25th Annual Report

of the

Securities and Exchange Commission

Fiscal Year Ended June 30, 1959

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SECURITIES AND EXCHANGE COMMISSION

Headquarters Office

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Washington 25, D.C.

COMMISSIONERS

January 6, 1960

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EARL F. HASTINGS
JAMES C. SARGENT

ORVAL L. DUBOIS, *Secretary*

LETTER OF TRANSMITTAL

SECURITIES AND EXCHANGE COMMISSION,
Washington, D.C., January 6, 1960.

SIR: On behalf of the Securities and Exchange Commission, I have the honor to transmit to you the Twenty-Fifth Annual Report of the Commission covering the fiscal year July 1, 1958, to June 30, 1959, 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 Agreement Act.

Respectfully,

EDWARD N. GADSBY,
Chairman.

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

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FOREWORD

A little over 25 years has passed since adoption of the first Federal securities law which, like subsequent enactments, was designed to protect the interests of investors and of the public generally. On this "silver anniversary" of the organization of the Securities and Exchange Commission to administer those laws, it is fitting in this 25th Annual Report to review the causes, objectives and principal features of the statutes under which the Commission is charged with responsibilities in the interest of protecting investors and the public.

The Federal securities laws were not designed to prevent investors from losing money in the stock market; indeed, it is extremely doubtful whether any laws could do this in a free economy. These laws seek, by requiring disclosure of the facts about issues of securities offered in interstate commerce or traded on exchanges, by prohibiting fraud in such transactions, and by other means, to secure the dissemination of accurate information to investors and to foster sound securities markets. More fundamentally, they aim to require that those who deal with the investments of the American people observe high standards of conduct.

If the present financial markets are compared with those of thirty years ago, it may reasonably be concluded that these basic objectives have been realized. This is so notwithstanding the fact that the present level of economic and financial activity, with resulting opportunities for fraud and malpractice, puts the structure of Federal securities regulation to a most severe test.

One of the basic objectives of the Federal securities laws in providing protection for investors was to bring about a restoration of investor confidence in securities and the securities markets. Such confidence had been severely shaken as a result of the stock market debacle of 1929 and its aftermath. Restoration of investor confidence was important not only to those in the securities industry whose livelihood depended upon it, but was of tremendous importance to our whole economy. In order to grow and prosper, business and industry require large amounts of capital for plant expansion, new equipment and working capital, and the availability of such capital depends in large measure upon the investing public's confidence in securities as a safe and profitable medium for the investment of its savings. The restoration and maintenance of investor confidence are thus intimately related to industrial growth and a healthy economy.

On September 1, 1929, the market value of all stocks listed on the New York Stock Exchange amounted to $89 billion. By the middle of 1932 their market value had declined to $15 billion. As of June 30, 1959, stocks listed on that Exchange had an aggregate market value of almost $300 billion.

Also significant are the data with respect to the public offerings. During the last 5 fiscal years (1955–59), there have been 4,336 registered public offerings of securities aggregating nearly $71 billion in amount—or an average of 867 offerings amounting to $14 billion per year. For the prior 20 fiscal years (1935–54), the number of registered offerings averaged 446 and were in the average amount of $4½ billion per year. Although figures for the years prior to 1934 are not strictly comparable, it appears that less than $400 million of new issues were offered in the depression year 1933, while about $10 billion were offered in the peak year 1929, much of which proved worthless.

It is interesting to note in this connection that, according to available data, business invested about $11 billion in new plant and equipment in 1929. Capital outlays by business averaged $4½ billion per year during the 3 years 1934–35–36, increased to an average of $10 billion during the years 1944–45–46 and reached an average of $30 billion in the years 1954–55–56. New capital investment amounted to a record $37 billion in 1957 and $30 billion in 1958; and it is anticipated that such investments will increase to $33 billion in 1959. To complete the picture, gross national product, which amounted to $104 billion in 1929, averaged $73 billion per year for the period 1934–35–36, $212 billion for 1944–45–46, and $393 billion for 1954–55–56. The figure grew to $442 billion for each of the years 1957 and 1958, and is expected to reach an all-time high of $485 billion for 1959.

A true measurement of the benefits which have derived from Federal securities administration is of course impossible, but some indication of the advancements made in behalf of investor protection appears in a comparison of the financial community and the nature of its operations today with that which existed prior to the federal regulation of securities.

The picture of financial and corporate practices existing in the earlier era, as unfolded in congressional and other investigations, some conducted by the Commission itself, demonstrated the need for legislation action. Responsible persons in financial institutions, corporate executives and many others entrusted with the savings of investors, to whom they owed a high degree of fiduciary care and responsibility, had abused the trust thus reposed in them. With respect particularly to the sale of new securities, the House of Representatives in its report

on the first legislative enactment in the securities field (Report No. 85, 73d Congress, First Session) stated, in part:

> "During the post-war decade some 50 billions of new securities were floated in the United States. Fully half or $25,000,000,000 worth of securities floated during this period have become worthless. These cold figures spell tragedy in the lives of thousands of individuals who invested their life savings, accumulated after years of effort, in these worthless securities. The flotation of such a mass of essentially fraudulent securities was made possible because of the complete abandonment by many underwriters and dealers in securities of those standards of fair, honest and prudent dealing that should be basic to the encouragement of investment in any enterprise. Alluring promises of vast wealth were freely made with little or no attempt to bring to the investor's attention those facts essential to estimating the worth of any security. High-pressure salesmanship rather than careful counsel was the rule in this most dangerous of enterprises."

These and other abuses contributed to a collapse of values, and their revelation seriously undermined the confidence of the investing public in the capital markets and in securities as media of investment. The orgy of speculation which had existed in the stock market, coupled with the fraud, manipulation and other malpractices then prevalent, could lead only to disaster.

One of the evils was the artificial stimulation of interest in, and the manipulation of the market price of, a given security so that it might be "dumped" on unsuspecting investors at the higher price and with a handsome profit to the manipulator. "Pool" operations were numerous, the operators timing their purchases and sales in a manner which created market activity at increasingly higher prices and thereby stimulated participation by the investing public, whose purchases further accentuated the market rise. When the price reached its desired level, the pool operators "pulled the plug", dumping their securities on the market at the higher price, whereupon the market price slumped to its original level or lower. The operators also participated in "bear raids", and, assuming a short position in a particular stock, engaged in a series of transactions which drove the market price of the stock down to a level at which they could cover their short position at a profit.

These and similar operations resulted in a situation in which no one could be sure that market prices for securities bore any reasonable relation to intrinsic values or reflected the impersonal forces of supply and demand. In fact, the investigation record demonstrated that during 1929 the prices of over 100 stocks on the New York Stock Exchange were subject to manipulation by massive pool operations. One of the principal contributing factors to the success of the manipulator was the inability of investors and their advisers to obtain reliable financial and other information upon which to evaluate securi-

ties, and manipulators were further aided by the dissemination of false and misleading information, tips and rumors which flooded the market place.

There were other factors which were shown to have contributed to the fundamental weakness of the pre-SEC securities market. Principal among these was the extensive use of credit to finance speculative activities or the purchase of stock on margin. Speculators ignored the fact that the yield on stocks purchased on margin was far less than the interest on their debit balances with brokers. There was almost no limit to the amount of credit which a broker might extend to his customer. As a result, a slight decline in the market price of securities could, and did, set off a chain reaction—the customer was sold out in a declining market at a loss because he had insufficient funds to put up additional margin; such distress sales further accentuated the market decline and caused other margin customers to be sold out; and brokers who had over-extended themselves with banks in order to finance excessive speculation by customers were hard-pressed for capital and some even became insolvent, thus further endangering the position of other customers.

The misuse of corporate information by management officials and other "insiders" was also common practice. Executive officers who owed a high degree of fiduciary responsibility to the company and its stockholders withheld vital information about the company, its operations and earnings, while accumulating a personal position in its stock, placing themselves in position to capitalize on any fluctuation in the price of the stock when the news was released to the public. Moreover, the entrenched position of management was fortified by lax standards governing the solicitation of proxies by means of which management perpetuated itself in power.

An extensive investigation of electric and gas utility holding companies conducted by the Federal Trade Commission, which has often been termed the most comprehensive study of any industry undertaken by the Federal government, had disclosed widespread abuses in the formation and operation of utility holding company systems, including (1) inadequate disclosure to investors of the information necessary to appraise the financial position and earning power of the companies whose securities they purchase; (2) issuance of securities against fictitious and unsound values; (3) overloading of operating companies with debt and fixed charges, which tended to prevent voluntary rate reductions; (4) imposition of excessive charges upon operating companies for various services such as management, construction work and the purchase of supplies and equipment; (5) the control by holding companies of the accounting practices and rate, dividend and other policies of their operating subsidiaries so as to

complicate and obstruct State regulation; (6) the control of holding companies and subsidiaries through disproportionately small investment; and (7) the extension of holding company system control and domination over far-flung utility properties without regard to the integration and coordination of related properties.

Starting with operating company common stocks, representing fractional investments in the properties themselves, the holding companies issued billions of dollars of debt securities and preferred stocks and pyramided holding company upon holding company in such a way that control represented by the voting stock of the top company was based on little or no actual investment in the operating properties at the bottom level, at which level alone were generated the earnings and income to support the entire system. The imposition of leverage security upon leverage security had the result that a small percentage increase in operating company income would be phenomenally magnified at the level of the top holding company's most junior equity securities. But this factor of magnification worked in reverse when income declined. Electric and gas operating companies actually suffered less during the depression days of the early 1930s than almost any other substantial segment of our economy. Their operating revenues dropped no more than about 15 percent from the peak levels of the 1920s. That drop, however, was enough to bring down in ruins many of the fantastic corporate superstructures that had been imposed on top of the operating companies. Several of the largest holding companies were forced into bankruptcy. The investing public which had been induced to purchase their securities suffered tragic losses of untold millions of dollars.

It has been estimated that, from 1924 to 1930, utility holding companies floated some $5 billion of securities, the great bulk of which went not to build or improve utility properties but to purchase already outstanding voting securities of operating utility companies. The businesses of some of the companies acquired had no remote relationship to that of an electric or gas utility and one system even included a baseball team. The build-up, without any economic justification, of huge utility empires stretching across the nation was exempilfied by one holding company which grew in gross assets from $6 million in 1923 to $1 billion in 1929, only to become insolvent and require years for its reorganization and rehabilitation—not, however, without tremendous losses to the investing public.

From September 1929 to April 1936, 53 utility holding companies with about $1.7 billion of securities outstanding went into receivership or bankruptcy. An additional 23 holding companies with about $535 million of outstanding securities defaulted on interest and offered re-

adjustment plans. At December 1940, registered holding companies had about $2.5 billion of preferred stock outstanding of which $1.4 billion had dividend arrearages amounting to $476 million.

The financial practices of the holding companies had also resulted in serious injury to many of their operating subsidiaries. From September 1929 to April 1936, 36 utility subsidiaries, with outstanding securities of $445 million, went into bankruptcy or receivership. An additional 16 such companies with $152 million of outstanding securities offered readjustment or extension plans after defaulting on interest. Of preferred stocks of operating subsidiaries aggregating about $1.6 billion at December 1940, some $453 million had dividend arearages amounting to about $165 million.

Another investigation, conducted by the Commission in the mid-1930's, of companies engaging in the business of investing, reinvesting and trading in securities and which offer their own securities for public sale in order to obtain investment capital, clearly indicated the need for regulation of this important segment of our financial community. Here again, the evidence showed a callous disregard by certain management officials of their fiduciary obligations to investors and, in many instances, a course of conduct which clearly constituted fraud. Among the practices revealed by the Commission's investigation were the purchase and sale of portfolio securities by and between the company, its management officials and other affiliated interests, for the personal profit of the insiders. The sale of investment company shares through false and fraudulent representations was a common practice.

This investigation also disclosed that no machinery existed for enforcing fiduciary responsibilities of individuals and firms which were engaged in the business of advising others, for compensation, with respect to their purchases and sales of securities, and that serious abuses were possible and probable.

Another Commission investigation disclosed practices which evidenced a need for independent trustees to provide protection of the interests of security holders in the areas of corporate reorganizations of insolvent corporations and the issuance and sale of debt securities pursuant to mortgage and other indentures.

With these exposures of malpractices Congress stepped into the breach and imposed, upon those engaged in the purchase and sale of securities, standards of conduct which should long since have been universally recognized by them as basic to any proper relationship to public investors. In fact, they were based upon the fundamental concepts of fiduciary obligation which the law already imposed on those managing other people's money and securities.

The first remedial measure, the Securities Act of 1933, dealt with the capital formation process so essential to industrial growth. In urging the passage of this legislation, which he characterized as the "Truth in Securities" law, President Roosevelt stated that what was sought was "a return to a clearer understanding of the ancient truth that those who manage . . . other people's money are trustees . . ." The primary aim of the legislation was to provide public disclosure of all financial and other data bearing upon the worth of securities so that they might be realistically evaluated by investors. It also sought to outlaw fraud in the sale of securities under a broadened concept of fraud not limited by technical common law definitions.

Disclosure under the Securities Act is accomplished in a two-step process: (1) by filing a registration statement with the Commission containing certain required financial and other data; and (2) by making available to purchasers and to investors who receive written offers to sell through the mails, a prospectus containing all pertinent facts upon which the company's operations may be appraised and its securities evaluated. Among other things, the prospectus must contain information with respect to the character, size and profitableness of the business; the capitalization of the issuer; the purpose of the proposed offering of securities and the use to which the proceeds are to be applied; outstanding options for the purchase of securities of the issuer; remuneration of officers and directors, including bonus and profit-sharing arrangements; contractual or other arrangements with management officials or other affiliated interests; pending or threatened legal proceedings; and the underwriting and other terms of the offering. Moreover, the prospectus must include a balance sheet and three-year earnings statement, certified by an independent public accountant.

When the registration statement is filed, the securities covered thereby may be offered for public sale, either orally or by means of certain written instruments prescribed by Commission rules. But the securities may not be sold until the registration statement becomes or is made effective. The duration of this "waiting period", usually several weeks, depends upon the degree of initial compliance with the disclosure requirements. The waiting period provides an opportunity, explicitly provided for in the statute and the Commission's rules, for widespread dissemination in the financial community and among dealers and the investing public, of the salient factual disclosures, financial and otherwise, contained in the registration statement. Thus, opportunity is given the investing public to be informed of the essential facts about the company and the securities it proposes to offer for public sale before the public investor is committed to their purchase.

During this waiting period, also, the Commission conducts a thorough examination of the registration statement and prospectus to determine, as best it can, that all required facts have been disclosed, accurately and completely, and that there are no "half truths" due to the omission to state facts required to be stated in order to make not misleading the disclosures and representations made. If in its examination the Commission finds that the registration statement is inaccurate or incomplete in respect of material facts, the Commission may, after notice and opportunity for hearing, issue a "stop order" suspending the registration statement, which operates to bar distribution of the securities so long as the stop order remains in effect. The order may be lifted when and if the registration statement is amended to correct the deficiencies upon which the stop order was based. Normally, however, resort to the stop order procedure is not essential to a determination of compliance with the disclosure requirement, and the issuing company is advised of and given an opportunity to file any revision, correction or clarification of disclosures which the examination may show to be necessary to an understanding of the facts.

An analysis of an issuing company's balance sheet and earnings statement is of paramount importance in the evaluation of securities. The value of financial statements is directly dependent on the soundness of the accounting principles and practices observed in their preparation and on the adequacy and reliability of the work performed by public accountants who certify as to their fairness. Uniformity in auditing practices and consistency in accounting presentation are essential to public reliance upon and an understanding of the earnings and other data presented and to a proper comparison with the financial statements of other companies. Therefore, a major objective of the Commission has been to improve accounting and auditing standards and to assist in the establishment and maintenance of high standards of professional conduct by certifying accountants.

The accounting rules, decisions and opinions of the Commission, in conjunction with authoritative pronouncements by professional accounting societies and by other governmental agencies, have achieved a substantial clarification and improvement in the accounting and auditing principles and practices generally followed in the preparation of financial statements throughout the financial community, whether or not the particular issuing company is directly subject to the Commission's regulations. Moreover, the Commission's requirement that an accountant who certifies financial statements filed with it shall be "independent" of his client, has extended and fortified the ethical standards customarily observed by certifying accountants.

The Commission's examination relates only to the accuracy and adequacy of the disclosures. The Commission is not empowered to, and does not, appraise the merits of the securities or otherwise pass upon the soundness of the venture. In fact, the Act declares it to be unlawful to represent to investors that the Commission has approved or otherwise passed on the merits of registered securities or found the registration disclosures accurate and complete. However, it should be noted in this connection that heavy penalties attach to the filing of registration statements which are false and misleading. Moreover, investors who suffer losses in the purchase of registered securities have important recovery rights (which they may pursue in Federal or State courts) if the disclosures contained in registration statements are false and misleading. While the Commission cannot and does not vouch for the accuracy and adequacy of registration disclosures, its examination, coupled with the penalties against false filings and the recovery rights of investors, tend to contribute to the general reliability of the disclosures.

Dissemination of information contained in the registration statement is basic to the statutory objective of investor protection. This is accomplished by the large-scale distribution of the prospectus to all members of the underwriting and distributing or selling groups as well as to prospective investors. The law requires the delivery of the prospectus to any person to whom a written offer is made through the mails, and to each and every purchaser. This dissemination of information is supplemented by the extensive redistribution of the registration disclosures by the various securities manuals and other investment advisory and statistical services, which are readily available to all broker and dealer firms, trust departments and others. Thus, new securities may be evaluated by a broad cross-section of the investing public.

The registration process has been an effective instrument for the restoration of investor confidence. The fact that there has been a $15 billion average volume of public offerings of registered securities during the past four years, and that capital expenditures during that period have reached record heights, is eloquent testimony to the smooth functioning of the capital formation processes today and of the steady flow of private capital into industry.

The second enactment in the field of Federal securities regulation was the Securities Exchange Act of 1934, which sought to outlaw misrepresentation, manipulation and other abusive practices in our securities markets and to establish and maintain just and equitable principles of trade which would be conducive to open, fair and orderly markets.

The Congress recognized that the dearth of reliable financial and other information in the pre-SEC days had made it difficult, if not impossible, to evaluate adequately and realistically securities traded on exchanges, and that this paucity of information facilitated the dissemination of false information about the issuing companies and their securities and the manipulation of the prices of securities. Accordingly, the 1934 act extended the disclosure principle by requiring every company which has securities listed on an exchange to register with the Commission and to file annual and other periodic reports disclosing financial and other data which the investing public needs in evaluating the company's securities. A similar periodic reporting requirement is imposed by this law upon the larger companies whose securities have been registered for public offering under the Securities Act, whether or not they are listed on an exchange. The Commission is given authority to require that these financial statements be certified by independent public accountants. On June 30, 1959, securities of 2,236 issuing companies were listed and registered on national securities exchanges. The volume of trading on the exchanges in these securities during the year ended that date was about $50 billion, and their aggregate market value at the year end was about $350 billion. The very size of these figures is evidence of the importance to investors of reliable financial and other information with respect to the issuing companies and their securities. The data contained in the reports of these companies receives widespread dissemination through securities manuals, statistical and advisory services, the financial press and otherwise, and has an important impact upon the evaluation of their securities by the investing public.

The disclosure principle was further extended by two additional provisions of this law, applicable to "insider" trading in listed securities and to the solicitation of proxies from the holders of such securities. With respect to the former, the 1934 act requires that insiders (officers, directors, and 10% owners) report regularly to the Commission and the exchange their holdings of and transactions in all equity securities of the particular issuer with whom they are affiliated. The number of these reports of holdings and transactions of insiders now exceeds 39,000 annually. Furthermore, in order to curb the misuse of "inside" information by such persons, which had been so prevalent prior to enactment of the statute, insiders are made liable to account to their companies for their profits on any purchase and sale, or sale and purchase, which occurs within a six-month period.

Moreover, management officials of listed companies must disclose in their solicitation of proxies basic financial and other information reflecting the company's financial condition and the results of its opera-

tions—information which reflects management's stewardship. To enable investors in such companies to vote intelligently upon all corporate matters requiring stockholder approval, whether the election of directors, authorization for the issuance of additional securities, merger with another company or otherwise, the Commission has promulgated a set of "proxy rules" which require disclosure of the basic facts pertinent to the subject matter of the vote. In addition, the form of proxy must give the stockholder freedom of action to vote for or against different proposals and may not bind him to vote on an all-or-none basis.

The Commission's proxy rules also entitle independent or minority stockholders to include, in management solicitations, any proper proposals which they wish to have put to a vote of the stockholders. Under the rules, independent solicitations of proxies by minority stockholders, including the solicitation of proxies for the election of their own nominees to the board, are also facilitated.

The 1934 act also provides for the registration of stock exchanges and of brokers and dealers who engage in the over-the-counter securities business. A prerequisite to stock exchange registration is a requirement that the rules of the exchange shall proscribe practices by members which may not be just and equitable to public investors, and the exchange must be empowered to suspend, expel or otherwise discipline members for violations of those rules. The Commission has a residual power to see that exchange rules are modified or supplemented to accomplish these objectives. Today, 14 national securities exchanges are registered with the Commission.

This system of self-regulation, which recognizes that exchanges are vested with a public interest and that the exchanges themselves have the primary responsibility for establishing, maintaining and enforcing just and equitable principles of trade, is an important factor in the market place today. It also has its counterpart in the over-the-counter markets, contained in a 1938 amendment to the law providing for the organization of associations of over-the-counter dealers which would "police" their membership. One such institution, the National Association of Securities Dealers, Inc. (NASD), has been organized and now has over 4,000 members. It has adopted and enforces a code of fair practice governing the conduct of its members and their relationships to investors.

As previously indicated, brokers and dealers must register with the Commission before they may engage in the securities business in interstate commerce. At the end of the 1963 fiscal year, 4,997 brokers and dealers were registered with the Commission. The Commission may deny or revoke the registration of a broker-dealer in cases of fraud in securities transactions, or other misconduct in the securities

business, where the Commission, after notice and opportunity for hearing, finds such denial or revocation in the public interest. Likewise, the Commission may, on similar grounds, suspend or expel a member from membership in the NASD or in a stock exchange.

The Commission maintains an active surveillance of securities trading practices, both on exchanges and in the over-the-counter markets. It also has adopted numerous rules which establish standards of conduct governing the activities of brokers and dealers and prohibit acts and practices inimical to the interests of investors. Two of these are worthy of special note. One prohibits short selling on an exchange which would tend to precipitate or accentuate a price decline. Another requires that brokers and dealers maintain at all times a minimum capital position in relation to their liabilities to other persons so that the funds and securities of customers in their custody will not be jeopardized. This rule minimizes the possibility that sudden reverses will cause a firm to become insolvent and thereby endanger customers' free credit balances and securities held in custody. It may be noted in this connection that the Commission carries on a program of broker-dealer inspections to ensure compliance with its net capital rule and otherwise to see that the activities of brokers and dealers are conducted properly.

No less important to the stability and orderliness of the stock market today are the rules of the Board of Governors of the Federal Reserve System which regulate the amount of credit which brokers and banks may extend on the purchase of listed securities by investors. The margin requirement has fluctuated over the years from a low of 25 percent in 1934 to 100 percent (no margin) during the war years, in accordance with that Board's view as to proper margin in light of the over-all credit position of the Nation. By curbing excessive speculation, the rules have added a stabilizing influence in the market. The necessity for frequent and drastic "margin calls" has thus been reduced, offering further stability to the market. The Commission has the duty of enforcing compliance by brokers and dealers in securities with the rules so established.

Both the 1933 and 1934 acts authorize the Commission to take testimony under oath and to subpoena books and records for the purpose of developing the facts with respect to possible securities violations, and to seek Federal court orders of injunction against the continuance of acts and practices violative of the laws or Commission rules thereunder. They also provide for criminal prosecution (through the Department of Justice) of any individual, firm or corporation if evidence developed in the Commission's investigations establishes that they have engaged in fraud, manipulation or other misconduct in connection with the purchase and sale of securities or have otherwise willfully violated the law.

The record of investigation and enforcement actions of the Commission is a formidable one, far too long to be recited here. That record is detailed in the several annual reports which have been filed by the Commission with Congress over the years. It may be noted that many violations of the law are discovered and stopped before any substantial damage to investors has occurred. In other cases, the Commission's investigations have resulted in restitution of investors' funds in substantial amount. Of perhaps even greater importance to the investing public is the deterrent effect which the statutory sanctions and the Commission's enforcement powers have upon those who might otherwise have, and exercise, a free hand to defraud innocent investors.

The legislation designed to meet the problems posed by the abuses disclosed in the investigation of the electric and gas utility industry was embodied in the Public Utility Holding Company Act of 1935. The principal objective of this statute was to free local operating utility companies from the control and domination of absentee and uneconomic holding companies, and to permit them to be regulated more effectively by the States in which they operate. In 1930, 15 holding company systems controlled 80 percent of the privately owned electric generating capacity in this country, and similar concentration existed in the gas utility field. As previously indicated, these countrywide utility empires were put together with little regard for efficient and economic service of electricity and gas to consumers and without regard for the investors whose funds had been used to concentrate a maximum of control and profit in the hands of a few. The act called for a breakup of the huge utility combines and, generally speaking, sought to restrict the operations of utility holding companies to one or more systems whose operations are integrated and confined to a single State and States contiguous thereto. It also had as one of its major objectives the simplification of the corporate and capital structures of holding company systems and the redistribution of voting power among security holders on a fair and equitable basis.

In 1940, when the statutory program of integration and simplification actually got under way, 12 of the registered systems each conducted retail operations in 10 or more States, and 17 additional systems operated in 5 to 9 States. At one time or another since 1938, these systems contained a total of 2,387 companies, many engaged in miscellaneous unrelated nonutility businesses, and many being subholding companies serving no demonstrable economic function. Drastic surgery was called for to simplify these structures, to restore some semblance of sane and sensible corporate and capital structures and to redistribute voting power and control on a fair and equitable

basis consistent with a realistic evaluation of the rights of the various and conflicting interests of security holders.

The volume and complexity of the corporate and capital structures which were required to be simplified, and the nature and scope of the geographical dispersion of the properties required to be integrated presented extremely difficult and novel problems which it was the task of the Commission to resolve. Opponents of the legislation had asserted that the law would cause dumping and forced liquidation of securities, demoralizing the market therefor, and they characterized the integration and simplification requirements as a "death sentence" for the utility industry. The Congress, on the other hand, contemplated that this program should not destroy any legitimate investment values, and the Commission was given a mandate to bring about the required integration and simplification in keeping with that objective.

The opposition of industry which marked the passage of this reform measure was continued after its enactment. Most of the larger companies refused to register with the Commission, as the law required, and it was not until the Supreme Court upheld the constitutionality of the registration requirement in 1938 that these companies bowed to the registration requirement. They continued, however, to resist the law's integration and simplification requirements.

The act contemplated that industry would be given an opportunity to propose voluntary plans which would effectuate the objectives of integration and simplification, but it also wisely empowered the Commission to take necessary action to that end if the industry failed so to do. For the most part, at least initially, the industry was unyielding, and it became necessary for the Commission to invoke its power to issue administrative orders directing compliance with the requirements of the law. Of course, such orders could only be issued after notice and opportunity for hearing and after the development of an evidentiary record. Many of the orders requiring integration and simplification were challenged in the courts, on constitutional and other grounds, but all were ultimately sustained.

After the Commission had thus established the general pattern of compliance, holding company systems came forward with voluntary plans for divestment of nonretainable properties and securities of nonretainable subsidiaries. Such plans had to comply with the statutory mandate in this respect and had to be fair and equitable to all affected security holders. Plans proposed for simplification of corporate and capital structures also had to be tested in the same manner. In ruling upon these plans, the Commission developed the so-called "investment value" doctrine under which the claims of security holders are evaluated for purposes of reorganization on a going-con-

cern basis rather than on the liquidation basis followed in reorganizations in equity receivership and bankruptcy proceedings where the claims are treated as matured. Under the investment value doctrine, which was duly sustained by the courts, plans of reorganization were approved which accorded participation to senior claimants upon the basis of the present worth of their securities on a going-concern basis, and similarly to junior security holders on the basis of their secondary claim to future earnings, even though they would not have had a right to participate if the senior claims were evaluated upon the basis of their liquidation preferences.

Compliance with the integration and simplification requirements took various forms. They included mergers and consolidations, separation of large systems into smaller, integrated systems, divestment of nonutility properties unrelated to the utility business, sale of nonretainable utility properties to other systems with whose properties they could be integrated, sale of the securities of nonretainable subsidiaries to the public at competitive bidding or pursuant to a rights offering to stockholders of the parent company and distribution of securities pro rata among stockholders.

The fundamental economic soundness of the act and the methods prescribed for its administration have been demonstrated by the results achieved, and the directive of Congress that the program could and should be effectuated without injury to investors has been carried out. Although tremendous values were salvaged by integration and simplification, that process unavoidably entailed the realization of losses by many investors who had purchased securities on the basis of anticipated values which had been but a mirage, or had been dissipated by the holding companies themselves. All the damage could not possibly be undone—the dollar amount of securities which had been issued was in some instances vastly in excess of the values that could be realized by the salvage and rebuilding process.

The integration and simplification program represented the most comprehensive undertaking ever assumed by the Government to rehabilitate an entire major industry. In the process, the number of companies now comprising the 18 active registered holding company systems has been reduced to 176—and only 3 of the systems operate in more than 4 States and none operates in more than 9. Today, the securities of the divested companies and of those registered companies which have completed their integration and simplification programs have an excellent market acceptance. The utility industry as a whole is enjoying financial health and stability, and has been able to finance expansion programs of unprecedented proportions largely out of new money raised from the public sale of securities. It is interesting to note in this connection that a study made by the Commission in 1951

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of the market values of the common stocks of 12 holding companies between the dates of their registration with the Commission and September 24, 1951, showed that in each instance the market value of the company's stock increased during that period and in almost all instances the rate of increase substantially exceeded the rate of increase in the Dow Jones utilities averages. Holders of utility preferred stocks have similarly benefited in that all dividend arrearages have been satisfied and the holders have been accorded securities and cash representing the fair value of their investments.

In actuality, then, the feared integration and simplification provisions of the law have been vindicated and those who condemned the act have come to praise it. That which was once denounced as a death sentence to the progress of the utility industry is now generally regarded as having been the means of its regeneration.

The 176 companies which remain subject to the Commission's continuing jurisdiction under the act must comply with its regulatory provisions governing their purchase and sale of utility securities and properties, dividend payments (in circumstances where such payment might result in a corporate abuse), intercompany loans, solicitation of proxies, and insiders' transactions. The act also forbids registered holding companies to charge for services to their subsidiaries and requires that all services performed for any company in a holding company system by a mutual or subsidiary service company be rendered at cost, fairly and equitably allocated.

With respect to the issuance and sale of securities, the act generally provides that the Commission shall not authorize their sale unless it finds that the security meets certain tests, including the requirement that the security must be reasonably adapted to the earning power of the company and its issuance necessary and appropriate to the economical and efficient operation of the issuer's business and not detrimental to the public interest or the interest of investors or consumers. The Commission has adhered to the policy of requiring sound capital structures containing adequate common stock equity. The Commission also must find that fees, commissions and other remuneration paid in connection with the sale are not unreasonable.

It is recognized that the cost of capital is an important element of expense affecting utility rates and that utility companies are under a duty to obtain their capital at the lowest cost consistent with a sound financial structure. One of the evils disclosed by the investigation was the absence of arms-length bargaining in the sale of securities and utility assets, which was in large measure an outgrowth of the "traditional banker" relationships between certain large investment banking firms and particular holding company systems. Such relationships had given these bankers a virtual monopoly over the financing

of system companies and had generally resulted in exorbitant underwriting commissions.

To implement the statutory objective that underwriting fees and commissions be reasonable in amount, to eliminate investment banker control and to assure the maintenance of competitive conditions, the Commission in 1941 adopted a rule under the act which generally requires that securities of registered holding companies and their subsidiaries be sold by means of competitive bidding. Since the adoption of that rule, there has been active competition among investment bankers for the purchase of utility securities. Approximately $11 billion of utility securities of various classes have been sold by means of competitive bidding under the rule in the past 17 years. The rule allows an exception from competitive bidding under special circumstances and upon a showing that a negotiated underwriting or a direct placement would be more advantageous and that competitive conditions are otherwise maintained. Some $2.3 billion of securities have been excepted from the rule since it was adopted.

The effect of the competitive bidding rule actually extends beyond the limited number of companies subject to its requirements, for the prices obtained and the underwriting spread paid by these companies in their offering and sale of securities through competitive bidding have set the standard for all security offerings, whether or not subject to the rule. Competitive bidding is regularly required by the Interstate Commerce Commission, the Federal Power Commission, and many State regulatory commissions. This technique was in effect in some areas before 1941, but it is clear that its adoption by the SEC has been instrumental in achieving the wide acceptance which is now given to it. Moreover, it has been employed by a number of utility companies who were under no compulsion to do so. There can be little doubt that the competitive bidding rule has been responsible in a substantial degree for the noticeable decrease in the cost of flotation of securities over the past two decades.

In furtherance of the statutory objectives of economy in the raising of capital and the protection of the interests of investors, consumers and the public, the Commission has from time to time promulgated other rules and policy statements governing the financing of registered system companies. Notable among these are statements of policy governing "protective provisions" which must be included in mortgage indentures pursuant to which debt securities are issued and sold and in corporate charters governing the rights and interests of preferred stockholders. With respect to bond indentures, for example, the bonds must be redeemable at any time at reasonable redemption premiums, certain asset and earnings tests must be met if a company wishes to issue additional bonds, a sinking fund is required as well as

a renewal and replacement covenant which, in effect, requires the company to expend for property additions an amount reflecting the depreciation taking place in the mortgaged properties, and certain restrictions are imposed upon the acquisition of properties subject to a prior lien and upon the amount of common stock dividends the company may pay.

With respect to preferred stock, the charter must include provisions that dividends shall be cumulative, that the preferred shall be redeemable at any time at a reasonable redemption premium, and that the preferred shareholders are entitled to elect a majority of the members of the board of directors in the event of the accumulation of a year's arrearages in the payment of dividends on the preferred. Furthermore, the payment of dividends upon the common stock must be restricted if the common stock equity falls below a certain prescribed percentage of the company's total capitalization and surplus, and a favorable vote of the holders of a certain percentage of the outstanding preferred shares is required before certain corporate actions affecting their interests may be taken.

It is apparent that the accomplishments under the Holding Company Act and particularly in connection with the vast integration and simplification program have been considerable. While the integration and simplification programs for some ten of the registered systems have not been completely effectuated, the Commission is hopeful that the remaining problems, some of a more or less serious nature, may soon be resolved and the overall program of utility integration and simplification consummated. The continued expansion of utility systems, of course, including the creation of new holding companies through the purchase of utility securities or the acquisition by existing registered systems of the assets or securities of other nonaffiliated companies, has created and will from time to time continue to create new problems of integration and simplification.

A number of holding company systems will continue to be subject to the Commission's jurisdiction under the act for an indefinite period. The many aspects of their financial and related activities will call for the continued exercise of the Commission's jurisdiction, as in the past, to assure that the public interest is protected and to guard against the recurrence of the evils which gave rise to the enactment of the law. In addition, new technological developments, such as the use of atomic energy, the pooling together of facilities by various nonaffiliated systems for the purpose of effecting economies in the generation of electric energy and other similar challenges will no doubt continue to command the Commission's attention in the years to come. / End of insert

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The Holding Company Act authorized the Commission to conduct a study and investigation of investment trusts. After 5 years of in-

tensive and exhaustive inquiry into the entire industry, the Commission recommended comprehensive legislation for its regulation. Vigorous opposition to the extent of the regulation proposed in the original bill led to conferences between the Commission and industry representatives, resulting in a compromise statute which passed both Houses of Congress unanimously as the Investment Company Act of 1940. This unanimity was no doubt due in large part to the Commission's exposé of the sordid history of the organization and operation of certain investment trusts and to a recognition on the part of the more responsible element in the industry that Federal regulation was not only necessary in the interest of investor protection but was also essential to the full acceptance by the public of investment companies as a feature of our financial system.

The Commission's study showed that investment companies had all too often been organized and operated in such a way as to further the selfish interests of the sponsors and insiders at the expense of the stockholders to whom they owed a high fiduciary duty. Subordination of the interests of stockholders took many forms. In some cases, the promoters, management officials and controlling persons unloaded worthless securities and dubious investments upon the investment company, or took for their own account profitable ventures offered to the company. In others, the investment company financed clients of insiders or companies in which insiders were personally interested. Insiders also engaged in practices which permitted them to obtain large profits without any risk by trading in the securities issued by the investment company, to the pecuniary detriment of its investors. They also engaged in practices which increased their distribution profits and management fees and resulted in substantial dilution of the investors' interests. Many other abuses came to light, including sales and promotional literature designed to create the false impression that investment companies were not unlike savings banks and insurance companies, except that they were not limited to legal investments. The sales load in some types of companies exceeded 30 percent of the net amount invested.

The 1940 act seeks to obtain a degree of independence in the board of directors and to prohibit self-dealing and the taking of excessive commissions or profits by affiliated persons or companies. It seeks to achieve greater participation by stockholders by requiring them to act on basic policies, to restrict the types of securities which may be issued by investment companies and to guard against inadequate and unfeasible capital structures, to require transmission of informative reports to stockholders, including financial statements certified by independent accountants when the Commission so prescribes, and to eliminate improper selling practices. Persons guilty of securities frauds are barred from serving as officers and directors.

Underwriters, investment bankers and dealers may not constitute more than a minority of the board of directors.

Basic to Commission regulation under this law is the requirement that companies engaged in investing, reinvesting and trading in securities register with the Commission and file periodic financial and other reports. The registration statement must include a declaration of policy by the investment company on various aspects of its business, including its investment policy, and the company may not deviate from its stated policy without the consent of the holders of a majority of its outstanding voting securities. Transactions with affiliated persons and companies are prohibited, although the Commission, upon application by the company, may grant an exemption from such prohibition if it finds that the terms of the transaction are fair and reasonable, that no "over-reaching" on the part of any individual is involved and that the transaction is consistent with the company's established policies and with the intent and purposes of the law. A registered investment company must, subject to Commission rules, maintain its assets under a custodianship agreement with a bank or a member of a national securities exchange, or under a safekeeping arrangement with a bank. Officers and employees who have access to the assets of the company or authority to direct their disposition must be bonded.

The act also empowers the Commission, where necessary, to seek court injunctive orders to prevent transactions, acts and practices in contravention of its provisions or rules of the Commission thereunder. If the activity constitutes gross misconduct or gross abuse of trust in the management of investment companies, the Commission may apply to the court for removal of management officials responsible therefor, for the appointment of trustees or receivers where necessary to preserve the company's assets and for an order compelling the restitution of funds to stockholders.

In one case, for example, the controlling stockholder caused the investment company to liquidate capital assets to meet interest requirements and pay current expenses, including salaries and rentals to himself, and to acquire control of a race track. In an action initiated by the Commission, the court appointed a receiver and enjoined the controlling stockholder and other defendants from serving as officers and trustees of the company. Similarly, in another action brought by the Commission an officer who caused an investment company to make unsecured loans to various business corporations he controlled was enjoined from serving any investment company in any capacity in the future. Injunctions and appointments of receivers have been obtained where the sales literature falsely stated that the investment company was guaranteed against loss by the United States Government and where the officers and directors attempted to unload worthless securities upon the investment company.

An important aspect of the Commission's administration of this law has been its insistence upon the elimination of abusive practices in the offering and sale of investment company securities. Several years ago some companies were found to be employing sales literature of a misleading character, such as representations that a particular security was as safe an investment as a United States savings bond. Leading members of the industry cooperated with the Commission in a study of the sales literature and sales practices being employed. Following this study, the Commission issued a Statement of Policy setting forth various types of advertising and sales literature considered to be in violation of the law, and the industry has cooperated with the Commission in administering it.

In the administration of the act, the Commission must rule upon various applications by investment companies for exemptions from specified provisions. The exemption most frequently sought concerns transactions involving the purchase and sale of property or securities between investment companies and affiliated interests. In order to receive an exemption, the applicant must establish to the satisfaction of the Commission that the terms of the proposed transaction are fair and reasonable and do not involve overreaching. Many difficult problems of evaluation and potential conflict of interest are presented in these cases. Since 1940, more than 1,200 exemption applications have been acted upon by the Commission.

The growth of investment companies since 1940 has been phenomenal. At June 30, 1941, 436 companies with aggregate assets of $2.5 billion were registered with the Commission. The number of registered companies has varied since that date, with a low of 352 in 1947 and a present high of 512. The aggregate assets of the 512 companies at June 30, 1958, was $20 billion, or eight times the size of the 436 companies in 1941. The Congress recognized that investment companies might become so large as to raise problems concerning "concentration of control of wealth and industry" and other questions, and the act directs the Commission to conduct a study of such problems and to report the results thereof to Congress. Such a study is now in progress.

In a recent decision of the Supreme Court, it was held that "variable annuity" contracts were "investment contracts" subject to the Commission's jurisdiction under the Securities Act and the Investment Company Act. As a result, these contracts must satisfy the registration and disclosure requirements of the Securities Act, and the issuing companies must register as investment companies and comply with the other provisions of the Investment Company Act. The Commission is now endeavoring to resolve the problem of fitting this type of

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investment company into the pattern of regulation which the 1940 act established.

Closely related to the Commission's surveillance of over-the-counter securities dealers and of investment companies is its administration of the Investment Advisers Act of 1940. The regulatory provisions of that act, however, touch only a few aspects of a field not yet adequately covered. Although modeled on the broker-dealer registration provisions of the 1934 act, and dictated by certain abuses indicated by the Commission's investment trust study, it has few "regulatory teeth." It does not give the Commission the same control over the activities of the investment advisers (including power to impose sanctions) now applicable to brokers and dealers, and is considered to be largely a mere "census-taking" statute. The most serious defect in the current statute is the inability of the Commission to inspect the books and records of registered investment advisers, to prescribe what books and records shall be maintained or to require the filing of reports. In light of market conditions existing today, it would appear contrary to the public interest to allow such a condition to continue. As part of its current legislative program, the Commission has proposed amendments to the law to include adequate regulatory provisions with respect to investment advisers.

Prior to the Commission's investigation of investment trusts, it undertook a study of protective and reorganization committees. This study resulted in two additional Congressional enactments, the Trust Indenture Act of 1939 and chapter X of the National Bankruptcy Act (1938 revision).

This study concerned itself with the events which led to the insolvency of debtor companies, and in particular with the activities of protective and reorganization committees organized to protect the interests of the various classes of creditors and security holders and to participate in the reorganization of the debtor corporation. Numerous instances came to light where the indenture trustee, whose primary responsibility was to protect the interests of the holders of indenture securities, had basic conflicts of interest, including divided loyalties as between the debtor and its management officials on the one hand and the interests of public investors on the other. Such conflicts precluded any effective action by the trustee to safeguard the interests of investors prior to default or to see that their rights were asserted in a timely and proper fashion in the event of default.

The Trust Indenture Act seeks to protect the purchasers of bonds, debentures, notes and similar debt securities when sold in amounts exceeding $1 million, by prescribing certain minimum standards governing the provisions of indentures. It requires the indenture to spell out the rights of the holders of the securities and to provide reasona-

ble standards of diligence and loyalty applicable to the indenture trustee, and to facilitate its actions to protect the investor. The emphasis of this law is upon an effective and "independent" trustee whose interests do not conflict with those of investors and upon eliminating indenture provisions which might exculpate the trustee against dereliction in carrying out duties and responsibilities prescribed by the indenture.

The provisions of this act and the Securities Act are so integrated that registration under the latter act of securities to be issued under a trust indenture is not permitted to become effective unless the indenture conforms to the standards of the Trust Indenture Act. Like registration statements, trust indentures are examined by the Commission for compliance with the law. The Commission may issue an order refusing qualification if the indenture does not conform to the prescribed standards or if the trustee has any conflicting interests. Once an indenture is qualified, enforcement of its terms is left to the trustee and the indenture security holders.

The report of the Commission's investigation also had shown serious abuses in the functioning of protective committees and the manner in which insiders used such committees to control reorganization proceedings for their personal benefit and to the detriment of public security holders.

The basic thrust of chapter X of the Bankruptcy Act (the Chandler Act) was to eliminate the practical control of reorganization proceedings by inside groups and self-constituted committees and to require, in all cases in which the debtor's indebtedness exceeds $250,000, the appointment by the court of a disinterested trustee, whose attorney must also be independent. It is the function of the trustee to assume charge of the debtor's operations and proceed with the preparation of a plan for its reorganization. He may investigate the acts of the prior management and institute recovery actions where the facts justify such action. Although protective committees and other representatives of security holders are permitted to participate, their activities are subject to strict court review and control. Fees for services in reorganization proceedings are also subject to court approval, which serves to prevent unwarranted and excessive fees to special groups while providing fair and reasonable compensation to those whose services can be shown to have benefited the estate.

Furthermore, chapter X provides that the Commission may participate in corporate reorganization proceedings if requested or approved by the court, so as to aid the court and the independent trustee by rendering expert and independent advice and assistance on all important phases of the proceeding. It operates in an "advisory" capacity, and has the right to be heard on all matters arising in the

proceeding, but no right to appeal. It usually undertakes intensive legal and financial studies related to the company, its operations, its indebtedness and other outstanding securities, possible claims against management officials or controlling persons, the prospects for the company's future operations and the possibility of a successful reorganization.

If the indebtedness of the debtor exceeds $3 million the court must, and if less than that amount it may, submit to the Commission all plans of reorganization deemed worthy of consideration. The Commission may thereupon prepare and file with the court its "advisory report" which analyzes the plan or plans in detail and recommends for or against court approval, depending upon whether the Commission considers that the plan provides fair and equitable treatment to all interests affected and is feasible. In some instances the Commission's recommendations are presented orally to the court through its counsel.

The Commission's report is in no way binding upon the court, which may either reject the plan or approve it and submit it to a vote of creditors and affected security holders. In the latter event, a copy or summary of the Commission's advisory report is transmitted to security holders along with the plan, so that they may be informed of the Commission's analysis of and views on the fairness and feasibility of the plan before casting their votes for or against the plan.

Since September 1938 the Commission has participated in chapter X proceedings for the reorganization of 457 debtor companies (371 principal debtors and 86 subsidiaries thereof) with stated assets of more than $3.5 billion and indebtedness of nearly $2.5 billion. Over 60 of these proceedings are still pending. The proceedings have involved the reorganization and rehabilitation of companies engaged in a variety of industries and businesses, including agriculture, mining, manufacturing, financial and investment, merchandising, real estate, construction and allied industries, transportation and communication, service, and utilities. In these proceedings, the Commission has issued a total of 40 advisory reports and 37 supplemental reports. In most other cases, its views and recommendations on the fairness and feasibility of the reorganization plans were presented orally by Commission counsel.

The assistance rendered by the Commission in corporate reorganization proceedings has been favorably noted almost without exception by Federal courts, although they do not always follow the Commission's recommendations. The Chief Judge of the Court of Appeals for the Second Circuit had the following to say about the Commission's advisory services 4 years ago:

"We regard the service being rendered by the Commission to the Courts in connection with the reorganization of corporations to be most valuable, if

not indispensable, for the proper disposition of this vital segment of court business according to the Congressional intent. The Commission affords the necessary expert knowledge, the skill, and the uniform approach which individual judges cannot have; and to the district judges in particular, the assistance is unique in its usefulness, and not otherwise to be obtained." 21st Annual Report, p. 89.

More recently, a district court judge made the following comment on the role of the Commission following a hearing on fee allowances in which the Commission had objected to allowances in the requested amounts exceeding $4 million and where the Court approved allowances of $2,068,000, some $250,000 above that recommended by the Commission:

"Though I have been forced to differ from the recommendations of the SEC in many of the instances, I wish to pay tribute to the careful and helpful analysis that the Commission made of the claims. Indeed, I take this opportunity to express my gratitude for the active and intimate participation of the Commission and its counsel in the reorganization proceedings. If any proof were needed of the wisdom of Congress in providing for representation of the public by the Securities and Exchange Commission in reorganization proceedings, it has been furnished in this case. I would have felt helpless without the aid given unstintingly by counsel for the Commission. Each has cheerfully rendered, at the usual modest salary of a public servant, services equal in value to those of any to whom awards are made by this decision." *In the Matter of Third Avenue Transit Corporation*, S.D.N.Y. Nos. 85851, 86410, 86412, 86413, 86537, unreported, (1958).

Upon appeal, the allowances were further reduced to a figure only $30,000 more than the Commission initially recommended, or an ultimate saving to the debtor estate and its security holders of nearly $2¼ million.

This report began with a discussion of "investor confidence." As indicated herein, all available signs would seem to bear out the fact that investor confidence has been largely restored. In fact, it may be noted that recent estimates place the number of public investors today at 12,500,000, nearly double the 1952 total. The record volume of securities successfully offered for public sale, taken together with the recent rise in the volume of trading on the New York Stock Exchange to the highest level in the Commission's history, is adequate evidence of the restoration of investor confidence.

But the impact of the Federal securities laws and their administration has been felt no less by financial institutions, corporate executives, professional people, and other elements in the financial community than by investors. It can reasonably be said that these acts and their administration have generally fostered improved standards of business conduct among all groups in their relationship to stockholders and investors. While this no doubt has been dictated in part by enlightened self-interest, it nonetheless has contributed substantially to investor confidence.

This, as we have seen, has had its desired effect, for the capital formation processes have successfully served their purpose of being a conduit for the flow of investors' savings into industry in ever increasing volume.

While the Commission can view with pardonable pride the record of its contribution to the interests of the investing public, it cannot rest on the record of its past accomplishments. In a dynamic economy such as this nation is experiencing, new problems of investor protection are constantly arising. The very fact that securities are being offered for public sale in record volume and that exchange trading in securities has reached a high level, plus the fact that more and more people have surplus savings, some of which is being used for investment and speculation in securities, are in and of themselves adequate reasons for the Commission not to become complacent. A boiling stock market not only attracts new investors, some of whom have neither the resources nor the knowledge and skill to speculate in the stock market, but also attracts a fringe element, ever ready to take unfair advantage of the innocent and unsuspecting investor. A substantially increased record of law enforcement actions by the Commission within the past year leaves no doubt of this latter fact.

Nor would we suggest that the investing public might reasonably become complacent. It cannot be overemphasized that nothing in the securities laws or their administration can keep the market price of securities from fluctuating, down as well as up. No reasonable person would wish it otherwise. It is, therefore, incumbent upon individual investors and their advisers to exercise care and even restraint in their analysis, evaluation and purchase of securities.

It is most essential that investors exercise extreme care in their dealings with unknown brokerage firms and their salesmen, particularly those who telephone long-distance with "pie-in-the-sky" promises that the investor can double or triple his money overnight, without risk of loss, through the purchase of stock of a particular company. Common sense would dictate that such a promise is utterly fantastic and ridiculous. Unfortunately, foresight is never quite so good as hindsight, particularly when the promise of quick and easy profits is dangled before one's eyes, as many investors have learned to their sorrow.

The Commission would like to take this occasion to express its thanks and appreciation to a capable, industrious, and efficient staff, both past and present.

In the 1949 Task Force Report on "Regulatory Commissions" by the first "Hoover Commission," the Commission was characterized as "*an outstanding example of the independent commission at its best.*" [Italics supplied.]

The statement, of course, applied to the Commission and its work more than 10 years ago and was surely well-deserved. However, it is no less applicable, we submit, to the excellent work of a most competent staff during the past 10 years.

The volume of Commission business in recent years, in nearly all phases of its activities, has been on the increase. An example of this is to be found in the record of Securities Act registration statements filed with and examined by the Commission. In the 26-year administration of that act, a total of 15,930 registration statements were filed which proposed offerings of securities aggregating $167 billion in amount. The past 6 years alone accounted for 5,561 of the filings and $81 billion of the total amount. That the staff has been able to carry on effectively under a tremendous increase in the volume of Commission business is a tribute to its ability and conscientious devotion to duty.

ORIGINAL COMMISSION

(As of July 2, 1934)

JOSEPH P. KENNEDY, *Chairman*
*JAMES M. LANDIS
GEORGE C. MATHEWS**
ROBERT E. HEALY**
FERDINAND PECORA

Other former members of the Commission, in order of their appointment:

J. D. ROSS**
*WILLIAM O. DOUGLAS
*JEROME N. FRANK**
*EDWARD C. EICHER**
LEON HENDERSON
SUMNER T. PIKE
*GANSON PURCELL
EDMUND BURKE, Jr.
ROBERT H. O'BRIEN
ROBERT K. MCCONNAUGHEY
*JAMES J. CAFFREY
RICHARD B. MCENTIRE**
*EDMOND M. HANRAHAN
*HARRY A. MCDONALD
PAUL R. ROWEN
*DONALD C. COOK
EDWARD T. MCCORMICK
ROBERT I. MILLONZI
CLARENCE H. ADAMS
J. HOWARD ROSSBACH
*RALPH H. DEMMLER
*J. SINCLAIR ARMSTRONG
A. J. GOODWIN, Jr.

*Served as Chairman.
**Deceased.

COMMISSIONERS AND STAFF OFFICERS

(As of October 15, 1959)

Commissioners	*Term expires June 5*
EDWARD N. GADSBY of Massachusetts, *Chairman*	1963
ANDREW DOWNEY ORRICK of California	1962
HAROLD C. PATTERSON of Virginia	1960
EARL F. HASTINGS of Arizona	1964
JAMES C. SARGENT of New York	1961

Secretary: ORVAL L. DUBOIS

Staff Officers

ALBERT K. SCHEIDENHELM, Executive Director.
  CHARLES T. KAPPLER, Associate Executive Director.
BYRON D. WOODSIDE, Director, Division of Corporation Finance.
  SHARON C. RISK, Associate Director.
JOSEPH C. WOODLE, Director, Division of Corporate Regulation.
  W. ALLEN JOHNSON,[1] Associate Director.
PHILIP A. LOOMIS, Jr., Director, Division of Trading and Exchanges.
  RALPH S. SAUL, Associate Director.
THOMAS G. MEEKER, General Counsel.
  WALTER P. NORTH,[1] Associate General Counsel.
ANDREW BARR, Chief Accountant.
LEONARD HELFENSTEIN, Director, Office of Opinion Writing.
  W. VICTOR RODIN, Associate Director.
MANUEL F. COHEN,[2] Adviser to the Commission.

[1] Designated October 5, 1959.
[2] Designated August 31, 1959. Formerly Chief Counsel, Division of Corporation Finance.

REGIONAL AND BRANCH OFFICES

Regional Administrators

Region 1. New York, New Jersey.—Paul Windels, Jr.; Edward Schoen, Jr., Associate Regional Administrator, 225 Broadway, New York 7, N.Y.

Region 2. Massachusetts, Connecticut, Rhode Island, Vermont, New Hampshire, Maine.—Philip E. Kendrick, Federal Building, Post Office Square, Boston 9, Mass.

Region 3. Tennessee, North Carolina, South Carolina, Georgia, Alabama, Mississippi, Florida, and that part of Louisiana lying east of the Atchafalaya River.—William Green, Suite 138, 1371 Peachtree Street NE., Atlanta 9, Ga.

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

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, Tex.

Region 6. Wyoming, Colorado, New Mexico, Nebraska, North Dakota, South Dakota, Utah.—Milton J. Blake, 802 Midland Savings Building, 444 17th Street, Denver 2, Colo.

Region 7. California, Nevada, Arizona, Hawaii.—Arthur E. Pennekamp, 821 Market Street, San Francisco 3, Calif.

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

Region 9. Pennsylvania, Maryland, Virginia, West Virginia, Delaware, District of Columbia.—William J. Crow, Courts Building, 310 6th Street NW., Washington 25, D.C.

Branch Offices

Cleveland 13, Ohio. Standard Building (Room 1628), 1370 Ontario Street.

Detroit 26, Mich. Federal Building (Room 1074).

Houston 2, Tex. 424 Bettes Building, 201 Main Street.

Los Angeles 28, Calif. Guaranty Building (Room 309), 6331 Hollywood Boulevard.

Miami 32, Fla. Plaza Building (Room 440), 245 South East First Street.

St. Louis 1, Mo. Arcade Building (Room 1025), 812 Olive Street.

St. Paul 1, Minn. Main Post Office and Courthouse (Room 1027), 180 East Kellogg Boulevard.

Salt Lake City, Utah. Newhouse Building (Room 1119), 10 Exchange Place.

COMMISSIONERS

Edward N. Gadsby, Chairman

Chairman Gadsby was born in North Adams, Mass., on April 11, 1900. He received an A.B. degree from Amherst College in 1923 and a J.D. degree from the New York University School of Law in 1928. From 1929 to 1937 he was associated with the law firm of Mudge, Stern, Williams & Tucker of New York City. From 1937 to 1947 he practiced law in North Adams, Mass. In 1947 he was appointed a Commissioner of the Massachusetts Department of Public Utilities and held that position until 1952, serving as Chairman from 1947 to 1949. From 1952 to 1956 he served as General Counsel of the Massachusetts Department of Public Utilities and thereafter was a member of the law firm of Sullivan & Worcester of Boston, Mass. On August 20, 1957, he took office as a member of the Securities and Exchange Commission for a term expiring June 5, 1958 and was designated Chairman of the Commission. He was reappointed effective June 5, 1958 for a term expiring June 5, 1963 and was again designated as Chairman.

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 and was separated from the service 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 25, 1955, when he was sworn in as a member of the Commission for a term of office expiring June 5, 1957. On June 12, 1957, he was reappointed as a member of the Commission for a term of office expiring June 5, 1962. During the periods from May 27, 1957 to June 6, 1957 and from June 12, 1957 to August 20, 1957 he as designated as Acting Chairman of the Commission.

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. He was reappointed, effective June 5, 1959, as a member of the Commission for a term expiring June 5, 1964.

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 Company 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. 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. He is a Lecturer at Law at the University of Virginia.

PART I

CURRENT PROBLEMS BEFORE THE COMMISSION

The foreword to this report has described the nature of the laws administered by this Commission, the abuses in the securities markets which led to their enactment and some of the problems encountered in administering these laws during the past quarter century. During the 1959 fiscal year these laws were put to their severest test for during that year the nation witnessed the highest level of activity in the securities markets since the organization of the Commission in 1934. This increase in market activity created complex enforcement problems, required the adoption of new regulatory measures and techniques and imposed heavy administrative burdens upon the staff of the Commission. The effects of surging securities markets upon the activities of the Commission are described in detail later in this report. This section briefly sets forth some of the more important problems created by these conditions and the impact of these problems upon the work of the Commission.

The following salient statistics reveal the remarkable increase in activity in the securities markets and the tremendous growth of public interest and participation in those markets:

The total amount of new securities for which registration statements were filed with the Commission in fiscal 1959 totaled $16.6 billion, only $300 million less than the record amount filed in fiscal 1958.

During fiscal 1959 the Commission processed 1,119 registration statements, the largest number of registration statements ever to be processed in a single year in the history of the Commission.

The number of broker-dealers registered with the Commission rose to 4,907, an increase of almost 1,000 registrants since 1951, and the number of representatives registered with the National Association of Securities Dealers, Inc., on June 30, 1959 was 77,917, the largest number in its 20-year history.

The aggregate market value of all stocks on all stock exchanges, which never exceeded $100 billion between 1933 and 1945, reached $337.6 billion on June 30, 1959, almost three times the market value of all stocks on exchanges during the first decade of the Commission's history.

The reported volume of trading on the New York Stock Exchange increased from a daily average of 2 million shares in February 1958, to a peak of 4,100,000 shares in October and November 1958, the highest daily average for any month since June 1933.

The number of holders of shares of publicly owned corporations, according to estimates by the New York Stock Exchange, increased from 6,490,000 in 1952 to 12,500,000 in 1959, the largest number of public shareholders in the nation's history.

The number of registered investment companies increased from 367 in 1952 to 512 in 1959, and the total assets of investment companies increased from $6.8 billion in 1952 to $20 billion in 1959.

A number of factors appear to be responsible for this increase in activity and interest in the securities markets. Among these are the attractiveness of these markets for financing new corporate enterprises and the expansion of old ones, the emphasis upon capital gains in selling equity securities, the fear of inflation, the growing participation in the market of the large institutional investor and an unfortunate tendency among some persons to use the stock market as a medium for gambling. However, the principal concern of the Commission is not with the cause of this activity but with insuring that the securities markets, however active, are fair, orderly and honest, that prices in these markets express the free interplay of supply and demand and that decisions by investors to buy or sell are made in the light of full disclosure of all material facts. The discharge of these statutory responsibilities by the Commission is complicated in present securities markets by the participation of a large number of inexperienced investors and by broker-dealers and promoters unfamiliar with, or contemptuous of, the ethical and legal obligations owed to investors.

Fraud in the Sale of Securities

Active and rising markets have raised the expectations of a substantial segment of the public that it is possible for the unsophisticated investor to reap large and quick profits. In this atmosphere opportunities for fraud and manipulation multiply. Investors become less concerned with the facts about the issuer and the investment characteristics of its securities than with the allure of a possible "killing" described to them by an unknown salesman over the telephone. They become more susceptible to baseless tips and rumors, thus facilitating a variety of deceptive and manipulative practices.

This atmosphere has attracted into the business of selling securities not only the confidence man, the petty swindler and the corporate plunger, but also an outright criminal element. These persons have seized upon the technique of selling securities to unsuspecting customers through the use of boiler rooms. The term "boiler room" refers to a firm engaged in the sale of securities primarily over the long distance telephone, to persons with whom the firm has had no previous contact, and by high pressure methods ordinarily accompanied by gross misrepresentation and other fraudulent devices.

Boiler rooms may operate not only from the large financial cen-

ters but also in other locations around the country. There has been a noticeable increase, for example, in migratory operators moving from state to state. In some promotions several boiler rooms may be used to sell the spurious issue in widely scattered areas around the country, each boiler room being assigned to saturate its particular region. Not infrequently the long distance telephone salesmen for the boiler room establish themselves in hotel rooms, apartments and alleged business offices.

In many cases, the security sold by a boiler room is unknown and worthless. To create the appearance of an active over-the-counter market for the security, the promoter will place with numerous brokers and dealers, orders for the purchase and sale of small amounts of the security at prices set by him, or arrange to have others do this, with the result that such brokers and dealers will publish quotations for the security at the prices specified in the orders. The salesmen for the boiler room are now able to refer in their sales "pitch" to a market price for the security which the unsuspecting investor can independently verify. When the distribution of the promoter's holdings is completed, however, the orders are withdrawn and the "market" disappears.

In his telephone sales pitch, the boiler room salesman usually promises rapid increases in the market price of the security and no risk of loss in its purchase; he may make numerous misrepresentations concerning the issuer and its future prospects; he may urge purchases notwithstanding statements on the part of the customer that he cannot afford to do so; and he may advise the customer, of whose financial situation he knows nothing, to sell valuable securities in order to purchase the spurious boiler room security being offered.

The Commission has found that resort to the civil injunction and administrative proceeding, no matter how vigorously employed, is not completely effective in halting the operation of boiler rooms. Promoters easily find another worthless issue and either establish or use an existing boiler room as a vehicle for a new fraudulent promotion. The Commission believes that only criminal prosecution will effectively stop those who show such a contemptuous disregard for the law. The Commission has, therefore, placed increased emphasis in its work upon the prosecution of such offenders. In fiscal 1959 the Commission referred to the Department of Justice 45 cases for criminal prosecution, one of the highest number of referrals in the Commission's history, and referrals are continuing at approximately the same rate in fiscal 1960.

A large portion of the Commission's staff is now engaged in investigating, developing, and assisting in the prosecution of criminal actions. Such activity requires careful and painstaking work usually over a period of many months. Investors must be identified and inter-

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viewed. Books and records of brokers, dealers and others must be examined and analyzed. The information thus obtained then has to be developed in a form permitting its introduction into evidence in legal proceedings.

Emphasis upon developing criminal cases means that the Commission with its limited resources has had to utilize staff personnel who would otherwise devote their full attention to other urgent enforcement and regulatory problems. The Commission believes, however, that its policy of pressing for criminal prosecution of violators of the Federal securities laws is the most effective deterrent to fraud in the sale of securities and must be vigorously pursued.

In addition to its enforcement program against boiler rooms, the Commission has sought through a broad publicity campaign to alert investors to the risks involved in the purchase of securities from unknown high-pressure salesmen. Posters warning investors of boiler room operators have been widely distributed, spot radio and television announcements carrying similar warnings have been prepared to be broadcast in cooperation with The Advertising Council, and brochures listing protective measures that an investor should take before making a purchase have been prepared for wide public distribution.

Manipulation in the Securities Markets

In April 1959 the Commission issued a statement warning investors to exercise extreme caution and self-restraint when considering the purchase of securities upon the basis of tips and rumors.[1] Price fluctuations were occurring in certain securities on the exchanges and in the over-the-counter markets without apparent economic reason. Also there appeared to be a considerable amount of speculation on the part of public investors. These conditions facilitated the manipulation of securities prices and boded eventual losses to investors. Officials of the leading exchanges also joined in warning investors, and brokerage houses urged their customers to exercise caution in purchasing unknown securities.

In volatile markets where prices are susceptible to swift and wide changes on the basis of rumors, manipulation is facilitated and the task of enforcement becomes increasingly difficult. The Commission has therefore had to place greater emphasis upon the detection and prevention of manipulation and a substantial number of investigations are now in progress. Some of these investigations have resulted in indictments and it is anticipated that certain other cases now under investigation will also lead to criminal prosecution.

Exemptions From Registration and Prefiling Publicity

One of the areas of evasion of the registration and prospectus requirements of the Securities Act of 1933 is the claiming of exemp-

[1] Securities Exchange Act Release No. 5927 (Apr. 7, 1959).

tions which, in fact, are not available. The attempt to use these exemptions to evade registration requirements usually occurs where the issue, or the sales procedure to be employed, would not stand the light of the full disclosure requirements of registration. In order to narrow this area of evasion, the Commission has consistently sought through its participation in litigation involving claimed exemptions, through its own decisions and through its rule-making power, to define and clarify the proper limits of certain of these exemptions. One of the significant developments in this area has been the recent amendment by the Commission of Rule 133.

Under Rule 133, which embodies an interpretation of long standing, the issue of securities in connection with certain types of corporate mergers, consolidations, reclassifications of securities and acquisitions of corporate assets is not deemed to constitute a "sale" of securities to stockholders of corporate parties to the transactions. This rule has the effect of exempting these transactions from the registration requirements, but not from the anti-fraud provisions, of the Securities Act. The rule provides no exemption for subsequent distribution of such securities. Because of the substantial number of transactions ostensibly effected in reliance upon the rule but which involved violation of the registration requirements, the Commission amended Rule 133 to restate the purpose and effect of that rule and to clarify its application and limitations. In addition, the Commission adopted a new registration form to provide an expeditious registration procedure for securities issued in a transaction within Rule 133 where such registration is required and where the issuer has solicited proxies under the Commission's proxy rule with respect to such transaction.[2]

In three significant cases the courts have further delineated the boundaries of exemptions from the registration requirements of the Securities Act. A frequently used device for evasion has been the abuse of the intrastate exemption under section 3(a)(11) of the act. The issuer may attempt to use a resident of the state as a nominee for non-resident beneficial owners or the alleged sales to residents may be merely a step in a planned interstate distribution. In *S.E.C. v. Hillsborough Investment Corporation, et al.*[3] the Court upheld the limitation on the scope of that exemption, long viewed as applicable by the Commission, that a single sale to a non-resident, directly or indirectly, destroys the intrastate exemption for the entire issue, including the securities sold only to residents.

Various devices have been used in an attempt to avoid registration on the claim that a distribution is within the "private offering" exemption under section 4(1) of the act. The Commission and the courts have consistently rejected a numerical test as a conclusive basis

[2] Securities Act Release No. 4115 (July 6, 1959).

[3] D. New Hampshire No. 1965 (Dec. 11, 1958).

for determining the availability of that exemption. In *Gilligan, Will & Co. et al.* v. *S.E.C.*,[4] the Court of Appeals for the Second Circuit further held that even if a numerical test did exist, persons claiming the exemption would have the burden of establishing a reasonable and bona fide belief that the total number of individuals involved in the placement would remain within that limit. The Court also concluded that the private offering exemption was not available to a dealer who assertedly acquired securities for "investment" where the dealer speculatively purchased unregistered securities in the hope that the financially weak issuer had "turned the corner" and then unloaded the securities on an unadvised public when he later determined that their purchase was an unsound investment.

The third case dealt with the exemption under section 4(1) of the act for trading transactions—an exemption frequently claimed by boiler rooms. In *S.E.C.* v. *Culpepper et al.*,[5] the Court of Appeals for the Second Circuit held that a broker-dealer who engages in steps necessary to consummate a public distribution is an "underwriter" within the meaning of the act even though the broker-dealer has no privity with the issuer or a control group.

Another area of evasion of the registration requirements is the use of publicity with respect to an issuer or its securities prior to the filing of a registration statement. In two cases coming before it last year, the Commission undertook to set forth the precise limitations on pre-filing publicity under section 5(c) of the Securities Act of 1933.[6] In these opinions, the Commission pointed out that the statutory procedure for disseminating information about the issue prior to the time of sale is exclusive and that it "cannot be nullified by recourse to public relations techniques to set in motion or further the machinery of distribution before the statutory disclosures have been made and upon the basis of whatever information the distributor deems it expedient to supply." [7]

Regulation of the Exchanges

During the fiscal year 1959, the Commission took a more active regulatory role with respect to exchange activities. A Commission investigation found, for example, that on the American Stock Exchange floor trading activities were accentuating market swings particularly in issues susceptible to extreme price fluctuations because of a small floating supply. At the suggestion of the Commission that Exchange adopted a rule designed to prevent floor traders from making purchases of stock at successively higher prices and to restrict the impact

[4] C.A. 2 No. 25171 (June 3, 1959).

[5] C.A. 2 No. 25242 (Sept. 10, 1959).

[6] *Carl M. Loeb, Rhoades & Co. and Dominick & Dominick*, Securities Exchange Act Release No. 5870 (Feb. 9, 1959); *First Maine Corporation*, Securities Exchange Act Release No. 5898 (Mar. 2, 1959).

[7] *Carl M. Loeb, Rhoades & Co. et al.*, *id.*, at p. 11.

of their trading upon the market for active and volatile issues.[8] The Commission also questioned the activities of certain specialists on that Exchange, particularly off-floor transactions by specialists in securities in which they were registered. At the suggestion of the Commission, that Exchange adopted a number of additional rules relating to specialists for the purpose of restricting their dealings so far as practicable to those reasonably necessary to permit them to maintain a fair and orderly market in the securities in which they are registered.

The regulation of commission rates on the exchanges was the subject of the Commission's attention during fiscal 1959. In line with the suggestions of the Commission, the New York Stock Exchange in March 1959 reduced minimum commissions on small value transactions and instituted a broad study in consultation with the staff of the Commission into the costs of effecting exchange transactions.[9]

Regulation of the Over-the-Counter Markets

The increase in new offerings traded over-the-counter and the phenomenal growth in the number of broker-dealers registered with the Commission and of representatives registered with the National Association of Securities Dealers, Inc., evidence the growing interest in over-the-counter securities. The Commission is seeking to ascertain what changes, if any, may be occurring in the distribution and trading practices of the over-the-counter market as a result of this growth.

In recent securities markets, there has been a strong underlying public demand for so-called "glamor" stocks. These securities often sell at a substantial premium on the first day of trading. Most of these issues are low-priced, have no public market prior to the offering and often involve companies in the electronics, missile and related defense fields. In some instances, promoters have changed the name of the company and its operating divisions to suggest some connection with these activities.

The Commission, after the end of the fiscal year, instituted a broad inquiry into the genesis and distribution of some of these issues to determine, among other things, whether some of these issues have been generated primarily to enrich the promoters, underwriters and others; whether artificial restraints have been imposed upon the floating supply of these issues in order to raise the market price; and whether certain practices have developed in connection with the distribution and marketing arrangements for these issues which violate provisions of the federal securities laws.[10]

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[8] Securities Exchange Act Release No. 5981 (June 5, 1959).

[9] Securities Exchange Act Release No. 5889 (Feb. 20, 1959).

[10] During the course of the inquiry the Commission, on October 23, 1959, issued Securities Act Release No. 4150 calling to the attention of the financial community certain practices disclosed by the inquiry which, in view of its staff, may involve violations of federal securities laws.

PAUL GONSON
SECURITIES AND EXCHANGE COMM'N

Inspection of Investment Companies

The rise in the number of new investment companies and the tremendous growth of the industry led the Commission several years ago to develop a program for the routine inspection of investment companies. Since there has been no additional staff available for this purpose and in view of the increased workload of regular administrative business, the Commission has been able to conduct inspections only on a pilot basis for the past few years. It is hoped, however, that additional personnel will be made available so that the inspection program will move forward more rapidly in the future and that a realistic cycle of inspections can be instituted and maintained.

The inspections made by the Commission to date, limited in number though they have been, have shown the urgent need for this method of assuring compliance with the Investment Company Act. In some cases failures to comply with the act or improper practices were discovered and corrective action requested and taken. In one case, the violations were serious in nature and resulted in a stop-order proceeding under the Securities Act and the issuance of an opinion and stop-order. Apart from bringing to light improprieties or fraudulent conduct, the institution of routine inspections should prove to be particularly beneficial to the newly organized or smaller investment company in complying with the requirements of the Investment Company Act.

Other Factors in the Securities Markets

Under the statutes which it administers, the Commission has the duty to conduct inquiries into the securities markets not only for the purpose of enforcement but also to ascertain facts to aid in the adoption of rules and regulations and for making appropriate legislative recommendations. In dynamic and changing markets, the Commission must continually reassess the statutes and the rules and regulations which it administers in light of new knowledge. For example, the Commission has instituted an inquiry into the problems created by the growth in the size of investment companies for the purpose of determining whether the increased size of investment companies has created problems requiring remedial legislation.[11] Another inquiry of somewhat less importance but of interest to the public is one into the "put" and "call" market. This little known and little explored area of the securities market is now being studied by the Commission to ascertain, among other things, who writes these options, how they are marketed and who purchases them.

[11] See 23d Annual Report, p. 159.

PART II

LEGISLATIVE ACTIVITIES

Statutory Amendments Proposed by the Commission

Proposals to amend 87 provisions of the Federal securities laws were submitted by the Commission to the 85th Congress in July and August 1957. These proposals were introduced in both the Senate and the House of Representatives, and the bills were referred to committee, but no action was taken on the bills during the 85th Congress.[1]

During the latter part of 1958 the Commission reexamined these recommendations for legislation and made some modifications, deleting certain proposals and adding others. The modified proposals, which would amend the Securities Act of 1933, The Securities Exchange Act of 1934, the Trust Indenture Act of 1939, the Investment Company Act of 1940 and the Investment Advisers Act of 1940, were then submitted in the 86th Congress to the Committee on Banking and Currency, United States Senate, and the Committee on Interstate and Foreign Commerce, House of Representatives. These Committees have the duty of exercising watchfulness over the execution of the securities laws under section 136 of the Legislative Reorganization Act of 1946.

The Commission's proposals were introduced in the Senate by Senator A. Willis Robertson, Chairman of the Committee on Banking and Currency, for himself and for Senator Homer E. Capehart, as S. 1178, S. 1179, S. 1180, S. 1181, and S. 1182. In the House of Representatives, Representative Oren Harris, Chairman of the Committee on Interstate and Foreign Commerce, introduced companion bills, H.R. 5001, H.R. 2480, H.R. 5002, H.R. 2481, and H.R. 2482.[2]

Basically the Commission's proposals, the more significant of which are briefly described below, are intended to strengthen the safeguards and protections afforded the public by tightening jurisdictional provisions, correcting certain inadequacies revealed through administrative experience and facilitating criminal prosecutions and other enforcement activities.

The proposed amendments to the Securities Act of 1933 would clarify the jurisdictional basis of the civil liability provisions of the

[1] For a detailed discussion of the Commission's legislative program during the 85th Congress, see pages 10–12 of the Commission's 23d Annual Report and page 9 of the Commission's 24th Annual Report.

[2] H.R. 5001 and H.R. 5002, proposing amendments to the Securities Act of 1933 and the Trust Indenture Act of 1939, respectively, are substitutes for H.R. 2488 and H.R. 2483, respectively, which included earlier recommendations that the Commission decided to withdraw on further consideration.

statute; extend existing civil liabilities and provide criminal liability with respect to documents filed with the Commission pursuant to Commission rules in connection with exempt offerings; increase from $300,000 to $500,000 the size of offerings which may be exempted from registration under section 3(b) of the statute; and make it clear that a showing of past violations is a sufficient basis for injunctive relief and that aiders and abettors may be responsible in civil and administrative proceedings.[3]

The proposed amendments to the Securities Exchange Act of 1934 would make comparable changes with respect to injunctive relief and liability of aiders and abettors. In addition, changes proposed in that statute would make it a violation of the act to embezzle monies or securities entrusted to the care of an exchange member or a registered broker or dealer; clarify and strengthen the statutory provisions relating to manipulation and to the financial responsibility of brokers and dealers; authorize the Commission by rule to regulate the borrowing, holding or lending of customers' securities by a broker or dealer; make it clear that attempts to purchase or sell securities are covered by the antifraud provisions of the statute; revise the provisions relating to broker and dealer registration with respect to (a) the basis on which action for denial or revocation may be taken, (b) the sanctions which may be imposed by the Commission, (c) the conditions under which an application for registration may be withdrawn, and (d) the postponement of the effectiveness of an application for registration; authorize the Commission to suspend or withdraw the registration of a securities exchange when the exchange has ceased to meet the requirements of its original registration; clarify the Commission's authority to suspend a security from exchange trading where there has been a failure to comply with the act and where otherwise necessary in the public interest; prohibit trading in the over-the-counter market for limited periods where the public interest and the protection of investors so requires; provide that an insolvent broker or dealer may be adjudicated a bankrupt in an injunctive proceeding instituted by the Commission; and provide for a monetary forfeiture for each day that certain reports required under the act are delinquent.

The changes proposed in the Trust Indenture act of 1939 are designed primarily to conform this statute to recommendations made under the Securities Act.

The proposed amendments to the Investment Company Act of 1940 would require an investment company to state as matters of fundamental policy, which generally could not be changed without the consent of its stockholders, the extent to which it intends to invest in particular types of securities and such other basic investment objectives as it represents it will emphasize; strengthen the provi-

[3] See p. 13, *infra*.

sions requiring a minimum number of independent or nonmanagement directors; limit the extent to which a face-amount investment company can include preferred and common stock in its "qualified investments"; make clear the application of the statute to an "advisory board"; and modify the exception for companies subject to regulation by the Interstate Commerce Commission and clarify the exceptions applicable to companies engaged in banking, insurance, small loan, factoring, discount or real estate businesses.

The proposed changes in the Investment Advisers Act of 1940 would expand the basis for disqualification of a registrant because of prior misconduct; authorize the Commission by rule to require the keeping of books and records and the filing of reports; permit periodic examinations of a registrant's books and records; empower the Commission by rule to define and prescribe means reasonably designed to prevent fraudulent practices; extend criminal liability for willful violation of a rule or order of the Commission; and revise the provisions relating to the postponement of effectiveness and the withdrawal of applications for registration.

Many minor amendments of these statutes are also proposed.

Hearings on the bills were held before the Subcommittee on Securities of the Banking and Currency Committee of the Senate, on June 15, 16, 17, 18, 23, 24, and 25, 1959, and before the Subcommittee on Commerce and Finance of the Committee on Interstate and Foreign Commerce of the House of Representatives on June 3, July 8 and 9 and August 4, 1959. The Commission and staff members presented testimony at the beginning of the hearings before each committee, and again after interested industry representatives and others had been heard. As a result of conferences with industry representatives, similar to those held in connection with the formulation of the legislative recommendations in the 85th Congress, and as a consequence of comments and suggestions made during the course of the hearings by members of Congress and witnesses, the Commission made certain modifications in its proposals. These modifications did not represent abandonment of the original proposals, but essentially constituted clarification and statutory specification of matters in conformity with the original intention of the Commission.

The Commission also advised the Committees that it had no objection to three amendments to the Investment Advisers Act proposed during the hearings by certain investment advisers and their representatives. One would modify the definition of the term "control" in the statute, the second would grant the Commission authority to provide exemptions from the statute, and the third would modify the conditions under which an investment adviser may call himself an "investment counsel."

Other Legislative Proposals

Various other bills to amend the securities laws were introduced, and the Commission submitted comments to the committees of Congress. These bills, except for H.R. 4025 and H.R. 5543, renewed proposals made in previous sessions of the Congress. No hearings were held on the bills, which are discussed briefly below.

1. **Proposal to Increase Registration Fees.**—On January 28, 1959, Senator Homer E. Capehart for himself and for Senator Frank J. Lausche introduced S. 737, and on April 13, 1959, Representative John B. Bennett introduced an identical bill, H.R. 6294. Both bills would amend section 31 of the Securities Exchange Act of 1934, which now provides an annual fee for registration of exchanges of one five-hundredths of 1 percent of the aggregate dollar amount of stock exchange transactions, equal to 2 cents per $1,000. Under the bills this exchange registration fee would be increased to a rate of 5 cents per $1,000 and there would be a similar registration fee for brokers and dealers of 5 cents per $1,000 on transactions effected otherwise than on a national securities exchange.[4]

2. **Disclosure of Beneficial Ownership of Registered Securities in Election Contests.**—On January 9, 1958, Senator Homer E. Capehart introduced S. 132, a bill directed to identifying beneficial owners of securities in proxy contests. The bill would add to section 14 of the Securities Exchange Act of 1934 a provision making it unlawful for any person to give or to attempt to give a proxy to vote a registered security at any annual or special meeting for the election or removal of directors, with respect to which proxies are solicited by opposing nominees, unless (1) such person is the beneficial owner of the security, or (2) the name and last known address of the beneficial owner appears on the proxy. In addition, the bill would make it unlawful for any person knowingly to exercise or attempt to exercise any proxy in violation of this provision.[5]

3. **Reporting Requirement of Beneficial Owners of Registered Securities and Officers and Directors of Issuers Thereof.**—On January 28, 1959, Senator Homer E. Capehart introduced S. 736, which would amend section 16 of the Securities Exchange Act of 1934 to require every beneficial owner of more than 5 percent (instead of 10 percent as now provided) of any class of any equity security which is registered on a national securities exchange to file reports of his securities holdings and transactions with the Commission.[6]

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[4] See the Commission's 23d Annual Report, pp. 12–13, for a discussion of similar proposals in the 85th Congress.

[5] See the Commission's 23d Annual Report, p. 16, for discussion of a similar proposal in the 85th Congress.

[6] See the Commission's 23d Annual Report, pp. 15–16, for a discussion of a similar proposal in the 85th Congress.

H.R. 1028 was introduced by Representative Abraham Multer on January 7, 1959. This bill would amend section 16(a) of the Securities Exchange Act of 1934 to require officers and directors of any issuer of registered securities to report periodically the extent to which, and the purposes for which, their holdings of such securities are pledged.

4. Proposals Relating to Exempt Offerings and Civil Liabilities in Connection Therewith.—Two bills designed to impose additional civil liabilities in connection with exempt offerings under section 3(b) of the Securities Act of 1933 were introduced in the first session of the 86th Congress. On January 7, 1959, Representative Leonard Farbstein introduced H.R. 93, a bill which would augment existing provisions for civil liabilities by providing for specific liability on the part of those responsible for untrue statements of material facts or omissions to state material facts in any statements or document filed with the Commission in connection with an exempt offering under section 3(b). This bill is identical with the proposal embodied in the Commission's legislative program,[7] except that the Commission proposal also encompasses false filings pursuant to section 3(c) of the statute.

On February 17, 1959, Representative John R. Bennett introduced H.R. 4568, a bill which would raise the exemptive ceiling under section 3(b) from $300,000 to $500,000 and would make applicable to such exempt offerings the strict civil liabilities now pertaining solely to registered offerings.[8]

5. Repeal of Exemption for Intrastate Offering.—H.R. 884, introduced by Representative Abraham Multer of New York, would remove the exemption provided by section 3(a)(11) of the Securities Act for a security offering confined to the residents of the state within which the issuer is both incorporated and doing business. The Commission has not submitted its views on this proposal.

6. Reduced Sales Load for Certain Purchases of Investment Company Shares.—As a consequence of the Commission's promulgation on December 2, 1958, of rule 22d-1 under the Investment Company Act,[9] Representative Edward W. Hiestand introduced H.R. 4025 and H.R. 5543, both of which would amend section 22(d) of the statute to authorize quantity purchases of investment company shares by certain retirement associations at reduced sales loads. Prior to the adoption of rule 22d-1 several associations of individuals, which would not be exempted under the provisions of the rule, had received the benefit of a smaller sales load in connection with certain quantity

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[7] See p. 10, *supra*.

[8] H.R. 93 and H.R. 4568, insofar as they relate to civil liabilities, are identical with H.R. 173 and H.R. 4744, 85th Congress, respectively, and H.R. 11308 and H.R. 9319, 84th Congress, respectively. The background of the latter bills is discussed in the 22d Annual Report of the Commission, pp. 11–12.

[9] See p. 23, *infra*.

purchases and had been advised by the Commission's staff that it would not recommend that any action be taken in respect of such purchases. Both H.R. 4025 and H.R. 5543 are designed to restore the earlier interpretation.

A substantial amount of time was directed to matters pertaining to other legislative proposals referred to the Commission for comment and to congressional inquiries. During the fiscal year 1959 a total of 76 legislative proposals were analyzed. In comparison, 58 proposals were analyzed during fiscal 1958 and 33 during fiscal 1957. In addition, numerous congressional inquiries relating to matters other than specific legislative proposals were received and answered.

Congressional Hearings

In addition to the hearings in connection with the Commission's legislative program discussed above, the Commission presented to the House Committee on Interstate and Foreign Commerce a general discussion of the Commission's activities and the particular problems currently facing the Commission.

The Commission appeared before the Subcommittee on Legislative Oversight of the House Committee on Interstate and Foreign Commerce in September and November 1958 and again in June 1959.[10]

The Commission also appeared on May 13, 1959, before the House Select Committee on Small Business to testify concerning the Commission's role in administering the laws governing the operation of small business investment companies.

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[10] See the Commission's 24th Annual Report, pp. 12–13.

PART III

REVISION OF RULES, REGULATIONS AND FORMS

The Commission made a number of changes during the 1959 fiscal year in its rules, regulations and forms under the various statutes administered by it. Other changes which the Commission published in preliminary form for the purpose of obtaining public comments thereon were pending at the end of the fiscal year. The changes made during the fiscal year and those pending at the end of the year are described below.[1]

Changing conditions, methods and procedures in business and in the financial practices of business make it necessary for the Commission to maintain a continuing review of its rules, regulations and forms. Certain members of its staff are assigned to this task. Changes are also suggested, from time to time, by other members of the staff engaged in the examination of material filed with the Commission, and by persons outside of the Commission who are subject to the Commission's requirements or who have occasion to work with those requirements in a professional capacity such as underwriters, attorneys, accountants, and other representatives. With relatively few exceptions, provided for by the Administrative Procedure Act, proposed changes in rules, regulations and forms are announced to the public and interested persons are invited to submit their views and comments thereon. These views and comments are carefully reviewed by the staff and by the Commission and are very helpful in connection with the Commission's consideration of proposed changes.

THE SECURITIES ACT OF 1933

Amendment of Rule 133

Shortly after the end of the fiscal year the Commission adopted certain amendments to rule 133.[2] The modification of this rule has been under consideration for some time and has been mentioned in

[1] The rules and regulations of the Commission are published in the Code of Federal Regulations, the rules adopted under the various Acts administered by the Commission appearing in the following parts of title 17 of that Code:

Securities Act of 1933, part 230.
Securities Exchange Act of 1934, part 240.
Public Utility Holding Company Act of 1935, part 250.
Trust Indenture Act of 1939, part 260.
Investment Company Act of 1940, part 270.
Investment Advisers Act of 1940, part 275.

[2] Securities Act Release No. 4115 (July 16, 1959).

previous annual reports of the Commission.[3] Rule 133 provides in general that for the purpose of determining the application of the registration and prospectus provisions of the Securities Act, no "offer" or "sale" shall be deemed to be involved so far as stockholders of a corporation are concerned where, pursuant to the provisions of a statute or the certificate of incorporation, there is submitted to a vote of such stockholders a plan involving a statutory merger, consolidation, reclassification of securities or transfer of assets of the corporation in consideration of the issuance of securities of another corporation. The general purpose of the amendments to the rule is to make it clear that under certain circumstances securities distributed by persons receiving them in connection with such transactions may be required to be registered under the act. For example, the amended rule provides that where one company is merged into another company, a stockholder in control of the merged company who receives securities of the surviving company with a view to making a distribution of such securities to the public shall be deemed to be an underwriter and registration of the securities is required before the distribution can be made. However, registration is not required with respect to securities sold in certain brokers' transactions as defined in the rule.

In connection with the amendment of rule 133, a new Form S-14 was adopted for the registration of certain securities issued in a rule 133 transaction. This form is discussed below at p. 20.

Amendment of Rule 135

This rule, as originally adopted, provided that a notice or other communication sent by an issuer to its security holders to inform them of the proposed issuance of rights to subscribe to additional securities would not be deemed to offer any security issue for sale if such notice was sent in conformity with the rule. The principal requirements were that the notice be sent within 60 days prior to the record date, state that the offering will be made only by the prospectus and in addition contain only certain specified information necessary to inform the security holders of the forthcoming offering. The purpose of the rule was to enable an issuer to furnish certain factual information to its security holders in advance of making the actual offering.

The rule was amended during the fiscal year to permit the sending of similar notices where an issuer proposes to offer securities to its own security holders, or to the security holders of another issuer in exchange for securities presently held by them, and also where the issuer proposes to make an offering of securities to its employees or to the employees of an affiliate.[4]

[3] 23d Annual Report, p. 20; 24th Annual Report, p. 14.

[4] Securities Act Release No. 4099 (June 16, 1959).

Proposed Rule Changes Relating to Assessable Stock

During the 1958 fiscal year the Commission invited public comments on a proposed new rule 136 and certain proposed amendments to rule 140 with respect to assessable stock and the levying of assessments thereon.[5] The general purpose of these proposals was to make it clear that the Securities Act of 1933 applies to the levying of assessments on assessable stock to the same extent that it applies to other securities. Action on these proposals was deferred pending further study of the matter. During the 1959 fiscal year the Commission published revised proposals with respect to the rules referred to and also a proposed exemption Regulation F,[6] which were adopted shortly after the close of the fiscal year.[7]

The new Regulation F, which provides an exemption from registration under the act for assessments and delinquent assessment sales in amounts not exceeding $300,000 in any one year, requires the filing of a simple notification giving brief information with respect to the issuer, its management, principal security holders, recent and proposed assessments and other security issues. This notification could be prepared in a relatively short time by any officer of the company who is familiar with the company's affairs and there is no fee or charge for its filing. The filing may be made by mailing the notification to the appropriate regional office of the Commission.

The only information which a company is required to send to its stockholders, or otherwise publish, is a statement of the purposes for which the proceeds from the assessment are proposed to be used. This information may be included in the notice of assessment given by mail or otherwise published as required by State law. If the issuer should employ any other sales literature in connection with the assessment, copies of such literature must be filed with the Commission.

Proposed Rule 144

During the fiscal year the Commission invited public comments on a proposed rule relating to certain transactions by the International Bank for Reconstruction and Development. The proposed rule, to be designated rule 144, would have defined the term "transactions by an issuer not involving any public offering," in section 4(1) of the act, to include certain activities of the Bank. After the close of the fiscal year, the Commission announced that it had discontinued consideration of the proposed rule since there appeared to be no present need for it.[8]

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[5] See 24th Annual Report, p. 16.
[6] Securities Act Release No. 4040 (Mar. 4, 1959).
[7] Securities Act Release No. 4121 (July 30, 1959).
[8] Securities Act Release No. 4028 (Feb. 10, 1959) and 4161 (Nov. 30, 1959).

The proposed rule would also define the term "distribution" in section 2(11) of the act as not applying to such transactions by the bank or by any dealer who is acting on an agency basis pursuant to a written contract with the bank.

The matter was still under consideration at the end of the fiscal year.

Adoption of Rule 151

This rule defines the term "public offering" to exclude under certain conditions the offering of stock of small business investment companies to small business concerns pursuant to the requirements of the Small Business Investment Act of 1958.[9]

Under section 304(d) of the Small Business Investment Act, whenever a small business investment company provides capital to a small business concern through the purchase of the latter's convertible debenture bonds, the small business concern is required to purchase stock of the small business investment company in an amount equal to not less than 2 percent nor more than 5 percent of the capital so provided, in accordance with regulations of the Small Business Administration. Those regulations specify certain minimum amounts of such stock which a small business concern is required to purchase depending upon the amount of capital which it obtains from a small business investment company through the issuance of convertible debenture bonds.

The new rule provides that a public offering of capital stock of a small business investment company is not deemed to be involved where the offer or sale is made in connection with the purchase of debenture bonds from a small business concern pursuant to the requirements of the Small Business Investment Act, the amount of stock involved is the minimum required by that act and the regulations thereunder in connection with the particular transaction, and the stock is acquired by the small business concern for investment and not with a view to its distribution.

Amendment of Rule 434A

This rule permits the use of summary prospectuses which omit in part or summarize information set forth in the more complete prospectus required to be used in connection with the offering and sale of securities. Summary prospectuses may be used in the form of newspaper advertisements, circulars, etc. as a screening device to locate persons interested in receiving a copy of the complete prospectus.

The rule was amended during the fiscal year to permit the use of summary prospectuses by a larger group of issuers.[10] The rule as previously in effect permitted the use of summary prospectuses only by

[9] See Securities Act Release No. 4033 (Feb. 13, 1959).
[10] Securities Act Release No. 4094 (June 11, 1959).

registrants which file reports under sections 13 and 15(d) of the Securities Exchange Act of 1934. The amended rule permits the use of summary prospectuses by certain other registrants which do not file such reports but which meet certain standards as to size, earnings, and the publication of reports.

Adoption of Regulation E

The Commission during the fiscal year adopted a new regulation, designated Regulation E, which provides a conditional exemption from registration under the Securities Act of 1933 for securities of small business investment companies which are licensed under the Small Business Investment Act of 1958 or which have received the preliminary approval of the Small Business Administration and have been notified by the Administration that they may submit an application for such a license.[11] The new regulation, which exempts issues not in excess of $300,000 from registration under the act, was adopted pursuant to the new section 3(c) which was added to the Securities Act by section 307(a) of the Small Business Investment Act.

Regulation E is similar in many respects to the general exemption for certain securities, other than those of investment companies, provided by Regulation A. It requires the filing of a notification with the Commission and, except in the case of offerings not in excess of $50,000, the filing and use of an offering circular containing certain specified information. In general, information is required in the offering circular as to the business and investment policies of the issuer, its management and its financial condition. The financial statements required must be prepared in accordance with generally accepted accounting principles and practices but need not be certified by independent public accountants. Provision is made for the suspension of an exemption in a particular case if the Commission finds that any of the terms and conditions of the regulation have not been met or complied with.

Adoption of Form N-5

During the fiscal year the Commission adopted a new form, designated Form N-5, for the registration under the Securities Act of 1933 of securities to be issued by small business investment companies which are licensed under the Small Business Investment Act of 1958 or which have received the preliminary approval of the Small Business Administration and have been notified by the Administration that they may submit an application for such a license.[12] This form is also to be used for the registration statements of such companies filed pursuant to section 8(b) of the Investment Company Act of 1940.

[11] Securities Act Release No. 4005 (Dec. 17, 1958).
[12] Securities Act Release No. 4004 (Dec. 17, 1958).

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The new form is a combination form which enables a small business investment company to register under the Investment Company Act of 1940 and at the same time to register securities for a public offering under the Securities Act of 1933 by means of a single registration statement. If a company has already registered under the Investment Company Act, the form may be used for subsequent registration under the Securities Act. If a company desires to register under the Investment Company Act prior to registering securities under the Securities Act, the form may be used for this purpose also.

Adoption of Form S–14

In connection with the adoption of amendments to rule 133,[13] the Commission also adopted a new Form S–14.[14] This form is designed to provide a simplified registration procedure for securities issued in a rule 133 transaction where such registration is required and where the issuer has solicited proxies under the Commission's proxy rules with respect to such transaction. The form provides that the prospectus may consist chiefly of the information set forth in the proxy statement supplemented by the necessary underwriting and distribution data and pertinent information regarding developments in the registrant's business subsequent to the rule 133 transaction.

THE SECURITIES EXCHANGE ACT OF 1934

Adoption of Rule 16b–8

The Commission during the fiscal year adopted a new rule under section 16(b) of the Securities Exchange Act of 1934.[15] This section of the act provides that profits obtained by certain holders of the stock of a listed company from purchases and sales, or sales and purchases, of any equity securities of such company (other than exempt securities) within any 6-month period may be recovered by the company or by any security holder on its behalf.

The new rule, designated rule 16b–8, exempts from section 16(b) under certain conditions the receipt from an issuer of shares of stock having general voting power and registered on a national securities exchange upon the surrender of an equal number of shares of stock of the same issuer which do not have such voting power and are not so registered, where the transaction is effected pursuant to the provisions of the issuer's certificate of incorporation for the purpose of making an immediate sale of the shares so received.

The conditions of the rule, briefly summarized, are that the person so receiving such shares is not an officer or director of the issuer or a person who was a beneficial owner immediately prior to the transaction of more than 10 percent of a registered equity security of the

[13] *Supra*, p. 15.
[14] Securities Act Release No. 4115 (July 16, 1959).
[15] Securities Exchange Act Release No. 5921 (Mar. 30, 1959).

issuer; that the shares surrendered and the shares received are freely transferable and entitle the holders thereof to participate equally per share in all distributions of earnings and assets; that the shares received must be registered upon issuance in the name of a person or persons other than the holder of the shares surrendered and may be required to be issued as of right only in connection with the public offering, sale, and distribution or gift of such shares; and that no shares of the class surrendered or any other shares of the class received are acquired by the person effecting the transaction within six months before or after the date of the transaction.

Amendment of Form 8-K

The Commission during the fiscal year adopted certain amendments to Form 8-K, which is the form prescribed for current reports filed pursuant to sections 13 and 15(d) of the Securities Exchange Act of 1934.[16] The amendments relate to the item of the form which requires information in regard to matters submitted to a vote of security holders, either at a meeting of such security holders or otherwise. The purpose of the amendments was to clarify the item with respect to the circumstances under which the information specified in the item is required to be furnished.

The Commission also invited public comments on certain other proposed amendments to Form 8-K designed to bring to the attention of investors promptly information regarding material changes affecting the company or its affairs where it appears that the changes are of such importance that they should be reported promptly and not deferred to the end of the fiscal year.[17] The amendments relate to matters such as the pledging of securities of the issuer or its affiliates, changes in the board of directors otherwise than by stockholder action, the acquisition or disposition of significant amounts of assets and transactions with insiders. Shortly after the end of the fiscal year the time for submitting comments on these proposed changes was extended to August 15, 1959.[18]

THE INVESTMENT COMPANY ACT OF 1940

Adoption of Rule 3c-1

In connection with the adoption of rule 151 under the Securities Act,[19] the Commission also adopted a new rule 3c-1 under the Investment Company Act of 1940 defining the term "public offering", for the purposes of section 3(c)(1) of that act, to exclude under certain conditions, the offering of stock of small business investment companies to small business concerns pursuant to the requirements of the

[16] Securities Exchange Act Release No. 5734 (July 16, 1958).
[17] Securities Exchange Act Release No. 5979 (June 9, 1959).
[18] Securities Exchange Act Release No. 6018 (July 14, 1959).
[19] *Supra*, p. 18.

Small Business Investment Act of 1958.[20] Section 3(c)(1) of the Investment Company Act provides that any issuer whose outstanding securities (other than short term paper) are beneficially owned by not more than 100 persons and which is not making and does not presently propose to make a public offering of its securities is not an investment company within the meaning of the act. Since the requirements of the Small Business Investment Act and the rules and regulations thereunder require that a small business investment company in its role as a provider of capital continually stand ready to sell its stock to small business concerns, a continuous disposition of stock by such investment companies may possibly be interpreted to be a "public offering." The Commission, therefore, adopted rule 3c-1 to effectuate the purposes and objectives of the Small Business Investment Act without adversely affecting the public investor interest. The terms and conditions of the rule 3c-1 definition are substantially the same as those contained in rule 151.

Adoption of Rule 10f-3—Permitting Acquisition of Securities of Underwriting Syndicates

To alleviate the problems and administrative burdens involved in processing individual applications for relief pursuant to section 10(f) of the act, the Commission, in December 1958, adopted rule 10f-3 exempting certain limited acquisitions of securities by registered investment companies during the existence of an underwriting syndicate where such acquisitions are not made from affiliated underwriters.[21] Notice of the proposed rule was issued in July 1958[22] and the comments received were unanimously in favor of the adoption of the rule, although a number of suggestions for its modification were included.

Section 10(f) of the act provides that an investment company, unless exempted by rule, regulation or order, is prohibited from purchasing a security during the existence of an underwriting syndicate, if any of the principal underwriters are affiliated persons of the investment company. Before the adoption of rule 10f-3, investment companies were required in all such cases to obtain an exemptive ruling by the Commission prior to the purchase of such securities or to purchase them conditioned on obtaining an exemptive order within such periods of time as a particular underwriter might be willing to grant even though extending beyond the date of the public offering. The new rule permits the investment company to make such purchases under certain conditions without the necessity of obtaining an order of exemption.

Through its experience in considering the many applications for

[20] Investment Company Act Release No. 2828 (Feb. 13, 1959).

[21] Investment Company Act Release No. 2797 (Dec. 2, 1958).

[22] Investment Company Act Release No. 2744.

relief filed pursuant to section 10(f) over the years, the Commission was in a position to determine what conditions and safeguards should be imposed in such situations to insure the protection of investors. These include limitations with respect to the consideration paid, as related both to the amount of the offering and the assets of the investment company. In addition, underwriters' commissions may not exceed stated amounts, no purchase may be made from an affiliated underwriter, and the offering must be effectively registered under the Securities Act of 1933. These conditions are designed to permit purchases where the circumstances are such as to make it likely that the purchases would be consistent with the protection of investors. Purchases that do not meet the strict conditions of the rule may, nevertheless, be exempted by order upon application where the statutory standards are satisfied.

Adoption of Rule 22d-1—Relating to Variations in Sales Load of Redeemable Securities

Section 22(d) prohibits a registered investment company, its principal underwriter, or a dealer from selling redeemable securities of the company to any person except at a current public offering price described in the prospectus. Rule 22d-1 was adopted by the Commission in order to settle and codify administrative interpretations of the provisions of section 22(d) and to provide by rule exemptions from its provisions which would obviate the necessity for numerous individual applications.[23] Thus, the burden is removed from the industry of preparing applications under section 6(c), and the Commission need not process such exemptions, in cases identical to those where such relief had previously been granted. The result of the rule is to ensure uniform compliance with the provisions of section 22(d).

The rule was the product of a comprehensive review of the legislative history of section 22(d) of the act, and all past administrative interpretations and exemptive orders issued under that section. One of the most important objectives of the rule was to determine the question of the availability of a quantity discount (i.e., a reduced sales charge for sales exceeding an established amount) for persons who were banded together for the purpose of making purchases as a group.

The rule permits the granting of quantity discounts and does not insist that the amount of securities must be determined as of a single point of time. In this respect the rule follows previous Commission decisions which had permitted a sales load discount to be based upon shares previously acquired and then owned plus the shares being purchased. Purchases made within a period of not more than 13 months pursuant to a "letter of intent" may also be aggregated for ascertaining the quantity entitled to a discount but the agreement

[23] Investment Company Act Release No. 2798 (Dec. 2, 1958).

under which such purchases are made must assure that the lower price is justified by the quantity actually purchased and that adjustments will be made if required. In each of these instances, the inclusion of shares of other mutual funds is permitted if the same principal underwriter is involved.

The rule, however, requires uniform prices to individual investors and prohibits quantity discounts to groups of individuals, except in the case of a family unit. A trustee or other fiduciary may obtain a quantity discount for a single trust estate of which there are more than one beneficiary, but quantity discounts may not be allowed on the aggregate of sales to a trustee or representative acting for more than one account or more than one trust. The rule specifically provides that the term "any person" shall not include a group of individuals whose funds are combined directly or indirectly for the purchase of shares, whether jointly or through a representative or agent of the group. The rule in this respect reflects a stricter interpretation than prior Commission views under which quantity discounts had been extended to trustees, custodians, or agents acting on behalf of members of an organization.

The rule permits sales at reduced prices to tax exempt organizations, following Commission decisions in the past granting such exemptive treatment. Sales at net asset value or with a lower load are also permitted to be made to officers, directors, and employees of the investment company, its underwriter and investment adviser, but written assurance must be given that the purchases are for investment purposes and that the securities will not be resold except through the usual redemption or repurchase procedure. Sales to employee pension or benefit plans are included within the exemption afforded by the rule.

With respect to the reinvestment of distributions the rule permits the limitation of reinvestment privileges to participants in a systematic investment or dividend reinvestment plan provided all shareholders are offered the opportunity to participate in the dividend reinvestment plan at any time. All stockholders must be notified of the availability of the dividend reinvestment privilege once each year by a statement in the annual report or other document.

The rule has been helpful in stabilizing the pricing methods of the mutual funds. The need for individual exemptive orders has been substantially eliminated, thus lightening the burdens on the companies and the Commission to that extent. The provisions of the rule are, of course, subject to review by the Commission, and specific applications for relief may still be submitted.

Adoption of Form N-5—Registration Form for Small Business Investment Companies

As previously indicated,[24] the new Form N-5 is a combination form which enables a small business investment company to register under the Investment Company Act pursuant to section 8(b) and at the same time to register securities for a public offering under the Securities Act of 1933 by means of a single registration statement. If a company has already registered under the Investment Company Act the form may be used for subsequent registration under the Securities Act. If a company desires to register under the Investment Company Act prior to registering securities under the Securities Act, the form may also be used for that purpose.

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[24] *Supra*, p. 19.

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. These documents are available for public inspection as soon as they are filed. The registration statement must become "effective," however, before the securities may be sold to the public. 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 pass upon its merits or the terms of its distribution. Its action in permitting a registration statement to become effective does not constitute approval of the securities, and any representation to a prospective purchaser of securities to the contrary is made unlawful by section 23 of the act.

DESCRIPTION OF THE REGISTRATION PROCESS

Registration Statement and Prospectus

Registration of any security proposed to be publicly offered may be effected by filing with the Commission a registration statement on the applicable form containing the prescribed disclosure. When a registration statement relates, generally speaking, to a security issued by a corporation or other private issuer, it must contain the information, and be accompanied by the documents, specified in schedule A of the act; when it relates to a security issued by a foreign government, the material specified in schedule B must be supplied. Both schedules specify in considerable detail the disclosure which should be made available to an investor in order that he may make an informed decision whether to buy the security. In addition, the act provides flexibility in its administration by empowering the Commission to classify issues, issuers and prospectuses, to prescribe appropriate forms, and to increase, or in certain instances vary or diminish, the information required to be disclosed in the registration statement,

as the Commission deems appropriate in the public interest or for the protection of investors.

In general the registration statement of an issuer other than a foreign government must set forth 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 the options or bonus and profit-sharing privileges allotted to them; the character and size of the business enterprise, its capital structure, past history and earnings and financial statements certified by independent accountants; underwriters' commissions; payments to promoters made within 2 years or intended to be made; acquisitions of property not in the ordinary course of business, and the interest of directors, officers and principal stockholdlers therein; pending or threatened legal proceedings; and the purpose to which the proceeds of the offering are to be applied. The registration statement of a foreign government must contain comparable information in regard to the underwriting and distribution of the securities being registered, the natural and industrial resources of the country, its revenues, obligations and expenses, a description of the securities being registered, and similar matters. The prospectus constitutes a part of the registration statement and presents the more important of the required disclosures.

Examination Procedure

The staff of the Division of Corporation Finance examines each registration statement for compliance with the standards of accurate and adequate disclosure and usually notifies the registrant by an informal letter of comment of any material respects in which the statement appears to fail to conform to those requirements. The regisrant is thus afforded an opportunity to file a curative amendment. In addition, the Commission has power, after notice and opportunity for hearing, to issue a "stop order" suspending the effectiveness of a registration statement. In certain cases, such as where a registration statement is so deficient as to indicate a willful or irresponsible failure to make adequate disclosure, no letter of comment is sent and the Commission either institutes an investigation to determine whether stop-order proceedings should be instituted or immediately institutes stop-order proceedings. Information about the use of this stop-order power during 1959 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 as promptly as possible. 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 to take into account the adequacy of the information respecting the issuer theretofore available to the public, the facility with which investors can understand the nature of and the rights conferred by the securities to be registered, and their relationship to the capital structure of the issuer, and the public interest and the protection of investors. The note to rule 460 under the act indicates, for the information of interested persons, some of the more common situations in which the Commission believes that the statute generally requires it to deny acceleration of the effective date of a registration statement.

The number of calendar days which elapsed from the date of filing to the effective date of the median registration statement with respect to the 925 [1] registration statements that became effective during the fiscal year ended June 30, 1959, was 28. The number of such calendar days in the 1958 and 1957 fiscal years was 24 and 23, respectively.

These 28 calendar days for the median registration statement in the 1959 fiscal year were divided among the three principal stages of the registration process as follows:

(a) from the date of filing the registration statement to the date of the staff's letter of comment, 17 days;

(b) from the date of the staff's letter of comment to the date of filing the first material amendment after such letter, 6 days; and

(c) from the date of filing the first material amendment after the staff's letter of comment to the effective date of registration, 5 days. Holidays as well as Saturdays and Sundays are included in these numbers of days.

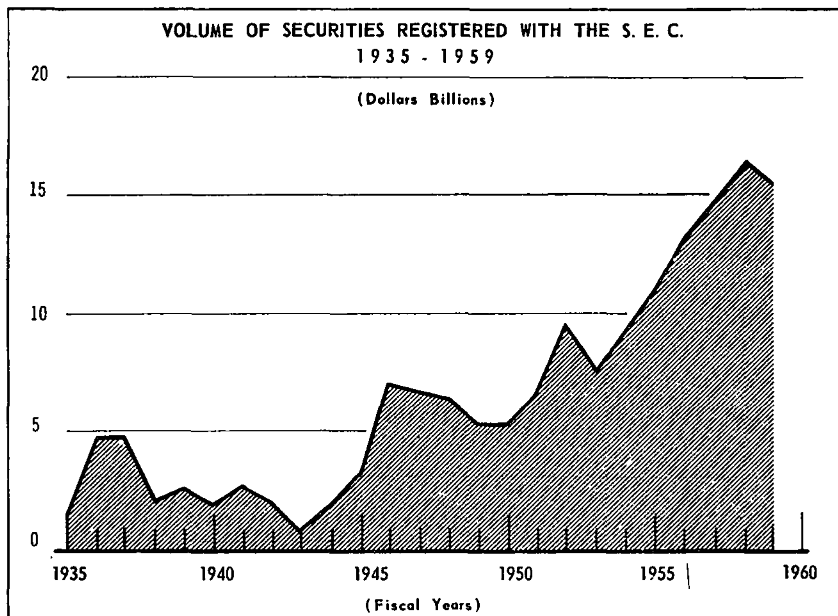
The increase in elapsed time is a reflection of the substantial increase in the number of registration statements filed, as indicated below, and of the fact that a large number of these statements related to new or unseasoned ventures which required relatively more time and effort in making an appropriate review.

VOLUME OF SECURITIES REGISTERED

Securities effectively registered under the Securities Act of 1933 during fiscal 1959 totalled $15.7 billion, 5 percent less than the record

[1] Does not include 149 regitsration statements of investment companies filed and effective as amendments to previously effective registration statements pursuant to section 24(e) of the Investment Company Act of 1940. The number of calendar days elapsed from the date of filing to the effective date of registration of the median (average) of these 149 registration statements was 22.

$16.5 billion registered the previous year. The number of registration statements filed was 1,226, 34% greater than in 1958. During the 25-year history of the Commission, approximately $160 billion of registrations have become effective, $71 billion in the last 5 fiscal years. The lowest annual volume of registrations was $659 million in the wartime year 1943. The chart below shows the dollar amount of effective registrations by fiscal years from 1935 to 1959.



These figures cover all securities effectively registered, including new issues sold for cash by the issuer, secondary distributions, and securities registered for other than cash sale, such as exchange transactions, issues reserved for conversion and issues reserved for long-term options. Of the dollar amount of securities registered in 1959, 77.3 percent was for the account of issuers for cash sale, 17.5 percent for account of issuers for other than cash sale and 5.2 percent was for the account of others, as shown below.

Account for which securities were registered under the Securities Act of 1933 during the fiscal year 1959 compared with the fiscal years 1958 and 1957

	1959 in millions	Percent of total	1958 in millions	Percent of total	1957 in millions	Percent of total
Registered for account of issuers for cash sale	$12,095	77.3	$13,281	80.5	$12,019	82.2
Registered for account of issuers for other than cash sale	2,746	17.5	3,008	18.3	2,225	15.2
Registered for account of others than the issuers	815	5.2	201	1.2	380	2.6
Total	15,657	100.0	16,490	100.0	14,624	100.0

Securities to be sold for cash for account of the issuer amounted to $12.1 billion in 1959, a decrease of $1.2 billion over the previous year. This reflects a 23 percent decrease, about $1.6 billion, in the volume of debt securities, partially offset by a small increase in the volume of common stock. Debt securities made up $5.3 billion of the 1959 volume, preferred stock $400 million and common stock $6.4 billion. Investment company securities showed a sharp increase in 1959 and accounted for 60 percent of the total for common stock compared with less than one-half in fiscal 1958.

The number of statements, total amounts registered, and a classification by type of security for issues to be sold for cash for account of the issuing company is shown for each of the fiscal years 1935 through 1959 in appendix table 1. More detailed information for 1959 is given in appendix table 2, while 5-year summaries of such information for the 25-year period appear in part II of appendix table 1.

The amount of securities registered by investment companies increased almost 50 percent in 1959 over the previous year while that registered by communication companies decreased 80 percent. Among the smaller groups, the trade group aggregate showed an outstanding increase. Securities classified by industry, registered for cash sale for account of issuers in each of the last 3 fiscal years are shown below:

	1959 in millions	Percent of total	1958 in millions	Percent of total	1957 in millions	Percent of total
Manufacturing	$1,974	16.3	$2,239	16.9	$2,674	22.2
Extractive	128	1.1	110	.8	283	2.4
Electric, gas and water	2,726	22.5	3,373	25.4	2,951	24.5
Transportation, other than railroads	41	.3	52	.4	112	.9
Communication	591	4.9	2,978	22.4	2,030	16.9
Investment companies	4,329	35.8	2,919	22.0	2,614	21.8
Other financial and real estate	880	7.3	1,109	8.4	952	7.9
Trade	543	4.5	34	.2	84	.7
Service	76	.6	29	.2	33	.3
Construction	75	.6	25	.2		
Total corporate	11,363	93.9	12,868	96.9	11,733	97.6
Foreign governments	732	6.1	412	3.1	286	2.4
Total	12,095	100.0	13,281	100.0	12,019	100.0

Investment company issues were classified as follows:

	1959 in millions	1958 in millions	1957 in millions
Open-end companies [1]	$3,760	$2,784	$2,361
Closed-end companies	140	12	
Face amount certificate companies	429	123	253
Total	4,329	2,919	2,614

[1] Periodic payment plans or their underlying securities are included.

Of the net proceeds of the corporate securities registered for cash sale for the account of issuers in fiscal 1959, 53 percent was desig-

nated for new money purposes, including plant, equipment, and working capital, 1 percent for retirement of securities, 43 percent for purchase of securities, principally by investment companies and 3 percent for all other purposes.

REGISTRATION STATEMENTS FILED

During the 1959 fiscal year, 1,226 registration statements were filed for offerings of securities aggregating $16,622,890,371, an increase of 34% over the 913 registration statements filed during the 1958 fiscal year for offerings amounting to $16,913,744,964.

Of the 1,226 registration statements filed in the 1959 fiscal year, 472, or 39 percent, were filed by companies that had not previously filed any registration statement under the Securities Act of 1933. Comparable figures for the 1958 and 1957 fiscal years were 254, or 28 percent, and 305, or 32 percent, respectively.

A cumulative total of 15,930 registration statements has been filed under the act by 7,397 different issuers covering proposed offerings of securities aggregating over $167 billion from the enactment of the Securities Act of 1933 to June 30, 1959.

Particulars regarding the disposition of all registration statements filed under the act to June 30, 1959, are summarized in the following table.

Number and disposition of registration statements filed

	Prior to July 1, 1958	July 1, 1958, to June 30, 1959	Total June 30, 1959
Registration statements:			
Filed	14,704	[a] 1,226	15,930
Disposition:			
Effective (net)	[b] 12,823	[c] 1,064	[d] 13,871
Under stop or refusal order	196	6	202
Withdrawn	1,540	65	1,605
Pending at June 30, 1958	145		
Pending at June 30, 1959			252
Total	14,704		15,930
Aggregate dollar amount:			
As filed (in billions)	$150.7	$16.6	$167.3
As effective (in billions)	147.2	15.7	162.9

[a] Includes 153 registration statements covering proposed offerings totalling $3,774,427,154 filed by investment companies under section 24(e) of the Investment Company Act of 1940 which permits registration by amendment to a previously effective registration statement.

[b] The *gross* number of registration statements that became effective, *including* such statements that were subsequently withdrawn or placed under stop order, was 13,273 as of June 30, 1958.

[c] Excludes 10 registration statements that became effective during the year but were subsequently withdrawn; these 10 statements are counted in the 65 statements withdrawn during the year.

[d] Excludes 2 registration statements that became effective prior to July 1, 1958, which were placed under stop order during the 1959 fiscal year, and also excludes 14 registration statements effective prior to July 1, 1958, that were withdrawn during the 1959 fical year; these 2 and 14 statements are counted under stop orders and withdrawn, respectively.

The reasons given by registrants for requesting withdrawal of the 65 registration statements that were withdrawn during the 1959 fiscal year are shown in the following table:

Reason for registrant's withdrawal request	Number of statements withdrawn	Percent of total withdrawn
1. Withdrawal requested after receipt of the staff's letter of comment	12	18
2. Registrant was advised that statement should be withdrawn or stop order proceedings would be necessary	5	8
3. Change in financing plans	36	55
4. Change in market conditions	7	10
5. Financing obtained elsewhere	1	2
6. Regulation A could be used	1	2
7. Insufficient funds raised under escrow agreement	2	3
8. Registrant was unable to negotiate acceptable agreement with underwriter	1	2
Total	65	100

RESULTS OBTAINED BY THE REGISTRATION PROCESS

The staff's examination of registration statements often results in significant changes being effected in order that adequate disclosure will be made to the investing public. These changes cover a wide range of subject matters. Examples of disclosures made as a result of the staff's examination are set forth below.

Disclosure of Speculative Features

A registrant organized to produce electronic equipment filed a registration statement for 175,000 shares of common stock (par value of 75¢ per share) to be offered at $5 a share, the underwriting commission to be $1 per share. Examination of the registration statement revealed that certain speculative features of the proposed offering had not been adequately disclosed.

The prospectus, as filed, stated that the book value of the company's shares prior to the offering was approximately 96 cents but that after the offering it would be approximately $1.86 per share. The registrant was required to include a further statement that such increase would be contributed by the public investors. The registrant was further required to disclose that the underwriters at a total cost of $75 had acquired 75,000 shares of the company's stock representing 15 percent of the total amount of such stock to be outstanding, whereas if all of the shares offered were sold, public investors would pay $875,000 for 35 percent of the stock to be outstanding.

The company was also required to point out in the prospectus that: (1) it proposes to operate in fields where large expenditures for research and development are considered normal and necessary; (2) competition is intense, there being many companies, some with substantially greater resources than the registrant, conducting research and development work in the same general areas; (3) because of research and development work being done, it is possible that one or more of the registrant's proposed products may became obsolete before

production is started or at any time thereafter; and (4) only actual production can determine the cost at which any of registrant's proposed products can be produced and only marketing can determine the prices at which they can be sold and the extent of the demand for them.

Disclosure as to Use of Proceeds

A company engaged in the business of acquiring and developing oil and gas properties filed a registration statement covering $1,500,000 of 6 percent convertible debentures due 1969, to be offered initially to its stockholders by means of subscription rights. The underwriter agreed that within 6 business days after the termination of the rights offering it would purchase or find purchasers for debentures not taken down by stockholders so that the company would receive the proceeds from at least $400,000 principal amount of debentures. The underwriter also agreed to use its best efforts for 60 days after the termination of the rights offering to find purchasers for debentures not taken down by stockholders.

As originally filed, the prospectus indicated that the great bulk of the net proceeds was to be used for acquisition of new properties and development of properties then held. However, an analysis made by our staff of the financial position of the company and its future cash needs disclosed that the company was in a precarious cash position, that on the basis of the prior year's operations cash requirements during the next 18 months would be substantially in excess of the amount of cash that would be generated during that period and that therefore the purpose of the offering was *not* to acquire and develop properties, but to remedy the company's serious financial situation. As a result of numerous comments made by the staff, the prospectus was extensively revised and there was set forth in the forepart thereof, a one and one-half page statement regarding the proposed offering and the company's financial problems, including the following categorical statements:

1. The purpose of the offering was to alleviate the company's shortage of working capital;
2. The company had a working capital deficit of $488,635;
3. Current liabilities included $87,835 of notes payable given for past due accounts payable;
4. Past due accounts payable and past due notes payable amounted to $256,572 and $86,335 respectively;
5. The total amount of funds required to remedy the working capital deficit and retire long term debt maturing within the next 18 months was $1,195,204;
6. Since, on the basis of the previous year's financial report, the company's operations would generate only $335,000 of cash during

the next 18 months, cash requirements would exceed cash generated by $860,000;

7. The minimum principal amount of debentures required to be sold to meet the company's present and anticipated cash needs was $1,050,000;

8. Past due accounts and notes payable which might not be paid if sufficient funds were not realized through sale of the debentures might be enforced through legal proceedings;

9. No priority would be accorded the debenture holders as to principal or interest vis-a-vis other general creditors in the event the company's cash needs were not met through the sale of debentures or otherwise.

While a skilled financial analyst, after study and analysis, might have been able to deduce some of the information set forth above, none of the statements recited was contained in the prospectus as originally filed. It is fair to assume that the average investor would have been materially misled by the prospectus as originally filed.

Revision of Summary of Earnings

A corporation which had both domestic and foreign subsidiaries filed a registration statement containing financial statements which failed to reflect significant losses from the operations of one of the foreign subsidiaries. After our staff determined this fact during the course of the examination procedures and discussed it with the corporation's representatives, the financial statements were appropriately amended to include provisions for the foreign subsidiary's losses.

The effect of such revision was to reduce net income for 1956, 1957, and 1958 by approximately $164,000, $88,000, and $10,000 respectively. After this revision net income per share for the 3 years was $0.06, $0.04 and $0.09 per share, or reductions of approximately 76, 70, and 10 percent, respectively.

Disclosure as to Operations

A company engaged in the development and production of certain electronic equipment filed a registration statement covering 240,000 shares of common stock at the par value of 75 cents a share. The offering price was $6 per share and the underwriting commission was $1 a share. In reviewing the registration statement it was noted that the proposed offering was to be made on an extremely high price-earnings ratio and price-book-value ratio. Accordingly the registrant was required to amend the prospectus to state that the price of the shares being offered had been arbitrarily determined by the board of directors and did not bear any relationship to assets or earnings of the company. It was further required to be pointed out that the offering price was 312 times the unaudited earnings per share for the last fiscal year and 13.2 times the net tangible book value on the basis of the company's balance sheet.

With respect to the company's operations, the company was required to state in regard to one of its lines of business that it had at all times operated substantially below production capacity and that during a recent month, for example, it operated at about 7.5 percent of such capacity, leaving 92.5 percent of its capacity idle. The company was further required to point out that it had not yet engaged regularly in the production of certain machinery for commercial use and had no assurance as to the size of the market for such machinery or the acceptability of the company's products in such market.

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.

The following table indicates the number of proceedings under section 8(d) of the act pending at the beginning of the 1959 fiscal year, the number initiated during the year, the number terminated and the number pending at the end of the year:

Proceedings pending at beginning of fiscal year	7	
Proceedings initiated during fiscal year	13	20
Proceedings terminated during fiscal year:		
By issuance of stop orders[1]	6	
By withdrawal of registration statement	1	7
Proceedings pending at the end of the 1959 fiscal year		13

Shortly after the end of the fiscal year stop orders were issued in two of the proceedings which were pending at the end of the fiscal year and a third proceeding was dismissed. The two proceedings in which stop orders were issued are included in the proceedings described below.

Comico Corporation.—Comico Corporation is a Delaware corporation organized in 1957 for the purpose of exploiting a deposit of silica material located in Arkansas and held under a leasehold assigned to the company by its promoters. The company filed a registration statement covering a proposed public offering of 750,000 shares of common stock at $2 per share. The Commission instituted

[1] One of these proceedings, Woodland Oil & Gas Co. Inc., was described in the Commission's 24th Annual Report, p. 40.

investigative hearings to determine whether a stop order should issue. Following these hearings and prior to the effective date of the registration statement the Commission instituted stop order proceedings. Prior to the institution of the stop order proceedings, the registrant filed an application for withdrawal of the registration statement which was denied by the Commission.

The registration statement contained a lengthy and optimistic discussion of the uses and markets for the minerals in the registrant's leasehold. The Commission found this statement materially misleading, among other things, because it was not based upon any factual engineering or market survey. The Commission found that the registration statement was also misleading for failure to disclose prior unsuccessful attempts to develop the property leased by the registrant and for failure to fully and adequately disclose the proposed use of the proceeds of the offering, the compensation to underwriters and the interests of management in transactions with the registrant. Moreover, the registration statement failed to indicate clearly that the management would receive 660,000 shares of the registrant's stock for $25,000, whereas the public would be asked to pay $1,500,000 for 750,000 shares. Other deficiencies included the failure to disclose the provisions of the lease and the obligation to pay unusually high royalties, and the failure to set forth clearly in one place the speculative feature of the registrant's business and securities. The Commission issued a stop order suspending the effectiveness of the registration statement.[2]

Diversified Oil and Mining Corporation.—This company was organized as a spin-off from Shawano Development Corporation and engaged principally in the acquisition of interests in and the operation of oil and gas properties. It filed a registration statement covering a proposed public offering of 2,500,000 shares of $1 par 6 percent convertible, noncumulative, preferred stock, and warrants to purchase at $2 per share 500,000 shares of the company's 10 cent par common stock. The securities were to be offered in units of 25 shares of preferred stock and 5 warrants at a price of $25.50 per unit.

The statement of matters to be considered at the hearing in a stop order proceedings challenged the adequacy and accuracy of the information disclosed in the registration statement in numerous respects, including information given with respect to the proposed plan of distribution, the use of the proceeds, the description of the business and securities of the registrant, transactions with the promoters and possible liabilities for the previous sale of unregistered securities. Prior to the commencement of the hearing, the registrant submitted a stipulation in which it waived a hearing and the post-hearing procedures provided for in the Commission's rules of practice and con-

[2] Securities Act Release No. 4050 (Apr. 27, 1959).

sented to the entry of an order suspending the effectiveness of the registration statement. Thereafter, the Commission issued an order suspending the effectiveness of the registration statement.[3]

Fort Pierce Port & Terminal Company.—This company was organized in 1956 primarily for the purpose of acquiring harbor front property at Fort Pierce, Fla., to be developed and operated as a deepwater port facility. The company filed a registration statement covering a proposed public offering of 2,138,500 shares of its $1 par common stock at $1.25 per share.

The company's properties, consisting of 3,000 feet of harbor front and certain other properties on nearby Causeway Island and on the mainland, were acquired by promoters of the company (including Joseph C. Mackey, board chairman, and H. A. Ramsey, president) with the intention of selling them to the company. The promoters' cost was $155,000 in cash and the assumption of mortgages aggregating $608,750. The properties were transferred to the company at an appraised value of $1,838,500, the company assuming the $608,750 of mortgages and issuing $1,229,500 par value of stock to the promoters. Subsequently, the company acquired 64.4 acres of submerged lands from the State of Florida for $3,220.

Various references in the prospectus to the appraised value of the company's properties were questioned by the Commission's staff including the $430,000 appraised value of the property acquired from the State of Florida for $3,220. According to the staff there appeared to be a lack of adequate basis for the values determined by the appraisal. The properties acquired from the promoters were carried in the company's balance sheet at the appraised valuation ($1,838,250) contrary to generally accepted accounting principles, and the prospectus failed to contain proper disclosures with respect, among other things, to (1) the competitive traffic situation in relation to the port development project, including the results of a study of the facilities made in 1957 by the U.S. Army Engineers; and (2) the speculative feature of the proposed offering. The Commission instituted stop order proceedings with respect to the registration statement.[4]

Prior to completion of the proceedings, the company filed an application for withdrawal of the registration statement. In its application the company conceded "certain inaccurate statements of material facts and certain omissions of material facts" and agreed that correction would be made in any new registration statement which might be filed by the registrant, although the company stated that it did not intend to proceed with its stock offering at that time. The Commission concluded that withdrawal would not be inconsistent

[3] Securities Act Release No. 3971 (Oct. 2, 1958).
[4] Securities Act Release No. 3951 (Aug. 6, 1958).

with the public interest and the protection of investors and consented to the withdrawal of the registration statement.[5]

Funeral Directors Manufacturing and Supply Company.—This registrant was organized in Kentucky in 1954 for the purpose of manufacturing plastic grave vaults and plastic and aluminum caskets. It filed a registration statement covering a proposed offering of 199,907 shares of the registrant's common stock at $100 per share. The registration statement represented that registrant owned no property but that, depending on the success of the offering, it intended to purchase or construct warehouses and plants and factories.

The Commission found that the registration statement contained material misstatements and omissions of material facts with respect to the state of the development work necessary to effect volume production of the registrant's products and failed to disclose the length of time it would take to effect full production. The registration statement also failed to list two officers employed by the registrant and stated that the remuneration to be paid registrant's officers had not been determined or authorized when, as a matter of fact, such remuneration had been authorized and the registrant had incurred a substantial contingent indebtedness to its officers. The registration statement also stated that there were no agreements to recompense any promoter for past or future services when, in fact, registrant was indirectly indebted to a promoter, who was the president of the registrant, for accrued rents, utilities, and services.

A post-effective amendment to the registration statement not only failed to correct the previously existing deficiencies but was itself deficient in additional material respects.

At the close of the case presented by the Commission's staff, the registrant admitted that the disclosures made in the registration statement and in the post-effective amendment were inadequate and that material events and changes which had occurred since the statement became effective were not disclosed in the post-effective amendment. The registrant consented to the issuance of a stop order by the Commission.[6]

Industro Transistor Corporation.—The registrant was organized in New York in December 1953 and engaged in the manufacture and sale of transistors. It filed a registration statement in 1958 covering a proposed public offering of 135,000 shares of 10-cent par value common stock and, in addition, 36,000 transferable 5-year warrants for the purchase of 1 share of common stock per warrant and the 36,000 shares of common stock subject to such warrants. Proceedings were instituted to determine whether a stop order should issue sus-

[5] Securities Act Release No. 3960 (Aug. 27, 1958).

[6] Securities Act Release No. 4071 (Apr. 23, 1959).

pending the effectiveness of the registration statement. Among the deficiencies found to exist are those described below.

The prospectus failed to contain an adequate and accurate statement with respect to the volume of the registrant's production, the amount of sales to the customers listed in the prospectus, the registrant's competitive position in the industry and the nature of its sales and distribution arrangements. The financial statements included in the prospectus were not prepared in accordance with the Commission's requirements and good accounting practice. For example, sales returns were not shown as a deduction from sales but were treated as purchases of raw material. The income statement showed a net profit from operations for a 4-month period of over $17,000 whereas, if it had been properly prepared, it would have shown a substantial loss.

The prospectus failed to disclose that the compensation of the underwriter included the difference between the exercise price of the 36,000 warrants which the underwriter was to receive and the market price of the stock. The prospectus was also misleading in stating that the underwriter was to pay 1 cent for each warrant, whereas it does not appear that any arrangement was made for such payment; in addition, the prospectus failed to state the possible adverse effect upon the registrant and its security holders of the granting of warrants to the underwriter and to certain other persons, and to state adequately and accurately the purposes for which proceeds from the sale of the securities were to be used.

The Commission issued a stop order suspending the registration statement shortly after the end of the fiscal year.[7] Subsequently, the registrant amended the registration statement to make appropriate disclosure in accordance with the Commission's decision and the Commission lifted its stop order, thus permitting the registration statement to become effective.[8]

Managed Funds Incorporated.—The registrant, an open-end management type investment company registered under the Investment Company Act of 1940, was organized under the laws of Delaware in 1946. The promoters were Hilton H. Slayton, Hovey E. Slayton, and Thomas W. Ruth. Hilton Slayton was president and a director, and Hovey Slayton was a vice president and a director, of the registrant. The registrant filed a registration statement under the Securities Act of 1933 in 1954 and subsequently registered additional securities by amendment as permitted by section 24(e) of the Investment Company Act. The Commission instituted proceedings under the Securities Act to determine whether a stop order should issue suspending the effectiveness of the registration statement.

[7] Securities Act Release No. 4116 (July 17, 1959).
[8] Securities Act Release No. 4120 (July 24, 1959).

The proceedings developed the fact that although Slayton Associates, Inc., all of the voting stock of which was owned by Hilton and Hovey Slayton, was under contract with the registrant to act as its investment advisor and had been paid for such services, it had entered into a contract with Stephen M. Jaquith, a registered representative of a brokerage firm, under which Jaquith was to perform the services of investment advisor for the registrant. For his services, Jaquith and his firm received substantial compensation in the form of commissions on securities transactions. A portion of these commissions were, at the direction of Hilton Slayton, credited to two other individual's, one his brother-in-law and the other a director of the registrant and the Slayton's former attorney. This contract with Jaquith was not disclosed in the registration statement nor had it been approved by the stockholders of the registrant as required by the Investment Company Act.

The record showed that the board of directors gave scant attention to the management of the registrant; made no effort to be informed concerning registrant's policies and whether such policies were being followed; made no decisions concerning purchases and sales of portfolio securities and generally permitted the registrant to be managed by the Slaytons without consultation with or approval by the board as a whole. None of this was disclosed in the registration statement. The prospectus represented that the operations of the registrant were under the supervision and direction of its board of directors and failed to point out that the Slaytons were assuming the functions of the board of directors in directing the operations of the registrant.

The prospectus represented that the principal objective of the registrant was capital growth, that such investment policy would result in normal turnover of portfolio securities and that dividends would be paid quarterly based on the receipt of income or profits on securities held. These representations were materially misleading since the registrant did not follow the stated policies but instead followed the policy of investment for the purpose of providing a flow of cash to its stockholders at a high uniform rate and engaged in a policy of excessive portfolio turnover.

The prospectus was also misleading in failing to disclose that the registrant's policy of realizing capital gains for the purpose of making quarterly distributions to shareholders was deleterious to the position of the shareholders in several respects. First, it required a high rate of portfolio turnover which resulted in the payment of large amounts of brokerage commissions and the payment of higher prices on the repurchase of identical securities immediately after their sale. Second, it further reduced the invested capital of shareholders who reinvested their distributions, since a sales load was charged on such reinvestment. Third, it did not take into consideration whether proper

management would require the sale of securities in which net unrealized depreciation existed and thus avoid making distributions which were taxable to shareholders. Fourth, as noted above, the policy of distributing capital gains quarterly was not consistent with the objective of capital growth of the portfolio.

It was registrant's policy to place a portion of the orders for transactions in portfolio securities with broker-dealers who sold its shares. Reciprocal business in the volume of eight or nine million dollars was directed to approximately 36 dealers for the fiscal year ended November 30, 1958. The Commission held that the prospectus should have disclosed that brokerage transactions were directed to broker-dealers who had sold shares of the registrant. In addition, the prospectus should have disclosed that obligations for merchandise and services rendered to the registrant's underwriters and investment advisors were being satisfied by directing to the suppliers brokerage commissions on transactions in the portfolio securities of the registrant. These disclosures should have accompanied the statements in the prospectus of the amount of sales load reallowed to dealers to make these statements not misleading.

On the basis of the Commission's findings, a stop order was entered shortly after the end of the fiscal year suspending the effectiveness of the registration statement.[9]

Mon-O-Co Oil Corporation.—Registrant, a Montana corporation, was organized in 1940 and engaged in the acquisition of oil and gas leases and exploration for oil and gas. It filed a notification and offering circular under regulation A in March 1957 for the purpose of obtaining an exemption from registration with respect to an offering to its stockholders, pursuant to preemptive rights, of 4,000 stock units, each unit consisting of one share of class A stock and 24 shares of class B stock at $75 per unit and an offering of 14,474 stock units in exchange for certain working interests held by public investors. The Commission thereafter temporarily suspended the exemption. In July 1957, the registrant filed a registration statement covering the same offering plus an additional offering of 4,000 stock units to the stockholders. Prior to the effective date of the registration statement, the Commission instituted stop order proceedings which were consolidated with proceedings to determine whether the order suspending the regulation A exemption should be vacated or made permanent.

The Commission determined that the regulation A exemption should be permanently suspended, on the grounds, among other things, that the offering circular contained false and misleading statements of material facts and that the amount of the offering exceeded the maximum amount of $300,000 permitted for offerings under regulation A. With respect to the stop order proceedings, the Commission found

[9] Securities Act Release No. 4122 (July 30, 1959).

that the geologist's report included in the prospectus contained an excessive estimate of recoverable reserves of oil, and that the registration statement was also materially deficient in the description of the registrant's other properties, in stating the total estimated expenses of the offering and in stating the purposes for which the proceeds were to be used. It also found that the material in the prospectus was poorly organized and that much of the information contained in it was not presented in clear and understandable fashion. Material relating to the same subject matter was scattered throughout various sections of the prospectus, with the result that the ordinary investor would have great difficulty in ascertaining the essential elements of the registrant's business and the merits of the proposed offering without referring to numerous portions of the prospectus and making independent calculations and conclusions as to the facts. The speculative features of the offering were not accurately and adequately disclosed, and there were a number of other deficiencies in the registration statement.

The Commission refused to permit the registration statement to be withdrawn and issued a stop order suspending its effectiveness.[10]

Texas Glass Manufacturing Corporation.—The registrant, a Texas corporation, was organized in 1952 to engage in the manufacture of window and heavy sheet crystal glass. The company's only property consisted of a plant site in Bryan, Tex., donated by that city and the deed for which was held in escrow contingent upon the execution of a contract to construct a plant. The registrant filed a registration statement in 1957 covering a proposed public offering of 2,700,000 shares of its $1 par value common stock at $2 per share, plus 300,000 shares subject to certain options at $1 per share. Amendments were subsequently filed which, among other things, changed the number of shares being registered. The Commission instituted stop order proceedings with respect to the registration statement in July 1957.

The Commission found that the registration statement contained many deficiencies, some of which were highly material and some of which, while relatively less important, were indicative of a general lack of care in the preparation of the registration statement. Thus, the registration statement contained materially misleading statements with respect to the company's stage of development, the kind of glass which it proposed to manufacture, the processes to be used in manufacturing glass, the source of raw materials and the nature of the market for the registrant's products. For example, it was stated that the company would produce its glass on machines and by methods that are unique and less time consuming, whereas it appeared that the

[10] Securities Act Release No. 4024 (Feb. 4, 1959).

machines and methods proposed to be used are those commonly known and employed by the glass industry.

The registration statement indicated that certain previous sales of the company's stock were exempt from registration under section 3(a)(11) of the act, whereas it appeared that no exemption was available and that there was a contingent liability on the part of the company for such sales which liability was not reflected in the company's financial statements. The prospectus also indicated that 80 percent of the proceeds from the sale of the stock would be placed in an escrow fund to be returned to investors should the company fail to raise enough funds to carry out its plans, but no further information was given with respect to the nature of any escrow agreement or the circumstances under which such fund would be returned to investors. The prospectus also set forth statements with respect to costs applicable to plant construction contracts without indicating that such contracts had not yet been executed. The registration statement also included hypothetical figures purporting to show production costs and revenues for the proposed plant and setting forth a substantial figure as the annual net profit, even though the company had not yet engaged in any business. There were also other deficiencies in the disclosures provided in the registration statement.

In view of the numerous and serious deficiencies in the registration statement the Commission issued a stop order suspending the effectiveness of the registration statement.[11]

EXAMINATIONS AND INVESTIGATIONS

The Commission is authorized by section 8(e) of the act to make an examination in order to determine whether a stop order proceeding should be instituted under section 8(d). For this purpose the Commission is empowered to subpoena witnesses and require the production of pertinent documents. Six such examinations were initiated during the 1959 fiscal year. None were pending from the previous fiscal year. In two cases the examinations led to stop order proceedings under section 8(d). Four examinations were pending at the close of the fiscal year.

The Commission is also authorized by section 20(a) of the act to make an investigation to determine whether any provisions of the act or of any rule or regulation prescribed thereunder have been or are about to be violated. Investigations are instituted under this section as an expeditious means of determining whether a registration statement is false or misleading or omits to state any material fact. The following table indicates the number of such investigations with which the Commission was concerned during the fiscal year.

[11] Securities Act Release No. 3984 (Oct. 31, 1958).

Investigations pending at the beginning of the fiscal year	13	
Investigations initiated during the fiscal year	8	
		21
Investigations in which stop order proceedings were authorized during the fiscal year	3	
Other investigations closed during the fiscal year	3	6
Investigations pending at the end of the fiscal year		15

EXEMPTION FROM REGISTRATION OF SMALL ISSUES

Under section 3(b) of the Securities Act, the Commission is empowered to exempt, by rules and regulations and subject to such terms and conditions as it may prescribe therein, any class of securities from registration under the act, if it finds that the 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. The statute imposes a maximum limitation of $300,000 upon the size of the issues which may be exempted by the Commission in the exercise of this power.

Acting under this authority the Commission has adopted the following exemptive regulations:

Regulation A:
- General exemption for 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 first lien notes up to $100,000.

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 association up to $100,000.

Regulation F:
- Exemption for assessments on assessable stock and for assessable stock offered or sold to realize amount of assessment thereon, up to $300,000.[12]

Under section 3(c) of the Securities Act, which was added by section 307(a) of the Small Business Investment Act of 1958, the Commission is authorized to adopt rules and regulations exempting securities issued by a company which is operating or proposes to operate as a small business investment company under the Small Business Investment Act. During the fiscal year the Commission, acting pursuant to this authority, adopted a new regulation E, which

[12] Adopted July 30, 1959, Securities Act Release No. 4121.

exempts upon certain terms and conditions limited amounts of securities, not in excess of $300,000, issued by any small business investment company which has received a license or a notice to proceed from the Small Business Administration. This regulation is substantially similar to the one provided by regulation A under section 3(b) of the act.

Exemption from registration under section 3(b) or 3(c) of the act does not carry any exemption from the civil liabilities for false and misleading statements imposed by section 12(2) or from the criminal liabilities for fraud imposed by section 17 of the act.

Exempt Offerings Under Regulation A

The Commission's regulation A permits a company to obtain not exceeding $300,000 (including underwriting commissions) of needed capital in any 1 year from a public offering of its securities without registration if the company complies with the regulation. Regulation A requires the filing of a notification with the appropriate regional office of the Commission, supplying basic information about the company, certain exhibits, and except in the case of a company with an earnings history which is making an offering not in excess of $50,000, an offering circular which is required to be used in offering the securities.

During the 1959 fiscal year, 854 notifications were filed under regulation A, covering proposed offerings of $170,241,400, compared with 732 notifications covering proposed offerings of $133,889,109 in the 1958 fiscal year. Included in the 1959 total were 42 notifications covering stock offerings of $9,460,253 with respect to companies engaged in the exploratory oil and gas business and 59 notifications covering offerings of $11,314,184 by mining companies.

The following table sets forth various features of the regulation A offerings during the past 3 fiscal years:

Offerings under Regulation A

	Fiscal year		
	1959	1958	1957
Size:			
$100,000 or less	222	231	307
Over $100,000 but not over $200,000	162	165	163
Over $200,000 but not over $300,000	470	336	449
	854	732	919
Underwriters:			
Used	318	243	328
Not used	536	489	591
	854	732	919
Offerors:			
Issuing companies	797	704	865
Stockholders	31	28	52
Issuers and stockholders jointly	26	0	2
	854	732	919

Most of the offerings which were underwritten were made by commercial underwriters, who participated in 251 offerings in 1959, 185 offerings in 1958, and 252 offerings in 1957. The remaining cases where commissions were paid were handled by officers, directors, or other persons not regularly engaged in the securities business.

Suspension of Exemption

Regulation A provides for the suspension of an exemption thereunder where, in general, the exemption is sought for securities for which the regulation provides no exemption or where the offering is not made in accordance with the terms and conditions of the regulation or in accordance with prescribed disclosure standards. Following the issuance of a temporary suspension order by the Commission, the respondents may request a hearing to determine whether the temporary suspension should be vacated or made permanent. If no hearing is requested within 30 days after the entry of the temporary suspension order, and none is ordered by the Commission on its own motion, the temporary suspension order becomes permanent.

During the 1959 fiscal year, temporary suspension orders were issued in 87 cases as compared with 88 in the 1958 fiscal year. Of the 87 orders, 2 were later vacated. Requests for hearing were made in 26 cases. In 11 of such cases the requests were later withdrawn, and as of June 30, 1959, the proceedings in the remaining 15 cases were still pending.[13] The names of the companies involved in the orders issued during the 1959 fiscal year are set forth in table 7 of the appendix.

As indicated in the 24th annual report, 11 cases were pending as of June 30, 1958, in which a hearing was requested after a temporary suspension order had been issued. In four of such cases the issuers withdrew their hearing requests and consented to the entry of permanent suspension orders and in three cases permanent suspension orders were entered by the Commission after hearings. The remaining four cases were pending on June 30, 1959.

Certain of the above cases are summarized below to illustrate the misrepresentations and other noncompliance with the regulation which led to the issuance of suspension orders.

Brookridge Development Corporation.—The temporary suspension order alleged that the terms and conditions of regulation A were not complied with in that the notification failed to disclose all sales of unregistered securities by the issuer or any principal security holder within one year prior to filing. It was asserted, moreover, that the amount of securities proposed to be offered and the amount sold during the past year in violation of section 5 of the act would exceed the regulation A $300,000 limitation. It was also alleged that the offering circular was materially misleading in failing to disclose:

[13] Shortly after the end of the fiscal year, the suspension orders in three of these cases were made permanent.

(1) Options to which officers of the issuer were entitled; (2) security holdings of the officers and directors; and (3) the effect of the underwriter's participation in the market on the price of the issuer's securities. In addition, the offering circular was alleged to be materially misleading in its inclusion of $176,478.86 described as "Investment in Subsidiaries" in the December 31, 1958, consolidated balance sheet, and by the inclusion in the consolidated income statement of dividends received from subsidiaries. The Commission's order further averred that the use of the offering circular without appropriate disclosure would be in violation of section 17 of the Securities Act of 1933. The issuer requested a hearing, but this request was subsequently withdrawn and the suspension order became permanent with the lapse of time.

Empire Oil Corporation.—The order temporarily suspending the regulation A exemption alleged that the terms and conditions of regulation A had not been complied with in that escrow arrangements for certain shares had not been made with an independent escrow agent and information was not supplied as to the issuer's predecessors and affiliates. Moreover, it was asserted, the offering circular was materially misleading in failing to disclose information with respect to the offering of securities for additional properties, the net production of crude oil and natural gas, estimated oil reserves, and existing or threatened litigation against the issuer. Also, the offering circular was alleged to be materially misleading in its use of appraisal valuations. Violation of section 17 of the Securities Act, in addition, was asserted. No hearing was requested, and the suspension order became permanent with the lapse of time.

Florida National Development Corporation.—The temporary suspension order alleged that the regulation A terms and conditions had not been complied with in that, among other things, the $300,000 ceiling was exceeded and the issuer failed to disclose that one MacElrod was a promoter or predecessor, or both, of the issuer. The issuer's offering circular was averred to be false and misleading in its failure to disclose: (1) the exact amount paid for the issuer's properties and whether such properties were acquired by the issuer in arms-length transactions; (2) the facts surrounding certain brokerage commissions; (3) the circumstances concerning a $759,660 mortgage and note; and (4) the status of an option on 1,860 acres of land. Further, the financial statements included in the offering circular were materially misleading. The temporary suspension order also asserted violation of section 17 of the Securities Act. No hearing was requested and the temporary suspension order became permanent with the lapse of time.

Gob Shops of America.—The Commission temporarily suspended the regulation A exemption because it had reason to believe that the

issuer's notification failed to comply with the terms and conditions of regulation A and that the offering circular contained false and misleading statements concerning the market and the market price of the stock and the underwriter's activities in the maintenance, domination and control of the market and market price of the stock. A hearing was held at the issuer's request. The issuer moved to dismiss the proceedings on the ground that its withdrawal had become effective and in the alternative requested that withdrawal be permitted, asserting that its failings involved "inadvertent and empty infractions of technical rules or mistaken acts." The Commission held that there was no right under the circumstances to withdrawal of a notification and denied the motion to dismiss. The Commission concluded that the omission to state that the price of the stock was artificially inflated and that the market was not free and open was a serious deficiency. Accordingly, the issuer's request for withdrawal was denied and a permanent suspension order was entered by the Commission.[14]

Inspiration Lead Company, Inc.—The temporary suspension order alleged numerous deficiencies in the issuer's offering circular concerning, among other things, the issuer's past operations, ore reserves, mining costs, and assets. A hearing was held pursuant to the issuer's request. At the hearing the issuer conceded that the offering circular was inadequate and incomplete in a number of respects, but asserted that the deficiencies were the result of inadvertence and mistake and asked that it be permited to withdraw its filing for the purpose of revision and correction. The Commission, however, found the deficiencies and omissions to be serious and extensive. It stated, "We have previously indicated that an opportunity to amend a deficient filing cannot be permitted to impair the required standards of careful and honest filings or to encourage a practice of irresponsible or deliberate submission of inadequate material to be followed by correction of deficiencies found by our staff in its examination." The Commission concluded that there was not such a showing of good faith or other mitigating circumstances in connection with the deficiencies as to justify a further opportunity to present an adequate filing in lieu of a permanent suspension. The issuer's request for withdrawal was denied and an order was issued permanently suspending the exemption.[15]

Macinar, Inc.—The order of temporary suspension in this case alleged that the notification failed to disclose that Automatic Table Co. was an affiliate of the issuer; that it failed to disclose securities sold by Paul Gaston, an affiliate; and that the $300,000 regulation A ceiling would have been exceeded by the offering. It was also averred that the offering circular contained untrue statements of material facts

[14] Securities Act Release No. 4075 (May 6, 1959).
[15] Securities Act Release No. 4076 (May 7, 1959).

and failed to disclose required information concerning a note payable in the sum of $17,400 held by the wife of the issuer's principal security holder. Moreover, there was a failure to set forth the issuer's assumption of an affiliate's $12,854.82 note and to disclose all material transactions of officers, directors, and controlling persons with the issuer, its predecessors, and affiliates. The issuer filed a request for hearing and a motion to vacate the temporary suspension order. Both the request for hearing and the motion to vacate were subsequently withdrawn and the temporary suspension order became permanent.

Sports Arenas (Delaware) Inc.—The temporary suspension order asserted that the issuer failed to disclose all promoters, controlling persons and affiliates and their backgrounds; that the aggregate public offering price of the securities and the aggregate gross proceeds actually received from the sale of securities to the public exceeded the $300,000 regulation A limitation; that an offering circular was not used in the offering of shares to the public; that certain sales material was used which was not filed with the Commission; and that the issuer failed to file a complete and accurate report of sales as required by regulation A. The issuer's offering circular, in addition, was alleged to be materially misleading in its failure to disclose the method of offering, whereby the issuer's securities would be sold to the public at a price higher than the $1.25 stated offering price, and to disclose the profits of those participating in the distribution. Violation of section 17 of the Securities Act was also alleged. No hearing was requested and the suspension order became permanent.

Exempt Offerings Under Regulation B

During the fiscal year ended June 30, 1959, 160 offering sheets were filed pursuant to regulation B and were examined by the Oil and Gas Section of the Commission's Division of Corporation Finance. During the 1958 fiscal year, 109 offering sheets were filed and during the 1957 fiscal year, 133 were filed. The following table indicates the nature and number of Commission orders issued in connection with such filings during the fiscal years 1957–59. The balance of the offering sheets filed became effective without order.

Action taken on offering sheets filed under regulation B

	Fiscal years		
	1959	1958	1957
Temporary suspension orders	4	9	12
Orders terminating proceeding after amendment	1	1	7
Orders fixing effective date of amendment (no proceeding pending)	87	60	72
Orders consenting to withdrawal of offering sheet (no proceeding pending)	2	3	3
Orders consenting to withdrawal of offering sheet and terminating proceeding	2	2	
Total number of orders	96	75	94

Reports of sales.—The Commission requires persons who make offerings under regulation B to file reports of the actual sales made pursuant to that regulation. The purpose of these reports is to aid the Commission in determining whether violations of law have occurred in the marketing of such securities. The following table shows the number of sales reports filed under regulation B during the past 3 fiscal years and the aggregate dollar amount of sales during each of such fiscal years.

Reports of sales under regulation B

	Fiscal years		
	1959	1958	1957
Number of sales reports filed	1,689	1,712	1,318
Aggregate dollar amount of sales reported	$1,204,751	$1,093,362	$1,154,792

LITIGATION UNDER THE SECURITIES ACT OF 1933

The Commission is authorized by the Securities Act to seek injunctions in cases where continued or threatened violations of the act are indicated. Many such actions were brought by the Commission during the past year. Generally these involved violations of both the registration and anti-fraud provisions of the act.

Litigation Involving Violations of the Registration and Anti-Fraud Provisions

Among the more important of such litigation was a complex of four cases involving the sale of common stock of General Oil and Industries, Inc. in violation of the registration and anti-fraud provisions. The company was originally organized in 1931 under the name of Pacific Gold Placers, Inc. All of its stock was issued prior to July 27, 1933, the effective date of the Securities Act. In 1958 the company was purchased by one Sidney B. Josephson, who changed its name, and increased the capitalization by 2 million shares. Thereafter, the complaints alleged, Josephson, a defendant in all of the cases, caused many of these unregistered shares to be sold in interstate commerce to the public by means of various misrepresentations. The Commission brought suits against A. G. Bellin Securities Corp.,[16] Stratford Securities Co., Inc.,[17] Phoenix Securities Corp.,[18] Stanley Brown,[19] registered broker-dealers, and numerous individual defendants, along with Josephson, to enjoin the sale of these securities. Orders of preliminary injunction have been entered in the first two cases for violation of the registration provisions, and the cases set for hearings.[20]

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[16] *S.E.C.* v. *Bellin, et al.,* U.S.D.C. S.D.N.Y. No. 139–301.
[17] *S.E.C.* v. *Josephson, et al.,* U.S.D.C. S.D.N.Y. No. 140–193.
[18] *S.E.C.* v. *Phoenix Sec.,* U.S.D.C. S.D.N.Y. No. 141–36.
[19] *S.E.C.* v. *Brown,* U.S.D.C. S.D.N.Y. No. 141–35.
[20] Bellin and Josephson filed notice of appeal on April 8, 1959.

Two cases involved the sale of Canadian Javelin Limited stock in violation of both the antifraud and registration provisions of the act. In the first case,[21] the Commission brought suit against Canadian Javelin, European Fiduciary Corp., and various officers and employees of these corporations. The complaint charged the defendants with selling the securities by telephone and through the mails in the United States without filing a registration statement. It further charged that the securities were being sold by concealing the identity of the sellers, the consideration being paid to the brokers and dealers for recommending the securities, and also by misrepresenting their value. The corporations and three of the defendants consented to entry of final judgment enjoining further sales.[22] In the second case,[23] a U.S. investment adviser and an associate were charged with similar violations in the sale of Canadian Javelin. A permanent injunction was entered against them by consent.

In another case involving the sale of Canadian securities in this country,[24] the Commission charged Philip Newman Associates, a registered broker-dealer, with selling securities of the Monarch Asbestos Co., Ltd., through the mails and by telephone to persons in the United States without filing a registration statement. The Newman firm and its officers were also charged with misrepresenting the securities with respect to the value of the stock and the business expectations of the company. A permanent injunction was entered against the Newman firm and its officers and employees by consent, and a preliminary injunction was granted as to Monarch Asbestos and others by default.

In *S.E.C.* v. *Los Angeles Trust Deed and Mortgage Exchange et al.*, 264 F. 2d 190 (C.A. 9, 1959), the district court granted the Commission's motion for a preliminary injunction and the appointment of a receiver in an action brought by the Commission based on violations of the registration and fraud provisions of the Securities Act and the Securities Exchange Act in connection with the sale of trust deeds on individual parcels of property. See the 24th Annual Report at pages 51–52 for a discussion of the district court action. The judgment was reversed by the Court of Appeals for the Ninth Circuit, which did not reach the issue of whether the trust deeds constituted securities. It felt that this question, as well as others, including the matter of the appointment of a receiver, should await trial on the merits, particularly since the Court believed that certain procedural errors had occurred on the hearing. Accordingly, the Court remanded the case for trial, and trial was pending at the end of the fiscal year.

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[21] *S.E.C.* v. *Canadian Javelin Ltd.*, U.S.D.C. S.D.N.Y. No. 138-85.

[22] The matter is pending as to the other defendants.

[23] *S.E.C.* v. *Loomis, et al.*, U.S.D.C. D. Mass. No. 58-1210.

[24] *S.E.C.* v. *Philip Newman Associates, Inc., et al.*, N.Y. 3113, U.S.D.C. D. N.J., 1397-58.

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As in past years, many cases involved fraud in the sale of securities of mining companies. In *S.E.C.* v. *Gotham Securities* [25] the Commission's complaint charged the defendants with fraud in the sale of Saskalon Uranium and Oil, Ltd. common stock. The purchasers were told that they would "reap rich rewards," that the shares would be listed on a national exchange, and that the company was about to pay a dividend. A permanent injunction was entered against the defendants by consent.

Permanent injunctions were also entered against the Lincoln Securities Corp.[26] and its officers and salesmen, for fraud in the sale of shares of Shoreland Mines, Ltd., a Canadian mining company. Judgment was entered upon consent of defendants. In *S.E.C.* v. *Del Marva Oil and Gas, et al.*[27] a final judgment was entered by consent against five oil and gas companies and their controlling stockholders. The judgment permanently enjoined defendants from making misleading statements of the value of mining properties, the ownership of leases, the probability of discovery of oil, etc. In *S.E.C.* v. *Scott Taylor and Co., Inc.*[28] a temporary restraining order has been issued to restrain the sale of shares of Atomic Mining Corp., a Canadian corporation, pending a hearing of the case. A temporary restraining order has also been issued in *S.E.C.* v. *Webster Securities Corp.*[29] to restrain sales of stock of Goldfield Mines Co. of Nevada. In *S.E.C.* v. *Gravity Science Foundation, et al.*,[30] the complaint charged defendant with selling investment contracts and undivided interests in oil and gas leases without registering under the Securities Act. Various misrepresentations concerning the operations of the company were also alleged to have been made. The Commission moved against the sale and offering of investment contracts without registration in *S.E.C.* v. *The Donna-June Co.*[31] In this case the investment contracts were represented by limited partnership interests plus a profit-sharing agreement. In both cases, a permanent injunction was ordered with consent of defendants.

Two important cases involved failure of defendants to meet the prospectus requirements of the 1933 act. In *S.E.C.* v. *North American Finance Co.*,[32] the complaint charged defendant with offering for sale 500,000 shares of common stock by transmitting through the mails a prospectus which did not meet the statutory requirements. The Commission alleged, among other things, that numerous misrepresentations were made as to the value of the shares, that the Commis-

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[25] U.S.D.C. S.D.N.Y. No. 886–58.
[26] *S.E.C.* v. *Lincoln Securities Corp., et al.*, U.S.D.C. N.Y. No. 135–79.
[27] U.S.D.C. D. Utah C–56–59.
[28] U.S.D.C. N.Y. No. 142–167.
[29] U.S.D.C. S.D.N.Y. No. 141–337.
[30] U.S.D.C. N.D. Ill. No. 594C484.
[31] U.S.D.C. E.D. Okla. No. 4520.
[32] U.S.D.C. D. Ariz. No. 2925.

sion had approved the price at which the securities were being sold, and that the stock was insured. The case is particularly significant in that it is the first to hold that a prospectus does not meet the requirements of section 10(a) of the Securities Act if the financial statements therein represent that an accountant is independent when in fact he is not. A permanent injunction was entered upon consent of defendants. A permanent injunction was entered against Universal Drilling Co., Inc. and its president, Louis J. Roussel [33] restraining defendants from transmitting any prospectus relating to the sale of common stock in Universal until the prospectus met the requirements of the Securities Act. Counsel for these defendants informed the court of their intention to make an offer of rescission to customers who purchased the stock from the defendants J. H. Lederer Co., Inc. and Jean R. Veditz Co., Inc., registered broker-dealers. The court continued the restraining order previously entered against the latter, to prevent dissipation of funds until determination of the Commission's application for appointment of a receiver. A permanent injunction was also entered by consent in *S.E.C.* v. *Universal Service Corp.*[34] for violation, *inter alia*, of the prospectus provisions.

A permanent injunction by consent was entered against the Vari-Pac Corporation for numerous fraudulent representations in violation of the 1933 act.[35] In a companion case, the Commission later succeeded in obtaining a permanent injunction against the defendant I. B. Morton & Co., Inc.[36] for violation of the antifraud provisions of the 1933 act and the registration provisions pertaining to broker-dealers in the Securities Exchange Act of 1934. Two other dealers in Vari-Pac stock were also enjoined from making further offers or sales.

In *S.E.C.* v. *O.T.C. Enterprises, Inc.* the defendants were offering shares in a company purportedly developing a spaceship to fly through the universe utilizing "free energy." A public inaugural flight of the prototype at Oklahoma City, scheduled for April 19, 1959, failed to materialize. Otis T. Carr, president of the company, publicly announced that a space craft designed by him would be constructed in which a flight to the moon would be made on December 7, 1959, returning to earth on December 15, 1959. In addition to selling shares to hundreds of investors, the promoters obtained additional income by selling plans for the spaceship and toy models at prices ranging from $5 to $10 a piece, and by organizing groups to study unidentified flying objects. They also attempted to promote a Space City, to be located near Washington, D.C., and to maintain direct contact with communities on other planets and stars. At least half a million dollars was obtained from hundreds of investors. Final judgment was

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[33] *S.E.C.* v. *J. H. Lederer Co., Inc., et al.*, U.S.D.C. S.D. N.Y. 140–328, NY 3103.
[34] U.S.D.C. S.D. Texas No. 11,608.
[35] *S.E.C.* v. *Albert & Co.*, U.S.D.C. D.N.J. No. 1142–58.
[36] *S.E.C.* v *I. B. Morton & Co.*, U.S.D.C. S.D. N.Y. No. 138–399.

obtained by the Commission permanently enjoining defendants from further sales or offers of sales.[37]

Among other cases in which fraudulent misrepresentations were enjoined were: *S.E.C.* v. *General Associates, Inc.*,[38] *S.E.C.* v. *The Angelique Co.*,[39] *S.E.C.* v. *J. P. Lord, Inc.*,[40] *S.E.C.* v. *Walker-Stevens, Inc.*,[41] *S.E.C.* v. *Consolidated Enterprises, Inc.*,[42] *S.E.C.* v. *Kimball Securities, Inc.*[43] and *S.E.C.* v. *International Corp., et al.*[44]

In *S.E.C.* v. *Arvida Corporation*[45] the Commission's complaint charged two broker-dealers with violation of section 5(c) of the Securities Act prohibiting public offerings of securities before the filing of a registration statement. In enjoining any further violation, the court held that the issuance of a press release giving a number of facts concerning the development of Arvida Corporation and the proposed stock offering, and the convening of a press conference at which additional facts were given, including the proposed price, constituted an offer to sell within the meaning of the act and was in violation of the act because a registration statement covering the securities offered had not been filed with the Commission. Judgment was entered upon consent of defendants. In related broker-dealer proceedings (see p. 103, *infra*) the Commission also concluded that defendants had violated the registration provisions of the 1933 act willfully, but held that no sanction was required in the public interest under the particular circumstances of the case. Securities Exchange Act Release No. 5870 (February 9, 1959). After the institution of these proceedings a registration statement was filed and became effective.

In a case still pending,[46] the Commission has brought suit to enjoin John Addison, Niles White, White, Green & Addison Associates, Inc., Trans-world Mining Corporation, Murchison Ventures, Inc., and numerous individual officers and employees, from further violating the registration provisions of the Securities Act of 1933, and to enjoin the defendants, their banks and depositories from dissipating or disbursing the assets or funds of these defendants, and particularly the sum of $146,625 found in a suitcase left by Addison in a public carrier terminal. The Commission's complaint charges that since 1955 the defendants have been selling securities, namely, notes, evidences of indebtedness, participation in profit-sharing agreements, investment

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[37] U.S.D.C. W.D. Okla. No. 8452.
[38] U.S.D.C. N.D. Wash. No. 4708.
[39] U.S.D.C. D. Conn. No. 7726.
[40] U.S.D.C. S.D. Fla. No. 9231–M.
[41] U.S.D.C. S.D. N.Y. No. 135–313.
[42] U.S.D.C. S.D. N.Y. No. 145–7.
[43] U.S.D.C. S.D. N.Y. No. 142–153.
[44] U.S.D.C. D.C. No. 1518–59.
[45] U.S.D.C. S.D. N.Y. No. 136–67.
[46] *S.E.C.* v. *Addison et al.*, U.S.D.C. N.D. Texas No. 8224.

contracts, and fractional undivided interests in oil, gas, and other mineral rights, by use of the mails and in interstate commerce, without having first registered with the Commission. In a supporting affidavit filed with the complaint, it was alleged that Addison and his associates obtained loans from approximately 400 individuals in 23 States, the total of such loans amounting to nearly $1 million. A preliminary injunction has been entered and the sum of $146,625 ordered impounded in the registry of the Court pending a hearing on the merits of the case.

Permanent injunctions restraining sales in violation of the registration provisions were decreed by consent in the following cases: *S.E.C.* v. *Pettyjohn, et al.*,[47] *S.E.C.* v. *Justus, et al.*,[48] *S.E.C.* v. *Hillsborough Investment Corp.*,[49] *S.E.C.* v. *Robbins*,[50] *S.E.C.* v. *Bonanza Oil Corp., et al.*,[51] *S.E.C.* v. *Hinsdale Raceway, Inc.*,[52] *S.E.C.* v. *Vanco, Inc., et al.*,[53] and *S.E.C.* v. *Mono-Kearsarge Consol.*[54] Permanent injunctions were also entered in *S.E.C.* v. *Southwest Securities Inc., et al.*,[55] and *S.E.C.* v. *Ben Franklin Oil and Gas Corp., et al.*,[56] both discussed in the 24th Annual Report.[57]

In the *Hillsborough* case, *supra*, the court granted a preliminary injunction against defendants Hillsborough Investment Corporation and Roger Mara, its manager. The defendant corporation, incorporated in New Hampshire, advertised in the newspapers, offering to sell its stock to New Hampshire residents. A few advertisements contained no such limitation. About a dozen sales were made to nonresidents, in some cases after being held in the name of a resident for 30 days. Defendants resisted the motion for a temporary injunction on the ground that a small number of interstate sales, where no future interstate sales were contemplated, should not take the issue out of the intrastate exemption contained in section 3(a)(11) of the 1933 act. The court held that even a single sale to a nonresident, whether directly or through the device of selling to a resident intermediary, destroyed the exemption as to the whole issue, and required registration in order to make future sales to residents.

[47] U.S.D.C. D. Alaska No. 10,470.
[48] U.S.D.C. S.D. Fla. No. 8779-M.
[49] U.S.D.C. D. N.H. No. 1965.
[50] U.S.D.C. S.D. Texas No. 12,644.
[51] U.S.D.C. D. Nev. No. 259.
[52] U.S.D.C. D. N.H. No. 1970.
[53] U.S.D.C. D. N.J. No. 737-58.
[54] U.S.D.C. D. Utah No. C-58-58.
[55] U.S.D.C. N.D. Ark. No. 3566.
[56] U.S.D.C. D. N.J. No. 601-57
[57] At p. 46 *et seq.*

The *Mono-Kearsage Consolidated Mining Company case*, *supra*, was an action by the Commission to enjoin sales of that company's stock without registration by broker-dealers and others who had received the stock from transferees of the company who were in control of the company. The defendants contended that they did not know of the control relationship. The Court, in granting an injunction, held that defendants were underwriters within the meaning of the Securities Act of 1933, that the term "underwriter" includes anyone who purchases from a person directly or indirectly controlling an issuer, or in common control with the issuer, with a view to public distribution of the securities of the issuer, that the defendants were to be held to have knowledge of those facts which they could obtain upon reasonable inquiry. The Court said further:

> Probably the facts directly known by them were sufficient to acquaint them with the true situation. If not, they were sufficient to impose upon them the duty of making further inquiry. Under the circumstances, they were not entitled to rely solely on the self-serving statements of Pennington and the other Canadians denying those facts which would have indicated that they were representing controlling persons, or were under common control with an issuer. With all these red flags warning the dealer to go slowly, he cannot with impunity ignore them and rush blindly on to reap a quick profit. He cannot close his eyes to obvious signals which if reasonably heeded would convince him of, or lead him to, the facts and thereafter succeed on the claim that no express notice of those facts was served upon him. 167 F. Supp. 248, 259 (D. Utah, 1958).

Litigation Relating to Stop Order Proceedings

In *Columbia General Investment Co.* v. *S.E.C.*,[58] the Court of Appeals for the Fifth Circuit affirmed a Commission stop order pursuant to section 8(d) of the Securities Act suspending the effectiveness of Columbia's registration statement and denying Columbia's application for withdrawal prior to the effective date of the registration statement. Relying on *Jones* v. *S.E.C.*, 298 U.S. 1 (1936), Columbia contended that the request for withdrawal divested the Commission of jurisdiction to issue the stop order. In upholding the Commission's order, the Court distinguished the Jones case on the fact that in the instant case 1,800 members of the public held 63,000 shares of the same class of securities covered by the registration statement. The Court noted that these stockholders and members of the investing public who might trade in these securities are proper subject of the official concern of the Commission. Moreover, the Court stated that since *Jones* a significant change in the law had taken place and it could no longer be said, as it was in *Jones*, that withdrawal was the concern of the registrant alone. Under the 1954 amendments to the act a registrant may now make offers to sell after filing but before registration. The

[58] 265 F. 2d 559 (C.A. 5, 1959).

Court ruled that, if a registrant has an unfettered right to withdraw under these conditions, then the machinery of the Commission could easily be employed as an instrument of fraud. The Court rejected Columbia's contentions that the filing of a substantive amendment terminates, for the purposes of stop order proceedings, the legal significance of the original registration statement.

Participation as *Amicus Curiae*

In *Woodward* v. *Wright*, 266 F. 2d 108 (C.A. 10, 1959), the Commission filed a brief *amicus curiae* in an appeal from a judgment for the defendant-sellers of an undivided interest in oil and gas rights. The action was based on the civil liability provisions of section 12 of the Securities Act, and while the lower court found that the sellers' prospectus contained a material false statement, it barred recovery since the purchasers had failed to show their reliance on the misrepresentation. After concluding that the contract of sale conveyed fractional undivided interests in oil and gas and hence securities, the Court of Appeals reversed and remanded the case to the district court on the ground that the evidence brought the appellants within the liability provisions of section 12(2). The court rejected the district court's ruling and agreed with the Commission's position that Congress did not impose upon a plaintiff the burden of proving reliance as a condition of recovery under section 12(2). The court refused to permit recovery under section 12(1) holding on the particular facts that a public offering had not been made.

In *Creswell-Keith, Inc.* v. *Willingham*, 264 F. 2d 76 (C.A. 8, 1959), the Commission also filed a brief as *amicus curiae*. This was a private suit wherein the plaintiff involved section 12(2) of the act to rescind a commitment for securities claiming fraudulent misrepresentations were made. The defendants filed motions for dismissal for want of jurisdiction stating that neither the misrepresentations nor the delivery of the securities was made by use of the mails or interstate commerce. The trial court upheld this contention; however this holding was overruled on appeal where the court held, as urged by the Commission, that the section 12(2) "remedy is available if the mails or interstate commerce is used in any manner in consummating the sale" and that "payment of the consideration is part of the consummation of the sale."

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

REGULATION OF EXCHANGES AND EXCHANGE TRADING

Registration and Exemption of Exchanges

As of June 30, 1959, 14 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
Midwest Stock Exchange
New Orleans Stock Exchange
New York Stock Exchange
Pacific Coast Stock Exchange
Philadelphia-Baltimore Stock Exchange
Pittsburgh Stock Exchange
Salt Lake Stock Exchange
San Francisco Mining Exchange
Spokane Stock Exchange

Four exchanges have been exempted from registration by the Commission pursuant to section 5 of the act:

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

Disciplinary Actions

Each national securities exchange reports to the Commission disciplinary actions taken against its members for violation of the Securities Exchange Act of 1934 or of exchange rules. During the year 4 exchanges reported 23 cases of such disciplinary action, including imposition of fines aggregating $27,550 in 14 cases, the sus-

pension of two individuals from allied exchange membership, and censure of a number of individuals and firms.

Commission Rate Study

On February 20, 1959, the Commission announced the completion by its staff of a study of commission rates charged by members of the New York Stock Exchange undertaken as a result of an increase in commission rates adopted by the Exchange on May 1, 1958.[1] The study was made in view of the responsibilities and duties imposed upon the Commission by section 19(b) of the Securities Exchange Act of 1934 with respect to the rules of national securities exchanges including rules relating to the fixing of reasonable commission rates.[2]

In line with suggestions of the Commission, the Exchange took steps falling into three general areas. First, the Exchange reduced commission rates on transactions ranging from $100 to $2,400 by approximately 5 percent. These modifications were suggested in view of the fact that the May 1958 percentage increases on transactions from $100 to $2,400 were relatively greater than the average percentage increase. The Exchange also eliminated the so-called "round turn" commission rate under which a reduced rate was granted to persons whose purchase and sale of the security was completed within 14 days. It was the view of the Commission that this type of transaction was not entitled to a special discount and the Exchange felt this rate had not achieved its desired objective.

Following the action of the New York Stock Exchange other registered national securities exchanges, including the American Stock Exchange, adopted a schedule of commission rates identical with that of the New York Stock Exchange.

Second, it was decided that an Exchange committee would study the use of a so-called volume or block discount for transactions involving multiple round lot units. The Exchange also agreed to study the possibility of further developing its income and expense survey of member firms as a source of data in connection with commission rates and to work with the staff of the Commission and consultants employed by the Exchange to prepare an outline for the basis of a cost study being made by the Exchange.

Third, the Exchange amended its rules to provide that any proposed constitutional amendment to change commission rates or other charges would be announced 30 days in advance of action by the Board of Governors of the Exchange. Also, it was agreed that the Commission would be advised of any steps taken by the Exchange looking toward changes in commission rates or other charges.

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[1] Securities Exchange Act Release No. 5889.

[2] Securities Exchange Act Release No. 5678.

Activities of Floor Traders and Specialists

As a result of a study made by the staff of the Commission of the activities of floor traders and specialists on the American Stock Exchange, certain steps have been taken by that Exchange to impose further controls upon the activities of these members. The Commission concluded from the study that further restrictions were necessary upon floor trading activities on that Exchange; that these restrictions should prevent floor traders from stimulating public interest in a stock by active and concerted buying; and that floor traders should be restricted from aggravating demand in present markets where many issues on the Exchange are peculiarly susceptible to extreme fluctuations because of a small floating supply. The Commission permitted the Exchange to put into effect on an experimental basis for six months a rule which the Exchange believes will minimize the undesirable features of floor trading, yet preserve certain asserted benefits.[3] The effect of the rule is to impose restrictions upon floor trading purchases in a rising market.

In line with suggestions of the Commission, the Exchange has also taken certain steps to regulate further the activities of specialists. Several new rules relating to specialists have been adopted, the most important of which makes subject to Exchange approval all off-floor transactions, with certain limited exceptions, by specialists in securities in which they are registered. The Exchange also has instituted a program for making periodic inspections of specialist dealer transactions in the securities in which they are registered. Under the program specialists will be required to report to the Exchange several times each year the details of their dealings for unannounced periods selected at random by the Exchange.

REGISTRATION OF SECURITIES ON EXCHANGES

A member of a national securities exchange or a broker or dealer may not effect any transaction in a security on an 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 necessary or appropriate to exempt in the public interest or for the protection of investors. Under this authority the Commission has exempted securities of certain banks, certain securities secured by property or leasehold interests, certain warrants and, on a temporary basis, certain securities issued in substitution for or in addition to listed securities.

[3] Securities Exchange Act Release No. 5981.

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, including 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 and securities of foreign governments.

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 reports. The principal annual report form is Form 10-K which is designed to keep up to date the information furnished in 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 such as changes in control of 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.

Statistics Relating to Registration of Securities on Exchanges

As of June 30, 1959, a total of 2,236 issuers had 3,808 classes of securities listed and registered on national securities exchanges, of which 2,631 were classified as stocks and 1,177 as bonds. 1,294 issuers had 1,512 stock issues and 1,124 bond issues listed and registered on the New York Stock Exchange. Thus, 58 percent of the issuers, 57 percent of the stock issues and 95 percent of the bond issues were on the New York Stock Exchange.

During the 1959 fiscal year, 73 issuers listed and registered securities for the first time on a national securities exchange, while registration of all securities of 73 issuers was terminated. The total number of applications for registration of classes of securities on national securities exchanges filed during the 1959 fiscal year was 203.

The following table shows the number of annual, semiannual, and current reports filed during the fiscal year by issuers having securities listed and registered on national securities exchanges. The table also shows the number of reports filed under section 15(d) of the Securities Exchange Act of 1934 by issuers obligated to file reports by reason

of having publicly offered securities effectively registered under the Securities Act of 1933. The securities of such issuers are traded generally in the over-the-counter markets. As of June 30, 1959, there were 1,503 such issuers, including 247 also registered under the Investment Company Act of 1940.

Number of annual and other periodic reports filed by issuers under the Securities Exchange Act of 1934 during the fiscal year ended June 30, 1959

Type of reports	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.	2,223	1,480	3,703
Semi-annual reports on Form 9-K	1,685	848	2,533
Current reports on Form 8-K, etc.	3,650	1,719	5,368
Total reports filed	7,558	4,046	11,604

MARKET VALUE OF SECURITIES TRADED ON EXCHANGES

The market value on December 31, 1958, of all stocks and bonds admitted to trading on one or more stock exchanges in the United States was approximately $419,585,963,000.

	Number of issues	Market value Dec. 31, 1958
Stocks:		
New York Stock Exchange	1,507	$276,665,191,000
American Stock Exchange	855	31,729,486,000
Exclusively on other exchanges	570	4,266,569,000
Total stocks	2,932	312,661,246,000
Bonds:		
New York Stock Exchange [1]	1,149	105,866,137,000
American Stock Exchange	59	908,340,000
Exclusively on other exchanges	28	150,240,000
Total bonds	1,236	106,924,717,000
Total stocks and bonds	4,168	419,585,963,000

[1] Bonds on the New York Stock Exchange included 50 U.S. Government and New York State and City issues with $77,690,873,000 aggregate market value.

The New York Stock Exchange and American Stock Exchange figures were 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 were also traded on one or the other of the New York exchanges. The number of issues as shown excludes those suspended from trading and a few others for which quotations were not available. The number and market value as of December

31, 1958, of preferred and common stocks separately was as follows:

	Preferred stocks		Common stocks	
	Number	Market value	Number	Market value
Listed on registered exchanges	586	$8,400,005,000	2,028	$282,313,930,000
All other issues [1]	59	493,783,000	259	21,453,528,000
	645	8,893,788,000	2,287	303,767,458,000

[1] Issues admitted to unlisted trading privileges only or listed on exempt exchanges.

The New York Stock Exchange has reported aggregate market values of all stocks thereon monthly since December 31, 1924, when the figure was $27.1 billion. The aggregate market value rose to $89.7 billion in 1929, declined to $15.6 billion in 1932, and was $298.8 billion in June 1959. The American Stock Exchange has reported December 31 totals annually since 1936. Aggregates for stocks exclusively on the remaining exchanges have been compiled as of December 31 annually by the Commission since 1948.

Share values on exchanges, in billions of dollars

December 31 each year	New York Stock Exchange	American Stock Exchange	Exclusively on other exchanges	Total [1]
1936	$ 59.9	$14.8		$ 74.7
1937	38.9	10.2		49.1
1938	47.5	10.8		58.3
1939	46.5	10.1		56.6
1940	41.9	8.6		50.5
1941	35.8	7.4		43.2
1942	38.8	7.8		46.6
1943	47.6	9.9		57.5
1944	55.5	11.2		66.7
1945	73.8	14.4		88.2
1946	68.6	13.2		81.8
1947	68.3	12.1		80.4
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
1956	219.2	31.0	3.8	254.0
1957	195.6	25.5	3.1	224.2
1958	276.7	31.7	4.3	312.7
June 30, 1959 [2]	298.8	34.2	4.6	337.6

[1] Total values 1936-47 inclusive are for the New York Stock Exchange and the American Stock Exchange only.
[2] As reported by the New York Stock Exchange and estimated for all others.

At the time of passage of the Securities Exchange Act of 1934, stock prices were rising from their low point, reached in 1932, and a substantial recovery occurred through 1936. Indices turned downward with the stock market decline in 1937. Share volumes on the exchanges dropped from 962 million in 1936 to 221 million in 1942 and dollar volumes thereof from $23.6 billion in 1936 to $4.3 billion in 1942. Thereafter, recovery set in. For the calendar year 1958, the exchange turnover reached 1.4 billion shares with $38.4 billion dollar volume of sales, and for the first 6 months of 1959, the turnover

reached nearly a billion shares with over $28 billion dollar volume. The number of stocks listed on the registered exchanges fell from 2,961 in 1937 to 2,584 in 1945, and recovered to 2,643 on June 30, 1959. Growth of the issuers is reflected by the increase in their outstanding shares as reported below:

Shares on exchanges, in millions

June 30	Listed on registered exchanges	Unlisted and exempted	Total on all exchanges	Percent listed on registered exchanges
1936	2,438	(1)	(1)	(1)
1937	2,601	(1)	(1)	(1)
1938	2,312	(1)	(1)	(1)
1939	2,344	(1)	(1)	(1)
1940	2,367	(1)	(1)	(1)
1941	2,279	(1)	(1)	(1)
1942	2,262	(1)	(1)	(1)
1943	2,284	393	2,677	85.3
1944	2,295	416	2,711	84.7
1945	2,320	420	2,740	84.7
1946	2,458	408	2,866	85.8
1947	2,668	398	3,066	87.0
1948	2,841	390	3,231	87.9
1949	3,022	393	3,415	88.5
1950	3,156	366	3,522	89.6
1951	3,490	377	3,867	90.3
1952	3,685	405	4,090	90.1
1953	3,915	420	4,335	90.3
1955*	5,009	467	5,476	91.5
1956*	5,852	483	6,335	92.4
1957*	6,247	526	6,773	92.2
1958*	6,465	544	7,009	92.2

[1] Net totals of unlisted shares on all exchanges and of shares listed on the exempted exchanges have not been compiled prior to 1943.
*December 31.

Shares listed on the New York Stock Exchange reached half a billion in 1926, 1 billion in 1929, 2 billion in 1948, and 5 billion in 1958. A further increase to 5.46 billion shares listed on this Exchange during the first 6 months of 1959 brings the total shares available for trading on all exchanges to around 7.5 billion as of June 30, 1959.

Assets of Domestic Companies with Common Stocks on Exchanges

The assets of all domestic companies having common stocks on the stock exchanges were roughly equal to the $291.4 billion market value of such common stocks on December 31, 1958. The equivalence owes to the preponderance of industrial stocks on the exchanges; it is not unusual for industrial stocks to sell for as much as or more than reported assets. The assets included about $280.8 billion for domestic companies with common stocks listed on registered exchanges and $11.4 billion for domestic companies with common stocks unlisted on the exchanges or listed on the exempted exchanges. The $280.8 billion listed aggregate included $266 billion on the New York Stock Exchange,[4] $9.8 billion on the American Stock Exchange, and

[4] New York Stock Exchange "Fact Book, 1959" supplies this figure for 1957 including some fiscal years ending in 1958. Figures for the other exchanges are for the most part as reported around December 31, 1958.

$5 billion exclusively on regional exchanges. The $11.4 billion unlisted and exempted aggregates included $8.2 billion on the American Stock Exchange and $3.2 billion exclusively on regional exchanges. The assets represent a conglomerate of individual and consolidated company reports and various treatments of such matters as reserves for depreciation.

Foreign Stock on Exchanges

The market value on December 31, 1958, of all shares and certificates representing foreign stocks on the stock exchanges was reported at about $12.5 billion, of which $11.1 billion represented Canadian and $1.4 billion represented other foreign stocks. The market values of the entire Canadian stock issues were included in these aggregates. Most of the other foreign stocks were represented by American depositary receipts or American shares, only the outstanding amounts of which were used in determining market values.

Comparative Over-the-Counter Statistics

Annual over-the-counter transactions of as much as $200 billion United States Government bonds, centered in the offices of 5 banks and 12 specializing dealers, are about 5 times the total bond and stock volumes on all the stock exchanges, and earn for the over-the-counter industry the distinction of being the world's largest securities market. Government bonds have in the past been actively traded on stock exchanges, reaching $2.9 billion per annum on the New York Stock Exchange in the 1919–20 price recovery, but the last significant Exchange volume was reported 20 years ago, in 1939, and current volumes on the Exchange are around $100,000 per annum.

Securities representing upward of $50 billion State and local government debt are, with few exceptions,[5] sold only over the counter. These bonds are usually issued in serial form, with a comparatively small amount for each maturity date, and have a specialized market owing to their tax-exemption features.

Corporate bond sales on the stock exchanges are only about $1.5 billion per annum, much less than those over-the-counter.

The over-the-counter potential for dealing in stocks is enormous, since there are perhaps a million corporations whose shares might come into the market.[6] However, less than 1 percent of these corporations appear to have the size and share distribution to command a continuing public market for their stocks. The following over-the-

[5] There is activity on the New York Stock Exchange in New York City Transit 3s of 1980, and on the American Stock Exchange in Chicago Transit Authority 3¾s of 1978.

[6] U.S. Treasury Department "Statistics of Income" reported 924,961 corporation income tax returns for 1956–57, an increase of 82,836 over 1955–56. About 8,500 of the returns accounted for 75 percent of the $949 billion total reported assets. There have been well over 100,000 new incorporations per annum over the past decade and this rate nearly doubled in the first 6 months of 1959 upon passage of laws granting certain tax elections to corporations with not over 10 shareholders.

counter data are derived from a continuing survey of the standard security manuals, the National Quotation Bureau Services, and reports to the Commission.

Somewhat over 700 domestic banks have stocks with 300 or more reported holders which are not on any stock exchange. Practically all are common stocks. Their aggregate market value on December 31, 1958, was about $15 billion, which was close to 10 percent of the $155 billion assets on that date of the issuing banks. The corresponding market value of bank stocks on stock exchanges aggregated about $237 million for 24 issues.[7]

About 300 domestic insurance companies have stocks with 300 or more reported holders which are not on any stock exchange. Nearly all are common stocks. The aggregate market value of their quoted stocks on December 31, 1958, was about $11.5 billion, which was close to 40 percent of their $29 billion assets on that date. The corresponding value of insurance stocks on stock exchanges aggregated about $1.6 billion for 17 issues of 16 issuers.

About 500 issuers are registered under the Investment Company Act of 1940, and their aggregate assets are about $20 billion. On December 31, 1958, 39 of these issuers, with about $2.2 billion net asset value, had stocks on stock exchanges with about $1.9 billion aggregate market value.[8] Over-the-counter market or redemption values of the remaining issuers' securities would bear a close correspondence to their approximate $17.8 billion net asset value.

About 2,500 additional domestic industrial, utility, and miscellaneous issuers have stocks with 300 or more reported holders which are not on any stock exchange. The aggregate market value on December 31, 1958, of their shares was about $32.5 billion. About $2.5 billion consisted of preferred stocks. The $30 billion common stocks were of companies with aggregate assets of about $39 billion on that date. Nearly all widely-held railroad stocks and a preponderance of widely-held utility and industrial stocks are on exchanges.

In all, some 3,500 domestic corporate issuers (excluding registered investment companies) [9] have stocks with 300 or more reported hold-

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[7] Of the 22 bank stocks remaining on stock exchanges on June 30, 1959, 1 was listed and registered, and 5 were listed and exempted from registration, on the Washington branch of the Philadelphia-Baltimore Stock Exchange, and 16 were listed on the exempted Richmond, Wheeling, and Honolulu Exchanges.

[8] With 2 exceptions, all investment trust shares on the stock exchanges are of closed-end issuers. Purchases and sales of closed-end investment trust shares are ordinarily made in the open market such as a stock exchange affords. Holders of open-end investment trust shares ordinarily buy them from distributors and redeem them at their liquidating values. The 2 open-end issuers on stock exchanges are Coca Cola International Corporation and General Capital Corporation, whose shares are listed on the New York Stock Exchange and the Boston Stock Exchange respectively, with no exchange volume reported during 1958 in either issue.

[9] The use of registered investment company totals in computing overall securities aggregates would be duplicative to a great extent in that their holdings consist of other securities, principally listed stocks.

ers which are not on any stock exchange, and whose aggregate market value on December 31, 1958, was approximately $59 billion. The assets of the issuers having over-the-counter common stocks aggregated about $223 billion on that date, of which nearly 70 percent ($155 billion) was of banks.

As in case of issuers having securities on stock exchanges,[10] the number of such issuers of over-the-counter stocks has not changed greatly in recent years. The constant additions are substantially offset by losses through new listings on stock exchanges, mergers, sales of assets, liquidations and reduction in number of shareholders in some instances.[11] Share price changes have kept pace with those of stocks on stock exchanges. Aggregate share values of $238.8 billion on stock exchanges on December 31, 1955, were about 5.3 times the $45 billion over-the-counter values as computed for that date in our 22d Annual Report (1956), and the $312.7 billion stock exchange values on December 31, 1958, were similarly about 5.3 times the $59 billion over-the-counter values as above computed.

The domestic over-the-counter stock values of $59 billion, as computed above, included $15 billion of stocks of banks, which report to their own regulatory agencies. Of the $44 billion of other stock values, about $24 billion, or over 50 percent, were of issuers reporting to the Commission pursuant to requirements of the Securities Exchange Act of 1934. The $24 billion included about $20.7 billion stocks of domestic issuers reporting under section 15(d) of the 1934 Act, by reason of registrations of securities for public sale,[12] and about

[10] Issuers represented on stock exchanges numbered 2,594 on June 30, 1956, and 2,527 on June 30, 1959, including issuers of both bonds and stocks.

[11] Purchases of stocks for control sometimes reduce holders below 300. Holders of preferred stocks, of real estate stocks issued in reorganizations, and of stocks distributed ("spun-off") by large companies to their numerous stockholders tend to decrease over the years.

[12] Issuers required to report under section 15(d) of the Securities Exchange Act of 1934 had aggregate quoted values of shares on December 31, 1958, as follows:

	Issuers	*Value of quoted shares*
Over the counter:		
Utility, industrial, etc.	948	$18, 115, 290, 000
Insurance	87	2, 629, 900, 000
Foreign	42	1, 909, 400, 000
	1, 077	22, 654, 590, 000
Unlisted on stock exchanges:		
Utility, industrial, etc.	30	1, 355, 800, 000
Insurance	3	790, 700, 000
Foreign	2	1, 465, 300, 000
	35	3, 611, 800, 000
	1, 112	26, 266, 390, 000
Registered investment companies	225	
Partnerships, voting trusts, stock purchase plans, etc.	77	
	1, 414	

$3.3 billion over-the-counter stocks of issuers reporting because they have other securities listed on registered exchanges.

Taking into account the share values of registered investment companies which do report, and those of banks which do not report to the Commission, it is evident that the total values of shares of domestic issuers reporting to the Commission is more than half of the total domestic over-the-counter share values, as above computed.

DELISTING OF SECURITIES FROM EXCHANGES

Pursuant to rule 12d2-1(b) under section 12(d) of the Securities Exchange Act, applications may be made to the Commission by issuers to withdraw their securities or by exchanges to strike any securities from listing and registration on exchanges. The Commission may not deny such applications if made in accordance with the appropriate exchange rules, but may impose such terms as it may deem necessary for the protection of investors.

During the fiscal year ended June 30, 1959, the Commission granted applications by issuers and exchanges to remove 39 stock issues and 1 bond issue from listing and registration pursuant to rule 12d2-1(b). There were 41 removals, since 1 stock was delisted from 2 exchanges. The number of issuers involved was 37. The removals were as follows:

Applications filed by:	*Stock issues*	*Bond issues*
New York Stock Exchange	15	1
American Stock Exchange	4	0
Cincinnati Stock Exchange	1*	0
Midwest Stock Exchange	3	0
Pacific Coast Stock Exchange	5	0
Philadelphia-Baltimore Stock Exchange	5	0
Spokane Stock Exchange	1	0
San Francisco Mining Exchange	1	0
Issuers	5	0
Total	40	1

*This stock was also delisted from the American Stock Exchange.

The applications by exchanges were based in general upon the ground that the issues were no longer suitable for exchange trading, by reason of reduced public holdings, small values, few holders, inconsequential trading volumes on the exchanges, or a combination of these factors. Some of the issuers were not operating, or were in process of liquidation. Failure to file reports with the exchange was cited in three instances. In six of the applications made by exchanges it was stated that the issuers had requested the action.

The five applications by issuers were for removal of stocks from various regional exchanges. The stocks remained listed on other exchanges where the principal trading volume therein occurred.

From July 1, 1936, through June 30, 1959,[13] there have been 533 delistings of securities on application of exchanges and 279 on application of issuers. Delistings from the New York Stock Exchange numbered 282 pursuant to its applications and 6 pursuant to applications by issuers. Delistings from the American Stock Exchange numbered 58 pursuant to its applications and 25 pursuant to applications by issuers. Delistings from the regional exchanges numbered 193 pursuant to their applications and 248 pursuant to applications by issuers. Thus, about 2 percent of the New York Stock Exchange delistings, 30 percent of the American Stock Exchange delistings, and 56 percent of the regional exchange delistings were pursuant to applications by issuers.

As indicated above, delisting applications filed by exchanges are ordinarily based on lack of adequate public interest in the security issues concerned. The usual exchange application cites diminution in number of holders and publicly held shares or the moribund condition of the issue or issuer. The reduction in the number of holders and publicly held shares frequently results from acquisitions involving an offer of exchange into other listed shares of the same or another issuer. In some cases, a company will have sold its assets for cash and distributed all but small final payments in liquidation. The specific reason given in an application in case of a moribund condition may be that the issuer has failed to file reports required by the listing agreement and registration, or has discontinued transfer and registrar facilities, or faces insolvency proceedings. Some exchanges, upon learning that an issuer has determined to delist an inactively traded issue, will make the application as a matter of good public relations, stating that it is made at the request of the issuer by reason of its inactivity on the Exchange. The New York Stock Exchange, as the leading exchange in number of listings and number of removals, has developed and published criteria on the basis of which it will consider initiation of a delisting application. (See 24th Annual Report, p. 63.) Some of the stocks delisted upon its application have remained or become listed on other exchanges.[14] One of the stocks delisted upon its application has since become prominent.[15] In general, however, there are very few instances of substantial public interest in securities after their delisting upon application by exchanges.

Delistings upon application by issuers fall into three classes: those which have little value, those which remain listed on other exchanges,

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[13] Comparable data are not available for the period prior to July 1, 1936.

[14] Examples include Kalamazoo Stove and Furnace Company and DTM Corporation stocks remaining on Midwest Stock Exchange, and Spear & Company, Clopay Corporation, and Davega Stores Corporation stocks which became listed on the American Stock Exchange.

[15] The number of holders of American Express Company stock, delisted in 1939 when it was nearly all owned by Amerex Holding Corporation, increased from under 100 to over 25,000 in its spin-off by the latter 11 years later.

and those which are good over-the-counter material. Upon the market break in 1937 and the subsequent drying up of exchange activity, from 962 million shares in 1936 to 221 million in 1942, and from $23.6 billion to $4.3 dollar volume respectively, there was a plethora of issuer applications. In this period, the Commission frequently required issuers to notify their stockholders of the pending application and to advise them of their right to be heard. Response of the holders was inconclusive,[16] but the contents of the notifications were made the cause of denials or dismissals in some instances. For some time after the low point of the decline in share volumes was reached in 1942, the flow of delisting applications by issuers continued, and the Commission in three cases during the period 1944–46 required important issuers to put their decisions to a vote of stockholders.[17] However, volumes on the exchanges were recovering. New delisting applications by issuers dropped to an average of about 7 per annum in the 15 years to June 30, 1959, compared to over 21 per annum in the 8 years to June 30, 1943. Notifications to stockholders were required in only a few instances after 1943, the last being in 1954; no voting requirement has been ordered by the Commission since 1946. On occasion, either voluntarily or in compliance with a rule of an exchange, issuers have put the matter of delisting to vote of their stockholders before submitting applications. Since 1947, the Commission has held hearings on delisting applications only if requested by an interested party, and only three such hearings have been held since that date, all on delisting applications of the New York Stock Exchange.

Most of the delistings pursuant to applications by issuers during the period have been with respect to issues having little value or issues remaining listed on other exchanges.[18] Excluding a number of open-end investment company stocks, originally listed to qualify for sale under blue sky laws and not suitable for exchange trading, issues having a current market value of around $500 million have been removed to over-the-counter trading by delistings pursuant to applications by issuers during the period.[19] The reporting requirements of the Commission pursuant to section 13 of the Securities Exchange Act seem not to have been much of a factor in the deliberations of the issuers with respect to delisting, since about $400 million of the market

[16] The letters received were about equally divided for and against delisting, and personal appearances at the hearings were few in number.

[17] In none of these cases did the issuer pursue its delisting application further after imposition of the voting requirement.

[18] Delistings on application of issuers during the period originally comprised about 117 with no substantial trading value, 95 remaining listed on other exchanges, and 67 which became good over-the-counter trading material. Since delisting, about half of the 67 last-mentioned issues have been exchanged into listed stocks of other companies or passed out of existence in other ways.

[19] This amount is less than 0.2 percent of the market value of stocks on the exchanges.

value is of issuers continuing to file similar reports under section 15(d) of the act.

Delisting Proceedings under Section 19(a)

Under section 19(a)(2) the Commission may suspend for a period not exceeding 12 months, or withdraw, the registration of a security on a national securities exchange if, in its opinion, such action is necessary or appropriate for the protection of investors and, after notice and opportunity for hearing, the Commission finds that the issuer of the security has failed to comply with any provision of the act or the rules and regulations thereunder. Shown below is the number of such proceedings during the 1959 fiscal year.

Proceedings pending at the beginning of the fiscal year	8	
Proceedings initiated during the fiscal year	5	13
Proceedings terminated during the fiscal year:		
By order withdrawing security from registration	5	
By order suspending registration of security	1	6
Proceedings pending at the end of the fiscal year		7

The six proceedings which were terminated during the fiscal year were terminated during the early part of the year and were described in the Commission's 24th Annual Report.[20]

Section 19(a)(4) authorizes the Commission summarily to suspend trading in any registered security on a national securities exchange for a period not exceeding 10 days if, in its opinion, such action is necessary or appropriate for the protection of investors and the public interest so requires. The Commission has used this power infrequently in the past. However, during the 1959 fiscal year the Commission found it necessary and appropriate in connection with three pending proceedings under section 19(a)(2) to use its authority summarily to suspend trading in securities registered on a national securities exchange. Only one of these suspensions remained in effect at the end of the fiscal year.

UNLISTED TRADING PRIVILEGES ON EXCHANGES

The classical method by which stock exchanges evolved was for a group of local brokers to commence trading in any available securities. For more than half a century after the historic 1792 meeting under the buttonwood tree, any security could be called up for trading on the New York Stock Exchange at the pleasure of any member. By 1856, vote of a majority of members present came to be required for the placing of a security on the list to be called, but upon payment of

[20] Pp. 64–71.

a 25-cent "fine" any member could have any other security temporarily inserted. Unlisted trading on the New York Stock Exchange was finally abolished in 1910, upon the recommendation of the New York Governor's Committee on Speculation in Securities and Commodities (the "Hughes Committee") and because most of the stocks in the unlisted department were in any event becoming listed.

The leading regional stock exchanges began trading in much the same way. For example, the rule on the Philadelphia Stock Exchange as late as 1876 was that "members may call up the various stocks of any chartered company, whether on the regular list or not." As their growth in trading volumes and prestige enabled them to impose formal listing agreements and listing fees upon issuers, many of these exchanges came to abolish unlisted trading entirely, as the New York Stock Exchange has done, or to restrict it to issues listed upon other leading exchanges.[21] A resolution adopted by the Boston Stock Exchange in 1869 provided that "securities dealt in at the New York or Philadelphia Stock Exchanges may be called once, after the regular list, without charge . . ." The rule on the Philadelphia Stock Exchange by 1932 was that no securities could be admitted to unlisted trading which were not listed on the New York Stock Exchange, New York Curb Exchange, as it was then styled, Boston Stock Exchange, Pittsburgh Stock Exchange, or Chicago Stock Exchange.

The American Stock Exchange (known as the New York Curb Exchange until 1953) is the principal center of exchange trading on an unlisted basis. In 1931–32 it had over 1,800 stock and 850 bond issues on its unlisted roster. As a result of the New York State Attorney General's examination of unlisted trading practices, the number was substantially reduced during 1933–34 by removal of issues inactively traded on the Exchange. The New York Produce Exchange provided facilities for security trading from 1928 to 1935, and had about 750 stock and 150 bond issues available for unlisted trading. The New York Real Estate Securities Exchange operated from 1929 to 1941, and had about 100 stock and 200 bond issues available for trading on an unlisted basis. A number of other exchanges on which unlisted trading occurred ceased to operate in the early days of the

[21] The listing process has had a long evolution. As early as 1847, the New York Stock Exchange called for transfer books to be located in New York City. Its Committee on Stock List, created in 1869, promulgated rules protecting against forgery and over-issuance of securities, and sought to obtain statements of condition and lists of officers of issuers. The regular files of printed listing statements date from 1884. By 1900, the Exchange had commenced to call upon applicants for agreements to publish detailed statements and annual reports. The issuers' agreements with the Exchange became more comprehensive over the years, providing for periodic earnings statements, independent auditing, prompt notifications of issuer actions affecting their security holders, etc. With the advent of the Commission, the requirements of the listing agreements were supplemented by the requirements for registration along with listing.

Commission. The net number of securities admitted to unlisted trading on the exchanges prior to 1934 is not available, but clearly ran into thousands.

Under section 12(f) of the Securities Exchange Act of 1934 [22] the Commission may approve applications by national securities exchanges to admit securities to unlisted trading privileges without action on the part of the issuers, if it finds such admissions are necessary or appropriate in the public interest or for the protection of investors. Such admissions impose no duties on issuers beyond any they may already have under the act. Section 12(f) provides for three categories of unlisted trading privileges. Clause (1) provides for continuation of unlisted trading privileges existing on the exchanges prior to March 1, 1934. Clause (2) provides for granting by the Commission of applications by exchanges for unlisted trading privileges in securities listed on other exchanges. Clause (3) provides for granting by the Commission of applications for unlisted trading privileges conditioned, among other things, upon the availability of information substantially equivalent to that required to be filed by listed issuers.

Included under clause (1) of section 12(f) are securities which had unlisted trading privileges on some exchanges prior to March 1, 1934, and (a) were also listed and registered on some other exchange or exchanges, or (b) were admitted only to unlisted exchange trading. Issuers of securities in group (a) are subject to the statutory reporting requirements by reason of the listing and registration of their securities. Issuers of securities in group (b) may or may not be issuing public reports. Of the issues in group (b), only 246 stock and 20 bond issues remained in that status as of June 30, 1959. The attrition has been due to many factors. Bond and preferred stock issues have been retired. Companies have merged or liquidated. Marginal exchanges opening around the 1929 peak of market activity ceased operations thereafter. Many leading common stocks traded on an unlisted basis have subsequently been listed or exchanged for listed stocks of merging companies.

The stocks with only unlisted trading privileges on the exchanges had an aggregate market value of $21.4 billion as of December 31, 1958. Standard Oil (New Jersey) held 52.5 percent of this total in stocks of Creole Petroleum Corporation, Humble Oil & Refining Company, Imperial Oil Limited, and International Petroleum Company, Limited. An additional 17.5 percent of the total was of 58 issues of

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[22] The original bills proposed abolition of unlisted trading on stock exchanges. The proposals were opposed by the American Stock Exchange and other smaller exchanges as presenting too sharp a transition. Congress directed the Commission to study the problem and submit its recommendations, which was done in a "Report on Trading in Unlisted Securities upon Exchanges," dated January 3, 1936. The recommendations were adopted and the present section 12(f) was enacted in May 1936.

55 issuers reporting as fully as though they were listed, by reason of registrations under the Securities Act, the Public Utility Holding Company Act, the Investment Company Act, or because the issuers in some cases had other securities listed on registered exchanges. The residue in public hands of such unlisted stocks accordingly amounted to only about $6.5 billion, and of this amount, about $4.2 billion was of 70 Canadian and other foreign stocks and American depositary receipts for foreign shares. The reported volume of trading on the exchanges in stock admitted to unlisted trading only, for the calendar year 1958, was about 32.3 million shares or about 2.5 percent of the total share volume on all the exchanges. Over 90 percent of this 32.3 million share volume was on the American Stock Exchange.

Unlisted trading privileges on exchanges in issues listed and registered on other exchanges, granted under clause (1), are for the life of the issue, while those granted under clause (2) are only for the duration of the issue's listing and registration on another exchange.[23] The number of unlisted trading privileges[24] granted under clause (1), in issues listed on other exchanges, were 991 in stocks and 75 in bonds on December 31, 1935. Similar privileges were thereafter granted under clause (2) for 1,410 stock issues and 8 bond issues. Mergers of exchanges, mergers of issuers, etc., have reduced the number of such privileges, which as of June 30, 1959, comprised 1,492 in stocks and 1 in bonds. The reported volume of trading on the exchanges pursuant to these unlisted trading privileges for the calendar year 1958 was about 38.7 million shares or about 3 percent of the total share volume on all the exchanges. About 15 percent of this 38.7 million share volume was on the American Stock Exchange and 85 percent was on the regional exchanges.

On June 30, 1959, unlisted trading privileges existed pursuant to clause (3) of section 12(f) in only 12 bond and 4 stock issues, and 2 of the stock issues have also become listed on other exchanges. There have been no applications under clause (3) since 1949.

Applications for Unlisted Trading Privileges

Applications by exchanges for unlisted trading privileges in stocks listed on other exchanges, made pursuant to clause (2) of section 12(f) of the Securities Exchange Act, were granted by the Commission during the fiscal year ended June 30, 1959 as follows:

[23] Ordinarily, delisting occurs upon termination of the existence of an issue, and so the unlisted trading privileges therein, whether under clause (1) or clause (2), also end. Occasionally, however, an unlisted trading privilege on one exchange granted under clause (1) has continued after the issue has been delisted from another exchange upon application by the issuer or by the exchange or because a listing was dropped upon merger of exchanges. Currently, 4 such unlisted trading privileges continue in stocks which were formerly listed on other exchanges.

[24] The number of trading privileges is greater than the number of issues because there may be trading privileges in an issue on more than one exchange.

Stock exchange:	Number of stocks
American	2
Boston	20
Cincinnati	1
Detroit	10
Midwest	1
Pacific Coast	7
Philadelphia-Baltimore	27
Pittsburgh	1
	69

Rule 12f-2 under section 12(f) of the Securities Exchange Act provides that when a security admitted to unlisted trading on an exchange is changed in more than certain stipulated minor respects, the exchange may apply for Commission determination that the unlisted trading privileges may continue on the ground that the changed security is substantially equivalent to the security theretofore admitted to unlisted trading privileges. During the fiscal year the Commission granted applications by the American Stock Exchange for continuance of unlisted trading under this rule in three stock issues and two bond issues.

BLOCK DISTRIBUTIONS REPORTED BY EXCHANGES

Rule 10b-2 under the Securities Exchange Act of 1934 in substance prohibits any person participating or otherwise financially interested in the primary or secondary distribution of a security from paying any other person for soliciting a third person to buy any security of the same issuer 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 rule 10b-2 exempts transactions 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. The Commission in its declaration may impose such terms and conditions upon such plan as it deems necessary or appropriate in the public interest or for the protection of investors.

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 by the exchange 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 plan 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, blocks of listed securities may be distributed to the public by a "Secondary Distribution" on the over-the-counter market, after the close of exchange trading. The exchanges generally require members to obtain the approval of the exchange before participating in such secondary distributions.

The following table shows the number and 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 December 31, 1958 [25]

	Number	Shares in offer	Shares sold	Value (thousands of dollars)
Special offerings	5	93,445	88,152	3,286
Exchange distributions	38	620,806	619,876	29,454
Secondary distributions	122	9,321,712	9,508,505	361,886
	6 months ended June 30, 1959 [25]			
Special offerings	1	28,000	28,500	1,550
Exchange distributions	14	334,906	296,119	14,683
Secondary distributions	89	10,214,617	10,503,726	455,764

MANIPULATION AND STABILIZATION

Manipulation

The Exchange Act describes and prohibits certain forms of manipulative activity in any security registered on a national securities exchange. The prohibited activities include wash sales and matched orders effected for the purpose of creating a false or misleading appearance of trading activity in, 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 actual or apparent active trading is created for the purpose of inducing purchases or sales of such security 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 in the price of such security; and the making of any false and misleading statement of material information by a broker, dealer, seller, or buyer regarding such security for the purpose of inducing purchases or sales. The act also empowers the

[25] Details of these distributions appear in the Commission's monthly statistical bulletin. For data for prior years see appendix table.

Commission to adopt rules and regulations to define and prohibit the use of these and other forms of manipulative activity in any security registered on an exchange or traded over the counter.

The Commission's market surveillance staff in its Division of Trading and Exchanges in Washington and in its New York Regional Office and other field offices studies the tickertape quotations of securities listed on the New York Stock Exchange and on the American Stock Exchange, 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 for any unusual or unexplained price variations or market activity. The financial news ticker, 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 examined 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 to discover rapidly 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 subpoenas and to take testimony under oath, is issued by the Commission. If violations by a broker-dealer are discovered, the Commission may institute administrative proceedings to determine whether or not to revoke his registration or to suspend or expel him from membership in the National Association of Securities Dealers, Inc., or from a national securities exchange. The Commission may also seek an injunction against any person violating the act and it may refer information obtained in its investigation to the Department of Justice recommending that persons 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 Commission is much concerned with indications of increased manipulative activity in present securities markets. Accordingly, the Commission has placed greater emphasis in its enforcement work upon the detection and prevention of manipulation and a substantial number of investigations are now in progress in this area.[26]

Active securities markets are particularly susceptible to manipulation because of the ease with which public interest can be generated.

[26] Securities Exchange Act Release No. 5927.

Devious schemes may be employed to take advantage of this public interest. These include schemes to increase the quoted over-the-counter prices for relatively obscure issues being distributed without registration in asserted reliance upon some exemption, or the creation of fictitious markets for such issues. Such schemes are not uncommon in connection with distributions effected by "boiler rooms." These activities when conducted with ingenuity through numerous intermediaries are difficult to detect. Persons engaged in, or proposing distribution of a security not outstanding in the hands of the public may place orders for the purchase and sale of small amounts of a security with numerous brokers and dealers, or arrange to have others do this, with the result that such brokers and dealers will publish quotations for the security at prices specified in the orders, thus creating the appearance of an active over-the-counter market for the security, when in fact no such market exists except as generated by the distributors. When the distribution is completed, the orders are withdrawn and the "market" disappears.

The investigation and prosecution of a manipulation case requires careful and painstaking work usually over a period of many months. Investors must be identified and interviewed, books and records of brokers, dealers and others must be examined and analyzed, and the information thus obtained then has to be developed in a form which would permit its introduction in evidence in legal proceedings.

The following table shows the number of quizzes and formal investigations pending at the beginning of fiscal 1959, the number initiated in fiscal 1959, the number closed or completed during the same period, and the number pending at the end of the fiscal year:

Trading investigations

	Quizzes	Formal investigations
Pending June 30, 1958	46	8
Initiated during fiscal year	89	
Total	135	8
Closed or completed during fiscal year	55	
Changed to formal during fiscal year	3	3
Total	58	3
Pending at end of fiscal year	77	11

When securities are to be offered to the public, their markets are watched very closely to make sure that the price is not unlawfully raised prior to or during the distribution. One thousand and fifty-five registered offerings having a value of $15,657 million and 854 offerings exempt under section 3(b) of the Securities Act, having a value of about $170 million were so observed during the fiscal year. Two hundred and seventy-four other offerings, such as secondary distri-

butions and distributions of securities under special plans filed by the exchanges, having a total value of $715 million, were also kept under surveillance.

Stabilization

When, in 1934, the provisions of the Securities Exchange Act were being drafted, Congress concluded that at times it would be necessary to stabilize offerings of securities in order to raise funds for industry and to protect existing investors while doing so. But rather than set stabilizing standards as a matter of law, Congress delegated to the Commission the authority to adopt rules to govern this little-understood function.

When the Commission was organized, one of its first tasks was to study the subject of stabilizing, decide what was improper and consider the adoption of rules. The principal difficulty has been that stabilizing is a form of market manipulation. The problem was to retain the benefits while removing those antisocial practices which might cause loss to investors. The Commission proceeded slowly, as many new facets of the problem were revealed, and it was difficult to devise a simple formula which had the particularity required in a rule binding on all who dealt in securities, without literally strangling the business.

Until it gained more expertise in the field, the Commission encouraged issuers, underwriters and their counsel to consult with it and the staff concerning problems which might arise in this area. Each such problem was judged on its own merits in the light of whether or not the interests of investors might be adversely affected. As the Commission gained experience, general principles were laid down. It was held, among other things, that stabilizing was not improper if it did no more than prevent or retard a price decline during an offering; that stabilizing purchases should be confined to the fewest transactions necessary to accomplish such a purpose; that stabilizing levels must be based on an existing independent market and not some level believed desirable by the person stabilizing; and that it was improper for a stabilizer to follow a rise in price too closely. Releases were issued from time to time to publicize the Commission's viewpoint with regard to stabilizing. In addition, the Commission expressed its viewpoint in its decisions and opinions.

From time to time it was suggested that what had now become a rather extensive list of settled practices be codified in specific rules, but in various conferences, the industry claimed that any code must necessarily be too rigid to allow for changing conditions.

However, on December 30, 1952, the Committee on Interstate and Foreign Commerce of the House of Representatives recommended that the "Commission should earnestly and expeditiously grapple with the problem of stabilization with the view of either the early

promulgation of rules publicly covering these operations, or of recommending to the Congress such changes in legislation as its experience and study show now to be desirable." The Commission therefore undertook to codify the stabilizing practices which had been developed over the years.

The Commission requested and obtained the assistance of the securities industry in formulating its stabilizing rules. An ad hoc committee of the public was formed. This committee conferred with and submitted proposals to the staff, which were considered by the Commission together with the recommendations of the staff and views obtained in a public hearing held prior to the adoption of the rules.

The rules as finally adopted are extremely technical. They have, however, served well their purpose of facilitating distributions and preventing unlawful manipulations. Rule 10b-6 restricts the trading activities of those who issue or participate in the distribution of securities. Rule 10b-7 governs the times, methods and prices at which stabilizing transactions are permissible. Rule 10b-8 deals with the peculiar problems arising in an offering of securities through rights. The Commission is continuously reexamining the effect of these rules and if it appears necessary, it will amend them to conform to any developing practice of the industry which appears to be in the public interest.

During 1959 stabilizing was effected in connection with stock offerings aggregating 32,097,212 shares having an aggregate public offering price of $770,503,662 and bond offerings having a total offering price of $129,038,300. In these offerings, stabilizing transactions resulted in the purchase of 710,015 shares of stock at a cost of $18,146,077 and bonds at a cost of $2,938,340, and 4,461 stabilizing reports showing purchases and sales of securities effected by persons conducting the distribution were received and examined during the fiscal year.

INSIDERS' SECURITY HOLDINGS AND TRANSACTIONS

Section 16 of the act is designed to prevent the unfair use of confidential information by directors, officers and principal stockholders by giving publicity to their security holdings and transactions and by removing the profit incentive in short term trading by them in equity securities of their company. Such persons by virtue of their position may have knowledge of the company's condition and prospects which is unavailable to the general public and may be able to use such information to their personal advantage in transactions in the company's securities. Provisions similar to those contained in section 16 of the act are also contained in section 17 of the Public Utility Holding Company Act of 1935 and section 30 of the Investment Company Act of 1940.

Ownership Reports

Section 16(a) of the Securities Exchange Act requires every person who is a direct or indirect beneficial owner of more than 10 percent of any class of equity securities (other than exempted securities) which is registered on a national securities exchange, or who is a director or officer of the issuer of such securities, to file reports with the Commission and the exchange disclosing his ownership of the issuer's equity securities. This information must be kept current by filing subsequent reports for any month in which a change in his ownership occurs. Similar reports are required by section 17(a) of the Public Utility Holding Company Act of officers and directors of public utility holding companies and by section 30(f) of the Investment Company Act of officers, directors, principal security holders, members of advisory boards and investment advisers or affiliated persons of investment advisers of registered closed-end investment companies.

All ownership reports are available for public inspection as soon as they are filed at the Commission's office in Washington and reports filed pursuant to section 16(a) of the Securities Exchange Act may also be inspected at the exchanges where copies of such reports are filed. In addition, for the purpose of making the reported information available to interested persons who may not be able to inspect the reports in person, the Commission summarizes and publishes such information in a monthly "Official Summary of Security Transactions and Holdings," which is distributed by the Government Printing Office on a subscription basis. Increasing interest in this publication is evidenced by the increase in the total circulation from a rate of about 6,000 at the end of the 1958 fiscal year to more than 8,000 at the end of the 1959 fiscal year.

During the fiscal year, 39,275 ownership reports were filed. This represents a considerable increase over the 33,126 reports filed during the 1958 fiscal year. The following table shows details concerning reports filed during the fiscal year ended June 30, 1959.

Number of reports filed during fiscal year 1959

Securities Exchange Act of 1934:[27]	
Form 4	33, 848
Form 5	660
Form 6	3, 550
Total	38, 058

[27] Form 4 is used to report changes in ownership; Form 5 to report ownership at the time an equity security of an insurer is first 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.

Public Utility Holding Company Act of 1935: [28]	
Form U-17-1	23
Form U-17-2	343
Total	366
Investment Company Act of 1940: [29]	
Form N-30F-1	488
Form N-30F-2	363
Total	851
Grand total	39, 275

Recovery of Short-Swing Trading Profits by Issuer

In order to prevent insiders from making unfair use of information which may have been obtained by reason of their relationship with a company, section 16(b) of the Securities Exchange Act, section 17(b) of the Public Utility Holding Company Act, and section 30(f) of the Investment Company Act provide for the recovery by or on behalf of the issuer of any profit realized by insiders from certain purchases and sales, or sales and purchases, of securities of the company within any period of less than 6 months. The Commission has certain exemptive powers with respect to transactions not comprehended within the purpose of these provisions, but is not charged with the enforcement of the civil remedies created thereby.

REGULATION OF PROXIES

Scope of Proxy Regulation

Under section 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 14 requiring the disclosure in a proxy statement 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 distributing 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 prepa-

[28] Form U-17-1 is used for initial reports and Form U-17-2 for reports of changes of ownership.

[29] Form N-30F-1 is used for initial reports and Form N-30F-2 for reports of changes of ownership.

ration 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 is furnished to stockholders.

Statistics Relating to Proxy Statements

During the 1959 fiscal year 1,975 proxy statements in definitive form were filed under the Commission's regulation 14 for the solicitation of proxies of security holders; 1,959 of these were filed by management and 16 by nonmanagement groups or individual stockholders. These 1,975 solicitations related to 1,814 companies, some 150 of which had more than one solicitation during the year, generally for a special meeting not involving the election of directors.

There were 1,790 solicitations of proxies for the election of directors, 152 for special meetings not involving the election of directors and 33 for assents and authorizations for actions not involving a meeting of security holders or the election of directors.

In addition to the election of directors, the decisions of security holders were sought through the solicitation in the 1959 fiscal year of their proxies, consents and authorizations with respect to the following types of matters:

Mergers, consolidations, acquisitions of businesses, purchases and sales of property, and dissolutions of companies	103
Authorizations of new or additional securities, modifications of existing securities, and recapitalization plans (other than mergers, consolidations, etc.)	270
Employee pension and retirement plans (including amendments to existing plans)	71
Bonus, profit-sharing plans and deferred compensation arrangements (including amendments to existing plans and arrangements)	21
Stock option plans (including amendment to existing plans)	178
Stockholder approval of the selection of management of independent auditors	608
Miscellaneous amendments to charter and by-laws, and miscellaneous other matters (excluding those involved in the preceding matters)	410

Stockholder Proposals

During the 1959 fiscal year, 48 stockholders submitted a total of 156 proposals which were included in the 99 proxy statements of 99 companies under rule 14a–8 of regulation 14.

Typical of such stockholder proposals submitted to a vote of security holders were resolutions relating to amendments to charters or by-laws to provide for cumulative voting for the election of directors, limitations on the granting of stock options and their exercise by key employees and management groups, the sending of a post-meeting report to all stockholders, changing the place of the annual meeting of stockholders and the approval by stockholders of management's selection of independent auditors.

The management of 20 companies omitted from their proxy statements under the Commission's rule 14a–8 a total of 65 additional pro-

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posals submitted by 25 individual stockholders. The principal reasons for such omissions and the numbers of times each such reason was involved (counting only one reason for omission for each proposal even though it may have been omitted under more than one provision of rule 14a-8) were as follows:

(a) 18 proposals related to the ordinary conduct of the company's business;

(b) 17 proposals involved the election of directors;

(c) 13 proposals concerned a personal grievance against the company;

(d) 11 proposals were not a proper subject matter under State law;

(e) 5 proposals were resubmitted after not having received sufficient affirmative votes at a previous meeting; and

(f) 1 proposal was not submitted timely.

Ratio of Soliciting to Non-Soliciting Companies

Of the 2,236 issuers that had securities listed and registered on national securities exchanges as of June 30, 1959, 1,985 had voting securities so listed and registered. Of these 1,985 issuers, 1,544 or 78.7 percent, solicited proxies under the Commission's proxy rules during the 1959 fiscal year for the election of directors.

Proxy Contests

During the 1959 fiscal year, 19 companies were involved in proxy contests when nonmanagement persons filed detailed statements as participants, or proposed participants, under the requirements of rule 14a-11 when proxies are to be solicited from stockholders for the election of directors. A total of 259 persons, including both management and nonmanagement, filed such statements in 11 cases for control of the board of directors and in 8 cases for representation on the board.

Management retained control in 8 of the 11 contests, opposition nominees won in 2, and 1 was settled by negotiation. Of the 8 cases where representation on the board was involved, management retained all places on the board in 5 and in the other 3 cases nonmanagement persons were elected to the board.

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

Registration

The Securities Exchange Act requires under section 15(a) that brokers and dealers, with certain exceptions, using the mails or instrumentalities of interstate commerce to engage in securities transactions on the over-the-counter market must register with the Commission. Brokers and dealers whose business is exclusively intrastate or exclusively in exempt securities are not required to register.

The chart below sets forth statistics regarding the registration of brokers and dealers and applications for such registration during the fiscal year 1959.

Effective registrations at close of preceding fiscal year	4,752
Applications pending at close of preceding fiscal year	60
Applications filed during fiscal year	944
Total	5,756
Applications denied	4
Applications withdrawn	21
Applications cancelled	1
Registrations withdrawn	632
Registrations cancelled	59
Registrations revoked	41
Registrations suspended	5
Registrations effective at end of year	4,907
Applications pending at end of year	87
	5,757
Less:	
Suspended registrations revoked during year	*1
Total	5,756

*23 registrations were in suspension at close of the fiscal year.

Administrative Proceedings

Section 15(b) of the Securities Exchange Act provides that the Commission shall revoke a firm's broker-dealer registration or deny broker-dealer registration to an applicant if, after appropriate notice and opportunity for hearing, it finds such action is in the public interest and that the registrant or applicant or any partner, officer, director or other person directly or indirectly controlling or controlled by such broker-dealer or applicant is subject to one or more of the disqualifications set forth in the act. In addition, pending final determination whether any registration shall be revoked, the Commission shall by order suspend such registration if after appropriate notice and opportunity for hearing, suspension shall appear to the Commission to be necessary or appropriate in the public interest or for the protection of investors.

The disqualifications referred to above, are briefly:

(1) conviction in the past 10 years of a felony or misdemeanor involving the purchase or sale of securities or any conduct arising out of business as a broker-dealer;

(2) willful false or misleading statements in the application or documents supplementing the application;

(3) injunction by a court of competent jurisdiction from engaging in any conduct or practice in connection with the purchase or sale of securities; and

(4) willful violation of any of the provisions of the Securities Act of 1933 or the Securities Exchange Act or any of the Commission's rules and regulations thereunder.

Under section 15A of the Securities Exchange Act brokers and dealers may be suspended or expelled by the Commission from membership in a national securities association, and under section 19(a)(3) from national securities exchanges, for violations of the federal securities laws or the regulations thereunder. Registration may not be denied to an applicant absent evidence of misconduct specified in the act. Other factors, such as bad reputation or character, lack of experience in the securities business or even conviction of the applicant of a felony unrelated to securities transactions, do not constitute statutory grounds for denial of registration as a broker-dealer.

Section 15A(b)(4) of the Securities Exchange Act of 1934 provides that in the absence of the Commission's approval or direction, no broker or dealer may be admitted to or continued in membership in a national securities association if the broker or dealer or any partner, officer, director or controlling or controlled person of such broker or dealer was a cause of any order of revocation or suspension or expulsion from membership which is in effect. An individual named as such a cause often is subject to one or more statutory disqualifications under section 15(b) and his employment by any other broker-dealer thus could also become a basis for broker-dealer revocation proceedings against the new employer.

The following statistics deal, among other things, with administrative proceedings instituted to deny and revoke registration and to suspend and expel from membership in an exchange or a national securities association:

Proceedings pending at start of fiscal year to:	
Revoke registration	20
Revoke registration and suspend or expel from NASD or exchanges	25
Deny registration to applicants	5
Total proceedings pending	50
Proceedings instituted during fiscal year to:	
Revoke registration	60
Revoke registration and suspend or expel from NASD or exchanges	43
Deny registration to applicants	8
Total proceedings instituted	111
Total proceedings current during fiscal year	161

Disposition of Proceedings

Proceedings to revoke registration:	
Dismissed on withdrawal of registration	5
Registration revoked	21
Total	26
Proceedings to revoke registration and suspend or expel from NASD or exchanges:	
Registration revoked	6
Registration revoked and firm expelled from NASD	14
Dismissed on withdrawal of registration	3
Dismissed—registration and membership permitted to continue in effect	5
Suspended for a period of time from NASD	1
Total	29
Proceedings to deny registration to applicant:	
Registration denied	4
Dismissed on withdrawal of application	1
Dismissed—application permitted to become effective	2
Total	7
Total proceedings disposed of	62
Proceedings pending at end of fiscal year to:	
Revoke registration	54
Revoke registration and suspend or expel from NASD or exchanges	39
Deny registration to applicants	6
Total proceedings pending at end of fiscal year	99
Total proceedings accounted for	161

Administrative proceedings in which action was taken during the year included the following:

Suspension Proceedings

During the past year the Commission suspended the registration of several broker-dealers pending final determination as to whether their registrations should be revoked. Since suspension has the effect of stopping all securities business by the registrant, this sanction is imposed only in the most serious type of cases where the Commission finds, on the evidence adduced at a hearing, that such action is required, in the public interest and for the protection of investors.

A. G. Bellin Securities Corp.—The registrant was found, in connection with the sale of unregistered stock in General Oils & Industries, to have made false and misleading statements regarding, among other

things, prospects of profits, payment of dividends, increase in market price, listing on exchange, merger, interest of officials of prominent oil companies in General, and the issuers' ownership of and production from oil and gas properties. In addition, registrant was preliminarily enjoined from selling stock of General.

The Commission, on the basis of these findings, held that a sufficient showing had been made to require suspension of registration in the public interest and for the protection of investors. In determining this the Commission stated, ". . . we are required . . . to suspend registration where the record before us on the suspension issue contains a sufficient showing of misconduct to indicate the likelihood that after hearings on the revocation issue registrant will be found to have committed willful violations or any of the other grounds prescribed with respect to the revocation in section 15(b) will be established, and that revocation will be required in the public interest." The Commission also stated that under the suspension provision, ". . . we are only directed to inquire into the question of whether the public interest or the protection of investors warrants suspension, and there is no requirement that suspension be based upon findings of willful violation or the other grounds specified with respect to revocation." [30] At the close of the fiscal year revocation proceedings were pending against registrant.

Herman Bud Rothbard, doing business as Jonathan & Company.—Rothbard admitted that he filed a false and misleading financial statement with his application for registration, violated the net capital rule, failed to amend his registration to disclose transfer of control of his business, failed to file a required financial report, and maintained materially deficient books and records and he consented to suspension of his broker-dealer registration. The Commission concluded that suspension was appropriate in the public interest and for the protection of investors.[31] In addition, on June 30, 1959, the Commission revoked Rothbard's registration. This is discussed in more detail later in this report.

Jean R. Veditz Co., Inc.—Registrant consented to suspension of its broker-dealer registration. The Commission found suspension to be appropriate in the public interest and for the protection of investors. The order instituting proceedings charged registrant, Jean R. Veditz, its president and sole stockholder, and Ben Goldstein, its sales manager, with violation of the antifraud provisions of the federal securities laws in the offer and sale of stock of Universal Drilling Company. Registrant and Veditz were stated in the order to have been enjoined by the Supreme Court of New York, County of New York, from engaging in certain activities in connection with the purchase and sale

[30] Securities Exchange Act Release No. 5966 (May 18, 1959).
[31] Securities Exchange Act Release No. 5797 (Oct. 17, 1958).

of securities. Revocation proceedings against registrant were pending at the end of the fiscal year.[32]

Philip Newman Associates, Inc.—In the latter part of 1958 registrant's books showed sales through the use of the mails of 124,520 unregistered shares of the common stock of Monarch Asbestos Co., Limited. Evidence at the suspension hearing established that, to induce purchase of this stock, registrant made numerous false representations, including among other things, that Monarch was an operating company with highly profitable production, and that Monarch's asbestos mine was adjacent to that of Johns-Manville Corporation and contained asbestos superior to that produced by the latter. It was also falsely represented that Johns-Manville Corporation had determined to acquire or to merge with Monarch and that the market price of Monarch stock had risen and would increase from $5 to $16 per share in from 1 to 6 months. The Commission held that there had been a sufficient showing of willful violations by registrant, including a course of conduct replete with fraud, to make it necessary and appropriate in the public interest and for the protection of investors that registrant's registration be suspended until final determination on the question of revocation. Proceedings on the question of revocation of registrant's broker-dealer registration were pending at the end of the fiscal year.[33]

Alexander Dvoretsky, doing business as Dennis & Company.—The Commission found on the basis of stipulations entered into by Dvoretsky that he employed individuals who were permanently enjoined from engaging in certain securities practices and that he willfully violated provisions of the Securities Exchange Act and rules thereunder in that his application for registration denied existence of such injunctions and that he failed to file any correcting amendment to the application to state their existence. He was also found to have willfully violated the Commission's net capital rule and books and records requirements. These violations, the consent and the record so far made, were held to be a sufficient showing to require suspension of registration in the public interest and for the protection of investors. At the end of the fiscal year proceedings to revoke Dvoretsky's registration were still pending.[34]

Denial Proceedings

Kelly Rubenstein, Inc.—William Rubenstein, president and a director of applicant, was found by the Commission to have willfully made a false and misleading statement in the broker-dealer application of Washington Securities Corporation. Both Rubenstein and Washington were found to have willfully violated section 15(b) of the Securities Exchange Act of 1934 and rule 15b-2 thereunder in not

[32] Securities Exchange Act Release No. 5843 (Dec. 23, 1958).
[33] Securities Exchange Act Release No. 5856 (Jan. 15, 1959).
[34] Securities Exchange Act Release No. 5952 (May 12, 1959).

promptly filing an amendment correcting the inaccuracy of this information. In addition, the Commission found that Rubenstein, while president, treasurer and a director of Keith Richard Securities Corp. caused that firm to willfully violate Commission rules concerning keeping of books and records. Under all the circumstances, the Commission found it in the public interest to deny the application of applicant and found Rubenstein to be a cause of the denial. However, the order stated that the above findings did not necessarily mean that Rubenstein was permanently barred from registration or from employment by a registered broker-dealer in a supervised capacity upon a proper showing.[35]

Alan Russell Securities, Inc.—The Commission denied broker-dealer registration to applicant and named Nathan L. Batterman and Omos Maiers as causes of the denial. The action was based on a permanent injunction issued by the United States District Court for the Southern District of New York against applicant, Batterman and Maiers. The decree, entered by consent, enjoined applicant, Batterman and Maiers from making untrue and misleading statements in connection with the sale of International Ceramic Mining Limited stock in violation of the antifraud provisions of the Securities Act.[36]

Leonard Burton Corporation.—Broker-dealer registration was denied applicant and Leonard Burton was named the cause of denial based on willful violations of the antifraud provisions of the Securities Act of 1933 and the Securities Exchange Act.

The Commission found that Leonard Burton while employed as a securities salesman by Steven Randall & Co., Inc. made misleading representations in connection with the offer or sale of Texas Union Oil Company stock. Burton represented that there would be no commissions on the sale of the stock and failed to state that Steven Randall & Co., Inc. was selling the stock as principal. Burton also presented an optimistic picture of large and quick increases in the market value of the stock based on actual production without apprising investors of the speculative and contingent factors known by him. The statement that a stock is likely to go up was deemed to imply, ". . . that there is an adequate foundation for such prediction and there are no known facts which make such a prediction dangerous or unreliable." The Commission rejected registrant's allegation that the practicalities of merchandising the stock excused the registrant from the requirements of disclosure necessary to render the statements made not misleading.[37]

[35] Securities Exchange Act Release No. 5770 (Sept. 8, 1958).
[36] Securities Exchange Act Release No. 5779 (Sept. 25, 1958).
[37] Securities Exchange Act Release No. 5978 (June 4, 1959).

Washington Securities Corporation.—The Commission denied broker-dealer registration to applicant and named Joseph Freundel as a cause of denial. Freundel, president, director and sole stockholder of applicant, was permanently enjoined, with others, on August 19, 1958, by the United States District Court for the District of New Jersey from making untrue or misleading statements in connection with the sale of common stock of Saskalon Uranium and Oils Limited. On the basis of the injunction against Freundel and his control of applicant, it was found in the public interest to deny applicant's registration.[38]

Revocation Proceedings

Pilgrim Securities, Inc.—This broker-dealer registration was revoked by the Commission on findings of fraud in the sale of securities, sales of unregistered securities, making of false records, failure to keep required records, failure to file promptly an amendment to the registration application, filing of an amendment containing a false statement and failure to file a report of financial condition for 1957 as required.

The Commission found that registrant and Joseph Leo Gruber, Jr., president of registrant, sold over 23,000 unregistered shares of Eagle Oil and Supply Company to at least 32 investors. In connection with some of these sales Gruber and registrant made false representations regarding a stock split, dividends, sales quotas and expected profits. The Commission found Gruber to be a cause of the revocation.[39]

John D. Ferris, doing business as Ferris & Co.—The Commission found that Ferris engaged in the securities business without disclosing that he was insolvent, issued bad checks, failed to pay for securities sold and delivered, and failed to meet his obligations arising from the purchase and sale of securities. In addition, registrant failed to furnish a customer a confirmation of sale, failed to comply with the net capital rule, failed to maintain accurate and current books and records and failed to file a report of financial condition for 1956. Accordingly, the broker-dealer registration of Ferris was revoked. The Commission held, "The conduct of a securities business involves implied representations of solvency and a readiness and ability to meet all attendant obligations as they arise and to consumate transactions in the usual manner in accordance with trade custom." By failure to disclose his insolvency and repeated failure to meet his responsibilities in connection with his securities transactions, Ferris was held to have engaged in a course of conduct which operated as a fraud and deceit

[38] Securities Exchange Act Release No. 5899 (Mar. 16, 1959).
[39] Securities Exchange Act Release No. 5958 (May 15, 1959).

upon persons with whom he conducted business in violation of the antifraud provisions of the Securities Act of 1933 and the Securities Exchange Act.[40]

Sills and Company.—In this case also revocation was in part based on effecting securities transactions without disclosing insolvency. In addition, the Commission found that registrant converted to its own use customer's funds in connection with the purchases and sales of securities, filed a false financial report, failed to comply with the net capital rule, failed to keep accurate books and records, and failed to correct information in its registration application. It was determined that registrant and Robert Bernard Sills, president and a director of registrant, converted to their own use funds of 19 customers, totaling $28,240, which had been obtained upon the false representation that registrant would use funds for the purpose of purchasing securities for the customers. The Commission named Sills as a cause of the order of revocation.[41]

William Rex Cromwell, doing business as Cromwell & Co.—Revocation of Cromwell's registration was based in part on his retaining funds received from the sale of securities for customers, amounting to $15,700, for periods of from 2 to 5 years. Also, Cromwell misappropriated funds received from customers for the purchase of securities amounting to almost $9,000 and failed to return the money or deliver the securities for periods of about 1½ to 4 years. In addition, Cromwell was found to have failed to comply with the net capital

[40] Securities Exchange Act Release No. 5947 (May 8, 1959).

[41] Securities Exchange Act Release No. 5919 (Mar. 27, 1959). On February 5, 1959, Sills and Arthur P. Green, sales manager for Sills and Company, were indicted by the United States District Court for the Southern District of Florida. Both were charged with violating the Securities Exchange Act by filing false information with the Commission and with violations of the antifraud provisions of the Securities Act and the Mail Fraud Statute.

rule, to make and keep current required books and records and to make his books and records available for reasonable inspection. He failed to file a report of financial condition for the year 1957 and failed to correct information in his registration application.[42]

William Harrison Keller, Jr., doing business as W. H. Keller, Stockbroker.—The Commission revoked the broker-dealer registration of Keller based in part on the sale of securities to customers at prices not reasonably related to and substantially in excess of prevailing market prices as evidenced by registrant's contemporaneous cost. In 54 transactions with customers while acting as principal, Keller sold securities at markups over cost ranging from 6.25 to 40 percent with profits to Keller of over $20,000, representing an average markup of over 16 percent. Thirty-seven of these sales took place on the same day that Keller purchased the securities, and in 13 of the transactions involved the purchases were effected from other customers. In connection with all of these sales, Keller failed to disclose to the customers the prices paid for the securities or the current market price established by other broker-dealers. In addition, Keller failed to comply with the net capital rule, to make and keep current required books and records, and to amend his application for registration to disclose employment of a person subject to a court injunction. Also, on April 29, 1958, he was permanently enjoined from effecting securities transactions in violation of the net capital rule by the United States District Court for the Southern District of Indiana. Keller was also expelled from membership in the National Association of Securities Dealers, Inc.[43]

Allied Securities Corporation.—The Commission revoked this broker-dealer's registration and expelled it from membership in the National Association of Securities Dealers, Inc., naming Jack R. Parkman and William E. Powell causes of the order of revocation and expulsion. The Commission found that registrant sold unregistered securities of Life Insurance Company of South Carolina and Georgia Pacific Underwriters, Inc., and made false and misleading statements concerning the market prices and value of these securities and the financial condition of the issuer. Additional grounds for revocation were violation of the net capital rule, failure to keep accurate books and records and violation of regulation T.[44]

Richard A. Sebastian, doing business as Sebastian & Company.—Sebastian sold shares of Canada General Fund to a customer without revealing that the stock was pledged to secure a loan and would not promptly be released from such lien. In addition, Sebastian violated the net capital rule and failed to keep current required books and

[42] Securities Exchange Act Release No. 5917 (Mar. 25, 1959).
[43] Securities Exchange Act Release No. 5909 (Mar. 18, 1959).
[44] Securities Exchange Act Release No. 5880 (Feb. 16, 1959).

records. Consequently, the Commission revoked Sebastian's registration and expelled him from membership in the National Association of Securities Dealers, Inc.[45]

Graham & Company.—The broker-dealer registration of Graham & Company was revoked based on various false and misleading representations made to purchasers of stock of Hard Rock Mining Co. and Texas Adams Oil Company. These false representations included statements concerning the market for and the price of Hard Rock stock and statements that securities would be delivered to customers promptly; no disclosure was made of the fact that the registrant and Hard Rock were under common control. In addition, registrant offered, sold and delivered stock of Hard Rock in violation of the registration provisions of the Securities Act of 1933. Also, securities in both these companies were sold at prices not reasonably related to the current market prices. The Commission expelled registrant from membership in the National Association of Securities Dealers, Inc. and found E. W. Sterling Graham and Susan P. Graham causes of the order of revocation and expulsion.[46]

J. H. Lederer Co., Inc.—Registrant was found by the Commission to have sold over 1 million shares of stock of Continental Mining Exploration, Limited at prices ranging from $2.85 to $3.70 per share in violation of the registration requirements of the Securities Act of 1933. The shares were sold through long distance telephone solicitation in which false and misleading statements were made concerning, among other things, dividends to be paid, appreciation in the market price and registration of the securities. The Commission revoked the broker-dealer registration of J. H. Lederer Co., Inc., expelled registrant from membership in the National Association of Securities Dealers, Inc. and found Joseph Herbert Lederer a cause of the order of revocation and expulsion.[47] In addition, pursuant to a complaint filed by the Commission, the United States District Court for the Southern District of New York permanently enjoined J. H. Lederer Co., Inc., and Lederer from further violations of the registration provisions of the Securities Act of 1933 in the offer and sale of the common stock of Continental Mining Exploration Limited.

Shelley, Roberts & Company of California.—The Commission found that Billy E. Boyle, president and controlling person of registrant, while an officer and a director of another broker-dealer, caused that broker-dealer to make various false and misleading statements in the sale of stock of United Mercury Corporation in violation of the antifraud provisions of the Securities Acts. These misrepresentations concerned, among other things, prospective increases in market prices, guarantees against loss, and listing on an exchange. Also,

[45] Securities Exchange Act Release No. 5876 (Feb. 12, 1959).
[46] Securities Exchange Act Release No. 5864 (Jan. 27, 1959).
[47] Securities Exchange Act Release No. 5848 (Dec. 29, 1958).

Boyle was found to have caused the other broker-dealer to extend credit in violation of regulation T. Registrant was found to have refused to make its books and records available for reasonable inspection. The Commission revoked the broker-dealer registration of Shelley, Roberts & Company of California and found Boyle a cause of the revocation.[48]

Gill-Harkness & Co.—This broker-dealer registration was revoked by the Commission on findings that registrant solicited and effected securities transactions without disclosing it was insolvent. Bruce A. Johnston, registrant's president and controlling stockholder, induced customers with whom he was in a relationship of trust and confidence to lend him funds and securities for purposes of supplying capital to registrant and sold to other customers shares of stock in registrant, and failed to inform any of these customers of the registrant's operating losses and insolvency. Alan D. Selditch, general manager of registrant's securities department, made false and misleading statements in the offer and sale of registrant's stock to two customers in violation of the antifraud provisions of the Securities Acts. He represented that registrant was in good shape, had a capitalization of $100,000, was expanding and would pay dividends, none of which was true. Registrant was found to have failed to keep accurate books and records, violated the net capital rule and failed to correct information in its registration application. The Commission's order of revocation also expelled registrant from membership in the National Association of Securities Dealers, Inc., and found Johnston and Selditch causes of the order of revocation and expulsion.[49]

Benjamin and Company, Inc., David Joel Benjamin, doing business as Benjamin and Company.—David Joel Benjamin was found by the Commission to have sold and delivered 243,000 shares of stock of Hardy-Griffin Engineering Corporation in violation of the registration provisions of the Securities Act of 1933. Furthermore, a notification and offering circular used in selling the securities contained untrue statements concerning the sale of unregistered stock within the previous year, Benjamin's ownership of shares of the stock, payments made to Hardy-Griffin by its officers, directors, and promotors, and the number of shares that would be outstanding upon completion of the offering, all in violation of the antifraud provisions of the Securities Acts. David Joel Benjamin was also found to have violated the net capital rule and failed to make and keep current required books and records. Based on this record, the Commission revoked the broker-dealer registration of Benjamin, and Benjamin & Company, Inc. In addition, the latter was expelled from

[48] Securities Exchange Act Release No. 5837 (Dec. 22, 1958).
[49] Securities Exchange Act Release No. 5822 (Nov. 24, 1958).

the National Association of Securities Dealers, Inc. and Benjamin was found to be a cause of the order of revocation and expulsion.[50]

Whitney Phoenix Company, Inc.—The Commission revoked the broker-dealer registration of registrant and found Strabo V. Claggett, president and director of registrant, a cause of the order of revocation.

Registrant and Claggett offered and sold stock of Selevision Western, Inc. (Western) and its parent, Selevision Corporation of America (Selevision) by means of false and misleading information in wilful violation of the antifraud provisions of the Securities Acts. The Western offering circular and other sales literature falsely stated that registrant had increased its stock holdings in Selevision by purchase of an additional 65,000 shares and contained optimistic statements regarding Selevision's business prospects and future operations, but failed to disclose that Selevision had recently discontinued an important part of its business. Also, Claggett falsely stated to two purchasers of Selevision's stock that the stock would double or triple in price and, "that things were rolling along like a house afire."

Registrant sold Western's securities pursuant to a filing with the Commission under regulation A. However, in the offer and sale of these securities, it used letters soliciting the purchase of the stock which were not filed with the Commission as required. In addition, registrant sold the stock in jurisdictions other than those indicated in the filing. Since it failed to comply with the provisions of regulation A, the exemption from registration was not available and the sale and delivery of Western stock by registrant and Claggett was in wilful violation of the registration requirements of the Securities Act of 1933.

In addition, registrant violated the net capital rule, failed to comply with record requirements and refused to permit inspection of its records.[51]

Herman Bud Rothbard, doing business as Jonathan & Co.—The Commission revoked the broker-dealer registration of Rothbard and expelled him from membership in the National Association of Securities Dealers, Inc. The Commission had previously suspended his broker-dealer registration.[52]

Rothbard, in the sale of about 40,000 shares of stock of U.S. Electronics Development Corporation (EDCOR), used circulars which stated that EDCOR was operating at a profit and that a dividend might be expected when in fact EDCOR had suffered losses and had an earned surplus deficit. Based on these findings the Commission held that Rothbard wilfully violated the antifraud provisions of the Securities Acts.

[50] Securities Exchange Act Release No. 5798 (Oct. 21, 1958).
[51] Securities Exchange Act Release No. 5995 (June 26, 1959).
[52] Securities Exchange Act Release No. 5797 (Oct. 17, 1958).

Rothbard also violated the registration requirements of the Securities Act of 1933 in that he sold 93,333 unregistered shares of EDCOR's stock. The sale of these shares was held not to be an exempt private offering for it was clear that the purchasers took for resale and not for investment and the ultimate offerees were members of the general public.

In addition, Rothbard was in violation of the net capital rule on several occasions, filed a false financial statement with his registration application, failed to amend his registration application to reflect a change in control, failed to keep required books and records and failed to file a report of his financial condition for 1957.[53]

J. A. Latimer & Co., Inc.—The revocation of this broker-dealer registration was based in part on false and misleading statements in its application for registration concerning control of registrant. In addition, the Commission found that registrant effected wash sales in the stock of U.S. Hoffman Machinery Company and Artloom Company on the New York Stock Exchange, while Hyman Marcus, the person who controlled registrant, was Chairman of the Board of each of these companies. Moreover, registrant was found to have made purchases of these securities while participating in the distribution of such securities in violation of section 10(b) of the Securities Exchange Act and rule 10b-6 thereunder, and to have borrowed money on these securities from unqualified persons in wilful violation of section 8(a) of the Securities Exchange Act and regulation T thereunder. Besides revoking registrant's registration, the Commission expelled registrant from the National Association of Securities Dealers, Inc. and found John Albert Latimer and Marcus to be causes of the order of revocation and expulsion.[54]

Gotham Securities Corporation.—The Commission revoked this broker-dealer registration on the basis of a permanent injunction obtained in the United States District Court for the District of New Jersey barring registrant, Joseph Fruendel, a director and president of registrant, and Rico Tomasco, Jr., a director and secretary-treasurer of registrant, from making various untrue or misleading statements in connection with the sale of stock of Saskalon Uranium and Oils Ltd. Fruendel and Tomasco were named as causes of the revocation.[55]

Steven Randall & Co. Inc.—The broker-dealer registration of registrant was revoked and it was expelled from membership in the

[53] Securities Exchange Act Release No. 5998 (June 30, 1959).

[54] Securities Exchange Act Release No. 5849 (Dec. 29, 1958). On July 2, 1959, subsequent to the close of the fiscal year, Latimer was indicted by the United States District Court for the Southern District of New York. The indictment contained 51 counts and charged violations of the antimanipulative provisions of the Securities Exchange Act of 1934 in connection with a series of transactions in the stock of the American Tractor Company listed on the American Stock Exchange.

[55] Securities Exchange Act Release No. 5899 (Mar. 16, 1959).

National Association of Securities Dealers, Inc., with Frank M. Naft, its president, being named a cause of the order. Registrant and Naft were subject to a permanent injunction issued by the United States District Court for the Southern District of New York, pursuant to a complaint filed by the Commission, barring further sales of unregistered stock of Swan-Finch Oil Company. Another permanent injunction was issued by the Supreme Court of the State of New York, New York County, barring Steven Randall & Co., Inc. from conducting a securities business in the state of New York. The complaint filed by the Attorney General of the State of New York charged registrant with distributing fraudulent literature and engaging in other fraudulent practices in connection with the sale of securities of Texas Union Oil Corporation. In addition, registrant was found to have failed to amend its registration statement to indicate existence of the injunctions.[56]

Frederick Securities Corporation—Fred Kaufman, doing business as Fred Kaufman Co.—The broker-dealer registrations of these registrants were revoked based on findings by the Commission that registrants were permanently enjoined by the United States District Court for the District of New Jersey from offering and selling stock of Ben Franklin Oil & Gas Corporation in violation of the registration provisions of the Securities Act of 1933. In addition, both registrants failed to file a report of financial condition for 1957. Fred Kaufman, president and sole stockholder of Frederick Securities Corporation, was found to be a cause of the order of revocation issued against that corporation.[57]

William Harold Hilbert.—Hilbert was found to have sold stock of Great Fidelity Life Insurance Company (Great Fidelity) and Farm & Home Agency, Inc. (Agency) to customers in several states in violation of the registration requirements of the Securities Act of 1933 and while he was not registered as a broker-dealer. The United States District Court for the Southern District of Indiana in an action instituted by the Commission permanently enjoined Hilbert and others from selling unregistered shares of Great Fidelity. Later, the same court permanently enjoined Hilbert and others from selling unregistered stock of Agency. Hilbert failed to send customers confirmations of transactions, failed to maintain and preserve books and records and failed to correct his registration application to state his correct business address and the existence of the injunctions. Accordingly, the Commission revoked Hilbert's broker-dealer registration.[58]

James C. Graye, doing business as J. C. Graye Co.—The broker-dealer registration of Graye was revoked based on three injunctions

[56] Securities Exchange Act Release No. 5872 (Feb. 11, 1959).
[57] Securities Exchange Act Release No. 5861 (Jan. 20, 1959).
[58] Securities Exchange Act Release No. 5860 (Jan. 21, 1959).

entered against him. On April 3, 1958, the United States District Court for the Southern District of New York, pursuant to complaints filed by the Commission, issued two permanent injunctions against Graye barring him from further violations of the antifraud provisions of section 17 of the Securities Act of 1933 in the sale of stock of Atlas Gypsum Corporation Limited (Atlas) and from further violations of the Commission's net capital rule. The decree enjoining the sale of Atlas stock barred the use of false statements and misleading omissions concerning the market price of Atlas stock, listing on a national securities exchange and plans to merge Atlas with other corporations, among other things. An injunction was also entered by the Supreme Court of New York on February 17, 1958, permanently enjoining Graye from engaging in securities transactions in the state of New York. In addition, Graye was found to have failed to amend his application for registration to indicate existence of the injunctions and failed to file a financial report for the year 1957 as required.[59]

Tannen & Co., Inc.—Registrant and Philip Tannen, president, director and sole stockholder of registrant, were subject to two permanent injunctions issued by the United States District Court for the Southern District of New York pursuant to complaints filed by the Commission. On June 27, 1957, registrant and Tannen were enjoined from the sale of unregistered shares of stock of Swan-Finch Oil Corp. and on October 11, 1957, from selling unregistered shares of stock of Cornucopia Gold Mines, in violation of the registration provisions of the Securities Act of 1933. The Commission revoked the broker-dealer registration of registrant and found Tannen to be a cause of such revocation.[60]

Carl J. Bliedung.—Bliedung was subject to a permanent injunction entered in the United States District Court for the District of Columbia on March 16, 1955, barring him from effecting financial transactions unless promptly recorded in his books and records pursuant to Commission rules and requiring him to account for and record all financial transactions not recorded in his books and records. Bliedung also used customer funds for his own benefit, failed to deliver customers' securities promptly and sold securities at prices not bearing a reasonable relationship to the market prices. In addition, he sold securities to a customer and prior to delivery permitted securities of a like kind owned by him to remain subject to a lien for a loan made to him, in violation of the Commission's rule prohibiting hypothecation of customer securities. The broker-dealer registration was revoked and Bliedung was expelled from membership in the National Association of Securities Dealers, Inc.[61]

[59] Securities Exchange Act Release No. 5838 (Dec. 29, 1958).
[60] Securities Exchange Act Release No. 5761 (Aug. 21, 1958).
[61] Securities Exchange Act Release No. 5745 (July 30, 1958).

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McGrath Securities Corporation.—The Commission found that registrant and Robert C. Leonhardt, its president and sole stockholder, sold 447,614 shares of stock of Micro-Moisture Controls, Inc. (Micro-Moisture) in violation of the registration provisions of the Securities Act of 1933. As a result of a complaint filed by the Commission, registrant and others had been enjoined from selling and delivering the stock of Micro-Moisture in violation of the registration provisions of the Securities Act of 1933. Registrant stipulated that the Court's findings and conclusions be considered as facts in the administrative proceeding. The Commission accordingly found that Micro-Moisture issued over 2 million shares of its unregistered common stock to a Canadian corporation in exchange for the latter's assets and the latter in turn distributed such stock to its shareholders. Shortly thereafter a group of these stockholders who were then in control of Micro-Moisture sold over 700,000 shares to various broker-dealers, including the shares later sold by registrant and Leonhardt. The Commission concluded that registrant and Leonhardt were underwriters with respect to the unregistered shares sold by them. Accordingly, the Commission revoked the broker-dealer registration of McGrath Securities Corporation, expelled it from membership in the National Association of Securities Dealers, Inc., and found Leonhardt a cause of the order of revocation and expulsion.[62]

Keith Richard Securities Corp.—Registrant was found by the Commission to have sold stock of Arliss Plastics Corporation (Arliss) to purchasers in over 30 States principally through the use of local and long distance telephone calls. The Commission concluded that in connection with these sales, Julius Silver, president and sole shareholder of registrant, Samuel Goldberg, former sales manager, and G. Norman Waldman and Hyman Germanowitz, salesmen of registrant, made false and misleading representations concerning, among other things, prospects of a merger, payment of dividends, listing on a stock exchange, increase in market price of Arliss' stock and Government contracts held by Arliss. In addition, registrant, aided and abetted by Silver and William E. Rubenstein, former president of registrant, was found to have failed to keep current required books and records. Registrant, aided and abetted by Silver, was also found to have wilfully violated the net capital rule.

In February 1959, based on a complaint filed by the Commission, the United States District Court for the Southern District of New York preliminarily enjoined registrant from engaging in the securities business while not making and keeping current books and records required by Commission rules. The Commission revoked the broker-

[62] Securities Exchange Act Release No. 5783 (Sept. 26, 1958).

dealer registration and found Silver, Rubenstein, Goldberg, Waldman, and Germanowitz causes of the order of revocation.[63]

In separate actions, the Commission revoked the broker-dealer registration of **Owens & Co.**[64] (Owens) and **Churchill Securities Corp.**[65] (Churchill), and denied requests for withdrawal of registration. Revocation in each instance was based on a permanent injunction and violation of the net capital rule. Owens was enjoined by the United States District Court for the District of Colorado on January 24, 1958, from further violations of the net capital rule. Churchill was enjoined on May 2, 1957, by the Supreme Court of the State of New York, County of New York, from engaging in the securities business in that State. In addition, the Commission expelled Churchill from membership in the National Association of Securities Dealers, Inc. and found Nat Girsky, Emanuel Bisgeier and Melvin Heiman, officers of Churchill, to be causes of the order of revocation and expulsion. John Cuthbert Owens, president, director and controlling stockholder of Owens, was found to be a cause of the order of revocation entered against Owens.

The Commission determined that **J. D. Creger & Co.**[66] had violated the Commission's net capital rule, failed to make and keep current required books and records, and kept inaccurate records. Also, pursuant to a complaint filed by the Commission, registrant was permanently enjoined from doing business with inadequate net capital by the United States District Court for the Southern District of California, Central Division, on September 16, 1957. The Commission revoked the registration of J. D. Creger & Co. and found James D. Creger, president, director and controlling stockholder of registrant, a cause of the order of revocation.

The Commission revoked the broker-dealer registration of **William Whitehead**[67] upon a determination that he had failed to comply with the net capital and record keeping requirements of the Securities Exchange Act of 1934 and was permanently enjoined by the United States District Court for the State of New Jersey from further violations of these provisions on the basis of a complaint filed by the Commission.

The registration of **Vickers Brothers**[68] was revoked by the Commission based on findings that between December 31, 1957, and October 30, 1958, registrant was in violation of the Commission's net capital rule on eight different occasions. In addition, Vickers Brothers was expelled from membership in the National Association

[63] Securities Exchange Act Release No. 5988 (June 17, 1959).
[64] Securities Exchange Act Release No. 5916 (Mar. 25, 1959).
[65] Securities Exchange Act Release No. 5871 (Feb. 10, 1959).
[66] Securities Evchange Act Release No. 5953 (May 15, 1959).
[67] Securities Exchange Act Release No. 5735 (July 17, 1958).
[68] Securities Exchange Act Release No. 5945 (Apr. 30, 1959).

of Securities Dealers, Inc. and Henry G. Vickers and Norman L. Martin, general partners in registrant, were found to be causes of the order of revocation and expulsion.

Lynne B. Fenner, president and principal stockholder and a director of **The Fenner Corporation,**[69] had been permanently enjoined by the Supreme Court of the State of New York on April 30, 1957, from engaging in securities transactions in that State. On January 24, 1958, the United States District Court for the Southern District of New York entered a decree of consent permanently enjoining Fenner and registrant from violations of the Commission's net capital rule based on a complaint filed by the Commission. Accordingly, the Commission revoked the broker-dealer registration of The Fenner Corporation and found Fenner to be a cause of revocation.

The Commission revoked the broker-dealer registration of **John T. Pollard & Co., Inc.,** now known as **Webb Securities, Inc.**[70] Registrant had misstated its capital in a financial statement filed with its application for registration, engaged in transactions while in violation of the Commission's net capital requirements and made false entries in its books and records. The Commission, in addition, found John T. Pollard, president and a director of registrant, and Louis H. Greenberg, vice president, treasurer and a director of registrant, to be causes of the order of revocation.

The broker-dealer registration of **Arthur R. Gilman**[71] was revoked for failure to file a report of his financial condition, to keep and preserve current books and records and to correct information regarding his business address in his application for registration.

Ross Natale Barengo[72] had his broker-dealer registration revoked based on findings that he made false and misleading statements in his application for registration regarding the name under which he would conduct business and the persons who controlled his business. In addition, he failed to file an amendment correcting such statements and failed to file required annual financial reports for the years 1956 and 1957.

The following broker-dealer registrations were revoked by the Commission for failure to file financial reports as required by section 17(a) of the Securities Exchange Act of 1934 and rule 17a-5 thereunder: **George D. Clarke, Ltd.,**[73] **Walter O'Donnell,**[74] **James A. Heaney, Jr.,**[75]

[69] Securities Exchange Act Release No. 5757 (Aug. 21, 1958).
[70] Securities Exchange Act Release No. 5777 (Sept. 24, 1958).
[71] Securities Exchange Act Release No. 5859 (Jan. 21, 1959).
[72] Securities Exchange Act Release No. 5866 (Feb. 2, 1959).
[73] Securities Exchange Act Release No. 5939 (Apr. 22, 1959).
[74] Securities Exchange Act Release No. 5940 (Apr. 22, 1959).
[75] Securities Exchange Act Release No. 5941 (Apr. 22, 1959).

Stacy, Bell & Co., Inc.,[76] **David Handel,**[77] and **John B. Sullivan** doing business as **John B. Sullivan Company.**[78]

Other Sanctions

Carl M. Loeb, Rhoades & Co.—Dominick & Dominick.—The Commission instituted broker-dealer revocation proceedings against registrants, based upon offers to sell or solicitation of offers to buy securities of the Arvida Corporation (Arvida) in violation of section 5(c) of the Securities Act of 1933. Registrants were the prime underwriters of the offering. Prior to the filing of a registration statement with the Commission, a partner of one of the registrants, with the consent of the other and of the issuer, composed a release for use in the New York papers. The release stated, among other things, that Arthur Vining Davis, holder of considerable real estate in Florida, was going to convey some 100,000 acres of properties, described in the release as in an area of the Gold Coast in three named Florida counties, to Arvida, that Arvida would have assets of over 100 million dollars, and that within 60 days there was going to be a public offering of Arvida's securities through an investment banking group headed by registrants. In addition, newspaper reporters were called to the office of one of the registrants, were told that the offering price would be in the vicinity of $10 or $11 per share and were given further information about Davis and his career. The information contained in the release, together with the additional information furnished orally, appeared in three New York newspapers on September 19, 1958, and in numerous other news media throughout the country.

A limited survey indicated that for the two business days of September 19 and 22, Loeb, Rhoades received indications of buying interest amounting to $500,000 with a total of 101 securities firms expressing an underwriting interest in the offering. Loeb, Rhoades made notations of selling group interest on the part of about 25 securities dealers. In addition, registrants received, prior to September 30, at least 58 expressions of interest from members of the public, including at least 17 specific orders to buy. Arvida did not file a registration statement under the Securities Act until October 27, 1958.

The Commission concluded that publicity, prior to the filing of a registration statement, by means of public media of communication, with respect to an issuer or its securities, emanating from broker-dealer firms who as underwriters or prospective underwriters have negotiated or are negotiating for a public offering of the securities of such issuer, must be presumed to set in motion or to be a part of the distribution process and therefore to involve an offer to sell or a solicitation of an offer to buy such securities prohibited by section

[76] Securities Exchange Act Release No. 5886 (Feb. 17, 1959).
[77] Securities Exchange Act Release No. 5887 (Feb. 17, 1959).
[78] Securities Exchange Act Release No. 5815 (Nov. 5, 1958).

5(c) of the Securities Act of 1933. Therefore, the Commission held the press release and meeting and resultant publicity wilfully violated section 5(c) of the Securities Act. However, under all the circumstances, including registrant's excellent reputation, and the fact that they acted on reliance of counsel and that no investors appeared to have been injured, the Commission found that no sanction was necessary in the public interest or for the protection of investors.[79]

A related action brought by the Commission in the United States District Court for the Southern District of New York, in which a consent decree was entered permanently enjoining violation of section 5(c) by Arvida, registrants, and others, is discussed at p. 54, *supra*.

First Maine Corporation.—Registrant, in violation of section 5(c) of the Securities Act of 1933, was found to have offered to sell or to have solicited offers to buy unregistered securities of Life Insurance Securities Corporation (LISCO) for a period of over 3 months before a registration statement was filed with the Commission. Burton M. Cross and Herbert L. Rackliff, president and beneficial owner of equity securities of registrant, respectively, were found to have caused registrant to distribute by mail, notices, circulars and other publicity which constituted the illegal offers to sell or solicitations of offers to buy LISCO's stock. In addition, registrant, Cross and Rackliff were found to have violated section 5(b)(1) of the Securities Act by transmitting improper prospectuses after LISCO's registration statement was filed.

Also registrant, Cross and Rackliff were held to have made false and misleading statements of material facts in offering the securities of LISCO, thereby violating the antifraud provisions of the Securities Act. The Commission found that the material distributed by registrant contained two general themes, (1) the attractiveness of stock of life insurance companies in which it was stated LISCO would invest, and (2) the knowledge, experience, ability and competency of LISCO's officers and directors, particularly Cross. This literature was materially misleading in stressing the investment opportunities of life insurance companies without disclosing that the funds of investors would be invested in a casualty insurance company organized by Cross and Rackliff and not yet in operation. The information in regard to the experience of LISCO's management was misleading for failure to state that the active officers have had only very limited experience with an operating insurance company.

The Commission, in view of the nature of the violations, ordered that registrant be suspended from the National Association of Securities Dealers, Inc., for 20 days and that Cross and Rackliff be named causes of the suspension.[80]

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[79] Securities Exchange Act Release No. 5870 (Feb. 9, 1959).

[80] Securities Exchange Act Release No. 5898 (March 2, 1959).

Net Capital Rule

The Commission has adopted under section 15(c)(3) of the Securities Exchange Act rule 15c3-1, commonly known as the net capital rule, which is intended to provide safeguards for securities and funds of customers dealing with broker-dealers by limiting the amount of indebtedness which may be incurred by a broker-dealer in relationship to net capital. A broker-dealer subject to the rule may not allow his "aggregate indebtedness" to be more than twenty times his "net capital," as those terms are defined in the rule.

When it appears, from an examination of reports filed with the Commission or through inspection of books and records, that a broker-dealer is in violation of the net capital rule, an opportunity is generally afforded the registrant to correct such capital deficiencies. Failure promptly to bring the capital position into compliance with the rule may result in injunctive action to restrain further violations or the institution of proceedings to determine whether or not the registrant's broker-dealer registration should be revoked. Violations of the net capital rule were alleged in 13 injunctive actions filed by the Commission in the last fiscal year and in 22 revocation proceedings.

Broker-dealers participating in "firm commitment" underwritings must have sufficient net capital to permit participation in the underwriting for the amount they have agreed upon. The staff, in order adequately to protect issuers and customers of broker-dealers participating in such underwritings, carefully analyzes the latest information concerning the capital position of such a broker-dealer in order to determine if assumption of the new obligations involved in the underwriting is possible without violating the net capital rule. The Commission will refuse to accelerate the effectiveness of registration statements filed under the Securities Act when it appears that any of the underwriters would, by virtue of commitments in the underwriting, be in violation of the net capital rule. Broker-dealers named as underwriters in offerings of securities registered with the Commission who appeared to be inadequately capitalized to fulfill their commitments and, at the same time, remain in compliance with the net capital rule, were informed of the potential violation of the rule and the effect this would have upon the pending registration statement. Such broker-dealers either obtained sufficient additional capital, comply fully with the rule, reduced their commitments in the underwriting to such an extent as to participate in the underwriting without violaing the rule, withdrew as underwriters, or participated in the underwriting on a "best efforts" basis only.

Financial Statements

Under section 17(a) of the Securities Exchange Act, the Commission has promulgated rule 17a-5 requiring the filing of periodic financial statements by registered brokers and dealers. Under this rule,

every financial report filed must be certified by a certified public accountant or a public accountant who is in fact independent, with certain limited exemptions applicable to situations where certification does not appear necessary for customer protection. Thus, under certain conditions, a member of a national securities exchange need not file such a certified report. Also, if since his previous report a broker has limited his securities business to soliciting subscriptions as an agent for issuers, transmitted funds and securities promptly, and has not otherwise held funds or securities for or owed monies or securities to customers, he is exempt from the certification requirement. An exemption from the certification requirements is also given a broker-dealer who, from the date of his last report, has only bought and sold evidences of indebtedness secured by liens on real estate and has not carried margin accounts, credit balances, or securities for securities customers.

The requirements for filing financial reports enable the Commission and the public to determine the financial responsibility of broker-dealers and enable the staff to analyze the reports in order to determine whether the registrant is in compliance with the Commission's net capital rule. Revocation proceedings are instituted against registrants who fail to make the necessary filing. However, it is the practice of the Commission to first inform a registrant of his obligations under rule 17a-5 prior to taking such action against him. During the past fiscal year, 4,560 reports of financial condition were filed, an increase of 87 over fiscal 1958.

Broker-Dealer Inspections

Section 17(a) of the Securities Exchange Act provides for regular and periodic inspections of registered broker-dealers. The Commission has continued to place emphasis on this program to insure a more adequate protection of investors. Inspection serves to assure compliance by broker-dealers with the securities acts and the rules and regulations promulgated by the Commission. The inspection device is one of the most useful instruments at the Commission's disposal in protecting investors and preventing and detecting violations of the Federal securities laws.

Generally, inspections involve, among other things: (1) review of a broker-dealer's pricing practices; (2) a determination of financial condition; (3) a review of the safeguards used in handling customers' funds and securities; and (4) a determination of whether adequate disclosures relating to transactions are made to customers.

In addition, the inspectors also determine whether brokers and dealers keep their books and records in compliance with the Federal securities laws and conform to the margin and other requirements of Regulation T as prescribed by the Federal Reserve Board. Furthermore, a check is made to see if excessive trading in customers' accounts

involving "churning" or "switching" has occurred. Inspections often turn up evidence of sale of unregistered securities or the use of fraudulent practices, including the use of improper sales literature or sales methods. Frequently, the inspections enable the Commission to nip in the bud situations which if not corrected, could result in loss to customers.

In 1956, the Commission inaugurated a policy of increasing the number of inspections over that of previous years. The same policy has been followed in the past fiscal year. Inspections completed during the year numbered 1,471.

In determining whether to institute action against a broker-dealer found to be in violation of the statutes or rules as a result of an inspection, consideration is given to the nature of the violations and to the effect such violations may have upon members of the public. It is not the Commission's policy to take formal action against broker-dealers for every violation. For example, inspections frequently reveal various inadvertent violations which are discovered before becoming serious and before customers' funds or securities are endangered. Where no harm has come to the public in such situations, the matter is usually brought to the attention of the registrant and suggestions made to correct the improper practices. If the violation appears to be willful and the public interest or the protection of investors is best served by formal action, the Commission promptly institutes the appropriate proceedings.

The following table shows the various types of violation disclosed as a result of the inspection program during the fiscal year 1959:

Type	*Number*
Financial difficulties	180
Hypothecation rules	53
Unreasonable prices for securities purchases	255
Regulation T of the Federal Reserve Board	170
"Secret profits"	7
Confirmations and bookkeeping rules	1,081
Miscellaneous	324
Total indicated violations	2,070
Total number of inspections	1,471

The principal stock exchanges, the National Association of Securities Dealers, Inc. and some of the States each have somewhat similar but not identical inspection programs to that of the Commission. Each agency conducts its inspections, examinations or audits in accordance with its own procedures and with particular reference to its own regulations and jurisdiction. Inspections by other agencies cannot be adequate substitutes for Commission inspections since they are not primarily concerned with the detection and prevention of violations of the Federal securities laws and the Commission's regula-

tions thereunder. However, the inspection programs of these other organizations do afford added protection to the public. For this reason, the Commission and certain other inspecting agencies maintain a program of coordinating inspection activities to obtain the widest possible coverage of brokers and dealers and to avoid unnecessary duplications of inspection. By this program, each inspecting agency makes available to all such agencies advice that it has started a particular inspection but the reports or findings of such an inspection are not exchanged between the parties. Information discovered in the course of such inspections or examinations indicating serious violations of regulations administered by another agency may, however, be called to the attention of such other agency. The program does not prevent the Commission from inspecting any firm recently inspected by another agency and such inspections are made whenever there exists good cause.

Agencies now participating in this coordination program include the American Stock Exchange, the Boston Stock Exchange, the Midwest Stock Exchange, the National Association of Securities Dealers, Inc., the New York Stock Exchange, the Pacific Coast Stock Exchange, the Philadelphia-Baltimore Stock Exchange, and the Pittsburgh Stock Exchange.

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 and establishes standards for such associations. The rules of such associations must be designed to promote just and equitable principles of trade, to prevent fraudulent and manipulative acts and practices and to meet other statutory requirements. Such associations serve as a medium for the cooperative self-regulation of over-the-counter brokers and dealers. They operate under the general supervision of this Commission which is authorized to review disciplinary actions and decisions which affect the membership of members, or of applicants for membership, and to consider all changes in the rules of associations. The National Association of Securities Dealers, Inc. ("NASD") is the only Association registered under the act.

In adopting legislation permitting the formation and registration of such associations, Congress provided an incentive to membership by permitting such associations to adopt rules which preclude a member from dealing with a nonmember, except on the same terms and conditions as the member affords the investing public. The NASD has adopted such rules. Accordingly, membership is necessary to the profitable participation in underwritings and over-the-counter

trading since members may properly grant price concessions, discounts and similar allowances only to other members. Loss or denial of membership due to expulsion or suspension or other ineligibility due to a statutory disqualification, or to failure to meet standards of qualification established in NASD rules, thus imposes a severe economic sanction.

At June 30, 1959, there were 4,018 NASD members, an increase of 198 during the year, as a result of 542 admissions to and 344 terminations of membership. At the same time, there were registered with the NASD as registered representatives 77,917 individuals, including generally all partners, officers, traders, salesmen and other persons employed by or affiliated with member firms in capacities which involved their doing business directly with the public. The number of registered representatives increased by 12,603 during the year as a result of 19,071 initial registrations, 11,043 re-registrations and 17,511 terminations of registrations. The membership and registered representative figures as of June 30, 1959, both represent all-time high marks.

NASD Disciplinary Actions

The NASD furnishes the Commission summaries of decisions on all disciplinary actions against members and registered representatives of members. Each such decision is considered by the Commission's staff to determine whether the underlying facts indicate conduct in violation of the statutes administered by the Commission or the rules thereunder and whether the Commission should, on its own motion, call up a particular case for review. This staff consideration often includes an examination of the Association's complete file on a particular case. Where such action appears warranted by the available facts, independent Commission inquiry or action is initiated through the appropriate regional office.

During the fiscal year the NASD forwarded to the Commission 248 disciplinary decisions on 209 formal complaint cases. It is not unusual for there to be more than one decision on a particular case for all decisions of District Business Conduct Committees are appealable to or reviewable by the Board of Governors which may affirm, modify, or reverse such decisions or remand them for reconsideration. Final Association decisions were reported to the Commission during the year in 175 formal complaint cases.

Each formal complaint must rest on allegations that a member firm had violated specified provisions of the NASD Rules of Fair Practice, although registered representatives of members and other persons controlling or controlled by members may also be cited for violations or for having been the cause of violations. Of the 175 decided cases, 103 were based on complaints solely against members. Eight such complaints were dismissed on findings that the allegations had not

been sustained, whereas in 95 cases it was found that the alleged violations had occurred, and a penalty was imposed on the member. The remaining 72 cases involved allegations of violations against the member firms concerned and 108 of their registered representatives or associates. Two such complaints were dismissed as to the two members and three individuals concerned and 21 others were dismissed as to the members involved, while 11 other individuals were found not to have been guilty of the alleged violations. Violations were found and a penalty was imposed on 49 members and 94 individual associates of members involved in this category of complaints. In all, there were disciplinary decisions adverse to 144 members and to 94 registered representatives.

The penalties imposed included censure, fine, suspension or expulsion of the member or suspension or revocation of the registration of a registered representative and in some cases a finding that an individual had been a cause of an expulsion, suspension or revocation. In many instances more than a single penalty was imposed and in a substantial majority of the cases some or all of the costs of the proceedings were assessed against those found to have acted improperly.

Thus 31 members were expelled; 4 were suspended for periods ranging from 1 week to 18 months; the registrations of 28 registered representatives were revoked and 9 were suspended, also from 1 week to 18 months; and 16 individuals were held to have been the cause of an expulsion, suspension, or revocation. Moreover, 88 members were assessed fines as were 10 registered representatives, in amounts varying in each category from $25 to $5,000. The minimum penalty of censure was imposed on 18 members and 18 registered representatives. In the fiscal year the Association collected a total of $77,658.66 as a result of fines and costs imposed in disciplinary actions. In some cases, of course, fines or costs imposed on an expelled member or a revoked representative are never paid.

In addition to disciplinary action by formal complaint procedure, as described above, action was also taken against members pursuant to the Minor Violation Procedure, provided in the Association's Code of Procedure for Handling Trade Practice Complaints, for the disposition of disciplinary cases where the facts are not in dispute and where the matter involves minor or technical violations of the rules with no significant damage to customers or other parties. Under this procedure a member charged with violation of the rules may waive a hearing, admit the violations as alleged and accept a penalty not in excess of censure and a fine of $100. A member's rights of appeal are preserved as is the right of the Board of Governors to review action by a District Business Conduct Committee. A member, however, is not required to follow the Minor Violation Procedure and may elect to face formal charges and to require a hearing.

The Association reported to the Commission during the year the disposition of 31 complaints pursuant to Minor Violation Procedure. In 20 cases fines were imposed in amounts ranging from $25 to $100 and aggregating $1,325 and in 8 other cases the only penalty imposed was censure. In another case after the member admitted alleged violations and paid a fine of $100 under Minor Violation Procedure, the Board of Governors remanded the case to the appropriate committee for formal complaint treatment on the grounds that minor violation treatment was inappropriate where a member was charged with the repetition of acts for which it had previously been disciplined. The remand resulted in the filing of a formal complaint and a finding of violations for which a fine of $200 was imposed.

In two other cases members rejected Minor Violation Procedure and required the filing of formal complaints. In one such case, the member demonstrated to the committee's satisfaction at a hearing that it had not acted improperly and the committee dismissed the complaint. In the remaining case, the member rejected an offer to admit alleged violations and to pay a fine of $25. A formal complaint was then filed and the district committee found violations and imposed a $25 fine. The member appealed this decision to the Board of Governors which affirmed the findings of violations and increased the penalty to a fine of $300 plus costs.

Commission Review of NASD Disciplinary Action

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 timely application of any aggrieved person. The effectiveness of any penalty imposed by the NASD is automatically stayed pending determination in any matter which comes before the Commission for review. At the beginning of the fiscal year, two such review cases had been pending before the Commission. During the year eight other such petitions were filed and three cases were disposed of, leaving seven petitions pending at the year end.[81]

The Commission dismissed an application filed by Samuel B. Franklin & Company seeking review of disciplinary action by the Association which had found that the firm had violated the Association's Rules of Fair Practice by selling securities to, and purchasing securities from, customers at prices which were not fair in view of all the relevant circumstances.[82] An NASD District Committee had censured the firm, fined it $1,000 and assessed costs amounting to $773.80. The

[81] The pending cases concerned applications filed by Sterling Securities Co., Marc Sterling, et al. (File 16–1A77); Raymond G. Chalikian (File 16–1A79); A. J. Grayson & Co., Inc. and Albert J. Grayson (File 16–1A80); Gerald M. Greenburg and Robert Leopold (File 16–1A81); L. C. Fisher Co. (File 16–1A82); Whitney & Co., Inc. (File 16–1A83); and Franz Bachmann (File 16–1A85). After the close of the fiscal year, the L. C. Fisher application was remanded to the NASD for reconsideration on the joint request of the NASD and Fisher.

[82] Securities Exchange Act Release No. 5915 (Mar. 24, 1959) and File 16–1A72.

NASD Board of Governors on appeal affirmed this action and assessed an additional $153.29 in connection with the costs of the appeal.

According to the Commission's decision, the basic facts were not in dispute. Out of 731 transactions in which Franklin & Co. as principal sold securities to customers during the period between January and May 1956, not including sales of investment company shares and other securities sold in a public offering pursuant to a prospectus, 642 transactions involved markups in excess of 5 percent. The company, as principal, purchased securities from customers in 428 transactions and in 159 of these transactions its markdown exceeded 5 percent. In the 642 sales transactions the markups were more than 10 percent in 549 instances, more than 15 percent in 402 cases, more than 20 percent in 260 transactions, and ranged from 30 to 62 percent in 99 cases. On its 159 purchases from customers, the markdown in 68 transactions exceeded 10 percent, in 32 it exceeded 15 percent, in 20 it exceeded 20 percent, and in 6 cases it ranged from 30 to 37 percent. In discussing the gross dollar amount of transactions, the Commission pointed out that of the 731 sales, 498 were in the $100–$500 category, and 108 each involved more than $500, and that of these 606 transactions, the markups were 30 percent or more in 55 cases and in excess of 20 percent in 184 cases. The price range of the securities sold was less than 10 cents per share in 127 transactions, less than 50 cents in 477 transactions, and less than $1 in 499 transactions.

These markups were computed on the basis of the firm's own cost on same day or contemporaneous purchases of shares of the same securities except that, in a relatively small number of instances where such information was not available, the computations were made on the basis of quotations obtained from the National Daily Quotation Service. The markdowns on the firm's purchases from customers were computed on the basis of same day or contemporaneous sales by the firm of shares of the same securities for its own account.

The applicant urged, among other things, that most of the transactions involved purchases or sales of so-called "penny" stocks selling for less than $1 per share; that in most cases the dollar value of a transaction was small; that the NASD 5 percent markup policy should not be applied to low priced securities sold in small dollar transactions; that it was justified in charging an amount over cost sufficient to cover expenses; and that its markups over cost were not greater than the differences between the published bid and asked quotations on typical penny stocks.

In its findings and opinion the Commission concluded that Franklin & Co.'s pricing practices clearly were unreasonable, at least in those transactions where the markups or markdowns were greater than 20 percent, as there was no showing of special circumstances such as unusual expenses, extraordinary services to customers or acquisition of

inventory at special concessions. The Commission sustained the NASD finding that the firm had purchased and sold securities at prices which were not fair under all the relevant circumstances and which were not reasonably related to current market prices, that such conduct was inconsistent with just and equitable principles of trade and that the penalties imposed were not excessive, having due regard to the public interest.[83]

Two other applications for review of Association disciplinary action were dismissed by the Commission, consideration having been stayed pending determination of administrative proceedings against the parties concerned. These petitions had been filed by Batkin & Co.[84] and Churchill Securities Corp.[85] Dismissal of the petitions as moot followed action by the Commission revoking the broker-dealer registration of Batkin & Co. and expelling it from the Association[86] and similar action as to Churchill Securities Corp.[87]

Commission Review of NASD Action on Membership

Section 15A(b) of the act and the by-laws of the NASD provide that, except where the Commission finds it appropriate in the public interest to approve or direct to the contrary, no broker or dealer may be admitted to or continued in membership if he, or any controlling or controlled person, is under any of the several disabilities specified in the statute or the by-laws. By these provisions Commission approval is a condition to the continuance in Association membership of any broker-dealer who, among other things, controls a person whose registration as a broker-dealer has been revoked or who was found to have been a cause of a Commission order of revocation.

A Commission order approving or directing admission to or continuance in Association membership, notwithstanding a disqualification under section 15A(b)(4) of the act or under an effective Association rule adopted under that section or section 15A(b)(3), is generally entered only after the matter has been submitted to the Association by the member or applicant for membership. Where, after consideration, the Association is favorably inclined, it ordinarily files with the Commission an application on behalf of the petitioner. A broker-dealer whose application is refused Association sponsorship, however, may file an application directly with the Commission. The Commission reviews the record and documents filed in support of the application and, where appropriate, obtains additional evidence. At the beginning of the fiscal year one such petition was pending before the

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[83] After the close of the fiscal year the firm filed a petition for review of the Commission's decision with the Court of Appeals for the Ninth Circuit.

[84] Securities Exchange Act Release No. 5763 (Aug. 22, 1958) and File 16–1A67.

[85] Securities Exchange Act Release No. 5951 (May 11, 1959) and File 16–1A71.

[86] Securities Exchange Act Release No. 5709 (June 9, 1958).

[87] Securities Exchange Act Release No. 5871 (Feb. 10, 1959).

Commission; during the year six petitions were filed and three were disposed of; and four were pending at the year end.

The three disqualified individuals whose employment was thus approved were: William A. Spanier,[88] formerly president of Bennett, Spanier & Co., Inc., a firm revoked as a broker-dealer and expelled from the NASD by the Commission on May 28, 1952, on findings that, among other things, it had engaged in manipulative activities and had sold unregistered securities; [89] Kenneth E. Goodman,[90] formerly sole stockholder of Kenneth E. Goodman & Co., a firm similarly revoked and expelled by the Commission on April 23, 1958, on findings that it had falsely stated its bank balance on its books and had effected securities transactions in violation of the Commission's net capital rule; [91] and Leonard H. Whitaker,[92] whose registration as a broker-dealer had been revoked by the Commission in 1952 because of certain securities violations, including, among other things, the sale of unregistered securities and conversion to his own use of a payment from a customer for securities.[93] Whitaker's employment by another NASD member firm had earlier been approved by the Commission under specified conditions.[94] This second approval petition was necessary because Whitaker had changed employers. In each case the Commission found it appropriate in the public interest to approve the NASD applications in view of all the circumstances, including the lapse of time and supervision of the representatives.

LITIGATION UNDER THE SECURITIES EXCHANGE ACT OF 1934

In order to protect the public, the Commission is authorized to institute actions to enjoin broker-dealers and other persons from engaging in activities which violate the provisions of the Securities Exchange Act of 1934. Some of these activities also violated provisions of the Securities Act of 1933 and are discussed above.

Anti-Fraud Litigation

In discharging its obligation to prevent frauds upon the public, the Commission filed a number of complaints during the past year. Final judgment enjoining Louis E. Wolfson from further violating the anti-fraud and antimanipulative provisions of the Exchange Act was obtained.[95] This case is discussed at length in the 24th Annual report.[96] The complaint alleged that Wolfson and others had attempted to

[88] Securities Exchange Act Release No. 5778 (Sept. 25, 1958) and File 16–1A46.
[89] Adams & Co., Bennett, Spanier & Co., Inc. and Ray T. Haas, 33 S.E.C. 444 (1952).
[90] Securities Exchange Act Release No. 5828 (Dec. 5, 1958) and File 16–1A73.
[91] Securities Exchange Act Release No. 5684 (Apr. 23, 1958).
[92] Securities Exchange Act Release No. 5989 (June 16, 1959) and File 16–1A78.
[93] Leonard H. Whitaker, 33 S.E.C. 72 (1952).
[94] Securities Exchange Act Release No. 5581 (Sept. 3, 1957) and File 16–1A64.
[95] USDC SD NY No. 135–30.
[96] At p. 100.

defraud the public and to manipulate the market of American Motors stock; that he and his associates caused to be published in a financial newspaper an article stating that they owned 460,000 shares of that stock at a time when they had disposed of 200,000 shares, and that they later caused an article to be published stating that Wolfson had disposed of one-quarter of his 400,000 shares and would sell the rest during the coming months. Wolfson, according to the complaint, omitted to disclose that he had disposed of all his holdings in American Motors, had in fact sold short, and was attempting to buy stock to cover his short position. Judgment against Wolfson was entered by consent.

In *S.E.C.* v. *Wilkes*,[97] the Commission's complaint charged violations of the short selling and antifraud provisions of the Exchange Act and the Commission's rules in that defendant caused four broker-dealers to sell for his account on the American Stock Exchange an aggregate of 29,100 shares of Hazel Bishop, Inc. common stock, by falsely representing to the brokers that he owned such stock. A final decree enjoining further violations of the act was entered on consent of defendant.[98]

Three cases involved violations of the Exchange Act with regard to over-the-counter sales. In *S.E.C.* v. *McDonald*[99] the complaint alleged that the corporate defendant broker-dealer accepted moneys and securities and represented that it would fulfill its obligation to deliver securities or moneys due when in fact it could not and did not intend to do so. Affidavits filed in support of a motion for a temporary restraining order alleged, among other things, that a broker-dealer firm had paid defendant $50,000 for the purchase of securities which were never delivered, that employees of defendant stated that members of the public had paid more than $250,000 for securities which were not delivered, and that the Dayton Aviation and Radio Equipment Corp., which had engaged defendant as underwriter for its offering of some 500,000 shares of common stock, had received proceeds from the sale of only 274,200 shares although in fact the whole issue had been sold. A permanent injunction was obtained by default against the firm and its president.

In *S.E.C.* v. *Campbell*[100] and in *S.E.C.* v. *Rosen*[101] the Commission charged defendant brokerage firms with accepting customers' orders and deposits of money and securities upon the representation that they were ready and able to meet all obligations, when in fact they were insolvent and unable to meet current liabilities. Permanent injunctions were entered in both cases.

[97] USDC SD NY No. 145-163.

[98] In a companion case, *S.E.C.* v. *Brown*, USDC SD NY, No. 145-236, the defendant was permanently enjoined from further short-sales of Hazel Bishop, Inc. stock.

[99] USDC SD NY, No. 139-190.

[100] USDC SD Texas, No. 12,347.

[101] USDC D Mass., No. 58-869-A.

Cases under the Net Capital Rule

The "net capital rule" provides an important protection to investors against loss of securities or monies, due to financial straits of broker-dealers, by requiring every broker-dealer to limit his aggregate indebtedness to all persons to 2,000 per centum of net capital. During the year injunctions were obtained to enjoin broker-dealers from further violations of the net capital rule in *S.E.C.* v. *Trigg*,[102] *S.E.C.* v. *Wagner*,[103] *S.E.C.* v. *Sano*,[104] *S.E.C.* v. *The Christopher Corp.*,[105] *S.E.C.* v. *Empire State Mutual Sales, Inc.*,[106] and *S.E.C.* v. *Green*.[107]

In the Empire State and Green cases, and in *S.E.C.* v. *Aronson*[108] and *S.E.C.* v. *Carroll*[109] the Commission charged defendants with violations of the fraud and record-keeping provisions of the Exchange Act, as well as the net capital rule.

M. J. Shuck v. *S.E.C.*, 264 F. 2d 358 (C.A. D.C., 1958), involved a petition for review of a Commission order denying withdrawal and revoking petitioner's registration as a broker-dealer. The Commission's revocation was based on findings that petitioner had been enjoined by a district court from violating the Commission's net capital rule and that revocation would be in the public interest. The Court of Appeals for the District of Columbia, in affirming the Commission's order, held, first, that the Commission had observed the fundamental purposes of section 9(b) of the Administrative Procedure Act and, second, that under the circumstances of this case, the Commission properly found revocation was in the public interest. Service on the petitioner of the temporary restraining order and the Commission's complaint in the action for the preliminary injunction as well as the issuance of the injunction itself met the requirement in 9(b) that written notice of the facts warranting a revocation be sent to the licensee prior to the agency proceeding. The Court stated that the record shows that even prior to the district court proceedings the Commission's staff had discussed with Shuck the matter of compliance. In addition, the court proceedings, the Court held, afforded petitioner a further opportunity to demonstrate compliance.

Moving to the merits of the case, the Court concluded that it is not required that the injunction contain an express finding of wilfulness as petitioner had contended where revocation is based on the entry of an injunction. Evidence of wilfulness, however, might be considered by the Commission in applying the public interest criterion. The record of Shuck's action in the past supported the Commission's

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[102] USDC SD Texas, No. 12,236.
[103] USDC SD NY, No. 138–41.
[104] USDC SD NY, No. 147–363.
[105] USDC SD Fla., No. 8982–M.
[106] USDC SD NY, No. 142–295.
[107] USDC ND Texas, No. 8060.
[108] USDC SD Calif., No. 938–58 HW.
[109] USDC D Mass., No. 59–194A.

findings that the violation of the net capital rule was not unintentional or inadvertent. This past record coupled with the District Court's finding that Shuck would not maintain the required standards in the future could properly justify the Commission's revocation for the future protection of the investing public. Nor did the Court feel that Shuck's expressed wish to withdraw from the securities business or his alleged satisfaction of creditors precluded the Commission from taking this step. The Court stated that the Commission could hold its hearing which would reflect the facts shortly after they occurred and take prompt and appropriate action without waiting until Shuck re-entered into business. The Court of Appeals restated its ruling in *Hughes* v. *S.E.C.*[110] that wilfulness means "no more than that the person charged with the duty knows what he is doing."

Litigation Involving Broker-Dealer Registration and Reporting Requirements

Gilligan, Will & Co., et al. v. *S.E.C.*, 267 F. 2d, 461 (C.A. 2, 1959) involved a petition for review of the Commission's order suspending Gilligan, Will & Co. for 5 days from the National Association of Securities Dealers, Inc. for violations of section 5 of the Securities Act and finding James Gilligan and William Will causes of the order.[111] Petitioners challenged the Commission's findings that they were underwriters with respect to 1955 and 1956 transactions in Crowell-Collier debentures and stock. The Court upheld the findings and conclusion of the Commission that the resale of securities contemplated and executed by petitioner was a distribution or public offering and hence petitioners were underwriters. The Court rejected petitioners' argument that they took for investment where they intended to retain the stock only if the issuer continued to operate profitably.

Some of the cases brought by the Commission involved failure of the defendants to file the reports required by the Exchange Act. In *S.E.C.* v. *Alexander L. Guterma*, and *F. L. Jacobs Co.*[112] the complaint sought to enjoin the company and its then president and controlling stockholder, Guterma, from continuing to violate the antifraud and reporting requirements of the 1934 Act and the antifraud and registration requirements of the 1933 act. After Guterma resigned and disposed of his interest in the company, the new management consented to entry of a mandatory injunction ordering the company to prepare and file with the Commission all information, documents and reports required by the act.

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[110] 174 F. 2d 969, 977 (1949).

[111] For a discussion of the Commission's Findings and Opinion see 24th Annual Report, pp. 83–84.

[112] USDC SD NY, No. 144-363. A criminal indictment is also pending against Guterma. See the discussion of criminal litigation, *infra*, this report.

Upon application of the Commission the District Court at New York City appointed receivers for the assets of the company. Immediately thereafter a petition for reorganization under chapter X of the Bankruptcy Act was filed and is now pending in the District Court at Detroit, Mich. The Commission is participating in these proceedings.

In *S.E.C.* v. *Interworld T. V. Films, Inc.*,[113] the court entered a mandatory injunction requiring the filing of reports on Forms 8–K, 9–K, and 10–K and restraining future violations of the reporting requirements. In a companion case, *S.E.C.* v. *Guild Films Co.*,[114] the court ordered reports to be filed correcting a previously filed Form 10–K and enjoined future violations.

A mandatory injunction was entered by consent in *S.E.C.* v. *Peruvian Oil Concessions Co., Inc.*,[115] requiring the company to file annual reports for fiscal 1955, 1956 and 1957.

In *S.E.C.* v. *First Lewis Corporation*,[116] defendant was charged with failing to make available for examination by representatives of the Commission the books and records required to be kept by the Exchange Act. The Court enjoined the defendant from doing business in securities while failing to make such books and records available. A permanent injunction was also entered in *S.E.C.* v. *Bradford*,[117] for failure to make available books and records and for failure to file a report of the financial condition of a brokerage firm.

Proxy Litigation

The Commission appeared as plaintiff in one case of proxy litigation. In *S.E.C.* v. *Central Foundry Co., et al.*,[118] the Commission obtained a court order delaying the effect of votes cast by stockholders of the company at the Annual Meeting, charging both management and the opposing Independent Stockholders Protective Committee with violations of the proxy rules. The management filed a notice of appeal from the order and the case was set for hearing on the Commission's complaint. However, before any further action was taken, the next Annual Meeting was held from which the stockholders' faction emerged victorious by a substantial margin. Neither side was charged with illegal practices in connection with the second meeting. The management faction then stipulated to dismissal of its appeal. Thereupon the Commission stipulated to dismissal of its complaint.

Contempt Proceedings

In *S.E.C.* v. *East Boston Co., Bernard Goldfine, et al.*,[119] the Com-

[113] USDC SD NY, No. 145–328.
[114] USDC SD NY, No. 145–327.
[115] USDC SD NY, No. 144–363.
[116] USDC D Mass, No. 59–479–F.
[117] USDC SD Calif, No. 179–58. Bradford has filed notice of appeal.
[118] USDC SD NY, No. 138–110.
[119] USDC D Mass, No. 54–438–W.

mission found it necessary to bring a contempt action to enforce an injunction order previously obtained. The respondents were found in civil contempt for failure to file the semi-annual report of the company required under the Exchange Act. The respondents consented to payment of a $2,500 fine by the individuals. The company had earlier paid $3,000 compensatory damages.

Participation as *Amicus Curiae*

As noted in the last annual report, the Commission filed briefs in two cases in which the validity of rule 16b-3, insofar as it exempts the exercise of stock options from section 16(b) of the Exchange Act, was brought into question. In the first of these cases, *Perlman* v. *Timberlake*, the judge of the United States District Court for the Southern District of New York declared in dictum that the rule is invalid, but held that the defendants were protected from liability because of their good faith reliance upon the rule. The other case, *Van Aalten* v. *Hurley*, now pending before another judge of the same court, has not yet been decided.[120]

In *Taylor, et al.* v. *Janigan* (USDC D. Mass, No. 85-1056), the case arose out of the purchase by the President of Boston Electro Steel Casting, Inc. of substantially all of the outstanding stock from the shareholders. The plaintiffs brought suit under section 10(b) of the Exchange Act and rule 10b-5 thereunder, charging that they were induced to sell by defendant's misrepresentation. The defendant moved to dismiss on the grounds of lack of jurisdiction and failure to state a cause of action. Defendant also argued that 28 U.S.C. § 1331, which requires a $10,000 amount to be in controversy, governs the implied right of action under the Exchange Act and the rules under it.

The Commission filed a brief *amicus curiae*. The court supported the Commission's arguments, denying the motion to dismiss. The court stated that section 10(b) and rule 10b-5 gave rise to the cause of action and to Federal jurisdiction, and that interveners need not comply with the requirement as to amount in controversy, because section 27 of the Exchange Act grants jurisdiction without reference to amount.

[120] After the close of the year the United States District Court for the Southern District of Texas held, in *Continental Oil Co.* v. *Perlitz*, that the rule is within the Commission's exemptive authority. The opinion expressly declined to accept the rationale of the *Timberlake* case. In addition, the *Van Aalten* case was decided on July 30, 1959, but the trial judge held that it was unnecessary to decide the validity of the rule, and declined to express an opinion.