Nevertheless, the practice of seeking or accepting membership on an issuer's board and making an over-the-counter trading market in its stock does exist in considerable degree. Tabulation of questionnaire OTC-3 responses indicates that in the spring of 1962, some 508 different broker-dealers, out of the total number of 4,964 broker-dealers responding to the questionnaire,[86] reported that they carried on such trading activity in the stocks of one or more corporations while at the same time represented on the issuer's board by an officer, director, partner, or employee.[87]

Although some of these broker-dealers take the position that board representation is essential, or at least highly desirable, in performing the functions of making a market, most do not go so far.[88] Rather than considering one as tied to or necessitated by the other they would regard both as stemming from a common source, their role as underwriter. In other words, having underwritten an issue they assert a double-barreled responsibility to provide a continuous market and to participate in management. These are briefly considered in turn.

Most firms asserting a responsibility to maintain a trading market for an underwritten issue recognize that obligation entirely apart from the question of board representation. It is a responsibility voluntarily assumed as a matter of business practice, as distinguished from being imposed by law or regulation, and is thus subject to self-imposed limitations or complete disavowal and abandonment when it proves inconvenient or burdensome. Nevertheless it is undoubtedly taken seriously by many firms, whatever they may consider to be the scope and depth of the obligation in particular circumstances.[89] Depending upon the responding broker-dealer, it has been described to the Special Study in various ways, including:

> * * * [requiring] that we "make a market," whenever a satisfactory market outside of our firm has not been developed by other dealers. * * *
>
> * * * * * * *
>
> We feel our responsibility * * * is continuous as an original underwriter to see that a market is maintained. * * *
>
> * * * * * * *
>
> We feel a responsibility to maintain a reasonably good market in stocks of companies where we have been a principal or managing underwriter. * * *
>
> * * * * * * *
>
> * * * we are prepared to commit more funds to the maintenance of an orderly market * * * [where] we were managing underwriters in the flotation of these issues. * * *
>
> * * * * * * *
>
> In all cases where we have managed financings for companies whose securities are traded over the counter, we would feel it incumbent upon us to continue to make a market even though market conditions and other similar factors were unfavorable, whereas we would not feel it incumbent upon us to do so in other situations. * * *

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[86] OTC-3 was sent to every broker-dealer in the country registered with the Commission.

[87] It should noted that, under the holding of *Blau* v. *Lehman*, 368 U.S. 403 (1962), unless an individual is "deputed" by his firm, trading profits of the firm are not affected by application of sec. 16(b). Corrective legislation is recommended below.

[88] Although there are obvious differences between stock exchange specialists and over-the-counter market makers, it might be noted that at least the New York Stock Exchange and the American Stock Exchange both prohibit specialists from acting as directors of issuers in whose stocks they specialize. Indeed, the former's prohibition extends not only to the specialist but also to the partners or stockholders of the firm to which he may belong, and any firm employee.

[89] See discussion at chs. III, IV, and VII.

Many such firms refer to their obligation to trade as simply requiring that they "make a market." [90] Others go further and call themselves a "sponsor" for the market of an underwritten stock. While their definitions of sponsorship differ, the emphasis seems to be on continuous performance of the function of market making rather than on a special kind of performance.[91] A typical description, by a leading investment banking firm, is as follows:

> We consider ourselves sponsors only of those unlisted securities of corporations toward which we currently deem ourselves investment bankers and whose offerings we have, as managing underwriters, publicly offered in which cases we will not withdraw from making a regular two-way market in the securities of such corporations. It does not necessarily follow that in all such cases or at all times we make the primary market.

The responsibility of serving on corporate boards of directors, and its advantages from several points of view, have also been defined in varying ways. Although many broker-dealers apparently see no such responsibility or need, either from the point of view of an underwriting relationship or in relation to market making, those who make a practice of obtaining board representation are vigorous in its defense. As already indicated, they generally point for their reason to the underwriting relationship rather than the market making function as such. However, some go further and seriously contend that they cannot, or find it quite difficult to, effectively make a market without the benefit of board representation.

Typical of the statements received by the study which throw some light on the interrelationship between the two functions are the following:

> * * * [We] feel a greater confidence in a corporation in which we are represented by a director. Because of this confidence we are able to make a better market, and by doing so render a public service. As a matter of fact, we would not have agreed to be managing underwriters in a number of issues in which we have acted in that capacity unless we had been assured of representation on the board of the company in question, for the reason that having recommended—and sold—the company's securities to many of our clients, we feel a most definite moral obligation to see to it that there is no conflict between the company activities and the legitimate interests of the stockholders. In other words, our interest in directorships is not financial, because the compensation is usually minimal and completely out of proportion to the time consumed, but rather, it is a "watchdog" interest * * *.
>
> * * * * * * *
>
> We are more likely to continue "making a market" in those stocks in which a partner or employee of our firm is a director than we are in the stocks in which this is not the case.
>
> As you will note in our answers to previous questions, a much higher percentage of those stocks in which a director is involved are sponsored stocks as compared to those issues in which no directorship is involved.
>
> Where a partner or employee of our firm is a director of a corporation whose stock we trade, it is usually the result of a previous investment banker relationship with the company. For this reason, it is natural that our interest in the subject company should be greater than otherwise, and that we should feel more of a responsibility in the continuity of a market for its securities.

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[90] Questionnaire OTC–3 defined the term "make a market" as "enter a listing in the daily 'sheets' of the National Quotation Bureau and/or stand ready to buy or sell the stock in limited quantity."

[91] The Commission has defined sponsorship as "* * * [making] a continuous market in the securities of a particular issuer regularly executing orders to buy or sell coming from other investors or other dealers" SEC, "Report on S. 2054," Senate Committee print, 84th Cong., 2d sess., p. 12 (1956).

Without questioning the sincerity of motives in most cases, it must be pointed out that less altruistic motives are sometimes present, and presumably even dominant. Board repesentation is admittedly sought in some instances as the best assurance of future investment banking business, or purely for whatever prestige may be involved, and presumably in still other instances as a source of advantage in trading or retailing activities.[92]

The possible consequences of terminating either board representation or marketmaking by reason of section 16(b) is further discussed below. The immediately following section identifies and describes the characteristics of issuers involved in the interrelationship, i.e., those which might be directly affected by extention of section 16(b) in the sense that a broker-dealer represented on their board and making a market for their stock might feel compelled to discontinue one or the other activity.

a. The characteristics of issuers with interlocking director-market makers

In answer to question 15 of questionnaire OTC–3, which was sent to every registered broker-dealer in the country, responding broker-dealers listed all stock in which they made trading markets and at the same time were represented on the board of the issuer. They also indicated those stocks on their lists of which they considered themselves a "sponsor." Thus, the questionnaire responses showed substantially every trading market being made a broker-dealer represented on the board of the issuer in the country at the time, early 1962, whatever the degree of broker-dealer responsibility to the market by reason of responsibility to the issuer happened to be. It was possible, moreover, to learn something about the nature of the group of issuers involved from the virtually contemporaneous questionnaire, OTC–4, in which a 1-in-5 random sample of issuers of stocks quoted in the January 1962 monthly summary of the National Quotation Bureau were asked to supply certain information about themselves, including corporate size and securities activity data.[93] The two questionnaires thus made it possible, for the first time, to ascertain the extent to which board representation and market making coincided and to study the characteristics of representative issuers involved.

From questionnaire OTC–3 it appears that the 508 broker-dealers who made trading markets for stocks of corporations on whose boards they were represented did so, in the aggregate, for 1,610 stocks of 1,481 different issuers. Three hundred and fifty-two of the 1,481 fell into the OTC–4 sample and responded. A detailed presentation of the corporate characteristics of the 352 that were gleaned from OTC–4 is set forth in table IX–6; here only a summary analysis will be given. The nature of the OTC–4 sample, a random selection of issuers characterized by broker-dealer interest, provides strong probability that the 352 are typical of all 1,481 issuers listed in the OTC–3 responses as falling in the board-represented market-maker category.

Issuers with interlocking director-market maker relationships tend to be of moderate asset size, with 34.2 percent of the corporations in

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[92] See ch. III.F.

[93] OTC–4 issuers were asked to identify any of their officers or directors who were associated with broker-dealer firms that maintained trading markets in the issuers' stocks (OTC–4, question 3). The definition of the term "made a market" was taken from OTC–3. See note 90, above.

the sample group reporting assets of between $1 million and $4,999,-999 and another 40.2 percent reporting assets of $5 million or greater. Their stocks tend to be held by substantial numbers of shareholders with 85.2 percent of the issuers reporting 300 or more shareholders, 67.8 percent reporting 500 or more, and 54.1 percent reporting 750 or more. The director-market maker issues also tend to be rather actively traded; 76.4 percent reported 200 or more transfers and 62 percent reported more than 500 during a 1-year period. Similarly, two-way quotations were listed in the National Monthly Stock Summary edition at the close of the period October 1–December 31, 1961 by five or more dealers for 54.0 percent of the issuers. Finally, most exhibited a marked degree of concentration of ownership. The 10 largest shareholders of record owned more than 30 percent of the outstanding shares in 78.5 percent of the cases and in 53.9 percent of the cases they owed 50 percent or more. These data should be borne in mind when the impact of extension of section 16(b) to the over-the-counter market is considered.

b. The potential impact of section 16(b) on market making generally

Policy considerations and problems involved in board representation of broker-dealers generally have already been canvassed in part F of chapter III and it has been seen that complex questions of obligation may arise where the director or his firm is also effecting transactions as principal or for customers. Quite apart from section 16(b), the combined functions are avoided by some firms or, when undertaken, are often subject to inhibitions or difficulties in performing one function or the other. Against this background, the section 16(b) question is largely reduced to determining whether the demands of over-the-counter market making or sponsorship, while simultaneously serving as director, are still so compelling in over-the-counter markets generally as to necessitate a general exemption for market makers when the section is extended to over-the-counter securities.

It should be noted preliminarily that applying section 16 and its companion sections, 13 and 14, to over-the-counter issuers would in and of itself eliminate one of the principal reasons usually advanced to justify the seeking or acceptance of directorships by broker-dealers—to insure a proper flow of information and a proper recognition of other obligations of a publicly held corporation to its shareholders. Adequate financial reporting to a public agency—when proxies are solicited—to shareholders, proxy solicitation controls designed to enable shareholders intelligently to exercise their corporate franchise, and protections against insider-trading abuses, would make unnecessary efforts by broker-dealer-directors to see to it that investors—more accurately those investors that happened to be their customers—were adequately informed. The information essential to intelligent investment decisions would be available to investors, actual and potential, and the opportunity to take advantage of inside information would be greatly reduced. The disclosure need of investors is not for broker-dealer board representation; it is for extension of the protections of sections 13, 14, and 16 to unlisted securities. As a senior partner of one of the largest brokerage concerns in the country put it:

> With respect to directorships in companies whose securities are not listed, it is my opinion, that if disclosure * * * [is] required in the future, the need for investment bankers or brokers sitting on the boards of such companies will be minimized.

Even apart from this, however, the available data leave little question that the demands of the market-making or sponsorship function are not compelling in most circumstances. In the first place, even on the most drastic assumption that all broker-dealers that both maintain trading markets and sit on the corresponding corporate boards were to elect to retain their board seats at the cost of abandoning their markets, only a very small segment of the whole over-the-counter market would be affected. It has already been noted that of a total of 5,785 broker-dealers then registered with the Commission, only 508 of the 4,964 that responded to questionnaire OTC–3 indicated that they made a market for one or more stocks and at the same time held directorships. The issuers involved numbered only 1,481 or only 13.38 percent of the total of some 11,069 different issuers which are estimated to have then evoked at least some market interest in the 10-month period examined.[94]

Since the standard of coverage discussed in part B.3, however, restricts applicability of section 16(b) to those issuers that have 300 or more shareholders, some of even the 13.38 percent would not be affected. Of the 352 issues in the OTC–4 sample that had director-market makers or sponsors, only 85 percent had 300 or more shareholders. Those that would be included, moreover, would not be deprived of a market althogether, since 214, or 60 percent, of the 352 issues were being quoted by at least 4 broker-dealers. The withdrawal of one broker-dealer in such circumstances would presumably have little effect. Overall, therefore, the actual impact of section 16(b) would at most be minimal.

Actually there is good reason to assume that many broker-dealers would choose to resign as directors rather than abandon their trading markets. The latter are, after all, profitmaking operations; compensation for the former is, to repeat part of the testimony already quoted, "usually minimal and completely out of proportion to the time consumed." Compensation aside, moreover, there is a substantial body of opinion that board representation does not facilitate market making. As one wholesale broker-dealer put it:

Q. But you are paying a man a salary for being on the board. Now I just want you to tell me frankly * * * whether you can possibly conduct that trading operation without making use of the information that he has received * * *.

A. This is amazing, but when we traded our own issue we lost money and big money. The insiders will not believe you on this.

What happens: either there are all buyers or all sellers. And, either way, we have to make a market, and we have to sell sometimes when we don't want to sell. We will look at Bob's position, and he hasn't any position. We have to make a market.

A partner of an "integrated" house, i.e., one that both maintains interdealer markets and services retail customers, said much the same thing:

* * * the information we have as directors does not influence our market activity. As we have discussed in other places, one of the real tricks in making a market is not to have an opinion as to the value of the stock. We try to tell our trading department that whereas we brought out a stock at a given price, they have no obligation to maintain that price. They must let the market move up or down with supply and demand. That is really the secret of making a market * * *.

[94] See table IX–f, above.

The facts of the marketplace, indeed, show that, whatever opinions individual broker-dealers might hold, board representation is certainly not *necessary* to making a market. As already pointed out, the vast majority of all over-the-counter stocks have trading markets without board representation. Many of them are public utility stocks the issuers of which are forbidden by law to include broker-dealers among their directors. One hundred and twenty-three of the OTC–4 sample of 1,618 were actually described as "sponsored"—enjoyed the assertedly most responsible species of trading market—without board representation.

In short, sections 13, 14, and 16 would themselves make academic one of the commonly ascribed reasons for board representation; section 16(b) would impinge at all on only a very small segment of over-the-counter market making; moreover, only a much smaller segment of the impact area could be expected to be actually significantly affected; and even that effect would be unnecessary in most if not all instances in the sense that the alternative of resigning the directorship would be available.

c. The potential impact of section 16(b) in cases of market "sponsorship"

Notwithstanding the considerations just discussed, it is recognized that, when put to a choice, some board-represented broker-dealers might elect to retain their directorships and withdraw from making markets for the corresponding stocks. Even though the number of such withdrawals could be expected to be quite small, their significance might be thought to be large because some of the broker-dealers involved might be not merely market makers but that more important group calling themselves "sponsors." The loss of a sponsor, it has been asserted, would deprive an issue of its most reliable market, the one that can be expected to continue during periods of market inactivity or instability when investors' needs are most urgent. Market continuity, a willingness to purchase or sell in substantial amounts, and a willingness to take greater positions, all have been suggested as the special virtues of sponsorship.

In the analysis of questionnaire OTC–4 (see pt. B.3.b, above) a separate study was made of all issues in the sample of 1,618 stocks for which price data were available, in terms of price level (high bids) at two selected points of time, near the peak of the general market in December 1961 and after the May 1962 market break. This sample included 308 instances in which there was a market maker and/or a sponsor represented on the board, 116 instances in which sponsorship was asserted (in responses to OTC–3) without board representation, and 878 instances with neither board representation nor claim of sponsorship. In view of the size of the sample and its random selection, it is believed that actual price changes between these points of time for the different categories are of some significance in measuring the importance of sponsorship, whether or not reflected in board representation, in relation to market performance.[95]

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[95] No doubt some of the nonsponsored stocks which reflected little price decline or experienced price rises during the period were among the more inactively traded stocks. On the other hand, shareholder size and trading activity of many of those nonsponsored stocks were equal to if not greater than for many of the sponsored stocks. The 2 extremes presumably cancel themselves out to the point where the 2 categories may appropriately be compared.

Comparing first the 116 instances of asserted sponsorship (without board representation) with the 878 instances of nonsponsorship (also without board representation), it was found that in the former category 67 percent of the issues declined 20 percent or more in quoted price, whereas in the latter category this was true of only 30 percent of the issues; and on the other hand, 9.5 percent of the former group increased in price, whereas 49 percent of the latter showed an increase. When comparison was made between the 308 instances of board representation (with or without asserted sponsorship) and the same 878 instances of nonrepresentation and nonsponsorship, the contrasts were similarly striking: For the former group of board-represented issues, 64 percent showed price declines of 20 percent or more and only 15 percent showed increases, in contrast with the above figures of 30 and 49 percent for the 878 issues having neither board representation nor asserted sponsorship. See table IX–g, below.

TABLE IX–g.—*Sample of issuers of over-the-counter stock classified by "sponsorship" and percentage change in price of stock, December 1961 to June 1962*

Percentage price change [1]	Nonsponsored [2]		Sponsored [2]		Director-market maker and/or director-sponsored	
	Number of issues	Percent of total	Number of issues	Percent of total	Number of issues	Percent of total
Total	878	100.0	116	100.0	308	100.0
Decline:						
80 to 99	12	1.4	4	3.4	5	1.6
60 to 79	45	5.1	12	10.3	36	11.7
40 to 59	79	9.0	27	23.3	84	27.3
20 to 39	124	14.1	35	30.2	75	24.4
1 to 19	189	21.5	27	23.3	61	19.8
Increase:						
1 to 49 [3]	399	45.5	10	8.6	41	13.3
50 and over	30	3.4	1	.9	6	1.9

[1] Prices were obtained from the National Quotation Bureau, Inc., the National Monthly Stock Summary (issues of Jan. 1 and July 1, 1962). The December price represents the high bid closest to Dec. 31, 1961, and the June price represents the high bid closest to June 30, 1962.
[2] Without board representation by any market maker or sponsor.
[3] Includes those stocks in which there was no price change.

NOTE.—Sample includes approximately 1 out of 5 issuers listed in the National Quotation Bureau, Inc. the National Monthly Stock Summary (Jan. 1, 1962).

Whatever the theoretical obligations involved in sponsorship, the above analysis indicates, at the very least, that sponsored stocks, with or without board representation, do not generally perform better than nonsponsored ones in terms of one objective and measurable criterion—price performance over a period including a market crisis. Undoubtedly some sponsored stocks performed better than did some nonsponsored stocks, but it would be as inappropriate to conclude that in such instances sponsorship was the cause of the superior performance as it would be to conclude that sponsorship was the cause of the inferior price performance for the majority of sponsored stocks shown in table IX–g.

In the analysis of questionnaire OTC–3 [96] a further effort was made to study the actual performance of sponsors as compared with other market makers, all responding broker-dealers having been asked to

[96] See ch. VII.

indicate those stocks of which they considered themselves a sponsor. A list of 200 stocks was randomly selected and all respondents were asked to supply detailed schedules of their transactions in those stocks for the 1 day (or in the case of less active stocks a longer period) selected for study. The trading of all broker-dealers who listed any of those 200 stocks as sponsored was studied in detail, to determine whether sponsorship had distinguishable results in terms of the number of shares traded with other dealers or with public customers and their prices of execution. In addition, a period of price stress was studied with respect to the same stocks and sponsoring firms, by means of a followup questionnaire, OTC–5, and numerous interviews after the May 1962 market break.

The results of the findings are discussed in chapter VII and the appendixes thereto. Generally, they show that the activity of most sponsors for the "normal" day of January 18, 1962, and for the days of the market break, was not readily distinguishable from the activity of other market makers in terms of their relative importance as professional participants or the price at which they executed transactions. Although some sponsors were of considerable importance in certain securities with limited professional participation, these were exceptions to the typical performance of sponsors.[97]

Because sponsorship seems to involve in actual practice no more than ordinary market making without a directorship, it is entirely probable that the gap left by the withdrawal from the market of a sponsor—presumably one having board representation if section 16(b) were the cause—would in most instances be filled by some other market maker. Indeed, it has already been shown that the broker-dealer interest in sponsored stocks generally is sufficiently great so that the loss of a single dealer choosing to remain on an issuer's board would not deprive most such stocks of active broker-dealer interest.[98] And as already indicated, for those relatively rarer situations where sponsorship might be indispensable, withdrawal from board representation is an alternative frequently chosen and sometimes compelled (in the instance of public utilities) even without any compulsion of section 16(b). As will be seen in the following discussion of small business investment companies, still another possibility that some broker-dealers have found workable is to conduct a trading market with such limited accountability for profits as section 16(b) might entail.

d. Analysis of the impact of section 30(f) of the Investment Company Act

It has been possible to observe the actual over-the-counter impact of section 16(b) in one limited area, that occupied by small business investment companies (SBIC's), a species of closed-end investment company authorized by the Small Business Investment Act of 1958.[99] Section 30(f) of the Investment Company Act, to which SBIC's are subject, has always by reference applied section 16(b) to closed-end companies, both listed and unlisted, but until SBIC's came on the scene such companies were generally exchange traded and no special problem of impact on over-the-counter trading markets was presented.

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[97] Ibid.
[98] See subsec. a, above.
[99] 15 U.S.C. 681 ff.

Since 1959 however, publicly owned SBIC's—the vast majority of which are unlisted—have offered valuable, if limited, material for a "pilot study" of the actual reactions of broker-dealers and issuers to over-the-counter applicability of section 16(b) and the actual consequent market behavior of the issues involved.

By the end of 1961, 40 SBIC's had registered issues under the Securities Act and were publicly traded, 39 over the counter and 1, Venture Capital Corp., on the American Stock Exchange. In 1962, a second SBIC,[100] Business Capital Corp., was listed on the Midwest Stock Exchange. Three SBIC's, Boston Capital Corp., Midland Capital Corp., and St. Louis Capital Corp., were among the 200 OTC–3 stocks chosen for trading analysis. (See chapter VII.) Insofar as the market aspects thus studied are concerned, the three stocks appear to reflect no significant variation from other securities in the OTC–3 sample of comparable size and activity.

The SBIC pilot study was carried out as follows: All annual reports and proxy solicitation materials filed with the Commission by each of the 39 SBIC's were scrutinized for such information as number of stockholders, asset size, and the names of any directors who appeared to be broker-dealers. All ownership reports of these directors were then reviewed, as were their firms' responses to questionnaire OTC–3 regarding the over-the-counter markets which they made. Representatives of several of the broker-dealer firms that were at any time represented on the board of an SBIC were then interviewed as to the nature and extent of their firms' trading in the stock of the corporation, both in periods when they were represented and when they were not. Finally, the market performance of those stocks were studied.

(1) *The reactions of broker-dealer directors to section 30(f)*

In the case of 7 of the 39 SBIC's, at no time since their initial public offering has a broker-dealer been represented on the board. Five of the seven had trading markets regularly maintained by one or more broker-dealers, three of which were "sponsored." The 7 as a group are entirely representative in other respects of the whole group of 39; their stockholder families range in number from 750 to more than 11,000 and asset sizes range from just over $1 million to more than $14 million. The corporate attributes of the issuer therefore supply no explanation for broker-dealer absence from the boards. In one case, section 30(f) was stated to have been the sole factor, and in another, where the underwriter did not make a market, section 30(f) was not a problem. But clearly the group of 7 as a whole shows the Investment Company Act equivalent of section 16(b) to be far from fatal to the making of over-the-counter markets.

All of the remaining 32 SBIC's have at some time had a broker-dealer board member and invariably his firm was either an underwriter or a principal member of the selling group that offered the stock to the public. In 6 of the 32 cases, the broker-dealer board members resigned as directors at varying times subsequent to the public offering, so that their firms could continue to trade the company's stock without section 30(f) liability. Each submitted his resignation immediately upon becoming aware of potential liability and deciding that it was more important to continue to maintain a

[100] One of the 39.

trading market than to continue the directorship. None of the firms involved indicated that the nature and extent of their market-making activities was altered after they gave up board representation. One, however, said that without it, "we deal a little more in the dark today." Here again, the equivalent of section 16(b) clearly had minimal effect on trading markets for the issues involved.

Another 17 of the 39 SBIC's had among their directors a representative of an investment banking firm which underwrote the company's stock or was a principal member of the selling group, but which did not maintain a trading market for its stock. In certain of these 17 cases, a choice may not have been required. Thus, in one, the broker-dealer firm made no trading market in any stock; in a second, the number of stockholders was so small and the market so local that a trading market was neither required nor feasible; and in a few others, an easy solution was at hand, since two broker-dealer firms were represented on the issuer's board and the directorships and market making could easily be divorced. In several of the 17 cases, however, the investment banking firms involved were required to choose, and because they felt that board representation was of foremost importance, potential liability under section 30(f) dictated a decision to refrain from trading the stock. It should be noted that apparently all but 1 of the 17 companies continued to have a trading market for their stocks, since throughout 1962 two-way quotations appeared in the wholesale quotation sheets at least weekly for all of the companies except the one referred to above that had very few shareholders and primarily a local market.

In only two cases of the underwriter's withdrawal from the market for the stock of an SBIC have the companies themselves reacted overtly. One, Growth Capital, Inc., applied to the Commission for an exemption or special treatment for one of its underwriters, McDonald & Co., so that the firm could resume trading the stock without subjecting its principal officer, who is a member of Growth Capital's board, to full liability under section 30(f).[101] The second, Business Capital Corp., secured a listing for its stock on the Midwest Stock Exchange in June 1962, as noted above, primarily because its underwriter felt that the company's stock would thereby enjoy the more stable and continuous market which it could not provide because of its board representation.

Finally, nine of the SBIC's continued to have the board representation of broker-dealers while their firms traded the company's stock. Essentially they fall into three groups: three in which the broker-dealer was represented by an employee, as contrasted with a principal, and therefore under present law apparently considered not subject to liability; another three in which the beneficial interest of the broker-dealer in his firm was so small, or the firm's trading profits considered to be so limited, that the potential liability was apparently considered minimal;[102] and still another three in which the affiliated director was simply unaware of the provisions of section 30(f).

[101] The case is still pending.
[102] As a matter of course, one such broker-dealer director regularly files with his ownership reports a copy of his letter to the corporation transmitting payment of his rather nominal liability for profit from the preceding month's transactions.

(2) *The market performance of SBIC stocks, both with and without trading markets made by their underwriters*

The study charted the week-to-week price movements throughout the year 1962 of each of the 40 SBIC's publicly held on December 31, 1961, and regularly quoted in the eastern "sheets" of the National Quotation Bureau or traded on a national exchange. In all cases, the high bid (or closing price in the case of the two stocks listed in 1962) of the last trading day of each week was taken as the charting point. In addition, the day-to-day movements of the same companies for the period May 21 to June 8, 1962, were plotted.

There appears to be no correlation between the presence or absence of an underwriter making a market and price movement measured in these ways. It thus seems clear from the analysis that, whatever the effect of market making by underwriters from transaction to transaction, their presence or absence from the markets for SBIC stocks was not a material factor affecting week-to-week or daily price movements, even over a period of price fluctuation such as the year 1962, and particularly the 3-week period selected for daily analysis. Although this is admittedly only a limited test of total market behavior, it can at least be said that the choice made by individual broker-dealer firms between making a market and retaining board membership does not appear, by itself, to have made an appreciable impact upon the markets for SBIC stocks when measured in terms of price trends.

e. Conclusion as to section 16(b)

From all of the above, the conclusion is inescapable that the potential effects of section 16(b) on over-the-counter trading markets have been greatly exaggerated. The available objective data indicate that for most if not all situations, the choice between serving on the board or making a market is not an impossible one and that neither the affected corporations nor the market for their securities need be harmed if the choice is compelled by section 16(b). The broad conclusion of the study, which is in accord with the publicly expressed view of one of the most knowledgeable authorities covering over-the-counter markets, Wallace H. Fulton, the retiring executive director of the NASD,[103] is that section 16(b) should apply generally to unlisted securities.

The present section 16(b) excludes from its coverage "* * * any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within [its] purpose." To date the Commission has promulgated eight rules exempting various types of transactions, and industry representatives have urged that any extension of section 16(b) to over-the-counter stocks should provide exemption for market makers. As one investment banker put it:

> I would not object to the addition of a new subsection to section 16, which would provide for the section's application to the over-the-counter market. However, there should be an exception; that exception should be the exemption of the forfeiture of insider profits when profits are made by a firm trading account, the exact language of the exemption to be defined by rules and regulations.

In view of the foregoing discussion it is clear that a general exemptive provision of such nature is unwarranted. If there are truly

[103] New York Times, Feb. 27, 1962, p. 51.

exceptional circumstances or instances—possibly for a limited period of years after a first public offering and/or in the case of geographically restricted markets—in which it can be affirmatively shown both that the same broker-dealer is uniquely available and essential for simultaneous board membership and market making and that it is necessary and appropriate in the public interest and for the protection of investors that his trading profits be exempt, such exemption may be provided for by rules of limited scope or on application of the issuer.

6. AN "OTC-LISTED" CATEGORY

Since it is contemplated that some issuers of securities in over-the-counter markets will and others will not be required to comply with sections 13, 14, and 16, the distinction will and should become a highly important one for many purposes. Thus, in chapter III, relating to selling and investment advisory practices, it is recommended that the availability or nonavailability of officially filed data concerning an issuer be required to be reflected in appropriate ways in the selling process. Similarly, in chapter IV it is recommended that, with respect to issues for which a reservoir of officially filed information exists—listed issues and those unlisted issues to which sections 13, 14, and 16 would apply—consideration should be given to possibilities for expediting and simplifying the Securities Act registration process in recognition of that fact. Again, one prerequisite for regularizing and improving quotation systems and procedures as recommended in chapter VII is identification of a group of issues, in connection with the routine newspaper or electronic quotation systems, that would be surrounded by at least the minimum investor protections of the three sections. Any changes in present provisions as to eligibility of over-the-counter securities for extension of credit, as discussed in chapter X, would be dependent on regular and reliable quotations as well as reliable underlying information for those issues which might be considered eligible. Finally, it may be anticipated that in many less formal ways, in the day-to-day operations of broker-dealers and the routine concerns of the investing public, ready identification of affected issues will be important and desirable. As a distinguishing hallmark, therefore, the term "OTC-listed" is suggested as a statutory designation for over-the-counter securities to which the continuing obligations of sections 13, 14, and 16 will apply.

Actually, the distinctions mentioned in the preceding paragraph exemplify what may be a considerably broader opportunity to adjust regulatory measures to needs. As pointed out in chapter VII, an important characteristic of over-the-counter markets and securities is their heterogeneity. This being so, a degree of categorization becomes useful if not essential for many regulatory as well as business purposes. Given a wide range of kinds and sizes, needs and possibilities, any uniform and undifferentiated measures are certain to be unsuitable for much if not most of the field to be covered. Rights and benefits may have to be denied to some because it is impossible to grant them at all. Restrictions and regulations may have to be kept to the lowest common denominator—to the detriment of investors—because what would be appropriate for some crucial segment would be impossible for the vast body; alternatively, regulation essential for the crucial segment would

be imposed on areas where they would be unnecessarily burdensome. The OTC-listed concept may thus be regarded as establishing a basic categorization—founded on the all-important distinction of whether continuing protections of sections 13, 14, and 16 are or are not available—that can undoubtedly be used in various ways to adjust privileges and obligations in the marketplace to the needs of each category.

The term and the category need not be restricted, indeed, to only those issues meeting the applicable number-of-shareholders criterion, since it may be anticipated that some, and perhaps many, issuers outside the mandatory group will find it desirable to bring themselves into the select category by voluntary compliance, and achieve both the status and privileges related to it. There would appear to be no reason of theory or practicality why this should not be encouraged. Legislation to extend sections 13, 14, and 16 and confer the OTC-listed designation should therefore provide that any issuers not required to comply might elect to do so and become entitled to be designated "OTC-listed."

7. SECTIONS 15(d), 12(f)(3), AND RULE 12f–4.

Extending sections 13, 14, and 16 of the Exchange Act to unlisted securities, under the phase coverage standard proposed above suggests the desirability of adjusting two other provisions of the Act and a Commission rule in order to provide a harmonious whole. The first statutory provision, section 15(d) of the Exchange Act, requires issuers that register an issue for public offering under the Securities Act to undertake to comply with section 13, the reporting requirement, when outstanding securities of the class registered aggregate $2 million, computed on the basis of the offering price. Reporting must continue until the amount outstanding, computed on the same basis, falls below $1 million (as a result of redemptions, treasury purchases, etc.). The second section, 12(f)(3), makes certain issues eligible for unlisted trading privileges on an exchange. The Commission's rule, 12f–4, exempts issuers of such securities and all other categories of securities admitted to unlisted trading privileges from sections 13, 14, and 16, with which they would have to comply except for the rule.

Section 15(d), added to the Exchange Act in 1936, was based on the rationale that whatever might be the obligations of issuers of publicly owned securities generally, the very fact that an issuer resorts to the public to raise new funds in substantial amount is sufficient basis for requiring at least adequate reporting to that public. Section 15(d) has been a valuable protective force in the over-the-counter market, but its rationale results in less embracing coverage than that here recommended. Going to the public for capital obviously should entail concomitant obligations to that public, but the same obligations should be owed, and under the above proposals will be owed, to shareholders of any publicly held company, quite independently of any link to the registration process as such. Similarly, when protection is extended to all shareholders of publicly held companies to whom it can feasibly be extended, a standard of coverage based in part on the total market value of the issue becomes inappropriate. Section 15(d), moreover, provides no proxy and insider-trading controls at all. If it were practicable, therefore, immediately to extend the benefits of sections 13, 14, and 16 to all issuers that have 300 or more shareholders,

the ultimated coverage recommended, section 15(d) would no longer be needed.

Until that ultimate coverage is accomplished, however, section 15(d) might usefully play a part in the "phasing-in" program recommended above. That program is geared exclusively to practical considerations, and it appears quite consistent with these practical considerations to include additional companies as and when they register for a public offering and meet the ultimate test of 300 or more shareholders, even if not meeting the higher criteria temporarily in effect for other companies. Section 15(d) of the Exchange Act should therefore be modified to require all issuers that register an issue pursuant to the Securities Act to undertake to comply with sections 13, 14, and 16 of the Exchange Act if and when the number of their respective shareholders of record reaches 300. By parallel reasoning the same result should apply to issues offered under regulation A. To the extent possible, Commission rules should be modified to require compliance with the three sections accordingly.

In the case of issues enjoying unlisted trading privileges on exchanges, both a statutory and a rule amendment are in order. Three categories of issues are eligible for such privileges: (1) issues traded unlisted before the Exchange Act came into force and permitted to continue to be so traded—section 12(f)(1); (2) issues fully listed on some other exchange—section 12(f)(2); and (3) issues as to which data substantially equivalent to those for listed securities are available—section 12(f)(3). Issues in the second category present no problem here because compliance with sections 13, 14, and 16 is required in any case by reason of full listing on some exchange. The statutory and rule amendments called for relate to the first and third categories.

Extension of sections 13, 14, and 16 to unlisted securities suggests eliminating the third category altogether, by statutory amendment. When such extension has been accomplished, all included issues now traded over the counter would prima facie be within the orbit of section 12(f)(3), and a multitude of applications by exchanges for unlisted trading privileges might ensue. Although the Commission is the ultimate arbiter under section 12(f)(3), it would seem better to permit the choice between exchange and over-the-counter trading to be determined by the preference of issuers and ordinary competition among markets, but freed of the regulatory disparity between the two markets brought about by the Exchange Act. As sections 13, 14, and 16 are extended to unlisted issues, therefore, section 12(f)(3) eligibility should be concurrently withdrawn.

Elimination of the regulatory disparity, finally, would destroy the justification for the general exemption from sections 13, 14, and 16 now afforded to section 12(f)(1) issues by rule 12f-4. That rule was promulgated because in the absence of an exemption, issuers admitted to unlisted trading might have been tempted to avoid compliance with sections 13, 14, and 16 at the risk only of loss of the exchange's unlisted trading privilege. Rule 12f-4 should therefore be amended to exempt section 12(f)(1) issuers only in the quite unlikely case that they have less than the number of shareholders applied as the test of coverage for over-the-counter securities.

8. IMPROVEMENT OF EXISTING INVESTOR PROTECTIONS

In addition to extending sections 13, 14, and 16 to unlisted securities, experience has shown a need to improve the protections provided by those sections for listed (and hereafter also unlisted) securities in certain respects:

When proxies are solicited, it is important to insure that financial statements included in company reports to shareholders accompanying or preceding proxy solicitations—required by the rules when management solicits proxies for an annual meeting—be presented on the same basis as that of those filed officially. Rule 14(a)-3(b) under the Exchange Act now requires that such reports adequately reflect, in the opinion of the management, the financial position of the corporation, but management opinion has on occasion proven to be woefully inadequate, indeed so far from the requirements of form 10-K as to be seriously misleading; see, for example, the discussion of suspension of trading of the stock of Atlantic Research Corp. in chapter III and part C of this chapter, below. Rule 14(a)-3(b) should therefore be amended to require that the reports which must accompany or precede proxy solicitation be not misleading in the light of the requirements of form 10-K and the accounting rules governing preparation of reports on that form.

Another proxy-solicitation precaution should also be mentioned: Section 14(b) of the Exchange Act empowers the Commission to adopt rules governing the manner in which broker-dealers give proxies on listed securities carried for the account of customers. Presumably because the Commission has no authority to compel the actual giving as contrasted with the manner of giving such proxies, and because the principal exchanges have adopted pertinent rules, the section 14(b) powers have never been exercised. The exchange rules need not be evaluated to conclude that corresponding rules should be adopted by the NASD. They are needed now, but will be indispensible when section 14 applies to unlisted securities. The recommended legislation should also confer on the Commission adequate reserve powers in respect of both listed and unlisted securities.

Finally, it is also appropriate to refer to the question posed in the case of *Blau* v. *Lehman*, 368 U.S. 403 (1962), in which the Commission urged a reading of section 16(b) to cover the full insider-trading profits of a partnership, a member of which serves as a corporate director subject to the section, rather than merely the single director-partner's proportionate share. In this case the Supreme Court felt compelled to reach the more limited result because the partner-director had not been "deputed" as such by the partnership and had not known of the transactions in the corporation's stock until after the first of them was made, and the statute, as the Court interpreted it, did not in the circumstances makes the partnership a director. This conclusion left a large loophole in the insider-trading ban, since houses like Lehman Bros. are frequently represented on many boards and the limitation of section 16(b) to merely one partner's share of profits may conceivably permit all to benefit from each one's inside information at the cost of relatively insignificant forfeitures. To leave the protection of the section dependent on piercing the murky questions whether a partner has been "deputed" to act as director on behalf

of his firm and whether or to what extent he has had a hand in its insider transactions is inconsistent with the rationale on which the section is based.

The Supreme Court decision was based, of course, on statutory interpretation rather than consideration of policy. The arguments of policy should therefore be presented to Congress, as the Supreme Court suggested, and *Blau* v. *Lehman* should be reversed by appropriate statutory amendment.

9. IMPROVED DISSEMINATION OF OFFICIALLY FILED INFORMATION

As pointed out in another connection in chapter IV, required disclosures under the Securities Act are of two kinds, those intended for actual transmittal to investors—essentially prospectuses and proxy statements—and those merely required to be filed publicly—including reports of issuers under section 13 and of insiders under section 16(a) of the Exchange Act. The virtues of mere public filing of specified information, under the statutory sanctions, should not be discounted: Undoubtedly it has great prophylactic effect on those required to disclose; at least the true professionals in the financial community can be expected to use and understand it; and in various ways and varying degrees it does reach members of the general investing public. Nevertheless, to the extent that disclosure is unused and unheeded, its ultimate purpose is frustrated. The Commission and the self-regulatory agencies could go further in fostering, in various ways, wider dissemination of publicly disclosed information and its more consistent use in selling and advisory processes.

Taking the later first, it is recommended in chapter III that the reservoir of filed information about an issuer—and after extension of sections 13, 14, and 16 as recommended above, this would include issuers of OTC-listed as well as exchange-listed securities—should be required to be used to a greater extent in research, advisory and selling activities, and that the obligations of broker-dealers and investment advisers in this regard should be appropriately defined from time to time by the Commission and other regulatory authorities. It is suggested, for example, that broker-dealers and investment advisers who sell or recommend specific securities ought to be under an appropriately described obligation to consult officially filed information where available and to make copies available to their customers. These few thoughts, however, do not necessarily exhaust the possibilities that may exist for bringing the statutory disclosure processes into more active and meaningful use in connection with advisory and selling activities.

A still broader point is that wider dissemination or at least wider availability of filed information ought to be generally fostered. Today's advanced techniques for speedy and inexpensive communication and duplication of the printed word make quite obsolete and inadequate the present system—essentially unchanged for a generation—of requiring "public" filing in but one or two locations and providing copies only with considerable delay and at substantial cost. It would seem perfectly feasible to establish a system whereby filed reports of issuers would immediately be duplicated and distributed, for example, to all regional offices of the Commission and district offices of the

NASD and, upon request and at a nominal charge, to any broker-dealer or member of the public. It should even be possible to standardize the physical presentation of reports sufficiently so that up-to-date information about an issuer could be made available in some kind of looseleaf form in the manner of present privately published services. The possibilities would seem to be numerous and varied and at least some of them should prove, now or in the foreseeable future, well within the bounds of practicality. With minimum burdens, the benefits of bare filing might be multiplied greatly through imaginative measures of this kind.

In other respects, too, the general goal of fostering public awareness and use of disclosed data in making investment decisions should be a continuing and active concern of the regulatory authorities, so that maximum benefit may be derived from the disclosure which it is the basic purpose of the Federal securities laws to provide. For example, continuous educational measures of various kinds, to advise the public of what prospectuses are designed for and what they contain, what kinds of reports of issuers are publicly available, and why their contents or particular portions need be read and heeded, would seem to be an appropriate or even necessary function of the Commission.

10. SUMMARY, CONCLUSIONS, AND RECOMMENDATIONS

Disclosure is the cornerstone of Federal securities regulation; it is the great safeguard that governs the conduct of corporate managements in many of their activities; it is the best bulwark against reckless corporate publicity and irresponsible recommendation and sale of securities. In light of such considerations, it seems wholly indefensible, in terms of logic and of public policy, that most investors in over-the-counter securities should be afforded drastically less protection than is provided for investors in exchange listed securities through sections 13, 14, and 16 of the Exchange Act. It is also highly anomalous that market allocations (in the sense of selections between exchange markets and over-the-counter markets) should be importantly affected by a sort of Gresham's law whereby many issuers may avoid the protective measures applicable to all listed securities by simply electing to have their securities traded over the counter. Issues traded in over-the-counter markets are far too numerous and important—partly as a result of this Gresham's law—to permit the present anomalous distinction to continue.

Investors in all exchange listed securities are afforded protection both by statute and by rules of various of the exchanges. The Exchange Act requires full information about an issuer to be disclosed in a publicly filed application for registration before securities of the issuer may be listed for trading on an exchange, and requires the information to be kept current by subsequent periodic and current (special) reports (sec. 13). It also requires that complete information be supplied shareholders in accordance with Commission rules when proxies are solicited (sec. 14). Finally, the Exchange Act controls the use of confidential corporate information for personal gain by requiring public disclosure of insiders' transactions in the equity securities of their corporations and providing for the corporate recovery of resulting "short-swing" profits.

Statutory protections are supplemented by the exchanges. The principal New York exchanges, for example, in their listing agreements require all listed companies to disseminate independently audited financial statements to share holders annually, and require most companies newly listing securities to publish quarterly statements of earnings as well. The New York Stock Exchange also requires listed companies to solicit proxies for all meetings of shareholders. The American Stock Exchange is in the process of extending the same requirement to all of its issuers of listed issues. Certain of the regional exchanges provide the same or similar protection.

By contrast, comparable protections in the over-the-counter market are provided for only limited classes of securities and, for some of those, only in part. A vast number of issuers of over-the-counter securities are not required to file reports or to furnish their shareholders with adequate information when proxies are solicited, nor are they subject to insider-trading controls. A limited number of issuers are subject to reporting requirements only, by reason of a prior public offering, and a limited number are required to supply shareholders with annual financial statements in order to have securities eligible for the retail quotation lists of the NASD, but even these partial protections apply to securities comprising only a small part of the over-the-counter market. Viewed as a whole, that market presents a striking regulatory disparity with exchange markets.

The disparity and the need to eliminate it have long been recognized. When Federal securities laws were first enacted, Congress itself expressly provided for "comparable protection" and various studies since then, which the Special Study has confirmed, have demonstrated the need. Legislation to accomplish the desired end has been proposed in the past, but has failed of adoption at least in part because of unresolved questions as to its scope of coverage. Indeed, the open questions in this area cannot be questions of principle as to whether or not the protections are desirable, but only questions of where lines should be drawn in the light of practicalities.

The Special Study attempted to assemble data that would be helpful in determining the scope of remedial legislation. It is established law that an offering may be "public" for purposes of the registration requirements of the Securities Act, whatever the number of persons involved, if the circumstances are such that the protections afforded by registration are needed. By parallel reasoning, if securities are already traded in public markets, the protections of sections 13, 14, and 16 theoretically should not depend on the size of the issuer or the number of its security holders. Nevertheless, practicalities of administration made it advisable to seek data bearing on the number of companies that would be affected by various coverage criteria and some of the characteristics of those that might be included and excluded.

A comprehensive survey of issuers of over-the-counter stocks—more comprehensive than any before attempted—leads to the conclusion that a number-of-shareholders criterion of coverage (the kind of standard principally adopted in prior legislative proposals) is both most theoretically sound and most workable. Comparisons of corporate characteristics and numbers of shareholders of the corresponding issuers show that a clear relationship exists between shareholders

size and the apparent degree of trading activity indicated by numbers of transfers of record and frequency of broker-dealer quotations. Little, if any, relationship between either of the foregoing and asset size is apparent. In the light of the detailed data set forth, including estimates of the total number of companies affected, a coverage standard of 300 shareholders is indicated. Administrative needs, however, suggest a phased program of reaching that standard gradually by at first adopting a higher figure and progressively lowering it as administrative means are made available.

The potential impact of section 16(b), the insider-trading provision, on broker-dealers who both maintain dealer markets in securities and sit on the corresponding corporate boards of directors appears to have been greatly exaggerated. Only a small segment of all over-the-counter issues are involved; many broker-dealers, if faced with the choice of resigning as director or abandoning a trading market, would doubtless choose to resign rather than cease trading; and except in a very rare case it is difficult to conceive of any individual's indispensability as both director and market maker. Nevertheless, if such indispensability can be affirmatively shown, the Commission should be empowered to grant exemption from section 16(b). A general exemption for market-making transactions would be unwarranted.

Over-the-counter securities which are made subject to sections 13, 14, and 16 will be a special and distinct segment of over-the-counter securities for many regulatory and business purposes. To distinguish them appropriately, a designation such as "OTC listed" should be officially recognized. Issuers not subject to mandatory compliance with sections 13, 14, and 16, should be permitted to have their securities "OTC listed" by electing to comply.

Apart from extending existing protections for listed securities to over-the-counter securities, improving the existing protections in certain respects and wider dissemination of officially filed information would be desirable in any event.

The Special Study concludes and recommends:

1. Sections 13, 14, and 16 of the Exchange Act should be extended to issuers of unlisted securities, in the first instance to all issuers having 750 or more equity security holders of record and/or known beneficial holders, and, thereafter as rapidly as feasible to all issuers having 300 or more such holders, subject to the exemptions and exemptive powers recommended below. An issuer once subject to sections 13, 14, and 16 should continue to be so despite the fact that its number of equity security holders falls below 300 from time to time and should be relieved of compliance only after that number falls to and has remained at or below 200 for (say) 2 years, and thereafter only so long as the number remains below 300.

2. Section 15(d) of the Exchange Act is based on the principle that an issuer entering the public markets for capital should undertake continuing obligations to investors in those markets, if the amount of the issue (plus other securities of the same class) is at least $2 million. Under the recommendation made above to extend sections 13, 14, and 16 to all over-the-counter issuers that have 300 equity security holders a different and more embracing practical standard will become applicable, whether or not the

issuer undertakes a new public offering. Since a phased approach to the ultimate coverage recommended is proposed on purely practical grounds, however, and since it does not appear to be impractical immediately to apply the ultimate standard to all issuers hereafter making a public offering, section 15(d) should be amended to apply the protections of sections 13, 14, and 16 to every issuer making a public offering and thereafter having 300 or more equity security holders. Issuers of future regulation A issues should be similarly provided for by appropriate amendment of the applicable regulations.

3. Since extension of sections 13, 14, and 16 to over-the-counter issuers will make their securities prima facie eligible for unlisted exchange trading privileges under section 12(f)(3) and it would be better to leave determination of the principal market in which an issue is traded to competition among markets and issuers' preferences, section 12(f)(3) of the Exchange Act should be concurrently repealed. Rule 12f-4, which exempts from sections 13, 14, and 16 issuers of issues granted unlisted trading privileges pursuant to section 12(f)(1), should be amended so that the exemption will be available only where the number of shareholders is less than the prevailing criterion for over-the-counter securities.

4. In principle, the recommended legislation should not exempt any category of issuers merely because they file reports or are otherwise regulated under other laws, unless such reports or other regulations are clearly designed for the protection of investors (as distinguished from consumers, policyholders, depositors or other categories) and do in fact provide protections reasonably equivalent to those of the Exchange Act. The legislation should expressly exempt only securities already defined as "exempted securities" by section 3(a)(12) of the Exchange Act (essentially Federal, State and municipal securities) and securities of nonprofit organizations, but the discretionary exemptive power granted to the Commission by section 3(a)(12) should be available to enable it to exempt other categories upon a finding that their inclusion is not required in the public interest or for the protection of investors. The Commission should, as is now the case with respect to listed securities, permit any issuer filing data with any other Federal or State regulatory agency reasonably comparable to those required under section 13, to file copies of such data in lieu of data otherwise required under section 13.

5. There is no need for a general and broad exemption from section 16(b) requirements (relating to "insider" trading) in respect of broker-dealers making markets in securities of issuers on whose boards of directors they are represented. Entirely apart from the merits of broker-dealers' services on corporate boards generally, the combination of making a market in an issue (as "sponsor" or otherwise) and representation on the board of the issuer appears to be in most, if not all, circumstances an unnecessary one; and when consideration is given to the potential conflicts of interest inherent in the combination,[104] the balance clearly does not lie in favor of a general and broad exemption.

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[104] See ch. III.F.

To provide for any truly exceptional circumstances or instances (possibly, e.g., for a limited period of time after a first public offering and/or in the case of geographically restricted markets) the Commission should be empowered to provide limited exemptions on an affirmative showing both of unique need of the issuer or class of issuers and necessity and appropriateness in the public interest and for the protection of investors.

6. Since it is contemplated that some issuers of securities in over-the-counter markets will, and others will not, be required to comply with sections 13, 14, and 16, the distinction will and should become a highly important one for many purposes; see, for example, paragraph 5 of conclusions and recommendations under chapter III.B, paragraph 1 under chapter IV.F, and conclusions and recommendations under chapters VII and X. The term "OTC-listed" is suggested as a distinguishing hallmark for any over-the-counter security the issuer of which is required to comply with sections 13, 14, and 16. The legislation should expressly permit any other issuer to elect to comply, and thereby to bring its securities within the "OTC-listed" category.

7. Both in their present application to exchange-listed securities and in their proposed application to "OTC-listed securities, sections 13, 14, and 16 or the regulations thereunder should be amended to provide improved protections in certain particulars: (a) Except in extraordinary circumstances, to be defined, financial statements included in reports to stockholders accompanying or preceding proxy solicitations should be required to be prepared and presented on substantially the same basis as the financial statements in officially filed reports; (b) appropriate rules with respect to broker-dealer transmission of proxy-soliciting material should be adopted by the NASD and section 14(b) of the Exchange Act should be amended to empower the Commission both to compel the giving and to control the manner of giving proxies on customers' securities, both listed and unlisted; (c) section 16(b) should be amended to permit recovery of short-swing profits of a broker-dealer firm where one of the principals is a director, "reversing" *Blau* v. *Lehman*.

8. If disclosure of information is fundamental in Federal securities regulation, the widest possible dissemination and use of filed information will obviously best serve the purposes of disclosure. In light of modern techniques for duplicating and communicating the printed word, it would seem that dissemination and not mere filing should be required in many instances. For example, just as there are now unofficial services that regularly distribute summaries of data concerning individual securities, it would seem feasible to require officially filed information to be presented in form for inexpensive duplication and distribution. It would also seem possible to require that copies be filed in appropriate Commission or NASD offices and/or that broker-dealers making markets or recommending purchases have copies on file or actually distribute them to customers in stated circumstances. The technical and economic feasibility of such measures and the advances in investor protection that they would make possible should receive immediate and continuing study by the Commission and the self-regulatory agencies.

C. Corporate Publicity and Public Relations

1. INTRODUCTION

Informal corporate publicity is an important supplement to the disclosures required by the securities acts. In order to keep shareholders, the investment community, and the general public continuously informed of corporate developments, it is desirable for issuers to disseminate publicity through the channels of news distribution as well as by other means. This fact has been recognized by the Commission, which has encouraged publicly held corporations to employ publicity and public relations for these purposes.[105] One authority recently stated:

> Corporations have come a long, long way in the last 35 years or so in making information available for the use of stockholders and the investment fraternity generally. The widespread ownership of U.S. corporations deepens the necessity for better and more timely corporate disclosure.[106]

Since the 1930's, a specialized industry has grown up to meet the demand for professional services in handling corporate publicity. In general, the financial public relations consultant is responsible for communications from publicly held companies to their stockholders and the financial community.[107] Although there are no reliable statistics on the size of the financial public relations industry, there is evidence that its growth has been rapid during the last few years. The 1962 edition of the Financial Publicists Directory, published by the Investment Dealers Digest, lists approximately 600 firms, an increase of 23 percent over 1961.

The growing recognition of the need for keeping stockholders and investors informed of corporate matters has been marked by a greater flow of useful information from publicly held companies. At the same time, abuses of the financial public relations function have become increasingly evident. In recent years, and particularly during the speculative bull market that preceded the 1962 market break, the Commission and its staff have become aware of disturbing signs that public relations consultants and corporate public relations departments have been used for purposes contrary to the letter and the spirit of the securities acts. In a widely publicized case, the Commission found that publicity had been used illegally as a selling device in violation of the registration and prospectus requirements of section 5 of the Securities Act of 1933.[108] Several instances have come to light in which it has appeared that misleading publicity has directly affected the market price of securities.

For these reasons the Special Study decided to include the subject of financial public relations activities as part of its study and investi-

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[105] "There has been an increasing tendency, particularly in the period since World War II, to give publicity through many media concerning corporate affairs which goes beyond the statutory requirements. This practice reflects a commendable and growing recognition on the part of industry and the investment community of the importance of informing security holders and the public generally with respect to important business and financial developments. This trend should be encouraged * * *." (Securities Act release No. 3844 (Oct. 8, 1957)).

[106] Anderson, "Corporate Reporting for the Professional Investor: What the Financial Analyst Wants to Know" (1962) (sponsored by the Corporate Information Committee of the Financial Analysts Federation).

[107] One practitioner gave the following definition: "Financial public relations is public relations designed to influence the attitudes of the financial community. * * *"

[108] *In the Matter of Carl M. Loeb, Rhoades & Co. and Dominick & Dominick*, 38 S.E.C. 843 (1959); see also *In the Matter of G. J. Mitchell, Jr., Co.*, Securities Exchange Act release No. 6433 (Dec. 13, 1960).

gation of securities markets. The study did not consider it necessary or feasible to make an exhaustive survey of prevailing corporate practices or of the financial public relations industry generally. It was instead determined to make an intensive study of the financial public relations activities of a small number of companies in order to obtain examples of differing concepts and practices and to identify current or emerging problems. For this purpose a questionnaire was mailed to 46 issuers, all of which were believed to have conducted significant financial public relations activities or whose common stock had extreme price fluctuations during the past 2 or 3 years. While the companies selected therefore are by no means a typical group of publicly owned issuers, an effort was made to obtain a reasonably broad cross section from the point of view of size, industry, and principal market on which the companies' common stock was traded. The questionnaire [109] sought information concerning financial public relations activities by or on behalf of the companies and requested the companies to furnish copies of certain news releases and reports to stockholders distributed during the period under consideration.

After this material had been received and analyzed, five of the companies whose activities stood out as demonstrating current or emerging problems of financial public relations practices were selected for further study. Trading data and other records were obtained with respect to these companies; and company officials, public relations men, brokers, and others were questioned under oath.[110] Another questionnaire [111] was sent to several hundred investors who had purchased stock of several of the companies, in order to determine the motivation for their purchases. Additional data concerning these and other companies, and concerning public relations practices generally were gathered through an examination of Commission records and by informal interviews with several public relations men, members of the financial press, and securities analysts.

The study did not examine the use of publicity in proxy contests. The financial public relations industry is deeply involved in these contests, in ways which are frequently a matter of concern to the Commission.[112] However, it was felt that this area, which is already the subject of detailed regulation,[113] presents special problems which are

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[109] A copy is attached as app. IX–B.

[110] The five companies and their principal markets are Avnet Electronics Corp. (NYSE), BarChris Construction Corp. (Amex), Chemtree Corp. (OTC), General Development Corp. (Amex), and Technical Animations, Inc. (OTC). In addition, a certain amount of similar data was obtained with regard to Curtiss-Wright Corp. (NYSE), Guardian Chemical, Inc. (OTC), the Lionel Corp. (NYSE), and Universal Controls, Inc. (Amex).

[111] A copy is attached as app. IX–C.

[112] Commission concern over publicity techniques in proxy solicitation is reflected in the following statement by a former Chairman:

"A large number of the more difficult problems in any proxy contest result from the fact that a considerable proportion of the corporation's outstanding shares are often held in street names and their ownership is constantly changing. No longer can participants in a proxy contest rely on being able to communicate with the beneficial owners indirectly through the solicitation of stockholders of record. As a result, the use of paid advertisements, prepared press releases, press conferences, and radio and television broadcasts, has become common in attempting to reach stockholders and to sway the opinion of the public and persons who may advise or influence stockholders with respect to giving, revoking or withholding proxies" (Gadsby, "Public Relations Counsel and the Federal Securities Laws," speech made to the New York chapter of American Public Relations Association, New York, N.Y., Apr. 8, 1958).

[113] Sec. 14(a) of the Exchange Act makes it unlawful, with respect to listed securities, to solicit proxies in contravention of Commission rules; and rule 14a–9 prohibits false or misleading written solicitations. Under rule 14a–6, material used in solicitation must be filed with the Commission for comment before it is distributed, except for "speeches, press releases, and radio or television scripts," which must be filed with or mailed for filing to the Commission "not later than the date such material is used or published."

beyond the scope of this general survey of financial public relations activities.

It is difficult to estimate how widespread are the questionable practices described in this subchapter of the report. There is evidence that a substantial number of issuers and financial publicists have engaged in them, and that they pose serious problems. Nevertheless, there is reason to believe that many companies and their publicity agents conduct their activities in this area with restraint and propriety. The discussion which follows therefore should not be regarded as an exhaustive description of financial public relations activities by American corporations, nor should the more questionable activities described be regarded as typical, even though to the extent that they do exist, they are far from being inconsequential.

2. THE FINANCIAL PUBLIC RELATIONS INDUSTRY

The emergence of financial public relations as a distinct "industry" is of relatively recent date. DeWitt Conklin Organization, Inc., and Gartley & Associates, Inc., two of the oldest firms doing only financial public relations, entered the field during the late 1940's. A number of other prominent public relations firms are older, but many of these only recently began doing financial public relations. During the last few years, and especially since 1959, there has been a proliferation of new firms.[114] Many financial public relations firms, however, have lost substantial amounts of business since the 1962 market break. The reason they generally give for this is that most issuers regard their services as a "luxury" which can conveniently be forgone when budgets must be cut. Another reason may be that corporate publicity, as will be shown below, has been used to raise security prices; this can be done, however, only to the extent that the general public displays a willingness to enter the market.[115]

Most financial public relations firms are quite small. DeWitt Conklin has 10 account executives; Wall Street Consultants, Inc., has 4; several others, such as Wyle Associates, Inc., and Samuel Weiss & Associates, Inc., are essentially 1-man organizations though many include several writers and assistants depending upon the degree of success which they have achieved. Some of the larger public relations firms today have separate departments to handle financial publicity, and a number of large corporations have employees who specialize in communications with stockholders and with the financial community. General Development Corp., for example, has a director of corporate and industrial development whose duties are principally in the area of financial public relations.

Many financial public relations men have backgrounds as journalists or financial writers.[116] According to the financial editor of one

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[114] See Financial Publicists Directory for years 1959–62.

[115] See sec. 3, below.

[116] Some practitioners have observed that many unqualified persons have recently entered the financial public relations field. See McIntyre, "Financial Reporting Has Opportunities," Editor & Publisher, Aug. 18, 1961, p. 42; address of Weston Smith to Publicity Club of Boston, Apr. 4, 1962 (reprinted in Commercial & Financial Chronicle, May 3, 1962, p. 25). These observations may be true, but most of the financial public relations men interviewed in the course of this study had journalistic or financial experience, or both. A notable exception was the account executive of the firm representing one issuer, who had no background or experience in the financial field and who was selected for the job because he was the only male in the firm, which generally specialized in using public relations to help people who wished to be accepted into "society."

New York newspaper, the loss of staff members to the more lucrative financial public relations field is a constant problem. Experience and familiarity with financial writing are, of course, valuable assets to any financial public relations man. There is, however, another reason why firms draw their talent from the financial press: personal associations and contacts are of great importance in this field. One practitioner testified, "Contact is an important part of our business, and the more contact you have, the more valuable your organization becomes." Many firms, in their selling literature designed for prospective clients, emphasize that their close working relationship with the financial press enables them to "place" articles concerning their clients in the financial pages of newspapers and magazines. Bozell & Jacobs, Inc., claims that it—

> has continuing personal contact with the people who write for and who edit financial news magazines and papers, as well as weekly news magazines and business and trade publications * * *. Constant contact is maintained with the editorial personnel of investment and financial magazines. It is generally possible to place newsworthy material with these media for publication.[117]

Other financial public relations men are former securities analysts. Personal contacts and associations with those who write and distribute investment advisory material are also considered important by the financial public relations industry. One practitioner states that the fact that his firm includes members of the New York Society of Security Analysts is a "talking point with clients."

Fees charged by financial public relations firms vary greatly. Some firms that merely write news releases and perhaps aid their clients in the preparation of annual reports charge as little as $250 per month. On the other hand, one firm charged as much as $6,000 a month for a variety of services, probably including some that cannot be classified as financial public relations. The average fee for complete financial public relations service, including preparation of reports to stockholders and news releases, arranging of addresses before analysts' groups, and general maintenance of contact with the financial press and the investment community, amounts to between $1,000 and $1,500 per month. Most contracts for public relations services also provide for the payment of expenses for printing, mailing, entertainment, travel, and similar items.

Some financial public relations firms receive all or part of their compensation in options to purchase stock of their clients. This practice can be criticized on the ground that it gives the publicist an incentive to try to increase the price of the client's stock rather than to disseminate unbiased corporate information. The results of this study indicate that, while the practice of paying publicists' fees in options is not prevalent, it nevertheless does exist. Of the 46 companies that received questionnaires, only 5 had paid their financial public relations firms wholly or partially in stock options. It is the policy of some firms not to accept options so as to avoid any conflict between their interest in monetary gain and their obligation to disseminate honest publicity. Other firms defend stock options on the ground that they enable small and little known companies to obtain the services of firms which they could not otherwise afford.

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[117] Bozell & Jacobs, Inc., "An Estimate of Financial Relations," pp. 5–6.

It is not unusual for public relations men to trade in the securities of their clients, acquired either through the exercise of options, purchase from the company or corporate insiders, or purchase on the open market. During 1961 the principals in the financial public relations firm of Wall Street Consultants, Inc., had personal transactions in the securities of 6 of the firm's 18 clients. Samuel Weiss, although he has stated that trading by public relations firms in the securities of their clients is an abuse that should be regulated, has accepted stock options as a fee from at least one client, Harvey Stores, Inc. These options were never exercised, since the price of the stock went down. Weiss also purchased $30,000 face amount of BarChris convertible debentures at the offering in May 1961 and sold them shortly afterward at a profit of 12 or 13 points. During this time, Weiss was preparing and issuing publicity releases and reports on behalf of BarChris. Harold Wolff, public relations consultant for Technical Animations, Inc., received options to purchase 15,000 shares of the company's stock at a price of $2,375 and 10,000 shares at $3,453, in payment for his public relations services for 2 years. In April 1961 an article concerning the company appeared in Time magazine and the stock rose sharply. Shortly after the appearance of the article, Wolff exercised options to purchase 1,700 shares which he sold on the market at prices ranging from 9¾ to 11¾.[118]

So far as is known to the Special Study, the most active trader among public relations men was Jerry Finkelstein, president of the public relations firm of Tex McCrary, Inc., until its dissolution in May 1961. Finkelstein purchased 20,000 shares of the common stock of Universal Controls, Inc. (then called Universal Products Co., Inc.), in April 1958 in a private sale for $500,000. During 1959 and 1960, while Tex McCrary, Inc., acted as public relations consultant for Universal Controls, Finkelstein sold almost all of these shares on the open market for a total consideration of approximately $2,600,000. In April 1958, Finkelstein also purchased 15,000 shares of the common stock of General Development Corp. (then called Florida Canada Corp.), another client of the firm, at a price of $9.50 per share. The stock closed at 14⅝ on the American Stock Exchange on the date of the purchase. In May 1961, after General Development had ceased to be a client, Finkelstein sold just under half of these shares, purchased for $70,300, to the Oppenheimer Fund for $263,625. Both of these blocks came to Finkelstein's attention through an individual who was a principal stockholder, director, and officer of both companies.

The above examples of trading by public relations men in the securities of their clients are set forth not to imply manipulative or any other improper intent on the part of these persons, but only to demonstrate the conflicts of interest present in such situations. Since the publicists are under no obligation to disclose their financial interests in issuers, neither the press, the financial community, nor the public may be aware that corporate information which they receive comes from an interested source.

Several firms not only do financial public relations, but offer their clients a variety of other services which are generally termed "financial consulting" or "management consulting." These services include

[118] See sec. 3, below.

advice on the composition of boards of directors, assistance in negotiating mergers or acquisitions, and finding of new financing. One practitioner grossed approximately $100,000 in finders' fees during 1961 and 1962 for arranging underwritings and private placements of securities, acquisitions of companies or product lines, and business leases for his clients.

Some financial public relations firms apparently have informal arrangements with underwriting firms whereby the underwriter recommends the public relations firm to issuers and the public relations firm reciprocates by bringing the underwriter together with those of his clients who are looking for new financing. For example, Wyle Associates, Inc., a public relations firm retained by Avnet Electronics Corp., arranged for Hemphill, Noyes & Co., to underwrite an issue of securities for Avnet. Subsequently, partners of Hemphill, Noyes who were members of the boards of directors of other publicly held companies were instrumental in Wyle's being retained as public relations consultant by these companies.

Samuel Weiss, who also has such reciprocal arrangements with underwriters, was paid for his services on behalf of BarChris Construction Corp. not only by the client but also by its original underwriter, Peter Morgan & Co., which had recommended him to the company. The compensation from Morgan consisted of warrants to purchase 900 shares of BarChris common stock at $3 per share. Weiss exercised these warrants in early 1962, when the market price of the stock was $9.

3. PUBLICITY AND SECURITY PRICES

It is hardly open to question that corporate publicity can have a powerful effect on the prices of securities. By virtue of his access to the financial press and investment advisers, the financial public relations man often has the ability to increase (or decrease) the market prices of the securities issued by his clients.

Members of the industry who were interviewed in the course of this study denied that their purpose was to affect prices. One practitioner stated the general attitude as follows:

> I don't think any program should be tied to the price of the stock. I think anybody in financial public relations who does anything to affect the price of the stock is treading on a very fine line of what is right and what is wrong.

Financial public relations men insist that their principal purpose is to disseminate the facts concerning their clients so that they will become better known to the financial community and will thus be in a better position to obtain new financing. Without an effective public relations program, one corporate official states, "We might be doing the best work in the world and nobody would know about us." [119]

Nevertheless, in their selling literature aimed at prospective clients, financial public relations men emphasize that one effect of a financial public relations program will be to increase the price of a company's common stock. They point out that the communication of a company's "story" to its stockholders and the investing public will result in a "full capitalization," "equitable evaluation," or "more realistic market appraisal" of the company's securities; and they state that

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[119] See Mellott, "Whys and Wherefores of a Public Relations Program," Commercial & Financial Chronicle, Dec. 29, 1960, p. 20.

companies that are well known to the financial community generally have a higher price-earning ratio than obscure companies of the same worth.[120] Whatever words are used, little doubt remains that their purpose is to increase stock prices. Indeed, some financial public relations men concede that they are salesmen of their client's stock. For example, one practitioner testified:

> The end result of our service is that people would be interested in the company and then desire, possibly, to buy their stock. This is no different than what we have been doing for 10 years before, when we sold products. We create a favorable image.

In outlining the services which he would perform on behalf of BarChris Construction Corp., Samuel Weiss wrote:

> It shall be the function of our office to interest significant brokers and underwriting houses to take a position in your company's stock, to foster sustained interest and, therefore, widen stock distribution.

Another financial publicist testified as follows:

> Q. What is your purpose in sending releases to analysts?
> A. I suppose you might say that we are generating an investment interest—investor interest, I might say—in the company.

Public relations firms promise their clients several advantages as a result of an increase in the price of their securities. The company will be able to obtain more favorable terms in any exchange of stock necessary to an acquisition or merger; future financings will be facilitated; stock options will have a greater value as incentives for management and as a means of granting competitive compensation; and the company will be better protected against proxy fights and raids.[121] The emphasis which the firms themselves place upon these incentives indicates that they believe them to be significant as a persuasive factor.

It cannot be ignored that, in addition to these corporate incentives to increase stock prices, members of company managements who own stock or options have a strong personal motive. Insiders of a few of the companies that were studied sold large amounts of stock at approximately the time of an intensive public relations effort. For example, between February and April 1961, the president of BarChris Construction Corp. and his wife sold 10,800 shares of BarChris stock, and the company's executive vice president sold 6,900 shares;[122] immediately before and during this period the company was disseminating extremely optimistic financial estimates and enthusiastic publicity concerning its alleged expansion into the European market. In April and May 1961, Alfred Globus, president of Guardian Chemical, Inc., and a corporation 100-percent owned by Globus, together sold 19,414 shares of Guardian stock. During this period, Globus was announcing

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[120] See, for example, Bozell & Jacobs, Inc., "An Estimate of Financial Relations"; bulletin on "Corporate Relations," published by New York Society of Security Analysts; Busch, "Corporations Must Promote Financial Public Relations," Commercial & Financial Chronicle, Mar. 23, 1961, p. 14.

[121] See sources cited at note 120, above. The Albert Frank-Gunther Law, Inc., program for one client stated:

"The long-term purpose * * * is to create an ever-increasing receptivity in the financial community to [your company] so that a more equitable evaluation of the company's securities will result in the marketplace. This is vital to [your company] for a number of reasons, the most important of which are: (1) The need to be better known and recognized in advance of any future financing, in order to obtain money as cheaply as possible, and (2) to enable the company to get more favorable terms in any exchange of stock necessary to an acquisition or merger."

[122] These sales were made on the American Stock Exchange at prices ranging from 13⅝ to 22¾. The stock had closed at 10¾ on Dec. 1, 1960 (prices adjusted for 2 to 1 split). The rise in price was probably caused in part by the public relations campaign described in sec. 5, below.

to security analysts and the press that a chemical developed by Guardian constituted a "breakthrough" in the chemical treatment of cancer. Guardian common stock rose from 2½ on April 3, 1961, to 14¾ on May 16, 1961. By June 30, 1961, it was down to 5¾; and by June 29, 1962, to 2¾.[123] Whether or not these insiders were motivated by the opportunities for profit when they authorized the releases of publicity by their companies, they clearly benefited from the increased prices that the publicity helped produce.

One of the most notorious recent examples of the use of financial publicity for purposes of personal gain was an attempt to *depress* the price of a security in order to cover a large short position. In June 1958, Alexander Rittmaster, financial consultant to Louis E. Wolfson, told a New York Times financial reporter that Wolfson and members of his immediate family were in the process of liquidating their holdings of some 400,000 shares of American Motors Corp. common stock, representing some 7 percent of the then outstanding stock. An article quoting a "spokesman" of Wolfson to this effect appeared in the Times on June 20, 1958.[124] In fact, by this date, accounts in which Wolfson or members of his family had an interest had already sold 464,100 shares and had acquired a short position of 172,400 shares. On Friday, June 20, American Motors fell ½ point to 12¼ on a reported volume of 92,000 shares, and on Monday, June 23, the stock fell to 11⅝ on a reported volume of 113,400 shares. On these 2 days, accounts in which Wolfson had an interest purchased 40,400 shares to cover short positions. Speedy injunctive action by the Commission had the effect of forcing Wolfson to disclose the true facts and delaying him from further covering his short position.[125]

The Wolfson incident demonstrates the effect that a single piece of publicity in a single newspaper can have on trading in a security. A skillful or lucky publicist is sometimes able to use one article or other item to generate others in a kind of snowballing effect. For example, Clement Wyle, public relations man for Avnet Electronics Corp., was able to interest the financial department of the New York Times in publishing a feature article on December 29, 1960, about a class of schoolchildren who owned two shares of Avnet stock and who attended the company's annual meeting. A writer for Investors' Reader, a magazine published by Merrill Lynch, Pierce, Fenner & Smith, noticed the New York Times article, and became interested in writing a report on Avnet; Investors' Reader, which is mailed to approximately 200,000 Merrill Lynch customers, ran an article about the company March 29, 1961. Avnet subsequently sent copies of the issue of Investors' Reader to all of its stockholders.

Perhaps the clearest demonstration in the course of this study of the ability of publicity to affect the price of a security, and of the dangers inherent in this ability, occurred where the publicity apparently was not generated by the issuer or its public relations man. The issuer was Technical Animations, Inc., a small company which owns the rights to a process by which animation or motion can be

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[123] Unless otherwise indicated, all prices of stocks traded over-the-counter are the highest bids reported by the National Quotation Bureau.

[124] According to Rittmaster, Wolfson was selling the stock because he planned to devote more of his energies to his duties at Merritt-Chapman & Scott Corp. Immediately after the article appeared, Wolfson was reported to have told a press conference that the figures quoted by his "spokesman" were "inaccurate." The effect of these remarks probably was to confirm the overall impression of the article.

[125] *S.E.C.* v. *Louis E. Wolfson,* U.S.D.C., S.D.N.Y. civ. file No. 135-30.

added to a slide or transparency without the use of conventional animation techniques. From the time of its incorporation in 1956 through the period under consideration, the company did not operate profitably in any year. For the year ending October 31, 1960, it had sales of approximately $367,000 and a net loss of $65,000. In the early part of 1961, its outstanding stock consisted of 200,000 shares of class A voting common stock and approximately 400,000 shares of class B nonvoting common stock. Officers and directors of the company held approximately 59 percent of the outstanding class A stock and approximately 19 percent of the class B stock. On March 31, 1961, the class B stock was priced at 4¾ in the over-the-counter market.

Early in April 1961, Joseph Purtell, senior editor in charge of the business-news section of Time magazine (he is no longer with Time), telephoned the company and expressed interest in it as a possible subject for an article in Time. According to Purtell's testimony, he had first heard about the company from his broker, Benjamin Weiss, a partner in the New York Stock Exchange member firm of Wineman, Weiss & Co., who had suggested that Technical Animations might be an interesting company to look into. Purtell subsequently had an interview with Harold Wolff, the company's public relations man, who demonstrated the company's process to him. On April 13 and 14, Purtell purchased 2,500 shares of Technical Animations B stock at prices of 6⅛ to 6¾ through Wineman, Weiss & Co. On April 18 Purtell assigned a Time writer and a researcher to prepare an article on the company. Between April 13 and 21, Weiss purchased 1,500 shares for his own account and an additional 4,500 shares for 4 of his regular customers at prices of 6⅛ to 7¾. By this time, word had leaked out in financial circles that Technical Animations was expected to be written up by Time, and on the basis of these rumors registered representatives of at least two brokerage houses were recommending the stock to their clients.[126] The full extent of the circulation of the rumors is unknown.

Apparently, as a result of these rumors and the consequent increase in the volume of trading, the price of the stock, which had been 6¾ on April 19, rose to 7½ on April 21 and 9¼ on April 24. The article appeared in the business-news section of the April 28, 1961, issue of Time, which became available on the Nation's newsstands late in the day on April 24, and on April 25. The stock continued to rise, reach-10⅛ on April 25, 12 on April 26, and 13½ on April 27. On that day, Technical Animations shares were purchased by members of the public for as much as 15⅛. During the first 3 days after the article appeared, Weiss and his 4 customers sold 4,700 shares, officers of the corporation sold 2,400 shares, and its public relations man sold 1,300 shares (acquired through the exercise of options), at prices from 9¾ to 13¼. The public relations man sold an additional 400 shares on May 3 at prices from 10⅝ to 11. On the following day Purtell sold 1,000 shares at a price of 11⅝. By May 31 the stock was down to 8¾. Purtell sold his remaining 1,500 shares on October 26, 1961, over 6 months after purchase, at a price of 5¼.[127] On December 31, 1962, Technical Animations class B stock was priced at 1¾.

[126] Six purchasers who were sent questionnaires by the Special Study replied that their brokers had told them that an article concerning Technical Animations would appear in Time. Two of these brokers were questioned under oath. One stated that he heard about the impending article from somebody to whom he gave a lift downtown in his car, while the other heard about it from a fellow broker who had been told about it at a party in Newark, N.J. Neither could remember the name of the informant.

[127] A chart of the price of Technical Animations stock during April and May of 1961 is attached as chart IX–e.

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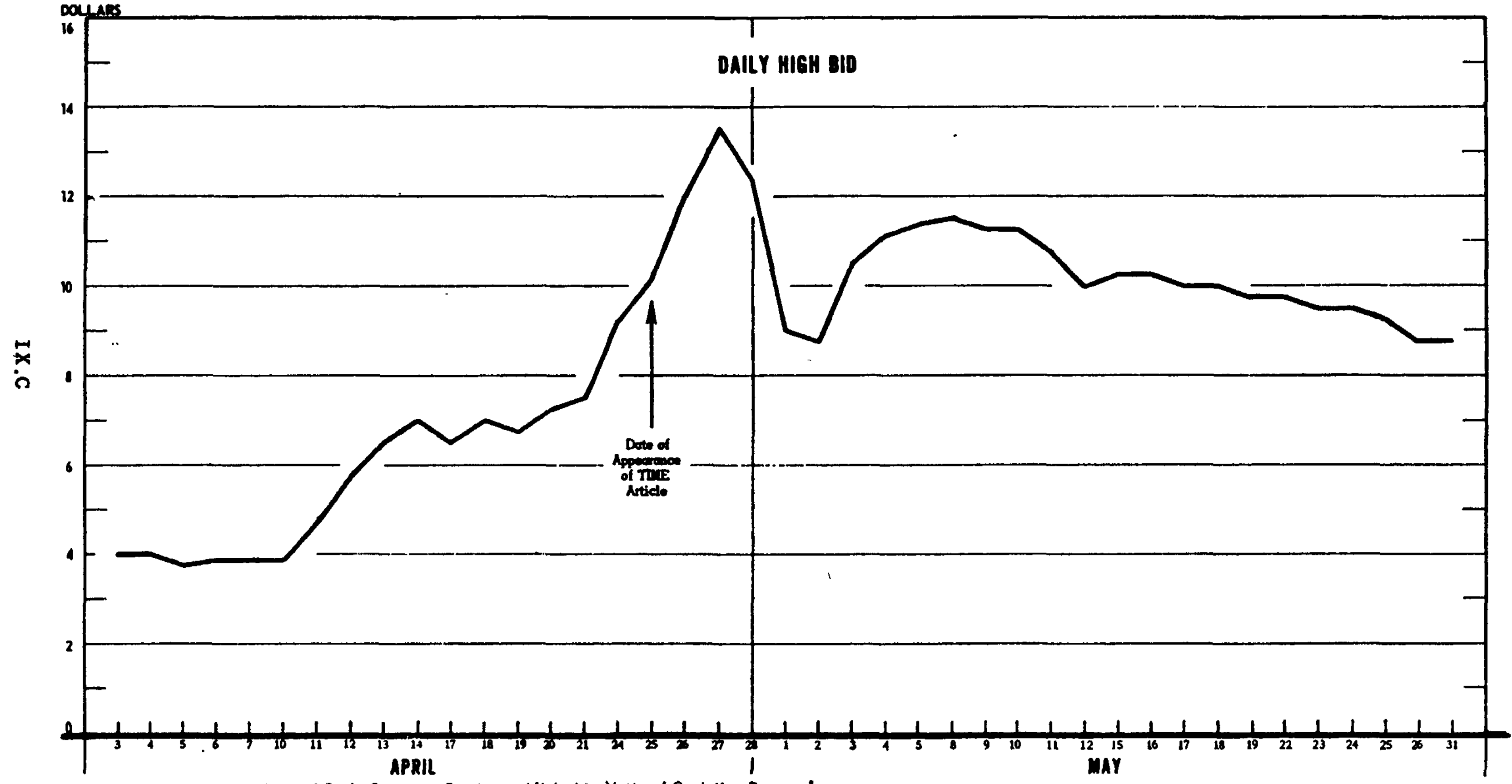
CHART IX–e

TECHNICAL ANIMATIONS, INC. Class "B" Common Stock

April - May 1961 *



* *Eastern Stock Section, National Daily Quotation Service, published by National Quotation Bureau, Inc.*

It is clear that the Time article was the principal cause for the rise in the price of the stock. Questionnaires were sent to approximately 300 customers who purchased the stock in April and May 1961, in order to determine their motives for investing.[128] The article was the determining factor for 101 customers out of a total of 160 who returned questionnaires and who made purchases after its publication. It is likely that many of the other 59 who stated that the stock was recommended to them by friends, acquaintances, or brokers were indirectly affected by the article in Time.

There were a number of reasons for the impact of the article. First, the article was unduly favorable, stating that the company's "sales have risen in 5 years from $7,000 to $600,000 this year," and that it "went into the black" in 1961. Sales for the year ending October 31, 1961, totaled approximately $450,000 and, although the company had earnings in one quarter of 1961, it had a small net loss for the year. Secondly, the volatility of the stock was undoubtedly increased by the fact that the country was in the midst of a speculative bull market; also, stocks of companies in the photographic and related fields were particularly popular with the investing public at the time. A third reason for the dramatic price rise was the smallness of the floating supply of the stock. The purchase before the publication of the article by persons who knew of the impending article contributed to the demand for the stock which helped to push the price up. Their sale of these shares shortly after the publication of the article no doubt contributed to and hastened the stock's rapid descent.

Technical Animations was not the only company in whose stock Purtell, Weiss, and Weiss' four customers had transactions of this nature. Between August 1957 and April 1961, Purtell had transactions in the securities of 64 companies, of which 27 were written up in the business-news section of Time. In each of the 27 cases he purchased the stock a few days or a few weeks before the date of the publication of the article concerning the particular company and he usually sold the stock within a few days following the date of publication. A substantial number of these companies were small and little known. In general, Purtell held the shares of companies not written up in Time for a longer period. He made a considerable profit from trading in stocks of companies that were written up in Time, since in most cases the price of the stock rose sharply upon the publication of the article or shortly before. Purtell's average purchase was about 1,000 shares, but in some cases he purchased considerably more, the largest purchase being 2,500 shares. His investment in each security was usually about $20,000, and on a few occasions it exceeded twice this amount. During this entire period Purtell was the business editor of Time. These transactions, which constituted a substantial part of Purtell's total trading, ceased abruptly at the end of April 1961, when Purtell's employment at Time terminated.

Purtell did all of his trading through Wineman, Weiss & Co. In the case of 16 of the 27 transactions, Weiss also purchased stock immediately before the article appeared and sold soon afterward. Purtell testified that prior to a number of these transactions, he may have discussed with Weiss the possibility that Time would publish an

[128] See app. IX–C.

article about the company. Weiss' four customers made similar transactions on several of these occasions.[129]

Purtell testified to the Special Study that he knew of no policy at Time which prohibited him from purchasing securities of companies about to become the subject of articles in Time. According to the editor-in-chief of Time, such a policy has existed since the magazine was first published, and any detected violation of it would have meant summary dismissal. The editor-in-chief further stated that Purtell's violations were not detected.[130]

In the course of this study, many additional instances were found in which corporate publicity appeared to have a direct effect on prices of securities. For example, on December 16, 1960, Samuel Weiss & Associates, Inc., public relations consultant for BarChris Construction Corp., and Edward Gottlieb & Associates, public relations consultant for Acme Missiles and Construction Corp., distributed 600 copies of a release to the business and financial press and 430 copies to research departments of brokerage houses, trade publications, and sports editors of New York newspapers, announcing that the 2 companies had formed an Italian subsidiary for the purpose of constructing and operating a series of bowling centers in Italy and other European countries. BarChris stock, which had closed at 23 on December 15, rose to 24¼ on December 16, to 25½ on December 19, and to 26⅞ on December 20. An even clearer example of the effect of publicity on prices is Chemtree Corp., whose common stock rose from 7/16 of a point on December 4, 1961, to 9½ on January 3, 1962, upon the announcement that the company had developed a new material for use as a shield against fallout radiation. By June 30, 1962, Chemtree stock had fallen to $2.

There are limits, however, on the ability of publicity to affect market prices of securities. A company whose claims and predictions for itself remain repeatedly unfulfilled, may, like the boy who cried "wolf," end up by being ignored. In February 1961, the public relations firm retained by the Lionel Corp. conducted an informal survey of Wall Street brokerage houses in order to find out how Lionel was regarded by the financial community. Some of the brokers' comments are extremely revealing as to the negative effects of an overenthusiastic public relations program. One broker's comment was:

> Right now, Lionel is selling for more than its earnings justify. Before it can go up again, Roy Cohn or General Medaris must pull a new rabbit from the hat. If this does not take place, the stock *will go down below the price it should sell at.* The reason for this is that much of the demand which caused the rise was based on hope. If the hope dies out, the buyer will remember only his disappointment, and he will sell regardless.
>
> We are staying out of the stock because there is too much *news* about things that then do not take place. I am not saying that any of these rumors originates with Lionel officers; they do affect the stock by making it too volatile for anyone but a floor trader to own. One of our account executives was following Lionel

[129] The 4 customers had transactions, respectively, in 20, 6, 5, and 3 of the 27 stocks at approximately the same time as Purtell's transactions.

[130] A written statement reflecting such a policy, which was distributed to Time employees on June 6, 1961, stated in part:

"*Profiting from special information.*—It has been a longstanding point of policy that no employee of Time, Inc., should try to profit (by buying or selling securities or otherwise) from special information that one of our magazines plans to carry a story or picture on a company. In the very unusual case of a staff member who holds a significant interest in a company and who might be assigned to work on a story about that company, his personal interest should be referred to the managing editor or his supervisor in advance."

closely, but the information he got contradicted itself so often that the partners called him in and told him to let it go. [Emphasis in original.]

Another broker said:

What I don't like is that we hear from time to time [an] acquisition is going to be made, and then we hear it is not. Simply having plans for good purchases is like you or I think about buying a stock that will go up in price. *Everybody* is thinking; the trick is to get it. [Emphasis in original.]

Corporate publicity can be used to accentuate but ordinarily not to reverse a market trend. For example, one public relations man testified:

The main thing, you can never buck a market trend. * * *

Q. But if there is a market trend in your favor, you can accent it?

A. Very definitely.

There can be no doubt that its potential upward effect on prices is greatest during periods in which the public is already infected with speculative fever and is eager to purchase securities. The publicity concerning BarChris referred to above came at a time when the bowling industry enjoyed great popularity with investors. A year later, when the interest in bowling companies had subsided, equally optimistic publicity which was distributed by the company did not reverse a downward movement in the price of its common stock. Likewise, the effect of Chemtree's publicity was no doubt increased by the Federal Government's announcement of the inauguration of a fallout shelter program and the public concern with protection from radiation which was in evidence in late 1961 and early 1962.

Material appearing elsewhere than in financial publications or on the financial pages of newspapers and magazines may have an influence on security prices. According to one financial public relations man:

You can actually influence the public to a much greater degree by having stories appear on other pages than the financial pages. Believe me, a story in Life magazine, Reader's Digest, can do more than 50,000 pages on the financial page * * *. If you distribute enough pencils with your name on them, it will influence the investor. He is not very bright.

The distinction between financial and product public relations is not always an easy one to draw. Publicity and advertising normally regarded as having the purpose of selling a company's goods or services may also affect the prices of its securities. For example, on February 23, 1961, General Development Corp. ran a full-page advertisement in the Wall Street Journal, the New York Times, the Chicago Tribune, and the Philadelphia Inquirer, describing the company's home-purchase plans at Port St. Lucie on the east coast of Florida. Its stock was the most actively traded on the American Stock Exchange on the day that the advertisement appeared, and it rose in price from its previous day's close of 12¼ to 14¼. By February 27, however, it had fallen back to 12⅛.

Conversely, the channels of financial public relations can be used for selling a company's products and for other business purposes.[131] Between March and May 1961, the president of Avnet Electronics Corp. addressed the New York Society of Security Analysts, as well as a

[131] According to one writer, good corporate publicity will help sell a company's products, "because it's only natural, when a choice is offered, to favor the products of those companies we like and in whose stock we have invested." Busch, "Corporations Must Promote Financial Public Relations," Commercial and Financial Chronicle, Mar. 23, 1961, p. 14.

smaller group of New York security analysts specializing in electronics stocks and groups of analysts in Chicago and Los Angeles; he was interviewed by many individual analysts; and the company mailed to all of its stockholders copies of favorable reports on Avnet which had been prepared by two large brokerage firms. According to the president, he was not concerned with the price of the company's stock, but he hoped to utilize the connections that some security analysts had with officials of major corporations in order to interest them in becoming licensees of the Shaw process, a method of casting metals of which Avnet owned the Western Hemisphere rights. Regardless of the president's intentions, the stock rose from 18⅞ on March 1, 1961, to 68½ on May 8, 1961. He concedes that this phenomenal rise was at least in part a result of the enthusiasm of the analysts which he played a part in generating. By the end of the year, the stock was down to 28½. Similarly, the president of Chemtree Corp. claims that his aim in seeking to persuade the financial press to write about the company's radiation-shielding material was to acquaint the public with it and to obtain licensees to produce it.

As these cases show, the motives underlying public relations activities may be of several kinds or may be mixed. In a given instance, the primary purpose may be to sell the company's products, increase its prestige in the financial community, increase the price of its stock for a future financing or merger, or a combination of these.[132] The essential point is that the investor who relies on publicity that is overenthusiastic or incorrect may be injured, regardless of the purpose of those who are responsible for it.

4. METHODS OF OPERATION

Many of the techniques and methods which the financial public relations industry uses to accomplish its purposes may be illustrated by a program mapped out for General Development Corp., a Florida land development company whose common stock is traded on the American Stock Exchange. This program was submitted by John F. Bonner, who was responsible for the company's financial public relations, to the officers of the company in January 1961, and a large part of it was subsequently carried out. Very few financial public relations campaigns include every activity suggested in Bonner's "proposed program," but it has the advantage of illustrating almost all of the techniques employed by financial publicists in recent years.

The program was divided into three parts, dealing respectively with relation with the investment community, relations with the financial press, and relations with stockholders. Under the first heading, Bonner recommended the following activities:

(1) Groups of security analysts should be invited to Miami and to the company's properties on a series of field trips.

(2) Senior partners of the investment firms which "can do us the most good" should be invited individually on similar field trips.

(3) A series of luncheons for small groups of investment people in New York and other northern cities should be arranged, at which officials of the company would speak and answer questions.

[132] Another motive for seeking to obtain publicity is egotism on the part of corporate officers. A public relations man states of one such individual: "He loved to see his name in print, whether it be on the financial page or the woman's page, or whatever page it may be."

(4) Luncheon or dinner meetings with Florida securities men should be held at least semiannually.

(5) "Top investment people" visiting Florida should be invited to the company's properties.

(6) "Pressure" should be placed upon the New York Society of Security Analysts to obtain a speaking date for company officials.

(7) Similar "pressure" should be brought to bear on analysts' societies in other northern cities.

(8) An attempt should be made to get company officials on "other key programs" such as the annual meeting of the Investment Bankers Association.

(9) Four of five of the best market advisory services should be persuaded to visit the company's properties.

(10) Full use should be made of members of the company's board of directors who have achieved stature in the financial community.

(11) An effort should be made to obtain speaking engagements with leading investment groups.

(12) More frequent trips to New York City should be made "in the interests of fence mending, arousing interest, answering current questions, etc."

The program recommended that the following steps be taken under the heading of "Relations With the Financial Press":

(1) More frequent financial press releases, such as releases on various aspects of the annual report before the report is published, should be issued.

(2) There should be better advance planning for the purpose of timing "financial-type" releases "more conveniently."

(3) "Pressure" should be applied to get one or more of the "very top people" of the Wall Street Journal to visit the company's properties.

(4) A series of luncheons for small groups of members of the financial press should be held in New York and other northern cities. Company officials should not let any visit to New York go by without getting together with "key financial newsmen."

(5) Full use should be made of company officials with national reputations in setting up interviews or holding luncheons with financial writers.

(6) Attention should be paid to finding outlets for the company's "corporate story" on other pages than the financial pages of newspapers, such as the women's page.

(7) A greater effort should be made to "place" stories of a technical nature in professional magazines such as banking and accounting publications.

(8) Company officials should make more frequent trips to New York and to other cities for "fence-mending contracts with the financial press."

(9) A policy should be devised for making a fast and full answer to any rumors which may hurt the company.

(10) Efforts should be made to interest financial editors of the Florida press in the company.

Under the heading of "Relations With Stockholders," Bonner made the following recommendations:

(1) A letter should be sent to stockholders giving preliminary figures on the "upturn of business" in the fourth quarter of 1960.

Unless the company was willing to make regular quarterly reports, however, this letter should be "disguised" as a news item.[133]

(2) A stockholder's magazine or newsletter on a monthly basis or quarterly basis should be published.

(3) The company should look into the advisability of holding regional stockholders' meetings which might take the form of luncheons in three or four key cities, such as New York, Philadelphia, and Chicago.

Bonner also recommended that the company run a series of "corporate image" advertisements which would "tell the General Development Corp. story in terms of customers, community growth, assets and other financial growth, economic impact on Florida, utility potential, how we differ from other land companies, what the stockholder owns in the way of equity, etc." These advertisements would be placed in the Wall Street Journal, Business Week, Barrons, and other financial publications. The program also recommended that Wyle Associates, Inc., a New York public relations firm whose contacts "appear to be exceptionally good in the financial and investment fields," be retained "to help put into effect during the coming year the various aspects of a full-scale corporate image program.* * *"

As the General Development program indicates, financial public relations men expend considerable effort on maintaining and improving their relations with security analysts. This is often done with a view to obtaining favorable mention of their clients in investment advisory material. Several instances were found in the course of this study in which publicists or corporate officials actually participated in the preparation of market letters which were distributed to the public as impartial investment advice, beyond checking for factual accuracy. For example, in the spring of 1961, Hemphill, Noyes & Co. prepared a detailed report on General Development Corp. and submitted it to the company for its comments. Several General Development officials worked on the draft, and an 11-page report containing 28 detailed suggestions and changes was sent back to the brokerage house, along with the notation that most of these comments—

> involve no corrections, but changes in wording or additions that * * * would add body, meaning, and overall understanding to your presentation.

A few weeks later, the research partner of Hemphill, Noyes replied:

> I have made all of the suggested changes and hope that it now meets with your approval.

The 8-page report, which gave a very favorable view of the company's prospects, was distributed to Hemphill, Noyes customers in July 1961, at a time that a registration for the public offering of 162,500 shares of General Development stock was pending before the Commission. Hemphill, Noyes was not a participant in the underwriting, and the research partner of the firm testified that he was not aware of its pendency.

There are other examples of publicity agents writing material which is sent to customers by brokerage firms. For example, in January 1962, a public relations man retained by Chemtree Corp. helped write

[133] Under the new policy of the American Stock Exchange, inaugurated in 1962, companies seeking now listings of securities are required to file quarterly financial reports. See also ch. IX.B.1, above.

a market letter of the brokerage firm of Hanson & Hanson which made several extravagant claims for the company's alleged new radiation shielding material.

DeWitt Conklin Organization, Inc., a financial public relations firm, prepares a "report" for each of its clients, which usually consists of a 4- or 6-page illustrated folder describing the client company, its securities, its management, and its prospects. These reports emphasize favorable information and may include highly optimistic projections of sales and earnings. DeWitt Conklin sends these reports to a master list of 18,000 members of the press, security analysts, and financial writers, together with an offer to imprint the name of the recipient's firm on the top of the front page of 500 or more additional copies of the report, at the expense of the issuer. A brokerage firm can thus, without cost to itself for research or printing, send out reports on DeWitt Conklin clients with the brokerage firm's name prominently displayed. These reports bear a legend in small type that:

> This report is released and distributed for and on behalf of the company in the interest of developing closer relations among the company, its stockholders, and the financial community. The information contained and any opinions expressed in this report are solely those of the management of the company.

Nevertheless, it is likely that the format of these reports leads many customers receiving them to believe that the brokerage firm is responsible for them. It is not unusual for 50 brokerage firms to request an average of 900 copies of a report to be imprinted with their firm names.

Personal contacts, both with the financial press and the investment community, are the very essence of financial public relations. In their selling literature, financial public relations firms emphasize the closeness of their contacts with financial writers and analysts. One firm informs prospective clients of its—

> systematic meetings of individual * * * staff members with the press, individual security analysts, investment counselors, security dealers and portfolio managers of banks, insurance companies, and mutual funds to keep them informed of [the client's] efforts and activities. This personalized approach has been most important in the building of specific interest in our clients companies.

Another firm promises to—

> make regular personal calls upon the more important bankers, brokers, investment services, and othed financial opinion leaders, as well as the security analysts who specialize in [the business of the client].

One of the largest public relations firms employs an ex-newspaperman principally for the purposes of maintaining friendly contacts with the financial press and "placing" articles concerning the firm's clients. This individual testified as follows:

> [A]s they say in my business, it is 50 percent what you know, 50 percent whom you know. I think a better average would be 80 percent whom you know.

The importance of personal contacts and associations is illustrated in the case of General Development Corp. In January 1961, Bonner invited Nicholas Crane, a member of the sales department of Dean Witter & Co. and a former president of the New York Society of Security Analysts, to assist the company in its public-relations program. Crane used his contacts with security analysts at several brokerage houses to invite them on the company's behalf to visit its Florida properties. Crane also arranged for the society to extend an invitation to the company to address one of its luncheon meetings. Crane received

no compensation for these services, but he hoped (in vain) to be rewarded by receiving some brokerage business from the company's pension fund, and to interest the company in purchasing a tract of Florida land, in which case he might have received a finder's fee.

Bonner's personal acquaintance with members of the financial press, acquired as financial editor of the Miami Herald prior to his joining General Development Corp., also proved to be of value in implementing the company's public relations program. In November 1961, learning that an old friend who was financial editor of a metropolitan daily newspaper had arrived in Florida to attend a meeting of the Investment Bankers Association, Bonner invited him to come to Miami to talk to company officials. The financial editor and his wife subsequently spent 2 days as guests of the company, and the following month he wrote an extremely favorable article about the company's prospects in his newspaper.

Bonner testified that in another instance a syndicated financial columnist, with whom he was friendly, agreed to write an article referring to General Development Corp., upon the promise of obtaining "the beat" on the results of a study of the effects of the Government's Apollo program on the economic prospects for Florida, which had been sponsored by several Florida companies, including General Development Corp. The column, when it appeared, included favorable mentions of the company.

Personal contacts also play an important part in the placement of public-relations releases. One practitioner testified that he was instrumental in obtaining an allocation of a "hot" issue for a member of the financial press: a few months later he was able to "place" an article concerning a client with the journalist.[134] It is not uncommon for financial public-relations men to distribute releases by hand or through an intermediary who is personally acquainted with a member of the financial press or a security analyst. Wyle Associates, Inc., a New York public-relations firm, was retained by General Development Corp., principally for the purpose of liaison with the financial press. News releases which the company wanted distributed in New York City were prepared by company employees in Florida and mailed to Wyle in New York where they were mimeographed and distributed, often personally by Wyle, who had close personal contacts with members of the financial press.[135]

Some financial public-relations men make a practice of telephoning or personally calling on members of brokerage houses in order to create interest in the securities of their clients. According to one public relations man, the technique is to—

> leak out a little news here, to talk with their friends and compatriots in Wall Street, to tell them that this deal * * * was coming up. * * *
>
> You call up your friends, tell them you have a hot tip. There are always customers, men in each company who are the hot tip boys; they are the aggressive boys. You know who they are; anybody in the business does. If you don't, why, you find out.

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[134] The underwriter concerned allotted new issues to financial writers of four New York City daily newspapers in 1961. For a discussion of allocations of new issues to publicists and financial journalists, see ch. IV.B.3.b(3)(b).

[135] In a letter to General Development written prior to his retention Wyle stated: "[Our] press contacts are close, not only in New York but throughout the country." He also promised that he would [d]evelop—when the time is ripe—closer liaison with financial analysts."

These practitioners are creators of rumors of mergers, stock splits, management changes, or other corporate news that might affect market prices of securities.[136] Because they operate by word of mouth, their activities are difficult to document or control. Evidence has been found of one public relations man who maintained close contact with several registered representatives at large brokerage houses, many of whose customers had extensive trading in securities of companies in which the public relations man had a financial interest. The pattern seems to be that when the public relations man wished to create demand for a security, he would call his brokerage connections—in some cases by means of a private wire which he had installed—and give them some favorable corporate news that was not yet public or would merely say that he and his associates were planning to buy large amounts of the company's stock. The registered representatives would relay the information to their customers and recommend that they purchase the stock. They would also purchase the stock for their own accounts and for accounts over which they had discretion.

The placement of articles in the financial press appears to be an important technique of the industry, and many clients expect placements as the natural outcome of their retention of a financial public relations firm. For example, one public relations firm wrote to a new client:

> A comprehensive publicity program will be carried out in all business and financial mediums * * *. This will result in placements in the Wall Street Journal, Barron's Weekly, Dow-Jones wire service, the Associated and United Press wire services, as well as other financial publications much too numerous to mention.

Some companies contract with public relations firms for specific number of placements. One company wrote to a firm it had just retained:

> After investigating the public relations field it appears to us that during the first year you should be able to accomplish a minimum of the following placements of information before the public: At least four résumés of the accomplishments of our company and one picture in the major newspapers * * *.

Placement of public relations material in investment advisory publications, though not unknown, seems to be less common than in the case of the financial press.[137]

Luncheon meetings with groups of analysts play an important part in many public relations programs. These meetings, at which corporate officials address the analysts, have become an established part of the financial scene. The principal such group is the New York Society of Security Analysts, which has 2,800 members, most of whom are analysts with financial institutions such as brokerage houses, banks, and mutual funds. To become a member a person must have been a security analyst for 5 (in certain cases, 3) years and must be regularly engaged as an analyst at the time of admission to membership.[138] There is no requirement that a member continue working as a security analyst in order to retain his membership and there are at least 17 financial public relations men, representing some of the principal firms, who are members of the society.[139]

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[136] Address of Weston Smith to Publicity Club of Boston, Apr. 4, 1962 (reprinted in Commercial and Financial Chronicle, May 3, 1962, p. 25).
[137] See pp. 81–82, above.
[138] Constitution of the NYSSA, art. III, sec. 1.
[139] 1962 Membership Directory of the Financial Analysts Federation.

Four or five times a week the society invites representatives of corporations to address its luncheon meetings, which are attended by an average of approximately 150 members. A financial public relations firm will normally try to arrange an appearance before the society for each of his clients as often as permitted.[140] The society limits the frequency of appearances by any one company to one every 2 years and it attempts to restrict such appearances to companies in which there is a substantial public interest. In general, the society regards companies with annual sales of less than $50 million or a floating supply of less than 600,000 shares as too small to warrant an invitation. There have been many exceptions made, however, to this policy.

Luncheon meetings of the society have frequently been used by companies as a vehicle to gain corporate publicity. New product developments, projections of earnings, and other items of corporate news are often revealed on these occasions. For example, BarChris Construction Corp., General Development Corp., the Lionel Corp., and Avnet Electronics Corp. used meetings of the society to make such announcements, all of which were extremely optimistic. Information which is released in this manner is likely to receive wide dissemination, since meetings of the society are often covered by the financial press. Press coverage of meetings is exemplified in the case of a meeting addressed by the president of General Development Corp. on October 10, 1961. The speech was reported prominently on the financial pages of newspapers throughout the country and in all six regional editions of the Wall Street Journal. Some brokerage firms make it a practice to print a condensed version of such speeches in their market letters, while others send a report on addresses to the society over their wires to branch offices.[141] Public relations firms often arrange to print up their clients' speeches and send them to the stockholders and to the full membership of the society. The results of one company's address in terms of publicity were reported as follows:

> There was good publicity in all major financial centers and in trade magazines. Investment firms have shown a greater interest in obtaining information about the company and at least two have prepared circulars recommending [the company's] stock. An increased public interest in [the company's shares] has made it easier for the company to pursue its plan of acquiring other properties.[142]

Similar but smaller analysts' groups in major cities outside New York City also invite officers of publicly held companies to address their meetings. In addition, groups of analysts specializing in particular industries have been formed; these relatively informal luncheon groups, each consisting of about 30 to 40 analysts, meet on a more or less regular basis for the same general purpose.

Besides getting their clients before these organized groups of analysts, public relations firms often arrange "hosted luncheons" to which a selected group of security analysts as well as members of the financial press are invited to listen to the president or other officer of

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[140] Of the 46 issuers who received questionnaires concerning public relations activities, representatives of 15 addressed the New York Society of Security Analysts between January 1960 and March 1962.

[141] The General Development speech was the subject of reports by Francis I. DuPont & Co., Shearson, Hammill & Co., Thomson & McKinnon, and Walston & Co., and a private wire of Bache & Co. A speech by the president of Avnet Electronics Corp. to the society on Mar. 16, 1961, was reported by Merrill Lynch, Pierce, Fenner & Smith in a wire flash to all branches, by Francis I. DuPont & Co. and Newburger, Loeb & Co. in market letters, and by H. Hentz & Co. in a morning wire.

[142] Public Relations News, Nov. 6, 1961, p. 4.

the client tell his corporation's "story." Unlike the luncheons of organized groups, these meetings are paid for by the company that wants to be heard.[143] Hosted luncheons are sometimes sponsored by underwriting firms on behalf of issuers subsequent to the completion of offerings. According to one partner in an underwriting firm, this is done in order to fulfill the underwriter's responsibility to keep the investing public informed of the progress of the company.[144] Such meetings were arranged by underwriters for Avnet Electronics Corp., BarChris Construction Corp., and Chemtree Corp. The effectiveness of these meetings as a means of persuasion is perhaps open to question. According to members of the financial community and the financial public relations industry, analysts are too sophisticated to be taken in by a sales pitch. One partner in a brokerage firm says of the analysts, "they have been around a long time, and as the saying goes, they have been pitched to by experts." Yet the fact that many companies continue to solicit invitations from analysts' groups and invite analysts to hosted luncheons tends to confirm their efficiency as a method of obtaining publicity or favorable mention in investment advisory material. One drug company announced its marketing of an important new drug for the treatment of diabetes, not to a gathering of physicians or pharmacists, but to an invited group of investment bankers, security dealers, brokers, and analysts at the Bankers Club. The announcement coincided with the listing of the company's common stock on the New York Stock Exchange.

Entertainment is considered an important part of financial public relations. Security analysts and members of the financial press are "deluged" by invitations from publicly held corporations or their public relations men to attend cocktail parties, exhibits or new products, "junkets," and other such events. A junket, which one public relations man has described as a "standard publicity procedure," is a trip by a group of analysts to visit a plant or other property of a company. Junkets are sometimes employed to introduce to the financial community a new product which has not yet been revealed to the public. All expenses, including transportation, hotel rooms, and meals, are paid for by the company. Some companies have expended substantial sums upon junkets; for example, General Development spent nearly $10,000 for such purposes during 1961. Junkets, however, serve the purpose of giving analysts an opportunity to visit a factory and meet members of company management, thus enabling them to make a better informed judgment concerning the company. Nevertheless, some companies apparently have used junkets principally as a method of entertaining analysts and financial writers. It is noteworthy that Florida land development corporations, which have the advantage of being able to offer their guests sunshine and other advantages of a resort, have been leaders in organizing junkets. Lefcourt Realty Corp. brought 35 analysts to Florida from New York City in the spring of 1960 at a cost of approximately $10,000. The junket was described as follows by a publicity man who was then working for the company:

They were flown down, came into Royal Palm Beach, where we gave them a description and a little explanation of the Palm Beach properties, and why we

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[143] An editor of Financial World magazine testified that he attends such luncheons on an average of one a month.
[144] See Business Week magazine, Sept. 24, 1962, p. 152.

felt the area would grow, and the profit potential, and so forth, and entertained them with Virginia Gentleman whisky. And then, Saturday, we took them by bus to Miami where they toured Carroll City and then went to the Diplomat Hotel * * *. Sunday, we took them by bus to Cape Florida and put them on the plane that afternoon, but the plane did not go so we had to entertain them that night, and they left late Monday.

But this is standard procedure; everybody does it. The only complaint that I heard from the analysts was that they did not get any information. [The president of the company] was a gracious host, but didn't talk about finance and [the treasurer] was asked not to appear. * * * Offhand, I would say it was a very pleasant weekend.

Gulf American Land Corp., another Florida land development company, on the suggestion of its financial public relations man, brought 42 analysts to its property at Cape Coral during 1961. General Development Corp. conducted a junket for more than 40 analysts and members of the financial press in 1958. In 1961 this company invited 21 analysts in 2 groups to visit its Florida properties. Each of the 1961 trips lasted 4 days and included tours of the company's principal real estate developments as well as interviews with officials of the company. The trips also included a day at a country club owned by the company, where there was an opportunity for golf, swimming, and other forms of relaxation. The analysts who participated were advised to bring their golf shoes—the company promised to supply the other equipment. Of the 18 brokerage houses represented on these junkets, 5 issued market letters favorable to the company within 3 months of the visits, and 6 others indicated approval in internal communications. In addition, an investment advisory service recommended the stock, and a large foundation which was represented on the trip purchased a large block of convertible debentures.

Security analysts and members of the financial press who have participated in such junkets almost invariably say that they could not possibly be "bought" for a free meal or a night's lodging. Nevertheless, it cannot be denied that "entertainment," especially in its more lavish aspects, constitutes a problem. To give a group of analysts a free vacation, complete with country clubs and parties but with little business activity, would seem to cross the line of propriety. The need is clear for more rigorous supervision by employers of the analysts and writers, and for a keener awareness of the inherent ethical problems on the part of issuers and also of the firms and publications furnishing the purportedly objective financial analysis and news upon which members of the public may base their investment decisions.

Not all public relations programs include entertainment of analysts or similar activities. Many companies, being primarily interested in making full disclosure of corporate information rather than in persuading the financial community of the desirability of purchasing their securities, confine their public relations efforts to sending regular reports to stockholders and issuing accurate press releases when justified by corporate development. But it is also apparent, even though the present inquiry is based on a small sample, that the methods of the press agent and the huckster are being used in the dissemination of information concerning some publicly held companies.

5. CONTENT OF CORPORATE PUBLICITY

The ultimate test of corporate publicity is its accuracy. To the extent that it is inaccurate or overoptimistic, the fault is in large part

attributable to the fact that the financial public relations man is not only a distributor of corporate information but also a kind of promoter. Some financial publicists even say that it is permissible to slant the truth in the interest of a client. One practitioner has expressed this point of view as follows:

> When you were wooing your wife, you told her she was the most beautiful girl in the world and she wasn't, but you thought she was. * * * [This] is the same thing, * * * I don't think you have got to tell the cold factual truth every time, what the unbiased civic minded would call the truth.

On the other hand, many public relations men will try to stick close to the truth. According to one financial editor, "they know they can fool a newspaper just once and never get another chance."

Financial public relations men generally refuse to accept responsibility for the accuracy of publicity which they distribute.[145] Their position is that, since there is no practical way for them to check most corporate facts, they have a right to assume that information given to them by their clients is true. However justified this attitude may be, it has led some brokers to distrust any material that is not received directly from responsible corporate officials. The research partner at Sutro Bros. & Co. put it this way:

> [A] public relations firm * * * can be hired and fired at will, and, if something goes wrong, I have no one to go to and try to straighten the situation out. Obviously the public relations concern that was hired by some company and no longer represents them has little interest in the matter. * * * It is just too bad and I have no one to turn to. * * *
>
> * * * [The] written information I receive from public relations firms, I tend to pay relatively little attention to it. The only time * * * a public relations firm can be helpful is when I want to get on the phone or establish a contact with a company personally.
>
> * * * [W]hen things don't go well, there is a certain quietness and you don't hear very much from them.

Some members of the financial community take a somewhat cynical attitude toward the reliability of corporate publicity, even when it comes directly from an officer of a corporation. For example, a partner of Goldman, Sachs & Co. has remarked that "it just does not make sense" for any substantial investor to "care one way or the other" about what a company's officials tell meeting of security analysts. Other members of the financial community have expressed similar sentiments. An investment adviser has informed the Commission that he is "appalled" by the erroneous financial information supplied by company officials. A member of the research department of Hemphill, Noyes & Co. has testified:

> My feeling is that a public relations man, working for a company, has an ax to grind and, therefore, the chances are you are not going to get anything of real use from him. You are going to get a slanted picture.

It is sometimes difficult to draw a sharp line between misleading publicity and publicity which merely puts a company in the best possible light that is still consistent with the truth. The public relations man considers it his duty to create a favorable impression of his clients. According to one practitioner, "* * * primarily, you are trying to communicate the good things, the newsworthy things about

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[145] One public relations man stated: "At no time do we take the responsibility for any client. This is standard procedure in every public relations organization, whether it be product publicity, financial publicity, or governmental publicity. This procedure is standard all over the United States."

your company to the people who are either stockholders or you hope will be stockholders." In speaking of regular financial reports to stockholders, another public relations man had this to say:

> If you run into a year when things are pretty bad, you have got to keep going. Normally, you don't use an unfavorable fact as an opening. But you keep on going, sending out the letters, and you report "the second quarter is down from a year ago." There is no question that you would get the facts in, but they would be sort of backward.

The corporate publicity examined in the course of this study ran the gamut from straightforward reporting of corporate affairs to what can only be described as deliberate attempts to falsify a company's financial condition or prospects. Only rarely, however, was information disseminated which was a complete fabrication. Misleading publicity usually consists of optimistic sales and earnings projections which seem to be based primarily on wishful thinking, glowing descriptions of new products which are still in the experimental stage, and announcements of mergers or acquisitions which are only vague possibilities.

A clear example of inaccurate and irresponsible corporate publicity was that distributed on behalf of BarChris Construction Corp. by its financial public relations firm, Samuel Weiss & Associates, Inc. From August to December 1960, Weiss distributed publicity to the investment community concerning the alleged expansion of the company's bowling alley construction operations in England, Italy, and other European countries. In August 1960, the company reported that it had "completed negotiations" for a contract to construct a 32-lane bowling center near London. Negotiations for such a contract apparently did take place, but no contract was concluded and BarChris never constructed any bowling alleys in England. On December 30, 1960, Leonard Russo, executive vice president of the company, told a luncheon meeting of the New York Society of Security Analysts that a bowling center was planned in London and also stated that:

> We already have a 24-lane bowling center under construction in Rome. * * * We expect to have bowling lanes in every major Italian city.

Over 1,000 copies of this speech were distributed to brokerage houses and others in the financial community. In its annual report for the year ending December 31, 1960, which was dated March 10, 1961, the company stated:

> In 1960 BarChris moved aggressively into the European market by signing a contract for a peerless modern 24-lane bowling center in Rome, Italy, the first of several to be built in other major Italian cities. In Belguim, France, the Netherlands and Great Britain negotiations and site selections were begun for other BarChris installations.

No construction was ever begun by BarChris or any company under contract with BarChris on any bowling center in Rome or any other European city, although a lease was signed and plans were drawn for the proposed Rome center. Despite its publicity concerning European operations during 1960 and 1961, BarChris never achieved any earnings from any such operations.

BarChris' announcements concerning its 1961 financial results were equally inaccurate. In 1960 the company shared in the prosperity that the bowling industry was then enjoying, achieving sales of $9,165,000 and net income of $868,000; this was by far BarChris' most

successful year. In his December 30, 1960, speech to the analysts' society, Russo predicted, "on the basis of orders already received," sales of $15 million and earnings of $1,200,000 in 1961. During the first 6 months of 1961, the investing public and the company's stockholders were given no reason to believe that these estimates would not be realized. In a letter to stockholders dated June 20, 1961, the company stated: "Sales and earnings are running well ahead of last year." A month later, the company reported that its sales were $4,137,000 and its net income $357,000 for the first 6 months of the year; these figures represented increases, respectively, of 30 and 50 percent over the same period of 1960. Two weeks later, however, the company revised the 6-month income figure downward to $237,000, explaining that it had decided to set up a reserve to cover possible losses arising from the bankruptcy of one of its customers. Despite this setback the company stated flatly, in a "report to the financial community" which was sent to stockholders in August 1961, that its sales "will approximate $10 million this year," and that "earnings will exceed the 75 cents per share recorded in 1960.[146]

On October 31, 1961, in a release that was sent to 800 members of the business and financial press, security analysts, and other members of the investment community, BarChris announced sales of $7,085,000 and earnings of $716,000 for the first 9 months of 1961. The estimates for the full year that had been made in August were reiterated, except that the earnings estimate was increased to $1,200,000, or $1 per share. On November 22, 1961, the company announced the declaration of a 4-percent stock dividend, which was said to be "based on the new high records in sales and earnings anticipated by BarChris for the year ending December 31, 1961." As late as March 20, 1962, the company reported to the Wall Street Journal that its 1961 sales totaled $9,500,000 and net income $400,000.

It was not until April 6, 1962, that BarChris issued an audited financial report for the year 1961. This report showed that the company's net sales for the entire year amounted not to $15 million or $10 million, but only $5,075,000, and that its net earnings amounted not to $1,200,000 or $400,000, but only $51,000 which included a special nonrecurring gain of $206,000. Thus the company actually sustained an operating loss of $155,000 for the year. The company explained that the preliminary figures for 1961 which had been reported did not take into account various final adjustments which had to be made to reflect the fact that several customers for whom BarChris had constructed or was constructing bowling alleys defaulted on their contracts. Since company management learned of these defaults during 1961, the optimistic predictions made in late 1961 and early 1962 seem indefensible.[147]

Other BarChris publicity was equally inaccurate. On August 11, 1960, the company announced, in a report that was sent to 2,175 security analysts and members of the press and 1,300 stockholders, that "BarChris has begun construction of an 80,000 square foot manufacturing plant near Valley Stream, Long Island," which was scheduled for completion in the spring of 1961. This information was incorrect.

[146] This report was the only one of BarChris' publicity releases referred to in this section which was not prepared and distributed by Samuel Weiss & Associates, Inc.

[147] On Oct. 29, 1962, BarChris filed a petition in U.S. district court for reorganization under ch. XI of the Bankruptcy Act.

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Construction was never begun on a plant at this site, because the New York Building Department never approved the plans submitted; a smaller plant, however, was later built on another site on Long Island.

The provisions of the Exchange Act requiring listed companies and certain unlisted companies to file periodic reports are not always proof against the dissemination of misleading informal publicity on the same subjects as those covered by the official reports. These provisions do not prevent companies from sending their stockholders financial statements inconsistent with—and much more favorable than—the statements for the same periods filed with the Commission. A striking example of such a practice which was recently exposed by the Commission involved Atlantic Research Corp., whose stock is listed on the American Stock Exchange. This company, which has several subsidiaries, in May 1962 filed with the Commission and the American Stock Exchange its required annual report for the year 1961, containing consolidated financial statements which showed a net loss of $1,066,015. The annual report for 1961 which the company sent to its stockholders, however, contained unconsolidated financial statements and these showed net income of $1,473,192.[148]

Projections of sales and earnings are of great interest to security analysts. One analyst stated:

> I can't imagine any group of analysts being together with company officials and not asking [for earnings predictions]. That would be one of the first questions we would ask * * *.

The New York Society of Security Analysts encourages publicly held companies to make financial predictions. A recent publication of the society expressed this view:

> What does the Security Analyst expect from a company.
>
> * * * * * * *
>
> 3. The heart of security analysis is the forecast. Management's forecast, based upon sound planning can be of great help to the analyst. While there are exceptions it is generally true that the more astute the management the more accurate the forecast. Overoptimistic and overpessimistic forecasts are equally harmful to the company, the analyst, and the stockholders. The company is justified in not giving current figures to analysts prior to general publication but it can be helpful to the company and the analyst if the trend of current earnings is discussed.[149]

Perhaps because of some innate characteristic of human nature, estimates of financial results tend to err on the side of optimism. Moreover, it is very difficult for new companies in new types of business to make accurate predictions. In the case of General Development Corp., for example, John Bonner has stated:

> It is almost impossible, because of the nature of the business, to make an accurate prediction some months in advance.

John L. Weinberg, a partner of Goldman, Sachs & Co. and a director of General Development, has expressed a similar opinion:

> * * * I have always said I believe making predictions of earnings for General Development is a mistake on the record, and everybody on the board knows I feel that way, because their predictions * * * have not been accurate. If you can predict it like a utility, all right.

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[148] See Securities Exchange Act release No. 6911 (Oct. 10, 1962). For a discussion of other aspects of the *Atlantic Research* case, see pt. D of ch. III.

[149] Bulletin on "Corporate Relations," published by New York Society of Security Analysts, p. 4.

Despite these misgivings of two of its officials, General Development gave security analysts and the press estimates of 1961 earnings that turned out to be far too optimistic. In March and April 1961, the company was making estimates of earnings of $1.40 per share for the year ending December 31, 1961, to security analysts who interviewed corporate officials. According to an analyst with Standard & Poor's, however, Bonner told him confidentially in May 1961 that the 1961 earnings would be "close to $2 a share." In September 1961, the company's chairman of the board repeated the $1.40 prediction in a speech to a group of analysts and in October the president of General Development told the New York Society of Security Analysts that earnings would be between $1.20 and $1.40.[150] Actual earnings, announced in March 1962, were $1.05 per share.

In September 1961, Specialty Electronics Development Corp., an over-the-counter issuer which manufactured communication equipment for the Armed Forces, distributed to analysts and financial writers a brochure which gave estimated earnings of $100,000 for the year which had ended on July 31, 1961. Actual earnings proved to be only $65,000. In the same brochure, sales of $8 million were predicted for fiscal 1962. For the first half of fiscal 1962 the company's sales totaled approximately $1,500,000 and the company suffered a net loss of approximately $85,000. In March 1962 the company's stockholders, who until that time had received only good news from the company and its public relations firm, learned that a petition for an arrangement of creditors had been filed under the Bankruptcy Act.

Several other companies whose publicity was examined in the course of this study gave sales and earnings estimates that turned out to be substantially too high. In a release dated February 14, 1961, Grayson-Robinson Stores, Inc., a company listed on the New York Stock Exchange, predicted that sales for the year ending July 31, 1961, would amount to more than $100 million. The actual figure was $77,354,000.[151] On September 20, 1960, the president of Universal Controls, Inc., stated that he was "confident" that earnings for the year ending March 31, 1961, would exceed the $4,174,000 of the previous fiscal year; he repeated the statement a month later, saying:

> This year I can predict that we will again establish even higher levels of sales, earnings, and progressive growth of development. * * *

On June 12, 1961, the company informed its stockholders that earnings for fiscal 1961 had actually amounted to approximately $1,900,000.

Even if the corporate officials or publicists who were responsible for the projections can show that they made them in good faith, these examples demonstrate the necessity of caution and restraint in giving financial estimates—as well as in evaluating them.

Overenthusiastic or premature publicity concerning product developments constitutes another potential abuse. In May 1960, Fairbanks Whitney Corp. announced at a stockholders' meeting that it had been engaged for several months in the development of a low-cost process for desalting sea water. Three months later, the company reported that a commercial desalinization plant was under construction in

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[150] See the Wall Street Journal, Oct. 11, 1961, and July 3, 1962.

[151] On Aug. 14, 1962, Grayson-Robinson Stores, Inc., filed a petition for an arrangement of creditors under ch. XI of the Bankruptcy Act.

Israel and was "due to go into operation after the 1961 midyear." In a release dated January 12, 1961, the company announced completion of the first mass-production unit, and promised that plans for worldwide marketing of its process would be announced in March 1961. Full operation of the plant in Israel was predicted by early 1962. These releases received wide publicity, which included articles in Fortune,[152] Look,[153] Newsweek,[154] as well as in the Wall Street Journal [155] and other newspapers, and the company was mentioned in advisory material published by Merrill Lynch, Pierce, Fenner & Smith, Hayden Stone & Co., Inc., E. F. Hutton & Co., and A. M. Kidder & Co., Inc.

By the spring of 1962, the plant was not yet in operation, and no plans for worldwide marketing had yet been announced. The 1961 annual report, published in early 1962, gave "technical delays" as the reason for the absence of results. It stated that the engineers had asked for more time to increase the efficiency of the unit and cited the newness of the components and the climatic conditions in Israel.

Another example concerns the Lionel Corp. On December 9, 1960, Gen. John B. Medaris, its president, told a meeting of the New York Society of Security Analysts that Lionel had developed a currency-sensing machine capable of identifying bills from $1 to $100, which "today is in the most advanced state of perfection." Medaris said that the company was "now beginning marketing discussions looking to the marketing of this product" and that it would be in production within a short time. Ten months later, however, the company reported in a proxy statement filed with the Commission:

> This company recently designed and developed a currency recognizing device, several prototype models of which have been built up to this time. The device has not yet been marketed and there is no assurance at this time as to whether it will be a profitable item.

The deliberate withholding of news by companies can be as harmful to investors as the release of inaccurate or overoptimistic news. On the day before General Medaris' speech, rumors that Lionel was entering the currency-sensing field reportedly were circulating on Wall Street and helped push the price of the stock from 28 to 30 on a volume of 64,000 shares.[156] (On the day of the speech the stock declined to 29⅜ on a volume of 50,000 shares.) Such incidents have caused the New York Stock Exchange to require listed companies to release immediately any corporate information which might affect the price of their securities.[157]

Sperry Rand Corp., a company listed on the New York Stock Exchange, flew 37 members of the press and security analysts to its Univac facilities in St. Paul, Minn., on December 6, 1960, for an exhibition of new products which according to the company constituted a "breakthrough" in the field of electronic data processing. The news of these developments was not scheduled for general release until December 15, 1960. The withholding of this publicity from the public, after its release to a few interested persons, caused a flurry of rumors and abnormal trading action in the company's stock. On December 8, 1960, it rose to 23⅛ on a volume of 143,700 shares. On December 9, at the

[152] June 1961.
[153] July 19, 1960.
[154] Feb. 13, 1961.
[155] Mar. 31 and Apr. 4, 1961.
[156] The Wall Street Journal, Dec. 9, 1960, p. 25.
[157] See sec. 6, below.

urging of the New York Stock Exchange, the company made the announcement which had been scheduled for December 15.

It must be recognized, of course, that the line between premature publicity of an event that may not come to pass and withheld publicity about events known to insiders is not easy to draw in practice. There does not seem to be any general agreement, for example, on the precise stage of merger negotiations at which it is appropriate to issue a release. Obviously, publicity about a prospective merger that is nothing more than a gleam in the management's eyes is totally unwarranted. The prevailing corporate practice seems to be to announce a merger as soon as the directors have taken any action toward it. Many public relations men seem to agree, however, that if rumors of a corporate development begin, the company should immediately release word of its exact status. The New York Stock Exchange policy of prompt disclosure appears[158] to have had a significant effect in inducing listed companies to release information rather than to hold it for release at some "convenient" time.

6. CONTROLS OVER CORPORATE PUBLICITY

The above report on existing practices surrounding corporations' financial publicity reveals problems which, for the most part, are subtle in nature even though the abuses may be gross in particular situations. Existing regulation in this field is relatively limited, at least as compared to that in other kinds of activity affecting the securities markets. Federal law is in the main not concerned with "unofficial" corporate publicity. Regulation as a whole—by all authorities, official and unofficial—leaves untouched some of the problems that have been revealed, and reaches others only indirectly, by such means as control over the use of publicity in connection with new issues; general provisions against fraud, manipulation, and commercial bribery; and, with respect to some issuers only, provisions of the Exchange Act as supplemented by the rules and policies of some of the exchanges and the NASD requiring periodic filing of data, regular reporting to stockholders, and prompt public disclosure of financially significant developments.

The Securities Act, establishing procedures by which "selling" information concerning public offerings of securities may be disseminated to the public, sharply restricts the use of public relations immediately before the offering. No offer may be made, of course, before the filing of a registration statement. During the interval between filing and effective date of a registration statement, no written communication offering the security may be used except an identifying statement or a prospectus, which must contain information specified by the statute and rules. After the effective date, sales literature other than a prospectus may be used, but only if preceded or accompanied by a prospectus. The prospectus requirements remain in effect as long as the offering continues and, for dealers selling registered securities, at least during the 40-day period following the effective date or the commencement of the public offering.

Despite these strict rules, a number of cases have come to the attention of the Commission in which planned publicity seemed clearly designed to condition the market in connection with a stock offering.[159] The Commission has pointed out that the use of public relations at a

[158] See sec. 6, below.
[159] See *In the Matter of First Maine Corporation*, 38 S.E.C. 882 (1959).