. See also S. Rpt. 2787, to accompany H. R. 10624, dated July 25, 1956, submitted by the Senate Committee on Interstate and Foreign Commerce. S. 4048 was identical to H. R. 10624, and we filed a Memorandum on it dated July 9, 1956. S. 4048 was introduced on June 13, 1956, by Senator Smith of New Jersey.

[18] *Denis J. Driscoll and Willard L. Thorp, etc.*, 11 S. E. C. 1115; 11 S. E. C. 1123 (1942).

[19] *Denis J. Driscoll and Willard L. Thorp, etc.*, 18 S. E. C. 283 (1945).

[20] *General Public Utilities Corp.*, Holding Company Act release No. 10982 (Dec. 28, 1951).

Our memorandum also traced the legislative history and purpose of section 11 (b) (1) and its effect on foreign properties. We concluded that the Act embodied a deliberate policy against combining domestic and noncontiguous foreign utility properties in a single holding company system. This policy was based upon the disruptive effect that foreign properties have on the market performance of the system's publicly held securities and the diversionary effect upon management of having foreign as well as domestic commitments and responsibilities. We stated that GPU had financed the rehabilitation of the Philippine properties from retained earnings and borrowings in the Philippines and in recent years had been able to take up substantial profits. On the other hand, if GPU did advance its own funds to the Philippines it would to a degree be causing its domestic customers to help finance Philippine development. This appeared to demonstrate the wisdom of Congress in 1935 in prohibiting such combinations of properties.

In response to certain fears expressed by GPU's management, the Commission pointed out that the divestment could be accomplished by the creation of a new corporation to hold the stock of the Philippine subsidiaries and whose stock would be distributed to GPU's stockholders. This device would give GPU's stockholders the protection of domestic supervisory management, would do much to assure continued responsible management, and would provide an American entity for assistance in obtaining financial and technical assistance. The Commission acknowledged, however, that whatever significance this matter had for United States foreign relations was within the special competence of other Government departments and agencies. Nevertheless it believed that divestment could be achieved in a manner which would protect such interests.

The Department of State advised the subcommittee that in the opinion of the Philippine Government a new holding company similar to the one suggested by the Commission would not have sufficient credit or technical expertness, that GPU's background, experience, and knowledge of the Philippines might be lost, and that divestment might cause abandonment of GPU's tentative plans for a nuclear power project in the Philippines. The committee therefore concluded:

> While the Commission has suggested that these objectives which are without the competence of its jurisdiction, as well as the purposes of the Utility Act, might be met by the stock of Manila being transferred to a newly created American holding company, and the stock of that company in turn distributed to the stockholders of General Public Utilities, we do not find on the record that this will assure to the degree of satisfaction necessary, the attainment of the objectives of rendering the maximum financial and managerial assistance possible to this highly important utility in the Philippines, with which country we have been and are bound with such ties of friendship and amity and which appears to favor continued ownership of the Manila Electric Co. by the General Public Utilities Corp.

The committee is opposed to legislation which would amend the Public Utility Holding Company Act of 1935 and which would be construed as a precedent for opening up that act to exceptions in other situations. The committee believes that enactment of H. R. 10624 is desirable under the special circumstances which prevail in this particular situation and the committee, accordingly, recommends early action on this legislation.[21]

The Senate committee, while stating that it did not desire to create a precedent for legislation exempting particular holding companies from provisions of the Act, noted that GPU was now the only integrated domestic system with a separate foreign subsidiary, and concurred in the views of the House committee.[22] The bill became law on August 9, 1956.[23]

Other Legislative Proposals

A substantial amount of time of the Commission was also devoted to matters pertaining to legislative proposals referred to the Commission for comment and to congressional inquiries. During fiscal year 1956, 19 legislative proposals were analyzed and reports submitted on them to the appropriate congressional committees at their request, as compared with ten in the prior fiscal year. In addition, numerous congressional inquiries were received and answered relating to matters other than specific legislative proposals.

Congressional Hearings

Senate Special Subcommittee on Antitrust and Monopoly of the Committee on the Judiciary

In July and November, 1955, the Chairman and other members of the Commission and various members of the staff testified before the Special Subcommittee on Antitrust and Monopoly of the Senate Judiciary Committee concerning the Commission's actions under the Public Utility Holding Company Act of 1935 with respect to the Atomic Energy Commission's power contract with the Mississippi Valley Generating Co. (the "Dixon-Yates" contract).[24] In December of 1955 Ralph H. Demmler, former Chairman of the Commission, also testified before the special subcommittee. During the hearings the Commission also made fully available to the subcommittee all of the Commission's files requested by the subcommittee regarding this matter.[25]

The Commission had no concern with governmental policy decisions involved or the negotiation of this contract. Its sole statutory jurisdiction was under the Public Utility Holding Company Act to determine whether financings by the holding company systems involved con-

[21] H. Rpt. 2477, to accompany H. R. 10624, dated June 26, 1956, pp. 4–5.

[22] S. Rpt. 2787, to accompany H. R. 10724, dated July 25, 1956, p. 8.

[23] Private Law 893 (84th Cong., 2d sess.).

[24] For a discussion of the Commission's proceedings in this matter, see pt. VI, p. 138.

[25] See hearings before the Subcommittee on the Judiciary, U. S. Senate, 84th Cong., 1st sess., pursuant to S. Res. 61 on Power Policy, Dixon-Yates Contract, pt. 1, pp. 326–373, 377–431, 624–674. Pt. 2, pp. 732–771, 778–838, 1075–1097, 1260–1293.

formed to the standards set forth in the Act. In this connection, allegations were made that the Commission had prejudged this matter because prehearing conferences had been held with other interested governmental agencies and the companies which were parties to the contract. As was explained to the subcommittee these conferences were in accord with long-established and publicized procedures of the Commission [26] which have been recognized as a desirable part of the administrative process. Thus, in a motion filed during the Commission proceedings, counsel for the State of Tennessee, et al. stated:

> The parties making this motion in no way suggest that any impropriety would attach to such informal discussions on the part of the Securities and Exchange Commission and its staff, if such informal discussions have taken place. Indeed, the published procedures of the Securities and Exchange Commission expressly make provision for informal advice and assistance (17 C. F. R. §§ 202.1–202.3), and it is recognized that this is a desirable part of the administrative process. Moreover, in past decisions the Securities and Exchange Commission has referred with approval to the helpful practice of its staff in making itself available for informal conferences at the instance of interested persons. See *The United Corporation*, Holding Company Act Release No. 10614 (1951), pp. 54–55, and cases cited.

The Commission representatives also pointed out to the committee that similar conferences were had with the Atomic Energy Commission and others in 1952 in connection with the *Ohio Valley Electric Co.* proceeding, which raised questions under the Public Utility Holding Company Act similar to those involved in the *Mississippi Valley Generating Co.* case. Similar conferences were held in the *Electric Energy, Inc.* matter, which included similar questions.

The fact that prehearing conferences are held for the purpose of explaining standards which must be met under the Act in no way alters the fact that the Commission ultimately decides cases solely on the record developed in public hearings. This fact was made clear by the testimony of the Chairman of the Commission and staff members who appeared before the subcommittee and by contemporaneous memoranda submitted to the subcommittee covering the conferences involved. These memoranda stated that it was impossible to state what the Commission's position would be with respect to various questions involved until the Commission had acted after a hearing in its quasi-judicial capacity.

The subcommittee also questioned the Commission's sitting *en banc* in the equity financing proceedings. As the committee was informed, the Atomic Energy Commission's power contract with the *Mississippi Valley Generating Co.* contained a deadline date of February 15, 1955,

[26] See 17 CFR 202.2–202.3. See also Report of the Attorney General's Committee on Administrative Procedure, 77th Cong., 1st sess., Doc. 10 (relating to procedure before the S. E. C.), pt. 13 (1941).

and failure of the Commission promptly to process the application under the Public Utility Holding Company Act might have deprived the parties of their rights to a timely legal determination under the statute. Accordingly, the decision to sit *en banc* was made in an effort to provide the parties with an expeditious statutory hearing.

The Commission from the very inception of its administration under the Public Utility Holding Company Act recognized the importance of speed in disposing of financing applications brought before it. As the Commission pointed out in July 1945 in its comments to the Congress on the then pending Administrative Procedure Act:

> It should be emphasized that time is frequently of the essence in dealing with the financial transactions which are subject to the licensing jurisdiction of the Commission under the Holding Company Act and, as pointed out in the appendix, it may not always be possible to distinguish or to separate licensing from non-licensing proceedings. * * * The need for speed in the typical cases under the Holding Company Act, such as security issues, acquisitions and sale of properties, declarations of dividends and the like is inherent in the nature of the transactions involved and the risk of changing conditions in the market. It is necessary to meet the needs of the parties before the Commission, not to satisfy any predilection of the Commission for hasty decision. In most of such cases delay would be equivalent to a denial of the agency clearance sought.

En banc hearings by the Commission also were specifically contemplated by the Congress. Both the Holding Company Act, section 19, and the Administrative Procedure Act, section 7 (a), make provision for full Commission hearings.[27]

The subcommittee also inquired into the reasons for the Commission's ordering a 3-day adjournment of the then pending *Mississippi Valley Generating Co.* debt financing proceedings. As made clear by the testimony of the Chairman (given on the basis of an opinion of the Attorney General as to the propriety of his testifying about the request of the Assistant to the President for the adjournment)[27a] in granting the temporary adjournment the Commission acted solely in an effort to provide the United States Government with a reasonable opportunity to consult with its counsel.

House Special Subcommittee on Government Information of the Committee on Government Operations

In September 1955 the Commission submitted to the Special Subcommittee on Government Information of the House Committee on Government Operations its detailed answers to a questionnaire relating to the availability of information in the Commission's files to the public, the press and the Congress. The Commission's response to the questionnaire, along with the responses of other agencies, was

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[27] For other cases in which the Commission recently has sat *en banc* see *Securities National Corporation*, Securities Exchange Act release No. 4866, May 29, 1933, and *Kaye, Real & Co.*, Securities Exchange Act release No. 5033, April 30, 1954.

[27a] Reprinted at pp. 378-379 of hearings before the Subcommittee on the Judiciary, U. S. Senate, 84th Cong., 1st Sess., pursuant to S. Res. 61 on Power Policy, Dixon-Yates Contract, Pt. 1.

published by this subcommittee on November 1, 1955. Thereafter, the Commission submitted supplemental material to the subcommittee from time to time, and the Chairman, other members of the Commission and staff members appeared and testified at its hearings on January 31, 1956. The Commission's general counsel also participated in a panel discussion held by the subcommittee in June 1956 on legal questions raised by the subcommittee in connection with the availability of such information.

The Commission advised the subcommittee that the statutes it administers are concerned largely with making information available to the public. The great bulk of the information on file with the Commission is public information. In addition, there is a limited amount of information which cannot be made generally available for the public. This includes information in the Commission's files which Congress specifically provided should be kept confidential where disclosures would be contrary to the public interest, as in the case of trade secrets and similar material.[28] The remaining nonpublic categories of information in the Commission's files consist primarily of two kinds: (1) the files of internal Commission documents and memoranda and correspondence, and (2) the Commission's investigation files developed as a result of information received by the Commission indicating violations of the statutes administered and enforced by the Commission. In the latter respect, the Commission's enforcement functions are the same as those performed by the other Federal law enforcement agencies in their respective fields, such as the Intelligence Unit of the Treasury Department and the Federal Bureau of Investigation of the Department of Justice, and the courts have equated the Commission's enforcement functions to those performed by a grand jury, which are not open to the public.

Even with respect to information which is not generally available to the public, the Commission carefully considers every request therefor and, to the extent compatible with the public interest and the performance of the highly important enforcement functions entrusted to the Commission, makes every effort to make available all the information that it possibly can. In those instances where full public disclosure would be inappropriate, the Commission nevertheless generally makes this information available to congressional committees to the fullest extent possible consistent with the statutory duties imposed upon it by the statutes it administers and appropriate safeguards by the Congressional Committees to assure against the harm to the public interest from general public release of such information. One of the basic purposes of the privacy of this data is to provide

[28] See, for example, schedule A, clause (30) of the Securities Act of 1933; sec. 24 (b) of the Securities Exchange Act of 1934; sec. 22 of the Public Utility Holding Company Act of 1935.

against exposure to the public of persons entirely innocent of wrongdoing.

All of the Commission's releases covering its decisions, rule making activities, and other matters are currently sent to the Senate Committee on Banking and Currency and the House Committee on Interstate and Foreign Commerce, the committees having jurisdiction with respect to the statutes administered by the Commission under the Legislative Reorganization Act of 1946. The Commission's published statistical reports on plant and equipment, savings, securities offerings, and working capital, together with related information are supplied to the Joint Committee on the Economic Report. The Quarterly Financial Report for Manufacturing Corporations, published jointly with the Federal Trade Commission, is supplied to the Joint Committee on Taxation. Much other information is supplied from time to time to Congressional Committees.

As the Commission advised the subcommittee, it attempts to cooperate in every way with the press and general public to make information conveniently available. The Commissioners and the Commission's Secretary, who serves also as public information officer, are available for discussion with the press in Washington, D. C., at all times. In addition to answering inquiries about all phases of the Commission's activities, the Commission's Secretary prepares daily, for the information of the press and the public, announcements of Commission action, a daily digest or summary of all important Commission decisions, orders, and regulations and of all financing proposals filed with the Commission; and his office prepares a "gist" of Commission decisions and orders (releases) which are distributed to its mailing lists. The members of the Commission and our regional administrators frequently hold conferences with the press in cities away from Washington in order to keep the public throughout the country advised of the Commission's activities. In all, hundreds of press contacts are had by Commission personnel in the course of a year and we consider this a vital part of our program of information and protection for the investing public.

The Chairman, the Director of the Division of Corporation Finance, the General Counsel and other members of the Commission and staff members also testified before the subcommittee with regard to questions which had been raised concerning the Commission's proxy rules and the assertion that the Commission's processing of proxy soliciting material in the form of speeches, press releases, newspaper advertisements, and radio and television scripts constituted an infringement upon the constitutional guarantees of freedom of speech and press. It was made clear to the subcommittee that the purpose of these rules is to make information available to security

holders in reliable form so that they may make an informed judgment in exercising their voting rights in corporate matters. The Commission also submitted to the committee various statements which it had received from the press endorsing the purpose and operation of proxy rules, including expressions of approval by responsible press representatives of the revision which provided that press releases, prepared radio and television broadcasts and speeches need not be filed with the Commission prior to their use, although they remain subject to the requirement that they must not be misleading.

The Commission pointed out that its proxy regulations were wholly in accord with its statutory powers and responsibilities and Congressional policy and that this position was fully sustained during the past year by the Court of Appeals for the Second Circuit in *S. E. C.* v. *May et al.*, 229 F. 2d 123 (1956). In this landmark case, the Court, in affirming the judgment of the District Court,[29] squarely rejected the contention that the proxy regulations were unconstitutional and also rejected the argument "that stockholder disputes should be viewed in the eyes of the law just as are political contests, with each side free to hurl charges with comparative unrestraint, the assumption being that the opposing side is then at liberty to refute and thus effectively deflate the 'campaign oratory' of its adversary." The Court stressed that this "was not the policy of Congress as enacted in the Securities Exchange Act * * * (and that) Congress has clearly entrusted to the Commission the duty of protecting the investing public against misleading statements made in the course of a struggle for corporate control." [30]

The subcommittee inquired into the Commission's handling of classified information and its use of the term "confidential" as a restriction on the disclosure of information. Executive Order 10501, issued Nov. 5, 1953, 3 CFR 115 (1953), withdrew the Commission's power to classify information and limited the use of the terms "confidential," "secret," and "top secret." On September 8, 1955, the Commission, pursuant to this Executive order, amended its rule 171 under the Securities Act of 1933, rule X–24B–2 under the Securities Exchange Act of 1934, and rule U–105 under the Public Utility Holding Company Act of 1935, to provide that confidential information should no longer be filed with it. It also amended various rules so that the term "confidential" would no longer be used, without qualification, as a designation of nondefense information.[31] The Commission has provided administratively for the use of the term "nonpublic," or other appropriate terms, on investigation and other files that are not

[29] *S. E. C.* v. *May et al.*, 134 F. Supp. 247 (S. D. N. Y. 1955).
[30] For a further discussion of the Commission's proxy rules, see pt. III, p. 33.
[31] Securities Act Release No. 3573.

available to the general public, but which nevertheless do not contain classified defense information.

Senate Subcommittee on Welfare and Pension Funds of the Committee on Labor and Public Welfare

On July 20, 1955, at the request of the Subcommittee on Welfare and Pension Funds of the Senate Committee on Labor and Public Welfare, Commissioner A. Jackson Goodwin, Jr., and members of the Staff appeared on behalf of the Commission before the subcommittee to testify in connection with the subcommittee's investigation of welfare and pension plans.[32]

The testimony given by the Commission member and staff covered the survey of pension plans then being made by the Commission, the registration experience which the Commission had with certain pension plans under the Securities Act of 1933, an explanation of the Commission's securities registration procedures, and a comparison between the operation of a pension fund and an investment company registered with the Commission under the Investment Company Act of 1940.

After this testimony was given, the Commission's survey of pension funds operated by companies registered with the Commission was completed.[33] The survey, which covered about 2,000 self-operated pension funds, was based upon questionnaires distributed to the companies involved. The subcommittee was particularly concerned with the extent to which self-operated funds were invested in the company's own stock.

It was pointed out to the subcommittee that the Commission has had registration experience over the past several years with some pension plans. These plans, which usually involve either a stock purchase plan or a stock option plan, are registered pursuant to the Securities Act of 1933.

The Subcommittee on Welfare and Pension Funds prepared and filed a final report to the Congress in which the subcommittee recommended the adoption of legislation to bring about the correction of abuses which it had uncovered among welfare and pension funds.[34] The subcommittee further recommended that the Securities and Exchange Commission be designated as the governmental agency to administer the proposed legislation.

The final report states, at page 75:

The Securities and Exchange Commission is the only Government agency with a long period of successful administration of disclosure statutes. It is an inde-

[32] Hearings before the Subcommittee on Welfare and Pension Funds of the Committee on Labor and Public Welfare, U. S. Senate, 84th Cong., 1st sess., pt. 3, pp. 940-951, inclusive.

[33] See Statistical Series Release No. 1335, October 12, 1955.

[34] Final Report of Senate Committee on Labor and Public Welfare submitted by its Subcommittee on Welfare and Pension Funds, 84th Cong., 2d sess., Report No. 1734.

pendent agency. Its existing tested administrative machinery is particularly adapted to the area of administration of disclosure, fact-finding, detecting frauds, and irregularities in complicated financial operations. It is a relatively small agency, but has a core of 500 or 600 trained analysts, lawyers, and investigators of long experience in complicated financial analysis and investigation. It has nine regional offices and several branch offices throughout the country.

It has some degree of familiarity with welfare and pension plans, as many companies must file these plans incident to registration statements and proxy contests. It has recently made a survey of financial holdings of pension trusts.

The agency has contributed over the past 20 years to raising accounting standards and practices and making registered accountants more responsible in the performance of audits. Its experience in this area would bear directly on any responsibilities charged to it under a disclosure statute.

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For the present the subcommittee is inclined to favor the Securities and Exchange Commission as the agency to administer such an act because of its past experience and its organizational setup.

Senator Paul Douglas, chairman of the subcommittee, introduced S. 3873 in the Senate on May 17, 1956. This bill, which is called the Welfare and Pension Plans Disclosure Act, provided for the Securities and Exchange Commission to administer the statute. The Congress adjourned without taking any action on this bill.

PART III

REVISIONS OF RULES AND FORMS

During 1956, as in the two preceding years, great effort was devoted to the Commission's program of revising its rules and forms to keep abreast of constantly changing techniques and conditions in the dynamic securities markets. This is part of an over all program of rule and form revisions undertaken by the Commission in 1953.[1] Now, for the first time, the Commission's promulgated changes in its Forms S–1, 10, 8–B, 8–C, and Regulation X–14, have coordinated and made uniform, so far as possible, the information required in the basic registration forms for new issues under the Securities Act and for issues to be listed and traded on national securities exchanges under the Exchange Act, and for proxy statements under the Exchange Act. The object of this program has been the simplification of forms to eliminate duplicate filings arising under different provisions of the Federal securities laws, and relieve persons subject to these laws of unnecessary burdens and costs without the sacrifice of any safeguards necessary for the protection of investors.

Soon after the conclusion of the fiscal year on June 30, 1956, the Commission has undertaken to bring up to date additional forms used for registration under the Securities Act of 1933. Such proposals include the revision of Form S–4 used by closed-end management investment companies;[2] Form S–3 used by certain exploratory mining companies and incorporation of Form S–11 therein which is also prescribed for mining companies in the development stage;[3] and Form S–6 used by unit investment trusts currently issuing securities including periodic payment plan certificates. The Commission also has adopted a summary prospectus rule which could be used by registrants using Forms S–1 and S–9.[4] Because of the legal and technical complexities of the subject matter, this program has engaged a large amount of the time of the commissioners and its senior professional staff. Many of these revisions are outlined below. Others, which are of primary interest to special groups, such as brokers and dealers and public utility holding companies, are described in the parts of this report dealing with the regulation of the activities of such persons and companies.

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[1] 20th Annual Report, Securities and Exchange Commission, p. 9.

[2] Securities Act Release No. 3667, August 2, 1956.

[3] Securities Act Release No. 3668, August 3, 1956.

[4] Securities Act Release No. 3722, November 23, 1956.

THE SMALL ISSUES EXEMPTION—NEW ISSUES OF $300,000 OR LESS

The special concern of the Securities and Exchange Commission with small business is in the area of public financing. Under the Securities Act any company which desires to raise capital by means of a public offering of its securities where the mails or instruments of interstate commerce are to be used must register the securities with the Securities and Exchange Commission unless a specific exemption from registration is available. Certain specific exemptions are provided by sections 3 (a) and 4 of the Act. In addition, section 3 (b) of the Act provides that the Commission may from time to time by its rules and regulations, and subject to such terms and conditions as may be prescribed, add to the classes of securities exempted in section 3 (a) of the Act (such as securities issued by the United States or other governmental organizations, commercial paper, building and loan association obligations, securities the issuance of which is subject to approval under the Interstate Commerce Act, and certain other specifically exempted classes), any class of securities if the Commission finds that enforcement of the registration provisions of the Act with respect to such securities "is not necessary in the public interest and for the protection of investors by reason of the small amount involved or the limited character of the public offering," provided no issue shall be exempted the aggregate offering price of which exceeds $300,000.

The most important regulation adopted by the Commission specifying the terms and conditions on which such exemption from registration would be available is called regulation A. On July 23, 1956, this exemptive regulation was substantially revised by the Commission to increase the legal protection it affords the investing public and make it clear and simple for companies to qualify under it.

The problem presented to the Commission in promulgating a workable regulation spelling out the terms and conditions upon which an exemption from registration is available for small issues of securities is twofold. First, it is important not to place such burdensome requirements upon small business as to discourage the raising of a limited amount of capital. On the other hand, the statute places the responsibility upon the Commission to protect the public from misrepresentation and fraud in the offer and sale of securities.

A number of changes effected by the revision are as follows.

1. The revised regulation as adopted on July 23, 1956, provides that Canadian issues, formerly exempted under a separate regulation, regulation D, are now treated the same as domestic issues insofar as the terms and conditions for the exemption are concerned, except that Canadian issues of companies without a net earnings record now have to be qualified for offering in the Canadian Province in which

the company has its principal place of business. This provision has the effect of consolidating the old regulation D with the new regulation A and adds to the public investors' protection by requiring the Canadian promotional issuer to meet the standards of the applicable Provincial securities laws.

2. The Commission is vitally concerned with the problems presented by promotional companies in offering securities to the public. It has found that certain underwriters and promoters appear to be the organizing force behind many new issuers and the new revision was designed to eliminate this condition. Previously, no exemption was available if any of the directors, officers, affiliates, predecessors, promoters, or principal underwriters of the issuer had been convicted within 5 years previously of a crime involving securities transactions or had been enjoined in connection with securities transactions. Under the revised regulation, the exemption is not available if any such conviction within the previous 10 years or injunction exists as to *any* underwriter of the issuer or any partner, director or officer of such underwriter. In addition, the exemption is not now available if the Commission, a national securities dealers association, or a national securities exchange has issued a disciplinary order against any underwriter of the issuer or any partner, director or officer of any such underwriter. Furthermore, no exemption is now available if any underwriter of the issuer, or any partner, officer or director of such underwriter was the underwriter of any other issue which is the subject of a pending suspension order proceeding or is the subject of an outstanding suspension order issued by the Commission within the past 5 years.

3. Another problem the present revision seeks to correct is the threat of the "bail-out" by the promoters and insiders of their securities holdings. Regulation A as revised now provides that offerings by companies newly organized and those without a net income for at least one of the last two fiscal years are subject to special requirements insofar as the exemption is concerned. Only the issuer itself in such a case may use the exemption, which means that an offering by a security holder of his own securities in such a company cannot be made under the regulation. An offering circular must be used by such a company even if the amount of the offering is less than $50,000, whereas other issuers need not use an offering circular for any offering below that amount. In computing the maximum amount of $300,000 under the exemption, such a company has to include all securities previously issued for assets or services and all securities issued or proposed to be issued to directors, officers, promoters, or underwriters unless such securities are effectively kept off the market, by escrow or otherwise, for 1 year after the commencement of the offering under the regulation.

4. The notification to be filed by an issuer on Form 1–A with the appropriate regional office of the Commission was revised to require certain additional information which will assist the Commission staff in its determination as to the availability of the exemption and in its review of the offering circular for the detection of false and misleading statements. In addition to the previously required filing of any underwriting contract and the consent of the underwriters to be named in the offering circular, there are now required to be filed as exhibits copies of the instrument describing the rights of holders of the securities being offered and consents by engineers, geologists, appraisers, accountants, and other experts to be named in the notification or offering circular where reference to them as experts or to their opinions is made.

5. The exemptive regulation includes a guide (schedule I of Form 1–A) to a company in the preparation of an offering circular, and limits the information required to be set forth in an offering circular to what may be called "bare bones" facts concerning the company and the securities to be offered. Thus the offering price per share to the public, underwriting commissions and proceeds to the company are to be set forth on the outside front cover page. A brief description is required of the proposed manner of distribution, whether by or through underwriters or otherwise. The purposes for which the proceeds will be used must be stated. The significant terms of the securities including dividend rights in the case of equity securities and interest rate in the case of debt securities are to be set forth. A brief description of the business or proposed business to be done and the names and addresses of directors and officers and any persons controlling the issuer must be given; so must the aggregate remuneration paid or to be paid to directors and officers as a group, annual remuneration of the three highest paid officers and the interest of all such persons in material transactions with the company. Options or warrants outstanding or proposed to be granted to purchase securities of the issuer must be revealed. Appropriate financial statements are called for but at the present time these statements need not be certified by independent public accountants. All of the information required in the notification and offering circular is readily available to the company desiring to use the regulation.

Rule 256 (c) further specifies that in no event shall an offering circular be used if it is false and misleading under the circumstances then existing.

Although most businesses will find it expedient to employ an attorney to prepare the filing, the instructions are sufficiently explicit that many small enterprises can prepare their own filing without the employment of counsel. These more complete instructions in large

measure set forth the administrative practice of the Commission in reviewing filings under the previous regulations.

6. Unless the offering terminates sooner, the offering circular now has to be revised every 9 months except that offering circulars for employee purchase plans must be revised every 12 months.

7. A report of sales on Form 2–A now must be made within 30 days after the end of each 6-month period following the date of the original offering circular until the offering has been terminated. Formerly, such report was due on a date computed with reference to the commencement of the offering which date was not known in advance to the Commission staff. Form 2–A has been revised to call for additional information which will assist the Commission staff in its enforcement of the regulation and supply information as to use of the proceeds for the public investor.

8. There was added as a ground for suspension of the exemption any failure by the issuer or any of its promoters, officers, directors or underwriters, to cooperate in any investigation by the Commission of an offering under the regulation.[5]

Proposed Further Amendment of Regulation

The Commission also announced its belief that further consideration should be given to revisions which would make the exemption available only to issuers and offerings meeting specified standards based either upon a record of net earnings on the part of the issuer or upon a limitation of the number of units of securities that might be issued pursuant to the exemption, as distinct from the aggregate offering price of the securities to be offered. The Commission's announcement discussed alternative bases and invited public comment thereupon.[6]

The Commission also has under consideration a proposed amendment to regulation A which would provide that the financial statements required to be contained in offering circulars be certified by independent public or certified public accountants and would also require that the certifying accountant consent to the use of his name on the certificate.[7]

Proposal to Exempt Option Stock Withdrawn

A proposal which the Commission had under consideration for sometime, which would have provided a conditional exemption from the registration provisions of the Securities Act of 1933 for the issuance of stock, not exceeding $300,000, pursuant to a restricted stock option plan, and a related amendment of Form 8–A, for registration of such securities on a national securities exchange under the Securities

[5] Securities Act Release No. 3663, July 23, 1956.
[6] Securities Act Release No. 3664, July 23, 1956.
[7] Securities Act Release No. 3600, December 27, 1955.

Exchange Act of 1934, was withdrawn July 2, 1956. By reason of the Commission's general simplification of its forms and procedures for registration under the Securities Act and because class registration of securities on an exchange has been provided under the Exchange Act the need for adoption of the proposal in the public interest was removed.[8]

Form S–1.—As noted above, the Commission's program begun in 1953 directed to the simplification of forms and the elimination of duplication in filings has resulted in the revision of Form S–1. This form, the basic form generally used for compliance by commercial and industrial companies with the registration provisions of the Securities Act, was revised effective October 25, 1955, in order to conform its requirements to those of the Commission's proxy rules, and the registration and annual reporting forms for securities registered for trading on securities exchanges and to clarify the disclosure requirements in the light of the Commission's experience in reviewing registration statements and of the practice of registrants using the form. In conjunction with this revision of Form S–1, the Commission adopted revisions of Forms 10, 8–B and 8–C, rescinded Forms 12 and 12–A, and amended rule X–12B–2, all of which were concurrently promulgated resulting in conforming these filing processes, thus completing the Commission's objective under the proxy rules and registration statements and eliminating costly and time-consuming duplication in these areas. In the revised form, those items which experience demonstrated had not been fully understood by registrants are required to be stated more clearly and in more detail and the treatment of stock options was revised to obtain more complete information as to the aggregate amount of options outstanding. At the same time, an amendment was made to rule 405, which added the definition of the terms "associate" and "voting securities." Rule 424 (c) was also amended to provide for the filing of three copies of any prospectus used before the effective date and provision was made for additional copies of the registration statement to be filed to facilitate examination thereof by the Division of Corporation Finance.[9]

Forms 10, 8–B and 8–C.—The revision of Form S–1 was accompanied on October 25, 1955, for the reasons stated in the discussion thereof above, by corresponding revisions of Form 10, the principal form for the registration of securities on an exchange under the Securities Exchange Act; Form 8–B which is used for such registration by certain successor issuers; and Form 8–C for registration of securities on an additional exchange.[10]

[8] Securities Act Release No. 3655, July 2, 1956.
[9] Securities Act Release No. 3584, October 25, 1955.
[10] Securities Exchange Act Release No. 5243, October 25, 1955.

Forms 12 and 12–A; and Supplement S–T.—As a further part of the program of coordination and clarification of forms made effective October 25, 1955, Forms 12 and 12–A were rescinded and incorporated in revised Form 10.[11] Forms 12 and 12–A were available for issuers, subject to the annual reporting requirements of the Interstate Commerce Commission or Federal Communications Commission, which were registering or amending their registration for listing of securities on a national securities exchange.

At the same time, supplement S–T, which it had been necessary to file for the qualification of trust indentures under the Trust Indenture Act of 1939 in cases where the indenture securities were required to be registered under the Securities Act of 1933, was rescinded because the significant information called for by this supplement is now included elsewhere in the registration statement and otherwise made available to the Commission.[12]

REVISION OF PROXY RULES

Section 14 (a) of the Securities Exchange Act, generally speaking, makes it unlawful for any person to solicit by the use of the mails, the facilities of interstate commerce or of a national securities exchange or otherwise, a proxy, consent, or authorization in respect of securities listed on a national securities exchange in contravention of rules and regulations promulgated by the Commission for the protection of investors.

Pursuant to this authority, the Commission since 1938 has had in effect its regulation X–14, usually known as the "proxy rules." This regulation has been amended from time to time, as the Commission's experience has suggested the necessity to make the rules more consonant with changes and developments in corporation practices or for the protection of investors. The basic purpose of the regulation has been to protect investors by means of disclosures of material facts important to an analysis of matters presented to shareholders for their vote. The theory of the rules is that if all such facts are clearly presented to the investor or shareholder he will be capable of arriving at his own decisions.

In general structure, the rules require specific disclosures in respect of specific corporate matters, including the election of directors. The specified disclosures must be embodied in a "proxy statement" to be furnished to every security holder whose proxy is solicited. The cardinal requirement of the rules is that there be no misleading statements of facts nor any omission of material facts necessary to make the facts stated not misleading under the circumstances.

[11] Securities Exchange Act Release No. 5243, October 25, 1955.
[12] Securities Act Release No. 3584, October 25, 1955.

Compliance with the rules is enforced by requiring the proxy statement in preliminary form to be filed with the Commission and withheld from use for 10 days unless the Commission permits its prior issuance to the shareholders. Supplemental soliciting material is also required to be filed but may be used within two business days after the filing.

Recent History

Principally the revisions involve an expansion of the rules to deal more specifically with proxy contests for the election of directors of listed companies. Prior to the adoption of these revisions their general scope had been the subject of testimony by the Commission's representatives before the Senate Committee on Banking and Currency in connection with its study of the stock market [13] and before the subcommittee on securities which had been investigating proxy contests.[14] In addition, the proposed rules were submitted for comment to all interested persons and companies. As a result of the comments received, the proposals were again revised and finally adopted.

Subsequent to their adoption, the revised rules were reviewed by the subcommittee.[15] It is the Commission's opinion that the revised proxy rules as they now deal with proxy contests have worked well and that they have been of material benefit to investors by providing them with the material to make an intelligent analysis of the possible effects upon their investment of the purposes and motivations of the contending forces in a proxy contest.

During the last 3 fiscal years there has been a rising frequency in the number of proxy contests for control of listed companies. In part, these struggles derive from the increasing prosperity of the country and the rise of new financial personalities who wish to obtain control of listed companies. The source material upon which the issues created by the opposing forces is usually based is almost invariably derived from the disclosures, financial, statistical and otherwise, required by the reporting provisions of the Securities Exchange Act in respect of listed companies. These required reports permit the direct comparison of companies in like industries and comparisons of managerial abilities and results. Because of the fact that the issues are almost always derived from the reports filed with the Commission by listed companies, our staff is in a unique position quickly to appraise the accuracy and fairness of statistics and other financial comparisons which almost universally are one of the important aspects of the conduct of a proxy contest.

[13] Hearings on S. 2054, 84th Cong., 1st. sess. (1956), 1283–1319 inc
[14] Hearings on S. 879, 84th Cong., 1st. sess. (1955), 1507–1576 inc.
[15] Hearings on S. 879, 84th Cong., 1st. sess. (1956), 1669–1728.

Perhaps more importantly, the many proxy contests have caused a reexamination by the Commission of the efficacy of its rules in such contests and a reaffirmation by the Commission and by the courts of the necessity for Commission regulation of such contests to the extent provided by section 14 (a) of the Securities Exchange Act of 1934. Finally, during the course of the last 3 fiscal years the Commission has been faced with the problem of the extent to which its rule-making power granted to it by section 14 (a) may, in the case of proxy contests, be in conflict with the first amendment's guarantees of freedom of speech and of the press.

Use of Press, Television, and Radio

A distinguishing feature of the proxy contests of the last 3 fiscal years from those in the past has been the extensive use by the contending parties of all modern media of opinion formation and communication. Public relations experts are frequently retained to determine the general strategy of the campaigns. The appeal for the shareholder's votes has been increasingly made by means of radio, television, and the public press. The press release, the press conference, and speeches before shareholders themselves and before groups having important influence upon shareholders have been a normal part of the apparatus of the contests. Reprints of published material tending to favor one group or the other have also been utilized. Furthermore, the opposition groups in many cases have engaged in concealed financing devices in connection with the purchase of shares both by themselves and by others whose vote they seek. Specifically, such agreements include arrangements by the contestants to purchase shares of others after they have been voted, agreements to guarantee profits on the purchase of shares by those willing to vote for such group, agreements to protect against loss and other contractual arrangements for financing. Disclosure of these financing procedures is necessary to enable shareholders properly to appraise the motivations of the group which engages in them. Our new rules now require disclosure of these financing arrangements, if any exist.

The intensity with which recent proxy contests have been fought and the resort by the contestants to all possible media of communications have aroused a general public interest in such contests. As a result, the interest of the press in these contests has been intense, particularly because of the prominence of the companies control of which has been the subject of the disputes. The companies involved have included the Nation's largest woolen manufacturer, its second largest railroad, its second largest mail-order and merchandising system, several other important railroads and a number of companies of significance in their industries.

Legislative History

It is clear from the legislative history of section 14 (a) that the Congress intended the Commission to insure adequate disclosure to investors, not only in the case of the usual unilateral solicitations by management but also in the case of proxy contests. The legislative history of section 14 (a) indicates a specific concern by Congress with the possibility that opposition groups might unseat management by the use of unfair and misleading statements to procure shareholders' votes. The overriding purpose of both the Securities Act and the Securities Exchange Act is that our economy is best served only if shareholders have information which is adequate and accurate so that decisions may be intelligent. Clearly, the decisions made by shareholders in the area of the selection of management for their companies are as important to them and to the economy as the decisions they make in connection with the purchase and sale of the securities they hold. This view is not only sustained by the legislative history of section 14 (a); the Commission has been vigorously affirmed in its own judgment on this point by a recent decision of the United States Court of Appeals for the Second Circuit.[16]

Misrepresentations

Furthermore, there are important practical reasons why it is essential in the interest of stockholder protection that the Commission impose disclosure requirements to prevent misleading statements and to insure a truthful exposition of material facts. If the Commission's regulation is abandoned, experience teaches that misrepresentation of fact will be countered by further misrepresentation of fact and distortion by distortion, the ultimate effect of which may be to deceive and mislead the shareholder, a result completely antithetical to the basic purpose of the Securities Exchange Act.

Patterns of attempted misrepresentation occur and reoccur in proxy contests which focus upon the primary issue of the comparative managerial ability and integrity of the two groups. Arguments are made from complex financial statistics and other data, the analysis of which is not too familiar to most investors. Statistical comparisons are made purporting to show superiority or inferiority of management to other groups or other companies supposed to be engaged in the same general line of business. In short, statistics can be used to distort.

Illustrations of the type of misrepresentations which may prevail in the absence of Commission regulation can be derived from those attempted in recent proxy contests. In a recent campaign for the control of the board of directors of a railroad, the group opposing management sought to illustrate the existing management's lack of ability by means of an income account which included a sinking fund payment

[16] *S. E. C.* v. *May et al.*, 229 F. (2d) 123 (C. A. 2d 1956).

as a charge against income, an accounting procedure totally opposed to acceptable accounting practice. The result of this was to indicate a loss in railroad operations for 6 years when, in fact, if the income account was depicted in accordance with accepted accounting principles, losses occurred in only 2 of such years. The Commission objected to this improper presentation.

In another case, misleading comparisons were sought to be made by an opposing group in a contest for control of a railroad that the company's stock had sold in 1929 at $250 a share in contrast to its then market price of about $25 per share. This statement was coupled with the assertion that if the opposition group succeeded in its efforts the stock would go to $100 and pay an $8 dividend. In view of the pronounced changes that have occurred in our economy since 1929, particularly in the growth of strongly competitive forces in the transportation industry such as automobiles and trucks, plus the fact that the company had earned $8 a share only three times in its history, the Commission insisted upon the deletion from the solicitation material of these comparisons.

In addition to the use of distorting statistics, two other misleading devices have been attempted. These devices are totally at variance with the tradition of the common law, with its insistence over the centuries on a requirement of probative evidence subjected to intense and objective tests as to veracity and accuracy. One is that of imputing guilt by association—often the most remote type of association. The other, a corollary device, is the rhetorical question based on any assumption for which there is no foundation in fact laid. This is the "When did you stop beating your wife" question. This type of misrepresentation in proxy contests has been condemned by the courts in an action brought by the Commission as a violation of the Commission's rules forbidding misleading statements.[17]

For example, a magazine which had published articles favorable to the management was sought to be disparaged by the opposition group, not on the ground of any illegal or immoral act which the magazine had committed but on the ground that it employed a law firm one of the partners of which had been accused, although never convicted, of bribery of a Federal court. Similarly, an opposition group soliciting requests for authority to call a special meeting to elect directors was attacked because two of the stockholders signing the request who owned insignificant amounts of shares and who had no connection with the formation and activities of the opposition group, had been indicted for alleged tax violation. Similarly, a member of an opposition group has been attacked because he allegedly joined with certain other persons of whom the management was critical

[17] *S. E. C.* v. *May et al.*, 134 F. Supp. 247 (S. D. N. Y.), affirmed, 229 F. (2d) 123 (C. A. 2d 1956). This case is more fully discussed in the Annual Report under "Litigation," p. 122.

in contributing large sums to the political campaign of a candidate for a public office.

The Commission, in carrying out the standards established by the Congress against false and misleading statements in the use of proxy soliciting material under the Exchange Act, objected to such misrepresentations. As a result they were not made.

Finally, if the parties are left to themselves free of Commission regulation, their recourse to remedy misleading statements by their opponents will be to the courts. This is a more cumbersome, costly and dilatory procedure than the continuous administrative processing of soliciting material by the Commission and its staff, a procedure which tends to prevent, although it cannot guarantee, the presentation of misleading statements. This administrative procedure provides for the correction of misleading statements and omissions discovered to have been in subsequent material or by resolicitation. The staff's corrective suggestions are almost invariably followed by the parties with a minimum of disruption of the course of the campaign. The Commission believes that its administrative procedure for resolving these problems before corporate meetings are held is manifestly more in the interest of the stockholder and the public interest than the more cumbersome court proceedings.

Constitutionality of the Proxy Rules

Of greater concern to the Commission has been the charge that its regulation of proxy contests is violative of the constitutional guarantee of freedom of speech and of the press. This charge arises out of the fact that the rules, prior to the revision in January 1956, required submission of all proposed soliciting material to the Commission prior to its use in order to enable the Commission to determine whether the material complied with the disclosure and other requirements of the proxy rules. This problem, as has been indicated, has become increasingly important in recent proxy contests because of the use which has been made by contending parties of press releases, press conferences and paid advertisements.

In answer to this charge it must be emphasized that neither the Act nor the rules, in the Commission's opinion, confer upon it the power to restrain argument, debate, rhetoric or legitimate inference from undisputed facts. Nor do the proxy rules contain any such restraints. On the contrary, the courts have required the Commission to permit a substantial degree of "contentious advocacy" in areas where underlying facts are not clear or are subject to legitimate dispute and argumentation. The Commission does not take sides in proxy contests. It is not concerned with their outcome.

The Commission, however, is concerned that statements presented to stockholders be not misleading. Its rules specifically provide that

such facts as are asserted to exist by the contending parties must be accurate and that factual statements made do not omit other facts which are material to an intelligent determination of the meaning of the disclosed facts. In this limited area it is clear that the Commission's activities do not contravene the first amendment. The Supreme Court, in fact, in a recent case has clearly indicated that the first amendment places no inhibition on legislation, such as the Securities Exchange Act of 1934 (to which the Court specifically referred), designed to prevent fraud or deceptions of the public in connection with securities or otherwise.[18]

Moreover, in its revised rules the Commission has expressly provided that press releases, prepared radio and television broadcasts and speeches need not be filed with the Commission prior to their use, although they remain subject to the cardinal requirement of our rule that they must not be misleading. They must also be filed promptly with the Commission after their use. Such material, of course, may be submitted to the Commission prior to its use, if the contestant so desires. A practical reason for this change in our rules, in addition to the importance of safeguarding freedom of speech and freedom of the press, is that time limitations and pressures of a proxy contest frequently necessitate the use of these documents as quickly as possible. The Commission is gratified to report to the Congress on this aspect of the thrust of its rules that responsible elements of the press are now completely satisfied that our rules do not impinge upon the freedom of the press or freedom of speech, particularly in view of the fact that they impose no "prior restraints" on press releases, press conferences and radio and television broadcasts and speeches.[19]

Solicitation Prior to the Formal Proxy Statement

Under the prior rules no solicitation could be made prior to the actual dissemination to shareholders of the "proxy statement" required by the rules. However, experience in proxy contests has demonstrated that discussion over as long a period of time as possible is desirable and important from the point of view of the shareholders and their ultimate understanding of the issues involved in the contests. Therefore, in view of this obvious public interest, the Commission's new rules for the first time permit pre-proxy statement solicitation, but subject such solicitation to compliance with the rules, particularly

[18] *Donaldson* v. *Read Magazine*, 333 U. S. 178, 191 (1947).

[19] See letters of James Russell Wiggins, Chairman of the Freedom of Information Committee of the American Society of Newspaper Editors, dated December 19, 1955 and January 23, 1956, to the Chairman of the Commission, in which Mr. Wiggins said: "We are glad to see that it provides that speeches, press releases, and scripts may, but need not, be filed with the Commission prior to the use or publication. The proposed rules in this form, we believe, will carry out the purposes you had in mind without skirting the First Amendment. * * * I was also interested in the United States Court of Appeals for the Second Circuit. That Congress intended to regulate these matters, I have never doubted. I am not quite as sure that the intention was carried out in a way that would not trespass upon the First Amendment by replacing [sic] a prior restraint upon utterance. The rules that you have adopted, it seems to me, wisely avoid this issue without interfering with any public interest." Submitted for the record of hearings before the Subcommittee on Information, Committee on Government Operations, May 29, 1956. See also editorial of Editor and Publisher, December 24, 1955. Ibid. Notwithstanding this, and apparently overlooking the decision of the Court of Appeals for the Second Circuit in *S. E. C.* v. *May et al.* (134 F. Supp. 247 (S. D. N. Y.), affirmed, 229 F. (2d) 123 (C. A. 2d 1956)), the Special Subcommittee on Government Information of the House Committee on Government Operations said in July, 1956: "There is strong doubt that the effort of the Securities and Exchange Commission to control the content of advertising in proxy contests would hold up in a court test under the first amendment. The legal authority for the SEC, or any other Government agency, to control or censor the reprint of articles that have previously been published and already are in the public domain is highly questionable" (Committee on Government Operations, Availability of Information From Federal Departments and Agencies, H. R. No. 2947, 84th Cong., 2d sess., 87-8 (1956)).

with a requirement that the interest and background of the participants must be disclosed in such solicitation material and that such material must not be misleading.

Disclosure of Identity of Participants

Another of the important purposes of the new rules is to bring all of the participants in a proxy contest out on the stage to be gazed upon by the shareholders; no participants may be left lurking in the wings. In a proxy contest, no solicitation of proxies by an opposition group may be commenced unless a statement concerning each participant in that solicitation is first filed with the Commission and each national securities exchange with which any security of the corporation is listed. This statement must set forth the detailed information required by a new schedule provided by the rule (schedule 14–B). If the solicitation is by management in opposition to another group or in anticipation of opposition by another group, the information required by the new schedule 14–B with respect to management participants must be filed promptly after the first solicitation. The term "participant" includes, in addition to the corporation and its directors and nominees for directors, all persons and groups primarily engaged in, financing and responsible for, the conduct of the proxy solicitation. Those taking the initiative in organizing a stockholders' committee or group or contributing more than $500, or lending money or furnishing credit for the purpose of financing or otherwise influencing the contest, are included in the definition of participant. These provisions should make available to the security holders information about the background and the financial and other interests not only of all persons who are nominees for election as directors, but also of all persons who may represent the real interest behind the formal nominees, and should reduce substantially the difficulty the Commission has had in the past with undisclosed principals, or "fronts."

Each participant is required to disclose, in the document filed in response to schedule 14–B, his occupational background and personal history, his criminal record, if any, the extent of his participation in other proxy contests involving any corporation, the amount of the corporation's securities he owns, the transactions in which the securities were acquired, the circumstances under which he became a participant in the solicitation, and any arrangement or understanding respecting future employment or other transactions with the corporation. A summary of this information concerning participants must be included in the respective "proxy statements" of the contesting groups.

In the past, participants in proxy contests have sometimes attempted to conceal their background, financial interests in the corporation and activities in the solicitation for proxies. This the courts have condemned as misleading under the Commission's previous rules.[20]

[20] *S. E. C. v. May*, 134 F. Supp. 247 (S. D. N. Y. 1955), affirmed, 229 F. (2d) 123 (C. A. 2d 1956).

Solicitation Methods and Costs

In contests for the election of directors, the proxy statement is also required to include a description of the methods of solicitation and the material features of solicitation contracts, the anticipated expense of solicitation, and whether reimbursement for soliciting expenses will be sought from the corporation. In the past expenditures made by the contending parties have been substantial, in some cases exceeding $1 million or more. It is imperative that stockholders be informed during the course of the campaign of the contemplated expenditures to be made to both sides, particularly where the management is using corporate funds on its behalf and it is the intention of the opposing group to reimburse itself out of the corporate treasury, if successful. Disclosure on these points is now compelled by the revised proxy rules.

Stock held in "Street Name"

Many of the more difficult problems in any proxy contest spring from the fact that a considerable portion of the corporation's outstanding shares are often held in street names and their ownership is constantly changing. Participants in a proxy contest no longer can rely on being able to communicate with the beneficial owners indirectly through solicitation of the stockholders of record. Therefore, the widespread use of paid advertisements, prepared press releases, press interviews, and radio and television broadcasts, has become common in attempting to reach security holders and to sway the opinion of the public and persons who may advise security holders with respect to giving, revoking or withholding proxies. Whether statements are written or oral, are prepared in advance or are spontaneous they nevertheless constitute part of a continuous plan to influence stockholders and are deemed subject to the Commission's standards of fair disclosure and, specifically, to the rule prohibiting false and misleading statements. This proposition is now clearly embodied in the new proxy rules.[21]

Filing of Soliciting Material

The new rules continue to require that all advertisements used as soliciting material in a proxy contest be filed with the Commission prior to publication. Reprints or republications of any previously published material used in soliciting proxies also must be filed prior to use, together with a statement identifying the author and any person quoted in the article and disclosing whether the consent of the author and of the publication to use the material has been obtained, and if any consideration has been, or will be, made for its republication.

The annual financial report of a corporation to its security holders is not usually considered to be proxy soliciting material and is not

[21] Rule X-14-A-9.

treated as a "filing" with the Commission. However, if any portion of the annual report discusses the solicitation of an opposition group, that portion is made subject to the proxy rules by the 1956 amendments and must be filed with the Commission prior to distribution.

Rule X–16B–3.—The exemption covers any acquisition of nontransferable options or of shares of stock, including stock, acquired pursuant to such options, by a director or officer of the issuer of such stock provided the stock or option was acquired pursuant to a bonus, profit-sharing, retirement, stock option, thrift, savings, or similar plan meeting all of certain conditions specified in the rule. These conditions provide, in general, that the plan must have been approved by a majority of the voting security holders of the issuer and limits the aggregate amount of funds or securities which may be allocated to the plan by a fixed amount, earnings formulas, dividends, compensation of the participants, percentages of outstanding securities, or similar factors.[22]

This rule was amended on May 21, 1956, to clarify its provisions in accordance with the considerable body of administrative interpretation which the Commission had built up over the years since the rule was adopted in 1935. Briefly stated, the rule provides under the Securities Exchange Act a complete exemption from section 16 (b) liability for profits derived from certain acquisitions of securities under incentive plans.

Form S–12.—This new registration form under the Securities Act of 1933, for American Depositary Receipts against outstanding foreign securities, was adopted effective November 17, 1955. Its purpose is to provide a simple procedure for such registration where there is no person who performs the acts and assumes the duties of depositor or manager. The form proposes that the prospectus information, which consists of only four items, might be embodied in the receipts. The form may be used, provided that the holder of the receipts may withdraw the deposited securities at any time, subject to temporary delays of a specified nature, the payment of fees, taxes and similar charges and to compliance with any laws or governmental regulations relating to the withdrawal of deposited securities and that the deposited securities, if sold in the United States or its territories, would not be subject to the registration provisions of the Securities Act of 1933.[23]

Since the early days of the Securities Act of 1933 the Commission has had before it the question whether the issuance by banks of American Depositary Receipts ("ADRs") for shares of foreign issuers are exempt from registration under the Act. In the case of ADRs which were outstanding at the time of the passage of the Act, the

[22] Securities Exchange Act Release No. 5312, May 21, 1956.
[23] Securities Act Release No. 3593, November 17, 1955.

Commission took the position that they were exempt from registration by reason of section 3 (a) (1) of the Act. As to ADRs issued afterwards, the position was sometimes urged that an exemption was available under section 3 (a) (2) of the Act. This section exempts among other things securities issued by a national bank and securities issued by any banking institution organized under the laws of any State or Territory, the business of which is substantially confined to banking and is supervised by a banking commissioner or other similar official. Section 2 (4) of the Act defines an "issuer" with respect to a certificate of deposit to mean "the person or persons performing the acts and assuming the duties of depositor or manager pursuant to the provisions of the trust or other agreement or instrument under which such securities are issued." The question presented, therefore, was whether the bank performed the acts or assumed the duties of depositor or manager so as to be deemed an issuer within the above definition and, if the bank should be deemed to perform such functions, whether it would be entitled to the exemption provided by section 3 (a) (2).

After extended consultations with representatives of a number of banks, the Commission concluded that section 3 (a) (2) was intended to provide an exemption only for a bank's own securities. To permit a bank to claim this exemption for any trust or similar entity that it might devise would permit the creation of voting trusts, investment trusts and a variety of other securities for which the disclosure requirements of the Securities Act of 1933 could be avoided. Furthermore, the concept of supervision by banking officials included in section 3 (a) (2) did not appear to embrace the issuance of ADRs so as to afford purchasers the protection intended by that section.

Accordingly, the Commission, again in consultation with representatives of the banks concerned, evolved a form to be used for registration in such cases. The new form provides a simple procedure for registration. The prospectus which consists of only four items may be embodied in the depositary receipts themselves. The form may be used only where the holder of receipts may withdraw the deposited securities at any time, subject to temporary delays of a specified nature, the payment of fees, taxes, and similar charges and compliance with any laws or governmental regulations relating to the withdrawal of deposited securities. The form also applies only where the deposited securities, if sold in the United States or its Territories, would not be subject to the registration provisions of the Act.[24]

The form therefore provides for disclosure of facts not heretofore required by prior Commission interpretation. Such procedure pro-

[24] Securities Act Release No. 3593, November 17, 1955.

vides greater investor protection in conformity with the standards of the Securities Act of 1933.

Rule 434.—This rule, made effective November 10, 1955, specifies the conditions under which a bulletin or card prepared by certain independent statistical services, primarily engaged in publishing statements and financial information for distribution to subscribers and summarizing information contained in a preliminary prospectus, might be deemed a summary prospectus meeting the requirements of section 10 of the Act prior to the effective date of the registration statement. This rule implements section 10 (b) of the Act under the amendment made in 1954 by Public Law 577, 83d Congress, which authorizes the Commission to adopt rules and regulations deemed necessary or appropriate in the public interest or for the protection of investors to permit the use of a summary prospectus which omits in part or summarizes information in the preliminary prospectus filed as part of the registration statement.[25]

Bulletins and cards of the type covered by this rule have been published since the early days of the Securities Act. Prior to the 1934 amendments to the Act the use of such materials was deemed to be permissible as a means of disseminating information contained in the registration statement. Of course, such bulletins and cards could not be used in the actual offering or sale of securities since they did not meet the prospectus requirements of the Act.

Rules 171, 485, 486, X-6, and U-105.—These rules govern applications for confidential treatment of certain information filed with the Commission which would otherwise be disclosed to the public. Rule 486 was repealed and the others were amended in minor respects to be consistent with Executive Order 10501, 18 F. R. 7049, which withdrew from the Commission any power to classify information in the interests of national defense, and to minimize any confusion between the word "confidential" as used in national defense classifications and elsewhere.[26]

The revision of rule 485 was made in compliance with the authority granted to the Commission pursuant to section 19 (a) of the Securities Act of 1933. Rule 485 provides that "confidential treatment" of material contracts or parts thereof be permitted where disclosure of the facts contained therein are not "necessary for the protection of investors" and disclosure of which would impair the value of the contract. The Commission in promulgating the rule, as amended, has considered the basic statutory mandate of Congress and the rule merely permits a registrant to request nondisclosure of matters such as trade secrets, patents, designs, and so forth.[27]

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[25] Securities Act Release No. 3592, November 10, 1955.

[26] Securities Act Release No. 3573, September 8, 1955.

[27] See page 212 for discussion as to non-disclosure of certain information.

Rule 434A.—This rule was adopted on November 23, 1956, pursuant to section 10 (b) of the Act, as amended in 1954, which authorizes the Commission to adopt rules and regulations permitting the use in making offers of securities of a prospectus which omits in part or summarizes information required to be set forth in the most recent prospectus required to be used in connection with the sale of securities. Under the rule the use of summary prospectus is limited to issuers whose securities are registered on Forms S–1 or S–9 and which are required to file reports with the Commission under section 13 or 15 (d) of the Securities Exchange Act of 1934. The new rule provides that summary prospectuses will contain substantially the same information as previously specified for newspaper prospectuses relating to securities registered on such forms. Such summary prospectus may be published in a newspaper or other periodical or be printed in a form suitable for distribution by hand, through the mails or otherwise.[28]

Forms 4, U–17–2, and N–30F–2.—These forms are used by directors, officers, and principal stockholders for the monthly report of their security transactions, and holdings pursuant to the Securities Exchange Act of 1934, the Public Utility Holding Company Act of 1935, and the Investment Company Act of 1940. In recent years there has been a marked increase in the amount of shares sold to insiders under restricted stock options and similar arrangements. Accordingly, any analysis of insider transactions as reported to the Commission is impeded if the source of acquisitions through the exercise of options is not indicated. Similar problems arise where the transactions are not otherwise effected upon the open market. The amendments to Form 4 (and related forms) provide for identification of purchases made through the exercise of options and private transactions.[29]

OTHER REVISIONS UNDER CONSIDERATION

The Commission devoted much study during 1956 to other important changes in its rules, regulations, and forms. Definitive action in regard to these matters is, in general, awaiting receipt and evaluation of comments from the public and, in some instances, the holding of a public hearing. The principal proposals are as follows:

(1) A Proposed Revision of Rule 133

This rule as currently in effect defines the terms "sale," "offer," "offer to sell," and "offer for sale" so as to make the registration and prospectus requirements of the Act inapplicable to certain corporate

[28] Securities Act Release No. 3722 (November 26, 1956).
[29] Securities Exchange Act Release No. 5410 (November 29, 1956).

mergers, consolidations, reclassifications of securities and acquisitions of assets of another person, in conformity with the statutory provisions of the state of incorporation or the organic instruments. For many years the Commission has taken the position that such transactions did not involve the offering or sale of securities, and hence registration of the new securities resulting from such transactions was not required under the Act. With the passage of time, this interpretation commonly referred to as the "no sale" theory has been administratively narrowed by the Commission. Moreover, the Commission does not extend the theory to the other statutes which the Commission administers. As a result of the "no sale" theory, a large number of transactions have been effected without registration in situations where security holders have, in effect, been traded out of their holdings into new securities of an entirely different company or business without the legal protection afforded by the registration provisions of the Act and often without proper information as to the nature of the enterprise into which they were going. Also the rule has facilitated distributions of securities to the public for cash without compliance with the registration requirements of the Act. The Commission felt that this situation was of sufficient gravity to warrant a thoroughgoing reexamination of the "no sale" theory.

(2) Certain Alternative Proposals for Limiting the Availability of the Exemption from Registration Provided by Regulation A

This proposal arose out of the Commission's concern with the problems presented by promotional companies in offering securities to the public. One of the proposals is to restrict the use of regulation A to companies which have had at least 1 year's record of net earnings within any 5 preceding fiscal years. Another alternative proposal would restrict the number of units of securities that could be issued under the regulation. The suggested maximum number of shares of stock is 100,000, which would, of course, eliminate the issuance and sale of so-called "penny stocks" under this regulation and the number of units of debt securities that could be offered to be 3,000 which would require the price to be $100 per unit if the full $300,000 under the exemption is to be raised.

(3) Proposed Note To Rule 460 Which Would Specify Certain of the More Common Situations Where It Is the Policy of the Commission To Deny Acceleration of the Effective Date of a Registration Statement Under the Standards of Section 8 (a) of the Act

Section 8 (a) of the Act provides that the effective date of a registration statement will be the 20th day after filing (or after the filing of an amendment) or such earlier date as the Commission may determine, having due regard to the adequacy of the information respecting the issuer theretofore available to the public, to the facility

with which the nature of the securities to be registered, their relationship to the capital structure of the issuer and the rights of holders can be understood, and to the public interest and the protection of investors. In passing upon requests for acceleration of the effective date the Commission acts on a case-by-case basis after consideration of all pertinent factors. However, certain of the principal areas in which the Commission has refused acceleration have formed a pattern and the decisions in these areas are reflected in the proposed note.

The proposed note would represent a major step in rounding out the program of publishing the Commission's major administrative policies as a part of the general rules and regulations under the Act and would facilitate administration of the long-standing policy of the Commission to cooperate with registrants in order that the effectiveness of registration statements filed under the Act may be expedited as much as possible consistent with the public interest and the protection of investors.

(4) Revisions of Forms S–2 and S–3

Forms S–2 is prescribed for commercial and industrial companies in the promotional or development stage. Form S–3 is a similar form for mining companies in the exploratory or development stage. It is proposed to merge another form, Form S–11, into the revised Form S–3. The purpose of these revisions is to bring the forms up to date in the light of the Commission's experience and current administrative practice.

(5) A Revision of Form S–4 Which Is Used for the Registration of Securities of "Closed-End" Management Investment Companies

The registration statement of this form consists largely of information and documents previously furnished in connection with the company's registration under the Investment Company Act of 1940. The principal purpose of the proposed revision of Form S–4 is to bring its requirements into line with those of certain amended forms under the Investment Company Act.

(6) Proposed Amendments to the Commission's Statement of Policy Relating to Investment Company Sales Literature

The statement of policy was adopted in 1950 and was amended in January 1955. It is designed to serve as a guide in the preparation of investment company sales literature so as to avoid violation of the anti-fraud provisions of section 17 of the Securities Act of 1933. The Commission's observation of the operation of the Statement of Policy, as amended in 1955, has aroused concern as to the propriety of certain types of presentation of information in tabular or chart form. The

purpose of the proposed amendments is primarily to establish clear standards for the fair and accurate presentation of statistical and financial data concerning investment company operations in sales literature and prospectuses. As a part of this program, the Commission is also considering proposed revisions of its forms N–8B–2 under the Investment Company Act and S–6 under the Securities Act. These forms are used by unit investment trusts and companies issuing periodic payment plan certificates.

PART IV

ADMINISTRATION OF THE SECURITIES ACT OF 1933

The Securities Act of 1933 is designed to provide disclosure to investors of material facts concerning securities publicly offered for sale by use of the mails or instrumentalities of interstate commerce, and to prevent misrepresentation, deceit or other fraudulent practices in the sale of securities. Disclosure is obtained by requiring the issuer of such securities to file with the Commission a registration statement, and related prospectus, containing significant information about the issuer and the offering. The registration statement must become "effective" before the securities may be sold to the public. These documents are available for public inspection as soon as they are filed. In addition the prospectus must be furnished to the purchaser at or before the sale or delivery of the security. The registrant and the underwriter are responsible for the contents of the registration statement. The Commission has no authority to control the nature or quality of a security to be offered for public sale or to approve or disapprove its merits or the terms of its distribution.

DESCRIPTION OF THE REGISTRATION PROCESS

Registration Statement and Prospectus

Registration of any security proposed to be publicly offered may be secured by filing with the Commission a registration statement on the applicable form containing prescribed disclosures. Congress provided that a registration statement must contain the information and be accompanied by the documents specified in Schedule A of the Act, when relating to a security issued, generally speaking, by a corporation or other private issuer, or those specified in Schedule B, when relating to a security issued by a foreign government. Both schedules specify in considerable detail the disclosures which Congress considered an investor should have available in order to make an informed decision whether to buy the security. In addition, Congress added flexibility to the administration of the statute by empowering the Commission to classify issues and issuers, to prescribe appropriate forms, and to increase or in certain instances vary or diminish the particular items of information required to be disclosed in the registration statement as the Commission deems appropriate in the public interest or for the protection of investors. Similar legislative treatment applies to prospectuses, with respect to which additional power was granted the Commission by the 1954 amendments adopted by the 83d Congress.

In general the registration statement of an issuer other than a foreign government must describe such matters as the names of persons who participate in the direction, management, or control of the issuer's

business; their security holdings and remuneration and options or bonus and profit-sharing privileges allotted to them; the character and size of the business enterprise; its capital structure and past history and earnings; its financial statements, certified by independent accountants; underwriters' commissions; payments to promoters made within two years or intended to be made; acquisitions of property not in the ordinary course of business, and the interest of directors, officers and principal stockholders therein; pending or threatened legal proceedings; and the purpose to which the proceeds of the offering are to be applied. The prospectus constitutes a part of the registration statement and presents in summary the more important of the required disclosures.

Examination Procedure

The Commission is responsible for preventing the sale of securities to the public on the basis of statements which contain inaccurate or incomplete information. The staff of the Division of Corporation Finance examines each registration statement for compliance with the standards of disclosure and usually notifies the registrant by an informal letter of comment of any material respects in which the statement on its face apparently fails to conform to these requirements. The registrant is thus afforded an opportunity to file an amendment before the statement becomes effective. In addition, the Commission has power, after notice and opportunity for hearing, to issue an order suspending the effectiveness of a registration statement. Information about the increased use of this stop-order power during 1956 in 8 new cases as compared with 3 in 1955 appears below under "Stop-Order Proceedings."

Time Required to Complete Registration

Because prompt examination of a registration statement is important to industry, the Commission completes its analysis in the shortest possible time. Congress provided for 20 days in the ordinary case between the filing date of a registration statement or of an amendment thereto and the time it may become effective. This waiting period is designed to provide investors with an opportunity to become familiar with the proposed offering. Information disclosed in the registration statement is disseminated during the waiting period by means of the preliminary form of prospectus. The Commission is empowered to accelerate the effective date so as to shorten the 20-day waiting period where the facts justify such action. In exercising this power, the Commission is required by statute to take into account the adequacy of the information respecting the issuer theretofore available to the public, to the facility with which the nature of the securities to be registered, their relationship to the capital structure of the issuer and the rights of holders thereof can be understood, and to the public interest and the protection of investors.

The median time which elapsed between the date of filing and the effective date with respect to 715 [1] registration statements that became effective during the 1956 fiscal year was 23 days, 1 day more than the corresponding figure in the preceding year. Despite this average increase of a day, in no case, involving any major financing absent some serious disclosure problem, did the Commission fail to meet the date requested by the issuer for effectiveness or cause delay of financing plans. This time was divided among the three principal stages of the registration process approximately as follows: (*a*) from date of filing registration statement to date of letter of comment, 13 days; (*b*) from date of letter of comment to date of filing first material amendment, 6 days; and (*c*) from date of filing first amendment to date of filing final amendment and effective date of registration, 4 days. All these days are calendar days, including Saturdays, Sundays, and holidays. In 1956, to meet the financing requirements of industry, in cases where the public interest was adequately protected, the Commission granted effectiveness in less than 20 days for 174 [2] registration statements.

It is not the function of the staff of the Commission to prepare or rewrite registration statements. The members of the staff are ready to assist registrants when it appears that a bona fide effort has been made to prepare a registration statement meeting the standards of the Act and are as helpful as possible in suggesting whatever may be needed by way of additional information if the registration statement, as filed, is not entirely complete. But the Commission's policy, in the public interest and for the protection of investors, is immediately to commence stop-order proceedings in those cases in which the issuer and underwriter refuse to comply with, or ignore, the disclosure standards of the law or where the registration statement appears on its face to be false and misleading. As pointed out under the heading "Stop-order Proceedings," the Commission instituted eight such stop-order proceedings during the 1956 fiscal year, and two were pending at the beginning of the year. In addition, it has several investigations under way with respect to a number of other registration statements.

There are several policies regarding acceleration which have been developed in the last year. These pertain to the Commission's unwillingness to grant acceleration where during the prefiling or post-

[1] Not included in this elapsed time study were 73 registration statements for American Depositary Receipts on Form S–12 and 127 effective registrations of investment company securities pursuant to post-effective amendments permitted under the Securities Act of 1933 by sec. 24 (e) of the Investment Company Act of 1940, as amended. The median number of calendar days of total elapsed time in registration for the 73 registration statements on Form S–12 was 4; and for the 127 posteffective amendments of investment companies it was 18.

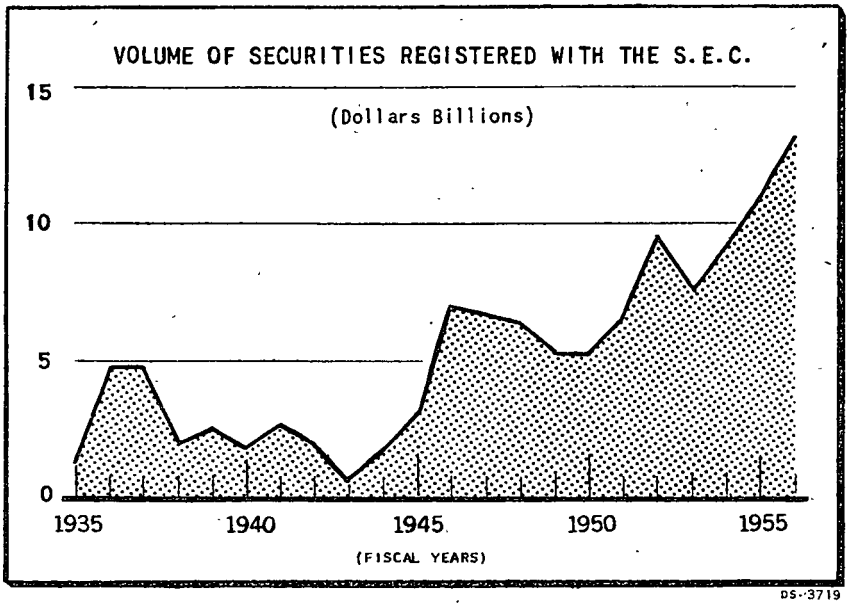
[2] This figure of 174 excludes 51 registration statements for American Deposit Receipts and 68 for additional amounts of securities of investment companies which also became effective in less that 20 days after the date of original filing. Therefore, a grand total of 293 statements became effective in less than such 20 days, constituting 32 percent of the 915 statements that became effective in the 1956 fiscal year.

filing but preeffective period there is evidence of "gun jumping," that is, preeffective sales which are illegal. Also, the Commission has been withholding acceleration where one or more of the underwriters does not meet the test of financial responsibility required under the Securities Exchange Act of 1934, and, most important, it has been withholding acceleration where, apart from the processing of the registration statement itself, it has been making an investigation of the issuer or the underwriter for illegal or fraudulent activities.

Attention should also be called to the fact that of the 67 registration statements withdrawn during the 1956 fiscal year for a variety of reasons, as tabulated under "Number and Disposition of Registration Statements Filed," 34, or 50 percent, were withdrawn because the registration statement was materially misleading and would otherwise have become subject to stop-order proceedings.

VOLUME OF SECURITIES REGISTERED

Securities effectively registered under the Securities Act during 1956 totaled $13.1 billion, the highest volume for any fiscal year in the 22-year history of the Commission. For each of the past 3 years the dollar amount of effective registrations has increased 19 percent or more over the amount effective in the previous year. From the $7.5 billion for 1953 the amounts have increased to $9.2 billion for 1954 to $11 billion for 1955 and to $13.1 billion for 1956. The chart below shows graphically the dollar amounts of effective registrations from 1935 to 1956.



These figures cover all securities including new issues sold for cash by the issuer, secondary distributions, and securities registered for other than cash sale, such as exchange transactions and issues reserved for conversion of other securities.

Of the dollar amount of securities registered in 1956, 70.3 percent was for account of issuers for cash sale, 21.5 percent for account of issuers for other than cash sale and 8.2 percent was for account of others, as shown below. Most of the registrations involving issues not to be sold for cash cover securities offered in exchange for other securities and securities reserved for conversion of other registered securities.

Account for which securities were registered under the Securities Act of 1933 during the fiscal year 1956 compared with the fiscal years 1955 and 1954

	1956 in millions	% of total	1955 in millions	% of total	1954 in millions	% of total
Registered for account of issuers for cash sale	$9,206	70.3	$8,277	75.5	$7,381	80.5
Registered for account of issuers for other than cash sale	2,819	21.5	2,312	21.1	1,638	17.9
Registered for account of others than the issuers	1,071	8.2	372	3.4	154	1.6
Total	13,096	100.0	10,961	100.0	9,173	100.0

The most important category of registrations, new issues to be sold for cash for account of the issuer, amounted to $9.2 billion in 1956 as compared with $8.3 billion in 1955. For 1956, 45 percent of the total volume was made up of debt securities, 49 percent common stock and 6 percent preferred stock. Approximately 60 percent of the volume of common stock represented securities of investment companies.

Figures showing the number of statements, total amounts registered, and a classification by type of security for new issues to be sold for cash sale for account of the issuing company for 1935 to 1956 appear in appendix table 1. More detailed information for 1956 is given in appendix table 2.

The classification by industries of securities registered for cash sale for account of issuers in each of the last 3 fiscal years is as follows:

Classification by industries of securities registered for cash sale for account of issuers during the fiscal year 1956 compared with the fiscal years 1955 and 1954

	1956 in millions	% of total	1955 in millions	% of total	1954 in millions	% of total
Manufacturing	$1,788	19.4	$1,779	21.5	$958	13.0
Mining	148	1.6	106	1.3	89	1.2
Electric, gas, and water	1,802	19.6	2,127	25.7	2,722	36.9
Transportation, other than railroad	118	1.3	12	.1	4	0
Communication	1,294	14.1	837	10.1	932	12.6
Investment companies	2,890	31.4	2,236	27.0	1,557	21.1
Other financial and real estate	852	9.2	789	9.5	512	6.9
Trade	73	.8	27	.3	52	.7
Service	41	.4	100	1.2	13	.2
Construction			160	1.9	8	.1
Total corporate	9,006	97.8	8,173	98.7	6,844	92.7
Foreign governments	200	2.2	104	1.3	537	7.3
Total	9,206	100.0	8,277	100.0	7,381	100.0

The classification of issues of investment companies according to type of organization for the last 3 fiscal years is as follows:

The classification of registered issues of investment companies according to type of organization during the 1956 fiscal year compared with the fiscal years 1955 and 1954

	1956 in millions	1955 in millions	1954 in millions
Management open-end companies	$2,267	$1,853	$1,106
Management closed-end companies	42	28	5
Unit and face amount certificate companies	582	355	446
Total	2,890	2,236	1,557

Of the net proceeds of the corporate securities registered for cash sale for account of issuers in 1956, 62 percent was designated for new money purposes, including plant, equipment and working capital, 2 percent for retirement of securities, and 36 percent for other purposes, principally the purchase of securities by investment companies and employee participation plans.

Activity and prices in the securities markets have reached highs unprecedented in the Commission's experience. Furthermore, this upsurge has taken place in a relatively short period of time. For example, the dollar amount of securities effectively registered under the Securities Act of 1933 increased by 75 percent from $7.5 billion in fiscal 1953 to $13.1 billion in fiscal 1956. This figure had never exceeded $5 billion during the period 1935 to 1945. The aggregate market value of all stock on all stock exchanges increased from $135.4 billion at the end of calendar 1953 to $238.8 billion at the end of calendar 1955 and had never exceeded $100 billion between 1933 to 1945. The Dow Jones Industrial average of stock prices on the New York Stock Exchange reached an all-time high of 521.05 on April 6, 1956. During the years 1933 to 1949 it never exceeded 220. The value of the gross national product broke through the $400 billion figure in 1956 as compared with $340 billion in 1952.

REGISTRATION STATEMENTS FILED

During 1956, 981 registration statements were filed for offerings aggregating $13,097,787,682, compared with 849 statements covering offerings of $11,009,757,143 in 1955.

Of the 981 statements in 1956, 415, or 42 percent, were filed by companies that had not previously registered any securities under the Securities Act of 1933 compared with 297, or 35 percent of the corresponding total during the previous fiscal year.

The growth in volume of proposed financing under the registration provisions of the Securities Act of 1933 is shown by the following tabulation which reflects a 3-year increase of nearly 77 percent in 1956 compared with 1953 in the aggregate dollar amount proposed to be offered as filed.

Fiscal year	Number of statements filed	Aggregate amount	Fiscal year	Number of statements filed	Aggregate amount
1953	621	$7,399,059,928	1955	849	$11,009,757,143
1954	649	8,983,572,628	1956	981	13,097,787,628

A cumulative total of 12,848 registration statements have been filed under the Act by 6,364 different companies covering proposed offerings of securities aggregating over $119 billion during the 23 years from the date of its enactment in 1933 to June 30, 1956.

Particulars regarding the disposition of all registration statements filed under the Act to June 30, 1956, and the aggregate dollar amounts of securities proposed to be offered which are reflected in the statements both as filed and as effective, are summarized in the following table.

Number and disposition of registration statements filed

	Prior to July 1, 1955	July 1, 1955, to June 30, 1956	Total as of June 30, 1956
Registration statements.			
Filed	11,867	[1] 981	12,848
Effective—net	10,248	[2] 906	[3] 11,147
Under stop or refusal order—net	184	3	187
Withdrawn	1,332	67	1,399
Pending at June 30, 1955	103		
Pending at June 30, 1956			115
Total	11,867		12,848
Aggregate dollar amount:			
As filed	$105,992,577,337	$13,097,787,628	$119,090,464,965
As effective	$103,040,287,182	$13,095,508,180	$116,135,795,262

[1] Includes 133 registration statements covering proposed offerings totaling $2,601,776,879 which were filed by investment companies under sec. 24 (e) of the Investment Company Act of 1940 which, since the amendment effective Oct. 10, 1954, has permitted registration of additional amounts of investment company securities by posteffective amendments to previously effective registration statements

[2] Excludes 9 additional statements which were withdrawn after they became effective; these 9 are counted in the 67 statements withdrawn during the 1956 fiscal year

[3] Excludes 7 registration statements which became effective prior to July 1, 1955, and were withdrawn; these 7 are also included in the 67 statements withdrawn during the 1956 fiscal year.

Reasons given for requesting withdrawal of the 67 registration statements withdrawn under the Securities Act of 1933 during the 1956 fiscal year

Nature of reason given	Number of statements withdrawn	Percent of total withdrawn	Percent cumulative
Registration statement was materially deficient and registrant requested withdrawal after receipt of staff's letter of comment	23	34	
Registration statement was materially deficient and registrant was advised that statement should be withdrawn or stop order proceedings would be necessary	11	16	50
Registrant requested withdrawal because financing plans as set forth in the registration statement had been changed	18	27	77
Registrant requested withdrawal because of market conditions having changed	4	6	83
Registrant requested withdrawal because financing had been obtained without the necessity for registration	3	4	87
Registrant requested withdrawal because proposed underwriters were not registered in United States	2	3	90
Registrant requested withdrawal because requirements of Investment Company Act of 1940 could not be met	2	3	93
Withdrawal was requested because registrant had gone into bankruptcy	2	3	96
Registrant requested withdrawal because no need to register (closed voting trust agreement)	1	2	98
Registrant requested withdrawal because not sufficient money was raised under an escrow agreement	1	2	100
Total	67		

EXEMPTION FROM REGISTRATION FOR SMALL ISSUES—$300,000 OR LESS

Under section 3 (b) of the Securities Act the Commission is empowered from time to time by its rules and regulations, and subject to such terms and conditions as it may prescribe therein, to add any class of securities to the securities specifically exempted by section 3 (a) of the Act, if it finds that the enforcement of the registration provisions of the Act with respect to such additional securities is not necessary in the public interest and for the protection of investors by reason of the small amount involved or the limited character of the public offering. The statute, as amended in 1945,[3] imposes a maximum limitation of $300,000 upon any exemption provided by the Commission in the exercise of this power.

Acting under this authority the Commission has adopted the types of exemption identified below:

Regulation A:
General exemption for small United States and Canadian issues up to $300,000.

Regulation A–M:
Special exemption for assessable shares of stock of mining companies up to $100,000.

Regulation A–R:
Special exemption for notes and bonds secured by first liens on family dwellings up to $25,000.

Regulation B:
Exemption for fractional undivided interests in oil or gas rights up to $100,000.

Regulation B–T:
Exemption for interests in oil royalty trusts or similar types of trusts or unincorporated associations up to $100,000.

The revision and consolidation of regulations A for United States issuers and D for Canadian issuers into a new regulation A, just after the close of the 1956 fiscal year, is discussed under "Revisions of Rules and Forms" above.

Exemption from registration under section 3 (b) of the Act does not carry exemption from the civil liabilities for material misstatements or omissions imposed upon any person by section 12 (2) or from the criminal liabilities for fraud imposed upon any person by section 17.

The Commission's regulation A implements section 3 (b) of the Securities Act of 1933 and permits a company to obtain not exceeding $300,000 (less underwriting commissions) of needed capital in any one year from a public offering of its securities if the company complies with the regulation. Upon complying with the regulation a company is exempt from the registration provisions of the Act. A regulation A filing consists of a notification supplying basic information about the

[3] As originally written and until the 1945 amendment the limitation was $100,000.

company, certain exhibits and an offering circular which is required to be used in offering the securities except in the case of a company with an earnings history and the offering is not in excess of $50,000 in securities.

As a convenience to the public, the processing of such filings has been decentralized to the Commission's nine regional offices. Ten business days must elapse between the filing with the regional office and the commencement of the offering unless the Commission authorizes a shortening of this period. During this period the staff of the regional office reviews the filing to determine whether the conditions to the use of the exemption have been met and whether any deficiencies exist which should be corrected before the offering commences.

One objective of the Commission's newly established Branch of Small Issues within the Division of Corporation Finance in Washington is to develop uniform procedures to be followed by the regional offices in their processing of regulation A filings and to coordinate the enforcement activities of the field offices in the administration of the exemption. Companies of the same type and offering the same type of securities should, to the extent possible, be treated uniformly regardless of the local office in which they file. By assigning to the Branch of Small Issues the duty to supervise the administrative procedures used by the regional offices the Commission is providing a valuable safeguard for small business as well as the interest of investors.

A second broad objective to be accomplished by the Branch of Small Issues is to assist the Commission in its determined effort to protect the public against fraud in the sale of small issues without unduly burdening small business. Regulation A is designed to assist legitimate small business and new ventures in bringing to market a small issue of securities. Regulation A was not designed as a shield for the perpetration of fraud on the investing public. One problem in this area is to detect as quickly as possible those filings which are schemes to obtain so-called "front money" to line the pockets of the promoters rather than to obtain funds for the conduct of bona fide business. Another problem is to detect those offerings under the regulation which are sold without use of the required offering circular, but rather are sold by false and misleading sales talk by high pressure salesmen often operating out of "boiler-rooms."

Regulation A itself disqualifies an issuer from offering securities under the exemptive regulation if the issuer or any person connected with the proposed offering (including any promoter, officer, director, major stockholder, or underwriter) has previously run afoul of any State or Federal securities law (through criminal conviction, injunction, or certain enumerated administrative proceedings). The Branch of Small Issues examines the Commission's comprehensive records of securities violations for each filing as it is made, to determine promptly

if any ground for disqualification from the exemption exists. If so, the Commission by order suspends the exemption for that issuer.

This procedure effectively prevents persons who have been guilty of fraudulent practices in the past from using the regulation A exemption. However, this reaches only a relatively few cases and the major problem remains of developing a follow-up program to detect fraud in regulation A filings by persons with no past history of securities violations. Toward this end the Branch of Small Issues will determine, in consultation with regional offices, those filings which on their face are open invitations to fraud, either because the properties of the company do not appear valuable; because the background and experience of the promoters appear dubious in light of the business proposed to be done; or because the venture is rank speculation. Such filings will be investigated under the direction of the Branch of Small Issues to determine the selling practices actually used. Furthermore, it is hoped that a program of "spot-checking" of filings can be inaugurated in each regional office under the supervision of the Branch which would involve inspecting the books and records of a selected number of issuers and their underwriters and interrogating, on a sampling basis, the purchasers of such securities as to representations made to them in connection with their purchases.

If the "boiler-room" stock salesman and the "front money" racketeer are promptly dealt with and denied use of the regulation A exemption, we will do much to build public confidence in the bona fides of issues made under the regulation which will redound to the benefit of legitimate small business seeking capital from the public for business growth. It is the Commission's expectation that the new Branch of Small Issues will make a significant contribution toward the attainment of this goal. Not only will the Branch maintain close liaison with our field offices but the Branch together with other Commission staff members will maintain liaison with the staff of the Small Business Administration on matters of common concern.

Exempt Offerings Under Regulations A and D

During the 1956 fiscal year 1,463 notifications were filed under regulation A, covering proposed offerings of $273,471,548, compared with 1,628 notifications covering proposed offerings of $296,267,000 in the 1955 fiscal year. Included in the 1956 total were 75 notifications covering stock offerings of $14,420,545 with respect to companies engaged in the exploratory oil and gas business, and 349 filings covering offerings of $72,303,567 by mining companies. These 349 filings by mining companies included 275 by uranium companies with proposed offerings aggregating $58,211,812 and 74 offerings by other mining companies aggregating $14,091,755. In addition, there

were 44 filings by companies exploring for both uranium and oil and gas with stock offerings aggregating $10,866,382. Thus there was a total of 319 filings by companies who proposed to use all or a part of the proceeds for exploration and development of uranium properties. Three hundred and two of these companies were less than 2 years old at the date of filing. There was a total of 119 filings by companies which proposed to use all or a part of the proceeds for exploration and development of oil and gas properties.

It is significant that most use of this exemption was made by newly organized enterprises. During 1956, approximately two-thirds of the filings and the offerings thereunder were made by companies less than 2 years old. Such new companies filed 843 of the year's notifications for aggregate offerings of $167,485,970, representing approximately 58 percent of all companies filing notifications under regulation A and approximately 61 percent of the total amount of proposed offerings thereunder. A breakdown of these filings made by new companies shows that uranium ventures accounted for 302 filings covering proposed offerings of $67,602,676, and new companies in all other lines accounted for 541 filings covering proposed offerings of $100,483,294.

Certain facts regarding these offerings are set forth in the following table.

Offerings made under Regulation A

Description	Number		
Fiscal year	1956	1955	1954
Size:			
$100,000 or less	481	544	503
Over $100,000 but not over $200,000	246	312	213
Over $200,000 but not over $300,000	736	772	459
	1,463	1,628	1,175
Underwriting:			
Employed	630	785	501
Not used	833	843	674
	1,463	1,628	1,175
Offerors:			
Issuing companies	1,389	1,517	1,079
Stockholders	62	109	92
Issuers and stockholders jointly	12	2	4
	1,463	1,628	1,175

Most of the underwritings were undertaken by commercial underwriters who participated in 528 offerings in 1956, 671 in 1955 and 419 offerings in 1954. Officers, directors, or other persons not regularly engaged in the securities business, who received remuneration or commissions therefor, handled the remaining cases, where commissions were paid.

Number of notifications filed under Regulation A by years for the 10 fiscal years ended June 30, 1947 through 1956, and the dollar amount proposed to be offered

Fiscal year ended June 30	Number of notifications filed	Amount of proposed offerings	Fiscal year ended June 30	Number of notifications filed	Amount of proposed offerings
1947	1,513	$210,791,000	1952	1,494	$210,673,000
1948	1,610	209,485,000	1953	1,528	223,350,000
1949	1,392	186,783,000	1954	1,175	187,153,000
1950	1,357	171,743,000	1955	1,628	296,267,000
1951	1,358	174,278,000	1956	1,463	273,472,000

Number of notifications filed under Regulation A by months during the 1954, 1955, and 1956 fiscal years and the dollar amount of proposed offerings

1954 Fiscal Year	Number of filings	Dollar amount of proposed offerings
1953:		
July	97	$13,555,599
August	83	13,518,087
September	92	13,672,362
October	76	11,237,170
November	112	18,129,552
December	95	14,063,477
Total for 6 months	555	84,176,247
1954:		
January	74	11,291,429
February	72	12,149,741
March	122	19,427,322
April	104	17,180,010
May	105	18,571,860
June	143	24,356,617
Total for 6 months	620	102,976,979
Total for fiscal year	1,175	187,153,226

1955 Fiscal Year	Number of filings	Dollar amount of proposed offerings
1954:		
July	118	$19,119,327
August	132	26,110,339
September	118	20,235,586
October	139	25,279,742
November	128	22,189,700
December	119	21,521,917
Total for 6 months	754	134,456,611
1955:		
January	130	22,512,941
February	126	21,134,808
March	171	32,404,406
April	130	25,773,601
May	162	29,905,432
June	155	30,080,234
Total for 6 months	874	161,811,422
Total for fiscal year	1,628	296,268,033

Number of notifications filed under Regulation A by months during the 1954, 1955, and 1956 fiscal years and the dollar amount of proposed offerings—Continued

1956 Fiscal Year	Number of filings	Dollar amount of proposed offerings
1955:		
July	138	$26, 393, 096
August	169	35, 218, 967
September	131	27, 435, 423
October	123	22, 319, 465
November	97	16, 181, 484
December	129	24, 191, 389
Total for 6 months	787	151, 739, 824
1956:		
January	96	17, 693, 674
February	115	18, 750, 526
March	136	25, 247, 493
April	104	18, 030, 298
May	120	22, 904, 041
June	105	19, 105, 692
Total for 6 months	676	121, 731, 724
Total for fiscal year	1, 463	273, 471, 548

During 1956, 15 notifications were also filed under regulation D for Canadian issuers, covering proposed offerings of $3,367,735, compared with 37 notifications covering proposed offerings of $10,004,176 in the 1955 fiscal year.

Denial or Suspension of Exemption

Both Regulation A and Regulation D provide for the denial or suspension of the exemption in appropriate cases. During 1956 denial or suspension orders were issued in 100 cases, compared with 18 cases in 1955.

Denial orders—

Regulation A:

Allied Industrial Development Corp., Houston; Securities Act Release No. 3588 (November 1, 1955).

Blue Chip Uranium Corp., Denver; Securities Act Release No. 3572 (September 1, 1955).

Calumet Hills Mining Co., Birmingham, Ala.; Securities Act Release No. 3646 (June 13, 1956).

Grand Canyon Uranium Co., Salt Lake City; Securities Act Release No. 3651 (June 25, 1956).

Lista, Inc., Reno, Nev.; Securities Act Release No. 3651 (June 25, 1956).

Navajo Uranium & Thorium Corp., Las Vegas; Securities Act Release No. 3631 (April 13, 1956).

Pittman Drilling & Oil Co., Independence, Kans.; Securities Act Release No. 3595 (November 30, 1955).

San Juan Uranium Corp., Oklahoma City; Securities Act Release No. 3564 (August 12, 1955).

Searchlight Uranium Corp., Searchlight, Nev.; Securities Act Release No. 3563 (August 4, 1955).

Denial orders—Continued

Regulation A—Continued

Speculators Diversified, Inc., Las Vegas; Securities Act Release No. 3585 (October 27, 1955).

The Uranium and Oil Development Project, Inc., Phoenix; Securities Act Release No. 3580 (October 5, 1955).

Uranium-Petroleum Co. for Hunter Securities Corp., Salt Lake City; Securities Act Release No. 3609 (January 26, 1956).

Regulation D:

Key Oil & Gas (1955), Ltd. (N. P. L.), Vancouver; Securities Act Release No. 3652 (June 29, 1956).

McKenzie Northern Mines, Ltd., Montreal; Securities Act Release No. 3610 (February 3, 1956).

Nicholson Creek Mining Corp., Seattle; Securities Act Release No. 3623 (March 13, 1956).

Suspension orders—

Regulation A:

ABS Trash Co., Inc., Washington; Securities Act Release No. 3649 (June 20, 1956).

Acryvin Corp. of America, Inc., Brooklyn; Securities Act Release No. 3654 (June 28, 1956).

Air Research & Exploration, Inc., Brooklyn; Securities Act Release No. 3654 (June 28, 1956).

Allied Finance Corp., Silver Spring, Md.; Securities Act Release No. 3644 (June 8, 1956). Vacated August 29, 1956.

Alpha Instrument Co., Inc., Washington; Securities Act Release No. 3642 (June 6, 1956).

Amarilla Uranium, Inc., Las Vegas; Securities Act Release No. 3651 (June 25, 1956).

A. M. Electronics, Inc., Washington; Securities Act Release No. 3642 (June 6, 1956).

American Mining & Smelting, Inc., Spearfish, S. Dak.; Securities Act Releases No. 3559 and 3622 (July 9, 1955; vacated March 12, 1956).

Badger Uranium Corp., Las Vegas; Securities Act Release No. 3651 (June 25, 1956).

Bellevue Mining & Concentrating Co., Hailey, Idaho; Securities Act Release No. 3559 (July 29, 1955).

Big Indian Uranium Corp., Provo, Utah; Securities Act Release No. 3643 (June 6, 1956).

Blaze-Master, Inc., Auburn, N. Y.; Securities Act Release No. 3579 (October 5, 1955).

Bridgehaven, Inc., Brooklyn; Securities Act Release No. 3633 (April 24, 1956).

Budget Funding Corp., Jamaica, N. Y.; Securities Act Release No. 3627 (April 4, 1956).

Butte Highlands Mining Co., Spokane; Securities Act Release No. 3559 (July 29, 1955).

Cal-Mex Oil Corp., Taft, Calif.; Securities Act Release No. 3649 (June 20, 1956).

Carolina Mines, Inc., King Mountain, N. C.; Securities Act Release No. 3608 (January 25, 1956).

Cherokee Uranium Mining Corp., Denver; Securities Act Release No. 3640 (May 31, 1956).

Suspension orders—Continued

Regulation A—Continued

Sterling Industries, Inc., Newark, N. J.; Securities Act Release No. 3611 (February 7, 1956).

Trans-Continental Uranium Corp., Salt Lake City; Securities Act Release No. 3597 (December 12, 1955).

Triangle Uranium Corp., Las Vegas; Securities Act Release No. 3649 (June 20, 1956).

U-H Uranium Corp., Moah, Utah; Securities Act Release No. 3602 (December 16, 1955).

Uranium Petroleum Co., Salt Lake City; Securities Act Release No. 3609 (January 26, 1956).

Uravan Uranium & Oil, Inc., Denver; Securities Act Release No 3620 (March 7, 1956).

United States Gold Corp., Spokane; Securities Act Release No. 3559 (July 29, 1955).

Vactron Corp., Fort Worth; Securities Act Release No. 3581 (October 5, 1955).

Vada Uranium Corp., Ely, Nev.; Securities Act Release No. 3598 (December 16, 1955).

Verschoor & Davis, Inc., New York; Securities Act Release No. 3654 (June 28, 1956).

Washington Institute for Experimental Medicine, Inc., Herndon, Va.; Securities Act Release No. 3642 (June 6, 1956).

World Uranium Mining Corp., Salt Lake City; Securities Act Release No. 3559 (July 29, 1955).

York Oil & Uranium Co., New Castle, Wyo.; Securities Act Release No. 3637 (May 23, 1956).

Zenith Uranium & Mining Corp., Boston; Securities Act Release No. 3597 (December 12, 1955).

Regulation D:

Bowsinque Mines, Ltd., Ontario; Securities Act Release No. 3607 (January 24, 1956).

Ladoric Mines, Ltd., New York; Securities Act Release No. 3615 (February 17, 1956).

Vigorelli of Canada, Ltd., Montreal; Securities Act Release No. 3597 (December 13, 1955).

In general, the reasons for the issuance of these orders included failure to comply with certain conditions of the exemption (such as failure to file reports of sales and use of proceeds) or, in certain cases, the perpetration of outright fraud and deceit (involving misstatements of material facts either in the offering circular or in oral communication). A few actual cases are summarized below to illustrate specific charges of misrepresentations occurring in suspension proceedings brought by the Commission.

Coastal Finance Corp.—This small loan company filed a regulation A notification with the Commission on July 31, 1955, for the purpose of obtaining an exemption from registration with respect to a proposed public offering of 5,669 shares of class A common stock ($10 par) at $28.50 per share. According to the offering circular, the offering was to be made to holders of outstanding class A shares at

the rate of 1 additional share for each 6 shares held of record on August 5, 1955. Unsubscribed shares were to be offered for public sale on a best efforts basis by an underwriter. Although not required to do so by regulation A, the financial statements included in the offering circular were certified by independent public accountants. All of these securities were sold.

After being advised by the certifying accountants, who discovered falsified accounts shortly after the offering and immediately reported it to the Commission, the Commission issued an order temporarily suspending the regulation A exemption and, alleged that there was reason to believe that the offering circular was misleading, and directed that a public hearing be held to determine whether the suspension order should be vacated or made permanent. In its order, the Commission asserted that it had reasonable cause to believe that the terms and conditions of regulation A were not complied with by Coastal, in that the notification and offering circular were false and misleading because, among other things, the offering circular represented that Coastal had purchased the assets of another finance company after its management had made an appraisal, whereas no appraisal was made by the Coastal management in accordance with the normal and customary techniques followed in the loan industry; the company did not write off all past due loans known to be uncollectible and the charges against current income as a provision for bad debts, and the reserves provided therefor, were inadequate; and the summary of earnings contained in the offering circular represented income figures greater than those actually realized. This case was awaiting decision by the Commission on the evidentiary record at the close of 1956.

Prior to the hearing Coastal filed a petition for reorganization under chapter X of the Bankruptcy Act in the United States District Court at Baltimore, Md. This case was also pending, with the Commission participating as a party to assist the court as provided in chapter X, at the close of the year.

Cherokee Uranium Mining Corp.—Two offerings of this issuer were temporarily suspended. The orders charged on the basis of information supplied by the staff that false and incomplete statements were made concerning the sale of unregistered securities of the issuer and affiliates within the previous year. It was also asserted that the offering would operate as a device, scheme and artifice to defraud because the issuer was insolvent, and that there was a failure to disclose in connection with a debenture offering that there might not be sufficient funds available for a profitable business operation and the issuer might not be in a position to satisfy the interest requirements on the debentures.

Insured Savings Life Insurance Co.—The issuer restricted the offering to purchasers of insurance policies of an affiliated insurance

company. The Commission temporarily suspended the offering asserting that a fraud or deceit would be involved in the offering in that false and misleading statements were being made concerning the amount and source of earnings and dividends of both companies, an anticipated increase in value of the securities, and the safety of the investment. It was also alleged that the required offering circular was not given to purchasers. The issuer consented to the entry of a permanent suspension order.

San Juan Uranium Corp.—In its order suspending the exemption, the Commission asserted that the offering operated as a fraud or deceit upon the purchasers in that the proceeds were not used for the purposes set forth in the offering circular but instead were used to make advances to, and to defray personal expenses of, a promoter and to finance the promotion of another of his corporations. It was also asserted that the offering circular contained material misstatements and omissions concerning affiliations and identity of promoters, and their receipt of consideration for properties; and that misleading sales literature was used concerning equipment acquired and the progress made on the properties.

Exempt Offerings Under Regulation B

During 1956, the Commission received 114 offering sheets filed under regulation B, compared with 71 in 1955. These filings, relating to exempt offerings of oil and gas rights, were examined by the Oil and Gas Unit of the Division of Corporation Finance which assists the Commission on technical and complex problems peculiar to oil and gas securities.

Number of offering sheets filed under Regulation B during the 1956 fiscal year compared with the 1955 and 1954 fiscal years

Fiscal year:	Number of offering sheets filed
1956	114
1955	71
1954	156

Action taken on offering sheets filed under Regulation B during the 1956 fiscal year compared with the 1955 and 1954 fiscal years

	Fiscal years		
Temporary suspension orders:	1956	1955	1954
Rule 340 (a)	5	6	9
Rule 340 (b)	1	----	----
Orders terminating proceedings after amendment	5	3	3
Orders accepting amendment of offering sheet (no proceedings pending)	60	21	72
Orders consenting to withdrawal of offering sheet (no proceedings pending)	4	1	2
Orders consenting to withdrawal of offering sheet and terminating proceedings	----	----	3
Order terminating effectiveness of offering sheet	1	----	1
Total number of orders	76	31	90

Report of sales under Regulation B during the 1956 fiscal year compared with the 1955 and 1954 fiscal years

	Fiscal years		
	1956	*1955*	*1954*
Number of sales reports filed	1,419	1,076	1,699
Aggregate dollar amount of sales	$1,234,541	$549,951	$770,042

Report of sales.—As an aid in determining whether violations of law have occurred in the marketing of securities exempt under regulation B, the Commission obtains reports of actual sales made pursuant to rules 320 (c) and 322 (c) and (d) of that regulation. In this connection it may be recalled that while this exemption is limited to a maximum offering of $100,000, the offering sheet does not disclose the actual amount of offering proposed.

RESULTS OBTAINED BY THE REGISTRATION PROCESS

Results secured by the staff's examination of registration statements during 1956 are illustrated by the following examples of corrections made by registrants as a result of comments to registrants by the staff of the Division of Corporation Finance.

Revision of representations as to profit potentialities of uranium investment.—A uranium mining venture filed a registration statement covering $900,000 8 percent convertible subordinated debentures due May 1, 1976, to be offered initially to stockholders. Unsubscribed debentures were to be offered to the general public through an underwriter who had agreed to act on a best efforts basis. Proceeds were to be used to complete acquisition of mining claims and a producing uranium mine. As a result of the staff's review the prospectus was revised to show that the properties being acquired for $1,000,000 in cash and stock from the company's president and his associates were acquired by them at no cost other than nominal expenses involved in locating the claims; that in connection with a table setting forth total receipts of $358,289 from sales of ore from the mine, net receipts for registrant's account after direct mining costs and excluding depreciation were $8,462; and that proven and probable ore reserves totaled 7,154 tons rather than 76,335 tons as originally claimed.

Withdrawal of registration statement failing to justify claimed sulphur reserves and to show stock dilution.—A sulphur mining company filed a registration statement for the purpose of registering 600,000 shares 6 percent convertible noncumulative preferred stock, par value $2. Such shares were to be offered through an underwriter to the general public at $2 per share. Part of the shares (25,000) were to be underwritten on a firm basis and the balance on a best efforts basis. The preferred stock was convertible into common stock, par value 1 cent, initially share-for-share and subsequently at ratios of two-thirds and one-half share common respectively, for one share

preferred. Directors, officers, and promoters had acquired from the company 300,000 shares (48 percent) of the outstanding common at 1 cent per share.

The proceeds were to be used to construct a sulphur extraction plant on land held by the company under leases. As a result of the staff's review, it appeared that a person preparing the geological report with respect to the company's properties was not competent to act in the sulphur mining field; the claimed sulphur reserves were substantially overstated; there was a serious question as to whether the project was economically feasible, as claimed, in view of the limited extent of the sulphur reserves; and there was a failure to disclose that purchasers of the preferred stock were given no protection against dilution of their equity through issuance of common stock at less than the purchase price of the preferred.

When the above matters were called to the company's attention it determined to withdraw the registration statement.

Disclosure of unprofitability of life insurance venture.—A company engaged in the business of life, accident and health insurance filed a registration statement covering 48,108 shares of capital stock to be offered to its stockholders. The offer was not underwritten. Proceeds were to be used to purchase life insurance in force and assets from other life insurance companies and, to the extent not so used, to invest in assets which would constitute a part of its reserves for life insurance policies.

As a result of the staff's analysis and comments, the company revised its prospectus to disclose prominently therein that the company expected to operate at a loss during 1956 and the next 4 years and was unable to predict when its operations would result in a net profit; the losses from operations from 1952 through 1955 resulted in part from lapses of insurance in force at a rate substantially higher than is considered normal for the industry; no dividends had been paid and no earned surplus was available for payment of dividends, there being an earned deficit of $797,178; and total contributions of stockholders to unassigned surplus amounted to $2,162,953, whereas the unassigned surplus was $755,864.

Revision of accounting for property acquired from promoters in exchange for stock.—Accounting for property received from promoters in exchange for shares of stock has been a problem recurring since the early days of the Commission. It has been the subject of Commission opinions and special accounting treatment has been prescribed in the Commission's forms and accounting regulations. These forms and regulations apply to the promotional period of the company and prescribe that when shares are issued for property no dollar values may be extended in the statement of assets and capital shares. Problems develop, however, when these companies reach an

operating status and balance sheets and operating statements must be prepared.

A representative situation may be cited from the past year. In the initial offering of shares the financial statements included a statement of assets and capitalized expenses which disclosed that the consideration for certain properties turned over to the registrant by the promoters was 52,000 shares of the company's common stock of $10 par value per share. Approximately 1 year after the offering was made a posteffective amendment was filed. At this time the company was in operation and consequently the financial statements furnished included balance sheets and statements of earnings.

With respect to the balance sheets the staff questioned the propriety of including in the value of land an amount of $415,000, being the excess of the par value of 52,000 shares ($520,000) issued to the promoters over the cash cost, $105,000, to them for options and contracts for the purchase of property to be acquired by the registrant. The prospectus disclosed that the determination of the amount of the interests of the various promoters and the amount of stock to be issued in exchange therefor was made by the promoters themselves, and that this determination was essentially arbitrary in character.

It was further disclosed that the shares were held in escrow and while so held could not be sold, transferred or encumbered without the express approval of a state corporation commission. The escrow agreement provided that the stock did not entitle the owners to participate in any distribution of assets until after the owners of all other securities are paid in full. Under the circumstances, the balance sheet was amended to reduce the item of land, leasehold and improvements by $415,000 and to show this amount as a deduction from the stated value of the capital stock with the explanatory caption "Excess of par value of capital stock issued to promoters over cost of acquired land."

Adjustment of income statement to reflect impact of differences between depreciation for income tax and accounting purposes.— Differences between income tax and book provisions for depreciation may, because of special circumstances in a company's operations, have a marked effect upon currently reported earnings. An instance arose in the case of a rapidly expanding trucking and truck leasing company.

The financial statements of a company as initially filed for the 11 months ended November 30, 1955, showed a net income approximating $958,000, or $2.56 per share on the shares outstanding on November 30, 1955. Notes to the financial statements and the summary of earnings, taken together, indicated that Federal income taxes for the 11 months had been reduced by approximately $185,000 as a result of the deduction of approximately $356,000 more depreciation for income tax purposes than was deducted for book or accounting

purposes. The explanation lies in the fact that for accounting purposes depreciation on trucking units was computed on a straightline basis over the estimated useful lives of the assets, whereas for income tax purposes the "sum of the years-digits" method had been used for 1954 and 1955 property additions as provided by the Internal Revenue Code. It so happened that the 1955 acquisitions of trucks had been very large in relation to those on hand at the beginning of 1955. The staff took the position that under such circumstances a fair statement of net income would require that provision be made for the deferred taxes which would otherwise be chargeable against income in future years. After discussion with the staff of various phases of the deferred tax effect, the registrant adjusted its income statement by a provision for deferred taxes approximating $185,000, thereby reducing reported net income to approximately $773,000, or $2.07 per share.

STOP-ORDER PROCEEDINGS

Section 8 (d) provides that if it appears to the Commission at any time that a registration statement contains an untrue statement of a material fact or omits to state any material fact required to be stated therein or necessary to make the statements therein not misleading, the Commission may institute proceedings looking to the issuance of a stop order suspending the effectiveness of the registration statement. Where such an order is issued, the offering cannot lawfully be made, or continued if it has already begun, until the registration statement has been amended to cure the deficiencies and the Commission has lifted the stop order. During 1956 8 new proceedings were authorized by the Commission under section 8 (d) of the Act and 2 such proceedings were continued from the preceding year. In connection with these 10 proceedings, 3 stop orders were issued during the year and the 7 remaining cases were pending as of June 30, 1956.

The Commission is also authorized by section 8 (c) of the Act to make an examination in order to determine whether a stop order should be entered under section 8 (d). For this purpose the Commission is empowered to subpena witnesses and require the production of pertinent documents. During 1956 the Commission authorized 4 private examinations pursuant to this section of the Act. As of June 30, 1956, 1 of the examinations was still pending, 2 had resulted in the withdrawal of the statements by the registrants, and 1 had been disposed of insofar as section 8 (c) is concerned by action of the Commission in ordering that the case proceed to a public hearing under section 8 (d).

(Page 73 follows.)

International Spa, Inc.

Proceedings against registration statement filed by this company, described in the 21st Annual Report at pages 16–17, were terminated during the 1956 fiscal year by issuance of a stop order.[4]

International Spa proposed to construct and operate a luxury hotel together with a shopping center, theater, swimming pool, and other facilities near Las Vegas, Nev., emphasizing the interracial aspects of its proposed development. It proposed not only to offer publicly 12,000 common shares at $500 per share, but to issue an equal number to the promoters "in payment for services rendered and to be rendered during the sale and distribution of the registrant's stock." After holding hearings the Commission issued a stop order. The Commission found that the registration statement was grossly inaccurate and misleading. The description of registrant's proposed business was materially deficient in failing to reveal that registrant had no information about possible patronage for its project, and failed to disclose the facts regarding potential competition with its project even though three other hotels which intended to operate on an interracial basis were being constructed or planned at sites closer to the business area of Las Vegas than registrant's site. The registration statement also contained untrue statements and omitted to state material facts regarding registrant's interest in the tract of land upon which it proposed to construct its development. While the registration statement said that registrant was not acquiring such tract of land from any person having a material relationship with it, and that no commissions were being paid, the Commission found such statements were untrue, and that the seller of the property originally acquired it on instructions from the principal promoters of registrant; that the seller would receive, in addition to his acquisition cost, $48,000 in cash and 870 shares of registrant's stock; and that the trust deed for the bulk of the original purchase price paid by the sellers was in default. The Commission also found that statements in the registration statement that registrant had issued no securities or options to purchase securities were untrue, in that registrant was under an obligation to issue stock to certain persons and that such persons had options to acquire stock.

Horton Aircraft Corp.

Proceedings under section 8 (d) with respect to the registration statement filed by this company, described in the 21st Annual Report at pages 15–16, were still pending at the close of the 1956 fiscal year.

[4] Securities Act Release No. 3603 (January 18, 1956).

The Sans Souci Hotel, Inc.

This registrant was organized in Nevada in 1954 for the purposes of acquiring property and operating and constructing additional facilities for the Sans Souci Hotel located near Las Vegas, Nev. It proposed an offering of 1,428,000 shares of its common stock at $1 per share. Of the total offering 300,000 shares were to be for the account of George E. Mitzel, president of registrant, and 30,471 shares were to be offered to creditors in payment of certain outstanding obligations. The balance of the offering was to be made to shareholders on a preemptive basis and any unsubscribed shares were to be offered to the general public.

Included among the allegations made with respect to the hearings brought under section 8 (d) were questions as to the adequacy and accuracy of disclosures with respect to the use of proceeds to be derived from the public sale of stock in the event less than all of the registered shares were sold; the description of the business proposed to be conducted by the registrant, in particular the cost of the additions to the hotel to be constructed, the contemplated negotiations of a lease covering the operation of the gambling casino, the regulations of the State of Nevada governing the granting of a gambling license and the effect thereof on the business intended to be done, and the competitive conditions in the area and the effect thereof upon its business; the option to purchase certain real estate, the price to be paid therefor, the nature of the title thereto, the defects and liens thereon, and the terms and conditions of the option; the identity of all affiliates of registrant and persons with whom its officers and directors have a material relationship, transactions with such persons; and the financial statements, including writeups resulting from appraisals, failure to amortize certain expenses and provide depreciation, incorrect statement of net profits, omission of notes and schedules applicable to financial statements as required by applicable Commission rules.

After the hearing was commenced and testimony was taken, registrant submitted a written stipulation and consent to the entry of an order by the Commission pursuant to section 8 (d) suspending the effectiveness of its registrant statement, and such order was duly entered.[5]

The Sun Hotel, Inc.

The Commission instituted proceedings under section 8 (d) with respect to the registration statement filed by the Sun Hotel, Inc., Las Vegas, Nev., which proposed the public offering of 3,750,000 shares of its common stock at $2.50 per share, aggregating $9,375,000.

[5] Securities Act Release No. 3636 (May 2, 1956).

through Golden-Dersch & Co., Inc.,[6] of New York, and Coombs & Company of Las Vegas.[7] Proceeds from the sale of the company's stock were to be used to acquire title to certain property and to construct a luxury hotel estimated to cost $7,000,000. Robert Brooks of Los Angeles was listed as president and one of the principal promoters.

In its order and notice of proceedings, the Commission raised questions as to the adequacy and accuracy of disclosures with respect to the description of the business intended to be carried on by Sun Hotel, in particular the size of the hotel to be constructed, the sites on which it would be constructed, the contemplated negotiation of a lease covering a gambling casino, and competitive conditions and the effect thereof upon the company's business; the lease for and the options to purchase certain real estate, the price to be paid therefor, the nature of the title thereto, the defects and liens thereon, and the terms and conditions of the lease and options; the use of the proceeds to be derived from the public sale of the stock; statements as to the identity of persons who had given options on real estate to the company and the transactions between such persons and the company; and the statement regarding the business experience of the officers, particularly with respect to any business owned or operated by Robert Brooks and any convictions or other litigation that had arisen with respect thereto.

Prior to the holding of the public hearing in this matter, the registrant consented to the issuance of a stop order suspending effectiveness of the registration statement, and such order was issued.[8]

American Republic Investors, Inc.

This proceeding concerned a registration statement filed by American Republic Investors, Inc., of Dallas, which proposed the public offering of 800,000 shares of $1 par common stock at $10 per share with a $2 per share maximum underwriting commission.

According to the registration statement and prospectus, the company was organized under Maryland law on March 28, 1955, for the purpose of offering its stockholders an opportunity to become charter members of a new legal reserve stock life insurance company, American Old Line Life Insurance Co. (organized under Texas law) and to seek capital gains and dividends through long-term appreciation in common stocks of old line legal reserve life insurance companies. Of

[6] On September 18, 1956, Golden-Dersch & Co., Inc., was permanently enjoined by the United States District Court for the Southern District of New York from further violations of the Commission's net capital rule. On September 27, 1956, a receiver of the assets of the defendant was appointed.

[7] On August 27, 1956, Coombs & Co. of Washington, D. C., was permanently enjoined by the United States District Court for the District of Columbia, from further violations of the Commission's net capital rule and the court ordered the appointment of a receiver of the assets of the defendant.

[8] Securities Act Release No. 3578 (October 3, 1955).

the proceeds of the stock sale, 60 percent was to be used to organize, own, and operate the Life Insurance Co. and the balance was to be invested in a fund for the acquisition of other insurance company stocks.

After the holding of hearings the Commission, shortly after the close of the fiscal year, issued its findings and opinion and a stop order.[9] The Commission found that the registration statement covered a proposed offering of stock in an enterprise that was so potentially hazardous for public investors that only the most scrupulously fair and complete disclosure could have afforded them adequate protection; that the registration statement contained numerous false statements and omitted information of the most important and significant nature. The Commission found that the promoters, officers, and directors had no substantial experience in operating a business similar to that proposed by registrant. Notwithstanding this fact and without adequate disclosure thereof registrant proposed to offer 800,000 shares of stock to the public at $10 a share, a total of $8,000,000. In contrast, registrant issued 222,815 shares to friends and close business associates at a stated value of $1 per share and optioned 377,185 shares to the 3 directors and officers at $1 per share, a total of 600,000 shares. Of the stock issued to friends and associates it was found that only 71,850 shares were sold for cash; the remainder having been issued for portfolio securities, some of which had been illegally issued and none of which had any market value, and that the securities received in exchange were arbitrarily priced by the directors of registrant.

Uranium Properties, Ltd.

This registrant was a joint venture which proposed the public offering of $600,000 of "Grubstake loans" by the joint venture in minimum amounts or multiples of $25.

Registrant was created by Hubert W. Sharpe and Reyburn F. Crocker for the purpose of exploration for, acquisition of, and development of mineral deposits, in particular uranium and other rare and valuable minerals and metals. The exploration for uranium was to be conducted by means of aircraft equipped with electronic and radiation detecting devices. The securities to be offered were in the form of agreements providing that with 75 percent of the principal sum delivered by investors the joint venture would purchase for, and in the name of, the investor a United States savings bond, series E, of a face value equal, at maturity to the principal sum advanced, and the balance of the funds would be used for the exploration and other purposes of the joint venture. The agreements further provided that the joint venturers would hold in trust for the benefit of investors

[9] Securities Act Release No. 3679 (August 21, 1956).

one forty-eighth thousandth (1/48,000th), for each $25 advanced, of all such uranium or other mineral deposits and a like proportion of the rents, issues and profits thereof, and would convey to the investors such fractional interest or pay such rents, issues or profits to investors upon demand.

After the holding of hearings the Commission, shortly after the close of the fiscal year, issued its findings and opinion and a stop order.[10] The Commission found that the attempted tie-in between the sales of the extremely speculative interests in an exploration project with sales of United States savings bonds was seriously misleading, that there was no relationship whatever between the two investments and that the attempt to tie them together was purely a sales device giving rise to a false implication that the investor could not lose the part of his investment relating to the exploration adventure. The Commission also found that registrant failed to disclose that it had only the most rudimentary plans for engaging in business, that the joint venturers had no experience in exploring for minerals and did not propose to employ geologists or other trained personnel, that registrant had selected no area for explorations, and that it had no plans for developing or otherwise realizing upon any mineral prospects it might locate.

Wyoming-Gulf Sulphur Corp.

The Commission instituted proceedings under section 8 (d) with respect to the registration statement filed by Wyoming-Gulf Sulphur Corp. of Jersey City, N. J., which related to a proposed public offering by the corporation of 700,000 shares for its own account, and 226,000 shares for the account of two stockholders. The offering was to be made at prices prevailing in the over-the-counter market but in no event at less than $2 per share. Proceeds of the sale of the company stock were to be used to furnish auxiliary equipment at its Cody, Wyo., plant, to acquire an additional site near Thermopolis, Wyo., and erect a plant thereon, to explore, develop and merchandise agricultural products, and to make additional acquisitions.

The Commission announced that consideration would be given at the hearing to questions about the adequacy and accuracy of statements concerning the history and development of the company's business, in particular the omission of information concerning its property in Cody, Wyo., information concerning the purchase of property in Thermopolis, the terms of such acquisition, the relationship of the parties to the purchase agreement, and the material mining facts concerning such properties; the cost of processing and of marketing the product of the issuer, the marketability thereof, competitive factors, and related facts; the proposed plan of distribution of company

[10] Securities Act Release No. 3678 (August 20, 1956)

stock; and the company's financial statements, including the fact that the accounting firm which prepared the financial statements was not in fact independent because of its ownership of stock of Wyoming-Gulf Sulphur.

The matter had not been determined at the close of the 1956 fiscal year.[11]

Columbia General Investment Corp.

Another case brought during, and pending at the close of, the 1956 fiscal year, related to the registration statement filed March 29, 1956, by Columbia General Investment Corp., of Houston, Tex., which proposed the public offering of 100,000 shares of its common stock to stockholders at $4.50 per share.

According to the prospectus, proceeds of the proposed stock offering were to be used for the purpose of making investments similar to those which Columbia General had in mortgage loans, real estate, stocks, bonds and other securities, including the common stock of Columbia General Life Insurance Co. The prospectus further listed Thomas E. Hand, Jr., and J. Ed Eisemann, III, both of Houston, as board chairman and president, respectively, and principal stockholders of the company.

The Commission also ordered a public investigation into past sales of Investment Corp. and the Insurance Co. stock, by the two companies and by Columbia Securities Co., Hand and Eisemann, to determine whether provisions of the Securities Act of 1933, the Securities Exchange Act of 1934, and the Investment Company Act of 1940 had been violated. The Commission was advised by the staff that stock of the two companies had been offered and sold by means of false and misleading representations with respect to the general history and development of the companies and the valuation of their assets; practices followed in connection with the offer and sale of their shares; and activities, transactions and interests of Hand and Eisemann in the formation of the companies and the sale and distribution of their securities. Also involved in the proceedings was an effort to determine whether Investment Corp. held itself out as being engaged primarily, or proposed to engage primarily, in the business of investing and reinvesting in securities and, therefore, was required to register under the Investment Company Act.

With respect to the Investment Corp. registration statement and prospectus, involved in the proceedings was an effort to determine, among other things, the adequacy or accuracy of information concern-

[11] The Commission issued a stop order on September 18, 1956, finding that the registration statement contained materially misleading statements and omissions with respect to, among other things, the potential market for registrant's products, the extent of mineral reserves, and the terms of the offering and plan of distribution of securities. Securities Act Release No. 3690 (September 18, 1956).

ing the plan for distributing the Investment Corp. stock; the use of the proceeds thereof; the description of the company's business; the history of the company's organization and the interests of management and others in certain transactions; the capital stock being registered; and the financial statements.[12] The matter had not been determined at the close of the fiscal year.

Ultrasonic Corp.

As a result of an investigation of the Ultrasonic Corp., a stop order proceeding was instituted by order of the Commission on November 4, 1955, against a registration statement filed by Ultrasonic Corp. This registration statement became effective on July 22, 1954, and an amendment was filed which became effective August 25, 1954. The filing covered a public offering of 200,000 shares of common stock priced at $12.75, with net proceeds to the company of approximately $2,300,000.

The staff of the Commission alleged that the registration statement was false and misleading because, among other things, the statement of income for the 6 months ended March 31, 1954, reported a small income instead of a substantial loss amounting to approximately $900,000 for that period, which amount should have been added to the deficit reported in the balance sheet as at March 31, 1954. Similarly, it was alleged that the assets set forth in this balance sheet were overstated and that liabilities stated therein were understated by an equivalent amount of approximately $900,000.

The Commission's staff based these allegations on the grounds that net income for the 6 months ended March 31, 1954, had been overstated in the registration statement because cost of goods sold had been determined improperly; because losses on government contracts and price redetermination thereunder had not been sufficiently provided for; and also because certain expenses were deferred improperly as assets. As a consequence, inventories, plant account and deferred assets had been overstated and liabilities and reserve for losses and price redetermination had been understated in the balance sheet as of March 31, 1954.

It was also alleged by the staff that substantial additional operating losses subsequent to March 31, 1954, amounting to approximately $486,000 to June 30, 1954, were not disclosed in the registration statement as it became effective, and approximately $800,000 to July 31, 1954, were not disclosed in the posteffective amendment.

The item in the registration statement relating to "Use of Proceeds," which indicated that the proceeds were required for the company's

[12] Securities Act Release No. 3653 (July 2, 1956).

increased working capital requirements, was charged to be false and misleading in the light of the undisclosed operating losses.

The Commission had this matter under advisement at the close of the fiscal year.

Universal Service Corporation, Inc.

On July 8, 1955, this company filed a registration statement covering a proposed public offering of 500,000 shares of its common stock, $0.002 par value, at $2.50 per share, or a total of $1,250,000. The company had been organized in September 1954 for the purpose of financing the exploration and, if warranted, the mining of uranium, quicksilver and other minerals as well as gas and oil. In October of 1954, a subsidiary, Universal Service Mining Corp., was organized for the purpose of exploring potential mining properties. This latter corporation eventually acquired acreage located in Brewster and Presidio Counties in the State of Texas from promoters of the enterprise and it was for the exploration and development of this property, among other things, that the proceeds from the proposed sale of the 500,000 shares of common stock were to be used.

In a radio broadcast on February 13, 1955, a commentator stated that Universal Service Corp. had discovered uranium ore in the Big Bend area of Texas, and that the stock of the company was being sold to the public in large quantities. Since registration of the securities of the company had not been effected under the Securities Act of 1933, the Commission, on February 21, 1955, directed its Fort Worth office to conduct an investigation to determine whether unregistered securities were being offered interstate in violation of section 5 of the Act.

In connection with the registration statement the Commission issued an order for a hearing pursuant to section 8 (d) of the Securities Act to determine whether the company's registration statement complied with the disclosure provisions of the Act. The Division of Corporation Finance charged, among other things, that the registration statement was deficient in that it failed to disclose the identities of the real promoters of the company, together with the interests these persons had retained in the property, and the amount of stock they had acquired and resold. It was further contended that the geological reports and other information given in the registration statement concerning the property raised serious questions as to the accuracy and completeness of data given concerning the geology, the assays reported, and the outcome of the work done, and that the claim in the prospectus to excellent possibilities for finding oil in the company's properties appeared highly questionable. It was also alleged that the registration statement failed to point out that the price of the stock had been arbitrarily established from time to time by the

company's board of directors, that sales had been made at prices ranging from 40 cents to $10 per share, and that the proposed offering price of $2.50, after a 5 for 1 stock split, was equivalent to $12.50 per share before the split.

The hearings were concluded on October 14, 1955, and the report of the hearing examiner was filed on July 27, 1956. Subsequently, counsel have filed briefs and oral argument has been heard by the Commission pending its determination of whether a stop order should issue.

LITIGATION UNDER THE SECURITIES ACT OF 1933

Injunctive Actions

In order to protect the public from the damage which might result from threatened violations of the Securities Act, the Commission is authorized to apply to the courts for injunctions to restrain conduct in violation of the Act. As in former years, the Commission again found it necessary in the fiscal year to invoke such sanctions as a result of investigations.

Illegal oil and gas promotions again claimed the Commission's attention and required the institution of injunctive action. The complaint filed in *S. E. C.* v. *Eldon L. Jewett & Perr Oil Co.*[13] charged that in the sale of fractional undivided interests in oil leases, the defendants falsely represented that the defendant Jewett was a substantial investor in these securities and that he was realizing an annual income of $60,000 to $84,000. The Commission also alleged that the defendants' representations that no person purchasing these oil interests had ever lost money and that the money received from investors would be used for the purpose of drilling and completing oil wells were false. The defendant Jewett filed an answer to the Commission's complaint in this action and the defendant corporation consented to the preliminary injunction against further violations of the registration and antifraud provisions of the Securities Act of 1933.

Fraudulent uranium promotions also required attention in the Commission's enforcement efforts. In *S. E. C.* v. *Colotex Uranium & Oil, Inc., W. H. Keasler, J. Wesley Puller and J. C. Paul,*[14] the Commission charged that the defendants not only violated the registration provisions in offering and selling temporary receipts representing a right to obtain shares of the common stock of the defendant corporation, but also that the defendants falsely stated that the defendant corporation was the owner of mineral interests or properties in Wyoming and that the proceeds from the sale of these securities would be transferred to the defendant corporation and used for expenses. By consent of the defendants the court issued a preliminary

[13] W. D. Wash. No. 1989 (February 16, 1956).
[14] D. Colo. No. 5371 (May 16, 1956).

injunction enjoining them from further violations of the registration and antifraud provisions of the Securities Act of 1933.

Fraudulent promotions were not limited to oil and mining ventures. In *S. E. C.* v. *Central Finance Service, Inc., Council Mayo Forsyth, Roy W. Adams and J. L. Hathcoat* [15] the Commission had occasion to ask the court to enjoin those defendants from further violations of the registration and antifraud provisions of the Securities Act of 1933 in connection with the offering and sale of the defendant corporation's common stock. The complaint alleged, among other things, that the defendants employed a scheme and device to defraud, and falsely represented that the stock of the defendant corporation held by stockholders of that company before September 15, 1955, would increase or had increased in value more than five times as a result of the corporation's action in issuing a 10 percent stock dividend and splitting its stock 5 for 1. Other fraudulent representations which were charged included references by the defendants to the fact that the corporation would return to the stockholders all of the money invested in its stock if such return were desired and that the company was planning to pay a 20 percent cash dividend and split its stock 10 for 1 in 1956, with the result that $1,000 invested in 1955 would be worth $10,000 in less than a year. The complaint further charged the defendants with omitting to tell purchasers that the stock being sold was that owned by the defendant Forsyth and that he was using the purchasers' money for his own benefit. Other allegations in the complaint were to the effect that the defendant corporation had operated at a loss throughout its entire existence and that the stock which was being acquired by the public at the price of $10 and $20 per share had been purchased by the defendant Forysth at 16 cents and 81 cents per share. A final judgment by consent was obtained against the defendants in this action.

In *S. E. C.* v. *Bertil T. Renhard* [16] the Commission's complaint alleged that the defendant had been offering and selling stock of a certain company through use of misleading statements and omissions relating, among other things, to the solvency and precarious financial condition of the company, the company's inability to pay its rent, and the market price and ownership of the shares being sold by the defendant. By consent of the defendant a decree of permanent injunction was issued enjoining him from further violations of the antifraud provisions of the Securities Act of 1933.

Another case involving fraudulent representations was that of *S. E. C.* v. *John Robert Fish & Fish Carburetor Corp.*[17] There the Commission charged that the defendants made untrue statements of

[15] E. D. Texas No. 566 (March 27, 1956).
[16] W. D. Wash. No. 4075 (January 24, 1956).
[17] S. D. Fla. No. 3400-J (April 2, 1956).

material facts and omitted to state other material facts relating to the value of the defendant corporation's assets, the future value of the company's stock, the profits investors could expect from investments in the defendant corporation's securities, and the stage of development, marketability and performance of the carburetors to be produced by the defendants. A preliminary injunction by consent was entered against the defendants to enjoin further violations of the registration and antifraud provisions of the Securities Act of 1933.

The Commission also filed a complaint against *Mitchell Securities, Inc., and C. Benjamin Mitchell and Russell P. Dotterer*,[18] officers and controlling persons of the corporation a registered broker-dealer, to enjoin them from further violations of the antifraud provisions of the Securities Act. The complaint charged that the defendants had been selling debt securities of the defendant corporation by use of untrue statements and omissions concerning, among other things, the financial results of the operations of the defendant corporation and its inability to make payments of interest on the debt securities being sold. The defendants consented to the entry of a final judgment, and the permanent injunction which had been sought by the Commission was entered by the court.

In the first action of such nature brought by the Commission in the Territory of Alaska, the Commission filed a complaint in the United States District Court for the Territory of Alaska against the *Alaska Chrome Corp. and Corneil A. Sherman*,[19] for an injunction against further violations of the registration provisions of the Securities Act. A permanent injunction was issued by the court after the defendants consented to the entry of a final judgment against them.

In *S. E. C.* v. *Thomas L. North, doing business as North's Newsletter*,[20] the complaint charged that the defendant, an investment adviser, in advance of distribution to clients of reports, solicited, received, and accepted compensation from issuers of and dealers in particular securities to disseminate and distribute copies of the reports to several mailing lists maintained by him in order to attract and spread interest in the securities so described among brokers and dealers, securities traders and among persons with the specific objective of attracting and stimulating trading in such securities, without disclosing the receipt and amount of such compensation. Upon the defendant's consent to the entry of judgment the court issued a decree of permanent injunction against further violations of section 17 (b) of the Securities Act by the defendant.

In addition, injunctions against further violations of the registration provisions of the Securities Act were obtained in many other cases.

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[18] D. Md. No. 8860 (May 8, 1956).
[19] T. Alaska No. A-11,509 (October 14, 1955).
[20] N. D. Calif. No. 35,250 (February 10, 1956).

One of these involved the sale of stock in the United States of *Camoose Mines Limited*, a corporation, organized under the laws of the Province of Ontario, Dominion of Canada. The Commission in its complaint charged the company and certain individuals with violations of the registration provisions of the Securities Act in selling in the United States securities which were not registered as required. The corporation and Philip M. King, Sr., consented to the entry of a permanent injunction.[21] The action was dismissed as to two other individual defendants.

Other actions based upon violations of the registration requirements of the Securities Act included the following:

S. E. C. v. *Pandora Metals, Inc., and Elwood T. Blakesley;*[22] *S. E. C.* v. *Tri-State Metals, Inc., Great Western Metals Corp., William Westra and H. O. Hart;*[23] *S. E. C.* v. *Americol Petroleum, Inc., M. G. M. Petroleum, Inc., Modco, Inc., Monte G. Mason and C. D. Moslander, Jr.;*[24] *S. E. C.* v. *Nev-Tah Oil & Mining Co., Arthur L. Damon, C. M. Dollarhide and Oscar Zapf;*[25] *and S. E. C.* v. *Wyco Development Corp., Daniel J. Leary, Arthur A. Sullivan, and Frank R. Campbell.*[26]

Further proceedings were also had in the case of *S. E. C.* v. *Jess Hickey Oil Corp., Jess Hickey and Loui M. White,*[27] which was referred to in the 21st Annual Report.[28] The individual defendants consented to the entry of a permanent injunction restraining them from further violations of the antifraud and registration provisions of the Act, and the Commission dismissed its complaint against the defendant corporation.

Participation as Amicus Curiae

The Commission participated as *amicus curiae* in *Whittaker* v. *Wall,*[29] a private action under section 12 (l) of the Securities Act of 1933 to recover the consideration paid for securities sold in violation of the registration requirements of that Act. Defendants denied that, under section 22 (a) of the Act, venue properly lay in the district in which the action was brought because no "sale," in the sense of a consummated transaction, had taken place there. Agreeing with the view of the Commission, the Court of Appeals held *inter alia* that the broad definition of "sale" in section 2 (3) of the Act, which included solicitations of an offer to buy such as had taken place in the district in question, applied notwithstanding the fact that plaintiff sought

[21] S. D. N. Y. No. 108-270 (April 17, 1956).
[22] D. Colo. No. 5111 (August 18, 1955).
[23] D. Nev. No. 132 (September 6, 1955).
[24] S. D. Calif. No. 18965 BH (November 4, 1955).
[25] D. Nev. No. 1239 (November 17, 1955).
[26] D. Conn. No. 6122 (April 26, 1956).
[27] N. D. Tex. No. 3058 (May 30, 1955).
[28] Page 20 (July 22, 1955).
[29] 226 F. 2d 868 (C. A. 8, 1955).

recovery of money for a completed transaction. The transaction had taken place before the 1954 amendments to the Act which substituted the phrase "offers or sells" in place of the word "sells" in section 12, and the phrase "offer or sale" in place of the word "sale" in section 22 (a). The court referred to the legislative committee reports cited by the Commission which made it clear that these changes were intended to preserve existing law.

LITIGATION CONCERNING DISCLOSURE OF COMMISSION'S CONFIDENTIAL FILES

During the fiscal year the Court of Appeals for the Sixth Circuit handed down a landmark decision upholding the confidential nature of the Commission's investigation files and internal staff and Commission deliberations, and sustaining the validity of the Commission's rules which prohibit Commission employees from divulging such information without specific Commission authorization. Sustained also was the position of the Commission that its employees who decline to divulge information of this character in obedience to these rules cannot be properly held in contempt of court. *In re Appeals of S. E. C. and William H. Timbers*, its general counsel.[30]

These questions arose in a private lawsuit in a Federal district court in Detroit to which the Commission was at no time a party.[31] Plaintiffs' allegations of corporate mismanagement included, *inter alia*, a charge that the defendant management had violated the Securities Act in failing to register an issue of voting trust certificates designed to prevent the plaintiffs from obtaining control of the company. Early in the litigation consummation of the voting trust was barred by stipulation of the parties and by injunctive orders.

After the institution of the lawsuit, the Commission commenced its own private investigation of the alleged violation. During the trial the plaintiffs' attorney, at the suggestion of the district judge, served a subpena upon the attorney in charge of the Commission's Detroit branch office calling for the production of the Commission's investigation file and for testimony on matters covered by the investigation. In an effort to cooperate and on the representation of plaintiffs' counsel that this would fully satisfy his needs, the Commission released its correspondence with the parties to the litigation and authorized the subpenaed Commission employee to testify on interviews and conversations which he may have had with the parties or their representatives. Thereafter, upon the further request of plaintiffs' counsel, the Commission voluntarily sent to Detroit two staff officials

[30] 226 F. 2d 501.

[31] *Kinsey* v. *Knapp*, E. D. Mich., Civil Action No. 13,179.

from its Washington office for the limited purpose of testifying on other conferences held in Washington with defendants' attorneys. The questioning of Commission employees in Detroit, however, went far beyond these conferences. Information was sought on intra-agency communications, reports, recommendations and internal administrative determinations with respect to the investigation and the action to be taken as a result thereof. Also sought were the identities of, and information obtained from, confidential informants other than the parties to the litigation. The staff witnesses, obeying the Commission's rules and specific Commission instructions, declined to divulge the information. The district judge having indicated that he might hold the staff witnesses in contempt, the Commission's General Counsel, William H. Timbers, went to Detroit to represent them. After several days of examination of Commission employees, the district judge summarily ordered Timbers himself, over his protest, to take the witness stand. When Timbers refused to produce unconditionally a preliminary report of investigation in the Commission's file, he was summarily held in contempt, committed to the custody of the United States Marshal, and sentenced to 60 days' imprisonment unless he sooner purged himself of the alleged contempt. An appeal was filed immediately and a stay of execution obtained from the Court of Appeals.

In reversing and setting aside the contempt order and in directing that Timbers be "completely absolved" from any "alleged contempt," the Court of Appeals also held that the district judge had "overstepped appropriate judicial bounds" in seeking to conduct "a searching inquisition" into the way in which the Commission was carrying out its statutory responsibilities in the particular matter. The appellate court also ruled that the district judge had abused "all justifiable discretion" in his conduct of the case and in his treatment of the Commission's general counsel.

The Department of Justice supported the position of the Commission and presented the matter to the appellate court.[32]

[32] It is of interest to note that in an appeal by the defendant in the private lawsuit, the Court of Appeals for the Sixth Circuit (232 F. 2d 458 (1956)) referred to the facts in the *Timbers* case as "an important background to the question now presented." The court agreed with appellant that the district judge "figuratively speaking, stepped down from the bench to assume the role of advocate for the plaintiff." The judgment was reversed and the case remanded for retrial before another judge.

PART V

ADMINISTRATION OF THE SECURITIES EXCHANGE ACT OF 1934

The Securities Exchange Act of 1934 provides for the registration and regulation of securities exchanges, for the registration of securities listed on such exchanges and establishes, for issuers of securities so registered, financial and other reporting requirements, regulation of proxy solicitations, and requirements with respect to trading by officers, directors and principal security holders. The Exchange Act also provides for the registration and regulation of brokers and dealers doing business in the over-the-counter market in interstate commerce, contains provisions designed to prevent acts and practices deemed to be fraudulent, deceptive or manipulative either on the exchanges or in the over-the-counter market, authorizes the Federal Reserve Board to regulate the use of credit in securities transactions, and contains other related provisions. A stated purpose of these statutory requirements is to insure the maintenance of fair and honest markets in securities transactions.

Regulation under the Exchange Act reflects the distinction between the exchange market and the over-the-counter market. In the exchange market, the exchange itself, which is the focal point of the market, is required to register, and, in order to do so, must demonstrate that it is able to comply with the statute and the rules and regulations thereunder and that its rules are just and adequate to insure fair dealing and to protect investors. Registered exchanges must provide for the discipline of any member for conduct inconsistent with just and equitable principles of trade and for willful violations of the statute and the rules and regulations. Issuers of securities listed on exchanges become subject to provisions of the statute and the rules requiring the filing of reports, including annual financial reports certified by independent certified public accountants, and semiannual reports of sales and earnings, which need not be certified; the requirement that proxies be solicited in accordance with the proxy rules, including the furnishing to stockholders from whom proxies are solicited of information necessary to the intelligent exercise of their voting rights, and the requirement that officers, directors, and 10-percent stockholders report currently changes in their holdings and account to the issuer for profits from short swing trading in their companies' stock.

In the over-the-counter market there is no such organized center of trading as the exchange upon which regulatory activities may focus and, under present law,[1] the issuers of securities traded in that market do not thereby become subject to the regulatory provisions of the statute, except for those subjected to financial reporting requirements pursuant to section 15 (d) of the Exchange Act, by reason of their registration under the Securities Act of securities of a class the aggregate value of which amounts to $2,000,000 or more.

In the over-the-counter market, brokers and dealers using the facilities of interstate commerce or the mails are generally required to register with the Commission and are subject to many statutory provisions and Commission rules designed to prevent fraudulent, deceptive or manipulative practices and to protect their customers. Any person may register as a broker or dealer unless subject to disqualifications specified in section 15 (b) of the Exchange Act. These disqualifications are all based on specified types of prior misconduct on the part of the applicant such as convictions or injunctions involving securities transactions or willful violation of the Federal securities laws.

REGULATION OF EXCHANGES AND EXCHANGE TRADING

Registration and Exemption of Exchanges

At the close of 1956, 15 stock exchanges were registered under the Exchange Act as national securities exchanges:

American Stock Exchange.
Boston Stock Exchange.
Chicago Board of Trade.
Cincinnati Stock Exchange.
Detroit Stock Exchange.
Los Angeles Stock Exchange.
Midwest Stock Exchange.
New Orleans Stock Exchange.
New York Stock Exchange.
Philadelphia-Baltimore Stock Exchange.
Pittsburgh Stock Exchange.
Salt Lake City Stock Exchange.
San Francisco Stock Exchange.
San Francisco Mining Exchange.
Spokane Stock Exchange.

The following four exchanges have been exempted from registration by the Commission pursuant to section 5 of the Exchange Act upon the ground that registration was impracticable and not necessary or appropriate by reason of the limited volume of transactions effected on such exchanges:

Colorado Springs Stock Exchange.
Honolulu Stock Exchange.
Richmond Stock Exchange.
Wheeling Stock Exchange.

These exemptions are, however, subject to conditions which subject such exchanges, their members and the issuers of securities listed thereon to most of the requirements which would be applicable if

[1] S-2054, 84th Cong., 1st sess., and predecessor bills would make certain larger issuers in the over-the-counter market subject to substantially the same requirements as issuers of listed securities. For further discussion of this Bill, see the chapter on Legislative Activities in this report.

they were registered, except for the proxy requirements of section 14 and the provisions of section 16 regarding transactions by officers, directors, and principal stockholders. Since 1935, companies listing additional classes of securities on exempted exchanges must comply with the reporting provisions of sections 12 and 13 of the Exchange Act.

Exchange Rules and Disciplinary Actions

Under section 19 (b) of the Exchange Act the Commission, after appropriate notice and hearing, may impose changes in exchange rules dealing with 12 enumerated topics ranging from the listing or delisting of securities to the hours of trading. The Commission has rarely found it necessary to exercise this power, the only instance to date having occurred in 1940. All exchanges are required to file copies of their rules and amendments thereto with the Commission and any significant changes are in practice discussed with and considered by the staff of the Commission prior to their formal adoption and the Commission may be consulted with respect thereto. Consideration of any problems which may arise from such proposals at this stage has largely obviated, up to now, the necessity for formal proceedings under section 19 (b).

Each national securities exchange reports to the Commission disciplinary action taken against members for violations of the Securities Exchange Act or exchange rules. During the year 6 exchanges reported 37 cases of such disciplinary action. The actions taken included fines in 18 cases, expulsion of 1 individual from exchange membership, suspension of 6 individuals, and censure of individuals and firms.

REGISTRATION OF SECURITIES ON EXCHANGES

It is unlawful for a member of a national securities exchange or a broker or dealer to effect any transaction in a security on such exchange unless the security is registered on that exchange under the Securities Exchange Act or is exempt from such registration. In general the Act exempts from registration obligations issued or guaranteed by a State or the Federal Government or by certain subdivisions or agencies thereof and authorizes the Commission to adopt rules and regulations exempting such other securities as the Commission may find it necessary or appropriate in the public interest or for the protection of investors to exempt. Under this authority the Commission has exempted securities of certain banks, certain securities secured by property or leasehold interests, certain securities of issuers in bankruptcy, receivership or reorganization, certain warrants, and, on a temporary basis, certain securities issued in substitution for or in addition to listed securities.

Section 12 of the Exchange Act provides that an issuer may register a class of securities on an exchange by filing with the Commission and the exchange an application which discloses pertinent information concerning the issuer and its affairs. An application requires the furnishing of information in regard to the issuer's business, capital structure, the terms of its securities, the persons who manage or control its affairs, the remuneration paid to its officers and directors, the allotment of options, bonuses and profit sharing plans, and financial statements certified by independent accountants.

Form 10 is the form used for registration by most commercial and industrial companies. There are specialized forms for certain types of securities such as voting trust certificates, certificates of deposit, securities of foreign governments, etc.

Section 13 requires issuers having securities registered on an exchange to file periodic reports keeping current the information furnished in the application for registration. These periodic reports include annual reports, semiannual reports, and current (monthly) reports. The principal annual report form is Form 10–K which is designed to keep up to date the information furnished on Form 10. Semiannual reports required to be furnished on Form 9–K are devoted chiefly to furnishing mid-year financial data. Current reports on Form 8–K are required to be filed for each month in which any of certain specified events have occurred. A report on this form deals with matters such as changes in control or the registrant, important acquisitions or dispositions of assets, the institution or termination of important legal proceedings, and important changes in the issuer's capital securities or in the amount thereof outstanding.

As of June 30, 1956, a total of 2,253 issuers had 3,686 securities issues listed and registered on national securities exchanges of which 2,659 were stocks and 1,027 were bonds. Of the 2, 253 issuers, 1,275 had 1,513 stocks and 985 bonds listed and registered on the New York Stock Exchange. On a percentage basis, the New York Stock Exchange had 57 percent of both issuers and stocks and 96 percent of the bonds.

During the fiscal year, 109 issuers listed and registered securities for the first time on a national securities exchange and the listing and registration of all securities of 75 issuers was terminated during the year. Of the 109, the securities of 18 were listed and registered on the New York Stock Exchange and of the 75 whose listing and registration was terminated, 30 had had securities listed and registered on the New York Stock Exchange during the year.

The number of applications filed for registration of classes of securities on national securities exchanges during the fiscal year was 232. The following table shows the number of annual, semiannual, and current reports filed by issuers having securities listed and registered

on exchanges. The table also shows the number of annual, semiannual and current reports filed under section 15 (d) of the Securities Exchange Act of 1934 by issuers obligated to file such reports by reason of their undertaking contained in one or more registration statements effective under the Securities Act of 1933. As of the close of the fiscal year there were 1,167 such issuers.

Number of annual and other periodic reports filed by issuers under the Securities Exchange Act of 1934 during the fiscal year ended June 30, 1956

Type of report	Number of reports filed by—		Total reports filed
	Listed issuers filing reports under sec. 13	Over-the-counter issuers filing reports under sec. 15 (d)	
Annual reports on Form 10-K, etc	2,154	1,025	3,179
Semiannual reports on Form 9-K	1,554	512	2,066
Current reports on Form 8-K	3,367	1,066	4,433

MARKET VALUE OF SECURITIES TRADED ON EXCHANGES

The unduplicated total market value on December 31, 1955, of all stocks and bonds admitted to trading on one or more of the 19 stock exchanges in the United States was $344,504,530,000.

Stocks:	*Number of issues*	*Market value Dec. 31, 1955*
New York Stock Exchange	1,508	$207,699,177,000
American Stock Exchange	832	27,146,161,000
All other exchanges exclusively	667	3,986,665,000
Total stocks	3,007	238,832,003,000
Bonds:	*Number of issues*	*Market value Dec. 31, 1955*
New York Stock Exchange	1,024	$104,749,886,000
American Stock Exchange	72	809,360,000
All other exchanges exclusively	26	113,281,000
Total bonds	1,122	105,672,527,000
Total stocks and bonds	4,129	344,504,530,000

The New York Stock Exchange and American Stock Exchange figures are as reported by those exchanges. There is no duplication of issues between them. The figures for all other exchanges are for the net number of issues appearing only on such exchanges, excluding the many issues on them which are also traded on one or the other New York exchange. The number of issues as shown includes a few which are not quoted by reason of suspension or because no transactions have occurred.

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The bonds on the New York Stock Exchange include United States Government and New York State and City issues with an aggregate market value of $80,633,100,000.

The stocks quoted may be divided into categories as follows, with market value as of December 31, 1955, in millions of dollars:

	Preferred stock		Common stock	
	Issues	Values	Issues	Values
Listed on registered exchanges	595	$9,351.3	2,024	$209,149.4
Unlisted on all exchanges	52	599.4	234	19,314.5
Listed on exempted exchanges [a]	12	16.2	59	401.3
Total stocks	658	9,966.8	2,317	228,865.2

[a] Excluding issues also traded on registered exchanges.

The market value of all stocks on the New York Stock Exchange on June 30, 1956, was $218,579,190,000. It is estimated that, as of such date, the market value of all stocks on all exchanges was about $250 billion.

Market values of all stocks admitted to trading on the stock exchanges in billions of dollars at the close of each calendar year since 1948 have been computed as follows:

Dec. 31	New York Stock Exchange	American Stock Exchange	All other exchanges	Total value
1948	$67.0	$11.9	$3.0	$81.9
1949	76.3	12.2	3.1	91.6
1950	93.8	13.9	3.3	111.0
1951	109.5	16.5	3.2	129.2
1952	120.5	16.9	3.1	140.5
1953	117.3	15.3	2.8	135.4
1954	169.1	22.1	3.6	194.8
1955	207.7	27.1	4.0	238.8

New York Stock Exchange reported a previous high market value of $89.7 billion in September 1929 and a low of $15.6 billion in July 1932.

The number of shares of stock admitted to trading on the exchanges was approximately 5,476,000,000 as of December 31, 1955, including 152,300,000 preferred and 5,323,700,000 common. Of the total, approximately 5,000,000,000 shares were listed on registered exchanges, including 142,600,000 preferred and 4,866,000,000 common shares.

Comparative Over-the-Counter Statistics

There are no overall statistics with respect to over-the-counter securities comparable to those available from the exchanges. Certain data can be derived from registrations and other filings with the Commission under the Acts which it administers. For example, 357 issuers with about $13 billion assets registered under the Investment Company Act of 1940 have exclusively over-the-counter mar-

kets for their securities. 971 additional issuers reporting pursuant to section 15 (d) of the Securities Exchange Act of 1934 had stocks exclusively in over-the-counter markets with an aggregate value of over $17 billion as of December 31, 1955.

Recent studies have furnished increasing evidence as to the relative size of the over-the-counter market. With respect to bonds, the over-the-counter market is undoubtedly larger than the exchange market, since the principal market for bonds of the United States Government, States and municipalities and for high-grade corporate bonds is over the counter. With regard to stocks, there are many thousands which are quoted over the counter. The smaller issues among these, however, shade rapidly into substantially or completely privately owned issues with respect to which public bids and offers are rarely available. The studies conducted by the Wharton School of the University of Pennsylvania [2] indicate that during the period covered only 3.2 percent of the aggregate value of transactions over the counter in outstanding common stock was in issues with a market value of less than $1,000,000 and that only 5.1 percent of such value was in issues with 500 or less stockholders.[3] A study by the New York Stock Exchange [4] included stocks owned by at least 300 stockholders and finds 3,723 issues with 2,540,000,000 shares over the counter compared with 2,956 issues with 5,372,000,000 shares on exchanges. It also states that the number of holders of record of these over-the-counter stocks is 8,671,000 against 22,567,000 for the stocks on the exchanges. These figures as to holders of record are duplicated, each holder of record being counted once for each issue he owns. The number of domestic individual holders of 6,679 stocks covered by the study after elimination of duplication is stated to be about 8,630,000. The New York Stock Exchange study in addition concludes that 8 of 10 shareholders own stock listed on that Exchange.

The Wharton School study indicates that the dollar volume of transactions in outstanding stocks over the counter is only a moderate fraction of the total volume of transactions, including those on stock exchanges.[5] One of the larger investment firms, which has well over 100 offices scattered throughout the country, has for years constantly reported that less than one-quarter of its income from the securities business is derived from unlisted securities, retail sales, and underwriting.[6] The report of the Commission with respect to S.2054, referred to under "Legislative Matters" in this Annual

[2] Studies on the Over-the-Counter Market conducted by the Securities Research Unit of the Wharton School, University of Pennsylvania.

[3] Characteristics of Transactions on Over-the-Counter Markets, University of Pennsylvania Press, 1953, tables 3 and 4.

[4] Who Owns American Business? 1956 Census of Shareowners, New York Stock Exchange, 1956.

[5] Activity on Over-the-Counter Markets, University of Pennsylvania Press, 1951. Character and Extent of Over-the Counter Markets, University of Pennsylvania Press 1952.

[6] Merrill Lynch, Pierce, Fenner & Beane, Annual Reports 1944 et seq.

Report, indicates that there were about 1,200 domestic corporations (excluding insurance companies, investment companies, and banks) which appeared to have $2 million or more of assets and 750 or more stockholders and whose securities were traded in the over-the-counter market or admitted to unlisted and unregistered trading on exchanges. About 500 corporations would be added to this group if the test as to the number of stockholders was reduced to 300.

It thus appears from these studies that the exchange market for stocks is larger in terms of the number of shareholders and volume of trading and that, although there are many more stock issues in the over-the-counter market, the bulk of activity and of public stockholder interest is concentrated in larger issues, the number of which probably does not exceed the number of issues on exchanges.

The National Quotation Bureau reports about 20,000 stocks carrying over-the-counter quotations in its October 1956 Summary, which is a cumulative record extending over a period of years. This Bureau's daily quotation sheets carry about 6,000 stocks. About 10 percent of the stocks shown are listed on domestic or Canadian stock exchanges. The Commission estimates that there are about 3,500 domestic issuers with 300 or more stockholders each, whose stocks are traded only over the counter and which had an aggregate market value of around $45 billion on December 31, 1955, these figures being exclusive of issuers registered under the Investment Company Act of 1940.

DELISTING OF SECURITIES FROM EXCHANGES

During the fiscal year ending June 30, 1956, the Commission granted 12 applications filed by exchanges or issuers to remove securities from exchange listing and registration pursuant to section 12 (d) of the Exchange Act. The applications included 6 by exchanges covering 8 stocks and 6 by issuers covering 6 stocks. The applications by exchanges were with respect to 2 stocks where shares and holders were stated to be insufficient for further exchange trading, 5 where a merger, sale of assets or liquidation was involved and 1 where the listing and registration was transferred to another exchange. The applications by issuers were with respect to 4 stocks which remained listed and registered on other exchanges and 2 which were stated to have insufficient shares and holders for further exchange trading. At the close of the fiscal year, 5 applications were pending, of which 3 were made pursuant to a policy adopted by the New York Stock Exchange that it will consider delisting a common stock where the size of a company has been reduced to below $2,000,000 in net tangible assets or aggregate market value of the common stock and the average net earnings after taxes for the last three years is below $200,000.

This policy of the New York Stock Exchange reflects an attempt to make more congruent the standards for original listings and the standards for continuance and maintenance of listing.

Under section 12 (d) of the Exchange Act if the Commission finds that an exchange seeking to remove a security from listing and registration has complied with its own rules the Commission may not deny such an application but is limited to imposing such terms as it may find necessary for the protection of investors. In two recent delisting cases filed by the New York Stock Exchange, Atlas Tack Corp. and Exchange Buffet Corp.,[7] hearings were held to determine whether exchange rules had been complied with and whether any terms should be imposed for the protection of investors. The Commission found that there had been compliance with exchange rules and that the delisting applications should be granted without the imposition of any terms or conditions.

UNLISTED TRADING PRIVILEGES ON EXCHANGES

Volume of Unlisted Trading in Stocks on Exchanges

Under the provisions of section 12 (f) of the Act, the Commission may approve an application by a national securities exchange to admit a security to unlisted trading privileges even though the issuer has not agreed to list the security on the particular exchange. Section 12 (f) provides for three categories of unlisted trading privileges. Clause (1) securities are the residue of those admitted to unlisted trading privileges prior to March 1, 1934. Clause (2) securities are those admitted to unlisted trading privileges following their full listing and registration on another national securities exchange. Clause (3) securities are those admitted to unlisted trading privileges conditioned upon the availability of information substantially equivalent to that filed in the case of listed issues. Securities admitted to unlisted trading privileges consist primarily of issues listed on other exchanges and the residue of issues which were already admitted to unlisted trading privileges when the statute was enacted.

The reported volume of shares traded on an unlisted basis on the stock exchanges during the calendar year 1955 included approximately 37.9 million shares in stocks admitted to unlisted trading only and 33.9 million shares in stocks listed and registered on exchanges other than those where the unlisted trading occurred. These amounts were respectively about 3.1 and 2.8 percent of the total share volume reported on all exchanges. Appendix table 8 shows the distribution of share volumes among the various categories of unlisted trading privileges on exchanges.

[7] Securities Exchange Act Release No. 5359. (September 4, 1956.)

Applications for Unlisted Trading Privileges

Pursuant to applications filed by the exchanges with respect to stocks listed on other exchanges, unlisted trading privileges were extended during the year to June 30, 1956, as follows:

Stock exchange:	*Number of stocks*
Boston	16
Cincinnati	1
Los Angeles	33
Midwest	12
Philadelphia-Baltimore	12
San Francisco	46
Total	120

The Commission's rule X–12F–2 provides that when a security admitted to unlisted trading privileges is changed in certain minor respects it shall be deemed to be the security previously admitted to unlisted trading privileges, and if it is changed in other respects the exchange may file an application requesting the Commission to determine that notwithstanding such change the security is substantially equivalent to the security theretofore admitted to unlisted trading privileges. During the year to June 30, 1956, the Commission granted 2 applications by the American Stock Exchange and 1 by the New Orleans Stock Exchange for a determination that changed securities were the substantial equivalent of the securities previously admitted to unlisted trading privileges. Two bond issues and two stock issues were involved.

BLOCK DISTRIBUTIONS REPORTED BY EXCHANGES

Rule X–10B–2, in substance, prohibits any person participating or interested in the distribution of a security from paying any other person for soliciting or inducing a third person to buy the security on a national securities exchange. This rule is an antimanipulative rule adopted under section 10 (b) of the Act which makes it unlawful for any person to use any manipulative or deceptive device or contrivance in contravention of Commission rules prescribed in the public interest or for the protection of investors. Paragraph (*d*) of the rule provides an exemption from its prohibitions where compensation is paid pursuant to the terms of a plan, filed by a national securities exchange and declared effective by the Commission, authorizing the payment of such compensation in connection with the distribution.

At the present time two types of plans are in effect to permit a block of securities to be distributed through the facilities of a national securities exchange when it has been determined that the regular market on the floor of the exchange cannot absorb the particular block within a reasonable time and at a reasonable price or prices.

These plans have been designated the "Special Offering Plan," essentially a fixed price offering based on the market price, and the "Exchange Distribution Plan," which is a distribution "at the market." Both plans contemplate that orders will be solicited off the floor but executed on the floor. Each of such plans contains certain anti-manipulative controls and requires specified disclosures concerning the distribution to be made to prospective purchasers.

In addition to these two methods of distributing large blocks of securities on national securities exchanges, a third method is commonly employed whereby blocks of listed securities may be distributed to the public over the counter. This method is commonly referred to as a "Secondary Distribution" and such a distribution usually takes place after the close of exchange trading. It is generally the practice of exchanges to require members to obtain the approval of the exchange before participating in such secondary distributions.

More complete details concerning these three types of plans are contained in previous annual reports of this Commission (see e. g., pp. 29–30 of the 20th Annual Report). The following table shows the number and dollar volume of special offerings and exchange distributions reported by the exchanges having such plans in effect, as well as similar figures for secondary distributions which exchanges have approved for member participation and reported to the Commission.

Total sales—12 months ended Dec. 31, 1955 [a]

	Number made	Shares in original offer	Shares sold	Value (thousands of dollars)
Special offerings	9	182,215	161,850	7,223
Exchange distributions	19	306,235	258,348	10,211
Secondary distributions	116	6,698,783	6,756,767	344,871
	6 Months Ended June 30, 1956 [a]			
Special offerings	5	113,980	102,503	2,625
Exchange distributions	10	106,701	93,831	2,161
Secondary distributions	61	5,468,266	5,475,587	293,835

[a] Details of these distributions appear in the Commission's monthly Statistical Bulletin.

MANIPULATION AND STABILIZATION

Manipulation

The Exchange Act describes and prohibits certain forms of manipulative activity in securities registered on a national securities exchange. The prohibited activities include wash sales and matched orders, if effected for the purpose of creating a false or misleading appearance of trading activity or with respect to the market for any such security; a series of transactions in which the price of such security is raised or depressed, or in which the appearance of active trading is created,

for the purpose of inducing purchases or sales by others; circulation by a broker, dealer, seller, or buyer, or by a person who receives consideration from a broker, dealer, seller, or buyer, of information concerning market operations conducted for a rise or a decline; and the making of material false and misleading statements by brokers, dealers, sellers, or buyers, or the omission of material information regarding securities for the purpose of inducing purchases or sales. The Act also empowers the Commission to adopt rules and regulations to define and prohibit the use of these and other forms of manipulative activity in securities whether or not such securities are registered on an exchange or traded over the counter.

The Commission's market surveillance staff in our Division of Trading and Exchanges in Washington and in our New York Regional Office and other field offices observes the ticker-tape quotations of the New York Stock Exchange and the American Stock Exchange securities, the sales and quotation sheets of the various regional exchanges, and the bid and asked prices published by the National Daily Quotation Service for about 6,000 unlisted securities to see if there are any unusual or unexplained price variations or market activity. The financial newsticker, leading newspapers, and various financial publications and statistical services are also closely followed.

When unusual or unexplained market activity in a security is observed, all known information regarding the security is evaluated and a decision made as to the necessity for an investigation. Most investigations are not made public so that no unfair reflection will be cast on any persons or securities and the trading markets will not be upset. These investigations, which are conducted by the Commission's regional offices, take two forms. A preliminary investigation or "quiz" is designed rapidly to discover evidence of unlawful activity. If no violations are found, the preliminary investigation is closed. If it appears that more intensive investigation is necessary, a formal order of investigation, which carries with it the right to issue subpenas and to take testimony under oath, is issued by the Commission. If violations are discovered, the Commission may suspend or revoke the registration of a broker-dealer or it may expel him from the National Association of Securities Dealers. Similarly, a member of a national securities exchange may be suspended or expelled from the exchange. The Commission may also seek an injunction against any person violating the Act and it may recommend to the Department of Justice that any person violating the Act be criminally prosecuted. In some cases, where State action seems likely to bring quick results in preventing fraud or where Federal jurisdiction may be doubtful, the information obtained may be referred to State agencies for State injunction or criminal prosecution.

The following table shows the number of quizzes and formal investigations initiated in 1956, the number closed or completed during the same period, and the number pending at the ending of the fiscal year:

Trading investigations

	Quizzes	Formal investigations
Pending June 30, 1955	107	9
Initiated during fiscal year	69	1
Total	176	10
Closed or completed during fiscal year	74	3
Changed to formal during fiscal year	1	
Adjustment *	1	
Total	76	3
Pending at end of fiscal year	100	7

* Two quizzes were combined as 1 case during year.

When securities are to be offered to the public their markets are watched very closely to make sure that the price is not artificially raised prior to or during the distribution. Eight hundred and thirty-three registered offerings having a dollar value of $13,095,000,000 and 1,478 offerings exempt under section 3 (b) of the Securities Act, having a value of about $277,000,000 were so observed during the fiscal year. About 300 other small offerings, such as secondary distributions and distributions of securities under special plans filed by the exchanges, were also checked and many were kept under special observation for considerable lengths of time.

Stabilization involves open-market purchases of securities to prevent or retard a decline in the market price in order to facilitate a distribution. It is permitted by the Exchange Act subject to the restrictions provided by the Commission's rules. These rules are designed to confine stabilizing activity to that necessary for purposes of the distribution, to require proper disclosure and to prevent unlawful manipulation.

During 1956 stabilizing was effected in connection with stock offerings aggregating 32,174,925 shares having an aggregate public offering price of $1,124,596,781. Bond issues having a total offering price of $208,222,619 were also stabilized. To accomplish this, 678,122 shares of stock were purchased in stabilizing transactions at a cost of $18,488,813 and bonds costing $4,881,171 were also bought. In connection with these stabilizing transactions more than 8,900 stabilizing reports which show purchases and sales of securities effected by persons conducting the distribution were received and examined during the fiscal year.

In order more closely to police stabilizing activities, the Commission revised the rule requiring the filing of stabilizing reports effective

July 1, 1956.[1] Hitherto such reports were required only when registered offerings were stabilized. The present rule requires reports not only on registered offerings, but also offerings exempt from registration under section 3 (b) of the Securities Act and any other offering having a value of at least $300,000. While these revisions were being made, the stabilizing report form was simplified, also effective July 1, 1956.[2] Hereafter only the managing underwriter must file daily reports. Other members of the syndicate may file a summary report after stabilizing is discontinued. In addition, many transactions at the same price level may be "bunched" and only certain key transactions need be timed. The changes will continue to give the investor adequate protection, but they will greatly relieve the reporting burden on the securities industry. It is felt that in spite of the greater area to be covered, the number of reports necessary to be filed with the Commission will be reduced by about a half.

INSIDERS' SECURITY TRANSACTIONS AND HOLDINGS

Every person who owns more than 10 percent of any class of equity security which is listed on a national securities exchange, or who is an officer or director of the issuer of any such security, is required by section 16 (a) of the Securities Exchange Act of 1934 to file with the Commission and the exchange a report disclosing his ownership of each class of the issuer's equity securities and an additional report for each month in which any subsequent change in his ownership occurs, setting forth information as to the transactions involved. Officers and directors of registered public utility holding companies and officers, directors and 10 percent stockholders of registered closed-end investment companies are subject to similar requirements under section 17 (a) of the Public Utility Holding Company Act and section 30 (f) of the Investment Company Act.

These reports are available for public inspection at the Commission's office and at the exchanges. In order to make the information contained therein more readily available to interested persons throughout the country it is summarized and published in the Commission's monthly "Official Summary of Security Transactions and Holdings," which is distributed on a subscription basis by the Government Printing Office. The widespread public interest in transactions reported by insiders is evidenced by the fact that the circulation of this publication exceeds 4,000 copies a month.

The number of reports filed continues an upward trend, 32,001 during the 1956 fiscal year, as compared with 28,975 during the 1955 fiscal year, 23,199 during the 1954 fiscal year, and 22,333 during the 1953 fiscal year. The following tabulation shows details concerning the reports filed during the 1956 fiscal year.

[1] Securities Exchange Act release No. 5300.
[2] *Supra.*

Number of ownership reports of officers, directors, principal security holders, and certain other affiliated persons filed during the fiscal year ended June 30, 1956

Description of report	Original reports	Amended reports	Total
Securities Exchange Act of 1934: [1]			
Form 4	25,460	1,667	27,127
Form 5	945	2	947
Form 6	2,960	9	2,929
Total	29,325	1,678	31,003
Public Utility Holding Company Act of 1935: [2]			
Form U-17-1	27		27
Form U-17-2	292	3	295
Total	319	3	322
Investment Company Act of 1940: [3]			
Form N-30F-1	260		260
Form N-30F-2	414	2	416
Total	674	2	676
Grand total	30,318	1,683	32,001

[1] Form 4 is used to report changes in ownership; Form 5 to report ownership at the time an equity security of an issuer is 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 the issuer.
[2] Form U-17-1 is used for initial reports and Form U-17-2 for reports of changes of ownership.
[3] Form N-30F-1 is used for initial reports and Form N-30F-2 for reports of changes of ownership.

Recovery of Short Swing Trading Profits by or on Behalf of Issuer

For the purpose of preventing the unfair use of information which may have been obtained by an officer, director or 10-percent stockholder by reason of his relationship to his company, sections 16 (b) of the Securities Exchange Act, 17 (b) of the Public Utility Holding Company Act, and 30 (f) of the Investment Company Act provide for the recovery by or on behalf of the issuer of any profit realized by the officer, director or 10-percent stockholders from certain purchases and sales, or sales and purchases, of securities of the company within any period of less than 6 months. The Commission is not charged with the enforcement of the civil remedies created by these provisions, which are matters for determination by the courts in actions brought by the proper parties.

REGULATION OF PROXIES

Scope of Proxy Regulation

The scope and character of the Commission's regulation of the solicitation of proxies—written authority from a shareholder to another to act in the shareholder's place—is more fully described in this report under "Revision of Forms, Rules, and Regulations" at page 33.

Under sections 14 (a) of the Securities Exchange Act, 12 (e) of the Public Utility Holding Company Act of 1935, and 20 (a) of the Investment Company Act of 1940 the Commission has adopted Regulation X-14 requiring the disclosure of pertinent information in connection with the solicitation of proxies, consents and authorizations in respect of securities of companies subject to those statutes. The

regulation also provides means whereby any security holders so desiring may communicate with other security holders when management is soliciting proxies, either by arranging for the independent distribution of their own proxy statements or by including their proposals in the proxy statements sent out by management.

Copies of proposed proxy material must be filed with the Commission in preliminary form prior to the date of the proposed solicitation. Where preliminary material fails to meet the prescribed disclosure standards, the management or other group responsible for its preparation is notified informally and given an opportunity to avoid such defects in the preparation of the proxy material in the definitive form in which it may be furnished to stockholders.

Statistics Relating to Proxy Statements

During the 1956 fiscal year 2,016 solicitations were made pursuant to regulation X–14, of which 1,995 were conducted by management and 21 by nonmanagement groups. The 1,995 solicitations by management related to 1,711 companies, more than one solicitation having been made with respect to some of the companies.

The purpose for which proxies are most often sought is the voting for nominees for directors. In fiscal 1956 this was an item of business in 1,705 stockholders' meetings, while at 288 meetings the election of directors was not involved. The remaining 23 solicitations, which did not involve any meeting of stockholders, sought consents or authorizations from stockholders with respect to certain proposals other than the election of directors.

In addition to the election of directors, stockholders' decisions were sought in the 1956 fiscal year with respect to the following types of matters:

Nature of business other than election of directors	*Number of proxy statements*
Mergers, consolidations, acquisition of businesses, purchases and sales of property, and dissolution of companies	147
Issuance of new securities, modifications of existing securities, and recapitalization plans other than mergers and consolidations	459
Employee pension and retirement plans	98
Stock option plans (including amendments to existing plans)	246
Bonus and profit-sharing plans	45
Approval of selection by management of independent auditors	496
Amendments to charters and bylaws and other miscellaneous matters	361

Stockholders' Proposals

One of the most important provisions of the proxy rules is the principle adopted by the Commission as early as 1939 and codified in the rules in 1942 (now rule X–14A–8) by which a qualified security holder may require the management of a company to include in the management's proxy soliciting material a proposal which he desires

to submit to a vote of his fellow security holders. As revised over the years, the rule provides that, if the management opposes the proposal, it must, at the request of the security holder, include in the proxy statement the name and address of the security holder and a statement of the security holder in not more than 100 words in support of the proposal. The rule also requires that the proposal be submitted to the management a reasonable time before the solicitation is made and that it be a proper subject for action by the security holders under the law of the State where the company is incorporated. It cannot be submitted primarily for the purpose of enforcing a personal claim or redressing a personal grievance against the company or its management or for the purpose of promoting general economic, political, racial, religious, social, or similar causes. In conformance with State laws, the proposal may not be a recommendation or request that management act with respect to a matter relating to the conduct of the ordinary business operations of the company. The rule also contains provisions to limit the introduction year after year of proposals which receive little or no support from other security holders by providing that certain percentages of the vote must be obtained to require the management to include the proposal again in its proxy material within certain periods of time.

During the 1956 fiscal year, 19 stockholders of 65 companies submitted a total of 102 proposals to a vote of security holders in the management's proxy soliciting material under rule X–14A–8.

Typical of matters thus submitted to a vote of all security holders on the initiative of individual stockholders were such proposals as the following: to restrict the sale of stock to employees; to require participants in employee stock purchase plans to hold their stock for three years; to provide for cumulative voting in the election of directors; to require the election of all directors; to require the election of all directors annually; to place a ceiling of $25,000 on pensions to employees; to require ownership of a certain number of shares of a company as a qualification for a director; to increase the number of members on the board of directors of a company; to require that auditors be elected by the stockholders and be present at the following annual meeting of the company for questioning by shareholders; to furnish all stockholders with a postmeeting report; to resubmit incentive compensation plans to stockholders' approval every 5 years and to make no payment under the plans in any year that common dividends are passed; and to terminate a company's stock option plan.

The management of 20 companies omitted from their proxy statements, under the conditions specified in rule X–14A–8, a total of 41 additional stockholder proposals tendered by 26 individual stockholders. The reasons why these 41 stockholder proposals were omitted

from management's proxy statements are enumerated below with a parenthetical indication of the number of times each reason was operative; the proposal was withdrawn by the stockholder concerned (6); did not involve a proper subject matter for shareholders' action under State law (16); was not submitted to the management within the time prescribed by the proxy rules (6); proposal gained insufficient votes at previous meeting (2); involved the conduct of the ordinary business operations of the company (6); involved a personal grievance (4); and did not really constitute a proposal within the meaning of the rule (1).

Ratio of Soliciting to Nonsoliciting Companies

Generally speaking, section 14 (a) and the Commission's proxy rules are operative only if a solicitation is in fact made. The statute and the rules do not in terms compel corporations to solicit proxies if they do not wish to do so. During the last fiscal year the Commission was requested by a subcommittee of the Senate Banking and Currency Committee to make a report as to whether or not solicitations of proxies in respect of the election of directors of corporations should be made mandatory by statute. The Commission has not formulated its views for presentation to the Congress. It expects, however, to do so before the next session of the Congress. To aid it in making its report the Commission, among other things, has conducted a special study to ascertain the proportion of listed companies which solicit proxies from their security holders. Out of 2,253 companies with securities listed and registered on a national securities exchange as of June 30, 1956, 120 were foreign issuers exempt from regulation X-14 under rule X-3A12-3; and 128 were domestic issuers (including for classification purposes Canadian, Cuban, and Philippine issuers) whose listed securities were nonvoting. Of the remainder, 519 domestic companies did not solicit proxies for the election of directors during the 1956 fiscal year, but these included 42 companies which initially registered voting securities after their 1956 annual meetings had been held, thus, 477 companies that did not solicit proxies for the election of directors although such companies had voting securities listed and registered at the time of the annual meeting. The remaining 1,486 (76 percent) domestic companies did solicit proxies for the election of directors.

Proxy Contests

As more fully described under the heading "Revision of Forms, Rules and Regulations" in this report at page 33, the Commission has been concerned in recent years with the efficiency of its proxy rules as applied to proxy contests—struggles between management and opposition groups for control of a company by means of obtaining sufficient proxies from shareholders to elect at least a majority of the

directors. As indicated in the discussion at page 33 of this report, during the last fiscal year the Commission extensively revised its proxy rules in order to obtain important detailed disclosures for shareholders in connection with such contests. A feature of the revised rules is a requirement that each participant in the proxy contest, existing directors as well as the nominees for directors and the promoters of opposition groups, must file with the Commission a detailed statement (schedule B of the revised proxy rules) covering his background, business experience, criminal record, if any, participation in other proxy contests of any corporation, share ownership, and the sources of funds used to purchase such shares. In addition his proposed position with the company and any other transactions he contemplated in which the company or its subsidiaries will be involved must be described. All of this information must be made available to shareholders in the course of the contest.

In 1956 there were 17 companies involved in proxy contests, of which 8 were for control and 9 were for representation on the board of directors. In these contests 218 individual participants filed the detailed statements required by schedule 14B. Of the 8 contests for control, 5 were won by management, 2 were won by the opposition, and 1 was pending in the courts; while of the 9 proxy contests in which opposition groups were seeking representation on the board, 3 were won by management, 4 were won by the opposition, and 2 were settled through negotiation whereby opposition was given a place on management's slate and no opposition solicitation was made.

REGULATION OF BROKER-DEALERS AND OVER-THE-COUNTER MARKETS

Registration

Section 15 (a) of the Securities Exchange Act of 1934 requires registration of brokers and dealers using the mails or instrumentalities of interstate commerce to effect transactions in securities on the over-the-counter market, except those brokers and dealers whose business is exclusively intrastate or exclusively in exempt securities. The tabulations below reflect certain statistical data with respect to registration of brokers and dealers and applications for such registration during the fiscal year 1956.

Effective registrations at close of preceding fiscal year	4,334
Applications pending at close of preceding fiscal year	49
Applications filed during fiscal year	764
Total	5,147

Applications denied	4
Applications withdrawn	16
Applications cancelled	0
Registrations withdrawn	428
Registrations cancelled	40
Registrations revoked	15
Registrations effective at end of year	4, 591
Applications pending at end of year	53
Total	5, 147

Administrative Proceedings

Under section 15 (b) of the Exchange Act the Commission may deny registration to a broker-dealer or revoke such registration only if it finds such action to be in the public interest and that the applicant or broker-dealer or any partner, officer, director, or other person directly or indirectly controlling or controlled by such broker-dealer, has been guilty of one or more of 4 specified types of misconduct. In general, such types of misconduct comprise the willful making of false or misleading statements in the application and related proceedings, conviction within 10 years of a crime involving the purchase or sale of securities or the conduct of the business of a broker-dealer, injunction by a court from engaging in any practice in connection with the purchase or sale of securities, or willful violation of the Federal securities laws or the Commission's regulations thereunder. The Commission may not deny to any person the right to register and engage in business as a broker-dealer in interstate commerce, absent misconduct of the specified types enumerated in the Act, and irrespective of whether such individual has had any experience in the brokerage business.

Statistics of administrative proceedings to deny and revoke registration, to suspend and expel from membership in a national securities association or an exchange

Proceedings pending at start of fiscal year to:	
Revoke registration	22
Revoke registration and suspend or expel from NASD or exchanges	10
Deny registration to applicants	3
Cancel registration	2
Total proceedings pending	37
Proceedings instituted during fiscal year to:	
Revoke registration	24
Revoke registration and suspend or expel from NASD or exchanges	13
Deny registration to applicants	7
Cancel registration	1
Total proceedings instituted	45
Total proceedings current during fiscal year	82

Disposition of proceedings

Proceedings to revoke registration:	
Dismissed on withdrawal of registration	9
Dismissed—registration permitted to continue in effect	4
Dismissed on cancellation of registration	1
Registration revoked	10
Total	24
Proceedings to revoke registration and suspend or expel from NASD or exchanges:	
Registration revoked and firm expelled from NASD	5
Dismissed on withdrawal of registration	1
Dismissed—registration and membership permitted to continue in effect	5
Suspended for a period of time from NASD	1
Total	12
Proceedings to deny registration to applicant:	
Registration denied	4
Dismissed on withdrawal of application	2
Total	6
Proceedings to cancel registration:	
Dismissed upon withdrawal of registration	2
Registration canceled	1
Total	3
Total proceedings disposed of	45
Proceedings pending at end of fiscal year to:	
Revoke registration	22
Revoke registration and suspend or expel from NASD or exchanges	11
Deny registration to applicants	4
Cancel registration	0
Total proceedings pending at end of fiscal year	37
Total proceedings accounted for	82

Proceedings in which action was taken during the year include the following:

In a proceeding against *Robert Dermot French, doing business as French & Co.*[8] the Commission denied an application for registration as a broker-dealer after finding that the applicant had effected transactions as a broker and dealer without registration, had sold securities which were not registered under the Securities Act of 1933, and had been enjoined from sales of unregistered securities. In addition, the

[8] Securities Exchange Act Release No. 5267 (December 28, 1955).

Commission found that the applicant had filed a false and misleading financial statement in support of his application for registration.

A proceeding against *A. M. Kidder & Co.*[9] was based upon violations of the registration provisions of the Securities Act in connection with the sales of the stock of a Canadian corporation. A. M. Kidder & Co. made offers of rescission to all persons and firms to whom it or one of its partners in charge of its branch offices had sold shares of the Canadian corporation's stock. The Commission decided that it was not in the public interest to impose any penalty against the registrant, although it did find that a violation of the registration provisions of the Securities Act had been committed both by the firm and by one of its partners. A. M. Kidder & Co. as a result of its offer of rescission repurchased a total of 206,500 shares at a cost of approximately $216,500.

In another proceeding which was instituted against *Haley & Company, Inc.*[10] the Commission denied the application for registration, finding that Haley, its president, sold the applicant's preferred stock in violation of the antifraud provisions of the Securities Act of 1933 by representing to purchasers that they would receive dividends of 8 percent, and that Haley had invested money in the applicant's stock while failing to disclose that the applicant corporation was operating at a deficit, and dividends were paid out of capital, and that Haley did not in fact contribute cash to the applicant's capital; that Haley induced certain of his customers who had purchased the applicant's preferred stock to lend him money and to accept his notes, without disclosing that he was financially unable to repay the notes, as well as the fact that he intended to have the applicant use the money to repurchase its preferred stock from certain other customers; and that Haley also sold to four customers, all of whom were widows and inexperienced in securities matters, stock in a company that did no business and had no income.

In denial proceedings instituted against *Professional Investors, Inc.*[11] the Commission found that the applicant had delivered unregistered shares of its stock in violation of the Securities Act of 1933, had violated the antifraud provisions of that Act by publishing and circulating a magazine article describing certain securities without disclosing the compensation paid for such article, and had effected securities transactions as a broker and dealer in the over-the-counter market without being registered as such. The Commission denied the application for registration.

The registration of *Gabriel Sanders, doing business as Gabriel Securities,*[12] was revoked on charges that the registrant had appropriated

[9] Securities Exchange Act Release No. 5289 (March 21, 1956).
[10] Securities Exchange Act Release No. 5304 (April 25, 1956).
[11] Securities Exchange Act Release No. 5315 (May 25, 1956).
[12] Securities Exchange Act Release No. 5310 (May 11, 1956).

money and securities to his own use from customers who desired to purchase other securities. The record of proceedings disclosed that the registrant obtained from 35 customers a total of approximately $27,000 for the purchase by it of securities and that the registrant failed to deliver such securities and appropriated the money for his own use. In one instance a customer turned over to the registrant almost $6,000 in money and securities to pay for other securities which were to be purchased by the registrant. The registrant not only failed to deliver such securities but appropriated the money and the proceeds from the sale of the customer's securities.

The Commission also revoked the registration of four broker-dealers after proceedings were instituted on findings that the registrants had been permanently enjoined from engaging in or continuing certain conduct and practices in connection with the purchase and sale of securities.

The registration of *East Coast Securities Corp.*[13] was revoked after consideration was given to a record which disclosed that the registrant had been permanently enjoined by the State of New York in an action based on allegations that the registrant falsely represented in connection with the offering of an oil company's securities that the oil company had struck a producing gas well, was drilling a second well, and that most of the stock had been sold with very little remaining for the public. There were also allegations that the registrant falsely represented that members of the stock exchange were interested in acquiring all available shares of that oil company, that the stock would be listed on one of the exchanges and would double in price.

The revocation of *Kaye Real & Company, Inc.*[14] was based upon two injunctions against the firm, one obtained by State authorities in a New York State court and the other obtained by the Commission in the United States District Court for the Southern District of New York. The State court action charged insolvency, failure to comply with the Commission's net capital rule, and shortage in securities and money due or belonging to customers. The Commission's injunctive action was based upon violations of the registration and fraud provisions of the Securities Act.[15] After the entry of the revocation order, the registrant appealed to the Circuit Court of Appeals, which appeal was later dismissed by the court.[16]

The injunction against *Atlas Securities Corp.*[17] which the Commission considered in its revocation proceedings against that registrant was issued by a State court of New York on a complaint filed

[13] Securities Exchange Act Release No. 5198 (July 18, 1955).
[14] Securities Exchange Act Release No. 5226 (September 9, 1955).
[15] 122 Fed. Supp. 639 (D. C. S. D. N. Y.) (July 1954).
[16] C. A. 3. No. 11,762 (May 18, 1956).
[17] Securities Exchange Act Release No. 5247 (October 27, 1955).

by the State alleging that the registrant engaged in business while insolvent.

Revocation proceedings against *Kelleher Securities Corp.*[18] involved, among other things, an injunction issued upon the Commission's complaint. The complaint alleged among other things that the registrant had made false and misleading statements in the sale of certain securities concerning the identity and ownership of such securities, the use of the proceeds derived from the sale of such securities, the financial position of the issuer of the securities, and the advantages to be gained by canceling purchases of one security which the registrant was unable to deliver and investing the proceeds in another security. Further violations were alleged in the complaint regarding the sale by the registrant of certain securities at a price bearing no reasonable relation to prevailing market prices without disclosure of each market prices.

The registration of *R. H. Johnson & Co.*,[19] a partnership, was revoked upon a finding by the Commission, following a lengthy hearing, that there had been violations of the fraud provisions of the Securities Act and the Securities Exchange Act. The order also revoked the registration of R. H. Johnson, Inc., since R. H. Johnson was in control of both registrants. The Commission found that Johnson and five employees were each the cause of the order of revocation.[20] The firm, formed in 1935, had its principal office in New York with 2 branch offices in Boston and Philadelphia, and about 12 sales offices. At times it had over 100 salesmen servicing several thousand accounts.

The customers in whose accounts the transactions forming the basis for the proceedings took place were uninformed or inexperienced in securities matters, and generally relied upon the salesman's advice with respect to their transactions. The Commission found that the salesmen used this relationship of trust and confidence to cause an excessive number of transactions in the accounts, which frequently involved multiple trading in the same security and switches from one security to another, evidently motivated by a desire to produce income for themselves, as well as the registrant, without regard to the customers' best interests and in violation of a fiduciary duty owed to the customers. The Commission also found that despite notice of the fraudulent activities disclosed by the record of the hearing, the registrant failed adequately to supervise the salesmen, thereby permitting the practices to continue over a long period of time. The Commission's decision was later affirmed by the Court of Appeals for the District of Columbia, and a petition for writ of certiorari to the Supreme Court was denied.[21]

[18] Securities Exchange Act Release No. 5268 (December 27, 1955).
[19] U. S. D. C. of D. C. No. 2017-55 (Final Judgment May 20, 1955).
[20] Securities Exchange Act Release No. 5255 (November 16, 1955).
[21] Citations affirmed 231 F. 2 (d) 523 (April 5, 1956); cert. denied, S. C. Docket 174 (October 1956).

Financial Statements

Every registered broker-dealer is required by rule X–17A–5 to file with the Commission during each calendar year a report of financial condition. During the fiscal year 3,968 such reports were filed. These reports are analyzed by the staff to make certain that the registrant is in compliance with the net capital requirements prescribed by rule X–15C3–1. If a registrant is found not to be in compliance with the rule, and it is consistent with the public interest to permit him to effect compliance, a limited time is given him for that purpose. Failure to come into full compliance promptly results in appropriate action by the Commission. Revocation proceedings are also brought against any registrant who fails to make the necessary filing.

Net Capital Rule

As indicated in the 21st Annual Report, page 43, the Commission during the last fiscal year revised its net capital rule (rule X–15C3–1) to increase the safeguards thereby afforded to customers. No broker or dealer subject to this rule may permit his "aggregate indebtedness" to exceed 20 times his "net capital" as those terms are defined in the rule. These definitions were revised, effective May 20, 1955, to increase from 10 to 30 percent the deduction from market value of common stock forming a part of the capital of a broker or dealer, which is required to be made in computing his net capital. The revisions made at that time also included modified deductions from market values of bonds and preferred stocks in computing net capital and revisions with respect to the treatment of certain items in computing aggregate indebtedness. During the current fiscal year the rule was further revised to limit the exemption available thereunder. This revision eliminated the exemption afforded to all brokers and dealers who did not extend credit to customers or carry money or securities for the account of customers, and substituted an exemption available only to brokers whose activities are limited to soliciting subscriptions on behalf of issuers and who do not hold funds or securities in connection therewith. The Commission also reviewed the exemption afforded to members of certain stock exchanges whose rules impose capital requirements more comprehensive than those of the Commission's rule in order to make certain that all such exchanges had adequate inspection procedures for the enforcement of their rules. As a result of this review the Boston Stock Exchange, the Los Angeles Stock Exchange, the Pittsburgh Stock Exchange, and the Salt Lake Stock Exchange strengthened their enforcement procedures with respect to capital requirements for their members.

The Commission takes prompt action whenever it appears that any broker or dealer is not in compliance with this rule. Unless deficiencies are promptly corrected, injunctive action may be taken or

revocation proceedings commenced. During this fiscal year violations of this rule were alleged in 6 injunctive actions, 3 proceedings to revoke broker-dealer registrations, and 1 proceeding to deny such registration. The injunctive actions arising under this rule are referred to in this report under the heading, "Litigation Under the Securities Exchange Act of 1934."

Broker-Dealer Inspections

During 1956 the Commission placed increased emphasis upon its inspection program for registered brokers and dealers. Regular and periodic inspection of broker-dealers are a vital part of the Commission's activities for the protection of investors. The purpose of these inspections is to obtain compliance with the securities acts and the rules and regulations promulgated by the Commission and to detect and prevent violations.

An inspection ordinarily includes, among other items, (1) a determination of the financial condition of the broker-dealer; (2) review of pricing practices; (3) review of the treatment of customers' funds and securities; and (4) a determination whether adequate disclosures are made to customers. The inspection process also determines whether the required books and records are adequate and currently maintained, and whether broker-dealers are conforming with the margin and other requirements of regulation T, as prescribed by the Federal Reserve Board. They also check for "churning," "switching," sale of unregistered securities, use of improper sales literature or sales methods, and other fraudulent practices. These inspections frequently discover situations which, if not corrected, would result in losses to customers.

The following table shows the various types of violations disclosed as a result of the inspection program:

Type	*Fiscal 1956*
Financial difficulties	79
Hypothecation rules	25
Unreasonable prices for securities purchases	189
Regulation T of the Federal Reserve Board	141
"Secret Profits"	7
Confirmation and bookkeeping rules	545
Miscellaneous	90
Total indicated violations	1,076
Total number of inspections	952

The number of indicated violations found by inspections increased 31 percent in 1956 over 1955. This reflects existing conditions in the financial markets described in this report under "Enforcement Program." In particular, these conditions have brought a substantial number of new broker-dealers into the business. Many of these are

inexperienced and unfamiliar both with the obligations owed to their customers and with the rules of the Commission and established practices for the conduct of the business. A more serious problem is created by those who enter the business under present conditions in the hope of making a quick profit, rather than the establishment of a sound business based on responsible and ethical dealing. A substantial number of new brokers and dealers either lacked adequate financial resources or speculated unwisely, thus impairing their financial positions and threatening the safety of customers' funds or securities entrusted to them.

During the fiscal year the Commission filed 10 complaints in the Federal district courts based upon violations discovered in the course of broker-dealer inspections and commenced 7 proceedings to revoke the registration of brokers and dealers based upon violations so discovered. In the majority of instances the violations found are not of a character requiring formal enforcement action but are inadvertent or the result of a misunderstanding. In every such instance the broker-dealer is informed of the violations and required to report the steps he has taken to prevent a repetition. After an appropriate lapse of time it is the policy of the Commission again to inspect such brokers to determine whether they have in fact taken adequate measures to prevent repetition of the violations.

Several times during the course of the year the Commission dispatched so-called "task forces" of broker-dealer inspectors to particular areas where the public interest required a more intensive program than could be conducted with the manpower available in the particular area. During the fiscal year a task force of 6 inspectors and 2 attorneys conducted such inspections in the Denver Region, a task force of 2 inspectors visited the Hawaiian Islands, a task force of 2 inspectors conducted inspections in the Fort Worth Region, and at the end of the fiscal year 2-man task forces were at work in the Atlanta Region and in the State of Pennsylvania. The use of such task forces was necessary in order to cope with special problems existing in particular areas, but it is not a permanent solution of the problem since it tends to disrupt the inspection program in the areas from which personnel are dispatched.

During 1956, 952 inspections were made, which is the largest number since 1941. During the year, however, the number of registered broker-dealers increased from 4,334 to 4,591 and the number is continuing to increase, amounting to 4,652 at October 1, 1956. In response to these conditions the Commission proposes a substantial increase in the number of broker-dealer inspections to be made in 1957 and in future fiscal years.

In addition to the Commission's inspection program, the National Association of Securities Dealers, Inc., and the principal stock ex-

changes also conduct inspections of their members and some of the States also have inspection programs. Each inspecting agency conducts inspections in accordance with its own procedures and with particular reference to its own regulations and jurisdiction. Consequently, inspections by other agencies are not an adequate substitute for Commission inspections, since the inspector will not be primarily concerned with the detection and prevention of violations of the Federal securities laws and the Commission's regulations thereunder. The Commission and certain other inspecting agencies have, however, embarked upon a program of coordinating inspection activity for the purpose of avoiding unnecessary duplication of inspections and to obtain the widest possible coverage of brokers and dealers. This seems appropriate in view of the limited number of inspections which it is possible for the Commission to make. The program does not prevent the Commission from inspecting any person recently inspected by another agency, and this is done whenever reason therefor exists, but it has been necessary for the Commission to rely to a considerable degree upon the inspection programs of the major exchanges, such as the New York Stock Exchange.

Agencies now participating in the coordinated program include the New York Stock Exchange, the American Stock Exchange, the Midwest Stock Exchange, the Philadelphia-Baltimore Stock Exchange, the San Francisco Stock Exchange, and the National Association of Securities Dealers. During the fiscal year, and following discussions with the Commission's staff, the Boston and Los Angeles Stock Exchanges established regular field inspection programs and became participants in the program. During calendar 1955, an aggregate of 2,718 inspections covering 2,228 different firms were reported to have been made by the participating agencies.

SUPERVISION OF ACTIVITIES OF NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

Section 15A of the Securities Exchange Act of 1934 ("the Maloney Act") provides for the registration with the Commission of national securities associations. The statute prescribes standards for such associations. Their rules must be designed to promote just and equitable principles of trade, to prevent fraudulent and manipulative acts and practices and to perfect the mechanism of a free and open market and other requirements must be met. The Commission has jurisdiction to review disciplinary action by such associations and to consider all changes in their rules. The National Association of Securities Dealers, Inc. (NASD) is the only such association registered under the Act. That Association serves as a medium for self-regulation by over-the-counter brokers and dealers. Membership in this Association is important to brokers and dealers engaged in over-the-counter

activities since, as contemplated by section 15A (i) of the Act, the rules of the Association prevent members from dealing with nonmembers except upon the same terms and at the same prices as are accorded the general public. Accordingly, members may not accord the customary dealer's commissions, discounts, preferential rates, concessions, or allowances to nonmembers.

Membership in the National Association of Securities Dealers, Inc., at June 30, 1956, was 3,634. This represented an increase of 284 during the year as a result of 440 admissions to and 156 terminations of membership. At the same time there were registered with the National Association of Securities Dealers, Inc., as registered representatives, 48,566 individuals, including, generally, all partners, officers, salesmen, traders, and other persons employed by, or associated with, members in capacities which involve their doing business directly with the public. The number of registered representatives increased by 7,500 during the fiscal year as a result of 12,317 initial registrations, 3,353 re-registrations and 8,170 terminations of registrations.

Disciplinary Actions

During the fiscal year the Commission received from the NASD reports of final action in 102 disciplinary proceedings in which formal complaints had been filed against members alleging violations of specified provisions of the Association's Rules of Fair Practice. Each of these decisions is considered by the staff, and referred to the appropriate regional offices with comments as to whether further independent attention on the part of the Commission appears warranted. In most cases the staff also reviews the complete NASD file in such matters to determine whether the evidence there available indicates violations of the Federal securities laws which require enforcement action by the Commission. In 48 cases complaints were directed solely against member firms, while in 54 other cases the complaints included members and also 78 registered representatives of such members. One complaint was withdrawn prior to determination on the merits and, after consideration, 16 other complaints were dismissed on findings that alleged violations had not, in fact, occurred. In the remaining 85 cases the committees having jurisdiction found violations and in each of these cases some penalty was imposed on the firm and/or the registered representatives involved.

In 8 proceedings members were expelled, and in 6 proceedings members were suspended for periods ranging from 15 days to 1 year. In addition, the registration of 17 registered representatives was revoked and 7 other representatives were suspended for periods ranging from 30 days to 1 year. In 16 cases the only penalty imposed was censure of the firm or the representative found to have acted improperly, and 1 case was disposed of by acceptance of a statement pledging future compliance with the Rules of Fair Practice.

In 48 of the remaining cases members were fined sums ranging from $100 to $4,350, and aggregating $32,500, while in other instances representatives were fined sums ranging from $50 to $1,000, and aggregating $2,300. In addition to these direct monetary penalties, costs were assessed on firms or representatives in 55 instances. These costs ranged from $18.24 to $6,830.11, and aggregated $37,247.57. Many decisions involved multiple penalties so that, for example, a fine or a suspension, or both, was accompanied by the imposition of costs.

Commission Review of NASD Disciplinary Actions

Section 15A (g) of the Act provides that disciplinary actions by the NASD are subject to review by the Commission, on its own motion or on the application of any aggrieved party. The effectiveness of any penalty imposed by the Association is stayed pending determination of any matter brought before the Commission for review. One such petition referred to in an earlier report was pending at the close of the last fiscal year, and three other petitions were filed during the year. Two of these cases were disposed of during the year and two were pending at the year end.[22]

The Commission affirmed a decision by the NASD which resulted in the expulsion from the Association of *Mitchell Securities, Inc.*,[23] a Baltimore broker-dealer. The NASD's District Business Conduct Committee found that Mitchell violated the NASD Rules of Fair Practice by selling securities to customers at prices which were not fair in view of all relevant circumstances, this being conduct inconsistent with just and equitable principles of trade, and suspended Mitchell from NASD membership for 6 months, imposed a $2,000 fine, and assessed costs of $744.40. Upon appeal by Mitchell to the NASD Board of Governors, the latter also found a violation of the Rules of Fair Practice but concluded that the penalty imposed by the committee was too lenient and expelled Mitchell from membership. Mitchell thereupon appealed to the Commission, which affirmed the NASD action and dismissed the appeal.

The NASD's action was based on 55 sales of Trans Western Oil & Gas Co. common stock effected by Mitchell acting as principal, involving a total of 26,000 shares effected at prices ranging from 75 cents to $1.50 per share, for an aggregate price of $24,950. The Commission found that in 12 of the transactions the per share price Mitchell charged its customers exceeded the price paid by Mitchell for the shares bought by it on the same day from other customers or dealers by amounts ranging from 31.6 to 75 percent; and in the remaining 43 transactions the per share price charged the customer

[22] The two pending cases concerned petitions filed on behalf of Managed Investment Programs (File 16-1A59) and Lerner & Co. (File 16-1A62).

[23] Securities Exchange Act Release No. 5320 (June 6, 1956).

exceeded the high asked price quoted by other dealers on the dates of the transactions by amounts ranging from 10 to 59 percent. The average markup in the 55 transactions was 34.9 percent.

The Commission rejected arguments advanced by Mitchell in support of the validity of its markups, stating that they were clearly excessive by any reasonable criteria and found, contrary to Mitchell's contentions, that it had not performed any special services in the interest of the customers or assumed risks in maintaining an inventory which would warrant such large markups.

The Commission also affirmed an NASD decision against *Phillips & Co.*, a New York broker-dealer firm and its principal partner, Gerald G. Bernheimer.[24] The NASD action appealed from involved the suspension of the Phillips firm from NASD membership for 2 years and an assessment against the firm of the full costs of the proceedings.

According to the Commission's decision, the proceedings were initiated by the NASD Business Conduct Committee on complaints of three customers to the effect that Bernheimer, knowing their limited financial circumstances, urged them to purchase stock of Quebec Oil Development, Ltd., "on the basis of representations as to future price increases of the stock and a promise, which he subsequently repudiated, that he would guarantee them against loss." Although the committee found that the existence of a formal guarantee against loss had not been established, it concluded that Bernheimer had accompanied his solicitations of the complainants with "extravagent representations and glowing promises" which induced them to believe that a profit would certainly accrue to them if they made the purchases, and that he knew that prior sales to their customers had depleted their cash reserves so that the purchase of additional securities he suggested was not suitable on the basis of their financial situation. The committee censured the firm, suspended it from membership for 1 year, and assessed it with $506.10 costs. On appeal, the NASD Board of Governors suspended the firm from membership for 2 years and assessed it with full costs of the proceedings.

Commission Review of Action on Membership

Section 15A (b) of the Exchange Act and the bylaws of the National Association of the Securities Dealers, Inc., provide that except where the Commission approves or directs to the contrary, no broker or dealer may be admitted to, or continued in, membership if he or any controlling or controlled person is expelled or is currently under suspension from such an Association for violation of a rule prohibiting conduct inconsistent with just and equitable principles of trade or

[24] Securities Exchange Act Release No. 5294 (April 19, 1956).

is subject to an order of the Commission denying or revoking his broker-dealer registration or was a "cause" of any such order of expulsion, current suspension or denial or revocation. At the beginning of the fiscal year two such cases were pending before the Commission and during the year three additional cases were brought before the Commission. One of the cases was disposed of during the year and four were pending at the year end.

In the exercising of its authority the Commission approved [25] an application for the continuation in membership of a firm while employing Lowell Niebuhr, who was under a disqualification, having been expelled by the NASD on findings that Lowell Niebuhr & Co., which Niebuhr controlled, had operated with insufficient capital and otherwise violated various NASD rules. The Commission had earlier in 1947 approved another member's continuance in membership while controlling Niebuhr. Niebuhr's association with that member had terminated and he sought new employment requiring further Commission consideration and approval.

Commission Action on NASD Rules

Section 15A (j) of the Act provides that any change in, or addition to, the rules of a registered securities association shall be disapproved by the Commission unless such change or addition appears to the Commission to be consistent with the requirements for such rules as contained in subsection 15 A (b) of the Act.

Section 2 of article I of the bylaws of the NASD has operated to disqualify from membership, or association with a member in a controlling or controlled capacity, persons under any of the disqualifications set out in 15A (b) (4) of the Act. After adoption by the Board of Governors, and approval by the membership, three new subsections were added, effective November 15, 1955, creating barriers to membership or registration with the Association as registered representative against persons who are subject to an order canceling or revoking registration as registered representative with the Association, or with any stock exchange for conduct contrary to high standards of commercial honor or just and equitable principles of trade or who have been convicted within the preceding 10 years of a felony or misdemeanor involving securities transactions or arising out of the conduct of the business of a broker or dealer or convicted within the preceding 10 years of any felony or misdemeanor which the Association finds involved embezzlement, fraudulent conversion, misappropriation of funds, or abuse or misuse of a fiduciary relationship. Jurisdiction for these restrictions is based on section 15A (b) (3) of the Act. As provided in section 15A (b), the Commission may be called on to determine whether it should approve or direct the admission to or con-

[25] Securities Exchange Act Release No. 5271.

tinuance in Association membership of a firm controlling or controlled by a person under one or more of these disqualifications.

The Association also adopted, effective June 1, 1956, after requisite action by the Board of Governors and the membership, a new section 2 (b) of article I of the bylaws which would require any person seeking membership or registration as registered representative in any 1 of 4 categories, including a sole proprietor, a general partner, an officer or any controlling or controlled person requiring registration as a representative to meet standards of technical proficiency in, and knowledge of the securities business. Qualification is achieved either by a minimum of 1 year's experience in the business in one of the capacities specified above or by passing a written examination as prescribed by the Board of Governors.

As part of this board program of creating competency standards for those who engage in the securities business, a qualifying examination was established. The nature and scope of the qualifying examination is established by schedule C, filed by the Association as an amendment to its registration statement. The amendment also prescribes the manner in which the examination shall be marked, the passing grade and the times, intervals and places at which it shall be given, and provides that a particular examination shall consist of 100 questions taken from the master list of 344 questions included in the filing.

In its consideration of the rules establishing competency standards the Commission found the proposed restrictions "necessary and appropriate in the public interest or for the protection of investors and to carry out the purposes of the section" (15 A (b) of the Act) and permitted the rules to become effective.

The Association also adopted various other amendments to its rules during the year here under review which were in the main technical, or concerned only members and not the investing public, or were designed to modernize and conform the then existing rules to methods, practices and circumstances now existing in the securities industry.

LITIGATION UNDER THE SECURITIES EXCHANGE ACT OF 1934

As a protective measure for the public the Commission is authorized to institute actions in the courts to enjoin broker-dealers and other persons from engaging in conduct violative of the Securities Exchange Act of 1934. Some of the actions brought as a result of such violations also include violations of other acts administered by the Commission.

In *S. E. C.* v. *Trevor Currie* [26] defendant, a registered broker-dealer, was permanently enjoined from further violations of the antifraud

[26] D. Colo. No. 5268 (January 19, 1956).

provisions of the Securities Act of 1933 and the antifraud provisions and bookkeeping requirements of the Securities Exchange Act of 1934. The complaint charged, among other things, that the defendant, in connection with his acceptance of brokerage orders from customers for the purchase of securities, falsely represented that he had purchased such securities for their accounts and omitted to disclose to the customers the source and amount of certain remuneration which he had received or expected to receive in connection with those transactions. The defendant consented to the entry of a judgment against him.

In S. E. C. v. *Harold L. Nielsen, doing business as Nielsen Investment Co.*,[27] a preliminary injunction was issued against the defendant to enjoin further violations of the registration and antifraud provisions of the Securities Act, the antifraud and bookkeeping provisions of the Securities Exchange Act and the net capital rule under the latter Act. The Commission charged the defendant with selling securities while insolvent without disclosing his financial condition to customers, and failing to deliver securities paid for by his customers or returning the purchase price to them.

The Commission obtained injunctions against the defendants in *S. E. C.* v. *Glenn Galen Kolb, individually and doing business as Glenn Kolb & Co.*;[28] *S. E. C.* v. *Doxey-Merkley & Co.; William H. Doxey and Lon Babcock Merkley;*[29] *and S. E. C.* v. *Robert Dean Langlois, doing business as R. D. Langlois and Company*[30] restraining further violations of the Commission's rules pertaining to required net capital. In each case the defendants consented to the issuance of a permanent injunction.

In *S. E. C.* v. *National Securities, Inc., and Robert S. Herman*[31] the complaint alleged that the defendants had been soliciting and accepting orders for the purchase and sale of securities and had been soliciting and accepting the deposit of money and securities upon the representation that the defendant corporation was ready and able to execute such orders and meet its liabilities when in fact the defendant corporation had been unable to meet its current liabilities. By consent the defendants were enjoined from further violations of the antifraud provisions of the Securities Exchange Act and of the Commission's net capital rules.

A permanent injunction against further violation of the antifraud provisions of the Securities Exchange Act and the Commission's bookkeeping rules was also issued against *Daniel M. Sheehan, Jr.; doing business as Sheehan & Co.*[32] by consent. The Commission's

[27] D. Idaho No. 3204-S. (November 16, 1955.)
[28] D. Colo. No. 5220. (December 16, 1955.)
[29] D. Utah No. C-165-55. (January 13, 1956.)
[30] D. Utah No. C-132-55. (December 6, 1955.)
[31] D. Utah No. C-129-55. (November 10, 1955.)
[32] D. Mass. No. 55-972-M. (October 31, 1955.)

complaint charged that the defendant has been soliciting and accepting the deposit of monies and securities from customers and representing that he was ready and able to execute orders and make prompt settlement therefor without disclosing that he was unable to meet his current liabilities. The Commission also charged that the defendant had not kept current the required books and records relating to his business as a broker-dealer.

In addition to these actions against broker-dealers, the Commission obtained an injunction against *William H. Van Loo* [33] for violations of the antifraud provisions of the Securities Exchange Act. Defendant obtained a list of registered shareholders of a particular company by representing that he was in the business of tracing the whereabouts of security holders whom the issuing companies were unable to contact and sought to acquire the securities from persons named on the stockholders' list, or their heirs or beneficiaries, representing that their shares were worth considerably less than the prevailing market price. Defendant represented that the securities had a small liquidation value when the company had never been in the process of liquidation, and that the deadline for an exchange of the securities for other securities had passed when no exchange had ever been authorized or put into effect. He also misrepresented the amount of stock registered in the names of certain deceased persons whose certificates were lost or destroyed, and caused the names of deceased persons who had been the registered owners of the securities to be signed on stock powers purporting to assign their rights and interests therein to himself. The defendant consented to the issuance of a permanent injunction.

Proxy Litigation

One of the most important cases successfully litigated by the Commission under the Securities and Exchange Act during the past fiscal year involved enforcement of the Commission's proxy rules. The Commission does not attempt to guide, control or interfere in the strategy employed by participants in a proxy contest and scrupulously maintains a neutral position in these contests. However, the Commission does scrutinize objectively and impartially the proxy material filed with it for the purpose of enforcing the standards of fair and adequate disclosure to investors which are the primary objectives of the Federal securities laws. The objective of the proxy regulations is to obtain for investors and stockholders a fair and complete statement of material facts and to prevent the dissemination to them of false and misleading statements. Where necessary the Commission is authorized by the Act to seek injunctive relief in the Federal courts to enforce these objectives. A complaint seeking such injunctive relief

[33] W. D. Mich. No. 2835 (December 8, 1955).

was filed by the Commission on August 3, 1955, in the United States District Court (S. D. N. Y.) against *Mitchell May, Jr., Alfred Parry, Jr., and Wilbur E. Dow, Jr., individually and as members of the Independent Stockholders Committee of Libby, McNeill & Libby*, charging that the defendants had been soliciting proxies from the stockholders for the election of directors at the meeting scheduled to be held on August 17, 1955, in violation of the Commission's proxy rules. The complaint charged, among other things, that the defendants failed to disclose all the names of persons on whose behalf the solicitation was being made and in their representations concerning the formation and membership of the committee the defendants failed to state the circumstances leading up to the formation of the committee and the identity and purpose of the individuals who sponsored and underwrote the activities of the committee. The complaint also alleged that the material sent to stockholders by the committee was materially false and misleading in that it contained misleading questions which improperly implied: (1) that the company did not make full disclosure of its operations to its stockholders, (2) had withheld a proper accounting for a portion of the 1954 period and (3) that the management was guilty of improper manipulation or mismanagement of corporate funds.

On August, 15, 1955, Circuit Judge Lumbard, sitting by designation as a district judge, filed his opinion sustaining our allegations[34] and on the following day Judge Lumbard entered a preliminary injunction enjoining the defendants from making further solicitations in violation of the proxy rules and from using the proxies they had obtained, and ordered postponement of the stockholders' meeting until September 7, 1955, to permit defendants to solicit new proxies in compliance with the proxy regulation if they so desired. The defendants, who did not resolicit, appealed to the United States Court of Appeals for the Second Circuit and, in connection therewith and prior to the stockholders' meeting, made unsuccessful applications first to Chief Circuit Judge Clark and then to Supreme Court Justice Harlan for a stay of Judge Lumbard's injunctive order. The meeting was held on September 7, 1955, at which time the management's slate was elected.

On January 11, 1956, the Court of Appeals for the Second Circuit affirmed Judge Lumbard's injunctive order.[35] Fully approving and adopting the "well-supported findings and conclusions of Judge Lumbard," the Court of Appeals held that the proxy rules were violated by the use of rhetorical questions in defendant's soliciting material which

[34] *S. E. C.* v. *May, et al.*, 134 F. Supp. 247 (S. D. N. Y. 1955). The complaint also alleged that the defendants (1) had presented a misleading statistical presentation of comparative earnings of the Libby Company and other food distributing companies and (2) had failed to disclose a plan to liquidate the company. Judge Lumbard held (1) that the statistics were a matter of argument and (2) that the evidence on the preliminary hearing was insufficient to sustain the liquidation allegation.

[35] *S. E. C.* v. *May, et al.*, 229 F. 2d 123 (1956).

were based on false assumptions and carried the previously stated false and misleading implications. Although these proceedings were brought under the Commission's proxy rules in effect prior to the January 1956 revision,[36] the court held also that the provision of the proxy rule calling for disclosure of every person on whose behalf the solicitation was being made required disclosure of those persons who were leading factors in the committee's formation and activities notwithstanding the fact that they were not technically designated committee members. The revised proxy rules now plainly spell out this requirement.[37] The court of appeals rejected as meritless defendants' attacks upon the constitutionality of section 14 (a) of the Securities Exchange Act of 1934 and the Commission's proxy regulation thereunder, including the contention that the rules provided for censorship in contravention of defendant's constitutional guarantee of free speech, stating:

> Appellants argue that § 14 (a) of the Securities Exchange Act of 1934, 15 U. S. C. § 78n (a), and regulations adopted thereunder are unconstitutional as unauthorized delegations of legislative power and otherwise; but these contentions have no merit. *American Power & Light Co.* v. *S. E. C.*, 329 U. S. 90; *Yakus* v. *United States*, 321 U. S. 414. Furthermore, the Commission's proxy rules as applied either to management or to insurgent stockholder groups are clearly authorized by the statute.

The Appellate Court also flatly rejected the argument advanced by the defendants that because of the apparent similarity of proxy contests to political campaigns, the various groups soliciting proxies should be permitted with comparative unrestraint to engage in the same type of "campaign oratory" as that of participants in a political contest. The court in refusing to accept this contention emphasized that "Congress has clearly entrusted to the Commission the duty of protecting the investing public against misleading statements made in the course of a struggle for corporate control." Thereafter defendants consented to the entry of a final judgment which made permanent the provisions of the preliminary injunction previously entered.

Inside Reporting Litigation

Section 16 (a) requires that every stockholder owning more than 10 percent of the stock of a corporation registered on an exchange and every officer and director thereof shall report his ownership and the monthly changes in that ownership to the Commission and the exchange. In the vast majority of cases, the required reports are filed promptly. On the rare occasions when the statutory requirement is flagrantly disregarded notwithstanding repeated reminders the Commission is compelled to seek court enforcement. During the past fiscal year, two such actions were brought. One was against

[36] For a discussion of these proxy regulation revisions, see pt., III, pp. 33-45.
[37] See rule X-14A-11 (b).

Samuel A. Alesker,[38] a director of ABC Vending Corp.; the other was against *William D. Vogel*, [39] a director of Wisconsin Bankshares Corp. Both actions are pending.

In *S. E. C.* v. *East Boston Co.*,[40] the Commission, on July 13, 1955, secured a summary judgment requiring defendant corporation to file annual reports for each of its fiscal years since 1948 with the Boston Stock Exchange and the Commission, as required by section 13 of the Securities Exchange Act, no later than November 1, 1955. The company thereafter asked the court to extend its time to file the required reports. The Commission countered with a petition asking that both defendant and its officers and directors be held in civil contempt of court. The court agreed with the Commission that the company was in contempt, but declined so to find as to the officers and directors. Annual reports for the delinquent years were thereafter filed with the Commission and the Exchange but upon examination the Commission found them to be inadequate, misleading and not in accord with its rules and regulations. The Commission again petitioned in contempt. On April 5, 1956, upon stipulation, the court ordered defendant to pay a fine of $3,000 to the Government as compensatory damages and to file corrected reports within 90 days. The fine has since been paid and amended reports were filed by June 18, 1956.

Participation as Amicus Curiae

In *Speed* v. *Transamerica Corp.*,[41] which was pending for decision at the close of the fiscal year, the Commission as *amicus curiae* filed a memorandum of law on the question of the materiality under rule X–10B–5 of the failure to disclose the asset value of stock purchased by a controlling majority stockholder from minority public stockholders and the majority stockholder's intent to liquidate the company. The Commission expressed the view that it could not properly be held, as a matter of law, that a great appreciation in the realizable asset value of such stock was not in itself a material fact which must be disclosed under the rule, wholly apart from proof of the controlling stockholder's intention at the time of the stock purchases with respect to the realization of that value. Nondisclosure of a great disparity between the price offered and the realizable asset value of the stock, our memorandum stated, is a fact entitled to independent consideration in the determination of materiality. The Commission also expressed the view that the intent on the part of the controlling stockholder to liquidate the corporation, whether or not such intent had been translated into corporate action at the time of the purchases in

[38] E. D. Pa. No. 20465 (April 3, 1956).
[39] E. D. Wisc. No. 56–C–89 (June 11, 1956).
[40] D. Mass. No. 54–438W (May 24, 1954).
[41] C. A. 3, No. 11836 (1956).

question, was required by the rule to be disclosed to minority shareholders whose stock was sought.

In *Nash* v. *J. Arthur Warner & Co., Inc.*,[42] judgment was entered for the defendants in a civil action for damages for overtrading or "churning" of certain customers' accounts in alleged violation of section 17 (a) of the Securities Act and sections 10 (b) and 15 (c) of the Securities Exchange Act and the Commission's rules under the latter sections. The judgment appears to have rested in large part on the court's conclusion of fact that the customers, rather than the securities firm involved, were responsible for the degree of activity in the accounts. At the request of the Court the Commission prepared and filed a brief as *amicus curiae* on several questions pertaining to the proper construction of the statutes and rules involved.

[42] 137 F. Supp. 615 (D. Mass. 1955). J. Arthur Warner & Co., Inc., et al. were previously convicted as a result of a Commission investigation of violating the antifraud provisions of the Securities Act, the Mail Fraud and Conspiracy Statutes in connection with the fraudulent overtrading of customers accounts and also were enjoined from engaging in similar practices. See 21st Annual Report, p. 109.