

(Securities Exchange Act Release No. 9536)

ADMINISTRATIVE PROCEEDING FILE NO. 3-3068

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION
March 20, 1972

In the Matter of
FILTROL CORPORATION
3250 E. Washington Boulevard
Los Angeles, California

(1-3724)

Securities Exchange Act of 1934 -
Section 15(c) (4)

FINDINGS, OPINION AND ORDER

REPORTING COMPLIANCE PROCEEDINGS

Where annual reports filed under Securities Exchange Act of 1934 included among issuer's assets large amount of municipal bonds, in part under current assets as "short-term securities (at cost plus accrued interest, which approximates market)" and in part as "other investments (at cost)," but reports failed to disclose, among other things, inability of brokerage firm, whose agreement with issuer to repurchase certain bonds at issuer's cost was principal basis for their inclusion among current assets, to meet repurchase obligations; transaction in which issuer's board chairman caused issuer to purchase from that firm bonds delinquent as to interest payments on same day and at same price at which he had sold them to that firm pursuant to repurchase agreements; and delinquencies and defaults as to certain bonds making them publicly saleable only below cost, held, reports were materially misleading, and under circumstances in public interest to accept offer of settlement providing for filing of amended reports and transmission of such reports to stockholders requesting them.

APPEARANCES

Richard H. Rowe, Mario V. Mirabelli and Carl R. Klein, for the Division of Corporation Finance of the Commission.

Robert S. Daggett, of Brobeck, Phleger & Harrison, for Filtrol Corporation.

These are proceedings pursuant to Section 15(c) (4) of the Securities Exchange Act of 1934 (“Exchange Act”) to determine whether Filtrol Corporation failed to comply with the provisions of Section 13 of the Exchange Act and rules and regulations thereunder by filing annual reports on Form 10-K for its fiscal years ended December 31, 1966 through 1970 which included misleading statements of material facts and omitted information necessary to make the statements therein not misleading. 1/ The common stock of Filtrol, a Delaware corporation with principal offices in Los Angeles, California, has been registered on the New York Stock Exchange since 1953.

Filtrol submitted an offer of settlement in which, solely for the purpose of these proceedings and without admitting or denying the allegations in the Statement of Matters filed by our Division of Corporation Finance, it consented to findings based upon such Statement and the offer of settlement that the above-mentioned annual reports failed to comply with the provisions of Section 13 of the Exchange Act and rules and regulations thereunder. In addition, it agreed to amend those reports as specified in the offer of settlement and to notify each stockholder of record that he may obtain copies of the amended reports by returning a postage prepaid request to be enclosed with such notification.

Upon consideration of all the circumstances, including the recommendation of the Division, we determined to accept the offer of settlement, and we accordingly make the following findings:

Each of Filtrol’s annual reports on Form 10-K for its fiscal years ended December 31, 1966 through 1970 was materially misleading with respect to the value of certain municipal bonds representing a substantial proportion of the company’s assets.

1966 Report

Filtrol’s balance sheet as of December 31, 1966, contained in its 1966 10-K report, included under the caption “current assets” an item “short term securities (at cost plus accrued interest, which approximates market),” consisting entirely of municipal bonds and totaling more than \$22 million. 2/ Of this amount, a total of about \$2.7 million 3/ represented certain municipal bonds which Filtrol had purchased from the brokerage firm of Taylor & Company. Another balance sheet item, captioned “other investments (at cost)” and totaling about \$2.4 million, 4/ consisted principally of municipal bonds purchased from the brokerage firm of J. B. Hanauer & Company at a total cost of about \$1.9 million. The bonds purchased from those two firms represented about 15.5% of Filtrol’s stated total assets. We find that the balance sheet presentation respecting such bonds was materially misleading because of the failure to disclose certain information bearing on their value.

The principal basis on which Filtrol classified municipal bonds as “short-term securities (at cost plus accrued interest, which approximates market),” even though virtually all of

them had maturity dates of more than one year after December 31, 1966, was the existence and viability of agreements between it and various brokerage firms, including Taylor, under which those firms were obligated to repurchase the bonds at Filtrol's cost. However, at December 31, 1966, Taylor was not financially capable of fully meeting such obligations. ^{5/} Moreover, absent the possibility of a resale at cost to Taylor, bonds purchased from it on October 10, 1966 at a total cost of more than \$1.6 million could not have been publicly resold at a price as high as Filtrol's cost. Most of those bonds were at the time of such purchase already delinquent as to payment of interest, and the remaining ones had suffered a sinking fund deficiency prior to 1965 and the interest due on November 1, 1966 was not paid. Those bonds, or identical ones, had on the same day they were bought by Filtrol been sold to Taylor, pursuant to the latter's repurchase agreement, by Myron A. Bantrell, Filtrol's board chairman who had virtually complete control over Filtrol's investments, for precisely the same amount, which represented Bantrell's original purchase price plus accrued interest, and Taylor actually acted merely as a conduit in the sale to Filtrol without expending any of its own funds. In view of the delinquencies and deficiency and the fact that, as Filtrol knew, Taylor was already on October 10, 1966 unable to perform fully under the repurchase agreement, it was improper merely to show the bonds purchased on that date at cost figures without appropriate qualifying disclosure.

In addition, some of the bonds purchased from Taylor, for which Filtrol showed a total cost of more than \$1.1 million, were so-called California 1911 Act Assessment bonds, for which there was no established market that could serve as a basis for valuing the bonds.

Filtrol's failure to disclose the above facts regarding the bonds purchased from Taylor rendered its balance sheet presentation with respect to those bonds materially misleading.

With respect to the bonds purchased from Hanauer, they had in 10-K reports prior to 1966 been classified as "short-term" securities and were transferred to the "other investments" category because Hanauer had been adjudicated a bankrupt during 1966 and was financially incapable of performing repurchase obligations. No disclosure was made, however, concerning those facts. Moreover, the report did not disclose that as of December 31, 1966, a substantial proportion of the accrued interest on the Hanauer bonds was delinquent, thus indicating that the value of the bonds had been materially reduced. Of a total of \$71,404 in interest accrued as of that date, approximately \$30,500 was delinquent as of January 2, 1967.

1967 Report

Filtrol's balance sheet as of December 31, 1967, included in the financial statements in its 1967 10-K report, reflected the bonds purchased under repurchase agreements with Taylor and Hanauer in the same manner as in the previous report. In these respects, the report was materially misleading in failing to make appropriate disclosure of material facts relating to the value of those bonds.

At December 31, 1967, the bonds purchased from Taylor were carried at a total cost figure of more than \$2.2 million. However, the record indicates that Taylor could not have fully performed under the repurchase agreements as of December 31, 1967, because on February 2, 1968 it filed a petition under Chapter XI of the Bankruptcy Act. 6/ In addition, as of December 31, 1967, certain bonds purchased from Taylor at a cost of more than \$1.7 million were delinquent as to the payment of interest and certain of these bonds purchased at a cost of \$104,000 were also in default as to the payment of principal. The existence of the delinquencies and defaults indicates that the value of these bonds had been materially reduced and that, to the extent there was any market for them, they could only have been sold for a price below their cost. Indeed, in a sworn proof of claim filed by Filtrol in June 1968 in the Chapter XI proceedings, it alleged that the actual value of these bonds, as of January 31, 1968, was \$405,670, a reduction of more than \$1.3 million from the cost figure. 7/

With respect to the bonds purchased from Hanauer, which were reflected at a total cost of about \$1.8 million as of December 31, 1967, that firm was still in a bankrupt status on that date and was therefore unable to perform under the repurchase agreements with Filtrol. Moreover, delinquencies existed as to the payment of interest on a substantial amount of those bonds.

Reports for 1968-1970

Filtrol's balance sheets as of December 31, 1968, 1969 and 1970, which were part of the financial statements in its 10-K reports for the years ended on those dates, reflected the municipal bonds held under repurchase agreements with Taylor and Hanauer as "other investments (at cost)." However, Filtrol failed, in each of these reports, to disclose delinquencies and defaults with respect to a large proportion of those bonds, as a result of which they could only have been sold publicly at a price below Filtrol's cost. The following table reflects, as of the three year-end dates, total stated cost of those bonds, the aggregate cost of those which were delinquent as to the payment of interest (on all of which Filtrol had ceased accruing interest as of February 1968), and the total cost of those delinquent bonds which were also in default as to the payment of principal:

December 31; Total Cost; Cost of bonds delinquent due to interest; Cost of bonds in default as to principal

1968; \$3,851,000; \$1,884,000; \$147,000

1969; \$3,730,000; \$1,879,000; \$864,000

1970; \$3,529,000; \$1,870,000; \$799,000

Conclusion

The Division considers, and we agree, that the amendments proposed to be filed by Filtrol pursuant to its offer of settlement will provide appropriate disclosure regarding the matters discussed above.

Accordingly, IT IS ORDERED, pursuant to the undertakings in the offer of settlement of Filtrol Corporation, that it file correcting amendments to its Form 10-K reports for the 5 fiscal years ended December 31, 1970, and that it notify each stockholder of record that he may obtain copies of the amended reports, without charge, by returning a postage prepaid request to be provided him with such notification.

By the Commission (Chairman CASEY and Commissioners OWENS, HERLONG, NEEDHAM and LOOMIS).

Ronald F. Hunt Secretary

1/ Section 13 of the Exchange Act, as pertinent here, requires issuers of securities registered pursuant to Section 12 of that Act to file annual reports with us pursuant to rules prescribed by us thereunder. The requirement that reports be filed necessarily embodies the requirement that such reports be true and correct. See, e.g., Great Sweet Grass Oils Limited, 37 S.E.C. 683, 684 (1957), aff'd 256 F. 2d 893 (C.A.D.C., 1958). Moreover, Regulation S-X which states the requirements regarding the form and content of financial statements required to be filed as part of such annual reports, specifies in Rule 3.06 that "The information required with respect to any statement shall be furnished as a minimum requirement to which shall be added such further material information as is necessary to make the required statements, in the light of the circumstances under which they are made, not misleading."

2/ A supporting schedule listed the individual securities, the face amount and a cost figure for each, and an aggregate figure for accrued interest on all the securities.

3/ This figure, and those referred to hereafter, do not include accrued interest except where otherwise indicated.

4/ A supporting schedule showed, as to each issue of bonds, face amount and cost.

5/ Taylor's certified financial statement as of October 31, 1966 showed that its net assets (without taking into account liabilities under repurchase agreements) were substantially less than its liabilities under such agreements.

6/ This was more than three months before the filing of the 10-K report.

7/ All but \$6 of the value assigned to the bonds in the proof of claim was assigned to one issue, with a nominal value of \$1 each being assigned to the remaining 6 issues, all except one of which were California 1911 Act Assessment issues for which, as noted above, no established market existed that could serve as a measure of their value. The bonds as to which there were no delinquencies or defaults were valued more than \$111,000 below cost.