40TH ANNUAL REPORT OF THE SECURITIES AND EXCHANGE COMMISSION

For the Fiscal Year Ended June 30th

SECURITIES AND EXCHANGE COMMISSION

Headquarters Office
500 North Capitol Street
Washington, D.C. 20549

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PHILIP A. LOOMIS, JR.
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A. A. SOMMER, JR.
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LETTER OF TRANSMITTAL

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

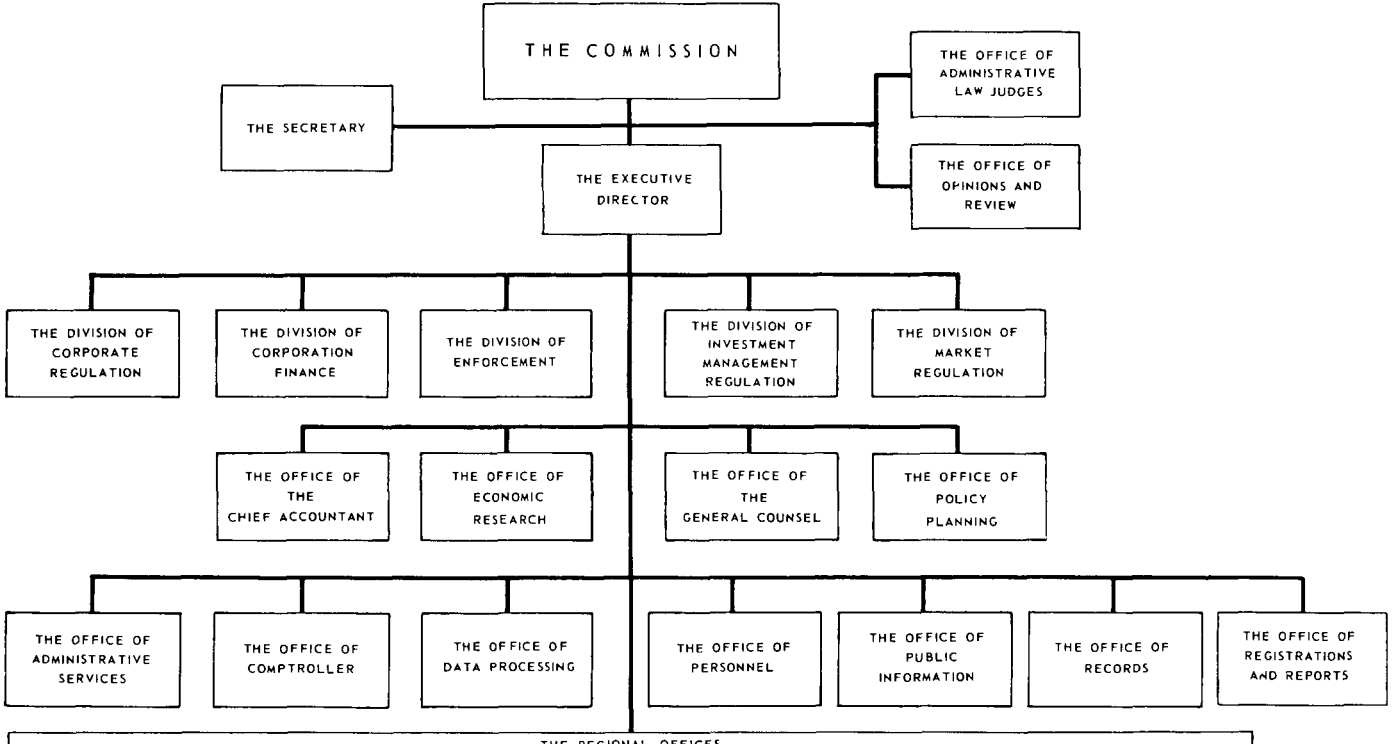
Sirs: On behalf of the Securities and Exchange Commission, I have the honor to transmit to you the Fortieth Annual Report of the Commission covering the fiscal year July 1, 1973 to June 30, 1974, in accordance with the provisions of Section 23(b) of the Securities Exchange Act of 1934, as amended; Section 23 of the Public Utility Holding Company Act of 1935; Section 46(a) of the Investment Company Act of 1940; Section 216 of the Investment Advisers Act of 1940; Section 3 of the Act of June 29, 1949, amending the Bretton Woods Agreement Act; Section 11(b) of the Inter-American Development Bank Act; and Section 11(b) of the Asian Development Bank Act.

Respectfully,

RAY GARRETT, JR.
Chairman

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

SECURITIES AND EXCHANGE COMMISSION



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(As of January 1, 1975)

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	Term expires June 5
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A. A. SOMMER, JR., of Ohio	1976
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Region 5. Oklahoma, Arkansas, Texas, part of Louisiana, Kansas (except Kansas City).—Robert F. Watson, 503 U.S. Court House, 10th & Lamar Sts., Fort Worth, Texas 76102.

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Miama, Florida 33131.—Suite 701 DuPont Plaza Center, 300 Biscayne Boulevard Way.

Philadelphia, Pa. 19106.—Federal Building, Room 2204, 600 Arch St.
St. Louis, Missouri 63101.—Room 1452, 210 North Twelfth St.
Salt Lake City, Utah 84111.—Room 6004, Federal Reserve Bank Bldg., 120 South State St.
San Francisco, California 94102.—450 Golden Gate Ave., Box 36042.

COMMISSIONERS

RAY GARRETT, JR., *Chairman*

Chairman Garrett was born on August 11, 1920, in Chicago, Illinois. In 1941 he was graduated from Yale University and he received his LL.B from Harvard Law School in 1949. Immediately prior to joining the Commission as Chairman, Mr. Garrett was a partner in the Chicago law firm of Gardner, Carton, Douglas, Children and Waud where he had been since 1958. From 1954 to 1958, he was on the staff of the Securities and Exchange Commission, serving for most of that period as Director of the Division of Corporate Regulation. In 1965, Mr. Garrett was Chairman of the Section of Corporation Banking and Business Law of the American Bar Association and has also served as Chairman of the ABA Committee on Developments in Corporate Financing. He is presently Chairman of the Advisory Committee for the Corporate Department Financing Project of the American Bar Foundation, a member of the Board of Editors of the American Bar Association Journal, and consultant to the "Reporter" for Codification of Federal Securities Laws Project of the American Law Institute. Prior to joining the SEC staff, he was a teaching fellow at Harvard Law School and Assistant Professor of Law at New York University. For several years he was a visiting lecturer at the Northwestern University School of Law. Mr. Garrett was sworn in as Chairman of the Securities and Exchange Commission on August 6, 1973, for a term expiring on June 5, 1977.

PHILIP A. LOOMIS, JR.

Commissioner Loomis was born in Colorado Springs, Colorado, on June 11, 1915. He received an A.B. degree, with highest honors, from Princeton University in 1938 and an LL.B. degree, cum laude, from Yale Law School in 1941, where he was a Law Journal editor. Prior to joining the staff of the Securities and Exchange Commission, Commissioner Loomis practiced law with the firm of O'Melveny and Myers in Los Angeles, California, except for the period from 1942 to 1944, when he served as an attorney with the Office of Price Administration, and the period from 1944 to 1946, when he was Associate Counsel to Northrop Aircraft, Inc. Commissioner Loomis joined the Commission's staff as a consultant in 1954, and the following year he was appointed Associate Director and then Director of the Division of Trading and Exchanges. In

1963, Commissioner Loomis was appointed General Counsel to the Commission and served in that capacity until his appointment as a member of the Commission. Commissioner Loomis is a member of the American Bar Association, the American Law Institute, the Federal Bar Association, the State Bar of California, and the Los Angeles Bar Association. He received the Career Service Award of the National Civil Service League in 1964, the Securities and Exchange Commission Distinguished Service Award in 1966, and the Justice Tom C. Clark Award of the Federal Bar Association in 1971. He took office as a member of the Securities and Exchange Commission on August 23, 1974, for the term of office expiring June 5, 1979.

JOHN R. EVANS

Commissioner Evans was born in Bisbee, Arizona, on June 1, 1932. He received his B.S. degree in Economics in 1957, and his M.S. degree in Economics in 1959 from the University of Utah. He was a Research Assistant and later a Research Analyst at the Bureau of Economics and Business Research at the University of Utah, where he was also an Instructor of Economics during 1962 and 1963. He came to Washington in February 1963, as Economics Assistant to Senator Wallace F. Bennett of Utah. From July 1964 through June 1971 Commissioner Evans was a member of the Professional Staff of the U.S. Senate Committee on Banking, Housing and Urban Affairs serving as minority staff director. He took office as a member of the Securities and Exchange Commission on March 3, 1973, for the term expiring June 5, 1978.

A. A. SOMMER, JR.

Commissioner Sommer was born in Portsmouth, Ohio on April 7, 1924. He received his B. A. degree from the University of Notre Dame in 1948 and LL.B. degree from Harvard Law School in 1950. At the time he was appointed to the Commission, he was a partner in the Cleveland law firm of Calfee, Halter, Calfee, Griswold & Sommer. Mr. Sommer was formerly Chairman of the American Bar Association's Federal Regulation of Securities Committee and a member of the Committee on Corporate Laws and Committee on Stock Certificates. He was also a member of the Board of Governors of the National Association of Securities Dealers, a lecturer on securities law at Case-Western Reserve Law School and a lecturer at various institutes and programs dealing with securities law, corporation law and accounting matters. Commissioner Sommer was formerly a member and Past-Chairman of the Corporation Law Committee of the Ohio State Bar Association. He has authored articles dealing with corporate reorganization, conglomerate disclosure and other securities and accounting topics. He took office as a member of the Securities and Exchange Commission on August 6, 1973, for the term of office expiring June 5, 1976.

IRVING M. POLLACK

Commissioner Pollack was born in Brooklyn, New York, on April 8, 1918. He received a B.A. degree cum laude from Brooklyn College in 1938 and an LL.B. degree magna cum laude from Brooklyn Law School in 1942. Prior to joining the Commission's staff he engaged in the practice of law in New York City after serving nearly four years in the United States Army, where he gained the rank of Captain. Mr. Pollack

joined the staff of the Commission's General Counsel in October 1946. He was promoted from time to time to progressively more responsible positions in that office and in 1956 became an Assistant General Counsel. A career employee, Mr. Pollack became Director of the Division of Enforcement in August, 1972 when the SEC's divisions were reorganized. He had been Director of the Division of Trading and Markets since August, 1965, and previously served as Associate Director since October, 1961. In 1967 Mr. Pollack was awarded the SEC Distinguished Service Award for Outstanding Career Service and in 1968 he was a co-recipient of the Rockefeller Public Service Award in the field of law, legislation and regulation. Mr. Pollack took the oath of office on February 13, 1974 as a member of the Securities and Exchange Commission, for the term expiring June 5, 1975.

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IMPORTANT DEVELOPMENTS

PART 1

IMPORTANT DEVELOPMENTS

MARKET REGULATION

During the past year, major developments affecting the Commission's regulation of the nation's securities markets took place. First, the Commission made significant progress toward implementation of the market structure principles enunciated in its March 1973 *Policy Statement on the Structure of a Central Market System.* It appointed an Advisory Committee on the Implementation of a Central Market System, composed principally of industry representatives; and oversaw the establishment of a consolidated transactional reporting tape under a plan filed jointly by several exchanges and the NASD.

Next, in September 1973, the Commission announced that registered exchanges must fully implement competitive commission rates after April 30, 1975. Looking toward that event, it endorsed the proposals advanced by the exchanges to initiate an experiment in negotiated public commission rates on orders not exceeding $2,000. That experiment went into effect April 1, 1974, and has been monitored closely by the Commission and the exchanges. The Commission also announced its intention to examine the question of whether intramember rates should be negotiated rather than fixed. And, in May and June it held hearings to gather information on that subject. Other developments in this area included the expansion of the secondary trading markets for listed call options, further refinement of the rules pertaining to nonmember access to exchange markets, continuing Commission inquiries into the NASD anti-reciprocal rule, and the initiation of an inquiry into the conditions under which foreign access to United States securities markets should be permitted.

At the same time, the Commission greatly improved during the fiscal year its early warning and examination program for broker-dealers. The designation of principal examining authorities for broker-dealers pursuant to Section 9(c) of the Securities Investor Protection Act of 1970 has eliminated unnecessary duplication in the oversight procedures of the Commission and the self-regulatory organizations. In addition, the Commission has strengthened the effectiveness of its oversight both by visiting the self-regulatory organizations to review and improve their early warning, surveillance and examination programs, and by visiting selected broker-dealer members in order to monitor the effectiveness of self-regulatory organizations' programs.

Finally, the Commission and its staff devoted substantial amounts of time in assisting subcommittees of both Houses of Congress in their consideration of proposed legislation that would both facilitate the establishment of a central market system and aid the Commission in its oversight of the national securities exchanges and securities associations. These Congressional deliberations foreshadow basic changes in the structural and regulatory framework of the securities industry; the Commission anticipates that if the legislation currently

being considered by Congress becomes law these changes will result in a truly competitive and efficient capital market system—one capable of meeting the Nation's need for investment capital while operating in the public interest and serving to protect the public investor.

Industry Advisory Committees

1. *Central Market System*

On March 29, 1973, the Commission issued its *Policy Statement on the Structure of a Central Market System,* setting forth the results of an extensive review of the recommendations of its three industry advisory committees,[1] two Congressional studies[2] and an analysis by its staff with respect to the development of a central market system for listed securities. The *Policy Statement* was intended to give direction to the development of the structure and regulatory framework within which such a system would operate. It also announced the Commission's general intention to establish an industry committee to advise it on ways of implementing its proposals for a central market system. On March 18, 1974, in compliance with the Federal Advisory Committee Act, the Commission announced its plans to establish a Central Market System Advisory Committee and its intended chairman;[3] on May 10, 1974 the Commission named some of its members.[4] Four additional members, one the Director of the Commission's Division of Market Regulation, were named in Securities Exchange Act Release No. 10826 (May 24, 1974), 4 SEC Docket 348. The Committee has generally been asked to study and to submit recommendations to the Commission on such matters as:

1. The appropriate structure for regulatory supervision of the central market system;

2. The nature and scope of the Commission's role during the process of implementing the central market system;

3. The ways in which a central market system should be structured in order to meet effectively the needs of our capital markets, the public interest, the protection of investors and the maintenance of fair and orderly markets for securities;

4. The needs and perspectives of users of a central market system including issuers of and investors in securities, as well as securities professionals; and

5. The appropriate resolution of fundamental policy issues relating to the central market system's operations.

One of the chief matters which the Committee will study is the role of competing market makers in a central market system. This study, along with parallel studies by the staff of the Division of Market Regulation, will aid the Commission in determining the proper role of the third market in a central market system and the extent to which comparable regulation of the exchange and third markets may be necessary to foster an appropriate level of competition in the public interest.

2. *Broker-Dealer Reports and Registration Requirements*

Recognizing that broker-dealers might be subject to duplicative and unnecessary regulatory and reporting requirements, the Commission in September 1972 established an Advisory Committee on Broker-Dealer Reports and Registration Requirements to study this problem. As previously reported, the Advisory Committee submitted its report to the Commission in December 1972. A Commission Staff Task Force considered the report and the Commission subsequently announced a program to implement the proposals therein.[5]

In general, the Commission, based upon the recommendations of the Advisory Committee Study, the program of implementation outlined by its staff, and other sources, is undertaking steps to achieve four substantive objectives:

1. A self-regulatory program which assures that in regard to financial responsibility and related recordkeeping a broker-dealer will be examined by and report to only one self-regulatory organization;

2. The development and implementation of a key regulatory report for use by the Commission and the industry, incorporating uniform definitions and reporting periods. The form would replace a number of forms currently in use;

3. The establishment on a continuing basis of a Report Coordinating Group under

the Federal Advisory Committee Act composed of knowledgeable persons from the securities industry, the accounting and legal professions, and elsewhere to advise the Commission regarding ways of providing for long-term simplification and standardization in reporting by broker-dealers, to advise the Commission on proposed new reports and forms, and to advise and assist the Commission in the development of the key regulatory report; and

4. The completion of a program already undertaken in cooperation with the state securities administrators and others to develop a uniform form for the registration of brokers and dealers for use by the states, the Commission, and the self-regulatory organizations, and the completion of the joint securities industry effort to develop a uniform form for the registration of principals and agents.

On May 16, 1974, the Commission named the members of its previously announced Report Coordinating Group.[6] The Group is expected to be a standing committee for a period of two years and, within the first six months of its formation, is expected to develop a uniform key regulatory report.

3. *Broker-Dealer Model Compliance Guide*

The Advisory Committee appointed in 1972 by the Commission to assist it in developing a model compliance program for the broker-dealer community has completed and made available to the public a draft of the Model Compliance Guide. Among the subjects covered are supervision, broker-dealer and personnel registration, financial and operations responsibility, and customer accounts. The proposed Guide is intended to assist each broker-dealer in preparing or supplementing its own compliance manual; and not to supplant it.

The Advisory Committee solicited and received suggestions on the proposed Guide from the broker-dealer community, the securities industry, the securities bar, the accounting profession and other interested members of the public. The Advisory Committee has met several times to discuss revisions and hopes to complete its work on the Guide during the fiscal year 1975.

Commission Rates

On September 11, 1973,[7] the Commission announced that it would act promptly to terminate the fixing of commission rates by stock exchanges after April 30, 1975, if the exchanges did not in the meantime adopt rule changes achieving that result. At the same time, the Commission announced that it would not object to a proposal by the New York Stock Exchange (NYSE) to increase fixed commission rates by 10 percent on orders up to $5,000 and by 15 percent on larger orders up to $300,000, effective through March 31, 1974. However, to retain those increases beyond March 31, 1974, exchanges would have to permit member firms to provide customers less than a full range of brokerage services and discounts of up to 10 percent from the then effective commission rate schedule. Subsequently, after discussions with representatives of the exchanges and the member firm community, the Commission determined that it would entertain proposed alternatives to the 10 percent discount but would adhere to the objective which the discount was intended to serve, *i.e.*, a meaningful experimental period prior to the introduction of completely unfixed commission rates on May 1, 1975.[8]

In a letter dated February 7, 1974, the NYSE submitted to the Commission a proposal providing for competitive commissions on orders of $2,000 or less and recission of the prohibition against charging commissions exceeding minimum rates. In a February 21, 1974 letter, however, the NYSE modified that proposal so that intra-member commission rates would remain fixed for all orders up to $300,000. On March 7, 1974, the Commission announced that it would not object to the NYSE's proposals and that it would study further whether to include intra-member rates in the experimental period of limited price competition.[9]

From May 29 through June 4, 1974, the Commission held public hearings[10] to gather comments, views and data concerning (1) whether the initiation in the near future of a limited experiment in competitive intra-member rates of commission on orders not exceeding $2,000 would cause substantial and irreparable harm to floor brokers or

to the market-making function of specialists, and (2) whether exchanges should maintain any prescribed schedules of intra-member rates of commission. The matter is under further study by the Commission's staff and is expected to be resolved during fiscal year 1975.

Rule 19b-2

As previously noted,[11] on January 16, 1973, the Commission adopted Securities Exchange Act Rule 19b-2. The Rule directed each securities exchange registered with the Commission to adopt rules requiring every member "to have as the principal purpose of its membership the conduct of a public securities business." For purposes of the Rule, a member is presumed to be conducting a public securities business if at least 80 percent of the value of exchange securities transactions effected by it consists of business effected for or with persons other than affiliated persons (as defined in the Rule) or consists of certain kinds of transactions which contribute to the liquidity or stability of the markets, such as those effected by a stock exchange specialist in a security in which he is registered. A phase-in period was included in the Rule whereby exchange members who acquired their memberships prior to January 16, 1973, were given up to three years to comply fully with its provisions.

Rules adopted by the New York and American Stock Exchanges to comply with Rule 19b-2 require all members to abide by the public business requirement, no matter when they joined the exchanges. Rules adopted by other exchanges which have complied with Rule 19b-2 apply that requirement only to members who joined on or after January 16, 1973.

After the adoption of Rule 19b-2, various parties, including the PBW Stock Exchange filed petitions for review in the United States Court of Appeals for the Third Circuit to test its validity. On March 19, 1973, that Court stayed the effectiveness of the Rule as to PBW members whose membership antedated the Rule's adoption.

As previously reported[12] the court of appeals dismissed the petitions to review Securities Exchange Act Rule 19b-2 on the ground, as urged by the Commission, that the court lacked jurisdiction directly to review the rule.[13] On January 21, 1974, the petitioners filed a petition for a writ of certiorari in the Supreme Court; that petition was denied on April 29, 1974.[14]

Thereafter, three lawsuits were filed in various United States District Courts, seeking to declare Rule 19b-2 invalid and to enjoin the Rule's operation and enforcement.[15] These suits are presently pending.

On July 29, 1974, the Commission announced[16] that, during the pendency of these actions, it would continue in effect the partial stay of the Rule, in effect since March 1973.[17] All exchanges which had not yet complied with Rule 19b-2 would be required to do so subject to these conditions: (1) all members who joined an exchange after January 16, 1973, the date of the Rule's adoption, would be expected to comply fully with its terms; (2) those members who joined prior to that date could continue membership, if their exchange so decided, without complying with the Rule's public business requirements, provided that their volume of business did not increase substantially pending the outcome of litigation as to the Rule's validity.

The Commission's determination to continue the partial stay was based, in part, on the fact that pending legislation would clarify and resolve most of the fundamental questions relating to the appropriate utilization of stock exchange membership, with which Rule 19b-2 is concerned.

Non-Member Access to the Exchanges

In its release announcing the adoption of Rule 19b-2,[18] the Commission stated that exchanges would be required to amend their non-member access provisions to eliminate any parent or related test as a condition to qualification for the 40 percent non-member discount from fixed exchange commission rates.[19] In addition, the Commission made it clear that exchanges should amend their non-member access rules to provide that the discount would be available only on non-member transactions effected for or with persons other than affiliates.

There has been substantial compliance with the Commission's request. In amend-

ing its non-member access provisions,[20] however, the NYSE submitted to the Commission a restrictive interpretation of the term "affiliated person, found in Rule 19b–2." The proposed interpretation delineated certain circumstances under which the term would include an institutional account over which a money manager exercises investment discretion. In response to the NYSE submission, the Commission informed the NYSE that the terms "affiliated person" and "control" (which is an essential part of the definition of "affiliated person") were assigned by the Commission their traditional legal meanings, and should be construed flexibly depending on the circumstances of each case. The NYSE's interpretation was deemed not to be in accord with these flexible standards of Rule 19b–2.[21]

In a related development the NYSE has submitted an amendment to its rules which would prohibit member and non-member money managers from crediting commission savings against advisory fees.[22] The Commission has solicited public comment on this proposal.[23]

Foreign Access to United States Securities Markets

On February 8, 1974, the Commission requested public comment on questions, the answers to which would enable it to decide whether foreign entities should be permitted to participate fully in the United States securities markets, or to what extent, if any, their participation should be limited or otherwise conditioned.[24] Currently, the participation of foreign persons in U.S. securities markets is a matter subject to the discretion of the self-regulatory organizations, which may elect whether to permit them to seek membership or otherwise participate in the benefits bestowed on domestic non-member broker-dealers.[25]

When the Commission eliminated the parent test from exchange membership requirements by Rule 19b–2, it stated that exchanges could permit firms with foreign parents to become members, at least until that subject could be studied and its respective merits and shortcomings explored, provided that such exchanges could satisfy themselves and the Commission that such members were in compliance with Rule 19b–2.

Consolidated Tape

As previously noted,[26] Securities Exchange Act Rule 17a–15 requires registered national securities exchanges, national securities associations and broker-dealers which are not members of such organizations, to file "plans" with the Commission, on a joint basis if desired, for the consolidated reporting of price and volume data as to completed transactions in exchange-listed securities. Such a plan was filed jointly by the American, Midwest, Pacific, PBW and New York Stock Exchanges and the NASD,[27] and was the subject of two Commission letters of comment to its sponsors.[28] It was subsequently refiled with the Commission[29] and was declared effective by the Commission as of May 17, 1974.[30] The plan, which specifies the manner in which the last sale reports will be collected and disseminated, provides for a 40-week period of development and testing before the consolidated tape becomes fully operational.

The plan's sponsors were working to implement by October 4, 1974 the 20-week pilot phase—a testing period using 15 widely traded NYSE securities.

In this area, the Commission also proposed an amendment to Rule 17a–15 to establish procedures for appeal to the Commission from certain actions which may be taken pursuant to the consolidated tape plan,[31] and exempted from the provisions of Rule 17a–15 the reporting of transactions in listed securities not eligible for reporting pursuant to the plan.[32]

On October 3, 1974, the Commission, pursuant to a request by the New York Stock Exchange, announced that it would not object to a postponement to October 18, 1974, of Phase I of the pilot phase of the consolidated tape, provided that Phase II of the pilot phase would commence as scheduled in February 1975, and that any further educational, mechanical and regulatory problems that may arise in connection with the consolidated tape would be remedied during operation of the tape. Securities Exchange

Act Release No. 11036 (October 3, 1974), 5 SEC Docket 213.

Option Market Regulation

When the Chicago Board Options Exchange (CBOE)[33] began as a pilot operation on April 26, 1973, it had 305 members and it listed call options on 16 NYSE-listed stocks. By the end of fiscal year 1974 it had 560 members and listed call options on 32 NYSE-listed stocks. The average daily volume of options traded reached approximately 23,000 contracts, representing 2,300,000 shares of the underlying stocks.

Because of the increased interest by the public and other securities exchanges in trading options, the Commission held public hearings in February 1974 to consider various questions regarding options trading on and off the exchanges.[34] The scope of the Commission's inquiry was broad and included such matters as whether the trading of options serves a useful economic purpose in relation to the securities markets, whether the various forms of option trading on and off registered securities exchanges serve the public interest, and the impact of exchange option trading on public investing and trading habits. The hearings also focused on the questions whether more than one exchange should trade options, what type of regulatory scheme the Commission should adopt if such multiple trading is permitted, and whether different exchanges should be competitive in trading.

The staff of the Commission, based at least partly upon the hearings, recommended strengthened financial responsibility requirements for CBOE market makers, improvements in the CBOE floor trading procedures, and adoption of appropriate exchange rules to deal with problems arising from trading in away-from-the-money options. The staff also recommended that, prior to expanding the CBOE pilot or the initiation of multiple exchange options trading, all exchanges concerned address themselves to the achievement of a common clearing system, standardization of option terms and conditions, a common tape for reporting transactions in all listed options, and, in view of present non-member broker exchange access provisions (and potential elimination of fixed commission rates) a system enabling all option quotations to be made available on a current basis to all qualified non-members as well as to members.[35] By the end of the fiscal year the Commission had noted that substantial progress in resolving these problems had apparently been made by the CBOE and the exchanges interested in multiple exchange option trading.[36]

On December 15, 1973, the Commission announced the adoption of Rule 9b–1 under the Securities Exchange Act, effective January 17, 1974.[37] This Rule, which was originally proposed on January 9, 1973, and subsequently revised, provides that a national securities exchange which effects transactions in options or allows its facilities to be used to effect transactions in options must file with the Commission a plan, which contains those requirements of the exchange that relate solely or significantly to transactions in options on the exchange. The plan must be declared effective by the Commission before any transaction in options can take place on that exchange. To permit continued CBOE operation, its plan for trading options was declared effective simultaneously with the adoption of Rule 9b–1.[38]

Following the adoption of Rule 9b–1, two additional exchanges, the American Stock Exchange (Amex) and the PBW Stock Exchange (PBW),[39] announced and filed with the Commission plans to begin pilot programs in call option trading. Under both of these plans, the exchanges proposed to rely on their existing specialist systems for making markets in options on their floors rather than to utilize a multiple market-maker system like that of the CBOE.[40] The PBW plan contemplates the trading of options on stocks which are also traded on the PBW. The proposals of both exchanges are currently under review.

The CBOE made numerous changes to its option plan under Rule 9b–1, which became effective. Among other things, it eliminated fixed minimum intra-member clearance commission rates. It also altered its floor trading procedures to provide improved market continuity and competitiveness. For example, multi-member market units were

eliminated and market-making responsibilities were given to individuals. In addition, the board broker was given the ability to call upon market-makers (who are appointed for a particular class of options) to make bids and/or offers not only in the interest of a fair and orderly market but also in the interest of a competitive market. In an effort to give the public more adequate notice of when out-of-the-money options transactions[41] would be restricted, the CBOE has proposed other changes in its plan that were under consideration by the Commission at the end of the fiscal year

On August 22, 1974, the Commission announced that it had approved in principle, subject to further submissions by the Amex, the CBOE and the PBW, and final Commission review: (a) the formation of a central options clearing organization; (b) a proposal for dissemination of last sale information and quotations for exchange options, and (c) proposed standardized terms and conditions for exchange options. The Commission also considered and determined not to object to CBOE's issuance of 195 additional memberships, nor to CBOE's proposal to list additional underlying securities subject to the adoption of satisfactory rules relating to trading away-from-the-money options, nor to CBOE's proposed financial responsibility rules. Further, the Commission advised the Amex that, subject to certain conditions and understandings it would be prepared to make effective that exchange's option plan. (Securities Exchange Act Release No. 10980, August 23, 1974, 5 SEC Docket 40).

As previously reported,[42] the Commission has proposed Securities Act Rule 238 and Securities Exchange Act Rule 9b–2, which would govern put and call options and those who deal in them. These proposed Rules were revised and republished for comment in late 1973.[43] Rule 238, as proposed, would exempt put and call options from the registration requirements of the Securities Act if certain conditions were met. These conditions are: (1) that the issuer of the underlying security be subject to the reporting requirements of the Exchange Act and, in brief, be current in its reporting obligations; (2) that the security underlying the option be registered on a national securities exchange or quoted by at least 5 market makers on an automated quotation system of a national securities association, and such security have a current price, of at least $5; (3) that the gross proceeds received from the sale of specified related options do not exceed $500,000; (4) that the writer of the option be neither the issuer of the underlying security not an underwriter of such security, nor a control person of the issuer; and (5) that the option be endorsed by a broker or dealer registered under Section 15 of the Exchange Act. Because of conditions (3) and (5), the Rule would apply neither to current CBOE option trading nor to the trading contemplated by the Amex and the PBW. Those exchange options would be fully registered under the Securities Act.

The present version of the proposed rule, unlike that previously proposed, is not available for limited price options, those involving a feature by which the option terminates prior to the stated terms, in the event the market price of the underlying security reaches a specified level.

The Rule does not purport to be exclusive; issuers of options can rely upon other exemptions from registration.

Proposed Rule 9b–2 as revised specifies standards of suitability for customers dealing in options, requires the disclosure by brokers and dealers to customers of the nature and risk involved in options, and requires endorsers of options to report their transactions and maintain a net capital of not less than $50,000.

Legislative Initiatives

At the close of the fiscal year, there were a number of bills pending in Congress which if enacted would effect major changes in the structure and regulation of the securities industry. Among the bills as to which the Commission commented, suggested revisions and testified were (1) S. 470, which would require all stock exchange members to conduct a public securities business after the breakpoint in commission rates is lowered to $100,000; (2) S. 3126, which would give the Commission authority to prohibit over-the-counter trading of securities listed on registered national securities ex-

changes; (3) S. 2058, a bill designed to regulate the transfer, clearance and settlement of securities; (4) S. 2234, a bill to require regular and full disclosure by institutional investors of their portfolio holdings and transactions; (5) S. 2707, which would give the Commission limited authority over the securities activities of banks offering automatic investment plan services; (6) S. 2842, which is designed to limit the amount of assets which institutions could invest in any single security and to decrease the rate of taxation on capital gains; and (7) H.R. 8951, a bill to limit foreign private investment in the United States.

Described in more detail below are three bills on which the Commission and its staff particularly devoted substantial amounts of time:

(1) H.R. 5050

In 1972 the Subcommittee on Commerce and Finance of the House Committee on Interstate and Foreign Commerce completed a comprehensive examination of the securities industry.[44] After taking voluminous testimony, the Subcommittee issued a report setting forth the information and analysis obtained, along with conclusions and legislative recommendations concerning almost every aspect of the securities industry with which the Division of Market Regulation is concerned.[45] On March 1, 1973, a bill entitled the *Securities Exchange Act Amendments of 1973*, designated H.R. 5050, was introduced in the House and referred to the Committee on Interstate and Foreign Commerce. On August 13, 1974, the bill was reported by the Subcommittee on Commerce and Finance to the House Committee on Interstate and Foreign Commerce.

Title I of H.R. 5050 would amend the Exchange Act provisions relating to the selection of members of and administration of the Commission. It would provide for concurrent transmission, to Congress and the executive branch, of legislative recommendations, testimony, comments on legislation and budget estimates. Title I would affect the tenure of the Commission's Chairman, authorize the Commission to conduct its own civil litigation, direct the Commission to supply requested documents to its legislative oversight committees in Congress and modify the provisions on Commission appropriations.

Title II is designed, among other things, to conform Section 6 of the Exchange Act to Section 15A of that Act so that national securities exchanges and national securities associations, as well as their members, would be subject to substantially identical regulation. Title II would expand the oversight authority of the Commission over exchange rules and over disciplinary actions by exchanges. It would permit the Commission to eliminate duplicative oversight responsibilities by the self-regulatory organizations. It would also phase out fixed commission rates on national securities exchanges on orders exceeding $300,000, and on orders under $300,000 unless the Commission acted to retain fixed rates, and would prohibit persons from providing both management and brokerage services to the same institutional account.

Title III would amend Exchange Act provisions relating to the regulation of brokers, dealers and exchange members. The revisions would affect, among other things, the financial responsibility requirements, the broker-dealer application, registration and examination process, and certain of the reporting requirements. The revisions would also clarify the Commission's authority to adopt rules with respect to securities information processors and to require a composite transaction tape and a composite quotation system, and would grant the Commission expanded authority over the accounting procedures of broker-dealers and exchange members.

Title IV provides for the development of an integrated national system for the prompt and accurate processing and settlement of securities transactions and includes provisions relating to the regulation and registration of clearing agencies, securities depositories and transfer agents. It also directs the Commission to eliminate by December 31, 1976 the use of the stock certificate as a means of settlement, and clarifies the Commission's authority as to missing or stolen securities.

Provisions of Title IV would designate the Commission as the sole regulator of clear-

ing agencies and depositories regardless of whether these entities are incorporated and authorized to operate as banking organizations. The Commission would be authorized to set standards for such entities, administer registration requirements, conduct inspections and ensure compliance with the standards it has set. Similarly, the Commission would be the sole regulator for those transfer agents which are not banking organizations; in the case of transfer agents organized as banking organizations, the Commission would set the standards and the Federal banking authorities (*i.e.*, the Board of Governors of the Federal Reserve System, Comptroller of the Currency and Federal Deposit Insurance Corporation) would administer registration requirements, conduct inspections and ensure compliance with the standards set by the Commission.[46]

Title V contains several miscellaneous provisions relating to the Commission's Annual Report to Congress and registration fees. In addition, that title would make uniform the criminal penalties which may be imposed for violations of the various Federal securities laws.

Title VI provides for the development of a national securities market system, including a transactional reporting system for eligible securities traded within the system, a composite quotation system for reporting bid and offered quotations in eligible securities, and rules or regulations designed to provide fair competition between competitors in the system. Title VI would grant to the Commission broad authority to regulate the national market system, to determine whether trading in listed securities should be confined to exchanges and to promulgate rules to eliminate unfair competitive advantages among securities dealers resulting from unjustifiable disparities in the regulation of such dealers by the self-regulatory organizations. The Commission would also be directed to study the feasibility of establishing a national market board to regulate the system.

Title VI would, in addition, prevent self-regulatory organizations from limiting, without Commission approval, after July 1, 1975, the ability of their members to transact business on any other exchange, or otherwise than on an exchange. Title VI would also amend the Investment Advisers Act so that, unless expressly provided otherwise by state statute, fiduciary money managers might exercise their reasonable business judgments in evaluating brokerage services and in paying brokerage commissions at reasonable rates even if such rates were in excess of what another broker would have charged.

(2) S. 2519

The Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs held hearings in November and December 1973 on S. 2519 which deals primarily with the subjects of Title II of H.R. 5050. S. 2519 is designed to facilitate the development of a central market system for listed securities and to render more comparable the Commission's oversight of securities exchanges and securities associations registered under the Exchange Act. The Subcommittee reported the bill with amendments to the full Committee, which voted its approval in May 1974. The Senate approved the bill, as amended, later that month.

The bill provides for the regulation of securities communications systems by bringing under the Commission's jurisdiction all organizations engaged in the business of collecting, processing, or publishing information relating to quotations for or transactions in securities. The Commission would be granted broad authority to regulate and oversee the activities of these newly designated "registered securities information processors," as well as the activities of national securities exchanges and associations.

The bill also would impose upon the Commission an affirmative obligation to review the rules of a securities exchange or association to assure that they do not impose any burden on competition, and to amend or otherwise alter such rules if it finds that competition has been impeded.

The bill further provides that public securities orders should be given priority over the orders of securities professionals. It seeks to strengthen the capacity of the securities markets to handle orders of institutional

size and to govern the activities of market makers in a central market system.

The bill would require the Commission to include in its annual reports to Congress information concerning development of a national market system and the activities, capabilities and plans of the self-regulatory organizations relating to development of that system.

The bill also provides for procedural standards which would have to be applied by the self-regulatory organizations in dealings with members and non-members for various purposes. Each organization would be required to make available to the Commission a concise general statement of the basis and purpose of each regulatory amendment it proposed to make and to publish each such amendment for public comment. The bill also would give the Commission broad authority to review the rules of the self-regulatory organizations and would require the Commission to approve any amendment of a rule before the amendment could take effect.

Finally, S. 2519 would authorize the Commission, after making specified findings as to competitive factors, the viability of exchanges and the public interest, to limit trading in listed securities to exchange floors, or to take such other action as it believes may be warranted. This provision is designed to remedy possible serious impairment of the auction trading markets (currently the exchange markets) which might attend the implementation of fully competitive commission rates.

(3) S. 2474

On September 11, 1973, the Commission transmitted to the Senate a proposal to amend the Securities Exchange Act to provide for regulation of trading in municipal securities by securities professionals, including banks. That proposal precipitated the introduction of S. 2474 in the Senate on September 24, 1974.

S. 2474 would provide a new statutory framework for the regulation of municipal securities professionals closely paralleling existing provisions of the Act governing brokers and dealers and their transactions in nonexempt securities. S. 2474 would (i) amend the definition of the term "exempted security" to exclude municipal securities for purposes of Section 15 and 15A of the Act; (ii) create a new class of dealers called "municipal securities dealers", which would include a bank or a "separately identifiable" division or department of a bank to the extent it engages in the business of trading municipal securities for its own account other than in a fiduciary capacity; (iii) provide for a new industry rulemaking board to establish rules governing municipal securities professionals; and (iv) provide for Commission regulation of municipal securities professionals, including banks.

DISCLOSURE RELATED MATTERS

The Rule 140 Series

In the Commission's 1969 Disclosure Policy Study,[47] a number of recommendations were made to improve the overall disclosure process under the Securities Act and the Securities Exchange Act and to promote objectivity in the operation, administration and enforcement of certain provisions of the Securities Act. The principal recommendations of the Study are embodied in a series of Commission rules known as the "Rule 140 Series", comprised of Rules 144, 145, 146 and 147, adopted pursuant to the Securities Act. Rules 144 and 145 were adopted in 1972 and 1973, respectively;[48] during the last fiscal year, the Commission adopted Rules 146 and 147.

Rule 144

Rule 144, "Persons Deemed Not to be Engaged in a Distribution and Therefore Not Underwriters," provides a method of resale of securities acquired in private placements and for securities held by affiliates. During the fiscal year, the Commission adopted several amendments to the Rule. Among others, subparagraph (g)(2) of the Rule was amended to permit brokers to continue to insert bid and ask quotations for a class of securities in an inter-dealer quotation system while selling securities in the class, subject to certain conditions. The amendment also allows a broker to make

inquiries of his customers who have indicated a bona fide unsolicited interest in the securities within the ten business days preceding the broker's receipt of the order to sell securities pursuant to the Rule. The Commission amended also subparagraph (h) to require transmittal of all amended notices of proposed sale on Form 144 to the principal stock exchange on which the securities to be sold are listed for trading.[49]

Rule 145

Rule 145, generally, provides that an "offer" or "sale" of securities is deemed to be involved when there is submitted for the vote or consent of security holders a plan or agreement for (1) reclassifications other than stock splits and changes in par value; (2) mergers, consolidations and similar plans of acquisition except where the sole purpose of such a transaction is to change an issuer's domicile; and (3) certain transfers of assets for securities where there is a subsequent distribution of such securities to those voting on the transfer of assets. On February 28, 1974 the Commission published a release setting forth the Division of Corporation Finance's interpretations of Rule 145.[50] The release deals with the relationship of Rule 145 to certain statutory exemptions; the application of Rule 145 to various types of reclassifications and business combination transactions; the type of communications deemed not to be a "prospectus" for purposes of Rule 145; resales of securities acquired in Rule 145 transactions; and related matters. On July 2, 1974, the Commission published a second interpretive release regarding the registration procedures applicable to open-end investment companies issuing securities in business combination transactions subject to Rule 134.[51]

Rule 146

The so-called "private offering" exemption from registration under the Securities Act, Section 4(2), provides that offers and sales by an issuer not involving any public offering will be exempt from registration. The section has long been a source of uncertainty for issuers wanting to sell their securities in private placements. In April 1974, the Commission adopted Rule 146 under the Securities Act, "Transactions by an Issuer Deemed Not to Involve Any Public Offering," which is designed to protect investors while at the same time providing more objective standards to curtail uncertainty as to the meaning of Section 4(2) to the extent feasible.[52]

In general, the Rule provides that transactions by an issuer meeting all the conditions of the Rule do not involve "any public offering." Major conditions to be met in general are that (1) there must be no general advertising or solicitation in connection with the offering; (2) offers can be made only to persons who the issuer reasonably believes have the requisite knowledge and experience in financial and business matters, or to persons who the issuer reasonably believes can bear the economic risk; (3) sales can be made only to persons who the issuer reasonably believes have the requisite knowledge and experience, or who can bear the economic risk and have an advisor (meeting certain standards) who can provide the requisite knowledge and experience; (4) all offerees either must have access to or must be furnished with the type of information that registration would disclose; (5) there can be no more than 35 purchasers of securities in the offering; and (6) reasonable care must be taken to prevent resale of the securities in violation of the registration provisions of the Securities Act.

Rule 146 does not provide the exclusive means for offering and selling securities in reliance on Section 4(2). Issuers may continue to rely on the Section 4(2) exemption by complying with relevant administrative and judicial criteria at the time of a transaction. The staff of the Commission will issue interpretative letters to assist persons in complying with the Rule, but will issue no-action letters relating to Section 4(2) only in the most compelling circumstances.

Rule 147

Section 3(a)(11) of the Securities Act, the intrastate offering exemption, which exempts from registration securities that are part of an issue offered and sold only to persons resident in a specific state by an issuer that is also resident and doing busi-

ness in that state, has been widely relied upon, but has also been the source of inquiry, misunderstanding, and uncertainty over the years. On January 7, 1974 the Commission adopted Rule 147 under the Securities Act which defines certain terms in, and clarifies certain conditions of, the intrastate offering exemption.[53] The Rule provides some objective standards for determining when a person is considered a resident within a state and whether an issuer is "doing business within" a state for purposes of the exemption. The Rule does not define which offers and sales constitute "part of an issue" but relies instead on the traditional understanding of when offers and sales will be integrated; it does however provide a "safe harbor" as to certain offers and sales. The Rule benefits only issuers and is nonexclusive. Since the adoption of Rule 147, the staff of the Commission has ceased responding to requests for no-action letters under Section 3(a)(11) except in the most compelling circumstances; but the staff does provide interpretative guidance as to the use of the Rule.

Campaign Fund Disclosure

During the fiscal year, the Commission announced that it had denied a rulemaking petition which had proposed that the Commission amend its proxy rules to require disclosure in proxy soliciting materials or in corporate annual reports of information required to be filed with the Congress or with the Comptroller General under the Federal Election Campaign Act of 1971 ("FECA").[54] The information relates to "the establishment, administration and solicitation of contributions to a separate segregated fund to be utilized for political purposes by a corporation. . . ," as permitted by FECA. The Commission noted that Congress had expressly specified the channels for the dissemination of information filed under the Act, and that the Commission could not assume that those channels were inadequate to achieve the Congressional goal of "wide dissemination" of the information. The Commission found itself unable to conclude that the information contained in the reports filed under FECA was of sufficient relevance to security holders to warrant adoption of the suggested amendments to the proxy rules.

In a separate action on March 8, 1974, the Commission announced the views of the Division of Corporation Finance as to whether disclosure should be made when the issuer and/or its officers or directors have been charged in an information or indictment with, or convicted of, making illegal campaign contributions in violation of 18 U.S.C. 610. That law makes it unlawful, among other things, for a corporation to make a contribution in connection with any election for President, Vice-President, Senator or Congressman or any primary election or convention or caucus to select nominees for any of such offices.[55] In the Division's view, the conviction of a corporation, its officers or directors for having made illegal campaign contributions in violation of 18 U.S.C. 610 is a material fact that should be disclosed to the public and specifically to shareholders particularly in the context of proxy statements in which such shareholders are being asked to vote for management. The release explains, in addition, that disclosure of such convictions, or pleas of guilty or *nolo contendere*, should be made in periodic reports under the Exchange Act, and in registration statements filed under the Securities Act.

The release states that such a conviction is material to an evaluation of the integrity of the management of the corporation as it relates to the operation of the corporation and the use of corporate funds. The Division's position as to disclosure of a pending indictment or information is that management is usually in the best position to determine whether disclosure is necessary.

Fuel Shortages, Extractive Reserve and Natural Gas Supplies

In view of present energy shortages and the actual or potential impact that such shortages may have on the operations of issuers subject to the registration and reporting provisions of the Federal securities laws, on December 20, 1973, the Commission issued a release reiterating the importance of making prompt and accurate disclosure of information, both favorable and

unfavorable, to security holders and the investing public.[56] The Commission recognized that the extent of possible energy shortages and the impact of shortages on particular industries or issuers might not be determinable at the time and stated it was not in a position to publish guidelines for disclosure. The Commission emphasized, however, that under the securities laws, the responsibility for making full and fair disclosure in filings with the Commission rests with the issuers required to make those filings; and that management has the responsibility to make full and prompt announcements of material facts concerning its issuer's operations.

On July 3, 1974, the Commission announced that Guide 28, "Extractive Reserves," of the Guides for Preparation and Filing of Registration Statements[57] under the Securities Act of 1933 had been amended to require that when using Forms S–1 and S–7 under the Securities Act, registrants engaged in the gathering, transmission, or distribution of natural gas must disclose material information based upon the facts and circumstances of their particular situation, with respect to the current availability of gas supplies.[58] The Guide sets forth certain nonexclusive factors that firms in the gas industry should consider in making disclosure of their capacity to respond to users' needs for natural gas. Guide 28 was also recaptioned "Disclosure of Extractive Reserves and Natural Gas Supplies."

The Commission also adopted the substance of Guide 28, as amended, as Guide 2 of the Guides for Preparation and Filing of Reports and Registration Statements under the Securities Exchange Act of 1934. Paragraph (a) of Guide 2 requires that companies engaged in extractive operations include, where appropriate, the quantitative amount of their estimated reserves on Form 10. Paragraph (b) applies to issuers engaged in the gathering, transmission or distribution of natural gas and provides for disclosure in Forms 10 and 10K similar to that required of registrants by Guide 28.

On June 14, 1974, the Commission announced certain practices followed by the Division of Corporation Finance in connection with the processing of filings which require information of registrants as to natural gas reserve estimates.[59] The Division will request registrants to explain differences between natural gas reserve estimates contained in filings with this Commission and estimates reported to any other regulatory authority within one year prior to the filing. In addition, copies of prospectuses filed by registrants subject to the Federal Power Commission will be submitted to that agency for comments and generally appropriate technical personnel from the FPC will be invited to attend conferences where supplemental natural gas reserve information submitted by a registrant is reviewed.

Annual Reports to Security Holders

On January 10, 1974, based in part on certain recommendations of the Commission's Industrial Issuers Advisory Committee,[60] the Commission proposed various amendments to its proxy rules dealing with the information required to be furnished to security holders in connection with meetings of security holders and the solicitation of proxies.[61] The proposals deal with improving both disclosure in and dissemination of annual reports to security holders.

Generally, the proposals would require that an issuer's annual report to security holders disclose the nature of its business, a lines-of-business breakdown as to sales and profits and a summary of its operations, all of which would be comparable to that information set forth in the issuer's annual report filed with the Commission, usually on Form 10–K. The issuer's annual report to security holders would also be required to disclose textual information regarding the nature and scope of the issuer's liquidity and working capital requirements based upon such considerations as peak seasonal demands for working capital, availability and cost of credit, policies followed with respect to the magnitude of inventory to be maintained, and future financing plans and requirements. Additionally, the proposals would require that the annual report to security holders disclose certain background information regarding an issuer's directors and executive officers; certain statistical information regarding dividends paid and the

high and low prices for the issuer's securities for each quarter during the past two years; and a statement of the issuer's dividend policy.

With respect to dissemination, the proposals would require an issuer to make inquiries of brokers, dealers, banks and voting trustees to determine whether other persons are the beneficial owners of securities held of record by such persons. If there are such other beneficial owners, an issuer would have to obtain information as to the number of proxy statements and annual reports required; supply the record holder with sufficient copies for distribution to the beneficial owners; and pay reasonable expenses of the record holder for mailing the material to the beneficial owners.

Finally, the proposals would require that a proxy statement contain a boldface undertaking that an issuer will furnish a copy of an annual report filed with the Commission (usually on Form 10–K) upon receipt of a written request from any person solicited in connection with the annual meeting.

Proposed Rule 240

On June 3, 1974, the Commission published for comment Proposed Rule 240 (and related Form 240), "Exemption of Certain Limited Offers and Sales by Closely Held Issuers," which would exempt from registration under the Securities Act limited offers and sales of small dollar amounts of securities to a limited number of purchasers by an issuer that, after the transactions pursuant to the rule, would continue to have a small number of beneficial owners of its securities.[62] The rule would be adopted pursuant to Section 3(b) of the Act. The Rule would not be available for resales.

In general, the proposed rule would exempt transactions by an issuer (other than a limited partnership) where (a) there was no general advertising or solicitation; (b) no renumeration was paid for soliciting prospective buyers; (c) the aggregate sales price of securities of the issuer sold by the issuer was not more than $100,000 in a twelve month period: (d) there were no more than 25 purchasers of the issuer's securities from the issuer in any twelve month period; (e) the securities of the issuer were beneficially owned, before and after the transaction, by 50 or fewer persons; and (f) the issuer informed the purchasers of restrictions on resale. In addition, the issuer would be required to file a notice of proposed sales on Proposed Form 240. In connection with the proposal, the Commission proposed an amendment to Rule 144 that would make that Rule available for securities acquired in a Rule 240 transaction. The staff is now considering the comments received on the proposed rule.

Textual Analysis of Summary of Earnings or Operations

On August 12, 1974 the Commission amended Guide 22, "Summary of Earnings," of the Guides for Preparation and Filing of Registration Statements under the Securities Act of 1933 as well as Guide 1, "Summary of Operations," of Guides for Preparation and Filing of Reports and Registration Statements under the Securities Exchange Act of 1934.[63]

Under the Guides, the issuer is required to make an analysis and give an explanation of the Summary of Earnings or Summary of Operations, as the case may be, whenever there are material changes in the amount and source of revenues and expenses, including tax expenses, or changes in accounting principles or methods or their application that have a material effect on net income or loss. The issuer should include, in the explanation, a discussion of material facts, whether favorable or unfavorable, required to be disclosed or disclosed in the prospectus, registration statement, or report which in the opinion of management may make historical operations or earnings as reported in Summary of Earnings or Summary of Operations not indicative of current or future operations or earnings.

In announcing the adoption of these Guides the Commission stated that investors should understand the extent to which accounting changes, as well as changes in business activity, have affected the comparability of year to year financial data included in the Summary of Earnings or Summary of Operations and should be in a position to assess the source and probability of recurrence of net income (or loss)

Disclosure of Professional Litigation

On July 25, 1973 the Commission announced an inquiry by the Division of Corporation Finance in conjunction with the Office of the Chief Accountant, to obtain information and ascertain views of interested persons relating to the disclosure in filings with the Commission of litigation involving professionals, such as accountants and lawyers, who practice before the Commission.[64] The Commission received 36 letters from professionals, corporations and interested associations who expressed their views and addressed themselves to the eight points raised in the release. The staff has the matter under consideration.

Real Estate Matters

The continued development of new ways to finance and sell real estate and the applicability of the Federal securities laws to such transactions continued to be an area of evolving interpretations and practice.

On March 1, 1974,[65] the Commission published proposed Guide 60, "Preparation of Registration Statements Relating to Interests in Real Estate Limited Partnerships," of the Guides for Preparing and Filing Registration Statements under the Securities Act. The proposed Guide contains comments and suggestions developed by the Division of Corporation Finance in processing registration statements relating to real estate limited partnerships. The comments received on the proposed Guide are being studied by the staff. The Division will continue to apply the substance of the Guide to filings during the comment period and thereafter, unless the Guide is adopted in an amended form.

See the discussion in Part 2 for a description of other developments related to real estate.

INVESTMENT COMPANIES

Variable Life Insurance

In the past fiscal year, the Commission conducted further hearings to determine whether to amend rules which presently exempt certain variable life insurance from the requirements of the Investment Company Act and the Investment Advisers Act.[66] Basically, the term variable life insurance refers to insurance contracts in which the death benefit, cash surrender value and other benefits vary to reflect the investment experience of a life insurance company's separate account which invests primarily in equity securities.

The Commission was persuaded to adopt Rule 3c–4 under the Investment Company Act and Rule 202–1 under the Advisers Act largely in recognition of the developing system of state insurance laws and regulation covering variable life, which the Commission believed would provide protections for purchasers substantially equivalent to relevant protections afforded by the 1940 Acts. However, in September 1973,[67] the Commission expressed concern that contracts might be sold in certain states prior to adoption by such states of necessary protections. In January 1974,[68] the Commission ordered hearings to assist it in determining whether Rules 3c–4 and 202–1 should be conditioned so that exemption from the Acts would be available only upon specific determination by the Commission that applicable state laws and regulations provide protections for purchasers substantially equivalent to relevant provisions of the 1940 Acts.

The Commission indicated it would consider whether the Model Variable Life Insurance Regulation developed by the National Association of Insurance Commissioners would meet the terms of the proposed amendments. Public hearings were conducted between March 25 and 28, 1974, and the staff is presently considering the substantial comments received from many interested persons.

A petition for review filed in the United States Court of Appeals in Washington, D.C. by a group of large mutual fund complexes seeking review and reversal of the adoption of the Rules[69] was stayed by the court in reliance upon the Commission's announced intention to review them.

ENFORCEMENT MATTERS

Joint SEC-NASD Task Force

In 1973, the Commission announced that it would participate in the formation of a

Joint Task Force with the NASD to investigate certain abuses emerging in the over-the-counter market. The Task Force was established to mobilize efficiently the resources of the Commission and the NASD to prevent the consummation of manipulative activities. Broker-dealers were selected as the focal points of investigation because of their strategic position in the securities industry.

During the past fiscal year, the Task Force was utilized in the New York, Salt Lake City and Los Angeles regions with very impressive results in the breadth and number of enforcement actions instituted. As a result, of its efforts, ten injunctive actions involving approximately 43 defendants, and thirteen administrative proceedings naming nearly 110 respondents have been brought by the Commission. In addition, trading in the securities of ten issuers was suspended to prevent the consummation of ongoing frauds. There has also been a criminal conviction for conduct uncovered by the Task Force. The NASD itself recently terminated the membership of a broker-dealer and sanctioned its principal. The Task Force is to continue its work in the three locations named above and consideration will be given to moving into new areas in the near future.

Municipal Bonds

The Division's staff is continuing its investigation of sales and trading practices within the municipal bond industry. In this area, during the fiscal year 1974, four civil actions were filed or pending in which 50 defendants, including 11 municipal bond dealers, were charged with violations of the Federal securities laws. While brokers and dealers who transact business only in municipal bonds are not required to register with the Commission as brokers and dealers, their activities generally are subject to the antifraud provisions of the Securities Act and the Securities Exchange Act.[70]

Whisky Interests

On January 7, 1974, the Commission in coordination with the Office of Consumer Affairs, issued a release on investment in whisky interests.[71] The release was designed to warn the American public of the dangers of investing in Scotch Whisky stored in casks in Scotland and held for promised capital gains over a four-year period. The release stated that the sales of such interests were usually made under such circumstances as to bring them within the definition of the term "security" in the Federal securities laws. The release further advised that many false and misleading statements were made in the promotion of such interests. The release pointed out that, among other things, promoters promised a 20-25 percent return per annum, made no disclosure regarding the quality of the whisky sold, failed to state that the price of the whisky sold to Americans was far in excess of the normal market price in Great Britain (sometimes 100 percent in excess of that price) and that the relatively limited quantities of whisky sold to individual investors often make resale very difficult.[72]

Significant Cases

U.S. v. *Stanley Goldblum.*[73]—In connection with one of the largest and most shocking frauds in recent years, 22 individuals associated with Equity Funding Corporation of America were indicted. Basically, defendants were alleged to have created fictitious life insurance policies which were then sold to other insurance companies for immediate cash. The indictment also charges that bank documents, securities purchase confirmations and bonds were counterfeited for the purpose of falsely portraying the income and assets of Equity Funding. The indictment alleges that this false financial picture was instrumental in increasing the market price of Equity Funding stock and in assisting Equity Funding's efforts to borrow money, make successful debenture offerings and conclude mergers.

Thirteen of the 22 defendants pled guilty to various counts of the indictment. The case is scheduled for trial as to the remaining defendants in fiscal year 1975.

National Student Marketing Corporation (NSMC)[74]—On January 17, 1974, a Federal Grand Jury in the Southern District of New York returned a 14-count indictment nam-

ing, among others, Cortes W. Randell, the former President of NSMC, and Bernard J. Kurek, its former chief accounting officer, Robert C. Bushnell and Dennis M. Kelly, former salesmen and executives of NSMC and John G. Davies, formerly its chief internal counsel. They were alleged to have conspired to violate the Federal mail and wire fraud statutes, antifraud provisions of the Securities Act and Securities Exchange Act and filing provisions of the Securities Exchange Act, in connection with the issuance in 1968 and 1969 of false and misleading financial statements and reports concerning the assets and earnings of NSMC.

The indictment also charges Anthony M. Natelli, a partner in the firm of Peat, Marwick, Mitchell & Co., outside auditors for NSMC, Joseph Scansaroli, a former employee of that firm, Randell, Kelly, Bushnell and Kurek, with making false and misleading statements in a proxy statement filed with the Commission in mid-1969.

The indictment charges that in March 1968, Randell and the four former employees of NSMC began a fraudulent scheme for recording income and assets on the financial statements of the corporation with respect to "contracts in progress," although they knew the income and assets resulting from those contracts were largely nonexistent, and that Randell used false reports of the corporation's sales, earnings and future prospects in attempting to induce financial institutions, private investors, and the shareholders of acquisition candidates to accept NSMC stock for money, property and securities. According to the indictment, shareholders of NSMC received an annual report for the company containing misleading financial statements for the fiscal year ended August 31, 1968 and misleading interim reports for subsequent periods.

In connection with the sale of more than 2,000,000 shares of NSMC stock in late 1969, Randell is alleged to have failed to disclose that NSMC's internal youth marketing division had operated at a loss during the fiscal year ended August 31, 1969 and was being substantially disbanded; that published reports and projections of substantial earnings by the corporation were based in large part on the earnings of other companies acquired by the corporation after August 31, 1969; that prior favorable reports as to the corporation's sales and earnings had been based in part on nonexistent contracts; and that unfavorable accounting adjustments had been made to the sales and earnings figures which had been reported previously for the year ended August 31, 1968 and for the nine-month period ended May 31, 1969.

The indictment also alleges that the stock of NSMC was manipulated from its initial offering price of $6 per share to $70 per share (after a 2 for 1 stock split). Finally the indictment charges that Randell, Bushnell and Kelly profited from the sale of their NSMC stock during 1969 and that Randell, individually, made $3,000,000 on the sale of his stock during 1969.

In carrying out the conspiracy, Randell, Bushnell and Kelly are alleged to have used forged letters purporting to be commitments from the Pontiac Division of the General Motors Corporation, Eastern Air Lines and American Air Lines to purchase National Student Marketing services.

S.E.C v. *American Shipbuilding Company*[75]—In April 1974, the Commission sued American Shipbuilding and its chief executive officer, George M. Steinbrenner III, for having failed to disclose in documents filed with the Commission and to its shareholders, as allegedly required by the Securities Exchange Act, that corporate funds were being used for illegal contributions to political campaigns. This action was the first one instituted by the Commission making such allegations.

S.E.C v. *U.S. Financial, Inc. (USF)*; *In the Matter of Touche Ross & Co.*—On February 25, 1974, the Commission, in major related actions, (1) filed suit in the United States Court for the Southern District of California against USF, its former chairman, president, special outside securities counsel, and four purchasers of USF's assets, alleging the issuance and filing by USF of false financial reports;[76] and (2) censured Touche Ross & Co. and imposed certain other remedial sanctions on it, in connection with its audits of USF for the years 1970 and 1971.[77]

The court action charged defendants with having schemed to publish financial statements reflecting fictitious earnings of mil-

lions of dollars for USF from 1969 through 1972 by causing USF to engage in purportedly arm's length transactions with purchasers of USF properties who were in fact nominees of USF (and in some instances nominees of USF's former chairman). Pursuant to the alleged scheme, the purchasers obtained down payments either directly or indirectly through loans or loan guarantees furnished by USF or USF's chairman who pledged his own USF common stock as security for the bank loans. USF also continued to bear the risks of ownership of the properties through secret guarantees against loss. USF's funds were also alledgedly diverted to the purported purchasers to fund their repayments to USF and USF's former chairman. USF and one of the alleged purchaser-nominees consented to the issuance of permanent injunctions. The matter is still pending as to USF's former chairman, president, special counsel and three alleged nominees.

As to Touche Ross, the Commission found that the firm had failed to obtain sufficient independent evidence and supporting materials to support its professional opinion in regard to the phony purchases of USF properties and that Touche had failed to appraise fully the significance of information known to it and to extend sufficiently its auditing procedures under conditions which called for great professional skepticism. Touche Ross consented to the findings and sanctions without admitting or denying the charges.

S.E.C. v. *Robert L. Vesco, and IOS Ltd.*[78]— As a direct result of the Commission's suit against Robert Vesco, IOS Ltd. and others filed in November 1972, liquidators have been appointed outside the United States for IOS Ltd, Transglobal Financial Services Ltd., and Fund of Funds Ltd. The Commission has been cooperating with the liquidators in their efforts to protect and reclaim the assets of the various funds involved.

Lawsuits have been filed by the Special Counsel to International Controls Corp., appointed by the U.S. Federal Court, against Vesco and others to reclaim money allegedly misappropriated from the company. In addition, two of the funds have filed suits asserting claims for monies they assert were fraudulently misappropriated from them.

A committee of regulatory authorities from the United States, Canada, Luxembourg, and the Netherlands Antillies has been established which is overseeing the activities of the various liquidators. In the meantime, the Commission's suit is being pursued.

S.E.C. v. *Westgate-California Corp.*[79]— This case involved the allegedly fraudulent inflation of earnings of this public company by C. Arnholt Smith and others through control and misuse of the assets of United States National Bank of San Diego. The alleged scheme consisted in part of effecting purported sales of Westgate's assets to nominees at grossly inflated prices. The nominees paid the purchase prices with money from loans by United States National Bank arranged and approved by Smith. As a result of the conduct involved in this case, both Westgate-California and United States National Bank went bankrupt. The bankruptcy of the bank involving over $400 million in loans of doubtful collectability, was the largest ever of a national bank in the United States.

During the past year, judgments of injunction by consent were entered against all of the defendants.[80] Defendant Smith was further ordered to resign as an officer or director of all public companies of which he was then acting. More recently, the United States Attorney in San Diego obtained indictments against Smith and Philip A. Toft, another defendant in the Commission's action, relating in part to their conduct with respect to Westgate-California and United States National Bank.

NOTES TO PART 1

[1] Advisory Committee on Market Disclosure (April-September 1972); Advisory Committee on a Central Market System (April-December 1972); and Advisory Committee on Block Transactions (April-August 1972).

[2] Securities Industry Study, Report of the Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs, 93d Cong., 1st Sess. (Comm. Print, 1973); Securities Industry Study, Report of the Subcommittee on Commerce and Finance of the House Committee on Interstate

and Foreign Commerce, H.R. Rep. No. 92–1519, 92nd Cong., 2d Sess. (1972).

[3] Securities Exchange Act Release No. 10688 (March 18, 1974), 3 SEC Docket 722.

[4] Securities Exchange Act Release No. 10790 (May 10, 1974), 4 SEC Docket 273.

[5] Securities Exchange Act Release No. 10612 (January 24, 1974), 3 SEC Docket 423.

[6] Securities Exchange Act Release No. 10808 (May 16, 1974), 4 SEC Docket 304.

[7] Securities Exchange Act Release No. 10383 (September 11, 1973), 2 SEC Docket 425.

[8] Securities Exchange Act Release No. 10560 (December 14, 1973), 3 SEC Docket 250.

[9] Securities Exchange Act Release No. 10670 (March 7, 1974), 3 SEC Docket 654.

[10] The hearings were announced in Securities Exchange Act Release No. 10751 (April 23, 1974), 4 SEC Docket 191.

[11] 39th Annual Report, p. 9.

[12] 39th Annual Report, p. 9.

[13] *PBW Stock Exchange* v. *Securities and Exchange Commission,* 485 F. 2d 718 (C.A. 3, 1973).

[14] 73-1134.

[15] *Connecticut Nutmeg Securities, Inc.* v. *Securities and Exchange Commission,* D. Conn., No. N–74–114 (May 8, 1974); *PBW Stock Exchange, Inc.* v. *Securities and Exchange Commission,* E.D. Pa., No. 74–1198 (May 10, 1974); *Equity Services Inc., Glicoa Associates, Inc.* and *Penn Mutual Securities Corporation* v. *Securities and Exchange Commission,* E.D. Pa., No 74–1589 (June 21, 1974).

[16] Securities Exchange Act Release No. 10934, 4 SEC Docket 658.

[17] Securities Exchange Act Release No. 10052 (March 22, 1973), 1 SEC Docket No. 8, p. 3.

[18] Securities Exchange Act Release No. 9950 (January 16, 1973).

[19] Under the so-called "parent test" an exchange member and any parent of a member had to be engaged primarily in the transaction of business as a broker or dealer in securities or commodities. The effect of that rule was to prevent those not engaged primarily in the securities or commodities business from entering the securities business through an exchange member subsidiary.

[20] NYSE Rule 385.

[21] *See* Securities Exchange Act Release No. 10391 (September 13, 1973), 2 SEC Docket 429.

[22] *See* NYSE Rule 440A.11.

[23] *See* Securities Exchange Act Release No. 10824 (May 24, 1974), 4 SEC Docket 342.

[24] Securities Exchange Act Release No. 10634 (February 8, 1974), 3 SEC Docket 507.

[25] For example, the NYSE and Amex have prohibited foreign brokerage firms or banks, or U.S. subsidiary broker-dealers owned or controlled by foreign persons, from obtaining membership or profitable access. Other exchanges, such as the PBW and Midwest Stock Exchange have permitted foreign entities to purchase direct membership as well as permitting foreign entities, including banks, to gain membership through ownership of a U.S. subsidiary company.

[26] 39th Annual Report, p. 9.

[27] Securities Exchange Act Release No. 10026 (March 5, 1973), 1 SEC Docket No. 6 at 1.

[28] Securities Exchange Act Release No. 10218 (June 13, 1973), 1 SEC Docket No. 20 at 6; Securities Exchange Act Release No. 10671 (March 8, 1974), 3 SEC Docket 655.

[29] Securities Exchange Act Release No. 10760 (April 26, 1974), 4 SEC Docket 199.

[30] Securities Exchange Act Release No. 10787 (May 10, 1974), 4 SEC Docket 271.

[31] Securities Exchange Act Release No. 10788 (May 10, 1974), 4 SEC Docket 272.

[32] Securities Exchange Act Release No. 10851 (June 13, 1974), 4 SEC Docket 425.

[33] 39th Annual Report, pp. 10–11.

[34] Securities Exchange Act Release No. 10490 (November 14, 1973), 3 SEC Docket 39.

[35] Letters to Joseph Sullivan, President of CBOE and Paul Kolton, Chairman of Amex from Lee A. Pickard, Director, Division of Market Regulation dated April 25, 1974.

[36] Securities Exchange Act Release No. 10981 (August 22, 1974), 5 SEC Docket 41.

[37] Securities Exchange Act Release No. 10552 (December 13, 1973), 3 SEC Docket 224.

[38] *Id.*

[39] Securities Exchange Act Release No. 10602 (January 15, 1974), 3 SEC Docket 395.

[40] CBOE has split the traditional specialist functions between a board broker (agent) and market-makers (dealers).

[41] The proposed CBOE rule defines as an out-of-the-money option one which is selling at $.50 or less or one where the underlying security is 5 points away from the exercise price.

[42] 39th Annual Report, pp. 10–11.

[43] Securities Act Release No. 5444 (December 13, 1973), 3 SEC Docket, 204; Securities Exchange Act Release No. 10550 (December 13, 1974), 3 SEC Docket 213.

[44] See Study of the Securities Industry, Hearings Before the Subcommittee on Commerce and Finance of the House Committee on Interstate and Foreign Commerce, 92d Cong., 1st and 2d Sess. Parts 1–9 (1971, 1972).

[45] H. R. Rep. No. 92–1519, 92d Cong., 2d Sess. (Oct. 4, 1972).

[46] In contrast, the Senate version S. 2058, which was passed by the Senate on July 30, 1973 and referred to the House, would provide for dual regulation of securities depos-

itories, clearing agencies, and transfer agents. The Commission would have general oversight responsibility with respect to those entities and would coordinate its activities, to the maximum possible extent possible, with the Federal Reserve Board, the Comptroller of the Currency and the Federal Deposit Insurance Corporation. Those authorities would have the primary responsibility to conduct inspections and enforce the bill's provisions with respect to depositories, transfer agents and clearing agencies incorporated as banks. The Commission would have inspection and enforcement responsibilities with respect to all such entities not incorporated as banks.

[47] See 35th Annual Report, p. 21.

[48] See 38th Annual Report, p. 12; 39th Annual Report, p. 15.

[49] Securities Act Release No. 5452 (February 1, 1974), 3 SEC Docket 449.

[50] Securities Act Release No. 5463 (February 28, 1974); 3 SEC Docket 600.

[51] Securities Act Release No. 5510 (July 3, 1974); 4 SEC Docket 524.

[52] Securities Act Release No. 5487 (April 23, 1974), 4 SEC Docket 154.

[53] Securities Act Release No. 5450 (January 7, 1974), 3 SEC Docket 349.

[54] Securities Exchange Act Release No. 10325 (August 7, 1973), 2 SEC Docket 259.

[55] Securities Act Release No. 5466 (March 8, 1974), 3 SEC Docket 647.

[56] Securities Act Release No. 5466 (March 8, 1974), 3 SEC Docket 647

[57] Securities Act Release No. 4936, as amended.

[58] Securities Act Release No. 5511 (July 3, 1974), 4 SEC Docket 525. The amendments were effective August 1, 1974. The amendment to Guide 28 and the adoption of Guide 2 were proposed in Securities Act Release No. 5454 (February 7, 1974), 3 SEC Docket 497.

[59] Securities Act Release No. 5504 (June 14, 1974), 4 SEC Docket 417.

[60] See 39th Annual Report, pp. 16–17.

[61] Securities Exchange Act Release No. 10591 (January 10, 1974), 3 SEC Docket 359.

[62] Securities Act Release No. 5499 (June 3, 1974), 4 SEC Docket 376.

[63] Securities Act Release No. 5520 (August 14, 1974), 5 SEC Docket 727. See 39th Annual Report, p. 17.

[64] Securities Act Release No. 5411 (July 25, 1973), 2 SEC Docket 189.

[65] Securities Act Release No. 5465 (March 1, 1974), 3 SEC Docket 606.

[66] Earlier, on January 31, 1973 (Securities Act Release No. 5360), the Commission had determined that variable life contracts, issuers and related persons were subject to the Federal securities laws but should be exempt from the regulatory requirements of the Investment Company and Advisers Acts. See 39th Annual Report, p. 19.

[67] Investment Company Act Release No. 8000 (September 20, 1973), 2 SEC Docket 481.

[68] Investment Company Act Release No. 8216 (January 31, 1974), 3 SEC Docket 488.

[69] Wellington Management Co. v. SEC, Civ. No. 73–1188.

[70] For specific cases involving municipal bond dealers, see pages 84–85 in Part IV.

[71] Securities Act Release No. 5451 (January 7, 1974), 3 SEC Docket 356.

[72] See pages 81–82 in Part IV for specific Commission enforcement actions.

[73] Litigation Release No. 6122 (November 1, 1973), 2 SEC Docket 714.

[74] Litigation Release No. 6207 (January 18, 1974), 3 SEC Docket 419.

[75] Litigation Release No. 6319 (April 15, 1974), 4 SEC Docket 148.

[76] Litigation Release No. 6258 (February 25, 1974), 3 SEC Docket 641.

[77] Securities Act Release No. 5459 (February 25, 1974), 3 SEC Docket 594.

[78] Previously reported in 39th Annual Report, pp. 22–23.

[79] Litigation Release No. 5941 (June 21, 1973), 2 SEC Docket 29.

[80] Litigation Release No. 6142 (November 9, 1973), 3 SEC Docket 30.

PART 2

THE DISCLOSURE SYSTEM

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THE DISCLOSURE SYSTEM

A basic purpose of the Federal securities laws is to provide disclosure of material financial and other information on companies seeking to raise capital through the public offering of their securities, as well as companies whose securities are already publicly held. This aims at enabling investors to evaluate the securities of these companies on an informed and realistic basis.

The Securities Act of 1933 generally requires that before securities may be offered to the public a registration statement must be filed with the Commission disclosing prescribed categories of information. Before the sale of securities can begin, the registration statement must become "effective." In the sales, investors must be furnished a prospectus containing the most significant information in the registration statement.

The Securities Exchange Act of 1934 deals in large part with securities already outstanding and requires the registration of securities listed on a national securities exchange, as well as over-the-counter securities in which there is a substantial public interest. Issuers of registered securities must file annual and other periodic reports designed to provide a public file of current material information. The Exchange Act also requires disclosure of material information to holders of registered securities in solicitations of proxies for the election of directors or approval of corporate action at a stockholders' meeting, or in attempts to acquire control of a company through a tender offer or other planned stock acquisition. It provides that insiders of companies whose equity securities are registered must report their holdings and transactions in all equity securities of their companies.

PUBLIC OFFERING: THE 1933 SECURITIES ACT

The basic concept underlying the Securities Act's registration requirements is full disclosure. The Commission has no authority to pass on the merits of the securities to be offered or on the fairness of the terms of distribution. If adequate and accurate disclosure is made, it cannot deny registration. The Act makes it unlawful to represent to investors that the Commission has approved or otherwise passed on the merits of registered securities.

Information Provided

While the Securities Act specifies the information to be included in registration statements, the Commission has the authority to prescribe appropriate forms and to vary the particular items of information required to be disclosed. To facilitate the registration of securities by different types of issuers, the Commission has adopted special registration forms which vary in their disclosure requirements so as to provide maximum disclosure of the essential facts pertinent in a given type of offering while at the same time minimizing the burden and expense of compliance with the law. In recent years, it has adoped certain short forms, notably Forms S-7 and S-16, which

do not require disclosure of matters already covered in reports and proxy material filed or distributed under provisions of the Securities Exchange Act.

Reviewing Process

Registration statements filed with the Commission are examined by its Division of Corporation Finance for compliance with the standards of adequate and accurate disclosure. Various degrees of review procedures are employed by the Division.[1] While most deficiencies are corrected through an informal letter of comment procedure, where the Commission finds that material representations in a registration statement are misleading, inaccurate, or incomplete, it may, after notice and opportunity for hearing, issue a "stop-order" suspending the effectiveness of the statement.

Time for Registration

The Commission's staff tries to complete examination of registration statements as quickly as possible. The Securities Act provides that a registration statement shall become effective on the 20th day after it is filed (or on the 20th day after the filing of any amendment). Most registration statements require one or more amendments and do not become effective until some time after the statutory 20-day period. The period between filing and effective date is intended to give investors an opportunity to become familiar with the proposed offering through the dissemination of the preliminary form of prospectus. The Commission can accelerate the effective date to shorten the 20-day waiting period—taking into account, among other things, the adequacy of the information on the issuer already available to the public and the ease with which facts about the offering can be understood.

During the 1974 fiscal year 2,888 registration statements became effective. Of these, 198 were amendments filed by investment companies pursuant to Section 24(e) of the Investment Company Act of 1940, which provides for the registration of additional securities through amendment to an effective registration statement rather than the filing of a new registration statement. For the remaining 2,690 statements, the median number of calendar days between the date of the original filing and the effective date was 36.

Financial Analysis and Examination

During the fiscal year, the Office of the Chief Financial Analyst of the Division of Corporation Finance conducted reviews of real estate investment trusts ("REITs") and the airline industry. The principal objective of the reviews was to provide a basis for more uniform and effective staff examination of disclosure documents filed with the Commission by companies in the selected industries. The review of REITs was signaled by the deterioration in earnings and liquidity levels occasioned by high cost of capital on the one hand, and declining portfolio yields on the other. The review of the airline industry indicated rising fuel costs, difficulties in securing outside capital funds, the negative effect of fare increases on effective utilization of existing seat capacity, and other problems attributable to sudden changes in the economic climate at the end of 1973.

Late in the fiscal year, additional reviews were initiated for two other industries—electric and gas utilities, and bank holding companies. Generally, priority for review is given to those industries most directly affected by significant changes in the economic environment.

The Office of the Chief Financial Analyst also is developing a system which will collect, correlate and interpret data to assist it in detecting significant impairment of liquidity of registrants in all industries. The system is intended to identify specific companies which have experienced events suggesting a likelihood of future financial difficulties. The system will entail a review of ratios and financial relationships within the tolerances of industry standards, qualified accountants' opinions, changes in auditors, late filings, declines in backlog, reductions or omissions of cash dividends, excessive amounts of debt maturing in a current or subsequent period, proposed recapitalizations, substantial declines in fixed charges coverage, discontinuance of certain opera-

tions, changes in line of business, write-downs, excessive amounts of non-earning assets and dividends paid out of capital. Where appropriate, the staff may ask a particular company about the need for additional public disclosure.

Investment Company Disclosure

The Division of Corporation Finance has continued to monitor the procedures instituted in September 1972[2] to expedite the processing of investment company post-effective amendments. It has found that the procedures have benefited both registrants and the staff by avoiding delays and by eliminating substantial numbers of "eleventh hour comments". The Division also continued to work on recommendations for a simplified prospectus and a new registration form to supplant those presently in use.[3]

The past fiscal year has seen a growing number of investment company mergers due to declining sales, increasing redemptions, declining assets and increasing costs, all of which have made the operation of many smaller funds unprofitable. A novel merger involved the merger of Surveyor Fund, a closed-end fund, into the Eberstadt Fund, Inc., an open-end fund.

A recent development has been the appearance of funds which tie their investment objectives to shifts in the market. The objectives of these funds are to increase sharholders' capital during periods of stock market strength and to preserve it during periods of stock market weakness. The switch from the growth objective to the preservation objective is usually made when appropriate in the judgment of management, although at least one fund (Pilgrim Formula Share's Inc.) revises its investment objective according to formula.

One response to high interest rates has been a rapid growth in the number of registered money market funds. These funds invest in money market instruments (e.g. certificates of deposit, bankers acceptances, U.S. Treasury bills, and commercial paper) maturing in one year or less. The growth in sales of money market fund shares contrasts with an abrupt drop in the registration of shares of tax exempt municipal bond funds from $402 million in fiscal 1973 to $319.4 million in fiscal 1974. A partial response to the increased offerings by money market funds has been the registration of funds in which the payment of bond principal and interest on the bonds in the portfolio of the funds is guaranteed by an independent company.

Office of Oil and Gas

The Division's Office of Oil and Gas has processing responsibility for all oil and gas drilling program filings, as well as filings on Form S–10 covering fractional undivided interests in oil and gas rights. Eighty-four registration statements were filed during fiscal 1974 for oil and gas drilling programs, totaling $819 million. Seventeen registration statements covering fractional undivided interests in oil and gas rights were filed aggregating $12.7 million.

In addition to the direct processing of those filings the Office of Oil and Gas is responsible for reviewing the disclosure relating to the oil and gas business and properties, including data on production and reserves of oil and gas, contained in other filings directly processed by the several branches of the Division of Corporation Finance. In fiscal 1974, such other filings consisted of 115 registration statements under the Securities Act of 1933 and 18 offering circulars pursuant to the Regulation A exemption thereunder, as well as registration statements and proxy statements under the Securities Exchange Act of 1934.

Additional information regarding offerings of fractional undivided interests is contained under Regulation B in this Part.

Tax Shelters

During the year, a significant number of registration statements relating to real estate limited partnerships and other tax shelter offerings were filed with the Commission. All registration statements relating to real estate limited partnerships were processed by one branch within the Division of Corporation Finance, while registration statements relating to other non-oil and gas types of tax shelters, such as cattle feeding and breeding, agri-business, and leasing, as

well as condominium offerings, were processed in a separate branch. A third branch, the Office of Oil and Gas, has processing responsibility for tax shelters relating to oil and gas.

In all of these types of offerings, the disclosure generally emphasized has included the compensation paid to the program sponsors, the conflicts of interest inherent in many such offerings, the record in prior offerings of the sponsors of the offering, and the tax ramifications of the offering.

See the discussion in Part 1 under the heading "Real Estate Matters" for a description of developments relating to real estate tax shelters.

Commercial Paper—Filing Fees

On February 1, 1974, the Commission amended Rule 457 under the Securities Act[4] which sets forth the method by which the registration fee required by Section 6(b) of the Act is calculated. The amendment provides that the fee for registering both commercial paper exempt from registration under Section 3(a)(3) of the Act, together with non-exempt commercial paper, is to be calculated only on the basis of the total amount of non-exempt commercial paper. The Rule before amended required that the fee be paid upon the aggregate amount of exempt and non-exempt commercial paper. This resulted in inordinately high registration costs which tended to discourage the registration of commercial paper.

Registration Summary Rule

In September 1973, the Commission adopted Rule 458 under the Securities Act, to require any company filing any registration statement under the Act, with certain exceptions, to provide in a letter (not part of the registration statement) a one-paragraph summary containing specified information about the offering. This summary will be published in the SEC News Digest, as notice of the registration statement.[5] The summaries in the Digest are intended to promote the dissemination of public information concerning proposed offers of securities. By requiring that offerors draft the summary paragraph, the Commission anticipates more complete descriptions in the Digest and savings in staff time.

SMALL ISSUE EXEMPTION

The Commission is authorized under Section 3(b) of the Securities Act to exempt securities from registration if it finds that registration for these securities is not necessary to the public interest because of the small offering amount or limited character of the public offering. The law imposes a maximum limitation of $500,000 upon the size of the issues which may be exempted by the Commission.

The Commission had adopted the following exemptive rules and regulations:[6]

Regulation A: General exemption for U.S. and Canadian issues up to $500,000.

Regulation B: Exemption for fractional undivided interests in oil or gas rights up to $250,000.

Regulation E: Exemption for securities of a small business investment company up to $500,000.

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

Rules 234-237 Exemptions of first lien notes, securities of cooperative housing corporations, shares offered in connection with certain transactions and certain securities owned for five years.

Regulation A

Regulation A permits a company to obtain needed capital not in excess of $500,000 (including underwriting commissions) in any one year from a public offering of its securities without registration, provided specified conditions are met. Among other things, a notification and offering circular supplying basic information about the company and the securities offered must be filed with the Commission and the offering circular must be used in the offering. In addition, Regulation A permits selling shareholders not in a control relationship

with the issuer to offer in the aggregate up to $300,000 of securities which would not be included in computing the issuer's $500,000 ceiling.

During the 1974 fiscal year, 438 notifications were filed under Regulation A, covering proposed offerings of $147,779,248 compared with 817 notifications covering proposed offerings of $298 million in the prior year. A total of 869 reports of sales were filed reporting aggregate sales of $69,664,554. Such reports must be filed every six months while an offering is in progress and upon its termination. Sales reported during 1973 had totaled $106 million. Various features of Regulation A offerings over the past three years are presented in the statistical section of this report.

In fiscal 1974, the Commission temporarily suspended 21 exemptions where it had reason to believe there had been noncompliance with the conditions of the Regulation or with disclosure standards, or where the exemption was not available for the securities. Added to 18 cases pending at the beginning of the fiscal year, this resulted in a total of 39 cases for disposition. Of these the temporary suspension order became permanent in 22 cases: in 11 by lapse of time, in 5 cases after hearings, and in 6 by acceptance of an offer of settlement. No temporary suspension orders were vacated. Seventeen cases were pending at the end of the fiscal year.

Litigation Involving Regulation A

In *Koss* v. *S.E.C.*,[7] the United States District Court for the Southern District of New York was asked by a securities underwriting firm and its president, to review certain letters of comment sent by the Commission's staff to companies that proposed to make public offerings of their securities through the plaintiff-underwriter. In those letters, the staff had requested the issuers to disclose in their offering circulars the fact that the plaintiffs were respondents in an administrative proceeding pending before the Commission. The plaintiffs asked the court to restrain the Commission from directing issuers to include such information in their offering circulars.

The court ruled, as the Commission had argued, that the case was not "ripe" for judicial review and accordingly granted summary judgment in favor of the Commission. The court noted that the staff comment letters contained only informal advice, were only advisory in nature and did not represent the views of the Commission. The court did in its opinion state that the fact of the pendency of an administrative proceeding against an underwriter of securities was material to purchasers of those securities.

In *Scientronic Corporation* v. *S.E.C.*[8] the issuer of securities sought review in the United States Court of Appeals for the Third Circuit of a letter to it from the Commission's Washington Regional Office to the effect that financial statements in its offering circular relating to a proposed Regulation A offering must comply with generally accepted accounting principles. In addition, petitioner sought to overrule the action taken by the Commission's Chief Accountant with regard to its "petition" directed to the Commissioners, dealing with accounting for research and development and other matters. Finally, petitioner asked the court to compel the Commission to take affirmative action to revise its rules to permit certain proposed accounting methods to be used in financial statements.

In moving to dismiss the petition and to dismiss as scandalous portions of a document filed by petitioner with the court, the Commission urged that petitioner had not yet exhausted its administrative remedies. In effect, petitioner was asking the court to determine that it should be permitted to utilize the Regulation A exemption from registration for its proposed bond issue, when the Commission had not yet made a final determination regarding the suspension of the exemption. The Commission also urged that even if petitioner had a right at that point to judicial review of the actions of which it complained, the right of review would not be in a court of appeals.

On February 21, 1974, the court of appeals dismissed the petition and struck as scandalous portions of the document filed by petitioner, of which the Commission had complained.

In *Tabby's International Inc.* v. *S.E.C.*,[9] the United States Court of Appeals for the Fifth Circuit affirmed *per curiam* an order

issued by the Commission which permanently suspended the Regulation A exemption of a 1969 offering by Tabby's International, Inc. The court of appeals stated that its affirmance was based upon the Commission's opinion which the court attached as an appendix to its own opinion.[10]

In the Commission proceeding, the parties stipulated that Tabby's had not been aware of the manipulative activities of its underwriter, which were the cause of the suspension. Tabby's argued that in view of this factor, the public interest would not be served by suspending Tabby's, Regulation A exemption and possibly exposing Tabby's to civil and criminal sanctions for violation of the Securities Act registration provisions. In its opinion, the Commission stated that the Regulation A exemption is available only where there is strict compliance with the conditions of that exemption and suspension of the exemption is appropriate where these conditions are not met, whether or not the issuer is at fault.

The Commission further stated that suspension of the exemption is not a penalty but rather serves the remedial purpose of protecting investors by making the safeguards of a registration statement a prerequisite for any further public offering of the securities either by the issuer or the underwriter where there has been a failure to adhere to the exemption's conditions. The Commission noted that the issuer could seek relief from these consequences under Rule 252(f) of Regulation A.

Regulation B

Regulation B provides an exemption from registration under the Securities Act for public offerings of fractional undivided interests in oil and gas rights where the initial amount to be raised does not exceed $250,000, provided certain conditions are met. An offering sheet disclosing certain basic and material information of such offering must be filed with the Commission. Copies of the final offering sheet must be furnished to prospective purchasers at least 48 hours in advance of sale of these securities.

Form S–10 is available for the registration of fractional undivided interests in oil and gas rights where the initial amount to be raised exceeds $250,000 or where the exemption is unavailable for any other reason.

During the 1974 fiscal year, 625 offering sheets and 751 amendments thereto were filed pursuant to Regulation B and were examined by the Office of Oil and Gas of the Division of Corporation Finance. Sales during 1974 under these offerings aggregated $29.1 million. During the 1973 fiscal year, 725 offering sheets and 1,020 amendments were filed covering aggregate sales of $19.9 million. For the fiscal year 1972, 1,124 offering sheets were filed with 1,259 amendments thereto, covering aggregate sales of $21.1 million.

In fiscal 1974, the Commission temporarily suspended the Regulation B exemption for one offeror where it had evidence that the offeror had failed to meet certain standards and requirements. The suspension became permanent later that year when the offeror withdrew its request for a hearing. In the prior fiscal year there were two temporary suspensions of the Regulation B exemption, one of which was vacated and the other became permanent.

Litigation Involving Regulation B

In *Olympic Petroleum Corporation* v. *S.E.C.*[11] a corporation which had filed Regulation B papers with the Commission, brought an action in the United States District Court for the District of Columbia seeking a judgment declaring that it had complied with the requirements of the Commission's Regulation B. The plaintiff argued that a letter from a member of the Commission's staff stating that the documents filed with the Commission did not appear to comply with Regulation B constituted a determination by the Commission and was therefore reviewable agency action. The Commission argued, *inter alia*, that there had been no determination by the Commission—as distinguished from its staff—and, therefore, there was no reviewable agency action, and that Olympic had failed to exhaust its administrative remedies.

In an order dated November 8, 1973, based solely upon the pleadings, the district

court dismissed the complaint for failure to exhaust administrative remedies. The suit was also dismissed as moot since Olympic had completed the offerings which were the subject matter of the suit. On January 4, 1974, Olympic appealed to the Court of Appeals for the District of Columbia Circuit.[12] The appeal had not been decided at the close of the fiscal year.

Regulation E

Under Section 3(c) of the Securities Act, the Commission is authorized to adopt rules and regulations exempting securities issued by a small business investment company under the Small Business Investment Act. Pursuant to that section, the Commission has adopted Regulation E, which conditionally exempts such securities issued by companies registered under the Investment Company Act of 1940 up to a maximum offering price of $500,000. The regulation is substantially similar to Regulation A, described above. No notifications were filed under Regulation E for the two preceding fiscal years.

Regulation F

Regulation F provides exemptions from registration for two types of transactions concerning assessable stock. First, an assessment levied upon an existing security holder may be exempted under the regulation, provided the assessable stock is issued by a corporation incorporated under the laws of and having its principal business operations in any State, Territory or the District of Columbia. Regulation F provides an exemption also when assessable stock of any such corporation is sold publicly to realize the amount of an assessment levied thereon, or when such stock is publicly reoffered by an underwriter or dealer. The exemption is available for amounts not exceeding $300,000 per year. The Regulation requires the filing of a notification and other materials describing the offering.

During the 1974 fiscal year, 12 notifications were filed under Regulation F, covering assessments of stock of $408,652, compared with 15 notifications covering assessments of $408,374 in 1973.

Proposed Rule 239: Residential First Lien Mortgages

On September 6, 1973, the Commission published for comment proposed Securities Act Rule 239,[13] which under certain conditions would have provided an exemption pursuant to Section 3(b) of the Act from registration under the Act, for certain promissory notes directly secured by first lien mortgages on residential real estate. The Federal Home Loan Mortgage Corporation had requested adoption of the Rule as appropriate to help it to implement its Congressional mandate to create a liquid secondary market in residential mortgages. On May 23, 1974,[14] the Commission withdrew the Rule from further consideration.

CONTINUING DISCLOSURE: THE 1934 SECURITIES EXCHANGE ACT

The Securities Exchange Act of 1934 contains significant disclosure provisions designed to provide a fund of current material information on companies in whose securities there is a substantial public interest. The Act also seeks to assure that security holders who are solicited to exercise their voting rights, or to sell their securities in response to a tender offer, are furnished pertinent information.

Registration on Exchanges

Generally speaking, a security cannot be traded on a national securities exchange until it is registered under Section 12(b) of the Exchange Act. If it meets the listing requirements of the particular exchange, an issuer may register a class of securities on the exchange by filing with the Commission and the exchange an application which discloses pertinent information concerning the issuer and its affairs. During fiscal year 1974, a total of 225 issuers listed and registered securities on a national securities exchange for the first time and a total of 434 registration applications were filed. The registrations of all securities of 218 issuers were terminated. Detailed statistics regarding securities traded on exchanges may be found in the statistical section.

Over-the-Counter Registration

Section 12(g) of the Exchange Act requires a company with total assets exceeding $1 million and a class of equity securities held of record by 500 or more persons to register those securities with the Commission, unless one of the exemptions set forth in that section is available or the Commission issues an exemptive order under Section 12(h). Upon registration, the reporting and other disclosure requirements and the insider trading provisions of the Act apply to these companies to the same extent as to those with securities registered on exchanges.

During the fiscal year, 527 registration statements were filed under Section 12(g). Of these, 342 were filed by issuers already subject to the reporting requirements, either because they had another security registered on an exchange or they had registered securities under the Securities Act. Included are companies which succeeded to the businesses of reporting companies, and thereby became subject to the reporting requirements.

Exemptions

Section 12(h) of the Act authorizes the Commission to grant a complete or partial exemption from the registration provisions of Section 12(g) or from other disclosure and insider trading provisions of the Act where it is not contrary to the public interest or the protection of investors.

At the beginning of the year, 18 exemption applications were pending, and 9 applications were filed during the year. Of these 27 applications, 6 were withdrawn, 11 were granted, and 0 denied. The remaining 10 applications were pending at the end of the fiscal year.

Periodic Reports

Section 13 of the Securities Exchange Act requires issuers of securities registered pursuant to Sections 12(b) and 12(g) to file periodic reports, keeping current the information contained in the registration application or statement. Similar reports are required pursuant to Section 15(d) of certain issuers which have filed registration statements under the Securities Act which have become effective. From time to time, the Commission has issued statements calling attention to registrants' obligation to report current events and explaining procedures to be followed in certain unusual types of situations. For example, see the discussion in Part I concerning Fuel Shortages, Extractive Reserves and Natural Gas Supplies.

In 1974, 53,298 reports—annual, quarterly and current—were filed.

One of the reports which certain issuers must file is a quarterly report on Form 10–Q. On December 12, 1973, the Commission published a release[15] consisting generally of a compilation of the views and comments of the Division of Corporation Finance as to questions frequently raised by public companies and as to problems and deficiencies frequently encountered by the staff, during the three years since Form 10–Q was adopted. It was pointed out in the Release that generally speaking, the majority of the deficiencies in Form 10–Q were the result of failures to examine closely and comply with the general instructions to the form and the specific instructions to the items contained therein.

Proxy Solicitations

Where proxies are solicited from holders of securities registered under Section 12 or from security holders of registered public-utility holding companies, subsidiaries of holding companies, or registered investment companies, the Commission's proxy regulation requires that disclosure be made of all material facts concerning the matters on which the security holders were asked to vote, and that they be afforded an opportunity to vote "yes" or "no" on any matter other than the election of directors. Where management is soliciting proxies, a security holder desiring to communicate with the other security holders may require management to furnish him with a list of all security holders or to mail his communication for him. A security holder may also, subject to certain limitations, require the management to include in proxy material an appropriate proposal which he wants to submit to a vote of security holders, or he may make an independent proxy solicitation.

Copies of proposed proxy material must be filed with the Commission in preliminary form prior to the date of the proposed solicitation. Where preliminary material fails to meet the prescribed disclosure standards, the management or other group responsible for its preparation is notified informally and given an opportunity to correct the deficiencies in the preparation of the definitive proxy material to be furnished to security holders.

Issuers of securities registered under Section 12 must transmit an information statement comparable to proxy material to security holders from whom proxies are not solicited with respect to a stockholders' meeting.

During the 1974 fiscal year, 6,757 proxy statements in definitive form were filed, 6,741 by management and 16 by nonmanagement groups or individual stockholders. In addition, 126 information statements were filed. The proxy and information statements related to 6,645 companies, and pertained to 6,615 meetings for the election of directors, 222 special meetings not involving the election of directors, and 30 assents and authorizations.

Aside from the election of directors, the votes of security holders were solicited with respect to a variety of matters, including mergers, consolidations, acquisitions, sales of assets and dissolution of companies (235); authorizations of new or additional securities, modifications of existing securities, and recapitalization plans (603); employee pension and retirement plans (44); bonus or profit-sharing plans and deferred compensation arrangements (245); stock option plans (781); approval of the selection by management of independent auditors (3,195) and miscellaneous amendments to charters and by-laws, and other matters (1,839).

During the 1974 fiscal year, 434 proposals submitted by 69 stockholders for action at stockholders' meetings were included in the proxy statements of 227 companies. Typical of such proposals submitted to a vote of security holders were resolutions on amendments to charters or by-laws to provide for cumulative voting for the election of directors, preemptive rights, limitations on the grant of stock options to and their exercise by key employees and management groups, the sending of a post meeting report to all stockholders, and limitations on charitable contributions.

A total of 161 proposals submitted by 78 stockholders were omitted from the proxy statements of 71 companies in accordance with the provisions of the rule governing such proposals. The most common grounds for omission were that proposals were not submitted on time or were not proper subjects for stockholders' action under the applicable state law.

In fiscal 1974, 15 companies were involved in proxy contests for the election of directors which bring special requirements into play. In these contests, 398 persons, including both management and nonmanagement, filed detailed statements required of participants under the applicable rule. Control of the board of directors was involved in 14 instances. In 5 of these, management retained control. Of the remainder, three were settled by negotiation, four were won by nonmanagement persons, and two were pending at year end. Management retained all places on the board in the one contest involving representation on the board of directors.

Litigation on Proxy Rules

In *Kixmiller* v. *S.E.C.*,[16] the United States Court of Appeals for the District of Columbia Circuit dismissed a petition to review a no-action determination informally given to a corporation by the staff of the Commission as well as the Commission's purported affirmance of that determination, in declining to review the staff's position. The court held that where the Commission has refused to review informal staff advice or to express its own informal views on the matter there does not exist any "order issued by the Commission"[17] that a court of appeals has jurisdiction to review. The court distinguished the situation involved in *Kixmiller* from that in *Medical Committee for Human Rights* v. *S.E.C.*,[18] noting that "*Medical Committee* involved a no-action ruling by the staff which was sanctioned by the Commission . . . ."

The court did not decide whether the Commission erred in refusing to deal with

petitioner's claim since, in any event, it was "not at liberty to override" the Commission's decision. An agency's decision to refrain from an investigation or an enforcement action was thought to be "generally unreviewable." As to the Commission, the specifications of the Securities Exchange Act "leave no doubt on that score." The court found nothing arbitrary about the Commission's policy (as described in 17 CFR 202.1d) not to involve itself in staff activity, as applied in the instant case. "It is for the Commission to initially draw the line on administrative review of staff decisions in this area, and we cannot say that its regulation has done so unreasonably." [footnotes omitted].

Takeover Bids, Large Acquisitions

Sections 13(d) and (e), and 14(d), (e) and (f) of the Securities Exchange Act, enacted in 1968 and amended in 1970, provide for full disclosure in cash tender offers and other stock acquisitions involving changes in ownership or control. These provisions were designed to close gaps in the full disclosure provisions of the securities laws and to safeguard the interest of persons who tender their securities in response to a tender offer.

During the 1974 fiscal year, 953 Schedule 13D reports were filed by persons or groups which had made acquisitions resulting in their ownership of more than five percent of a class of securities. One hundred five Schedule 13D reports were filed by persons or groups making tender offers, which, if successful, would result in more than five percent ownership. In addition, 45 Schedule 14D reports were filed on solicitations or recommendations in a tender offer by a person other than the maker of the offer. Five statements were filed for the replacement of a majority of the board of directors otherwise than by stockholder vote. Four statements were filed under a rule on corporate reacquisitions of securities while an issuer is the target of a cash tender offer.

Insider Reporting

Section 16 of the Securities Exchange Act and corresponding provisions in the Public Utility Holding Company Act of 1935 and the Investment Company Act of 1940 are designed to provide other stockholders and investors generally with information on insider securities transactions and holdings, and to prevent unfair use of confidential information by insiders to profit from short-term trading in a company's securities.

Section 16(a) of the Exchange Act requires every person who beneficially owns, directly or indirectly, more than 10 percent of any class of equity security which is registered under Section 12, or who is a director or an officer of the issuer of any such security, to file statements with the Commission disclosing the amount of all equity securities of the issuer of which he is the beneficial owner and changes in such ownership. Copies of such statements must be filed with exchanges on which the securities are listed. Similar provisions applicable to insiders of registered public-utility holding companies and registered closed-end investment companies are contained in the Holding Company and Investment Company Acts.

In fiscal 1974, 116,110 ownership reports were filed. These included 17,646 initial statements of ownership on Form 3, 93,338 statements of changes in ownership on Form 4, and 5,126 amendments to previously filed reports.

All ownership reports are made available for public inspection when filed at the Commission's office in Washington and at the exchanges where copies are filed. In addition, the information contained in reports filed with the Commission is summarized and published in the monthly "Official Summary of Security Transactions and Holdings," which is distributed by the Government Printing Office to about 11,500 subscribers.

Short-Swing Trading Litigation

In *Gold* v. *Sloan*,[19] the Commission filed a brief, *amicus curiae*, in which it urged that the defendants' acquisitions of securities pursuant to a corporate merger were "purchases" of those securities for purposes of Section 16(b) of the Securities Exchange Act. That section generally provides that an issuer whose securities are registered pursuant to Section 12 of the Securities Ex-

change Act or its shareholders suing derivatively, may recover the profits realized by an officer, director or beneficial owner of more than 10 percent of any class of the corporation's equity securities upon his "purchase and sale" (or "sale and purchase") of such securities of the issuer if the two transactions occur within a six-month period. The defendants who had been shareholders of the corporation acquired in the merger as a result of the merger became shareholders of the acquiring corporation. In addition, they assumed positions as either officers or directors of the acquiring corporation. Within the six months of the merger they sold some of the shares they had acquired in the merger.

The Commission urged that the defendants' acquisition of stock in the merger provided them the opportunity to engage in the kind of speculative abuse that Section 16(b) was designed to prevent and, therefore, should be held to be within the scope of that section. The Commission argued that, contrary to defendant's contention, their acquisitions could not be viewed as involuntary. The Commission pointed out that, even if defendants could not have possessed inside information prior to the merger, the defendants might have timed their sales on the basis of post merger, inside information.

In a 2–1 decision, the Court of Appeals for the Fourth Circuit held that, on the particular facts of the case, the acquisitions in question were to be deemed purchases only with respect to one of the defendants. The court stated that, in determining whether the "possibility of abuse" test was met, only those circumstances and events connected with the merger were relevant. The court concluded that the test was satisfied only as to the one defendant who had knowledge of certain inside information concerning the merger.

The dissenting judge was of the view that the majority should have considered the situation that existed in the post-merger period, when the defendants were officers and directors of the acquiring company and presumptively in possession of inside information that would have enabled them to time their sales. It was precisely this sort of abuse, the judge argued, that Section 16(b) was designed to prevent.

ACCOUNTING

The securities acts reflect a recognition by Congress that dependable financial statements of a company are indispensable to informed investment decisions regarding its securities. A major objective of the Commission has been to improve accounting, reporting and auditing standards applicable to the financial statements and to assure that high standards of professional conduct are maintained by the public accountants who examine the statements. The primary responsibility for this program rests with the Chief Accountant of the Commission.

Under the Commission's broad rulemaking power, it has adopted a basic accounting regulation (Regulation S–X) which, together with opinions on accounting principles published as "Accounting Series Releases," governs the form and content of financial statements filed under the securities laws. The Commission has also formulated rules on accounting and auditing of broker-dealers and prescribed uniform systems of accounts for companies subject to the Public Utility Holding Company Act of 1935. The accounting rules and opinions of the Commission, and its decisions in particular cases, have contributed to clarification and wider acceptance of the accounting principles and practices and auditing standards developed by the profession and generally followed in the preparation of financial statements.

However, the specific accounting rules and regulations—except for the uniform systems of accounts which are regulatory reports—prescribe accounting principles to be followed only in certain limited areas. In the large area of financial reporting not covered by its rules, the Commission's principal means of protecting investors from inadequate or improper financial reporting is by requiring a report of an independent public accountant, based on an audit performed in accordance with generally accepted auditing standards, which expresses an opinion whether the financial statements are presented fairly in conformity with accounting principles and practices that are recognized as sound and have attained general acceptance. The requirement that the opinion be rendered by an

independent accountant, which was initially established under the Securities Act of 1933, is designed to secure for the benefit of public investors the detached objectivity and the skill of a knowledgeable professional person not connected with management.

The accounting staff reviews the financial statements filed with the Commission to insure that the required standards are observed and that the accounting and auditing procedures do not remain static in the face of changes and new developments in financial and economic conditions. New methods of doing business, new types of business, the combining of old businesses, the use of more sophisticated securities, and other innovations create accounting problems which require a constant reappraisal of the procedures. In fiscal 1974, work was commenced on a new publication series to provide information to the public regarding informal administrative practices and guidelines developed by the accounting staff with respect to specific accounting and auditing problems considered in the review of the financial data filed. The first issue is expected to be published in the near future.

Relations With the Accounting Profession

In order to keep abreast of changing conditions, and in recognition of the need for a continuous exchange of views and information between the Commission's accounting staff and outside accountants regarding appropriate accounting and auditing policies, procedures and practices, the staff maintains continuing contact with individual accountants and various professional organizations. The latter include the American Institute of Certified Public Accountants (AICPA) and the Financial Accounting Standards Board (FASB), the principal professional organizations concerned with the development and improvement of accounting and auditing standards and practices. The Chief Accountant also meets regularly with his counterparts in other regulatory agencies to improve coordination on policies and actions among the agencies.

Because of its many foreign registrants and the vast and increasing foreign operations of American companies, the Commission has an interest in the improvement of accounting and auditing principles and procedures on an international basis. To promote such improvement, the Chief Accountant corresponds with foreign accountants, interviews many who visit this country and, on occasion, participates in foreign and international accounting conferences. In August 1973, he addressed the annual convention of the American Accounting Association in Quebec City, Canada. In September and December 1973, he participated in discussions with representatives of the Canadian Institute of Chartered Accountants in Toronto, Canada.

Professional efforts are being made to improve and harmonize accounting standards among countries through various international accounting conferences and committees. One committee, comprised of representatives of accountancy groups from eighteen countries, was established to promulgate international accounting standards. This committee has issued a number of proposed standards and is developing additional proposals. The Commission will cooperate closely with these committees and groups which have as their long-term objective the development of a coordinated worldwide accounting profession with uniform standards.

Accounting and Auditing Standards

The FASB supplanted the Accounting Principles Board (APB) of the AICPA, which ceased operations on June 30, 1973, as the organization which establishes standards of financial accounting and presentation for the guidance of issuers and public accountants. The new organizational structure was established on the basis of recommendations by a committee appointed by the AICPA in early 1971 to explore ways of improving this function. A financial accounting foundation, sponsored by the AICPA and consisting of representatives of leading professional organizations, appoints the seven members of the FASB who serve on a salaried, full-time basis, and the members of an advisory council to the

Board who serve on a voluntary basis. The Commission originally endorsed the recommendations for the new structure, which it believed would provide operational efficiencies and insure an impartial viewpoint in the development of accounting standards on a timely basis. Subsequently,[20] the Commission endorsed the FASB and stated that the FASB's statements and interpretations would be considered as being substantial authoritative support for an accounting practice or procedure.

The Chief Accountant and the FASB have developed liaison procedures for consultation on projects of either the Board or the SEC which are of mutual interest. The Board has adopted a heavy agenda of topics which urgently require consideration. They include accounting for foreign currency translation, accrual of future losses, reporting by diversified companies, accounting for leases by lessee and lessor, accounting for such costs as research and development, materiality criteria, business combinations and related intangibles, reporting the effects of general price-level changes in financial statements, and the conceptual framework for financial accounting and reporting. The Board has issued discussion memoranda and held hearings on several of the projects, and it has issued two proposed standards and has adopted a standard on disclosure of foreign currency translation information.

Another committee was appointed in early 1971 by the AICPA to study and refine the objectives of financial statements. It studied the basic questions of who needs financial statements, what information should be provided, how it should be communicated, and how much of it can be provided through the accounting process. The committee's report on the objectives of financial statements, which was published in October 1973, is being utilized by the FASB as the basis of its study of the conceptual framework for financial accounting and reporting.

The Chief Accountant also maintains liaison with other senior committees of the AICPA on projects of mutual interest, principally proposed audit guides and standards of the Auditing Standards Executive Committee and proposed statements of position of the Accounting Standards Executive Committee. Regular meetings are held with the Committee on SEC matters to provide information and guidance to the profession concerning the interpretation of and compliance with the Commission's accounting and auditing requirements applicable to registrants and their independent accountants.

Other Developments

During the fiscal year the Commission issued 13 Accounting Series Releases to provide interpretations or guidelines on matters of accounting principles and auditing standards, to require improved disclosure of financial information by amendment of reporting forms or Regulation S–X, or to announce decisions in disciplinary proceedings under Rule 2(e) of the Commission's Rules of Practice concerning accountants appearing before it.

One release[21] contained a statement of policy on the establishment and improvement of accounting principles and standards and the Commission's endorsement of the FASB. Two interpretative releases[22] dealt with the effect of treasury stock transactions on accounting for business combinations. The subjects of other interpretative releases were catastrophe reserves by property and casualty insurance companies[23] and disclosure of inventory profit reflected in income in periods of rising prices.[24] In conjunction with the Division of Market Regulation, a release[25] was issued providing guidelines for the maintenance of current books and records by broker-dealers in accordance with Rules 17a–3(a) and 17a–11 under the Securities Exchange Act of 1934.

A number of amendments to Regulation S-X were adopted to effect improved disclosures in specific areas of financial statements: one release[26] dealt with the disclosure of lease commitments by lessees; another[27] with disclosure pertaining to compensating balances and short-term borrowing arrangements; and a third release[28] with disclosure of income tax expense.

A general revision of Article 7A of Regulation S–X, pertaining to the requirements for

the form and content of financial statements of life insurance companies, was adopted[29] to reflect developments in accounting practice in recent years and the effect of the publication in 1972 of an AICPA audit guide for life insurance companies which provides for the presentation of the financial statements in accordance with generally accepted accounting principles. Registration Form 10 and annual report Form 10–K were also amended to remove the exemption from the requirement of audited financial statements which had previously been available to life insurance companies. Another release[30] announced an amendment in Article 4 of Regulation S–X relating to the requirements for consolidated and combined financial statements in filings with the Commission.

Finally numerous amendments to the instructions pertaining to the financial statements, the summaries of operations and the exhibits in various registration and reporting forms were adopted[31] to update and conform the instructions to current terminology and practice and to provide other clarifications and modifications.

Proposals for amendments to Regulation S–X were issued for public comment which would require improved disclosures regarding accounting policies followed by registrants,[32] the components of accounts receivable and inventories arising out of defense and other long-term contract activities of registrants,[33] and the capitalization of interest by non-utility companies.[34] In the final release, a moratorium was proposed on the adoption of a policy of capitalizing interest by non-utility companies who had not followed such a policy prior to the date of the release. Shortly after the end of the fiscal year, a general revision of Article 7 of Regulation S–X, pertaining to the form and content of financial statements of title insurance and mortgage guaranty insurance companies, was proposed[35] to reflect developments in accounting practice, including the requirement that the financial statements be prepared in accordance with generally accepted accounting principles.

The Commission issued opinions in two proceedings under Rule 2(e) of the Commission's Rules of Practice involving large accounting firms. In one proceeding,[36] the Commission censured and imposed remedial sanctions on a firm. The Commission concluded that the firm had not performed the audit of financial statements filed with the Commission which were found to be false and misleading in accordance with professional auditing standards. The sanctions in summary provide for the firm to adopt and maintain certain qualitative audit and office review procedures, for an investigation by the Commission regarding the review procedures and the professional practices subject thereto, and for certain restrictions on undertaking new professional engagements.

In the second proceeding,[37] concluded shortly after the close of the fiscal year, the Commission censured an accounting firm for failing fully to disclose to the Commission and the public the facts relating to a settlement negotiated between the firm and a client regarding an audit of certain inventories that were misstated in the financial statements of the client filed with the Commission.

In another proceeding,[38] the Commission accepted the sworn undertaking of a public accountant not to engage in practice before the Commission. The accountant had been permanently enjoined by a Federal court in a Commission injunctive action from violating antifraud provisions of the Federal securities laws.

EXEMPTIONS FOR INTERNATIONAL BANKS

Section 15 of the Bretton Woods Agreement Act, as amended, exempts from registration securities issued, or guaranteed as to both principal and interest, by the International Bank for Reconstruction and Development. The Bank is required to file with the Commission such annual and other reports on securities as the Commission determines to be appropriate. The Commission has adopted rules requiring the Bank to file quarterly reports and copies of annual reports of the Bank to its Board of Governors. The Bank is also required to file advance reports of any distribution in the United States of its primary obligations. The Commission, acting in consultation with the

National Advisory Council on International Monetary and Financial Problems, is authorized to suspend the exemption for securities issued or guaranteed by the Bank. The following summary of the Bank's activities reflects information obtained from the Bank. Except where otherwise indicated, all amounts are expressed in U.S. dollar equivalents as of June 30, 1974.

Net income for the year was $216 million, compared with $186 million the previous year. Of the $216 million net income the Executive Directors allocated $116 million to the Supplemental Reserve Against Losses on Loans and from Currency Devaluations and recommended to the Board of Governors that an amount of $100 million be transferred by way of grant to an affiliate of the Bank, the International Development Association.

Repayments of principal on loans received by the Bank during the year amounted to $487 million, and a further $112 million was repaid to purchasers of portions of loans. Total principal repayments by borrowers through June 30, 1974, aggregated $5.9 billion, including $3.8 billion repaid to the Bank and $2.1 billion repaid to purchasers of borrowers' obligations sold by the Bank.

Outstanding borrowings of the Bank were $9.7 billion at June 30, 1974. During the year, the bank borrowed $428 million through the issuance of 2-year U.S. dollar bonds to central banks and other governmental agencies in some 70 countries; DM 578 million (U.S. $220.3 million) in Germany; 122.2 billion yen (U.S. $460.6 million) in Japan; SwF 550 million (U.S. $177.5 million) in Switzerland; KD 25 million (U.S. $84.4 million) in Kuwait; U.S. $200 million in Iran; LD 30 million (U.S. $101.3 million) in Libya; UAED 300 million (U.S. $76 million) in United Arab Emirates; and the equivalent of U.S. $105 million in other countries outside the United States. The above U.S. dollar equivalents are based on official exchange rates at the times of the respective borrowings. The Bank also issued the equivalent of $43.5 million in bonds that had been sold in previous years under delayed delivery contracts.

These borrowings, in part, refunded maturing issues amounting to the equivalent of $616 million. After retirement of $60 million equivalent of obligations through sinking fund and purchase fund operations, the Bank's outstanding borrowings showed a net increase of $768 million from the previous year after deducting $277 million representing adjustment of borrowings as a result of currency devaluations and revaluations in terms of U.S. dollars of the value of the non-dollar currencies in which the debt was denominated.

The Inter-American Development Bank Act, which authorizes the United States to participate in the Inter-American Development Bank, provides an exemption for certain securities which may be issued or guaranteed by the Bank similar to that provided for securities of the International Bank for Reconstruction and Development. Acting pursuant to this authority, the Commission adopted Regulation IA, which requires the Bank to file with the Commission substantially the same type of information, documents and reports as are required from the International Bank for Reconstruction and Development. The following data reflects information submitted by the Bank to the Commission.

On June 30, 1974 the outstanding funded debt of the Ordinary Capital resources of the Bank was the equivalent of $1.316 billion, reflecting a net increase in the past year of the equivalent of $30 million. During the year, the funded debt was increased through public bond issues totaling the equivalent of $49.9 million as well as private placements for the equivalent of $58.1 million including $13.3 million of drawings under arrangements entered into during the previous year with Japan and Spain. Additionally, $40.2 million of two-year and five-year bonds were sold in Latin America and Israel, essentially representing a rollover of a maturing borrowing of $32.5 million. The funded debt decreased by approximately $47.3 million due to downward adjustment of the U.S. dollar equivalent of borrowings denominated in non-member currencies. The funded debt was decreased through the retirement of approximately $38.4 million from sinking fund purchases and scheduled debt retirement.

The Asian Development Bank Act, adopted in March 1966, authorized United

States participation in the Asian Development Bank and provides an exemption for certain securities which may be issued or guaranteed by the Bank, similar to the exemptions accorded the International Bank for Reconstruction and Development and the Inter-American Development Bank. Acting pursuant to this authority, the Commission has adopted Regulation AD which requires the Bank to file with the Commission substantially the same type of information, documents and reports as are required from those banks. The Bank has 40 members with subscriptions totaling $1 billion.

As of June 30, 1973, 12 countries had contributed or pledged a total of $242 million to the Bank's Special Funds. In addition to the $26.6 million set aside from Ordinary Capital in 1969 and 1971 by the Board of Governors for Special Funds purposes, another $51.6 million was set aside in April 1973, making a total of $78.2 million set aside. In addition, Congress has authorized a $100 million U.S. contribution to the Bank's Special Funds, and is considering the appropriation of these funds in fiscal 1974. There have been indications from other countries of additional contributions.

Through June 30, 1973, the Bank's borrowings totaled the equivalent of $229 million. In 1972, the Bank issued obligations of the equivalent of $58.6 million in Japan ($32.5 million), Luxembourg ($8.9 million) and Italy ($17.2 million). The last U.S. borrowing, in 1971, was $50 million, half in 5-year notes at 6½ percent and half in 25-year bonds at 7¾ percent. Before selling securities in a country, the Bank must obtain the country's approval.

TRUST INDENTURE ACT OF 1939

This Act requires that bonds, debentures, notes and similar debt securities offered for public sale, except as specifically exempted, be issued under an indenture which meets the requirements of the Act and has been duly qualified with the Commission.

The provisions of the Act are closely integrated with the requirements of the Securities Act. Registration pursuant to the Securities Act of securities to be issued under a trust indenture subject to the Trust Indenture Act is not permitted to become effective unless the indenture conforms to the requirements of the latter Act designed to safeguard the rights and interests of the purchasers. Moreover, specified information about the trustee and the indenture must be included in the registration statement.

The Act was passed after studies by the Commission had revealed the frequency with which trust indentures failed to provide minimum protections for security holders and absolved so-called trustees from minimum obligations in the discharge of the trusts. It requires, among other things, that the indenture trustee be a corporation with a minimum combined capital and surplus and be free of conflicting interests which might interfere with the faithful exercise of its duties on behalf of the purchasers of the securities, and it imposes high standards of conduct and responsibility on the trustee. During fiscal year 1974, 370 trust indentures relating to securities in the aggregate amount of $23.3 billion were filed.

INFORMATION FOR PUBLIC INSPECTION; FREEDOM OF INFORMATION ACT

Registration statements, applications, declarations, and annual and periodic reports filed with the Commission each year, as well as many other public documents, are available for public inspection and copying at the Commission's public reference room in its principal offices in Washington, D.C. and, in part, at its regional and branch offices.

The categories of available materials and those categories of records that are generally considered nonpublic are specified in the Commission's rules concerning records and information which include the rule (17 CFR 200.80) adopted by the Commission to implement the provisions of the Freedom of Information Act (5 U.S.C. 552). That rule establishes the procedure to be followed in requesting records or copies and provides for a method of administrative appeal from the denial of access to any record. It also provides for the imposition of fees when more than one-half man-hour of work is performed by the Commission's staff to locate and make records available. In addition to

the records described, the Commission makes available for inspection and copying all requests for no-action and interpretative letters received after December 31, 1970, and responses thereto (17 CFR 200.81). Also made available since November 1, 1972 are materials filed under Proxy Rule 14a–8(d), which deals with proposals offered by shareholders for inclusion in management proxy-soliciting materials, and related materials prepared by the staff (17 CFR 200.82).

The Commission has special public reference facilities in the New York, Chicago and Los Angeles Regional Offices and some facilities for public use in other regional and branch offices. Each regional office has available for public examination copies of prospectuses used in recent offerings of securities registered under the Securities Act; registration statements and recent annual reports filed under the Securities Exchange Act by companies having their principal office in the region; recent annual reports and quarterly reports filed under the Investment Company Act by management investment companies having their principal office in the region; broker-dealer and investment adviser applications originating in the region; letters of notification under Regulation A filed in the region, and indices of Commission decisions.

During the 1974 fiscal year, 18,970 persons examined material on file in Washington; several thousand others examined files in New York, Chicago, Los Angeles, and other regional offices. More than 52,948 searches were made for information requested by individuals, and approximately 5,163 letters were written on information requested.

The public may make arrangements through the Public Reference Section of the Commission in Washington, D.C. to purchase copies of material in the Commission's public files. The copies are produced by a commercial copying company which supplies them to the public at prices established under a contract with the Commission. Current prices begin at 15 cents per page for pages not exceeding 8½" x 14" in size, with a $2 minimum charge. Under the same contract, the company also makes microfiche and microfilm copies of Commission public documents available on a subscription or individual order basis to persons or firms who have or can obtain viewing facilities. In microfiche services, up to 60 images of document pages are contained on 4" x 6" pieces of film, referred to as "fiche."

Annual microfiche subscriptions are offered in a variety of packages covering all public reports filed on Forms 10–K, 10–Q, 8–K, N–1Q and N–1R under the Securities Exchange Act or the Investment Company Act; annual reports to stockholders; proxy statements; new issue registration statements; and final prospectuses for new issues. The packages offered include various categories of these reports, including those of companies listed on the New York Stock Exchange, the American Stock Exchange, regional stock exchanges, or traded over-the-counter. Reports are also available by standard industry classifications. Arrangements also may be made to subscribe to reports of companies of one's own selection. Over one hundred million pages (microimagery frames) are being distributed annually. The subscription services may be extended to further groups of filings in the future if demand warrants. The copying company will also supply copies in microfiche or microfilm form of other public records of the Commission desired by a member of the public.

Microfiche readers and reader-printers have been installed in the public reference areas in Washington, D.C. and the New York, Chicago, and Los Angeles regional offices, and sets of microfiche are available for inspection there. Visitors to the public reference room in Washington, D.C. may also make immediate reproduction of material on photostatic-type copying machines. The cost to the public of copies made by use of all customer-operated equipment is 12 cents per page. The charge for an attestation with the Commission seal is $2. Detailed information concerning copying services available and prices for the various types of services and copies may be obtained from the Public Reference Section of the Commission.

FREEDOM OF INFORMATION ACT LITIGATION

In Preferred Land Corporation v. *S.E.C.*[39] plaintiffs attempted to gain access, under the Freedom of Information Act, to a report of investigation prepared by the Commission's Atlanta Regional Office following an investigation by that Office into the activities of the plaintiffs. After oral argument, the district court concluded that "the Commission's staff report is one of the types of documents that Congress intended to protect when it enacted the Freedom of Information Act, exempt from disclosure under that Act as a part of an 'investigatory file compiled for law enforcement purposes,' in the words of the seventh exemption to that Act."[40] The district court also ruled that Securities Act Release No. 5310, "Procedures Relating to the Commencement of Enforcement Proceedings and Termination of Staff Investigation" (September 27, 1972), does not constitute a waiver of the investigatory files exemption under the Act, with respect to recommendations made by the staff to the Commission concerning the institution of enforcement proceedings. An appeal by plaintiffs of the district court's order is pending.[41]

PUBLICATIONS

In addition to releases concerning Commission action under the securities laws and litigation involving securities violations, the Commission issues a number of other publications, including the following:

Daily:
- News Digest; reporting Commission announcements, decisions, orders, rules and rule proposals, current reports and applications filed, and litigation developments.[a]

Weekly:
- SEC Docket; a compilation of Commission releases.[a]

Monthly:
- Official Summary of Securities Transactions and Holdings of Officers, Directors and Principal Stockholders.[a]
- Statistical Bulletin.[a]

Annually:
- Annual Report of the Commission.[a]
- Securities Traded on Exchanges under the Securities Exchange Act of 1934.[b]
- List of Companies Registered under the Investment Company Act of 1940.[b]
- Classification, Assets and Location of Registered Investment Companies under the Investment Company Act of 1940.[b]
- Directory of Companies Filing Annual Reports with the Commission under the Securities Exchange Act of 1934.[a]

Other Publications:
- Decisions and Reports of the Commission.[a]
- The Work of the Securities and Exchange Commission.
- Holding Companies Claiming Exemption from the Public Utility Holding Company Act of 1935.[b]
- Index of Active Registered Investment Companies under the Investment Company Act of 1940.[b]
- Report of SEC Special Study of Securities Markets, H. Doc. 95 (88th Congress)[a]
- Institutional Investor Study Report of the Securities and Exchange Commission, H. Doc. 64 (92nd Congress)[a]
- Part 8 of the Institutional Investor Study Report, containing the text of the Summary and Conclusions drawn from each of the fifteen chapters of the report.[a]
- Statement of the Securities and Exchange Commission on the Future Structure of the Securities Markets, February 2, 1972.
- The Financial Collapse of the Penn Central Company, Staff Report of the Securities and Exchange Commission to the Special Subcommittee on Investigations, August 1972.[a]
- Report of the Real Estate Advisory Committee to the Securities and Exchange Commission.[a]
- Report of the Industrial Issuers Advisory Committee to the Securities and Exchange Commission.[a]

Acts and General Rules and Regulations for all Securities Acts.[a]

Compilation of Releases Dealing with Matters Frequently Arising under the Securities Act of 1933.[a]

Compilation of Releases Dealing with Matters Arising under the Securities Exchange Act of 1934 and Investment Advisers Act of 1940.[a]

Compilation of Releases, Commission Opinions, and Other Material Dealing with Matters Frequently Arising under the Investment Company Act of 1940.[a]

[a] Must be ordered from the Superintendent of Documents, Government Printing Office, Washington, D.C. 20402

[b] This document is available in photocopy form. Purchasers are billed by the printing company which prepares the photocopies.

NOTES TO PART 2

[1] Securities Act Release No. 5231 (February 3, 1972).

[2] See 39th Annual Report, pp. 31–32.

[3] See 39th Annual Report, p. 32.

[4] Securities Act Release No. 5453 (February 1, 1974), 3 SEC Docket 453.

[5] Securities Act Release Nos. 5424 (September 20, 1973), 2 SEC Docket 462, and 5424A (November 1, 1973), 2 SEC Docket 653.

[6] As to proposed rules under Section 3(b), see the discussion in Part 1 concerning proposed Rules 238 and 240. A discussion of proposed Rule 239 appears hereafter.

[7] 364 F. Supp. 1321 (1973).

[8] No. 73–1889.

[9] 479 F. 2d 1080 (1973).

[10] Securities Act Release No. 5283 (July 21, 1972).

[11] Civ. No. 1657–73.

[12] No. 74–1254.

[13] Securities Act Release No. 5419, 2 SEC Docket 397.

[14] Securities Act Release No. 5497, 4 SEC Docket 322.

[15] Securities Exchange Act Release No. 10547; 3 SEC Docket 210.

[16] 492 F. 2d 641 (1974).

[17] See Section 25(a) of the Securities Exchange Act, 15 U.S.C. 78y(a).

[18] Previously discussed in 38th Annual Report, p. 31; 37th Annual Report, pp. 54–55; 36th Annual Report, pp. 49–50.

[19] 486 F. 2d 340 (C.A. 4, 1973), *petition for certiorari pending*, No. 73–1638.

[20] Accounting Series Release No. 150 (December 20, 1973), 3 SEC Docket 275.

[21] *Ibid.*

[22] Accounting Series Release No. 146 (August 24, 1973), 2 SEC Docket 342 and Accounting Series Release No. 146–A (April 11, 1974), 4 SEC Docket 221.

[23] Accounting Series Release No. 145 (August 2, 1973), 2 SEC Docket 254.

[24] Accounting Series Release No. 151 (January 3, 1974), 3 SEC Docket 345.

[25] Accounting Series Release No. 156 (April 26, 1974), 4 SEC Docket 218.

[26] Accounting Series Release No. 147 (October 5, 1973), 2 SEC Docket 593.

[27] Accounting Series Release No. 148 (November 13, 1973), 3 SEC Docket 64.

[28] Accounting Series Release No. 149 (November 28, 1973), 3 SEC Docket 155.

[29] Accounting Series Release No. 152 (February 14, 1974), 3 SEC Docket 564.

[30] Accounting Series Release No. 154 (April 19, 1974), 4 SEC Docket 152.

[31] Accounting Series Release No. 155 (April 25, 1974), 4 SEC Docket 218.

[32] Securities Act Release No. 5427 (October 4, 1973), 2 SEC Docket 525.

[33] Securities Act Release No. 5492 (May 6, 1974), 4 SEC Docket 261.

[34] Securities Act Release No. 5505 (June 21, 1974), 4 SEC Docket 468.

[35] Securities Act Release No. 5513 (July 11, 1974), 4 SEC Docket 551.

[36] Accounting Series Release No. 153 (February 25, 1974), 3 SEC Docket 645.

[37] Accounting Series Release No. 157 (July 8, 1974), 4 SEC Docket 589.

[38] Accounting Series Release No. 158 (July 19, 1974), 4 SEC Docket 621.

[39] *Preferred Land Corporation* v. *SEC* (D. D.C., Civ. No. 74–559).

[40] 5 U.S.C. 552(b) (7).

[41] 74–1701 (C.A.D.C.).

PART 3

REGULATION OF SECURITIES MARKETS

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In addition to the disclosure provisions discussed in the preceding chapter, the Exchange Act assigns to the Commission pervasive regulatory responsibilities for securities markets and persons in the securities business. The Act, among other things, requires securities exchanges to register with the Commission and provides for Commission supervision of the self-regulatory responsibilities of registered exchanges. The Act requires registration and regulation of brokers and dealers doing business in the over-the-counter markets, and permits registration of associations of brokers or dealers exercising self-regulatory functions under Commission supervision. The Act also contains provisions designed to prevent fraudulent, deceptive and manipulative acts and practices on the exchanges and in the over-the-counter markets. Some recent developments concerning regulation of the securities markets are discussed in Part 1.

REGULATION OF EXCHANGES

Registration

The Exchange Act generally requires an exchange to register with the Commission as a national securities exchange unless the Commission exempts it from registration because of the limited volume of its transactions. As of June 30, 1974, the following 13 securities exchanges were registered with the Commission.

American Stock Exchange, Inc.
Board of Trade of the City of Chicago[1]
Boston Stock Exchange
Chicago Board Options Exchange, Inc.
Cincinnati Stock Exchange
Detroit Stock Exchange
Midwest Stock Exchange, Inc.
National Stock Exchange
New York Stock Exchange, Inc.
Pacific Stock Exchange, Inc.
PBW Stock Exchange, Inc.
Intermountain Stock Exchange
Spokane Stock Exchange

Delisting

Pursuant to Section 12(d) of the Exchange Act, securities may be stricken from listing and registration upon application to the Commission by an exchange, or withdrawn from listing and registration upon application by an issuer, in accordance with the rules of the exchange and upon such terms as the Commission may impose for the protection of investors. It is the Commission's view that in evaluating delisting applications, it is not generally the Commission's function to substitute its judgment for that of an exchange, and that where there has been full compliance with the rules of an exchange with respect to delisting, the Commission is required to grant a delisting application. The authority of the Commission in such cases is limited to the imposition of terms deemed necessary for the protection of investors.

The standards for delisting vary among the exchanges, but generally delisting actions are based on one or more of the following factors: (1) the number of publicly held

shares or shareholders is insufficient (often as a result of an acquisition or merger) to support a broad-based trading market; (2) the market value of the outstanding shares or the trading volume is inadequate; (3) the company no longer satisfies the exchange's criteria for earnings or financial condition; or (4) required reports have not been filed with the exchange.

During fiscal 1974, the Commission granted exchange applications for the delisting of 115 stock issues and 29 bond issues. The largest number of applications came from the American Stock Exchange (40 stocks and 10 bonds). The number of applications granted other exchanges are: New York (31 stocks and 18 bonds); National (17 stocks and 1 bond); Pacific (14 stocks); Midwest and Boston (4 stocks each); Detroit (2 stocks); Cincinnati, Spokane and the Chicago Board of Trade (1 stock each).

The Commission also granted the applications of two issuers to withdraw their securities from listing and registration on the American Stock Exchange.

Exchange Disciplinary Actions

Although the Exchange Act does not specifically grant the Commission authority to monitor disciplinary actions taken by exchanges,[2] each registered national securities exchange reports to the Commission action taken against members and member firms and their associated persons for violations of any rule of the exchange or of the Exchange Act, or of any rule or regulation under the Act.

During the fiscal year, five exchanges reported a total of 83 separate disciplinary actions including the imposition in 33 cases of fines ranging from $400 to $20,000; the expulsion of 19 individuals; the suspension from membership (for periods of 3 to 18 months) of 9 member organizations and 16 individual members; and the censure of 22 member organizations.

New Commission Recordkeeping Rules

During the fiscal year the Commission adopted Securities Exchange Act Rule 17a–1 which requires every national securities exchange and association to keep on file for a period of five years (two years in an accessible place) and make available for examination and copying by the Commission and its representatives all documents which it originates or receives respecting its self-regulatory activities.[3]

In order to reduce the volume of material which must be kept, the Commission also amended Rule 17a–6 to provide that documents retained pursuant to the Exchange Act or any rule or regulation thereunder may be destroyed before the end of the retention period, or retained on microfilm or other recording medium for the remainder of the retention period if so provided by an exchange or association in a record destruction plan filed with and approved by the Commission.

Exchange Rules

The Commission's staff continually reviews the rules and practices of the nation's registered securities exchanges to determine the adequacy and effectiveness of the self-regulatory scheme. To facilitate Commission oversight, each registered national securities exchange is required to file with the Commission a report of any proposed change in rules or practices not less than three weeks (or such shorter period as the Commission may authorize) before implementing a change. These filings are available for public inspection.

During the fiscal year, the Commission received 127 letters from exchanges proposing changes in several hundred exchange rules and practices. The following were among the more significant:

1. The New York Stock Exchange and the Midwest Stock Exchange adopted rule changes permitting their members to sell all types of insurance. Previously their members had been limited to selling life, accident and health insurance.

2. During the fiscal year, most of the registered stock exchanges adopted rule amendments which provided for competitive brokerage commissions on orders of $2,000 or less. For further discussion of these changes, see Part 1.

3. During the year the New York Stock

Exchange's wholly-owned securities depository, the Depository Trust Company, submitted for Commission review rule changes designed to accomplish a direct electronic interconnection with the National Clearing Corporation. For further discussion, see p. 64, *infra*.

Litigation on Exchange Rules

In *Gordon* v. *New York Stock Exchange, Inc.*,[4] the Court of Appeals for the Second Circuit unanimously affirmed an order of the United States District Court for the Southern District of New York dismissing for lack of subject matter jurisdiction, a challenge under the antitrust laws to the fixed minimum commission rate policies of the national securities exchanges. The plaintiffs had sued the New York and American Stock Exchanges and two representative member firms of the exchanges.

The Commission filed a brief, *amicus curiae*, in the Court of Appeals arguing that, in the Securities Exchange Act, Congress intended to grant the Commission exclusive jurisdiction over a broad range of exchange activities, including the fixing of commission rates, and that a district court has no jurisdiction to entertain an antitrust challenge to exchange activities that are within the Commission's exclusive jurisdiction.

The Court of Appeals concluded that the legislative history of the Securities Exchange Act demonstrates Congress's intent that the Commission "assume the central role in assuring investor protection and exchange fair dealing" with respect to the fixing of commission rates. It held, as the Commission urged, that where governmental oversight of the exchanges' practices is vested expressly in the S.E.C. "both the language and the history of the 1934 Act, together with the sound policy behind supervised exchange self-regulation," mandate the conclusion that Congress intended to exempt those practices from the application of the antitrust laws. The court reasoned that if district courts, on an *ad hoc* basis, applied the antitrust laws to practices within the jurisdiction of the Commission, "duplicative or inconsistent standards announced contemporaneously by courts and Commission could result."

Moreover, the court noted, denial of antitrust jurisdiction with respect to the setting of fixed minimum commission rates was grounded in sound public policy because "when something as crucial to the survival of the securities industry as its very ancient rate structure is at stake, diagnosis and changes must come from an agency with the Commission's expertise, . . . [and] with respect to the fixing of commission rates, the process of administrative review in the first instance is far superior to judicial review." The court rejected the decision in *Thill Securities Corp.* v. *New York Stock Exchange*[5] to the extent inconsistent with its own opinion.

Exchange Inspections

An important element of the Commission's supervision of exchange self-regulation is its program of regular inspections of various phases of exchange activity. These inspections enable the Commission to recommend, where appropriate, improvements designed to increase the utility and effectiveness of self-regulation. Three inspections made in fiscal 1974 are described below.[6]

NYSE Specialists Inspection.—The Commission's staff inspected the NYSE's procedures for surveillance of the performance of its specialists and its stock allocation program. In the inspection, the staff interviewed NYSE Floor Department staff members, and examined, among other things, the Floor Department's case files regarding specialist performance, reports of specialist income and expenses and the minutes both of the Floor Committee and of the Committee on Specialist Ratings. The staff considered the methods and general adequacy of continuous specialist surveillance, the method by which new listings of stocks are allocated among specialists, instances of reallocations of stocks among specialists and disciplinary actions against specialists. It also considered the standards which the NYSE employs in determining whether a specialist is complying with its "affirmative obligation" under NYSE rules to engage in a course of dealings for its own account to assist in the maintenance of a fair and orderly market and its "negative

obligation" under Exchange Act Rule 11b–1 to restrict its dealings to those reasonably necessary to permit it to maintain a fair and orderly market.

The inspection was, however, primarily concerned with two of the NYSE's methods of specialist surveillance—the NYSE's "New Measures of Specialist Performance" ("New Measures") and its one-week spot-checks of specialist trading, which are made at least eight times each year—and with the manner in which new listings of stocks are allocated among specialists. The Commission's staff expressed the view that the "New Measures" and the one-week spot-checks did not adequately develop a basis upon which to measure the performance of specialists in fulfilling their affirmative and negative obligations. In addition, it appeared to the Commission's staff that neither the performance ratings computed under the "New Measures" nor those resulting from the spot checks are used as a basis for making stock allocations or reallocations; it was unclear what bases for allocations are actually utilized. The staff suggested, as the Martin Report[7] had earlier recommended, that the NYSE staff assume a greater role in the allocation and reallocation of stocks. In addition, the Commission's staff noted that a review of the minutes of the NYSE Committee on Floor Affairs revealed the crucial role currently performed by that Committee and its subcommittees in determining the regulatory approach to specialist compliance with Commission and NYSE rules. Because of the limited information revealed in exchange records respecting the basis for Committee decisions, the staff recommended that the Committee's minutes or other records be appropriately expanded.

Following the inspection, the NYSE established a committee to examine and make recommendations to the exchange regarding the NYSE's specialist system and its regulation. In addition, NYSE staff members met with the Commission's staff to discuss the inspection; the NYSE has agreed to respond to the matters raised at that meeting.

Amex Compliance Inspection.—The staff also conducted an inspection of the Compliance Department of the Amex. During the inspection the staff interviewed Amex staff members and examined selected investigatory case files. Among the matters considered in the course of the inspection were the qualifications of the members of and the size of the compliance staff; the sources of information available to it; its methods of investigation; the general adequacy of the disciplinary actions; and the depth and detail with which the staff conducts its investigations.

The Compliance Department is responsible for the investigation of possible violations by Amex members of exchange rules and of the Exchange Act. Although these violations are in some cases discovered by the Department, most are referred from sources outside the Compliance Department. When the Department believes, following its investigation, that an Amex member has committed a rule violation, it brings formal charges before Amex's Disciplinary Panel.

It was noted by the Commission staff that although the number of personnel on the Amex Compliance Department staff was not at its budgeted strength at the time of the inspection, its members were generally well qualified, adequately supervised and seemed to investigate their cases thoroughly. The Commission's staff did, however, note that the Compliance Department reviews only those arbitration cases which are referred to it by the Director of Arbitration. It suggested that, in order to improve its ability to identify rule violations, the Compliance Department should routinely examine all arbitration cases in which a decision had been rendered against a member firm respondent.

Following a previous inspection, the Commission's staff had suggested to both the Amex and the NYSE that they adopt rules to require member firms to report to the exchanges certain incidents indicating possible violative conduct involving a firm's employees on a current basis, rather than only at the termination of employment with the firm, so that the exchanges could make timely investigations of possible rule violations. The NYSE adopted such a rule (NYSE Rule 351) which appears to be accomplishing its purpose. Accordingly, following the most recent inspection of the Amex Compliance Department, the Commission's staff

suggested that the Amex adopt such a "current reporting" rule.

After its 1971 inspection of the Amex Compliance Department, the Commission's staff had expressed concern regarding the Amex's elimination, from its compliance program, of its periodic inspections of member firms' front offices. It was suggested that such inspections be reinstituted. During the most recent inspection, it was learned that the Amex was preparing to resume inspecting member firms' front offices. The next inspection will examine the impact of those inspections upon the Amex disciplinary program.

A few specific cases reviewed during the inspection were discussed at a meeting between Amex and Commission staff members. The Amex representatives assured the Commission's staff that any deficiencies in the manner these cases were handled would be corrected in the future.

PBW Stock Exchange Inspection.—In November 1973, the Commission's staff inspected the self-regulatory program of the PBW Stock Exchange, Inc. ("PBW"), as part of its regular oversight inspection program. It directed particular attention to the PBW's plans to begin the trading of options on a pilot basis and to establish a trading floor with market-making capability in Miami, Florida. The inspection of the PBW floor focused on order execution, specialist performance, and on-site, real-time surveillance by PBW staff. The staff also reviewed the performance of the PBW Department of the Stock List, Office of Chief Examiner and Office of General Counsel and examined the work of the exchange's two principal exchange-member self-regulatory committees, the Committee on Floor Procedure and the Committee on Business Conduct.

As a result of that inspection, the staff recommended to the PBW that it create a program to evaluate odd-lot dealer-specialist performance and that it consider adopting the following three performance standards for its odd-lot dealer-specialists in primary-listed securities: (i) minimum allowable quotation spreads; (ii) restrictions on trading with limited price orders on the specialist's book; and (iii) the prohibition or restriction of a member firm's promotion of primary-listed securities in which it is a registered specialist. The staff also recommended that the PBW formalize the procedures to be followed by its own staff when it makes inquiry into "news-pending" or unusual trading situations. It was further recommended that the exchange require its floor members to report to the Committee on Floor Procedure or to a floor official any dispute between floor brokers and specialists concerning the execution of an order, that the responsible floor official be satisfied that the public customers' interests are adequately represented in the dispute, and that a record be kept by the Committee of all such disputes reported to a floor official. The Commission's staff also recommended that the minutes and records of the exchange-member self-regulatory committees more completely reflect the committees' activities and the bases for their decisions.

Following the inspection, the PBW reviewed its parameters for quotation spreads, instituted a procedure whereby the presiding floor official involved in a dispute would submit a memorandum regarding the dispute to the Committee on Floor Procedure, and instituted additional surveillance of odd-lot dealer-specialist performance. It is anticipated that there will be further discussions between the PBW and the Commission's staff regarding the implementation of these procedures and the remaining recommendations.

SUPERVISION OF NASD

The Exchange Act provides that any association of brokers or dealers may be registered with the Commission as a national securities association if it meets the standards and requirements for the registration and operation of such associations contained in the Act. The Act contemplates that such associations will serve as a medium for self-regulation by over-the-counter brokers and dealers. In order to be eligible for registration, an association must have rules designed to protect investors and the public interest, to promote just and equitable principles of trade and to meet other statutory requirements. Registered national securities associations operate under the Commission's general supervisory author-

ity, which includes the power to review disciplinary actions taken by an association, to disapprove changes in association rules and to alter or supplement rules relating to specified matters. The National Association of Securities Dealers, Inc. (NASD), is the only association registered with the Commission under the Act.

In adopting legislation to permit the formation and registration of national securities associations, Congress provided an incentive to membership by permitting such associations to adopt rules which preclude members from dealing with a nonmember broker or dealer except on the same terms and conditions and at the same price as the member deals with the general public. The NASD has adopted such rules. As a practical matter, therefore, membership is necessary for profitable participation in many underwritings since members properly may grant only to other members price concessions, discounts and similar allowances not granted to the general public.

At the close of the fiscal year, the NASD had 3,318 members, reflecting a net loss of 567 members during the year. This loss reflects the net result of 184 admissions to and 751 terminations of membership. The number of members' branch offices decreased by 643, to 6,148, as a result of the opening of 1,334 new offices and the closing of 1,977. During the fiscal year, the number of registered representatives and principals (these categories include all partners, officers, traders, salesmen and other persons employed by or affiliated with member firms in capacities which require registration) increased by 2,158 to 207,095 as of June 30, 1974. This increase reflects the net result of 27,095 initial registrations, 25,658 re-registrations and 50,595 terminations of registration during the year.

During the fiscal year, the NASD administered 59,109 qualification examinations of which 35,105 were for NASD qualification, 2,624 for the Commission's SECO program[8] and the balance for other agencies, including major exchanges and various states.

NASD Rules

Under the Exchange Act, the NASD must file for Commission review copies of any proposed rules or rule amendments 30 days prior to their proposed effective date. Any rule changes or additions may be disapproved by the Commission if it finds them to be inconsistent with the requirements of the Act. Normally, the Commission also reviews, in advance of publication, general policy statements, directives and interpretations proposed to be issued by the Board of Governors pursuant to its powers to administer and interpret NASD rules.

During the fiscal year,[9] numerous changes in or additions to NASD rules, policies and interpretations were submitted to the Commission for its consideration. Among the more significant which were not disapproved by the Commission were:

(1) Amendments to Schedule D of the NASD's By-laws to provide for the implementation of annual assessments and entry fees for securities quoted on NASDAQ, the Association's automated quotation system.

(2) Amendments to Schedule E of the NASD's By-laws ("Self-Underwriting Rules"). Among other things, the amendments require NASD members which have made public offerings of their own securities to establish "Audit Committees" and to elect "public directors" to their Boards of Directors.

(3) Amendments to Schedule D of the NASD's By-laws to provide for summary complaint procedures for NASDAQ Committee disciplinary proceedings.

(4) Amendments to the NASD's By-laws to provide new procedures for the selection of candidates for nominating Committees (which nominate candidates for election to the District Committees and the Board of Governors) and to revise nomination and election procedures of membership on District Committees and the Board of Governors.

(5) Amendments to the NASD's Rules of Fair Practice to set forth the initial margin maintenance requirements to be followed by NASD members in extending credit to customers in securities transactions.

(6) Amendments to the Interpretation of the NASD Board of Governors regarding "free-riding and withholding"

in public offerings. Among other things, the amendments prohibit entirely any allocation of "hot issues" to NASD firms and persons associated with NASD firms.

Tax Shelters

In recognition of existing and potential abuses with respect to tax shelter programs, the Commission continued its efforts during the fiscal year to provide for adequate regulation of such programs. Specifically, the Commission directed its staff to continue to collect information concerning abuses involving tax shelter programs and to formulate various proposals, including new rules or guidelines applicable to all packagers and promoters of such programs, enlarged enforcement programs and suggestions for possible additional legislation.

As previously reported, in July 1973, the Commission requested public comments on proposed NASD Rules of Fair Practice designed to establish a system of regulation for the public distribution of tax shelter programs by NASD members.[10] The Commission reviewed the numerous comments received in response to its release and in a May 1974 letter to the NASD encouraged it to pursue its proposals in the traditional areas of its regulation (*e.g.*, underwriters' compensation, suitability and sales literature).

With respect to the NASD's proposals relating to the operation, structure and management of tax shelter programs, however, the Commission indicated that it did not then believe that the NASD should attempt to provide a regulatory structure having a direct impact on issuers, sponsors and other non-NASD members.

At the end of the fiscal year the staffs of the Commission and the NASD were discussing further steps to implement the NASD's tax shelter proposals.

Mandatory Bonding

Toward the end of the fiscal year, the Commission permitted to become effective a new NASD rule setting forth mandatory fidelity bonding requirements for NASD members. The rule evolved from a study of the fidelity bonding requirements imposed by the exchanges on their members. The study was conducted by the NASD at the suggestion of SIPC with a view to developing similar requirements for NASD members so that various special forms of risk (such as misappropriation of firm assets) would be covered through appropriate bonding and, as was the intention of Congress, be excluded from the risks covered by SIPC. The rule requires each NASD member to maintain the standard "Stock Broker's Blanket Bond" or an equivalent bond acceptable to the NASD to indemnify the firm (and indirectly its customers) against losses attributable to common law and statutory crimes such as burglary and theft (including "mysterious unexplainable disappearances" of property), losses of property in transit, "forgery and alteration" losses, and damages from any "securities loss." In addition, the rule requires NASD members to obtain specified minimum amounts of coverage under various insuring agreements.

Certain NASD members are exempted from complying with the rule to the extent that the nature of their business does not come within the scope of the fidelity bonding concept. Firms in this category chiefly include dealers engaged exclusively in the retail distribution of investment company shares—firms which typically do not hold customer funds or securities—and sole proprietorships and partnerships having no employees.

Both the NASD and the Commission intend to monitor the impact of the rule to ensure that no one is excluded from the securities business merely because it cannot obtain a bond at a reasonable cost.

Commission Abrogation of NASD Rule

The Exchange Act permits the Commission by order to abrogate any NASD rule if it appears that abrogation is necessary or appropriate to effectuate the purposes of the Act. The Commission, as previously reported[11] on June 7, 1972[12] abrogated Rule 25 of the NASD Rules of Fair Practice[13] to the extent that it permitted or had been con-

strued to permit the NASD to bar receipt by its members of any allowance from nonmembers. The NASD had traditionally interpreted Rule 25 as prohibiting its members from either granting or receiving commissions, concessions, discounts or any other allowances from nonmember broker-dealers.

The Commission determined that the NASD, in interpreting Rule 25 to prohibit the receipt of allowances from nonmembers, had gone beyond the authority granted by Section 15A(i)(1). The Commission's decision was based upon its conclusion that Section 15A(i)(1), which authorizes the adoption of rules such as Rule 25 restricting the business conduct of members of national securities associations, is an exception to the free and open market concept expressed in Section 15A(b)(8) and therefore must be narrowly construed.

The NASD filed a petition for review of the Commission's decision in the United States Court of Appeals for the District of Columbia Circuit.[14] On November 1, 1973, the court, *per curiam* and without opinion, affirmed the Commission's order.

NASD Inspections

During the fiscal year, the staff inspected the NASD's district offices in Boston, Chicago, Dallas, Denver, the District of Columbia, Kansas City, Los Angeles, New York, San Francisco and Seattle. These inspections were conducted as a part of the Commission's regulatory oversight responsibility to assure that the District committees and their staffs (which operate semi-autonomously from the NASD's national office) are properly carrying out the policy-making and administrative functions of the NASD assigned to them, and to assist in the proper coordination of the Commission's and the NASD's regulatory and enforcement activities in the over-the-counter markets.

These inspections involved a review of (1) the composition and effectiveness of the District Committees, the District Business Conduct Committees, examination subcommittees, nominating committees and quotation committees; (2) the functioning of the district staffs, especially their working relationships with the various committees; (3) the district staffs coordination and cooperation with the Commission's regional offices, exchanges and other interested regulatory bodies; (4) the effectiveness of disciplinary proceedings and enforcement procedures; and (5) the need, if any, for new rules or amendments to existing rules, policies or interpretations.

In general, the Commission staff reported relatively few substantive problems in the operations of the district offices visited. There were, however, several areas which the staff felt merited further discussion with the NASD's home office. Specifically, the staff noted that some districts were: (1) experiencing problems in processing formal complaints within a reasonable period of time, *i.e.*, there were occasional delays in writing and serving disciplinary complaints on respondents, and in holding hearings, negotiating settlements and reviewing transcripts and other materials; (2) finding difficulty in conducting on a regular basis inspections of principal offices of firms not engaged primarily in a general over-the-counter securities business; consequently, exchange, mutual fund and specialty firms, and branch offices of members were not being routinely examined, although it was recognized that exchange firms are generally examined by one or more exchanges of which they are members;[15] (3) in some disciplinary proceedings reviewed on appeal to the Commission, not documenting adequately the evidence presented or substantiating adequately the findings made; and (4) not applying disciplinary measures uniformly.

These matters were discussed at length on various occasions with representatives of the NASD; in response, the NASD has undertaken new programs and refinements of existing programs to improve its self-regulatory performance. With respect to the problems in the timely processing of formal complaints, the NASD has implemented a monthly reporting form which is being used by its district offices to report the status of all pending items. The report is also used by the NASD's national office to identify district offices experiencing delays and to assign to them the appropriate manpower to correct the problem. The NASD has also

undertaken corrective action in connection with its broker-dealer examination program, discussed elsewhere in this annual report.[16]

In connection with the adequacy of documenting evidence in NASD disciplinary records received on appeal to the Commission, the NASD noted that district staff personnel were being given pertinent training with respect to local NASD record-keeping and in the drafting of its decisions. The NASD is also closely monitoring the use of internal records as early warning devices in detecting violations and, where necessary, is developing new procedures to be followed by its district offices.

NASD Disciplinary Actions

The Commission receives from the NASD copies of its decisions in all cases where disciplinary action is taken against members and persons associated with members. Generally, such actions are based on allegations that the respondents violated specified provisions of the NASD's Rules of Fair Practice. Where violations by a member are found, the NASD may impose such penalities as expulsion, suspension, fine or censure. If the violator is an individual, his registration with the NASD may be suspended or revoked, he may be suspended or barred from being associated with any member or he may be fined and/or censured.

During the past fiscal year, the NASD reported to the Commission its final disposition of 919 disciplinary complaints (including 182 complaints involving NASDAQ)[17] in which 722 members and 873 individuals were named as respondents. Complaints against 40 members and 81 individuals were dismissed for failure to establish the alleged violations. Sixty-four members were expelled from membership and 32 members were suspended for periods ranging from one day to one year. In many of these cases, a fine also was imposed. In 576 cases, members were fined amounts ranging from $25 to $50,000 and in 45 cases members were censured. In disciplinary sanctions imposed on individuals associated with member firms, 173 persons were barred or had their registrations revoked and 112 had their registrations suspended for periods ranging from one day to eight years. In addition, 507 other individuals were censured and/or fined amounts ranging from $100 to $50,000.

Review of NASD Disciplinary Actions

Disciplinary action taken by the NASD is subject to review by the Commission on its own motion or on the timely application of any aggrieved person. In those cases reviewed by the Commission, the effectiveness of any penalty imposed by the NASD is automatically stayed pending Commission review, unless the Commission otherwise orders after notice and opportunity for hearing. If the Commission finds that the disciplined party committed the acts found by the NASD and that such acts violated the specified rules, the Commission must sustain the NASD's action—unless it finds that the penalties imposed are excessive or oppressive, in which case it must reduce them or set them aside.

At the beginning of the fiscal year, 22 proceedings to review NASD disciplinary decisions were pending before the Commission and, during the year, 17 additional cases were brought up for review. The Commission disposed of 13 cases. In four cases, the Commission affirmed the NASD's action. It remanded one case back to the NASD. In seven cases, the NASD's findings and/or penalties were modified and in one case the NASD's action was set aside. At the close of the fiscal year, 26 cases were pending.

In *Plaza Securities Corp.*,[18] the Commission set aside a finding by the NASD that an NASD member, by merely joining with a non-member affiliate in a distribution of securities to the public, had violated the NASD rule forbidding members to deal with non-members except on the same terms as they deal with members of the general public [Article III, Section 25]. The Commission, citing its earlier decision in the "Aetna" case,[19] stated that the NASD rule must be viewed merely as prohibiting a member from giving a non-member a discount or commission not accorded to the general public. Since the Commission could not find on the basis of the record that Plaza

gave such a discount or concession to its non-member affiliate, it saw no impropriety in Plaza's joining with the affiliate in a distribution of securities.

In another case, *Sumner B. Cotzin*,[20] the NASD found, as did the Commission on an application for review, that the respondent had violated the net capital rule and had engaged in sham transactions to avoid detection of its net capital deficiencies. The principal contention on review related to an asserted lack of due process in the NASD's procedures. This was based on applicant's belief that the NASD permitted its district director to perform investigative and prosecutory functions in their disciplinary proceedings while at the same time advising and participating with the District Business Conduct Committee in its deliberations preceding its decision. In sustaining the NASD's findings, the Commission held that there was no evidence to support applicant's claim. The Commission noted, however, that although it was unpersuaded that a rigid separation between investigative and adjudicative personnel is an essential element of fairness in NASD proceedings at the District Business Conduct Committee level, the NASD's existing procedures may present some problems. It suggested that the Association "re-examine its procedures to avoid even the appearance of" unfairness.

Review of NASD Membership Action

The Exchange Act and NASD By-laws provide that no broker or dealer can be an NASD member if it or any person associated with it is subject to specified disabilities. These disabilities can be waived only with specific approval of the Commission. Commission approval or a direction by it to admit a person to membership in the Association or to continue the membership of any person generally is made after initial submission to the NASD by the member or applicant for membership. The NASD in its discretion may then file an application with the Commission on behalf of the petitioner. If the NASD refuses to sponsor an application, the broker or dealer may apply directly to the Commission for an order directing the NASD to admit him to or to continue him in membership. At the beginning of the fiscal year, four applications for approval of admission to or continuance in membership were pending. During the year, seven applications were filed, four were approved and three were withdrawn, leaving four applications pending at the end of the year.

BROKER-DEALER REGULATION

Registration

Brokers and dealers who use the mails or means of interstate commerce in the conduct of an over-the-counter securities business are required to register with the Commission.

As of June 30, 1974, there were 3,982 broker-dealers registered, compared with 4,407 a year earlier. This represents a decrease of 425, or 9.6 percent, since June 30, 1973. During the year 766 registrations were terminated, 702 new applications were received, 341 applications were made effective, and 363 applications were returned, denied or withdrawn. Approximately 689, or 90 percent, of the 766 terminations were requested by the registrants for a variety of reasons, while 77, or 10 percent, were the result of Commission action (cancellation or revocation).

During the fiscal year, the Commission clarified certain of its rules imposing recordkeeping, reporting and financial responsibility obligations on broker-dealers. It also adopted or proposed for adoption new rules or amendments to certain of the existing rules in these areas.

Recordkeeping

During the fiscal year, the Commission for the first time published a comprehensive release clarifying the requirement of Rule 17a–3 under the Securities Exchange Act, that every broker-dealer make and keep current the books and records specified in the Rule.[21]

Financial Responsibility

The basic financial responsibility rules applicable to broker-dealers are Rules

15c3–1 and 15c3–3 under the Securities Exchange Act.

Rule 15c3–3, which became effective January 15, 1973, establishes standards regarding the custody of customers' securities and limits the use of customers' funds left with a broker-dealer in order to insure that such funds are not utilized to support firm activities unrelated to the servicing of customers. On October 12, 1973, the Commission published a release setting forth standards for the safekeeping of customers' securities held abroad.[22] Since that date over 180 applications for foreign control locations have been processed by the Commission. In addition, during the year the staff issued over 160 interpretive letters concerning Rule 15c3–3. Further releases interpreting this important Rule are anticipated in the next year.

Rule 15c3–1, the "net capital rule," sets standards of liquidity to be maintained by broker-dealers. During the fiscal year, the Commission issued an interpretive release to clarify the availability to broker-dealers of the $2,500 and $5,000 minimum net capital requirements of the Rule.[23] In addition, in a two-part program to raise minimum net capital requirements for broker-dealers who carry customers' accounts and hold customer funds and securities, the minimum net capital required by the Rule rose in the prior fiscal year from $5,000 to $15,000, and as of July 31, 1974 became $25,000.[24]

Most importantly, during the fiscal year, the Commission took a significant second step toward the implementation of a uniform net capital rule for broker-dealers, first proposed in late 1972.[25] After release of the proposal, a great number of constructive comments were received and were carefully considered by the Commission. During the 1974 fiscal year, the Commission published a revised proposed rule,[26] substantially changed to reflect many of the comments received. The rule as adopted would provide uniform financial regulations, definitions and interpretations throughout the securities industry including for the first time exchange members within its scope and would facilitate simplification of the financial reporting requirements for broker-dealers.

The new proposed rule does not change the basic liquidity concept of the original net capital rule under which the securities industry has been operating for many years, but does in some ways depart from the present Rule. The rule would provide for the flowing of net capital benefits from the subsidiaries held by broker-dealers to their broker-dealer parents in amounts equivalent to the liquid assets of such subsidiaries. In addition, the revised proposal substantially revises the present Rule's securities "haircut" provisions, in recognition of the liquidity of U.S. government securities and certain other securities. The new proposed rule also deals comprehensively with the risks associated with the writing and endorsement of options both by broker-dealers and their customers.

Financial Reporting

The Commission made two major revisions to Rule 17a–5, the basic financial reporting rule for broker-dealers, and to the forms thereunder, which serve to determine compliance by broker-dealers with applicable financial responsibility rules.

First, the Commission amended Rule 17a–5 and Form X–17A–5 under the Securities Exchange Act to permit independent public accountants to perform certain preliminary audit procedures before financial audits of the statements of broker-dealers.[27] To accomplish these changes, Part III of Form X–17A–5 was adopted. That Part requires the independent accountant to describe the scope of the preliminary audit examination, indicate that the information is presented fairly and comment on any material inadequacies found to exist at the date of the preliminary work. Part III also requires certain statistical information regarding the examination and the preliminary audit procedures performed. Under the amended Rule 17a–5 such a preliminary audit examination may not take place more than 190 days prior to the date of the broker-dealers' annual audit required pursuant to Rule 17a–5(a).

The amendments are designed to accommodate the elimination by most registered national securities exchanges of their surprise audit requirements. The amendments will also eliminate duplicate costs for

broker-dealers which are public companies and will lead to more effective audits and more uniform reporting of financial data and provide greater flexibility to the accountant.

The release announcing the amendments also provides the Commission's interpretive view of material inadequacies which should be reported by accountants in connection with audits performed pursuant to Rule 17a–5.

Secondly, Form X–17A–5 was amended[28] to reflect the additional information necessary to monitor compliance with Rule 15c3–3 under the Exchange Act and to give the Commission sufficient information to analyze the effectiveness of that Rule. Certain other amendments to the form were made in recognition of developments in the securities industry since 1967 affecting the auditing and financial regulation of broker-dealers. The amendments also require independent accountants to review and comment upon the procedures followed in complying with Rule 15c3–3 and Regulation T of the Board of Governors of the Federal Reserve System.

The amendments enable the Commission and the self-regulatory organizations to monitor compliance with both the Reserve Formula Computation required by Rule 15c3–3 and the aspects of Rule 15c3–3 related to possession or control of customers' fully paid for and excess margin securities.

In addition, an Advisory Committee on Reports and Forms, convened by the Commission, recommended that many financial reports required of broker-dealers by the Commission and the various self-regulatory bodies be consolidated into a single "Key Regulatory Report." Subsequently, the Commission announced a broad program to implement the recommendations of this Committee, including plans to develop the recommended "Key Regulatory Report."[29]

Rule 17a–18, Rule 17a–19 and Related Form X–17A–19

In order to promote more effective reporting by the brokerage community, the Commission proposed for public comment two new rules and a related form. Proposed Rule 17a–18 would require all self-regulatory organizations to submit to the Commission for its advance approval any new form, report or substantial amendment which it intends to require its member firms to submit.[30]

Proposed Rule 17a–19 and related Form X–17A–19 are intended to assist the Commission and SIPC in maintaining accurate, current lists of the memberships of the self-regulatory organizations, particularly with respect to the SIPC designations of principal examining authorities pursuant to Section 9(c) of the SIPC Act of 1970. At the Commission staff's request, all the self-regulatory organizations implemented proposed Rule 17a–19 and began using proposed Form X–17A–19 on a pilot basis in March 1974. In May 1974, the Commission prepared a directory of SIPC designees and broker-dealer memberships. In June, the draft directory was supplied to all self-regulators and an exception report of those firms which have not been examined will be produced. The Commission will use this report as a basis for reviewing the effectiveness of the self-regulatory organizations' examination programs.

Broker-Dealer Examinations

The Commission in January 1972 established the Office of Broker-Dealer Examination Program to deal more effectively with the problems detailed in the Commission's 1971 Study of Unsafe and Unsound Practices of Brokers and Dealers.[31] By creating this Office, the Commission substantially strengthened its continuing efforts to prevent a recurrence of the crisis which confronted the securities industry in the years 1968 through 1970. During that period, there occurred widespread failures of broker-dealer firms, accompanied by substantial customer losses of cash and securities. One major outgrowth of these crises was the passage in 1970 of the Securities Investor Protection Act.

During the past fiscal year, the Office has primarily devoted its efforts to three areas of activity: (1) early warning and surveillance; (2) examination; and (3) training. See also pages 56–58 *supra*, for information on other Commission action relating to the financial responsibility of brokers and dealers.

Early Warning and Surveillance Programs

The primary responsibility for insuring the financial and operational soundness of its member firms rests with each self-regulatory organization. The Commission periodically reviews through on-site inspections and in-house studies the early warning surveillance tools of the organizations to ensure that they constitute sound, effective programs, which will enable each organization to detect at the earliest possible time member firms which are in or approaching financial difficulty and to monitor their conditions. During the past fiscal year, the Commission's staff conducted on-site inspections of the early warning and surveillance programs of the American Stock Exchange, the Chicago Board Options Exchange, the New York Stock Exchange, the PBW Stock Exchange and the Pacific Stock Exchange. In addition, the Commission's staff reviewed the programs of the NASD as implemented by its district offices located in Boston, New York, Dallas, Kansas City, Chicago, Los Angeles, San Francisco, Seattle, Denver and Washington, D.C. The staff has also preliminarily discussed with the Boston Stock Exchange and the Midwest Stock Exchange inspections of their programs scheduled for the early part of fiscal 1975.

In-house efforts to review these programs have included continuing communications and informal meetings with the organizations regarding revisions in their programs, the monitoring of the SIPC 5(a) program[32] and the development of a monthly early warning and surveillance report.

The Office is planning to meet with the self-regulatory authorities, in Washington, D.C., at the Commission to review precisely each organization's early warning and surveillance tools in a round-table, informal discussion session. Representatives from SIPC will also attend the meeting to discuss the SIPC 5(a) program and the organizations' experiences with this program. When reviewing their early warning and surveillance programs, the Commission ensures that the self-regulatory authorities are complying with the provisions of Section 5(a) of the SIPC Act.

Working together with the NASD and the self-regulatory authorities having SIPC-designated examining responsibility,[33] the Commission has developed a monthly, combined early warning list and a Rule 17a–11 list for each regional office.[34] This combined list sets forth for each regional office information concerning any broker-dealer firm within its region which any self-regulatory authority has reported as in or approaching financial difficulty. Each month the self-regulatory organizations submit for the combined list data pertaining to the financial condition of troubled firms within each Commission region. The list is then timely transmitted to each regional office chief examiner for his verification within 24 hours. The list incorporates all of the features of the Commission's early warning rule, Rule 17a–11; at the same time the list provides information concerning firms which may not be in violation of any net capital rule to which they are subject, but are, nevertheless, considered by the self-regulatory organizations to be financially troubled. Such a complete, timely list had not existed before this fiscal year. It has been of great assistance to the regional offices in monitoring such firms.

Other Commission early warning and surveillance tools include Rule 17a–11, mentioned above, which requires a broker-dealer to notify the Commission if it breaks through certain specified financial or operational parameters; Rule 17a–5(j), which requires a broker-dealer to notify the Commission upon the termination of its membership in one of several enumerated national securities exchanges if the broker-dealer was exempt from the Commission's net capital rule by reason of its holding membership in and being subject to the capital rules of that exchange; and Rule 17a–10, which requires a broker-dealer to file Form X–17A–10 annually with the Commission. The Commission continues to monitor these programs, although some or all of them may eventually be incorporated into the Financial and Operational Combined Uniform Single Report being developed for the industry by the Report Coordinating Group.[35]

Examination Program

An effective examination program is essential to the overall regulatory program of

any self-regulatory organization and of the Commission.

The Commission's program for examining the self-regulatory organizations has two parts. First, the Commission staff reviews and attempts to strengthen, where necessary, their examination programs, while at the same time evaluating and defining the goals, policies, procedures, design, budget and staffing of those programs. During the past fiscal year, the Commission's staff conducted on-site examination program inspections of those self-regulatory organizations mentioned above at page 59, for which it conducted early warning and surveillance inspections. Inspections of the Boston Stock Exchange and the Midwest Stock Exchange were planned for the early part of fiscal 1975.

While these reviews are important, the real test of these programs takes place in direct examination of the members of the self-regulatory organizations. The regional offices are deemed to be in the best position to conduct these examinations and to ascertain whether the stated policies and procedures of the national offices of the self-regulatory organizations are being implemented. The regional offices' oversight programs involve (1) examinations of members of self-regulatory organizations to determine if they are in compliance with the securities laws, and (2) the examination of individual members of the self-regulatory organizations and a concurrent review of the reports and working papers of the latest examination of the individual members performed by those organizations to determine whether their examination programs are thorough and effective.

The Commission headquarters office monitors the examination activities of the regional offices, both in their review of self-regulatory organizations' examinations and in their direct inspections of member firms, and have frequent meetings with the field officers to review the effectiveness of the examination programs.

In addition to oversight examinations, the regional offices conduct cause examinations and SECO examinations. Cause examinations usually result from a complaint received by a customer or another broker-dealer and are usually limited to the subject matter of the complaint. The examiner may, however, enlarge the scope of the examination if he believes that the firm's operations warrant further study. SECO examinations are usually routine examinations covering all aspects of a broker-dealer's operations. The regional offices have established a regular examination cycle in which each SECO broker-dealer[36] is examined 30 to 60 days after it becomes registered with the Commission and on an annual basis thereafter.

In fiscal 1974, the Commission's regional offices conducted a total of 1176 broker-dealer examinations, representing a 13 percent increase over the previous fiscal year's total of 1044. Of the 1176 examinations conducted, 478 were oversight examinations, 551 were cause examinations and 478 were routine examinations (mostly of SECO firms).[37]

Of great assistance to the Commission and to the self-regulatory organizations in the case of members of more than one such organization, have been SIPC's designations pursuant to Section 9(c) of the SIPC Act of one self-regulatory organization to serve as a firm's principal examining authority.[38] Designations were urged by the Commission because they would eliminate much of the duplication in the examination programs of the self-regulatory organizations.

Another step toward eliminating duplication of effort has been the Commission's development of a monthly compilation of all examinations of all broker-dealers conducted during the previous twelve months by either a regional office of the Commission or a self-regulatory organization. The Commission is currently working on two revisions to the report in order to improve its usefulness. First, the report will be modified to incorporate the SIPC designations of principal examining authorities. Secondly, the report will, as revised identify, in one composite print-out for each SEC regional office and NASD district office, every member firm of every self-regulatory body and every broker-dealer situated within that jurisdiction, and set forth all relevant information as to examinations conducted during the immediately preceding twelve-month period.

The Commission has also made several revisions in and additions to its examination manual and forms. The Broker-Dealer Examination Manual, used by the SEC examiners for background material and as a guide for conducting examinations, was updated and reprinted for distribution to the regional offices. The Broker-Dealer Examination Checklist - Standard Form, to be used in examinations of broker-dealers which conduct a general securities business, has been revised and distributed to the regional offices. The regional offices will use the revised checklist on an experimental basis for several months and then comment on the checklist so that final revisions may be made.

The Commission also developed with its regional office chief examiners a new Broker-Dealer Examination Checklist - Short Form, to be used in examinations of broker-dealers which do not conduct a general securities business. A draft of this checklist has also been forwarded to all regional offices for use on an experimental basis for several months. After written comments have been received, a new Short Form will be adopted.

Training Program

In order to improve the caliber of the examination staff of both the Commission and the self-regulatory authorities, the Commission developed a series of training courses. Some were directed toward Commission examiners only and others toward both the Commission examiners and the self-regulatory organizations' examiners. These training courses included:

1. A series of two-day training seminars for all self-regulatory bodies on the subject of Commission oversight examinations in regional offices. Each seminar, of which there were several during the fiscal year, provided a forum for the interchange of experiences with, and suggestions for, the Commission's oversight examination programs.

2. A series of regional two-day office seminars for experienced regional office examiners. Several of these seminars, which focus on actual examination techniques, have been held by the regional offices.

3. A five-day training program for new broker-dealer examiners. A seminar was conducted by the Commission's Division of Market Regulation on June 4–6, 1974, to provide basic, updated information regarding examinations of broker-dealers. Participants included Commission compliance examiners with up to three years experience with the regional offices, various state securities commissions and several of the self-regulatory organizations. The seminar focused on the examination, early warning and surveillance programs of the Commission and the various self-regulatory organizations.

The participants in the seminar were given a case problem which contained a set of a firm's books and records and facts relating to the case. The use of such a case study method proved to be extremely effective as a training tool and will now become a regular part of the Commission's training programs.

4. Regional Office Continuing Examiner Training Program.

The regional offices have been holding brief bi-weekly training sessions for their examiners. Such sessions are generally one or two hours long and provide updated or new information concerning specific examination matters, rules or regulations and examination experiences.

5. Outside training programs. The Commission is encouraging its examiners in the regional offices to take correspondence and college courses. It is also assisting in the development of at least one correspondence course for examiners and has been requested to assist several self-regulatory organizations in developing their training programs.

Financial and Operational Combined Uniform Single Report—FOCUS Report

In November 1973, the Commission staff met with representatives of the self-regulatory bodies to discuss the elimination of unnecessary reports now required of broker-dealers. Recommendations regarding the format of a uniform "Key Regulatory Report", since renamed the "FOCUS Report", were later submitted.

Upon the adoption of a uniform net capital rule, the FOCUS Report will provide a uniform source of information for evaluating the financial and operational soundness of brokers and dealers. Completion of the form will require only a reasonable expenditure of effort by the member firm. An outline for the FOCUS Report has been developed by the Commission staff and will be considered by the Report Coordinating Group. The final draft of the FOCUS Report is expected to be completed shortly.

Regulation of Small Broker-Dealers

The Subcommittee on Government Regulation of the Senate Select Committee on Small Business held hearings on July 12 and 23, 1973, regarding the reporting burden on small broker-dealers. Testifying before the Senate Committee were representatives from the small broker-dealer community, various self-regulatory organizations, SIPC and the Commission.

Two documents came out of the hearings, Senate Resolution No. 173 and a report of the Senate Select Committee entitled The Federal Paperwork Burden.[39] Both contained recommendations aimed at alleviating reporting and other regulatory problems of small broker-dealers brought out during the hearings; the problems concerned unnecessary or duplicative reporting requirements and the small firm's lack of time, capital and qualified personnel to complete the reports.

The Senate Resolution directed the Commission to:

1. review and make appropriate amendments to its rules to reduce any unnecessary reporting burden on broker-dealers and help to assure the continued participation of small broker-dealers in the United States securities markets, consistent with its statutory responsibilities to protect investors;

2. review and, if necessary, amend its rules to assure that they take cognizance of the role of small broker-dealers in the United States securities market and permit such broker-dealers to comply effectively with the rules without unnecessary administrative burdens;

3. continue active consideration and implementation of the recommendations of the SEC Advisory Committee Study on broker-dealers reports;

4. continue to review the position of the small broker-dealer to ensure its continued participation in the securities markets within the context of competitive policy and the protection of investors;

5. immediately proceed to examine and modify its rules to the extent the public interest is not commensurate with the burden imposed on small broker-dealers; and

6. report its progress to the Congress in its annual report.

The Senate Report recommended additionally that:

1. the Congress consider enactment of legislation which would direct the Commission to establish a Joint Committee on Small Broker-Dealers and to include on the Committee representatives from both private and public regulatory agencies, major and regional stock exchanges and from the small broker-dealer community; this committee would be directed to develop:

(a) a standard, industry-wide definition of the term "small broker-dealer"; and

(b) common policies regarding the role and functions of the small broker-dealer in the securities industry;

2. the Commission direct its Report Coordinating Group to set a definite timetable for developing a uniform reporting system;

3. the Commission ensure that the Report Coordinating Group include at least one member of the small broker-dealer community; and

4. the Commission establish the position of Small Broker-Dealer Liaison Officer, to function both as an advisor and ombudsman for the interests of the small broker-dealer community.

Commission Action.—The Commission recognizes, and has been working toward alleviating, the reporting and regulatory burden on all broker-dealers, and in particular small broker-dealers. Its efforts in this area have involved a continuing review of the rules, regulations and related broker-dealer reporting requirements imposed not only by the Commission but also by self-regulatory organizations and other governmental agencies. Such efforts have

also involved the formation of Federal Advisory Committees including the Report Coordinating Committee, with industry-wide participation to study these particular reporting problems in the industry.

In particular, the Commission is responding as follows to the directives contained in the Senate Resolution:

1. The Commission's staff has been reviewing the financial and operational reporting rules and related reporting requirements of the Commission and of other regulatory bodies in an effort to alleviate the reporting burden on small broker-dealers. The staff recognizes the special problems of small firms in this area, and is making every effort to reevaluate existing requirements, within the context of the public interest and with a view toward ensuring the continued participation of such firms in the securities markets;

2. The Commission is fully complying with the Senate Resolution's directive as to the recommendations of the SEC Advisory Committee Study.

The first recommendation that a broker-dealer should be required to report to a single regulator in each area of regulation has essentially been adopted by virtue of SIPC's designations of sole regulatory agencies, pursuant to Section 9(c) of the Securities Investor Protection Act of 1970. Such designations became effective on June 30, 1973.

The second recommendation calls for the establishment of the Report Coordinating Group, which has been done. See below.

The third recommendation seeks to have uniform registration laws adopted by all regulatory bodies. An industry-wide *ad hoc* group has developed a proposed uniform registration form for consideration by the regulatory organizations and the Commission. This area is the subject of activity of a working subcommittee of the Report Coordinating Group.

The fourth through seventh recommendations concern the formats and filing frequencies for the uniform, industry-wide Financial and Operational Combined Uniform Single Report ("FOCUS Report") which is to be developed. This proposed report is one of the main projects of the Report Coordinating Group.

The eighth through tenth recommendations deal with the availability of broker-dealer economic data, the adoption of uniform record retention rules and the securing of trading information from the exchange's own data base. These issues are being considered by the Report Coordinating Group and the subcommittees thereof.

Regarding the Senate Report, the Commission believes the Committee's recommendation that Congress, through legislation, direct the Commission to establish a Joint Committee on Small Broker-Dealers is a constructive one. But there may be no need to form a new committee. It would appear appropriate and productive to utilize the already established advisory committees, the SEC Advisory Committee on the Implementation of a Central Market System and the Report Coordinating Group (Advisory), which are already considering the issues, in the course of their designated responsibilities, which would be assigned to such a committee.

The establishment of the Report Coordinating Group under the Federal Advisory Committee Act was announced by the Commission on January 24, 1974. Its members were selected in May 1974, and its first meeting was held in July 1974. The four subcommittees of the Group also have been meeting. The Group is to submit public recommendations on or before December 31, 1974. The Senate Report's recommendation that at least one respresentative of the small broker-dealer community be a member of the Report Coordinating Group has been implemented.

As to the Senate Report's call for the establishment of the position of Small Broker-Dealer Liaison Officer, the Commission is presently formulating plans for a broad program in this area.

In sum, the Commission has demonstrated its concern for the reporting burden on all broker-dealers and, in particular, the small broker-dealers in the securities industry by:

1. a review of the Commission's financial and operational responsibility rules, all other rules and regulations, and related reporting requirements;

2. the formation of the SEC Advisory Committee on Broker-Dealer Reports and

Registration Requirements—Report Coordinating Group;

3. the formation of the SEC Broker-Dealer Model Compliance Program Advisory Committee;

4. the formation of the SEC Advisory Committee on the Implementation of a Central Market System;

5. the development of a nationwide clearance and settlement system; and

6. the consideration of legislative proposals.

Clearance and Settlement

Presently there are in operation a number of clearing entities[40] and depositories[41] affiliated with national securities exchanges or the NASD. During the fiscal year 1974, numerous changes in or additions to the rules, practices, and operations of these clearing and depository entities were submitted to the Commission for its review and consideration under various provisions of the Securities Exchange Act.[42] The following are among the most signficant items on which the Commission acted favorably:

1. The National Clearing Corporation ("NCC"), a wholly owned subsidiary of the NASD, submitted proposed rule changes to initiate operation of a Free Account Net System ("FANS") FANS allows NCC members to leave securities with NCC to satisfy projected future settlements, thereby eliminating the need for a broker-dealer to take delivery of securities one day and return them to NCC in satisfaction of delivery obligations the next day. In reviewing FANS, the Commission requested NCC to establish an electronic interface with the Depository Trust Company ("DTC"), the wholly owned securities depository of the New York Stock Exchange, as expeditiously as possible. During fiscal 1974, DTC and NCC accomplished an interface which allows NCC members and DTC members to deliver securities to each other by bookkeeping entry.

2. DTC and the Midwest Securities Trust Company ("MSTC"), a wholly owned subsidiary of the Midwest Stock Exchange, Inc. ("MSE"), have developed a two-way link which permits dual members of MSTC and DTC to transfer stock by bookkeeping entry between their DTC accounts and their MSTC accounts.

3. MSTC will transfer all clearing activities to a new wholly owned subsidiary of the MSE to be called Midwest Clearing Corporation.

4. The Pacific Securities Depository, the wholly owned securities depository of the Pacific Stock Exchange, Inc., applied for and received an exemption pursuant to Rules 8c–1(g) and 15c2–1(g) under the Exchange Act.[43]

Securities Investor Protection Corporation (SIPC)

SIPC was established by the Securities Investor Protection Act of 1970 ("SIPC Act") to provide certain protections to customers of SIPC members. It is a non-profit membership corporation; most of its members are registered brokers and dealers and members of national securities exchanges. While SIPC is funded primarily through assessments on its members, it may borrow under certain conditions up to $1 billion from the United States Treasury.

During fiscal year 1974, the Chairman of SIPC formed a Special Task Force to recommend to the SIPC Board of Directors changes in the SIPC Act. The Special Task Force, which included a representative of the Commission, has made its report and recommendations to the SIPC Board.

In 1973 SIPC designated principal examining authorities (in regard to applicable financial responsibility rules) for SIPC members which are members of more than one self-regulatory organization.[44] As noted above, the Commission believes that these designations are important first steps in eliminating unnecessary and burdensome duplication of examinations and reporting requirements in the industry.

In August 1973, the Commission set forth its position that, in the case of those of its members for which it was not the SIPC-designated principal examining authority, a self-regulatory organization would not be in derogation of its responsibilities under the Exchange Act to police the financial responsibility rules as to its members if it deferred to the designated examing authority.[45]

Rule Changes Related to SIPC

During the fiscal year, the Commission adopted Rule S6d–1 and related forms under the SIPC Act.[46] Section 6(d)(1) of the SIPC Act provides for the completion by a SIPC Act trustee of those "open contractual commitments" effected by another broker-dealer with the debtor in which a customer had an interest. Rule S6d–1 places certain limitations on the commitments of a debtor which are eligible for completion.

Basically, the Rule permits the completion of only those fails-to-receive and fails-to-deliver (as defined in the Rule) which: (1) arose from a current transaction in which a broker was acting as agent for a customer, or a dealer was acting for a customer in certain narrowly defined principal transactions; (2) are not stale as of the filing date; (3) are promptly disposed of in accordance with the provisions of the Rule—normally by buying in or selling out; and (4) are promptly reported to the trustee and supported by appropriate documentation.

On May 1, 1974, the Commission announced a proposal to adopt Securities Exchange Act Rule 15b–1 and to amend Rule 15b6–1 and Form BDW thereunder.[47] The proposed rules and the form provide that in the case of Commission revocation or cancellation of the registration of a broker-dealer, or a broker-dealer's withdrawal of its registration, the effectiveness of such revocation, cancellation or withdrawal would be delayed for one year for purposes of the SIPC Act only. Thus, the protections of the SIPC Act would be available to the customers of such a broker-dealer during that period.

Litigation Relating to SIPC

In *SEC* v. *Guaranty Bond and Securities Corp.*[48] the Court of Appeals for the Sixth Circuit held that the protections of the SIPC Act were available to customers of a broker-dealer who, although insolvent prior to the effective date of the Act, continued to transact a substantial business in securities after the Act had become effective. The Court of Appeals also held that a receiver of the broker-dealer appointed by the district court had standing to bring an action on behalf of customers of the broker-dealer to compel SIPC to initiate liquidation proceedings under the Act. In its brief in the Court of Appeals, the Commission had argued in support of the first point but had urged that the receiver had no standing as to SIPC.

SIPC then filed with the U.S. Supreme Court a petition for a writ of certiorari seeking reversal of the decision by the Court of Appeals. The Commission filed a memorandum with respect to the petition stating its view that the Court of Appeals erred in concluding that the receiver of a broker-dealer has an implied right to file an action to compel SIPC to fulfill its statutory obligations. The Commission stated in the memorandum that a premature action brought by a customer to compel the institution of liquidation proceedings may adversely effect recourse to viable alternatives that might be in the public interest. The Supreme Court in October 1974 agreed to review the questions whether a customer of a broker-dealer had standing to sue SIPC for this kind of relief and whether the receiver could act on behalf of the customers.

SECO Broker-Dealers

Under the Exchange Act, the Commission is responsible for establishing and administering rules on qualification standards and business conduct of broker-dealers who are not members of the NASD in order to provide regulation of these SECO broker-dealers comparable to that provided by the NASD for its members.

During the fiscal year, the number of nonmember broker-dealers registered with the Commission increased from 276 to 300 and the number of associated persons of such firms (*i.e.*, partners, officers, directors and employees not engaged in merely clerical or ministerial functions) increased from 16,303 to 18,606.

On October 19, 1973, the Commission announced the adoption of Rule 15b10–10 under the Exchange Act, which prohibits certain reciprocal brokerage practices by SECO broker-dealers.[49] A similar rule had been adopted by the NASD, as described in the Commission's last annual report.[50]

Rule 15b10–10 prohibits SECO broker-

dealers from (1) favoring or disfavoring the distribution of shares of open-end investment companies on the basis of "brokerage commission" received; (2) soliciting or making promises of an amount or percentage of brokerage commissions in connection with the distribution of such investment company shares; and (3) seeking orders for the execution of portfolio transactions on the basis of their sales of fund shares.

Rule 15b9–2 imposes an annual assessment to be paid by nonmember broker-dealers to defray the cost of regulation. During the fiscal year, the Commission increased the base fee from $175 to $250 and the fee for each associated person from $10 to $12.[51] Additionally, Form SECO–5, required pursuant to Rule 15b9–1, was amended to increase the initial fee paid by nonmember broker-dealers from $150 to $500.

OTHER COMMISSION RULE CHANGES

Mortgage Market Exemptions

The Commission has been working with the Federal Home Loan Mortgage Corporation ("FHLMC") to clarify the applicability of Federal securities laws to Amminet Inc., which was established under FHLMC sponsorship to operate an automated trading information system designed to promote a more liquid secondary market for residential mortgages.[52] The system would list offerings to buy and sell: (1) government-guaranteed and non-guaranteed aggregated and individual whole loan mortgages; (2) certain participation interests in such mortgages;[53] (3) commitments for such mortgages;[54] (4) FHLMC-guaranteed participation certificates; and (5) Government National Mortgage Association pass-through securities.[55]

During the 1973 fiscal year, the Commission adopted Rule 3a12–1 under the Exchange Act[56] to classify as "exempted securities" those mortgages as defined in the Emergency Home Finance Act of 1970, which are or have been sold by FHMLC. As part of its continuing effort in this area the Commission, during the 1974 fiscal year, adopted Rule 3a12–4 and rescinded Rule 15a–1 under the Exchange Act.[57] The principal effect of Rule 3a12–4 is to exempt from the registration and financial requirements of Section 15 of the Exchange Act broker-dealers who deal, under specified conditions, solely in mortgage securities (as defined in the Rule) or other exempted securities. Rule 15a–1 had provided an exemption only from the registration requirement. Transactions in securities so exempted are still subject to antifraud provisions of the Exchange Act.

Real Estate Investment Contract Securities

On June 7, 1974, the Commission released for comment proposed Rule 3a12–5 under the Securities Exchange Act.[58] If adopted, the Rule would exempt from Sections 7 and 11(d)(1) of the Act (both of which deal with the extension or maintenance of credit to purchase securities) subject to various conditions, certain investment contract securities involving the direct ownership of specified residential real property offered by broker-dealers. In the release, the Commission stated its preliminary view that the unique characteristics of investment contract securities involving the direct ownership of specified residential real property (particularly the traditional modes of financing real property and the lack of any secondary trading market therefor) make it unlikely that the concerns addressed by Sections 7 and 11(d)(1) will be present.

On the same day the Commission released proposed Rule 3a12–5, the Board of Governors of the Federal Reserve System announced that it had deferred, until December 21, 1974, an amendment to Regulation T. The amendment would have the effect of treating the extension of credit on any part of an investment contract security as credit on the entire security and would prohibit broker-dealers from arranging for such credit unless collateralized in compliance with the requirements of Regulation T.

The Commission is presently considering the comments received on proposed Rule 3a12–5.

Corporate Repurchase Programs

On December 6, 1973, the Commission released for public comment a revision of proposed Rule 13e–2 and a related amendment to Rule 10b–6 under the Securities Exchange Act. Both are designed to prevent an issuer from effecting repurchases of its own stock that may have a manipulative or misleading impact on the trading market in the issuer's securities.[59]

Proposed Rule 13e–2 specifies conditions under which an issuer whose equity securities are registered pursuant to Section 12 of the Exchange Act may repurchase such securities in the open market or in negotiated transactions. It also provides for specific regulation in connection with repurchases by broker-dealer issuers. The proposed amendment to Rule 10b–6 would provide an exemption from that Rule for purchases by an issuer pursuant to the terms and conditions of Rule 13e–2. Absent the exemption, the purchases might have been prohibited by the existence of outstanding convertible securities, warrants or distributions pursuant to certain employee plans.

In reproposing Rule 13e–2 the Commission specifically solicited comments regarding whether an issuer should be required to disclose a repurchase program and, if so, the manner and content of such disclosure, and whether purchases by certain persons, such as officers, directors, or insiders of an issuer, should be exempted, conditionally or unconditionally, from the prohibitions of the Rule.

Confirmation Requirements for Periodic Transactions

On March 15, 1974, the Commission released for public comment a proposed amendment to Rule 15c1–4.[60] The amendment is intended to reduce the economic burden of the confirmation requirements of Section 11(d)(2) of the Securities Exchange Act and Rule 15c1–4, with respect to mutual fund investment plans, particularly those involving small and periodic purchases, without significantly lessening investor protections.

The proposed amendment would permit principal underwriters or their agents to delay sending confirmations for up to 90 days to investors purchasing mutual fund shares under certain employer-sponsored plans and certain tax-qualified plans, and for as long as 30 days to investors purchasing mutual fund shares under specified tax-qualified individual retirement plans. The confirmations would be required to summarize all transactions within the respective 90- or 30-day periods and could be sent in bulk to the employer or other designated person for distribution to participants in group plans. In addition, under the rule, an employer or designated person could collect and remit participants' payments for fund shares provided such funds were remitted promptly to the broker-dealer, but not later than 30 days after receipt.

Short Sale Regulation

On March 4, 1974, the Commission proposed amendments to Rules 3b–3, 10a–1 and 10a–2 to establish comprehensive short sale regulation for securities which will be traded in the planned central market system for listed securities.[61] The Commission indicated in its Policy Statement on the Structure of a Central Market System (March 29, 1973) that the adoption of more complete and effective short sale regulation was one of the first of a series of steps the Commission had under consideration to implement the proposals made therein, particularly in view of current plans to implement a composite last sale reporting system. The proposed amendments reflect the recommendations which were made to the Commission by its Advisory Committee on a Central Market System and which are contained in that Committee's Interim Report to the Commission on Regulation Needed to Implement a Composite Transaction Reporting System (October 11, 1972).

NOTES TO PART 3

[1] In March 1971, the Executive Committee of the Board of Trade of the City of Chicago adopted a resolution to close the Board's securities market. The Board has not, however, withdrawn its registration.

[2] Under legislation proposed to the Congress (H.R. 5050), the Commission would be given the authority to review and amend exchange disciplinary actions.

[3]Securities Exchange Act Release No. 10809 (May 17, 1974), 4 SEC Docket 322.

[4]498 F. 2d 1303 (C.A. 2, 1974).

[5]433 F. 2d. 264 (C.A. 7, 1970), *cert. denied*, 401 U.S. 994 (1971).

[6]Other inspections are described in Broker-Dealer Examinations at pp. 59–61, *infra*.

[7]Martin, William McC., *The Securities Markets, A Report, With Recommendations* (1971), reprinted in *Study of the Securities Industry, Hearings Before the Subcommittee on Commerce and Finance of the House Committee on Interstate and Foreign Commerce*, 1st and 2d Sess., Pt. 6, Appendix NN at 3189 ff. (1971–1972).

[8]Those registered broker-dealers which are not NASD members are referred to as SECO broker-dealers. See p. 65, *infra*.

[9]The NASD as well as others also requested the Commission to review the NASD's anti-reciprocal rule. For further information see Part V, p. .

[10]39th Annual Report, p. 12.

[11]See 38th Annual Report, p. 54.

[12]Securities Exchange Act Release No. 9632 (June 7, 1972).

[13]CCH NASD Manual, Rules of Fair Practice, Article III, Section 25, para. 2175 (1974).

[14]No. 72–1975 (C.A. D.C.).

[15]Since examinations of these exchanges do not concentrate on, and exchange examiners are not generally familiar with NASD rules governing a large number of significant matters which are unique to over-the-counter market regulation, NASD attention to these firms should be even greater than is customary presently.

[16]See pp. 59–60, *infra*.

[17]The majority of complaints involved the failure by NASDAQ market-makers to make timely reports of their trading volume in NASDAQ-quoted securities.

[18]Securities Exchange Act Release No. 10643 (February 14, 1974), 3 SEC Docket 545.

[19]Securities Exchange Act Release No. 9632 (June 7, 1972), *see supra*, p. 53 and 38th Annual Report, p. 54.

[20]Securities Exchange Act Release No. 10850 (June 12, 1974), 4 SEC Docket 420.

[21]Securities Exchange Act Release No. 10756 (April 26, 1974), 4 SEC Docket 195.

[22]Securities Exchange Act Release No. 10429 (October 12, 1973), 2 SEC Docket 567.

[23]Securities Exchange Act Release No. 10304 (July 30, 1973), 2 SEC Docket 218.

[24]Securities Exchange Act Release No. 9633 (June 14, 1972).

[25]See 39th Annual Report, p. 59.

[26]Securities Exchange Act Release No. 10525 (November 29, 1973), 3 SEC Docket 103.

[27]Securities Exchange Act Release No. 10398 (September 20, 1973), 2 SEC Docket 467.

[28]Securities Exchange Act Release No. 10825 (May 24, 1974), 4 SEC Docket 344. The amendments were first proposed in Securities Exchange Act Release No. 10392 (September 14, 1973), 2 SEC Docket 432.

[29]Now known as the "FOCUS Report." *See* pp. 61–62, *infra*.

[30]See Securities Exchange Act Release No. 10612 (January 24, 1974), 3 SEC Docket 423.

[31]Study of Unsafe and Unsound Practices of Brokers and Dealers, Report of the Securities and Exchange Commission (Pursuant to Section 11(h) of the Securities Investor Protection Act of 1970), H.R. Doc. No. 92–231, 92d. Cong., 1st Sess. (1971).

[32]The self-regulatory organizations must report each month to SIPC those member firms which are in or approaching financial difficulty.

[33]See p. 64, *infra*.

[34]See p. 60, *infra*.

[35]See p. 61, *infra*.

[36]See p. 65, *infra*.

[37]Few routine examinations are now conducted of firms other than SECO firms. All examinations of member firms of self-regulatory organizations must now be over-sight examinations which involve an evaluation of the self-regulatory organizations' reports of their own examinations.

[38]See p. 64, *infra*.

[39]S. Rep. No. 93–880, 93d Cong., 2d Sess. (1974).

[40]Clearing entities clear and settle transactions between participating broker-dealers. Offsetting transactions between broker-dealers are netted out and settlement and delivery are effected only as to the balance under the traditional balance order system. Under the more recent net-by-net system, balances may be carried forward and netted against future settling trades.

[41]Depositories hold securities certificates and effect delivery between participants by book entry.

[42]See Section 15A(j), and Rules 8c–1(g), 15c2–1(g), and 17a–8.

[43]Paragraph (g) of Rules 8c–1 and 15c2–1 requires a determination by the Commission that the agreements, provisions and safeguards established for the depository are adequate for the protection of investors.

[44]Section 9(c) of the SIPC Act provides that where a member of SIPC is a member of more than one self-regulatory organization, SIPC shall designate one of them to examine the members for compliance with applicable financial responsibility rules.

[45]*See* Securities Exchange Act Release No. 10612 (January 24, 1974), 3 SEC Docket 423.

[46]Securities Investor Protection Act Release No. 5 (July 25, 1973), 2 SEC Docket 173.

[47]Securities Exchange Act Release No. 10766 (May 1, 1974), 4 SEC Docket 230.

[48] 496 F.2d 145 (C.A. 6, 1974), *petition for certiorari granted.*

[49] Securities Exchange Act Release No. 10439 (October 19, 1973), 2 SEC Docket 598.

[50] 39th Annual Report, p. 8.

[51] Securities Exchange Act Release No. 10759 (April 26, 1974), 4 SEC Docket 198.

[52] The Emergency Home Finance Act of 1970 was enacted following a determination by Congress that the nation needed more capital in residential mortgages and that this could be best accomplished by the establishment of a liquid market for such securities. FHLMC was established by this Act with the power "to make and enforce such by-laws, rules and regulations as may be necessary or appropriate to carry out the purposes or provisions," of the Act. 12 U.S.C. 1452 (b) (3).

[53] The only participation interests which will be listed on Amminet are those which amount to at least $50,000 and represent one of two undivided interests in a whole loan or an aggregated whole loan, the remaining interest being retained by the originator.

[54] The only commitments that will be listed on Amminet are contracts to purchase whole loan mortgage interests which by their terms require that the contracts be fully executed within 2 years.

[55] The Government National Mortgage Association, pursuant to Section 306(g) of the Federal National Mortgage Association Charter Act, as amended, 12 U.S.C. 1721 (g), issues securities (referred to as "pass-through" securities) which are guaranteed as to timely payment of principal and interest by the full faith and credit of the United States.

[56] See 39th Annual Report, pp. 60–61.

[57] Securities Exchange Act Release No. 10828 (May 28, 1974), 4 SEC Docket 349.

[58] Securities Exchange Act Release No. 10845 (June 7, 1974), 4 SEC Docket 384

[59] Securities Exchange Act Release No. 10539 (December 6, 1973), 3 SEC Docket 167.

[60] Securities Exchange Act Release No. 10681 (March 15, 1974), 3 SEC Docket 691.

[61] Securities Exchange Act Release No. 10668 (March 6, 1974), 3 SEC Docket 650.

PART 4

ENFORCEMENT

PART 4

ENFORCEMENT

The Commission's enforcement activities, which are designed to combat securities fraud and other illegal activities, continued at a high level during the past year. These activities encompass civil and criminal court actions as well as administrative proceedings conducted internally. Where violations of the securities laws are established, the sanctions which may result range from censure by the Commission to prison sentences imposed by a court. The enforcement program is designed to achieve as broad a regulatory impact as possible within the framework of resources available to the Commission. In light of the capability of self-regulatory and state and local agencies to deal effectively with certain securities violations, the Commission seeks to promote effective coordination and cooperation between its own enforcement activities and those of other agencies.

DETECTION

Complaints

The Commission receives a large volume of communications from the public. These consist mainly of complaints against broker-dealers and other members of the securities community as well as complaints concerning the market price of particular securities. During the past year, some 5,300 complaints against broker-dealers were received, analyzed and answered. Most of the above mentioned complaints dealt with operational problems, such as the failure to deliver securities or funds promptly, or the alleged mishandling of accounts. In addition, there were some 6,000 complaints received concerning investment advisers, issuers, banks, transfer agents and mutual funds.

The Commission seeks to assist persons in resolving complaints and to furnish requested information. Thousands of investor complaints are resolved through staff inquiries to the firms involved. While the Commission does not have authority to arbitrate private disputes between brokerage firms and investors or directly to assist investors in the legal assertion of their personal rights, a complaint may lead to the institution of an investigation or an enforcement proceeding, or it may be referred to a self-regulatory or local enforcement agency.

Market Surveillance

To enable the Commission to carry out surveillance of the securities markets, its staff has devised procedures to identify possible violative activities. These include surveillance of listed securities, which is coordinated with the market surveillance operations of the New York, American and regional stock exchanges.

The Commission's market surveillance staff maintains a continuous watch of transactions on the New York and American Stock Exchanges and reviews reports of large block transactions to detect any unusual price and volume variations. Also the financial news tickers, financial publications and statistical services are closely fol-

lowed. In addition, the staff has supplemented its regular reviews of daily and periodic market surveillance reports of exchanges with a program for review of special surveillance reports, which provide a more in depth analysis of the information developed by the exchanges.

For those securities traded by means of the NASDAQ system, the Commission has also developed a surveillance program, which is coordinated with the NASD's market surveillance staff, through a review of weekly and special stock watch reports.

For those over-the-counter securities not traded through NASDAQ, the Commission uses automated equipment to provide an efficient and comprehensive surveillance of stock quotations distributed by the National Quotation Bureau. This is programmed to identify, among other things, unlisted securities whose price movement or dealer interest varies beyond specified limits in a preestablished time period. When a security is so identified, the equipment prints out current and historic market information. Other programs supplement this data with information concerning sales of securities pursuant to Rule 144 under the Securities Act, ownership reports, and periodic company filings such as quarterly and annual reports. This data, combined with other available information, is analyzed for possible further inquiry and enforcement action.

In addition, recognizing that the computer provides the most expeditious method of reviewing and analyzing the voluminous trading data generated by the securities markets, the Commission has developed a program which provides an analysis of the bid listings for each security by summarizing specified types of activity by each broker-dealer firm submitting price quotations for that particular security.

The staff also oversees cash tender offers, exchange offers, proxy contests and other activities involving efforts to change control of public corporations. Such oversight involves not only review of trading markets in the securities involved, but also filings with the Commission of required schedules, prospectuses, proxy material and other information.

INVESTIGATIONS

Each of the acts administered by the Commission authorizes investigations by it to determine if violations have occurred. Most of these are conducted by the Commission's regional offices. Investigations are carried out on a confidential basis, consistent with effective law enforcement and the need to protect persons against whom unfounded charges might be made. Thus, the existence or results of a nonpublic investigation are generally not divulged unless they are made a matter of public record in proceedings brought before the Commission or in the courts. During fiscal year 1974, a total of 382 investigations were opened, as against 472 the preceding year.

Litigation Involving Commission Investigations

Wichard v. *TPO, Incorporated*[1] was an action brought by a customer against her broker-dealer, charging violations of the antifraud provisions of the federal securities laws. The plaintiff moved, pursuant to Rule 34 of the Federal Rules of Civil Procedure, to compel the production of transcripts of depositions of the broker-dealer's officers and directors, taken during a private investigation conducted by the Commission. The Commission submitted a memorandum, *amicus curiae*, in response to the request of the court that the Commission generally advise the court of its position with respect to the proposed discovery.

In its memorandum, the Commission reaffirmed the position it earlier had outlined in a memorandum it had filed in *In re Four Seasons Securities Law Litigation*:[2] When discovery is sought in civil ligitation of transcripts of testimony given or documents submitted in a Commission investigation, if the witness who gave the testimony or produced the documents opposes such discovery, he should have the opportunity to present to the court any objections he may have, including those based on lack of relevancy or privilege. In the event the witness' objections are overruled and he does not then have the transcripts or documents sought, the witness should obtain the transcript or documents from the Commis-

sion pursuant to the court's order. Should a subpoena be issued to the Commission for transcripts or documents which, if requested by a witness, would be obtainable under Rule 6 of its Rules Relating to Investigations,[3] the Commission may resist compliance with the subpoena until the witness has had an opportunity to bring to the court's attention whatever objections he may have to production, or the Commission may itself object to disclosure on independent grounds.

In its memorandum, the court, agreeing with the procedures outlined by the Commission, ordered the broker-dealer and the other defendant to obtain copies of the requested transcripts from the Commission and to submit them to the court for inspection *in camera* so that the court could determine their relevancy to the issues presented in the case.

ENFORCEMENT PROCEEDINGS

The Commission has available a wide range of possible enforcement remedies. It may, in appropriate cases, refer its files to the Department of Justice with a recommendation for criminal prosecution. The penalties upon conviction are specified in the various statutes and include imprisonment for substantial terms as well as fines.

The securities laws also authorize the Commission to file injunctive actions in the Federal district courts to enjoin continued or threatened violations of those laws or applicable Commission rules. In injunctive actions the Commission has frequently sought to obtain ancillary relief under the general equity powers of the Federal district courts. The power of the Federal courts to grant such relief has been judicially recognized. The Commission has often requested the court to appoint a receiver for a broker-dealer or other business where investors were likely to be harmed by continuance of the existing management. It has also requested, among other things, court orders restricting future activities of the defendants, requiring that rescission be offered to securities purchasers, or requiring disgorgement of the defendants' ill-gotten gains.

The SEC's primary function is to protect the public from fraudulent and other unlawful practices and not to obtain damages for injured individuals. Thus, a request that disgorgement be required is predicated on the need to deprive defendants of profits derived from their unlawful conduct and to protect the public by deterring such conduct by others.

If the terms of any injunctive decree are violated, the Commission may file criminal contempt proceedings, as a result of which the violator may be fined or imprisoned.

The Federal securities acts also authorize the Commission to impose remedial administrative sanctions. Most commonly, administrative enforcement proceedings involve alleged violations of the securities acts or regulations by firms or persons engaged in the securities business, although the Commission's jurisdiction extends to all persons. Generally speaking, if the Commission finds that a respondent willfully violated a provision of or rule under the securities acts, failed reasonably to supervise another person who committed a violation, or has been convicted for or enjoined from certain types of misconduct, and that a sanction is in the public interest, it may revoke or suspend the registration of a broker-dealer or investment adviser, bar or suspend any person from the securities business or from association with an investment company, or censure a firm or individual. Proceedings may also cover adequacy of disclosure in a registration statement or in reports filed with the Commission. Such a case may lead to an order suspending the effectiveness of a registration statement or directing compliance with reporting requirements. The Commission also has the power to summarily suspend trading in a security when the public interest requires.

Proceedings are frequently completed without hearings where respondents waive their right to a hearing and submit settlement offers consenting to remedial action which the Commission accepts as an appropriate disposition of the proceedings. The Commission tries to gear its sanctions in both contested and settlement cases to fit the circumstances of the particular case. For example, it may limit the sanction to a particular branch office of a broker-dealer rather than sanction the entire firm, prohibit

only certain kinds of activity by the broker-dealer during a period of suspension or only prohibit an individual from engaging in supervisory activities.

A chart listing the various types of enforcement proceedings, as well as statistics on such proceedings are located in the statistical section.

ADMINISTRATIVE PROCEEDINGS

Summarized below are some of the many administrative proceedings pending or disposed of in fiscal 1974.

First Mid America, Inc. (FMA).[4]—In this administrative proceeding against a New York Stock Exchange member firm, its president, senior vice-president and wholly-owned subsidiary, the Commission found, pursuant to offers of settlement submitted by the respondents without admitting or denying the charges, that the respondents had violated antifraud and antimanipulative provisions of the Securities and Securities Exchange Acts. Specifically it was found that FMA prematurely closed an underwriting of debentures which it was co-managing and retained over $1,500,000 of the securities in its own account. FMA then entered NASDAQ as a market maker in the debentures, and dominated, controlled and artificially maintained the market and price for these securities. FMA was also found to have used increased compensation and a sales contest for its employees to distribute its position in the securities within a short period to its customers without disclosing its manipulative activities.

FMA and its subsidiary were suspended for 60 days from underwriting and over-the-counter trading activities subject to certain conditions. FMA's president was suspended from association with a broker-dealer for nine months and thereafter barred from such association in a supervisory capacity, except that he may apply to the Commission for removal of the bar after two years. FMA's senior vice-president was suspended from association with a broker-dealer for 60 days and from association as a director for an additional 120 days.

A. P. Montgomery & Co., Inc.[5]—Administrative proceedings were instituted on January 30, 1974, against twenty-seven respondents, including partnerships and corporations organized to invest in securities and three broker-dealers and certain individuals charging violations of the antifraud, antimanipulative, short sale, margin and recordkeeping provisions of the Exchange Act. The order for proceedings alleged that respondents, other than the broker-dealers, made short sales of certain securities to the broker-dealer respondents after they had given indications of interest to purchase the same class of securities covered by pending registration statements relating to "secondary offerings" of so-called "cold issues." The short sales were effected prior to the effective dates of the registration statements and were subsequently covered by shares obtained in the offerings. The broker-dealer respondents in turn resold the shares prior to the effective dates of the registration statements. The short sales were part of a scheme to manipulate the price of the securities. Ten of the securities were listed for trading on various exchanges and five were traded over-the-counter. The order also alleged that the short sales were effected in cash accounts rather than in margin accounts as a result of which the respondent customers avoided making the necessary initial margin deposits.

Eleven respondents thus far have consented to sanctions by the Commission in this matter. The registration of one broker-dealer has been revoked and other respondents have been suspended or barred from certain activities for periods up to one year. As a result of the investigation of this practice known as "shorting into secondary offerings," the Commission has issued proposed Rules 10b–20 and 10b–21 governing short sales prior to secondary offerings and other practices in connection with the marketing of securities.[6]

Holland Andrews & Perrier.—This administrative proceedings arose out of the Accurate Calculator Corp. matter, the subject of a companion civil action. In its respective Findings and Orders, the Commission found that Holland, Andrews & Perrier, a Canadian broker-dealer, Alan Perrier,[7] and Chartered New England Corp.[8] violated the registration provisions of the Securities Act

in that they offered for sale, sold or delivered after sale shares of the common stock of Accurate when no registration statement was on file or in effect with respect to said securities. In each case the respondents consented to the Commission's Findings and Order without admitting or denying the allegations contained in the Order for Proceedings.

Chartered New England Corp. in addition to consenting to a 10-day suspension of its over-the-counter retail operations, undertook to continue certain policies and procedures involving (a) the securing of specified information prior to quoting certain securities, (b) restrictions on the securities in which it can make a market, and (c) restrictions on the securities it may solicit retail customers to purchase or sell.

Holland Andrews & Perrier and Alan Perrier were barred from association with a broker-dealer with the proviso that Alan Perrier might reapply to the Commission after a period of two years to become so associated in a non-supervisory capacity.

TRADING SUSPENSIONS

The Securities Exchange Act authorizes the Commission summarily to suspend trading in a security traded on either a national securities exchange or in the over-the-counter market for a period of up to 10 days if, in the Commission's opinion, such action is required in the public interest.

During fiscal 1974, the Commission suspended trading in the securities of 279 companies, an increase of 60 percent over the 174 securities suspended in fiscal 1973 and almost a 400 percent increase over the 47 securities suspended in fiscal 1972. In most instances, this action was taken either because of substantial questions as to the adequacy, accuracy or availability of public information concerning the companies' financial condition or business operations or because of transactions in the companies' securities suggesting possible manipulation or other violations.

The Commission during fiscal 1974 suspended trading also in the securities of a substantial number of issuers who were delinquent in filing required reports with the Commission. This was done in order to alert the public to the lack of adequate, accurate and current information concerning such issuers.

On October 18, 1973 the Commission suspended trading in all securities of Seaboard Corporation.[9] The Commission initiated the suspension of trading because of questions which had been raised concerning: (a) the adequacy and accuracy of disclosures made in Seaboard's registration statement covering a prior sale of 500,000 Seaboard units (consisting of common stock and warrants), and in filings made with the Commission subsequent thereto; (b) certain activities engaged in by Seaboard in connection with its management of four registered investment companies with current net assets of approximately $90 million (Admiralty Fund, Inc., Competitive Capital Fund, Seaboard Leverage Fund, Inc., and The Income Fund of Boston); and (c) the possible termination by the aforementioned investment companies of their investment contracts with Seaboard which are Seaboard's primary source of income. In addition, the Commission had been informed that the investment companies under Seaboard's management had voluntarily terminated sales of new shares. Seaboard was the underwriter for these investment companies.

Delinquent Reports Program

Congress, in the Federal securities laws, established the framework for a disclosure scheme designed to provide public investors with financial and other information necessary to make informed investment decisions. One of the fundamental elements to the success of this disclosure scheme is the timely filing of required reports in proper form.[10]

In the latter part of fiscal 1973 the Commission became aware of two disturbing trends in this area. First, there appeared to be a general increase in the number of registrants which had failed to comply with the Exchange Act reporting requirements. Secondly, there were indications that registrants in certain industries, which were experiencing deteriorating business conditions, failed to comply with the Act's report-

ing requirements more often than other registrants.

On June 11, 1973 the Commission publicly expressed its concern with the many registrants who failed timely to file Exchange Act reports in proper form.[11] The staff then went to work to develop and implement a program (1) to monitor compliance by registrants with the reporting requirements and (2) to take prompt enforcement action where registrants were delinquent.

During the 1974 fiscal year, the Commission suspended trading in the securities of nearly 200 registrants solely because of their failure to file required reports. With few exceptions, the duration of such suspensions was ten days. While the majority of such registrants could be characterized as small in terms of net assets and number of shareholders, many of such registrants had securities listed for trading on a national securities exchange and thus enjoyed the recognition and market appertaining thereto.

An example of the type of action taken under this program was the suspension of trading in the securities of 48 registrants for the ten day period commencing April 11, 1974. As a result of diligent staff inquiry, each of these registrants was found to be delinquent at the least in filing its Annual Report on Form 10–K for its fiscal year ending in 1972.[12]

During this fiscal year the Commission also brought a civil injunctive action against registrant First Wisconsin Mortgage Trust ("First Wisconsin"), a Massachusetts real estate investment trust, solely on the basis of its failure to comply with the reporting requirements.[13] Its shares of beneficial interest are listed for trading on the New York Stock Exchange. At the time the action was commenced First Wisconsin was alleged to be delinquent in filing its Annual Report on Form 10–K for its fiscal year ended December 31, 1973 and its quarterly report on Form 7–Q for the fiscal quarter ended March 31, 1974. In this action the Commission seeks, *inter alia,* an order compelling First Wisconsin to file forthwith the delinquent reports with the Commission and permanently enjoining First Wisconsin from again violating the reporting requirements. This matter is pending.

In addition to the First Wisconsin action, the staff has done substantial work with a view to further litigation involving other registrants delinquent in filing reports.

The program is expected to result in prompter Commission responses to delinquent reporting. It is anticipated that the program will encompass substantially all Exchange Act reports. Beyond inducing compliance with Exchange Act reporting requirements, it is hoped that this program will bring about an increased public awareness of the importance of the Act's reporting provisions.

CIVIL PROCEEDINGS

During fiscal 1974, the Commission instituted a total of 148 injunctive actions. Some of the more noteworthy of these injunctive proceedings and significant developments in actions instituted in earlier years are reported below. Coordination between self-regulatory bodies and the Division of Enforcement resulted in several enforcement actions, in addition to investigations.

In *S.E.C.* v. *Shapiro*[14] the Court of Appeals for the Second Circuit affirmed a judgment of the district court[15] which permanently enjoined Norman Berman, a merger and acquisitions broker, from further violations of the antifraud provisions of the Exchange Act. The order in addition required Berman to disgorge all profits he derived from trading in the stock of Harvey's Stores, Inc. ("Harvey's") on the basis of material nonpublic information relating to the existence and progress of merger negotiations involving Harvey's and Ridge Manor Development Co. ("Ridge Manor"), and the ramifications of a merger. Berman had acquired the information in acting as a finder and participant in the merger discussions. The court agreed with the district court that Berman had violated the antifraud provisions by his own trading and by "tipping" others about the merger negotiations.

Although Berman admitted that he had acquired inside information, he contended that, at the time of each of his purchases of Harvey's stock, the prospects for a merger between Harvey's and Ridge Manor were so remote that information concerning a pos-

sible merger was not material, and therefore was not required to be disclosed. The court noted that facts are deemed material if a reasonable investor might have considered them important in the making of an investment decision. Citing *S.E.C.* v. *Texas Gulf Sulphur Co.*[16] the court stated that whether facts relating to a future event are material is dependent "upon a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the company activity." In applying the test, the court found that even at the time of the first of seven purchases by Berman of Harvey's stock two significant events had occurred which dictated a conclusion that the information concerning a proposed merger was material. In any event, the court found it unnecessary to "speculate as to how a reasonable investor might have received this information" in view of the substantial amounts of Harvey's stock purchased by Berman and other persons in possession of the information.

The court rejected Berman's contention that he should not be enjoined because it was not shown that he acted in bad faith, and determined that a likelihood of future violations was indicated since Berman engaged in not one but seven purchases of Harvey's stock in violation of Rule 10b–5, and that these violations occurred in the context of his regular business as a "corporate marriage broker." As to this latter factor, the court stated that, "[o]ne who has displayed such frailty in the past and faces so many temptations in the future may well need the admonition of an injunction to obey the law."

The court further ruled that the district court's approach—in requiring Berman to disgorge not the actual profits realized when he sold shares in Harvey's after public disclosure of the material information, but the "paper" profits which had earlier accrued as of the date of public disclosure—was reasonable and did not involve the imposition of a penalty. In effect, under the disgorgement order Berman had to surrender more profits than he actually realized since the price of Harvey's stock dropped after public disclosure. To hold otherwise, the court observed, "would emasculate the deterrent effect of Rule 10b–5."

S.E.C. v. *Bausch & Lomb Inc.*[17]—This case involves the dissemination and improper disclosure and use of inside information concerning Bausch & Lomb's disappointing sales and earnings from its soft contact lens. Defendant Richard J. Clancy, formerly a partner in the investment advisory firm of another defendant, without admitting or denying the allegations in the complaint, consented to a permanent injunction enjoining him from future violations similar to those alleged in the complaint. He consented also to a Commission suspension of the effective date of the application for registration as an investment adviser of Clancy Management Corp. of which he is the sole stockholder, officer, and director.[18] The action as to the remaining defendants is in the discovery phase.

SEC v. *Geon Industries Inc.*[19]—On April 2, 1974, the Commission, after a joint investigation with the American Stock Exchange, filed a complaint against Geon, its chairman, chief financial officer, a comptroller of a Geon subsidiary, a registered representative, his broker-dealer employer, Edwards & Hanly, and two tippees of Geon's chairman, seeking to enjoin them from further violations of the antifraud provisions of the Exchange Act. The complaint charged, among other things, that the tippees, the registered representative and the comptroller purchased Geon stock while in possession of, and without prior disclosure of, material non-public information concerning a proposed acquisition of Geon by Burmah Oil Company of England, and that the same persons later sold Geon stock while in possession of, and without prior disclosure of, negative material non-public information concerning Geon's financial condition and its potential effect on the proposed acquisition. The two tippees, Geon's comptroller and the registered representative consented to permanent injunctions enjoining them from future violations of the antifraud provisions of the Exchange Act and rescinded their transactions in Geon stock. In addition, the registered representative and the comptroller consented to injunctions against future violations of the margin provisions of the Exchange Act and the Federal Reserve Board's margin regulations. The

case was tried against the remaining defendants; the matter is pending.

In *S.E.C.* v. *Koscot Interplanetary, Inc.*[20] the United States Court of Appeals for the Fifth Circuit reversing the previously reported decision of the district court,[21] held that the interests in the Koscot pyramid promotion scheme that were sold to the public are "investment contract[s]" and therefore securities, as defined in the Federal securities laws. In so doing, the court rejected a restrictive interpretation of the standard enunciated by the Supreme Court in *S.E.C.* v. *W. J. Howey Co.*,[22] which found an investment contract to exist where "a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party." Instead, the court of appeals adopted a "resilient standard which will allow for a practical and dynamic scrutiny of investment schemes.

The court determined that the Koscot scheme involved a "common enterprise," although there was no pooling of profits. The "critical factor" was "not the similitude or coincidence of investor input, but rather the uniformity of impact of the promoter's efforts."

With regard to the element of the *Howey* formula that profits come "solely from the efforts of others" the court of appeals rejected a "literal" interpretation of *Howey* for a "functional" approach, which would not frustrate the remedial purposes of the Federal securities laws. It found the "proper standard" to be that recently explicated by the Ninth Circuit in *S.E.C.* v. *Glenn W. Turner Enterprises, Inc.*[23]—"whether the efforts made by those other than the investor are the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise." Thus, a scheme is no less an investment contract merely because an investor contributes "some effort as well as money to get into it."

The court concluded by noting that its holding was confined to "those schemes in which promoters retain immediate control over the essential managerial conduct of an enterprise and where the investor's realization of profits is inextricably tied to the success of the promotional scheme." Thus the holding does not extend to "conventional franchise arrangements" in which the investor contributes truly significant efforts which are "unfettered by promoter mandates." Such a "conventional" franchise would not be subject to the regulatory scheme of the Federal securities laws.

In *S.E.C.* v. *Continental Commodities Corp.*[24] the Court of Appeals for the Fifth Circuit held that commodity options are investment contracts and that notes are securities when issued in an "investment" context.

In its complaint the Commission had alleged violations of the registration and antifraud provisions of the Securities Act and the Exchange Act in connection with the offer and sale of purported options on commodity futures and in the subsequent offer of promissory notes in partial payment of claims owed to persons who had invested in the scheme. The district court dismissed the Commission's complaint holding that the court lacked subject matter jurisdiction because the so-called options and the promissory notes were not securities.[25]

In its brief in the court of appeals, the Commission disputed only so much of the district court's decision as held that the notes issued to investors were not securities. Nevertheless, the court of appeals considered whether the commodity options being sold were securities.

In holding these options, which it described as discretionary accounts, to be investment contracts, the court focused on whether the requisite "common enterprise" was present. Consistent with its recent decision in *S.E.C.* v. *Koscot Interplanetary, Inc.*, the court again adopted the view of the Court of Appeals for the Ninth Circuit, as expressed in *S.E.C.* v. *Glenn W. Turner Enterprises, Inc.*, that "[a] common enterprise is one in which the fortunes of the investor are interwoven with and dependent upon the efforts and success of those seeking the investment or of third parties." The court specifically rejected the proposition that the pro rata sharing of profits is critical to a finding of commonality. It also rejected the district court's view that no common enterprise was involved because Continental Commodities invested in different options on com-

modities futures for different investors. The court stated that "the critical inquiry is confined to whether the fortuity of investments collectively is essentially dependent upon promoter expertise."

On the question whether notes issued by Continental Commodities to its customers in payment of their claims were securities, the court of appeals considered it "not dispositive" that the notes possessed a maturity date of less than nine months. According to the court, "it is the character of the note, not its maturity date, which determines coverage" under the securities laws. Consistent with the position urged by the Commission, the court concluded that short-term notes are exempt under Section 3(a)(3) of the Securities Act and excluded from the definition of a security under Section 3(a)(10) of the Exchange Act, only if they are the type of prime quality commercial paper not generally offered to the public, and which qualifies for discount at a federal reserve bank.

In *S.E.C.* v. *Glen-Arden Commodities, Inc.*[26] and *S.E.C.* v. *Haffenden-Rimar International, Inc.*[27] the Courts of Appeals for the Second and Fourth Circuits, respectively, held that the offer and sale of interests in casks of unblended scotch whisky aging in warehouses in Scotland, to investors in the United States involved the offer and sale of investment contracts in violation of the registration and antifraud provisions of the Federal securities laws. In both decisions, the courts noted that investors, who were sold relatively small quantities of scotch never intended to take actual possession of the purchased casks, bought with the intention of reselling at a profit, and relied upon their sellers to select the types of whisky for them, and to assist in the contemplated resale to blenders since there was no organized scotch whisky market, were dependent upon the defendants to realize profits promised by the promoters of the investments. As the district court in *Haffenden-Rimar* stated in its decision, which was adopted by the Court of Appeals for the Fourth Circuit, "[t]heir participation in the enterprise was limited to providing capital with the hope of a favorable return."

S.E.C. v. *Marasol Properties.*[28]—This was a case brought by the Commission seeking to enjoin the sale of condominium units on the grounds that the promoters were offering securities in violation of the registration and antifraud provisions of the Federal securities laws. It is one of the first of its kind.

The Commission sought to enjoin Marasol Properties, Iberia Inmobiliaria Internacional Inc., Inter-Fed Travel Services Association, Inc., De Ritchie and Galarents, S.A. from violating Sections 5(a) and (c) and 17 of the Securities Act, and Sections 10(b) and 15(b) of the Securities Exchange Act and Rule 10b–5. The promoters were allegedly offering and selling condominum units in Costa del Sol, Spain, for the primary purpose of investment rather than occupancy by the purchasers. The sale of a unit is coupled with an undertaking to arrange continuing rental of the units for the benefit of the purchaser.

In connection with their activities it was also alleged that the defendants made false and misleading statements of material facts regarding, among other things, the parties and risks involved in such an investment.

A consolidated hearing on the merits was held on the Commission's application for a temporary restraining order and motion for a preliminary injunction on September 24, 1973. The court found that the defendant's offers and sales constituted offers and sales of securities in the form of "investment contracts" as well as certificates of interest or participation in a profit-sharing agreement. The action was dismissed as to Galarents, S.A. for lack of proper service of process. The court permanently enjoined the remaining defendants from violating registration and antifraud provisions of the Securities Act and of the Exchange Act.[29]

S.E.C. v. *Strathmore Distillery Co. Ltd.*[30]—In January 1974, the Commission filed an injunctive action in the United States District Court for the District of Columbia against Strathmore and John B. R. Turner, a director of Strathmore, alleging violations of the registration and antifraud provisions of the Federal securities laws. The complaint alleged that the defendants, without registration, were offering to sell and selling interests in scotch grain whisky which constituted investment contracts and thus securities. It was further alleged that Strathmore had made false and misleading

statements as to material facts about, among other things: the safety, profitability and marketability of the interests, the market price for scotch grain whisky, the variance between Strathmore's prices and the market price and the difficulty of resale.

In *S.E.C.* v. *Memme & Co.*[31] the Commission brought an action to enjoin Memme & Co., a broker-dealer, from further violating the net capital and recordkeeping provisions of the Securities Exchange Act and the rules promulgated thereunder and to enjoin several of Memme's registered principals from further aiding and abetting those violations. With the exception of John Charles Fina, a registered principal of Memme, injunctions were entered against all of the defendants either by default or by consent. After a evidentiary hearing the district court preliminarily enjoined Fina.

On appeal to the United States Court of Appeals for the Second Circuit,[32] Fina argued that he should not have been enjoined because, as he stated, he had not been responsible for the investment decisions which precipitated the net capital violations, had not had the authority to prevent Memme from doing business while it was out of compliance with the Commission's net capital rules, and had resigned from the firm before the violations were discovered by the Commission. The Commission argued that had Mr. Fina computed Memme's net capital position—which computations were his responsibility—he would have discovered that Memme was not in compliance and he could have informed Memme's principals of that fact. His resignation before the violations were discovered by the Commission, although after they had occurred, did not relieve him of his responsibility.

On January 8, 1974, the court of appeals affirmed the district court's order from the bench. Fina subsequently consented to the entry of a permanent injunction.

On June 11, 1974, the United States District Court for the Southern District of New York, in *S.E.C.* v. *Ezrine,*[33] entered a Final Judgment of Permanent Injunction and Ancillary Relief against an attorney (who consented to the final decree) upon a finding by the court that he intentionally appeared and practiced before the Commission in contravention of Rule 2(e) of the Commission's Rules of Practice. The attorney stipulated that he appeared as counsel at a Commission administrative proceeding after his privilege to appear and practice before the Commission had been permanently suspended. The district court earlier had preliminarily enjoined the attorney from appearing or practicing before the Commission in contravention of Rule 2(e).[34] Under the terms of the final decree, the attorney is enjoined from representing any person before the Commission, from preparing or filing any documents with the Commission, and from representing or advising, in connection with the Federal securities laws, any broker-dealer or other entity registered or required to be registered with the Commission.

The attorney is also enjoined from rendering advice with respect to the Federal securities laws, except where such advice is a necessary incident to any attorney-client consultation, the principal aspects of which do not relate to the securities laws, and certain other conditions are met. Under the terms of the decree, he is further prohibited from accepting any legal fees in connection with matters he is enjoined from performing. The order also directs him to disgorge any legal fees or compensation he received in connection with such matters during the period of his suspension from practice before the Commission.

As previously reported,[35] *S.E.C.* v. *National Student Marketing Corporation* ("NSMC") was originally brought by the Commission against NSMC and 19 others, including two law firms and NSMC's outside auditors. NSMC and its comptroller have thus far consented to injunctions. At the close of the fiscal year, documentary discovery was being conducted in both the Commission's civil enforcement action and private actions which had been consolidated with it for pretrial purposes.

In January 1974, an indictment charging, among other things, conspiracy to violate the mail and securities fraud laws was returned in the United States District Court for the Southern District of New York against five officers and employes of NSMC, including the former president. In addition, two members of the firm that audited NSMC's financial statements, a partner and a former

audit-manager, were charged with participating in the preparation for NSMC of a materially false and misleading proxy statement. See Part 1, pages 18–19 for further information on the criminal aspects of the NSMC matter.

In *S.E.C.* v. *Crofters, Inc.*,[36] the Commission brought an action against various corporate and individual defendants charging violations of antifraud provisions of the Federal securities laws in the sale of securities to the State of Ohio, and seeking an injunction against further violations. Most of the defendants consented to the entry of permanent injunctions; the complaint was dismissed as to one defendant. After a trial, the district court permantly enjoined the two remaining defendants, William V. Coffey and John M. King.

On appeal, (the case was captioned as *S.E.C.* v. *Coffey*,[37] in ordering the case remanded as to Coffey and dismissed as to King, the United States Court of Appeals for the Sixth Circuit applied standards for liability that had previously been applied only in private actions for damages. The court, in determining that the conduct of the defendants was not fraudulent, focused not on the nature of the conduct itself, but on the characteristics of the target of the alleged fraud and implied that for the Commission to establish a violation there must be actual injury. The court held that in an injunctive suit charging fraud the Commission must show that a defendant acted in "willful or reckless disregard for the truth." The Commission filed a petition for certiorari with the Supreme Court in the last half of the calendar year, arguing that the standard appeared to be in conflict with Supreme Court and other appellate authority.

In *S.E.C.* v. *Dolnick* [38] the Court of Appeals for the Seventh Circuit rejected the language in *Coffey* requiring the Commission to show a violation of Rule 10b–5 that a defendant acted with "wilful or reckless disregard for the truth," as "inconsistent with the law" of the Seventh Circuit. The court in *Dolnick* also held, *inter alia*, that pledges of stock at banks were sales within the meaning of the Securities Act of 1933, and that defendant had violated the registration provisions of that Act when he pledged unregistered shares of stock with banks as collateral for loans where the loans could be repaid only through the unregistered distribution of the pledged shares to the public. Some of the pledged shares were subsequently sold in the over-the-counter market as they were released by the banks to defendant, in order to reduce the balance of the loans with the proceeds of the sales.

In *S.E.C.* v. *Spectrum Ltd.*,[39] the Court of Appeals for the Second Circuit reversed the denial by the district court of a preliminary injunction requested by the Commission against an attorney who authored an opinion letter which was used to effect a distribution of unregistered securities. The district court had held that the attorney's conduct did not rise to a violation of the securities laws since the record did not show that the attorney had actual knowledge that he was aiding and abetting an illegal distribution of securities.

In remanding for further proceedings, the court of appeals stated that, in a Commission injunctive action, the proper standard to be applied in determining whether a defendant aided and abetted violations of the Federal securities laws is whether that defendant acted negligently. The court emphasized, among others things, that the negligence standard was not overly strict in the case of attorneys, in light of the unique and pivotal role the legal profession plays in the effective implementation of the Federal securities laws.

S.E.C. v. *Seaboard Corp.*[40]—The Commission filed a complaint in the Federal Court for the Central District of California against Seaboard and twenty-eight other individuals and entities. The suit essentially deals with the alleged mismanagement and outright looting of a complex of mutual funds ("Funds").

The complaint alleges that a portfolio manager of the Funds engaged in a practice of first purchasing thinly traded securities through nominees, then causing the Funds to purchase the same securities in large volume, thereby causing a price rise. He then allegedly sold his personal holdings either to the Funds or into the market when the Funds were buying. As a result, the Funds were alleged to have lost as much as $4,000,000.

The complaint also alleges that finders' fees in excess of $200,000 were illegally paid to affiliates of the mutual funds and that securities were purchased, investment advisers selected and other decisions relating to the investment funds made in order to benefit Seaboard and its affiliates to the detriment of the Funds.

S.E.C. v. *Republic National Life Insurance Company.* On March 8, 1974 the Commission instituted an injunctive action against Republic National Life Insurance Company ("Republic"), Realty Equities Corporation of New York ("Realty"), Peat, Marwick, Mitchell & Company, Westheimer, Fine, Berger & Co., and eleven individuals who were employees of Republic or Realty.[41] The Commission charged extensive violations of antifraud and reporting provisions of the Exchange Act. In essence, the complaint alleged that Republic, in trying to conceal its failing investment in Realty, put millions of dollars into Realty through certain transactions. The proceeds were usually channeled back to Republic to repay earlier Realty debt. Realty was thus enabled to retain sufficient funds through the transactions to continue in operation. Republic and Realty and each of their independent auditors were alleged to have made and issued false and misleading financial statements.

Realty, its president and treasurer consented to permanent injunctions enjoining them from future violations of antifraud provisions of the Exchange Act. In addition, the management of Realty has been restructured in an attempt to insure that violations of the law do not reoccur. Special counsel is to be appointed by the court, to prosecute, on behalf of Realty, civil actions which Realty may have. The litigation is continuing against the remaining defendants.

S.E.C. v. *Talley Industries, Inc.*[42]—On October 30, 1973 the Commission filed a complaint seeking injunctive and ancillary relief against Talley Industries, Peat, Marwick, Mitchell & Co. and two officers of Talley. The complaint alleged violations of the antifraud, reporting, and proxy provisions of the Federal securities laws, arising out of a merger in May 1970 of Talley with General Time Corporation.

The complaint alleged that Talley's financial statements, which were included in a joint proxy mailed in April 1970 to shareholders of Talley and General Time, were false and misleading in greatly overstating earnings. Projections of future sales and future production costs were alleged to have been made without reasonable bases. The complaint also alleged that at least $8.9 million classified as inventory should have been treated as an expense, which if done would have reduced Talley's earnings for the year ended March 31, 1969 from $1.71 per share shown in the proxy to 62¢ per share.

The complaint alleged that the false earnings statements in the proxy statements served to mislead former General Time shareholders by misrepresenting that the exchange ratio offered to them by Talley was fair and reasonable.

Among other things, the complaint sought an order directing Peat, Marwick to implement procedures designed to prevent the recurrence of the violative conduct alleged in the complaint, and such other relief as necessary and appropriate to redress the wrongs suffered by the former shareholders of General Time.

In April 1974, Talley and the 2 officers consented to an injunction without admitting or denying the allegations in the complaint.[43] The Commission's suit was settled by the defendants in conjunction with the settlement of related private litigation.

S.E.C. v. *Allegheny Beverage Corporation.*—As previously reported,[44] the Commission instituted an injunctive action against Allegheny and 24 other defendants alleging violations of reporting, antifraud, and registration provisions of the securities acts. In addition to Allegheny, the defendants include an Allegheny subsidiary, four Allegheny officers, the company's auditors, the underwriter of the subsidiary's public offering, counsel for the underwriter, counsel for the subsidiary, and the escrow agent for the public offering, Suburban Trust Company.

On August 31, 1973, Judge George Hart denied a Motion to Dismiss filed by certain of the defendants. On May 14, 1974, Judge Hart denied cross motions for summary judgment by the plaintiff Commission and certain of the defendants.

In *S.E.C.* v. *First U.S. Corporation*,[45] a Tennessee broker-dealer and 5 of its offi-

cers and employees were named as defendants in an injunctive action filed by the Commission in the Western District of Tennessee. The complaint charged violations of the antifraud provisions of the Federal securities laws. The complaint alleges that the defendants purchased from, and sold to, customers municipal bonds at prices not reasonably related to current market prices and churned certain accounts. In one instance, the complaint alleges that the defendants induced a 70 year old widow to engage in over 200 securities transactions in a one year period involving nearly $1 million which adversely affected the customer's interests.

S.E.C. v. *Investors Associates of America, Inc.*[46]—The Commission filed a complaint in October 1972 in the United States District Court for the Western District of Tennessee, alleging that the defendants, including 4 firms and 5 individuals, had violated the antifraud provisions of the Securities Act and the Exchange Act by having engaged in a fraudulent scheme to sell municipal bonds. The defendants were alleged to have used high pressure, "boiler room" techniques and employed a scheme in which two of the firms traded certain securities between themselves in order to create an artificial market for the securities.

In addition, the complaint alleged that the defendants engaged in "reverse trading," a practice whereby customers were induced to purchase municipal bonds at prices the customers believed to be less than the current market prices while at the same time the defendants purchased other municipal bonds from the same customers at prices unreasonably below the then current market price, thereby deriving a substantial undisclosed profit from the transactions. In this action, as well as in each of the previous suits filed by the Commission involving these practices, the Commission sought certain ancillary relief, including disgorgement of the alleged illegal monetary gains of the defendants.

The defendants, all of whom had previously consented to preliminary injunctions,[47] without admitting or denying the Commission's allegations consented to orders of permanent injunction. The orders required also that, under certain conditions, the defendants disgorge sums totaling $202,990.58.[48]

S.E.C. v. *Paragon Securities Co.*[49]—On August 2, 1973, the Commission filed an injunctive action in the District Court for the District of New Jersey charging Paragon, 4 associated firms, and 11 individuals with violations of the antifraud, broker-dealer registration and other provisions of the Federal securities laws.

In essence, the Commission's complaint alleges that Paragon while purportedly dealing only in municipal bonds was in fact dealing in other securities and failed to register as a broker-dealer with the Commission. Additionally, the complaint charged Paragon with filing false and misleading statements with the Commission with respect to its financial condition and with respect to its line of business in other matters. Moreover, the complaint charged the defendants with violations of the antifraud and prophylactic provisions of the securities acts and also alleged that they abused their discretionary authority with respect to various accounts; that they purchased and sold securities at prices unreasonably related to the current market price of such securities; and employed high pressure sales techniques to accomplish such fraudulent ends. Additionally, the complaint charges that the defendants made numerous fraudulent misstatements of material facts and omitted to state material facts concerning Paragon's relationship with its customers; the price of the securities being sold; Paragon's underwriting; its interest in the distribution of certain bonds it was selling; and the safety of an investment in bonds being sold.

During fiscal year 1974, the defendants in *S.E.C.* v. *Charles A. Morris & Associates, Inc.*, consented to permanent injunctions, without admitting or denying the Commission's allegations that they had engaged in high pressure sales campaigns to induce customers to purchase municipal bonds at prices as high as 75 percent in excess of their current market value. Among other things, the defendants consented to the disgorgement of alleged illegal profits.[50]

S.E.C. v. *Accurate Calculator Corp.*[51]—The United States District Court for the Southern District of New York entered de-

crees of permanent injunction by consent against Accurate, its promoter and five other defendants enjoining them from violating the registration and antifraud provisions of the Federal securities laws in connection with a distribution of Accurate's securities in the United States and Canada. As part of its complaint the Commission alleged, among other things, that Accurate's promoter had diverted for his own use and benefit and other non-corporate purposes a substantial portion of an offering of Accurate's securities in Canada and participated in the preparation of a false and misleading offering circular relating to Accurate.

The Court ordered the appointment of a receiver for Accurate with directions, among other things, to take custody of all assets of Accurate and to obtain funds and securities diverted from Accurate by its promoter and others. The Commission also accepted offers of settlement from three respondents in an administrative proceeding arising out of the Accurate matter who had been charged with violating the registration provisions of the Securities Act. See In the Matter of Holland Andrews & Perrier.[52]

S.E.C. v. *Whittaker Corporation.*[53]—On February 8, 1974, the Commission filed a complaint in the United States District Court for the Central District of California against Whittaker alleging violations of the proxy rules. The complaint alleged that Whittaker had failed to adequately and accurately describe its relationship with its independent certified public accountants in the proxy material which solicited shareholder approval for retention of the accountants for the coming year. The defendant allegedly had failed to disclose material facts concerning the settlement of a claim asserted against the auditors in connection with prior audits and failed to disclose that in Whittaker's opinion such auditors had done inadequate auditing for the fiscal years ended October 31, 1970 and 1971. Contemporaneously with the filing of the complaint, Whittaker, without admitting or denying the allegations, voluntarily consented to the entry of an order enjoining it from future violations of the proxy rules and requiring it to set forth in its next proxy statement a full and accurate description of its relationship with its accountants.

S.E.C. v. *J. Hugh Liedtke.*[54]—On July 1, 1974 the Commission filed a complaint seeking to enjoin J. Hugh Liedtke, chairman of the board of Pennzoil Co., William C. Liedtke, Jr., Pennzoil's President, and Choctaw Corp., a private investment company, from further violations of the antifraud provisions of the Exchange Act. The Commission's complaint alleged that both Liedtkes, through Choctaw Corp., purchased substantial amounts of Pennzoil stock during a two-month period when both Liedtkes were in possession of material non-public information regarding the fact that Pennzoil was planning to spin-off its wholly-owned gas pipe line subsidiary, United Gas Pipe Line Co. All three defendants consented to a permanent injunction against further such violations, and agreed to disgorge some $108,000 to persons who sold Pennzoil stock to Choctaw during the two month period.

This case is an example of expeditious investigation and enforcement action where the factual situation is relatively uncomplicated and uncontested. In this case the investigation was begun on May 28, 1974 and the complaint was filed on July 1, 1974.

S.E.C. v. *Prudent Real Estate Trust.*[55]—In May 1973, the Commission filed a complaint seeking an injunction and other relief against Prudent and its trustees, named only in their representative capacities. The complaint alleged that Prudent violated Sections 5(a) and 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b–5 thereunder in connection with Prudent's offering in March 1972, of $2.5 million principal amount of 7 percent convertible subordinated debentures and warrants.

The Commission alleged that Prudent had prearranged the sale of 50 percent of the offering to two private investors, prior to the effective date of the registration statement. The registration statement discloses neither this fact nor that Prudent had, as an inducement to purchase, entered into a consulting agreement with the investors which had the effect of providing them with a greater return on their investment than was to be realized by public investors. Prudent failed also to disclose that these two

investors would become the largest stockholders in the Trust and that various trustees of Prudent were purchasing shares of beneficial interest in Prudent on the American Stock Exchange throughout the offering period.

On November 9, 1973 the Court permanently enjoined Prudent from violating Sections 5(a) and 17(a)(2) of the Securities Act with respect to securities issued by Prudent.[56] The complaint was dismissed as to the trustees. The court also ordered Prudent to redeem all its then outstanding 7 percent convertible subordinated debentures no later than February 28, 1974. Prudent consented to the entry of the order without admitting or denying the allegations in the Commission's complaint.

S.E.C. v. *Techni-Culture, Inc.*[57]—The Commission in a complaint, filed in August 1973, alleged a massive fraudulent distribution of unregistered common stock of Techni-Culture, Inc. during the promotion of this shell corporation as a firm involved in an advanced form of hydroponic farming.

On April 2, 1974, after a hearing on the Commission's Motion for Preliminary Injunction, Judge William P. Copple, United States District Judge for the District of Arizona, preliminary enjoined five of the defendants from violations of the antifraud and registration provisions of the Federal securities laws.[58] In addition, he directed these defendants to deposit any shares of Techni-Culture, Inc. which they owned or controlled with the court for the benefit of public shareholders. He further ordered the alleged principal promoter of the scheme to file with the court a quarterly report of all his securities holdings and prohibited him from acting as an officer or director of any public company, except upon a showing to the court that measures have been taken to prevent repetition of the conduct of the nature alleged by the Commission.

S.E.C. v. *Marvin Bernstein.*[59]—In June 1973, the Commission filed a complaint for injunction in the United States District Court in New Jersey against Marvin S. Bernstein and eight others alleging violations of registration and antifraud provisions of the Federal securities laws. The Commission's complaint alleged that the promoters of Computron Corp., a Utah shell corporation, had made false and misleading statements in Computron's offering circular and had misappropriated funds received during its Regulation A offering. Additionally the promoters, working with M. Bernstein Securities Inc., a New Jersey broker-dealer, arranged a merger with a group of privately held New Jersey manufacturing concerns called Star-Glo Inc. The merged company, defendant Star-Glo Industries, Inc., was unable to make the filings required by the Securities Exchange Act because of inadequate financial and shareholder records kept by the promoters of Computron. Seven of the nine defendants have thus far consented to injunctions. The Court has also approved a plan which enabled Star-Glo to clarify its records concerning ownership of its stock, about which there was some question.

S.E.C. v. *Professional Service Association, Inc.*[60]—On April 29, 1974 the Commission filed a complaint seeking injunctive and other relief in the Western District of Missouri against Professional Service Association, Inc. ("P.S.A."), John E. Robinson and Hilton Patterson. The complaint alleges that the defendants violated antifraud provisions of the Federal securities laws in connection with the promotion of the securities of P.S.A.

The Commission alleged that the defendants were circulating false, misleading and fraudulent promotional materials and financial statements which materially overstated the value of the company's "training and reference" manuals. In addition, the Commission alleged that the defendants had forged a letter from a corporation domiciled in Missouri which purported to state its intention to make a substantial investment in P.S.A. Finally, the Commission alleged that the fraudulent promotional materials, financial statements and forged letter were part of the defendants' efforts to solicit stock subscriptions in P.S.A. from the investing public.

On the same day that the complaint was filed the defendants consented to the entry of a permanent injunction without admitting or denying the allegations in the complaint. Robinson and Patterson agreed to offer to rescind all agreements to purchase or sell

P.S.A. securities from November 1, 1973 to the date of the consent.

The institution of this enforcement action represents an additional phase of the Commission's program to deal effectively and expeditiously with on-going current abuses in the securities market. Within 24 hours after it had received information concerning the illegal activity, the Commission was prepared to file a complaint against the defendants. The defendants thereupon promptly agreed to consent to the injunction. It can be expected that future Commission enforcement efforts will continue to utilize this approach to attempt to enjoin violative conduct soon after it is discovered.

S.E.C. v. Occidental Petroleum Corporation.[61]—In December 1973, the Commission filed a complaint seeking to enjoin Occidental and its board chairman, Dr. Armand Hammer, from further violations of antifraud provisions of the Federal securities laws. The Commission's complaint charged that Occidental and Hammer had failed to disclose in prospectuses relevant to two public offerings of securities in 1971, that Occidental faced potential massive writedowns on its tanker fleet. The complaint further charged that there were various other material misrepresentations in the prospectuses with regard to its tanker fleet which had the effect of concealing Occidental's actual financial situation. Occidental and Hammer both consented to a permanent order enjoining them from future violations of the antifraud provisions.

S.E.C. v. Florida East Coast Railway Co. ("FEC").[62]—The United States District Court for the District of Columbia entered a decree of permanent injunction by consent enjoining FEC from violating the antifraud and proxy provisions of the Federal securities laws. The court additionally entered a consent order declaring null and void proxies solicited by FEC in 1971 and 1972 in connection with an exchange offer proposal of common stock for its outstanding First Mortgage Bonds.

The Alfred I. duPont Testamentary Trust, another defendant in the action, undertook to offer rescission to sellers of $476,000 face amount First Mortgage Bonds purchased by the Trust while allegedly in possession of material inside information relating to the railroad. The Trust and Florida East Coast's Chairman and it President (who were both also defendants) undertook not to engage in any transactions in FEC securities without prior notification to the court and the Commission. In view of these undertakings the Commission determined to discontinue the proceedings against the Trust and the two officers of the railroad.[63]

S.E.C. v. Sitomer, Sitomer & Porges.[64]—In October 1973, the Commission filed an injunctive action in the District Court for the Southern District of New York against the New York law firm of Sitomer, Sitomer & Porges, three of its partners and the Empire Fire and Marine Insurance Company and certain of its officers and directors, charging violations of the registration and antifraud provisions of the Federal securities laws in connection with the registered public offering of certain securities.

The complaint alleged the lawyer defendants had received a $200,000 undisclosed contingent fee upon the successful completion of a registered public offering by Empire Fire, in addition to legal fees of $95,000 (which were disclosed) and paper profits of approximately $167,000 on stock they purchased with a loan guaranteed by the issuer. Although the stock purchase itself was disclosed, that the stock was subject to a buy-back agreement and that the purchase loan was guaranteed by the issuer was not disclosed. The complaint alleged the compensation was received pursuant to a written compensation agreement with the issuer, which was hidden from the auditors of the issuer.

The law firm and its partners were also charged with attempting to employ a similar scheme in connection with an aborted registered public offering of the securities of another issuer. The defendants were alleged to have induced the issuer to enter into a written compensation agreement pursuant to which the defendants were to receive an undisclosed contingent fee of $400,000 in addition to legal fees of $200,000 and paper profits of $900,000 on stock of the issuer. The stock was subject to a buy-back agreement in the event the public offering was not successful.

Empire Fire and Marine Insurance Com-

pany and its officers and directors consented to the entry of permanent injunctions in March 1974, without admitting or denying the allegations in the complaint.[65] Empire consented also to an order directing it to file an amended registration statement disclosing the matters discussed above and amendments to other filings concerning the matter. The president and chairman of the board of Empire consented also to an order directing him to indemnify Empire for expenses incurred in connection with the alleged violations, up to $100,000. The case is pending as to the law firm and its partners.

MULTIDISTRICT LITIGATION

Amendments to Multidistrict Litigation Procedures—S. 2904 which was introduced in the Congress in the last fiscal year, would exempt enforcement actions brought by the Commission from 28 U.S.C. 1407. That section provides for the transfer to a single district court, for coordinated or consolidated pretrial proceedings, of civil actions that have one or more common questions of fact pending in different judicial districts. Presently, only injunctive actions brought by the United States under the Federal antitrust laws are exempt from Section 1407.

Section 1407 was enacted by Congress in 1968. The legislation was prompted by the institution of more than 2,000 private antitrust damage suits filed in 35 federal district courts following the successful criminal prosecution under the antitrust laws of electrical equipment manufacturers in 1961. For this reason, the primary focus during the hearings which led to the enactment of Section 1407 was upon the problems presented by the institution of numerous private damage actions having common parties and common issues of fact. Congress did, however, recognize the need to place certain Government civil actions on a different footing from private civil litigation. It excluded antitrust injunctive actions brought by the Government from the operation of the bill. There were no other express exclusions however from the bill.

Hearings on S. 2904 were held on February 20, 1974 before the Subcommittee on Improvements in Judicial Machinery of the Senate Committee on the Judiciary. At those hearings the Commission related that, in its experience, the resulting uncertainty of the outcome of a motion under Section 1407 has often caused district courts in which the Commission's enforcement action is pending, to await disposition of the motion by the Judicial Panel on Multidistrict Litigation before proceeding with the disposition of the Commission's action. Even where a motion has been ultimately denied by the Panel, [66] the Commission often has experienced substantial delay in its actions. When the motion is granted, the delay in resolution of the Commission's action is even more substantial. For example, in the Commission's injunctive action against *National Student Marketing Corporation*,[67] a motion was made to the Judicial Panel in April 1972 to transfer the Commission's case for pretrial consolidation with private damage actions pending in other districts. Almost eight months later, the Panel on December 1, 1972, ordered seven related private actions transferred to the district where the Commission's suit was pending. These cases were consolidated with the Commission's case for pretrial purposes.[68] The effect of that motion was to delay the Commission's injunctive case substantially, and that case at the close of the fiscal year was still only in the early stages of discovery.

In view of the Multidistrict Panel's decision in *National Student Marketing* and the adverse effect of that decision on the Commission's ability to obtain prompt dispositions of its injunctive actions, the Commission strongly urged passage of S. 2904.

In *In re Harmony Loan Co., Inc. Securities Litigation*[69] the Judicial Panel on Multidistrict Litigation refused under 28 U.S.C. 1407 to transfer to one district for consolidation or coordinated pretrial proceedings a Commission enforcement action—*S.E.C.* v. *Fisher*[70]—and to private actions all of which contained some common questions of fact. The Commission case and one private action were pending in one district and the other private action was pending in another district. The Panel noted that the pending actions sought different relief and were at different stages of development. The minimal discovery needed in the Commission's enforcement action had been

completed and it appeared to the Panel that that action was ripe for decision on the Commission's request for injunctive relief. Without reaching the Commission's basic argument that the nature and purpose of a Commission enforcement action requires its exclusion from consolidated pretrial proceedings with private damage suits, the Panel determined that inclusion of the Commission's case in Section 1407 proceedings could needlessly complicate and delay final disposition of all the actions involved.

Participation as Amicus Curiae

The Commission frequently participates as *amicus curiae* in litigation between private parties under the securities laws where it considers it important to present its views regarding the interpretation of the provisions involved. For the most part, such participation is in the appellate courts.

Manor Drug Stores v. *Blue Chip Stamps.*[71]—This is an action brought to recover damages for violations of Rule 10b–5 under the Securities Exchange Act. Plaintiffs, among the alleged beneficiaries of a government anti-trust consent judgment against certain of the defendants, were entitled to purchase shares in a newly formed corporation allegedly at a "bargain" price. The complaint alleges that defendants devised a scheme to dissuade the offerees, by means of misleading statements, from purchasing the securities. The district court dismissed the complaint on the basis of the so-called "*Birnbaum* rule," announced in *Birnbaum* v. *Newport Steel Corp.*, 193 F. 2d 461 (C.A. 2), *cert. denied,* 343 U.S. 956, which holds that a person who is neither a purchaser nor a seller of securities has no cause of action under Rule 10b–5.

The Commission as *amicus curiae* argued in the court of appeals that Rule 10b–5 should not be limited to actual purchasers and sellers of securities but should extend to all investors and potential investors. In the alternative the Commission contended that the consent decree was the functional equivalent of a contract to sell. The court of appeals adopted this alternative argument and reversed the district court.

Defendants petitioned for a writ of certiorari. The Commission, in a memorandum *amicus curiae* filed in support of this petition, urged the Supreme Court to review the matter, among other reasons, to resolve the conflict among the courts of appeals as to the *Birnbaum* rule by rejecting the rule. On November 1, 1974, the Court granted the petition.

In *International Controls Corp.* v. *Vesco,*[72] the Court of Appeals for the Second Circuit held that the pro rata distribution of a portfolio security by a corporation to its shareholders was a sale within Section 10(b) of the Securities Exchange Act and Rule 10b–5. The court of appeals further held that a district court could freeze assets of defendants "to assure compensation to those who are victims of a securities fraud."

The Special Counsel, who had been appointed for International Controls Corporation ("ICC") pursuant to a consent order of permanent injunction entered against ICC in *S.E.C.* v. *Vesco,*[73] filed a suit on behalf of ICC against 32 individual and corporate defendants alleging various violations of the Federal securities laws. Among the defendants were Fairfield General Corporation and two of its wholly-owned subsidiaries (the "Fairfield group"), Vesco and Co., Inc. and Robert L. Vesco. Among other things, ICC alleged that Vesco had fraudulently misled other directors of ICC into spinning off the company's stock holdings in the parent of the Fairfield group to ICC shareholders.

The district court had entered several orders to prevent dissipation of certain assets to which ICC would be entitled if its suit were successful. Specifically, the district court's orders prohibited the Fairfield group from selling its principal asset (an airplane) and enjoined Vesco and Co. from selling or otherwise disposing of its principal asset (approximately 850,000 shares of ICC). The district court also enjoined the continued prosecution of a number of actions by the defendants in state courts.

The Fairfield group argued primarily that the district court lacked jurisdiction over the subject matter. They argued that the spin-off of Fairfield General to ICC shareholders was not a sale under Section 10(b) of the Securities Exchange Act and Rule 10b–5 thereunder because the shareholders of ICC were in the same posi-

tion after the spin-off as they had been before it. The court of appeals rejected this argument and held that in light of the "umbrella protection placed over securities transactions by Section 10(b) . . . ICC must be deemed a seller. . . ." The court viewed a recent line of cases[74] which hold that spin offs are sales for purposes of the registration provisions of the Securities Act of 1933 as inapposite because those cases all involved consideration flowing to the parent corporation's principal shareholders (*e.g.*, in the form of the enhanced value of the retained shares because of the creation of a public market for the shares). In this connection, the court rejected the Commission's argument, as *amicus curiae*, that there had been consideration to ICC and/or Vesco in the transaction.

The court stated that, "although in other contexts the term 'sale' might appropriately be construed more narrowly, we find emphasis on consideration inconsistent with the broad scope of protection under Section 10(b) for those who engage in transactions eventuating in the acquisition or disposition of securities." The court also reasoned that it should look beyond the question of whether or not there is harm to the recipient shareholders in the stock distribution because Section 10(b) is designed for the protection of creditors as well. In the court's view, the spin-off was a "transaction involving . . . the disposition of securities and, therefore, one for which the corporation is well deserving and entitled to the protection of Section 10(b)."

The court of appeals affirmed the orders of the district court freezing the assets of the defendants, but vacated the district court's orders enjoining the continued prosecution of actions by the defendants in state courts, with one exception. The court of appeals reversed those orders which it deemed beyond the purview of the narrow exceptions to the Anti-Injunction Act, 28 U.S.C. 2283.

In *Safeway Portland Employees' Federal Credit Union* v. *C. H. Wagner & Co.*,[75] the Court of Appeals for the Ninth Circuit held, in accordance with the views expressed by the Commission as *amicus curiae*, that certain brokered bank certificates of deposit were required to be registered under the Securities Act. Each brokered certificate consisted of a certificate of deposit issued by a bank, together with a broker's promise to pay, upon the maturity of the certificate, bonus interest over and above the interest payable by the bank. The money used by the broker to pay the bonus interest came from a person who was seeking a loan from the bank and was willing to pay a premium to induce an investor to purchase a certificate of deposit issued by the bank so that the bank would be willing to make a loan. The court held that the combination of the bank certificate with the bonus interest "created an integrated investment package which must be viewed in its entirety in determining whether it is within or without the Act." Noting that this package differed "fundamentally" from the underlying certificate of deposit issued by the bank since there was a greater rate of return to the investor, and pointing out that the economic inducement for the purchase of the brokered certificate was the total combined rate of interest, the court concluded that the package, the elements of which were "inseparable," constituted an investment contract and therefore a security. The court further held that since the package, unlike the underlying bank certificates, was not issued by a bank, the exemption from registration accorded to bank-issued securities was unavailable.

Reserve Life Insurance Co. v. *Provident Life Insurance Co.*[76] involved the solicitation by the trustees of an expiring voting trust of certificate holders in the trust for their consents to a continuation of the trust for an additional term of ten years. The voting trust held the controlling voting stock of the Provident Life Insurance Co., an issuer that was exempt from registration under Section 12(g)(2)(G) of the Securities Exchange Act.

In its brief, *amicus curiae*, the Commission argued primarily that the solicitation of the voting trust certificate holders by the trustees involved the offer of a security required to be registered under the Securities Act of 1933, and that the exemption from registration contained in Section 3(a)(9) of the Securities Act for "[a]ny security exchanged by the issuer with its existing security holders, exclusively . . .," was not available to the voting trust, since, in the

Commission's view, the original trust by the terms of the trust agreement would and did expire at the end of its original 15–year term and the requirement of a single issuer under Section 3(a)(9) was not met. In rejecting the Commission's view, the court of appeals considered the trust and its renewal to be a single, continuing legal entity.

The court of appeals agreed with the Commission, however, that the voting trust was an issuer required to register its certificates under Section 12(g) of the Securities Exchange Act. In this connection the court upheld the validity of Rule 12g5–2 under the Securities Exchange Act, pursuant to which the assets of a corporation whose stock is held by a voting trust are attributed to the trust in order to determine if the trust has sufficient assets to require registration. The court also agreed with the Commission that the solicitation by the voting trustees to extend the term of the trust was a solicitation "in respect of" the voting trust certificates as well as the underlying insurance company stock and therefore subject to the proxy rules. The court stated that the solicitation by the trustees constituted "a solicitation for the trustees' right to exercise indirect control over the corporation for many years."

Finally, in response to a collateral issue concerning what weight, if any, is to be given to views expressed by members of the Commission's staff that conflicted expressly or by implication with the Commission's position as *amicus curiae,* the court of appeals held that the views expressed by the staff do not constitute an official expression of Commission opinion and do not bind or estop the Commission from espressing contrary views.

In *Meyerhofer* v. *Empire Fire & Marine Insurance Co.*[77] The United States Court of Appeals for the Second Circuit held that an attorney under the peculiar circumstances of the case did not violate provisions of the American Bar Association's Code of Professional Responsibility by disclosing certain information relating to one of his law firm's clients to attorneys who represented plaintiffs in a lawsuit against that client.

Upon learning that a registration statement and prospectus prepared by his law firm relating to the public offering of the client's securities did not contain certain required material information, the attorney reported that fact to the Commission and resigned from the law firm. Shortly thereafter, this material information was disclosed in a 10–K report filed with the Commission. As a result of that disclosure, certain shareholders of the client filed suit against it based on its failure to include the information in its registration statement and prospectus. The attorney also was named a defendant in the lawsuit. In order to demonstrate to plaintiffs' counsel that he was not culpable and have himself dropped as a defendant, the attorney gave plaintiffs' counsel a copy of the affidavit he earlier had provided to the Commission.

On motion by the client corporation, the district court ruled that the delivery by the attorney of his affidavit to the plaintiffs' attorneys, and their receipt of that affidavit, violated Canons 4 and 9 of the ABA's Code of Professional Responsibility in that it involved the revealing of confidential information by an attorney and had the appearance of impropriety. Accordingly, the district court dismissed the case without prejudice and enjoined the attorney who had revealed the information and plaintiffs' counsel from further association with the case.

In the court of appeals the Commission filed a brief, *amicus curiae,* arguing that the delivery of the affidavit by the attorney to counsel for the plaintiffs did not constitute a breach of the Code: (1) the information in the affidavit was not confidential because it involved a fraud perpetrated by the client; and (2) even if the information were confidential, the attorney had a right, under ABA Disciplinary Rule 4–101(c)(4), to reveal the information in the course of defending himself against an accusation.

Without reaching the issue of whether the attorney had, in fact, revealed confidential information, the court of appeals reversed the dismissal of the case on the ground that the delivery of the affidavit by the attorney to counsel for the plaintiffs was authorized under Disciplinary Rule 4–101(c)(4). The court concluded that in light of his urgent situation, the attorney had the right to make an appropriate disclosure of his role in the public offering; since the affidavit was the

best evidence of his innocence, it was also appropriate for the attorney to turn the affidavit over to counsel for plaintiffs.

The court of appeals also reversed the injunction against plaintiffs' counsel barring them from further association with the case, but sustained so much of the injunction against the attorney as would bar him from representing the plaintiffs in their case against the client corporation.

Merrill Lynch, Pierce, Fenner & Smith v. *Ware*[78] involved a wage dispute between a member of the New York Stock Exchange and a former employee. Pursuant to an Exchange rule, the employee had signed an agreement to arbitrate all disputes arising out of his employment. After the employee had brought suit in California state court, the member firm attempted to institute arbitration, arguing that since the Exchange rule was adopted pursuant to the Exchange's self-regulatory power under the Securities Exchange Act of 1934, it preempted a California statute which gave employees the right to a judicial forum in wage disputes regardless of any arbitration agreement.

Commission counsel participated in the filing of a brief for the United States as *amicus curiae* in the Supreme Court. Consistent with the views expressed in that brief, the Court held that since the Exchange rule requiring arbitration was, only peripherally, if at all, related to fair dealing and investor protection, it would not preempt inconsistent state law. The Court also rejected the member firm's contentions that national uniformity in regulation of exchanges required application of the Exchange rule, that the Securities Exchange Act required the law of New York (where the arbitration rule would be valid) to be applied because that is where the New York Stock Exchange is located, and that application of the California statute would unduly burden interstate commerce.

CRIMINAL PROCEEDINGS

As a result of investigations conducted by its staff, the Commission during the past fiscal year referred 65 cases to the Department of Justice for criminal prosecution. This represents more than a 35 percent increase over the 49 cases referred during the preceding fiscal year. As a result of these references, 40 indictments naming 169 defendants were returned, as compared to the same number of indictments against a total of 178 defendants during the previous year. In addition, during the past fiscal year, the Commission authorized its staff to file 2 criminal contempt actions and convictions were obtained against 6 defendants. During the past fiscal year, 81 defendants were convicted in the 28 criminal cases that were tried. Convictions were affirmed in 7 cases that had been appealed, and appeals were still pending in 7 other cases at the close of the period.

Members of the staff of the Commission who have investigated a case and are familiar with the facts involved and the applicable statutory provisions and legal principles, are usually requested by the Department of Justice to participate and assist in the trial of a criminal case referred to the Department, and to participate and assist in any subsequent appeal from a conviction.

The criminal cases that were handled during the fiscal year demonstrated the great variety of fraudulent practices that have been devised and employed against members of the investing public.

As a result of the Commission's reference of the files in the Everest Management Corporation case,[79] an indictment was filed in the Southern District of New York which named Morton Kaplan, Philip Zane, Jerome Silverman, Charles Fischer, Robert Persky, and others. Among other things, they were alleged to have concealed the fact that approximately $500,000 which had been raised by Microthermal Applications, Inc. ("Microthermal"), in a public offering of its stock, was dissipated by two coconspirators not named as defendants. They thereafter caused the company to file financial reports with the Commission which indicated that the money had been invested in certificates of deposit. Zane, Silverman and Persky were convicted after a non-jury trial of filing a false and misleading Form 10–K annual report with the Commission and were sentenced to two years imprisonment with all but four months suspended. The judgment was affirmed on appeal.[80] A petition for certiorari is now

pending before the Supreme Court.

Kaplan, the former president of Microthermal, pleaded guilty to conspiring with Zane, Silverman and Persky to file the report. He was sentenced to two years of which four months was to be served in a Federal institution.

By virtue of their convictions in this case, Zane and Silverman, both accountants, and Perksy, a lawyer, were automatically suspended from appearing or practicing before the Commission pursuant to Rule 2(e) of the Commission's Rules of Practice.

In December 1973 in the case of *U.S.* v. *Aloi*,[81] Vincent T. Aloi, John Dioguardi, Ralph Lombardo and John Savino were convicted of conspiracy to violate the securities laws and securities fraud in connection with the securities of At-Your-Service Leasing Corp. The defendants had engaged in a fraudulent scheme to acquire control of At-Your-Service Leasing Corp. in order to misappropriate corporate funds. The scheme also involved the distribution of fraudulent offering circulars. Dioguardi and Aloi were sentenced to prison terms of ten and nine years, respectively. This case is particularly significant in that these repeated securities violators received substantial terms of imprisonment.

U.S. v. *Arthur J. Levine*[82] was a case involving Weis Securities, Inc. ("Weis"), a broker-dealer firm registered with the Commission and a New York Stock Exchange member firm. Weis collapsed financially and is currently being liquidated pursuant to the Securities Investor Protection Act of 1970. Arthur J. Levine, the former chairman of the board of Weis; Sol Leit, former president; Alan Solomon, former vice-president and treasurer; Joel Kubie, former comptroller; and Robert Lynn, former assistant comptroller, were indicted in this case for falsifying the books and records of the firm in order to conceal its true financial condition. Weis, which had approximately 40,000 customer accounts is the largest brokerage firm ever to be liquidated under the provisions of the Act.

Leit, Kubie, Levine and Lynn each pled guilty to one count of the indictment alleging conspiracy to violate the Federal securities laws. In addition, Leit and Levine both pled guilty to an information charging each of them with violations of the bookkeeping provisions of the Exchange Act. Solomon, the only defendant to go to trial, was found guilty of one count of violating the bookkeeping provisions of the Exchange Act.

U.S. v. *Joel Kline*[83] and *U.S.* v. *Max Zerkin*.[84]—These two cases arose out ot a Commission investigation into the possible manipulation of certain over-the-counter stocks. Joel Kline, Eric Adolph Baer and Donald Harrison Abrams were indicted in connection with their efforts to obstruct the Commission's investigation. They were charged with influencing witnesses to testify falsely before the Commission, concealing, altering and destroying evidence relevant to the investigation and committing perjury before the Commission. Each defendant pled guilty to one count of the indictment charging conspiracy to obstruct justice. Kline was fined $10,000, and given a prison term of 20 months to five years; Baer was fined $10,000, given a suspended sentence and placed on probation for three years; and Abrams was fined $7,500, given a suspended sentence and placed on probation for two years.

After Kline, Baer and Abrams were sentenced, Max Zerkin waived indictment and pled guilty to a one count information charging him with manipulation of the over-the-counter market prices for the securities of Penn Metal Fabrications, Inc., U.S. Vinyl Corp. and Montgomery Land Investment and Development Corporation. Zerkin was fined $10,000 and placed on probation for three years.

United States v. *Bernard Deutsch*.[85]—After a six week trial Bernard Deutsch and Stanley DuBoff, two New York registered representatives and Milton Cohen, a St. Paul, Minnesota businessman and president of Richard Packing Company, were found guilty on all four counts of an information filed by the U.S. Attorney's Office in the Southern District of New York.

The information charged that the defendants conspired to manipulate and did manipulate the market price of Richard's common stock from 1968 to 1970. Deutsch and DuBoff were alleged to have secretly directed transactions in the common stock of the company at Kelly, Andrews & Bradley, a brokerage firm, pursuant to a "kickback"

arrangement. As part of the scheme Deutsch and DuBoff also induced three mutual funds to purchase 129,000 shares of the stock at an eventual loss to the funds of over $5 million.

The information also charged that Deutsch, DuBoff and Cohen caused a false and misleading offering circular to be mailed in connection with a public offering of 10,000 shares of Richard stock, pursuant to a Regulation A exemption from registration.

Deutsch and DuBoff are currently under indictment in four other cases involving violations of the conspiracy, mail fraud and Federal securities laws in connection with trading in the securities of Acrite Industries Inc., Frigitemp Corp. and Integrated Medical Services, Ltd.[86]

In *U.S.* v. *The Technical Fund, Inc.*[87] a twenty-count indictment was returned against an investment company and certain of its officers, directors and related individuals and entities in the Federal court in Boston. Several defendants were charged with violations of provisions of the Investment Advisers Act and affiliated transaction provisions of the Investment Company Act. This case is one of the small number of criminal cases charging violations of sections of the Investment Company Act.

In another significant case, *U.S.* v. *Manning*[88] a federal jury in the Central District of California convicted Daniel E. Manning and David A. Wooldridge of securities fraud, mail fraud, the sale of unregistered securities, and conspiracy in connection with transactions in the securities of Capitol Holding Corp. Three other defendants, Irwin "Steve" Schwartz, Robert Eisenberg, and Bernard Klavir failed to appear at trial and are classified as fugitives. The trial, which lasted more than six weeks, disclosed that millions of unregistered Capitol Holding shares were fraudulently sold to shareholders throughout the United States and Canada; that Schwartz was responsible for a market manipulation through Canadian brokerage firms; that Manning and a Schwartz associate met secretly in a Los Angeles motel and exchanged thousands of stock certificates for large sums of cash; that Manning and Wooldridge unlawfully received large profits from the sale of Capitol Holding stock through nominees; and that Eisenberg, a former Commission attorney, was the mastermind behind the scheme. On September 5, 1973, Judge Irving Hill sentenced Manning and Wooldridge each to six years imprisonment and fined each $10,000.

In *U.S.* v. *Seymour Pollack*[89] a conviction was obtained against Seymour Pollack, a chronic securities violator, on 13 counts of an indictment charging mail fraud, wire fraud and the sale of unregistered securities of Control Metals Corporation. Also convicted were Paul Sachs, an attorney practicing law in the District of Columbia, and William Cudd. Prior to the trial, another defendant in the case, Harold Rothman, pled guilty to one count of the indictment charging him with the sale of unregistered securities. Stanley Kaiser, an attorney also practicing law in the District of Columbia, pled guilty to an information charging him with violating antifraud provisions of the Federal securities laws.

In *U.S.* v. *A.J White & Co.*[90] Allen J. White pled guilty to one count of an indictment which charged violations of the broker-dealer bookkeeping requirements of the Exchange Act. Although bookkeeping provisions of the Act are frequently the subjects of Commission administrative and civil enforcement proceedings, they are infrequently the subjects of criminal indictments.

White was fined $8,500, given a one year suspended sentence and placed on probation for one year.

Organized Crime Program

The prosecution of securities cases is often based primarily on circumstantial evidence requiring extensive investigation by highly trained personnel. The difficulties in such investigations and prosecutions are compounded when elements of organized crime are involved. Witnesses are usually reluctant to cooperate because of threats or fear of physical harm. Books, records, and other documentary evidence essential to the investigation and to a successful prosecution may be destroyed or nonexistent. The organized crime element is adept at disguising its participation in transac-

tions, through the use of aliases and nominee accounts, by operating across international boundaries, and by taking advantage of foreign bank and other secrecy laws. It frequently operates through "fronts" and infiltrates legitimate business concerns. Organized crime has an extensive network of affiliates throughout this country in all walks of life, and in many foreign nations. Despite these difficulties, the Commission, working in cooperation with other enforcement agencies, has been able to make major contributions to the fight against organized crime.

During fiscal year 1974, the organized crime program focused principally on two ends (1) increasing the Commission's effectiveness in obtaining current reliable information relating to organized criminal activity in the securities industry; and (2) aggressively pursuing to completion investigations of situations brought to the Commission's attention as potentially involving the infiltration of elements of organized crime into the industry.

In order to increase the flow of reliable data, an intelligence unit has been established in the Division of Enforcement. Its principal function is to maintain channels of communication with state, local and other Federal agencies, as well as comparable agencies of foreign governments, which might have information on organized criminal activitiy in the securities industry. Information received by this unit is correlated with other available information and evaluated in light of the Commission's responsibilities under the Federal securities laws. Information indicating possible securities law violations by organized criminal elements is relayed by the intelligence unit to those other members of the staff whose principal duties are to investigate activity by organized crime.

Members of the staff have participated in seminars and lectures sponsored by state and local governments and state and local representatives have been included in the Commission's training programs. This has alerted local authorities to the role of the Commission in curtailing organized criminal activity in the securities industry. Members of the Commission staff are also assigned on a full time basis to certain of the Justice Department's Organized Crime Strike Forces. Both the Strike Forces and the Commission staff have thereby benefited in learning more about criminal activity in the securities industry.

As a result of the organized crime unit's enforcement efforts during the past fiscal year, there has been a dramatic increase in the number and importance of actions in this area. In the past year, in cases where members of organized crime were involved, the Commission filed injunctive actions naming 51 persons and contributed to the return of indictments relating to 39 individuals and the conviction of 54 individuals. Seven persons considered to be important members of organized crime were enjoined, two such members were indicted and eleven such members were convicted on indictments returned in prior years. The Commission presently has 48 matters under investigation involving organized crime.

Cooperation with Other Enforcement Agencies

In recent years the Commission has given increased emphasis to cooperation and coordination with other enforcement agencies, including the self-regulatory organizations, enforcement agencies at the State and local level, and certain foreign agencies. Its programs in this area cover a broad range. For example, the Commission believes that certain cases are more appropriately enforced at the local rather than the Federal level where the activities, while violating the Federal securities laws, are essentially of a local nature. In these instances, the Commission authorizes the referral of the case to the appropriate State or local agency, and members of the staff familiar with it are made available for assistance to that agency in its enforcement action.

The Commission has also fostered programs designed to provide a comprehensive exchange in information concerning mutual enforcement problems and possible securities violations. During the fiscal year, it continued its program of annual regional enforcement conferences. These conferences are attended by personnel from State

securities agencies, the U.S. Postal Service, Federal, State and local prosecutors' offices and local offices of self-regulatory associations such as the NASD. They provide a forum for the exchange of information on current enforcement problems and new methods of enforcement cooperation. One result of these conferences has been the establishment of programs for joint investigations. Although the conferences were initially hosted by the Commission's regional offices, many State agencies are now serving as sponsors or co-sponsors. During the past year, the Commission's Division of Enforcement conducted an Enforcement Training Seminar to which were invited representatives of all the State securities agencies and their counterparts in the Canadian provinces. Invitations were also extended to other Federal agencies having investigative or enforcement responsibilities involving laws relating to the issuance of or transactions in securities.

The Commission's Proceedings and Litigation Records Branch continues to provide one means for cooperation on a continuing basis with other agencies having securities enforcement responsibilities. The Branch acts as a clearinghouse for information regarding enforcement actions in securities matters that have been taken by State and Canadian authorities, other governmental and self-regulatory agencies, and the Commission itself. It answers requests for specific information and in addition publishes a periodic bulletin which is sent to contributing agencies and to other enforcement and regulatory bodies. During fiscal 1974, the branch received 3,964 letters either providing or requesting information, and sent out 3,023 communications to cooperating agencies. Records maintained by the Branch reflect a steady increase in recent years in the number of enforcement actions taken by State and Canadian authorities. The data in the SV (Securities Violations) Files, which is computerized, is useful in screening issuers and applicants for registration as securities or commodities brokers or dealers or investment advisers, as well as applicants for loans from such agencies as the Small Business Administration.

FOREIGN RESTRICTED LIST

The Commission maintains and publishes a Foreign Restricted List designed to alert broker-dealers, financial institutions, investors and others to possible unlawful distributions of foreign securities in the United States. The list consists of names of foreign companies whose securities the Commission has reason to believe have recently been or are currently being, offered for public sale in the United States in violation of registration requirements. While most broker-dealers refuse to effect transactions in securities issued by companies on the list, this does not necessarily prevent promoters from illegally offering such securities directly to United States investors. During the past fiscal year, 7 corporations were added to the Foreign Restricted List, bringing the total number of corporations on the list to 82. The following companies were added during the year:

City Bank AS.[91]—This is a company incorporated under the laws of Denmark, which, in United States publications, offered to pay 9 percent interest to United States investors who would open savings accounts in Danish kroner in the City Bank AS in Copenhagen.

Los Dos Hermanos, S.A. [92]—This Spanish corporation publicly offered in the United States bonds in 42,000 peseta (about $735.00) denominations for the stated purpose of financing a specialized hotel in Spain for rheumatic patients. Prospective investors were offered bonds at a substantial discount and were promised that each year they would receive a return of 18 percent, free round-trip air travel to Malaga, Spain, and one week's accommodation. Also offered were investment contracts involving a condominium in Spain, with similar promises of an 18 percent return and fully-paid travel and accommodations.

Global Insurance Company, Limited[93] offered in the United States "guaranteed income debentures" in face amounts of $1,000 or multiples thereof, maturing in one to four years and paying between 10 to 12 percent interest per annum. In addition, the firm represented that these investments would be "cloaked in Swiss-like secrecy"

and "tax free," implying that the investor might avoid payment of United States income taxes on the income received.

Globus Anlage-Vermittlungsgesellschaft NBH.[94]—This German corporation advertised in newspapers in the United States promising investors a return of 10 percent each month on funds in amounts not less than $1,000, or the equivalent of 120 percent interest per annum. The firm also represented to investors that the return on the securities would be "tax free" through the use of secret bank accounts in Luxembourg and also represented that the investments would be insured by Lloyd's of London.

Prestige Finance Corporation Limited of Nassau in the Bahamas solicited brokers and dealers in the United States with a proposal to rebate secretly 15 percent of all funds which the brokers and dealers might persuade their customers to invest in shares of the stock of corporations recommended for investment by Prestige. The initial shares recommended were those of *International Communications Corporation*,[95] a company said to be incorporated in the Cayman Islands, British West Indies. In an accompanying prospectus, it was stated that the company, which apparently intended to publish a directory of telex subscribers, would pay dividends of $1,900 for each $100 invested.

Atlantic and Pacific Bank & Trust Co., Ltd. of Nassau in the Bahamas[96] issued certificates of deposit in $50,000 denominations to United States nationals who in turn futilely endeavored to exchange these certificates for valuable assets, including, in one instance, eleven luxury automobiles. On September 7, 1973, the minister of finance of the government of the Bahamas revoked the license of the company.

James G. Allan and Sons,[97] of Edinburgh, Scotland engaged in an extensive newspaper and mail campaign to solicit United States investors to purchase investment contracts covering cases of newly distilled scotch whiskey, to be held in storage in warehouses in Scotland until the whiskey aged and became more valuable. One letter distributed by the firm promised a 30–34 percent return per annum. The investment opportunities were similar to those recently characterized as securities by the courts.

NOTES TO PART 4

[1] E.D. N.Y., No. 70 Civ. 1063.

[2] 54 F.R.D. 527 (W.D. Okla., 1972).

[3] Rule 6 provides: ". . . A person who has submitted documentary evidence or testimony in a formal investigative proceeding shall be entitled, upon written request, to procure a copy of his documentary evidence or a transcript of his testimony on payment of the appropriate fees: *Provided, however,* That in a nonpublic formal investigative proceeding the Commission may for good cause deny such request. In any event, any witness, upon proper identification, shall have the right to inspect the official transcript of the witness' own testimony."

[4] Securities Exchange Act Release No. 10846 (June 10, 1974), 4 SEC Docket 418.

[5] Securities Exchange Act Release No. 10637 (February 11, 1974), 3 SEC Docket 542.

[6] Securities Exchange Act Release No. 10636 (February 11, 1974), 3 SEC Docket 540.

[7] Securities Exchange Act Release No. 10590 (January 9, 1974), 3 SEC Docket 359.

[8] Securities Exchange Act Release No. 10853 (June 13, 1974), 3 SEC Docket 425.

[9] Securities Exchange Act Release No. 10445 (October 18, 1973), 2 SEC Docket 602.

[10] See generally Part 2, *supra.*

[11] Securities Exchange Act Release No. 10214 (June 11, 1973), 1 SEC Docket, No. 20, p. 3.

[12] Securities Exchange Act Release No. 10732 (April 11, 1974), 4 SEC Docket 82.

[13] Litigation Release No. 6404 (June 19, 1974), 4 SEC Docket 498.

[14] 494 F. 2d 1301 (1974).

[15] 39th Annual Report, p. 74.

[16] 401 F. 2d 833 (C.A. 2, 1968), *cert. denied*, 394 U.S. 976 (1969).

[17] Previously reported in 39th Annual Report, pp. 74–75.

[18] Investment Advisers Act Release No. 410 (April 30, 1974), 4 SEC Docket 253.

[19] 74 Civ. 1496 (S.D.N.Y.), Litigation Release No. 6304 (April 2, 1974), 4 SEC Docket 66.

[20] 497 F. 2d 473 (1974).

[21] 365 F. Supp. 588 (N.D. Ga., 1973), discussed in 39th Annual Report at p. 78.

[22] 328 U.S. 293, 298–299 (1946).

[23] 474 F. 2d 476, *cert. denied*, 414 U.S. 821 (1973).

[24] 497 F. 2d 516 (1974).

[25] See 39th Annual Report, p. 79.

[26] 493 F. 2d 1027 (C.A. 2, 1974). Review of the preliminary injunction granted by the district court at the behest of the Commission was consolidated with an appeal from a temporary restraining order and a petition for mandamus.

[27] 496 F. 2d 1192 (C.A. 4, 1974), *affirming per curiam*, 362 F. Supp. 323 (E.D. Va., 1973).

[28] Litigation Release Nos. 6018 and 6024 (August 13 and 16, 1973), 2 SEC Docket 308, 311.

[29] Litigation Release No. 6081 (October 2, 1973), 2 SEC Docket 542.

[30] Litigation Release No. 6217 (January 24, 1974), 3 SEC Docket 447.

[31] 73 Civil 3438 (S.D.N.Y.)

[32] No. 73–2402.

[33] No. 72 Civ. 3161 (CBM).

[34] See 39th Annual Report, pp. 83–84.

[35] See 39th Annual Report, pp. 84–85.

[36] 351 F. Supp. 236 (S.D. Ohio, 1972).

[37] 493 F. 2d 1304 (1974).

[38] C.A. 7, No. 73–1752 (August 16, 1974). The district court's opinion may be found in 359 F. Supp. 219 (N.D. Ill., 1973). The case was captioned as *S.E.C.* v. *Pig 'N Whistle*, and was previously reported in 38th Annual Report at pp. 77–78.

[39] 489 535 (C.A. 2, 1973).

[40] Litigation Release No. 6269 (March 5, 1974), 3 SEC Docket 681.

[41] Litigation Release No. 6273 (March 8, 1974), 3 SEC Docket 684.

[42] Litigation Release No. 6114 (October 30, 1973), 2 SEC Docket 711.

[43] Litigation Release No. 6330 (April 19, 1974), 4 SEC Docket 151.

[44] 39th Annual Report, p. 76.

[45] Litigation Release No. 6032 (August 22, 1973), 2 SEC Docket 340.

[46] Litigation Release No. 5583 (October 26, 1972); previously reported in 39th Annual Report, p. 80.

[47] Two defendants had also consented during fiscal year 1973 to permanent injunctions. Litigation Release No. 5763 (February 28, 1973), 1 SEC Docket No. 5, p. 24.

[48] Litigation Release No. 6164 (December 4, 1973), 3 SEC Docket 195.

[49] Litigation Release No. 6005 (August 2, 1973), 2 SEC Docket 252.

[50] Previously reported in 39th Annual Report, p. 80.

[51] Previously reported in 39th Annual Report, pp. 81–82.

[52] See p. 76, *supra*.

[53] Litigation Release No. 6245 (February 12, 1974), 3 SEC Docket 563.

[54] Litigation Release No. 6414 (July 1, 1974), 4 SEC Docket 544.

[55] Litigation Release No. 5880 (May 9, 1973), 1 SEC Docket, No. 15, p. 23.

[56] Litigation Release No. 6143 (November 9, 1973), 3 SEC Docket 63.

[57] Litigation Release No. 6010 (August 2, 1973), 2 SEC Docket 254.

[58] Litigation Release No. 6308 (April 5, 1974), 4 SEC Docket 68.

[59] Litigation Release No. 5949 (June 27, 1973), 2 SEC Docket 63.

[60] Litigation Release No. 6347 (May 1, 1974), 4 SEC Docket 257.

[61] Litigation Release No. 6186 (December 27, 1973), 3 SEC Docket 326.

[62] Previously reported in 39th Annual Report, pp. 79–80.

[63] Litigation Release No. 6259 (February 25, 1974), 3 SEC Docket 642.

[64] Litigation Release No. 6107 (October 23, 1973), 2 SEC Docket 648.

[65] Litigation Release No. 6298 (March 28, 1974), 3 SEC Docket 781.

[66] See *e.g., In re Harmony Loan Co., Inc. Securities Litigation*, CCh Fed. Sec. L. Rep. Para. 94,472 (J.P.M.L., No. 154, 1974); *In re King Resources Securities Litigation*, 342 F. Supp. 1179 (J.P.M.L., 1972); *In re Glen W. Turner Enterprises Litigation*, 355 F. Supp. 1402 (J.P.M.L., 1972).

[67] *S.E.C.* v. *National Student Marketing Corporation*, D. D.C., Civil Action No. 225–72.

[68] *In re National Student Marketing Corporation*, 368 F. Supp. 1311 (J.P.M.L., 1973).

[69] J.P.M.L., Docket No. 154 (April 1, 1974).

[70] S.D. Ohio, Civil Action No. 8876.

[71] 492 F. 2d 136 (C.A. 9, 1974), *cert. granted*, Docket No. 74–124.

[72] 490 F. 2d 1334 (C.A. 2, 1974).

[73] See discussion of this action in 39th Annual Report at pp. 22–23.

[74] See, *e.g., S.E.C.* v. *Datronics Engineers, Inc.*, 490 F. 2d 250 (C.A. 4, 1973), *certiorari denied*, 416 U.S. 937 (1974).

[75] 501 F. 2d 1120 (1974).

[76] C.A. 8, No. 73–1241, June 21, 1974.

[77] 497 F. 2d 1190 (C.A. 2, 1974).

[78] 414 U.S. 117 (1973).

[79] 38th Annual Report, p. 81 and 39th Annual Report, pages 84, 89. Litigation Release Nos. 5768 (March 5, 1973), 1 SEC Docket No. 6, p. 27; 5971 (July 13, 1973), 2 SEC Docket 155 and 6085 (October 4, 1973), 2 SEC Docket 543.

[80] 495 F. 2d 683 (C.A. 2, 1974).

[81] Litigation Release No. 6209 (January 21, 1974), 3 SEC Docket 444.

[82] Litigation Release No. 5988 (July 23, 1973), 2 SEC Docket 209.

[83] Litigation Release No. 5889 (May 14, 1973), 1 SEC Docket No. 16, p. 26.

[84] Litigation Release No. 6215 (January 22, 1974), 3 SEC Docket 446.

[85] Litigation Release No. 6394 (June 12, 1974), 4 SEC Docket 464.

[86] Litigation Release No. 6199 (January 11, 1974), 3 SEC Docket 384.

[87] Litigation Release No. 6282 (March 18, 1974), 3 Sec Docket 744.

[88] Litigation Release No. 6078 (September 27, 1973), 2 SEC Docket 519.

[89] Litigation Release No. 5951 (June 28, 1973), 2 SEC Docket 64.

[90] Litigation Release No. 5926 (June 11, 1973), 1 SEC Docket No. 20, p. 29.

[91] Securities Act Release No. 5409 (July 24, 1973), 2 SEC Docket 187.

[92] Securities Act Release No. 5507 (June 26, 1974), 4 SEC Docket 500.

[93] Securities Act Release No. 5478 (April 8, 1974), 4 SEC Docket 76.

[94] Securities Act Release No. 5417 (August 28, 1973), 2 SEC Docket 345.

[95] Securities Act Release No. 5415 (August 20, 1973), 2 SEC Docket 313.

[96] Securities Act Release No. 5425 (September 27, 1973), 2 SEC Docket 493.

[97] Securities Act Release No. 5458 (February 20, 1974), 3 SEC Docket 566.

PART 5

INVESTMENT COMPANIES AND ADVISERS

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INVESTMENT COMPANIES AND ADVISERS

Under the Investment Company Act of 1940 and the Investment Advisers Act of 1940, the Commission is charged with extensive regulatory and supervisory responsibilities over investment companies and investment advisers. The primary responsibility for discharging these duties lies with the Division of Investment Management Regulation.

Unlike other Federal securities laws which emphasize disclosure, the Investment Company Act provides a regulatory framework within which investment companies must operate. Among other things the Act: (1) prohibits changes in the nature of an investment company's business or its investment policies without shareholder approval; (2) protects against management self-dealing, embezzlement or abuse of trust; (3) provides specific controls to eliminate or mitigate inequitable capital structures; (4) requires that an investment company disclose its financial condition and investment policies; (5) provides that management contracts be submitted to shareholders for approval, and that provision be made for the safekeeping of assets; and (6) sets controls to protect against unfair transactions between an investment company and its affiliates.

Persons advising others on their securities transactions for compensation must register with the Commission under the Investment Advisers Act. This requirement was extended by the Investment Company Amendments Act of 1970 to include advisers to registered investment companies. The Advisers Act, among other things, prohibits performance fee contracts which do not meet certain requirements; fraudulent, deceptive or manipulative practices; and advertising which does not comply with certain restrictions.

Investment companies and assets under the management of investment advisers constitute important resources for investment in the nation's capital markets. In order to continue their role of channeling individual savings into capital needed for industrial development, investment companies and investment advisers must have the confidence of investors, and the safeguards provided by the Investment Company and Investment Advisers Acts contribute to sustaining such confidence.

PROPOSED LEGISLATION

From time to time the Commission develops and proposes further legislation which it deems necessary in the public interest and for the protection of investors. A number of such proposals have recently been submitted to Congress and are currently awaiting action.

Proposed Oil and Gas Investment Act

In June 1972, the Commission submitted to the Congress a proposed Oil and Gas Investment Act. The proposed legislation would require registration of oil programs and subject them to comprehensive regula-

tion. Oil programs are generally unincorporated associations which are primarily engaged in the business of holding or investing in oil or gas interests. They are designed to enable their investors to obtain directly the tax advantages provided in the Internal Revenue Code for the oil and gas business. Many of the problems with the programs with which this proposed legislation is concerned stem from the fact that generally ownership is separated from control. As a result, the arrangements for the management of oil programs virtually always involve self-dealing and other transactions and practices which may be unfair to investors.

The legislation would provide controls designed to prevent conflicts of interest and unfair transactions between the programs and their managers and to insure financial responsibility of program managers. It would further prohibit changes in fundamental policies of an oil program without approval of the participants, and require that a person acting as a program manager do so under a written contract which contains certain provisions. Some provisions of the proposed statute would be administered primarily by the National Association of Securities Dealers with Commission oversight. These relate to sales charges, sales literature, suitability of an investment and a classification system for the various forms of management compensation.

The legislation was introduced in both houses of the 92d Congress, but was not acted upon. It was reintroduced in the 93d Congress in 1973.[1]

Sale of Investment Adviser

In 1972, the Commission proposed legislation[2] to clarify the ambiguity created by the decision of the Court of Appeals for the Second Circuit in *Rosenfeld* v. *Black*.[3] In that case, the court held that the general principle in equity that a fiduciary cannot sell his office for personal gain is impliedly incorporated into Section 15(a) of the Act which requires shareholder approval of any new investment advisory contract. Consequently, a retiring investment adviser of an investment company violates the Act by receiving compensation which reflects either (1) a payment contingent upon the use of influence to secure approval of a new adviser or (2) an assurance of profits for the successor adviser under a new advisory contract and renewals.

In submitting the proposed legislation, the Commission expressed its view that the principles of equity were appropriately applied to the facts of the *Rosenfeld* case, which involved an outright sale by an investment adviser of its advisory contract with a registered investment company. The sweep of the court's language cast doubt however on whether an investment adviser without incurring liability to the company or its shareholders, could profit when it sold its business by selling its assets.

In its statement accompanying the legislation, the Commission suggested that it would be in the public interest to remove the uncertainty generated by the *Rosenfeld* decision. The amendments are intended to permit an investment adviser, or an affiliated person of an adviser, to obtain a profit in connection with a transaction which results in an assignment of the advisory contract if certain conditions are met. These conditions are designed to prevent an investment adviser or an affiliate from receiving any payment or other benefit in connection with the sale of its business which includes any amount reflecting its assurance that the investment advisory contract will be continued.

The proposed bill was not enacted in the 92d Congress. In 1973 it was reintroduced in modified form and passed by the Senate.[4] In September 1973, similar legislation was introduced in the House of Representatives.[5]

Institutional Disclosure

In the Letter of Transmittal of the Institutional Study Report the Commission stated that "gaps [exist] in the information about the purchase, sale and holdings of securities by major classes of institutional investors," and recommended that such gaps be eliminated by amending the securities laws "to provide the Commission with general authority to require reports and disclosures of such holdings and transactions from all types of institutional investors."[6]

On April 25, 1973, it was announced that

the Commission would draft and sponsor institutional disclosure legislation requiring all institutional investors to report all of their securities holdings and their institution-sized trades.[7] Such institutional disclosure would permit Commission study of the effects of institutional trading and holdings on the securities markets, and the characteristics of institutional investors, for the purpose of developing possible further disclosure requirements and, if needed, further regulatory controls on institutional investors. On July 23, 1973, Senator Harrison A. Williams, Jr., Chairman of the Senate Subcommittee on Securities, introduced legislation in the Senate along these conceptual lines[8] with the Commission's support as to the objectives of the bill. Later, on November 1, 1973, the Commission's own version of institutional disclosure legislation was introduced in the Senate.[9] On April 4, 1974, Representative John E. Moss, Chairman of the Interstate and Foreign Commerce Subcommittee on Commerce and Finance, introduced similar legislation in the House of Representatives.[10]

RULES

The normal continuing review of rules in light of changing conditions and administrative experience resulted in the revision or proposed revision of several rules relating to investment company and investment adviser activities.

Amendment of Rule 17g–1

Rule 17g–1, before amended, required a registered management investment company to provide and maintain a fidelity bond in such reasonable amount as a majority of its board of directors who were not persons covered by the bond should determine, subject to modification by the Commission as to the amount, type, form and coverage of such bond. In the last fiscal year,[11] the Commission amended the Rule to require the amount of the bond to be at least equal to an amount computed in accordance with a schedule set forth in the Rule. The minimum amount depends on the gross assets of the particular investment company.

The amendment also now makes clear that a registered management investment company has the option of maintaining either a single insured bond in which only the investment company is named insured, or a joint insured bond which names as an insured with the investment company one or more additional parties of a type specified in the Rule.

The amended Rule in addition now provides certain minimum factors which must be considered by the directors of investment companies in approving the amount and form of coverage of bonds and the portion of the premium to be paid by investment companies covered under joint insured bonds. Finally, the amendment tightens the cancellation, termination and modification requirements of fidelity bond coverage.

Investment Company Shareholder Account Processing Requirements

During the fiscal year, the Commission took several steps to enable mutual funds to provide more economical service in connection with payroll deduction plans, group rates and retirement plans. In March 1974, the staff posed no objection to the Investment Company Institute's proposal to permit funds to distribute in bulk to employers for distribution to employee participants, dividend statements, proxy statements and shareholder reports, and to permit the automatic redemption of small inactive accounts under certain conditions.[12] At about the same time, the Commission published a proposal to amend Rule 15c1–4 under the Exchange Act. The amendment would relax the Rule's confirmation requirements as to purchases of mutual fund shares pursuant to individual tax-qualified and group plans.[13]

Amendments of Rule 17d–1

Section 17(d) of the Investment Company Act prohibits any affiliated person of or principal underwriter for a registered investment company from effecting any transaction in which the registered company, or a company controlled by it, is a joint or a joint and several participant with the affiliated person or principal underwriter, in

contravention of any rule prescribed by the Commission for the purpose of limiting or preventing participation by the registered or controlled company on a basis different from or less advantageous than that of other participants.

Rule 17d–1 prohibits affiliated persons of and principal underwriters for registered investment companies from effecting any transaction in connection with any joint enterprise or other joint arrangement or profit-sharing plan in which any such registered company, or a company controlled by such registered company, is a participant unless an application regarding such joint enterprise has been filed with, and granted by, the Commission.

In March 1974, the Commission proposed for comment an amendment to Rule 17d–1 which would enable certain affiliated companies and persons affiliated with such companies to participate in joint transactions with registered investment companies and companies controlled by registered investment companies without an order of the Commission. Other described affiliated persons and the principal underwriter of the registered investment company would not be permitted to participate or have a financial interest in the transaction.[14] The amendment would also remove doubt in the present rule by making clear that certain registered small business investment company ("SBIC") stock option plans may become operative without an order of the Commission.

At the close of the fiscal year, the staff was analyzing comments received on the proposal; adoption of a rule in this area was expected soon.

Temporary Rule 6c–2(T) and Proposed Rule 6c–2 Regarding Alaska Native Claims Act Corporations

In February 1974, the Commission adopted Temporary Rule 6c–2(T)[15] to exempt corporations recently organized pursuant to the Alaska Native Claims Settlement Act of 1971[16] ("Settlement Act corporations") from most sections of the Investment Company Act, pending action on proposed Rule 6c–2.

Settlement Act corporations were created to hold, administer, and distribute the land, mineral properties and cash which the United States Government awarded Alaska's Native Indian, Aleut and Eskimo population in settlement of their aboriginal claims to land in the State of Alaska. These corporations are owned and managed exclusively by the Alaska natives; over 200 such entities, representing the various regions and villages in the state, have been established. Stock in the corporations has been given to each eligible native and may not be traded until after January 1, 1992. These corporations may be viewed as investment companies within the meaning of the Act because, pursuant to the terms of the Settlement Act, they have received significant amounts of the cash portion of the settlement prior to acquisition of the land and mineral assets to which they are entitled, and much of this cash has been invested in securities.

Under Rule 6c–2(T), Settlement Act corporations that register with the Commission under Section 8(a) will be exempt from all provisions of the Act except Sections 9, 17, 36, and 37.[17] Proposed Rule 6c–2, if adopted as proposed, would provide the same relief.

MUTUAL FUND DISTRIBUTION

The Commission has for some time been concerned about inefficiencies and inequities in the process by which mutual funds are sold to the public. Of particular interest has been the retail price maintenance system, a fundamental aspect of the distribution process. Under present law, in the sale of a mutual fund security to the public, the principal underwriter and any dealer must sell the security at the current public offering price—net asset value plus stated sales charge—set forth in the prospectus. The Section thereby precludes retail price competition in the sale of mutual fund shares.

In 1969 the Committee on Banking and Currency of the United States Senate requested that the Commission study the potential consequences of repeal of the section and report its findings to the Committee. Such a study was conducted by the Commission's staff, and its report, entitled

"The Potential Economic Impact of the Repeal of Section 22(d)," was transmitted to the Committee in November 1972. The Commission held public hearings in February and March 1973, to explore the major issues in the marketing of mutual funds and the laws and regulations which affect them. A broad range of subjects was covered including further liberalization of mutual fund advertising rules; measurement and portrayal of investment results and proposed rules to permit group sales or pooling of orders for the purpose of obtaining quantity discounts. The public hearings included 15 days of testimony from 72 witnesses. Among others testifying were representatives of the Department of Justice, the NASD, mutual fund underwriters and managers and various trade associations (including the Investment Company Institute, the No-Load Mutual Fund Association, the Securities Industry Association, the Independent Broker Dealers Trade Association, the National Mutual Fund Managers Association, and the American Life Insurance Association). More than 100 written submissions, many of which were quite extensive, were also made.

At the end of the fiscal year, the staff was nearing completion of a comprehensive report on the mutual fund distribution system and was preparing to submit its recommendations to the Commission.

As part of its efforts to deal with the problems in this area the Commission adopted Rule 22d–2, effective as of March 29, 1974.[18] The Rule permits an investment company to offer a shareholder who has redeemed investment company shares a privilege to reinvest an amount not in excess of the proceeds, in shares of the same company or in any investment company which offers shareholders in that investment company an exchange privilege at net asset value. This reinvestment privilege (a) must be offered pursuant to a uniform offer described in the prospectus or supplements thereto filed pursuant to Rule 424(c) under the Securities Act; (b) may be exercised only once by an investor with respect to any particular investment company; and (c) must be exercised within 30 days of redemption.

Action may be taken in the near future with respect to two other significant rule proposals which were published shortly before the 1973 mutual fund distribution hearings and which were the subject of comment and testimony at those hearings. One is a proposed amendment of Rule 22d–1 under the Investment Company Act to permit quantity discounts for group purchases of open-end investment company securities under certain limited circumstances.[19] The other is a proposed amendment of Rule 134 under the Securities Act to permit greater flexibility in investment company advertisements by expanding the categories of information includible in the advertisements.[20]

Litigation Relating to Mutual Fund Distribution

In early 1973, the Department of Justice and private persons separately brought civil suits in the District Court for the District of Columbia, alleging that the defendants (including several funds, underwriters, dealers, the NASD, and the Investment Company Institute) had conspired, in violation of the Federal antitrust laws, to inhibit a market for brokerage transactions in fund shares and to suppress growth of a secondary dealer market in fund shares. Specifically, plaintiffs attacked the agreements between the principal underwriters and the dealers in fund shares, which require dealers to sell to everyone at net asset value plus a stated sales load (the current public offering price). Moreover, all redemptions of shares are made by a particular fund at the prevailing net asset value. This precludes a competitive secondary market.

Defendants moved to dismiss the complaints on various grounds. The Commission set out its position in a letter to the district court. After oral argument, on December 14, 1973, the court dismissed the complaints for failure to state claims upon which relief could be granted.[21]

The court held that the challenged conduct was explicitly authorized by the Act and thereby immune from antitrust challenge. The court noted first that the mutual fund distribution network was "patently repugnant to the free and open competition requirements of the Sherman Act," but that plaintiffs had conceded antitrust immunity

for the primary distribution system. The court stated that plaintiffs had failed to take into account the fact that the maintenance of a free and open secondary market would be totally inconsistent with and might destroy the primary marketing system created by the Act and particularly by Section 22(d), the repeal of which, the court noted, had several times been urged upon Congress with no success. The court further stated that Congress knew of the existence before the passage of the Act of a secondary market in shares of mutual funds termed the "bootleg" market, and wanted to suppress this market. By Section 22(f), a fund was given the right to limit transferability of its shares; by Section 22(d), all dealers, including non-contract dealers, were required to maintain the public offering price. "Congress designed Sections 22(d) and 22(f) to create and protect a primary distribution system which is repugnant to the antitrust laws and did so in complete recognition of the fact that the legislature would frustrate the growth of a free secondary market." In this manner, non-contract dealers would be deprived for all practical purposes of a supply of fund shares other than through the contract dealer network.

The court also held that the practices challenged were impliedly immune from the antitrust laws. The court found that the Commission and the NASD were given pervasive statutory control over the area. Indeed, Section 15A(b)(8) specifically requires the Commission to employ antitrust standards when reviewing rules promulgated by the NASD. The court concluded that Congress "clearly intended to substitute a pervasive regulatory scheme, *i.e.*, Section 22 of the 1940 Act, for the usual antitrust prohibitions in the narrower area of distribution and sales of mutual fund shares . . ."

The Department of Justice filed an appeal directly to the Supreme Court under the Expediting Act. On October 7, 1974, the Supreme Court noted probable jurisdiction.

VARIABLE ANNUITY ILLUSTRATIONS

For a number of years, representatives of the life insurance industry have maintained that variable annuity contracts could best be explained through the use of illustrations based on hypothetical investment experience. These illustrations have not been permitted by the Commission's 1957 Statement of Policy which governs.

After the close of the fiscal year, the Commission proposed for comment an amendment to the Statement of Policy to permit variable annuity illustration. The proposal is designed to allow portrayal of the operation and unique characteristics of variable annuities and provide a basis for meaningful comparisons of potential costs and benefits of different variable annuity contracts.[22]

RECIPROCAL BROKERAGE PRACTICES

Over the past several years, the Commission has been quite concerned with reciprocal brokerage practices. And, in February 1972, in its "Statement on the Future Structure of the Securities Markets," the Commission urged the NASD to initiate measures designed to terminate reciprocal practices. Thereafter, in May 1973, the NASD adopted a new sub-section (k) to Article III, Section 26 of its Rules of Fair Practice (the "Anti-Reciprocal Rule"). This rule broadly prohibits reciprocal arrangements with respect to the sale of mutual fund shares and the allocation of brokerage by fund managers.

Recently, the NASD and representatives of the investment company and securities industries requested the Commission to review suggested interpretations of and amendments to the Anti-Reciprocal Rule. In response, the Commission at the close of the fiscal year announced that it would hold public hearings[23] to consider the following issues: (1) whether there is any relationship between the comparatively high portfolio turnover rates of investment companies and the allocation of brokerage on the basis of sales of shares of investment companies; (2) whether existing shareholders benefit from such allocations; (3) whether there is any pressure on investment companies to select broker-dealers which do not have adequate capabilities to provide best execution; (4) whether broker-dealers recom-

mend shares of particular investment companies to customers on the basis of allocation of brokerage; and (5) whether such allocations of brokersage create anticompetitive impacts on smaller investment companies and broker-dealers.

NUMBER OF REGISTRANTS

As of June 30, 1974, there were 1,288 investment companies registered under the Investment Company Act, with assets having an aggregate market value of over $62 billion. Those figures represent a decrease of 73 in the number of registered companies and a decrease of nearly $11 billion in the market value of assets since June 30, 1973. Further data is presented in the statistical section of this Report. At June 30, 1974, 3,014 investment advisers were registered with the Commission, representing an increase of 122 from a year before.

During the year, the staff of the Commission conducted 168 investment company examinations and 283 investment adviser examinations. As a result of the Commission's inspection and investigation program, numerous violations of the Investment Company Act and of the Investment Advisers Act were uncovered, and approximately $669,281 was returned to investment companies and their shareholders. Forty-one investment company and 16 investment adviser matters were referred to the Division of Enforcement for possible action.

APPLICATIONS

One of the Commission's principal activities in its regulation of investment companies and investment advisers is the consideration of applications for exemptions from various provisions of the Investment Company and Investment Advisers Acts or for certain other relief under these Acts. Applicants may also seek determinations of the status of persons or companies. During the fiscal year, 279 applications were filed under both acts, and final action was taken on 261 applications. As of the end of the year, 176 applications were pending under both Acts. Of the totals described, the predominant number were applications under the Investment Company Act. With respect to the Advisers Act, only four of the applications filed sought relief from its provisions; final action was taken on two such applications, and four were pending at year end.

By virtue of Section 17 of the Investment Company Act, affiliates of a registered investment company cannot participate in a joint arrangement or joint enterprise with the registered company or purchase securities from or sell securities to the registered company unless they first obtain approval of the Commission pursuant to Section 17. Many of the applications filed under the Investment Company Act relate to this Section.

Section 3(a)(1) of the Act defines "investment company" to include any issuer which is engaged primarily in the business of investing, reinvesting or trading in securities. However, Section 2(b) exempts from all provisions of the Act any agency, authority or instrumentality of the United States.

Student Loan Marketing Association ("SLMA") is a United States Government-sponsored private corporation created by the 1972 Amendments to the Higher Education Act of 1965. Its purpose is to provide liquidity to lenders under the Guaranteed Student Loan Program ("GSLP"), another Congressional program pursuant to which the United States Government, the States, and a limited number of non-private agencies insure loans made to students by eligible lenders. SLMA is authorized to make advances on the security of, purchase, service, sell or otherwise deal in GSLP loans at prices and on terms and conditions determined by SLMA.

SLMA filed an application pursuant to Section 6(c) of the Act for exemption from all of the provisions of the Act.[24] SLMA maintained that the participation in and control over its activities by the United States Government was sufficiently comprehensive to warrant treatment of SLMA as an instrumentality of the United States Government within the meaning of Section 2(b). SLMA cited the control of the Government over its functions and the statutory privileges accorded its securities[s]privileges generally reserved for quasi-governmental organizations. SLMA stock and obligations are "exempt securities" within the meaning of the Federal securities laws to the same extent as securities which are direct obliga-

tions of or obligations guaranteed as to principal or interest by the United States. SLMA argued that certain of its functions could not practically be performed if it were required to register. Based on the application, the Commission exempted SLMA from the Act to the extent it might be deemed subject to it.[25]

The Bank of New York acts as custodian of the assets of eight plans for the accumulation of mutual funds shares. Since amounts contributed by participants in such plans are invested in mutual fund shares, the plans themselves are investment companies and are registered under the Act as unit investment trusts. Section 26(a)(2)(D) of the Act requires a custodian of a unit investment trust to be in possession of all securities or other property in which the funds of the trust are invested. Strict compliance with this provision requires such a custodian to have physical possession of stock certificates representing mutual fund shares owned by a plan. However, the Bank, together with the sponsors of the involved plans, applied for an exemption from Section 26(a)(2)(D) to permit the Bank to hold up to 5 percent of the fund shares owned by the plans in the form of "book shares," *i.e.*, as entries on the records of the transfer agent of the mutual funds.[26] The Commission, by the Division of Investment Management Regulation, approved the application based on the applicants' statement of the impracticality of compliance and the lack of danger to investors.[27]

As previously reported,[28] in September 1971, Pacific Scholarship Trust Sponsored by the Pacific Scholarship Fund filed an application requesting exemptions from certain sections of the Investment Company Act to permit the sale of scholarship plans. The plans would require investors to deposit sums in bank savings accounts, from which earnings would be periodically transferred to a trust fund and invested to provide funds for the eventual college education of designated child beneficiaries. A portion of the payouts to students who did attend college would be derived from amounts forfeited by other investors in the plans. A forfeiture would result if the designated child failed to enter college or to complete the first year successfully, or if the investor failed to maintain his savings account or to make required periodic payments. In order to offer plans which include such a forfeiture feature, the trust required exemptions from several sections of the Act, including an exemption from Section 27(c)(1), which prohibits the sale of non-redeemable periodic payment plan certificates. After hearings, the parties waived an initial decision and the Commission heard oral argument.

On October 31, 1973, the Commission denied an exemption from Section 27(c)(1). It found that applicant had failed to show forfeitures and dilution of planholder interests to be consistent with the protection of investors and the purposes of the Act or to be necessary or appropriate in the public interest.[29] In reaching this result, the Commission specifically overruled its previous decision in *The Trust Fund Sponsored by the Scholarship Club, Inc.*[30]

Litigation Involving Applications

In *Independent Investor Protective League* v. *S.E.C.*[31] the Court of Appeals for the Second Circuit dismissed, for lack of standing, petitions filed by the Independent Investor Protective League, an organization of individual investors, to review the propriety of the Commission's entry of orders granting exemptions from provisions of the Investment Company Act to certain applicants. The review provisions of the Act grant standing to "any person or party aggrieved" by an order of the Commission. The court agreed with the Commission that, in the absence of a showing that the League or any of its members owned securities of the applicant companies or suffered any actual injury or discrimination as a result of the Commission's orders, the League had no standing to obtain court review under the Investment Company Act. The court deemed insufficient petitioner's claim that its members might in the future own securities of the applicant companies.

NOTES FOR PART 5

[1] H.R. 6821, S. 1050 (93d Cong., 1st Sess.).
[2] S. 3681, H.R. 15304 (92d Cong. 2d Sess.).
[3] 445 F. 2d 1337 (1971).
[4] S. 470 (93d Cong., 1st Sess.).
[5] H.R. 10570 (93d Cong., 1st Sess.).
[6] SEC, *Institutional Investor Study Report*, H.R. Doc. 64, 92d Cong., 1st Sess., Vol. 1 at X, XI (March 10, 1971).
[7] *Democracy in the Markets*, an Address by then SEC Chairman G. Bradford Cook Before the Economic Club of Chicago, April 25, 1973, at 20–22.
[8] S. 2234 (93d Cong., 1st Sess.).
[9] S. 2683 (93d Cong., 1st Sess.).
[10] H.R. 13986 (93d Cong., 2d Sess.).
[11] Investment Company Act Release No. 8267 (March 14, 1974), 3 SEC Docket 704.
[12] Letter from Director, Division of Investment Management Regulation, to President, Investment Company Institute, March 13, 1974.
[13] Investment Company Act Release No. 8275 (March 15, 1974), 3 SEC Docket 714.
[14] Investment Company Act Release No. 8273 (March 14, 1974), 3 SEC Docket 711.
[15] Investment Company Act Release No. 8251 (Feburary 26, 1974), 3 SEC Docket 631.
[16] 43 U.S.C. 1601, *et seq.*
[17] Section 9 generally prohibits certain persons from controlling an investment company. The remaining sections essentially are designed to prevent self dealing on the part of the persons controlling the investment company.
[18] Investment Company Act Release No. 8235 (February 20, 1974), 3 SEC Docket 579.
[19] Investment Company Act Release No. 7571 (December 21, 1972).
[20] Securities Act Release No. 5537, Investment Company Act Release No. 7632 (January 18, 1973).
[21] *U.S.* v. *NASD, dismissed sub nom. Haddad* v. *Crosby Corp.*, CCH Fed. Sec. L. Rep. Para. 94,319, 1973, probable jurisdiction noted U.S.S. Ct. (October 14, 1974).
[22] Securities Act Release No. 5516 (July 30, 1974), 4 SEC Docket 647.
[23] Securities Exchange Act Release No. 10867 (June 20, 1974), 4 SEC Docket 474.
[24] Investment Company Act Release No. 8077 (November 8, 1973), 3 SEC Docket 23.
[25] Investment Company Act Release No. 8121 (December 3, 1973), 3 SEC Docket 186.
[26] Investment Company Act Release No. 8136 (December 12, 1973), 3 SEC Docket 241.
[27] Investment Company Act Release No. 8176 (January 11, 1974), 3 SEC Docket 381.
[28] 39th Annual Report, p. 104.
[29] Investment Company Act Release No. 8065 (October 31, 1973), 2 SEC Docket 702.
[30] Investment Company Act Release No. 5524 (October 25, 1968).
[31] 495 F. 2d 311 (C.A. 2, 1974).

PART 6

PUBLIC UTILITY HOLDING COMPANIES

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PUBLIC UTILITY HOLDING COMPANIES

Under the Public Utility Holding Company Act of 1935, the Commission regulates interstate public utility holding company systems engaged in the electric utility business and/or retail distribution of gas. The Commission's jurisdiction also covers natural gas pipeline companies and other non-utility companies which are subsidiary companies of registered holding companies. There are three principal areas of regulation under the Act: (1) the physical integration of public utility companies and functionally related properties of holding company systems, and the simplification of intercorporate relationships and financial structures of such systems; (2) the financing operations of registered holding companies and their subsidiary companies, the acquisition and disposition of securities and properties and certain accounting practices, servicing arrangements, and intercompany transactions; (3) exemptive provisions relating to the status under the Act of persons and companies, and provisions regulating the right of persons affiliated with a public-utility company to become affiliated with another such company through acquisition of securities.

COMPOSITION

At the end of calendar year 1973, there were 22 holding companies registered under the Act.[1] Twenty were included in the 17 "active" registered holding company systems.[2] The remaining two registered holding companies, which are relatively small, are not considered part of "active" systems.[3] In the 17 active systems, there were 78 electric and/or gas utility subsidiaries, 63 non-utility subsidiaries, and 16 inactive companies, or a total, including the parent holding companies and the subholding companies, of 177 system companies. Table 27 in Part 9 lists the active systems and their aggregate assets.

PROCEEDINGS

New England Electric System.[4] The Commission approved a plan submitted by New England Electric System ("NEES"), for the sale of three of its gas utility subsidiaries and of an LNG-gas subsidiary to Eastern Gas and Fuel Associates, an exempt holding company.[5] A Massachusetts township and other intervenors which had opposed the acquisition by Eastern entered into a settlement and withdrew from the proceeding. The Commission noted that the acquisition by Eastern was not subject to its approval under Section 10, and stated: "Since the participants have settled their dispute and withdrawn from the proceeding, we have no occasion . . . to consider our jurisdiction, if any, with respect to the alleged consequences of Eastern's acqusition."

In a separate proceeding the Commission approved the sale, for cash, of Lawrence Gas Company, ("Lawrence"), the last remaining NEES gas subsidiary, to Springfield Gas Light Company (now Bay State Gas Company), an exempt holding company.[6] The plan provided for the retirement

of the publicly held minority stock in Lawrence. In addition, Bay State agreed to pay for the minority stock the same price per share that NEES received for its stock interest in Lawrence.[7]

The Association of Massachusetts Consumers opposed the acquisition and requested a hearing. The Commission denied the request[8] and a subsequent petition for rehearing.[9] The Association has filed a petition for review in the court of appeals,[10] which at the close of the fiscal year was pending.

Utah Power and Light Company. An application was filed by Utah Power and Light Company ("Utah"), an operating company as well as a registered holding company, seeking permission to acquire all of the assets of The Western Colorado Power Company ("Western Colorado"), its sole subsidiary utility company, thus terminating its holding-company status under the Act. The Commission ordered a hearing principally to determine whether the proposed merger of the Western Colorado system with the Utah system would satisfy the integration standards of Section 11(b)(1) of the Act.[11] Prior to hearing, Utah withdrew its application, consented to an order that it divest Western Colorado pursuant to Section 11(b)(1), and submitted a plan under Section 11(e) to sell the assets of Western Colorado. Utah accepted one of three final offers for the assets, subject to Commission approval. A hearing has been held on the proposed sale. At the close of the fiscal year, the matter was pending.

Delmarva Power & Light Company.[12]—On June 26, 1974, an administrative law judge rendered an initial decision in consolidated administrative proceedings to determine whether under Section 11(b)(1) of the Act Delmarva, an operating utility company and a registered holding company, should be required to divest its gas utility properties and whether Delmarva's application for exemption from the Act under Section 3(a)(2), should be granted. The administrative law judge found that Delmarva's gas sytem was not retainable under Section 11(b)(1), but that Delmarva was entitled to an exemption from the Act under Section 3(a)(2). He accordingly concluded that the 11(b)(1) proceeding should be dismissed and that divestiture should not be ordered. He further concluded that the current shortage of gas supply made it unnecessary to require at this time that the exemption be conditioned on divestiture of the gas properties. The Division's petition for review was granted by the Commission and briefs have been filed.

Union Electric Company.[13] The Commission granted Union Electric Company ("Union"), an exempt holding company, permission to acquire the common stock of Missouri Utilities Company("MU").[14] The Commission also continued Union's exemption as a holding company under Section 3(a)(2) of the Act.

The Commission declined to impose conditions requiring Union to divest MU's small water properties and a small isolated electric distribution property of MU which, unlike the other properties of MU, would not be a part of Union's integrated electric system. It held that an acquisition by an exempt holding company was not rigidly governed by the integration requirements of Section 11(b)(1) and that the minuscule size and other characteristics of the nonintegrated properties did not warrant a finding that their acquisition by Union, as an exempt holding company, was contrary to the Act under the "unless and except" clause of Section 3(a).

The Commission also held that it would not order at this time divestiture of the gas properties of Union and MU. It took note of the recent adverse developments in gas supply and concluded that it could not decide on the record whether such divestiture should be ordered. It considered further hearings in the pending proceeding inappropriate in view of the current state of the industry. The City of Cape Girardeau, Missouri, has filed a petition for review in the court of appeals, which is pending.[15]

General Public Utilities Corporation. The Commission authorized, pursuant to Sections 6 and 7 of the Act, certain amendments to the first mortgage bond indenture of Metropolitan Edison Company ("Met Ed"), a subsidiary of General Public Utilities, and authorized also the solicitation of proxies for bondholder consent to those amendments.[16] Later, Met Ed filed a request for an extension of time to solicit the requisite

consents. The Commission ordered a hearing,[17] at which a bondholder, Walplan and Company, opposed the solicitation, alleging that the proxy material was false and misleading. Walplan also urged that the amendments were contrary to the Act. In its brief to the Commission, the Division supported Met Ed's position. The matter is pending before the Commission.

Prior to its appearance in the administrative proceeding, Walplan sued Met Ed[18] alleging that Met Ed's proxy statement was false and misleading, substantially in the same respects as urged before the Commission. The suit was dismissed by the district court. Walplan appealed.[19] The Commission filed a brief *amicus curiae* urging that the district court had no jurisdiction to entertain the complaint. The case is now awaiting decision by the court of appeals.

John H. Ware—Penn Fuel Gas, Inc. An individual, John H. Ware, III, filed an application in 1969 to acquire a controlling stock interest in North Penn Gas Company, an operating gas utility, which was at that time unaffiliated with Ware or Penn Fuel Gas, Inc., an exempt utility holding company controlled by Ware. Ware's application was approved on condition that the minority stockholder interest in North Penn be eliminated.[20] Ware and Penn Fuel filed a plan under Sections 9 and 10, offering to issue shares of Penn Fuel stock in exchange for all the outstanding shares of North Penn stock held by Ware and by the minority.

The Commission issued a notice and order for hearing.[21] The principal issue was whether the proposed exchange offer satisfied Ware's commitment to eliminate the North Penn minority in light of the fact that, under the exchange offer, the minority stockholders of North Penn would become minority stockholders of Penn Fuel A number of minority shareholders appeared to oppose the exchange offer. The matter was pending at the close of the fiscal year.

FINANCING

Volume

During fiscal 1974, a total of 15 active registered holding-company systems issued and sold 62 issues of long-term debt and capital stock pursuant to authorizations by the Commission under Sections 6 and 7 of the Act. All of the issues were sold at competitive bidding. Except for approximately $85 million needed to refund maturing long-term debt, all of the issues were for purposes of raising new capital. Table 28 in Part 9 presents the amount and types of securities issued and sold by these holding company systems.

The volume of external financing by these companies aggregated $2.562 billion in fiscal 1974, a decrease of 5.7 percent from the total of $2.715 billion the prior fiscal year.

Leasing

Rule 7(d) adopted in fiscal year 1973 requires lessors of utility equipment to file Form U 7D for each lease of utility equipment.[22] During the initial filing period ending July 31, 1973, a total of 21 certificates covering $562 million in leased facilities were filed. During the period August 1, 1973–June 30, 1974, a total of 16 certificates were filed covering leased property valued at approximately $100 million.

Rule 7(d) concerns the status of the lessor under Sections 2(a)(3) and 2(a)(4) of the Act, but does not deal with the regulatory requirements applicable to the public-utility company as lessee. Since Section 2(a)(22) of the Act includes a lease within the definition of the word "acquisition," the leasing of utility assets, such as generating equipment or nuclear fuel, is an acquisition subject to Section 10. In a case of first impression, the Commission approved under Section 10 the leasing of nuclear fuel, at an estimated cost of about $40 million, by Arkansas Power & Light Co. ("AP&L"), a subsidiary of Middle South Utilities, Inc.[23] Although, as a matter of accounting, AP&L did not propose to capitalize the lease obligation, the Commission stressed that the lease must be considered under Section 10(b)(3), which "requires registered systems to maintain an appropriate balance of equity capital . . . [which] requirement cannot be avoided by indiscriminate use of lease obligations.[24] The Commission found that the lease in question did not have the effect proscribed by Section 10(b)(3).

Competitive Bidding

The Commission's Rule 50, adopted in 1941,[25] requires that securities issued by registered holding companies or their subsidiaries be sold by competitive bidding; where two or more independent bids have been received, the best bid may be accepted by the issuer without further authorization by the Commission. For more than 30 years, Rule 50 has provided an effective and economical procedure for marketing utility securities. In 1974, a group of registered holding companies and security underwriters informally presented to the Commission information and studies purporting to show that recent, generally unsettled securities markets, high interest rates and the utilities' unprecedented demand for new capital, have (1) adversely affected the capacity of the securities industry to handle utility common stock issues and (2) rendered it unfeasible for the utility industry to raise effectively the required common equity capital through competitive bidding.

Based on that preliminary presentation and on its own awareness of prevailing conditions in the securities markets, the Commission on July 19, 1974 noticed for comment a proposed temporary suspension of the competitive bidding requirements of Rule 50 with respect to the sale of common stock of registered holding companies. In its release, the Commission stated, ". . . it appears that registered holding companies under our jurisdiction have reason for concern as to their ability to comply with Rule 50 in the immediate future. The risks of continued insistence on competitive bidding procedures for holding company common stock issues seem substantial in comparison with the effects of a temporary suspension of that requirement."[26] The issuance and sale of preferred stocks and debt obligations of registered holding companies or their subsidiaries would however continue to be subject to the full requirements of Rule 50.

Revenue Bonds

As an additional source of capital, electric utility companies have turned increasingly to the use of tax-exempt revenue bonds to finance the substantial costs of pollution control equipment. Typically, such financing arrangements, made with local governmental authorities, involve the issue and sale of revenue bonds by the authority in an amount equal to the estimated cost of the facilities; disbursement of the bond proceeds to cover construction expenditures; and, when construction is completed, the sale of the facilities to the utility company pursuant to an installment-sale contract. The sale contract, which is pledged as security for the revenue bonds, obligates the utility company to make semi-annual payments thereunder in amounts sufficient to cover interest and principal, when due, on the related revenue bonds. In some cases the company also pledges a special series of first mortgage bonds issued under its own mortgage indenture as additional security for holders of the revenue bonds.

In each case the transaction is "capitalized" on the company's books, i.e., the physical equipment is included in plant account and the liability (equal to the principal amount of the related revenue bonds) is included in long-term debt. Besides facilitating the companies' compliance with a wide range of laws and regulations aimed at environmental protection, the tax-free revenue bond financings provide the companies with capital at costs considerably below the current costs of direct financing.

Where a revenue bond transaction involves a registered holding company or any of its subsidiary companies, the Commission's approval must be obtained under applicable provisions of the Act; during fiscal 1974 the first significant number of such transactions were authorized. In fiscal year 1974, applications filed by 16 electric-utility companies involved revenue bond agreements with authorities acting under the laws of ten states.[27] The applications covered approximately $263 million principal amount of revenue bonds;[28] and in the two months immediately following the close of fiscal 1974, filings covering another $217 million principal amount were pending.

NOTES TO PART 6

[1] One holding company, VGS Corporation, terminated its registration during the year.

[2]Three of the 20 are subholding utility companies in these systems. They are The Potomac Edison Company and Monongahela Power Company, public utility subsidiaries of Allegheny Power System, Inc., and Southwestern Electric Power Company, a public utility subsidiary of Central and South West Corporation.

[3]These holding companies are British American Utilities Corporation; Kinzua Oil & Gas Corporation and its subsidiary company, Northwestern Pennsylvania Gas Corporation.

[4]Previously reported in 39th Annual Report, p. 110.

[5]Holding Company Act Release No. 18132 (October 23, 1973), 2 SEC Docket 635.

[6]Holding Company Act Release No. 18149 (October 31, 1973), 2 SEC Docket 680.

[7]Application for enforcement of the plan with respect to those minority shareholders of Lawrence who have not surrendered their stock was filed on July 1, 1974, in the United States District Court for the District of Massachusetts, Civil Action No. 74–2466M. The application was later approved by the court.

[8]Holding Company Act Release No. 18149 (October 31, 1973), 2 SEC Docket 680.

[9]Holding Company Act Release No. 18254 (January 11, 1974), 3 SEC Docket 373.

[10]*Association of Massachusetts Consumers, Inc.* v. *SEC*, C.A.D.C., No. 74–1325.

[11]Holding Company Act Release No. 18189 (November 27, 1973), 3 SEC Docket 128.

[12]Previously reported, 39th Annual Report, p. 110; 38th Annual Report, p. 108.

[13]Previously reported in 39th Annual Report, p. 110; 38th Annual Report, p. 109, and 37th Annual Report, pp. 172–173.

[14]Holding Company Act Release No. 18368 (April 10, 1974), 4 SEC Docket 89.

[15]*City of Cape Girardeau* v. *SEC*, C.A.D.C. No. 74–1590.

[16]Holding Company Act Release No. 18001 (June 12, 1973), 1 SEC Docket No. 20, p. 16.

[17]Holding Company Act Release No. 18220 (December 13, 1973), 3 SEC Docket 236.

[18]E.D. Pa. No. 73–1684 (July 24, 1973).

[19]*Walplan and Company* v. *Metropolitan Edison Co.*, C.A. 3, No. 74–1099.

[20]Holding Company Act Release No. 16319 (March 29, 1969).

[21]Holding Company Act Release No. 18344 (March 26, 1974), 3 SEC Docket 762.

[22]A summary explanation of Rule 7(d) is given in the 39th Annual Report, p. 112.

[23]Holding Company Act Release No. 18442 (June 4, 1974), 4 SEC Docket 395.

[24]Holding Company Act Release No. 18442, p. 6, 4 SEC Docket 397.

[25]Holding Company Act Release No. 2676 (April 8, 1941).

[26]Holding Company Act Release No. 18504, 4 SEC Docket 604.

[27]See, e.g., *Georgia Power Company*, Holding Company Act Release No. 18088 (September 12, 1973), 2 SEC Docket 438.

[28]This figure includes $73 million approved just prior to the start of fiscal 1974.

PART 7

CORPORATE REORGANIZATIONS

PART 7

CORPORATE REORGANIZATIONS

The Commission's role under Chapter X of the Bankruptcy Act, which provides a procedure for reorganizing corporations in the United States district courts, differs from that under the various other statutes which it administers. The Commission does not initiate Chapter X proceedings or hold its own hearings, and it has no authority to determine any of the issues in such proceedings. The Commission participates in proceedings under Chapter X to provide independent, expert assistance to the courts, participants, and investors in a highly complex area of corporate law and finance. It pays special attention to the interest of public security holders who may not otherwise be respresented effectively.

Where the scheduled indebtness of a debtor corporation exceeds $3 million, Section 172 of Chapter X requires the judge, before approving any plan of reorganization, to submit it to the Commission for its examination and report. If the indebtedness does not exceed $3 million, the judge may, if he deems it advisable to do so, submit the plan to the Commission before deciding whether to approve it. When the Commission files a report, copies or summaries must be sent to all security holders and creditors when they are asked to vote on the plan. The Commission has no authority to veto a plan of reorganization or to require its adoption.

The Commission has not considered it necessary or appropriate to participate in every Chapter X case. Apart from the excessive administrative burden, many of the cases involve only trade or bank creditors and few public investors. The Commission seeks to participate principally in those proceedings in which a substantial public investor interest in involved. However, the Commission may also participate because an unfair plan has been or is about to be proposed, public security holders are not represented adequately, the reorganization proceedings are being conducted in violation of important provisions of the Act, the facts indicate that the Commission can perform a useful service, or the judge requests the Commission's participation.

The Commission in its Chapter X activities has divided the country into five geographical areas. The New York, Chicago, Los Angeles and Seattle regional offices of the Commission each have responsibility for one of these areas. Supervision and review of the regional offices' Chapter X work is the responsibility of the Division of Corporate Regulation of the Commission, which, through its Branch of Reorganization, also serves as a field office for the southeastern area of the United States.

SUMMARY OF ACTIVITIES

In fiscal year 1974, the Commission entered 23 new Chapter X proceedings involving companies with aggregate stated assets of approximately $1.1 billion and aggregate indebtedness of approximately $1.0 billion.

Including the new proceedings, the Commission was a party in a total of 132

reorganizations proceedings during the fiscal year.[1] The stated assets of the companies involved in these proceedings totaled approximately $3.3 billion and their indebtedness about $2.8 billion.

During the fiscal year, 17 proceedings were closed, leaving 115 in which the Commission was a party at fiscal year end.

ADMINISTRATIVE MATTERS

In Chapter X proceedings, the Commission seeks to protect the procedural and substantive safeguards afforded parties in such proceedings. The Commission also attempts to secure judicial uniformity in the construction of Chapter X and the procedures thereunder.

East Moline Downs, Inc.[2]—This publicly-held company operates a horse race track. It filed a voluntary petition under Chapter X. A number of mechanics lien claimants filed an answer to the petition alleging essentially that it was "unreasonable to expect that a plan of reorganization could be effected." The claimants sought dismissal of the petition for lack of good faith; and the special master so recommended. The district judge, however, approved the petition, relying in part on a commitment of a substantial loan to the debtor that was negotiated subsequent to the special master's report. The lien claimants appealed and their appeal is still pending. In the meantime, despite the pendency of the appeal, the district court approved a plan of reorganization that incorporates the loan commitment and provides for the continuation of the debtor's operations.

Imperial '400' National Inc.[3]—The district judge discharged counsel for the trustee pursuant to a resolution by the Judicial Council of the Third Circuit to the effect that when a client of counsel for a Chapter X trustee or of his law firm is a plan proponent there is "the appearance of a conflict of interest."[4] The district court[5] refused a mandamus application seeking relief against the council. The court of appeals on appeal from that order, in view of the long lapse of time since counsel's removal, remanded the case for reconsideration.[6] The Judicial Council petitioned for a rehearing. It asserted that the remand for a hearing should have been made to the Judicial Council rather than to the district court. The court of appeals however denied a rehearing since the district court was "*au courant* with the affairs of the case."[7] Subsequently, the district court accepted the trustee's counsel's resignation *nunc pro tunc* as of the date of the original order of removal.

Traders Compress Company.[8]—As previously reported,[9] the debtor, a small publicly-owned corporation, is engaged primarily in the distribution of liquified petroleum gas ("LPG") to over 8,500 rural customers in Oklahoma. A major supplier has sought to discontinue sales of LPG to the debtor, asserting a shortage of supply. The trustee, supported by the Commission, obtained a district court order permanently enjoining the supplier from terminating its agreement to supply the debtor. The Commission argued that the Chapter X court had summary jurisdiction to enter the injunction in order to preserve the going-concern value of the debtor for the benefit of its creditors and shareholders if local law prohibited termination of the supply contract. The court found that the termination was discriminatory and violated state public utility and antitrust laws. During the fiscal year, the supplier withdrew its appeal from the order.

Equity Funding Corp. of America.[10]—Two days before the debtor filed its Chapter X petition, its depository banks set-off about $10 million in deposits against secured notes of Equity Funding. The order approving the Chapter X petition directed the banks to reverse the set-offs, and the banks appealed. The court of appeals granted a temporary stay of the district court's order.

Prior to the submission of briefs on the merits, the trustee stipulated to a dismissal of the appeal and the retention by the banks of the funds set-off. Trustee's counsel was of the opinion that the reorganization court lacked summary jurisdiction over this matter; but no plenary action was initiated by the trustee. The Commission urged that a reorganization court has power to prevent a set-off which would interfere with the continued operation of the business being reorganized.[11] Such power does not alter the underlying rights of either party. Without the set-off the trustee would have use of

the debtor's bank account; the estate would remain fully indebted to the bank; and the plan of reorganization would give equitable recognition of any security interest the bank might have had in the bank account.

The Supreme Court subsequently dealt with the subject of set-off in reorganization proceedings, in an aspect of the reorganization of the Penn Central Transportation Company under Section 77. In its opinion, the Court concluded that a set-off "is a form of discrimination to which the policy of Section 77 is opposed. As a general rule of administration . . . the set-off should not be allowed."[12]

In the Equity Funding proceeding, the district court also authorized the trustee to sell the assets of Liberty Savings & Loan Association ("Liberty"), a wholly-owned subsidiary of the debtor, to another savings and loan institution. Liberty is but one subsidiary in the debtor's large and complex corporate system. The trustee had determined that Liberty was not needed for the reorganization of the debtor, and that it was in the best interest of the debtor to sell Liberty prior to the conclusion of these proceedings. The Commission supported the trustee in his effort to prune the debtor's business in order to facilitate a successful reorganization.[13] The court further ordered that the proceeds from the sale be deposited in an interest bearing account from which no disbursement could be made except with approval of the court and upon notice to interested parties.

The sale was opposed by a group of former Liberty shareholders, who had exchanged their stock for convertible preferred stock of the debtor in a 1971 merger of Liberty with Crown Savings & Loan Association, then a subsidiary of the debtor. The objectors asserted the right to rescind the 1971 transaction for alleged fraud and to reclaim the assets of Liberty. They appealed from the district court's order authorizing the sale.

The court of appeals, as urged by the Commission, affirmed the order of the district court.[14] The court of appeals agreed with the lower court's findings of fact ". . . that the market value of Liberty was likely to deteriorate in the near future, that it might be a very substantial decline and that the proposed sale would be in the best interest of the bankrupt estate." It also stated that impoundment of the proceeds adequately protected the interest of the appellants until their claims for rescission and reclamation should be resolved.

The objectors have asked the Supreme Court to overturn the ruling of the court of appeals. Further proceedings have been continued pending settlement negotiations. The sale was concluded by agreement, and a settlement agreement is pending before the bankruptcy court.

First Home Investment Corp. of Kansas, Inc.[15]—The debtor ("FHI") is a publicly-held face-amount certificate company registered under the Investment Company Act of 1940. Over 22,000 public investors purchased more than $50 million of its stock and face-amount certificates. Sales of FHI securities ceased after a Commission staff investigation disclosed that fraudulent misrepresentations had been made in the sale of the securities by Bush & Co.,[16] a broker-dealer and principal underwriter for FHI. FHI filed a Chapter X petition because it was unable to meet its obligations on over $30 million in loan commitments. Theretofore, the continuing sale of securities had been the principal source of funds to meet loan commitments. Subsequently the trustee was able to sell the bulk of the outstanding loan commitments but at a loss of almost $3 million primarily because of money market conditions and the uneconomic terms of the commitments.

The debtor's primary liability consists of face-amount certificates, of which over $33 million were outstanding when the Chapter X petition was filed. The trustee, with approval of the court, resumed redemption of these face-amount certificates. The trustee has thus far redeemed over $20 million of these certificates.

During the course of the proceedings, a former officer and director of the debtor and others associated with him began soliciting funds from public investors, as well as authority to represent them in the proceedings.[17] The Commission obtained an order from the court enjoining further solicitations and directing an accounting of receipts and disbursements.[18] The Commission subsequently filed objections to the accounting

and requested disallowance of substantially all claimed expenses. The district court has not yet rendered a decision.

Farrington Manufacturing Company.[19]—In approving the trustee's plan to distribute cash to creditors, the court ordered that stockholders, classified as creditors for alleged claims based on violations of the Federal securities laws, should be given notice of the plan by publication only. At the urging of counsel for creditor-stockholders and the Commission, the court amended its order to provide that they be given notice by mail and to receive, on request, the material required to be submitted to security holders under Section 175 of Chapter X.

Courts have held that fundamental requisites of due process require that persons whose rights are to be affected and whose identity can be ascertained with reasonable effort receive notice reasonably calculated to apprise them of the pending action. Publication is not a substitute for actual notice.[20]

TRUSTEE'S INVESTIGATION AND STATEMENTS

A complete accounting for the stewardship of corporate affairs by the prior management is a requisite under Chapter X. One of the primary duties of the trustee is to make a thorough study of the debtor to assure the discovery and collection of all assets of the estate, including claims against officers, directors, or controlling persons who may have mismanaged the debtor's affairs. The staff of the Commission often aids the trustee in his investigation.

Equity Funding Corp. of America.[21]—The Commission filed an injunctive action against this holding company, alleging violations of antifraud and numerous other provisions of the Federal securities laws.[22] After entry of a permanent injunction and appointment by the court of a special investigator and directors, the company filed its Chapter X petition.

Within ten months of his appointment, the trustee filed with the court an extensive report of his preliminary investigation of the debtor's affairs. A summary of it was transmitted to creditors and stockholders. The trustee reported that a large amount of the insurance policies, purportedly issued by a principal insurance subsidiary of the debtor were fictitious and a substantial portion of its assets were non-existent.

If the debtor had published its annual report for 1972, it would have shown consolidated assets of about $737.5 million and consolidated stockholders' equity of about $143.4 million. As adjusted by the trustee, consolidated revenues for 1972 were about $103.6 million, consolidated assets, about $488.9 million; consolidated stockholders' equity showed about a $42.1 million deficit.

Westec Corporation.[23]—The trustee has entered into a compromise settlement with almost all the major defendants in a civil action based on alleged violations of the securities laws and breaches of fiduciary duty, in connection with alleged manipulation of the debtor's stock.[24] The action was brought against 92 defendants on behalf of the debtor estate and the class of allegedly defrauded shareholders. Total estimated damages were about $37 million of which $28 million represented the out-of-pocket losses suffered by the class of shareholders.

In various separate settlements approved by the court to date, the major defendants have contributed approximately $6.8 million to the settlement fund, which is being held in escrow pending conclusion of the lawsuit. Thereafter, allocation will be made among the reorganized company, the class plaintiffs and certain creditors, pursuant to the confirmed plan of reorganization.

R. Hoe & Co., Inc.[25]—As a result of his investigation, the trustee commenced in 1971 a lawsuit against the debtor's former auditors and management. The claims against the auditors were based on their alleged failure to perform properly the professional services for which they were retained. The claims against debtor's management were based on its alleged waste and mismanagement of corporate assets and to recover profits from alleged insider trading in the debtor's securities. Both before and after the filing of the Chapter X petition, a number of individual and class shareholder actions had been initiated against the debtor, its former officers and management based upon substantially the same acts. Since the order approving the Chapter X petition enjoined the continua-

tion of suits against the debtor, proofs of claim in excess of $25 million have been filed in the Chapter X proceeding on behalf of class and individual shareholders.

After more than two years of negotiations, an overall settlement was proposed. A settlement fund of $4.5 million was created by the debtor's former officers, directors, auditors and their insurers. Under the proposed settlement $2.7 million plus interest was to be allocated to the shareholders in the class actions and $1.8 million plus interest to the estate.

The Commission urged that to determine whether the allocation was fair the court hold a hearing so that evidence be presented to permit a fair assessment of the compromise.[26] Following such a hearing, the Commission advised the court that it had no objection to the terms of the settlement, which the court subsequently approved.

King Resources Company.[27]—The trustee, during the fiscal year, continued to resolve key problems regarding the estate. He negotiated agreements of settlement with Global Natural Resources Properties, Ltd. and National Resources Company concerning the development of over 25 million acres of Canadian Artic oil and gas properties. Next, the court approved the sale of debtor's mining interests in South Africa for $4 million, which enabled the trustee to enter into a compromise agreement with the Bank of America to release its claims and liens on the property.

The court also approved the sale of debtor's interest in certain real estate in Denver, Colorado, and certain exploratory rights in the Dutch North Sea, from which the trustee realized a net of about $3 million and $1.4 million, respectively. These funds were used to repay the balance owed on trustee's certificates and to exercise an option to purchase certain property which the trustee had under lease. The trustee also settled claims of Canadian lien creditors on the same terms that had previously been accepted by domestic lien creditors, i.e., 75 percent in cash and the balance to be treated as an unsecured claim.

Diversified Mountaineer Corporation.[28]—The debtor, a financial service holding company, operated through eleven of its wholly-owned subsidiaries, located in four states, an uninsured industrial savings and loan business. Over 20,000 persons invested over $50 million in its pass book savings accounts.

The debtor's board of directors did not file reorganization petitions for the parent and all subsidiaries in one jurisdiction as permitted under Section 129 of Chapter X. Rather, the parent debtor and all of the West Virginia subsidiaries filed under Chapter X in the appropriate court in West Virginia about a month after the other subsidiaries, located in Kentucky and Tennessee, had filed Chapter XI petitions in their respective states.[29] The Virginia subsidiaries were placed under the control of state court-appointed receivers at the insistence of the Virginia State Corporation Commission.[30]

The fiduciaries appointed by the four jurisdictions each took different positions with respect to the interpretation of the inter-company debt and transfers that occured prior to reorganization and commenced litigation against one another. The primary controversy was whether certain sales of loan receivables by one subsidiary to another with the proceeds subsequently funnelled to the parent, were bona fide transactions or whether the sales were actually loans to the parent improperly collateralized by assets of the selling subsidiary. The fiduciaries recognized the complex nature of the inter-corporate transactions, and after extensive arm's length negotiations, in which Commission counsel assisted, entered into an overall settlement of all inter-company matters. The settlement was subsequently approved by the courts in all the jurisdictions.

PLANS OF REORGANIZATION

Generally, the Commission files a formal advisory report only in a case which involves substantial public investor interest and presents significant problems. When no such formal report is filed, the Commission may state its views briefly by letter, or authorize its counsel to make an oral or written presentation. During the fiscal year the Commission published two advisory reports to supplement a prior advisory report dealing with four plans of reorganization.[31]

its views on five other plans of reorganization were presented to the courts either orally or by written memoranda.[32]

Imperial '400' National, Inc.[33]—The court of appeals affirmed the district court's order of valuation subject to reconsideration in light of, among other things, "the manner of dealing with a possible tax carry-forward."[34] Subsequently, the district court reconsidered the valuation in connection with the various proposed plans of reorganization and concluded that it should be increased by "a maximum of $200,000" for the value of the tax loss carry-forward.[35]

One plan proponent amended its plan to comply substantially with the suggestions contained in the Commission's supplemental advisory report[36] and the district court's opinion.[37] The court approved the amended plan and an appeal was taken by a stockholder,[38] who had proposed a competing plan which the court declined to approve.[39]

Shortly after the approval of its amended plan, the successful plan proponent reported a sharp decline in gross revenues and net after-tax earnings. The plan was further amended at the court's direction, and after its approval the plan was submitted to Imperial's creditors and shareholders for their acceptances. The shareholder, who appealed from the original approval order, also has appealed from the order approving the plan as amended.[40] The two appeals were consolidated. The plan was not accepted by creditors or stockholders. The Commission's motion to stay the appeals on the ground that they may be moot, was granted. A new plan is to be proposed by the trustee.

TMT Trailer Ferry, Inc.[41]—The trustee's plan provided in the alternative for an internal reorganization or a sale of TMT as a going-concern to a privately-held shipping firm. The proceeds from the sale would be used to pay creditors in full, including post-bankruptcy interest, and to pay the holders of common stock $3 per share after adjustment for a one-for-five reverse split effected in 1958, which reduced the number of outstanding shares to about 800,000. In the interim, settlements of the principal disputed claims had been approved and the settlement amounts paid. After hearings, the court directed the trustee to proceed with the sale alternative.

The Commission filed a memorandum advising the district court that the alternative plan could be found to be fair, equitable and feasible. After the close of the fiscal year, the alternative plan was approved by the district court, accepted by the stockholders (the only affected class) and confirmed.

Atlanta International Raceway, Inc.[42]—The court approved the trustee's amended plan of reorganization, based on the solvency of this automobile race-track operator, which provided that (1) the mortage debt would be partially paid off and the remainder assumed at a higher rate by the reorganized debtor; (2) other creditors would receive new shares in satisfaction of their claims; (3) proponents would receive 52 percent of the reorganized company's outstanding shares in payment for a capital contribution and making available certain loans; and (4) existing stockholders would retain their shares, representing about 20 percent of shares to be outstanding. The creditors overwhelmingly accepted the plan; but stockholders, also overwhelmingly, voted against the plan.

Although a plan providing for the residual equity of a reorganized company to remain with its present stockholders does not alter substantive rights, the proponents agreed to purchase the shares of dissenting stockholders at $1.60 per share. Since the court previously found a reorganization value of not more than $1 per share, it concluded that the proponents' offer provided the "adequate protection" required by Section 216(8), and confirmed the plan.

An appeal from the order of confirmation was taken by a shareholder and one of the proponents of a competing plan.[43] The Commission in its brief supported the district court's order confirming the plan. On December 6, 1974, the Court of Appeals for the Fifth Circuit affirmed *per curiam* without opinion the district court's confirmation order.

Tilco, Inc.[44]—The debtor is a publicly-held holding company with a number of wholly-owned subsidiaries engaged in the business of producing oil and gas. One of

the debtor's subsidiaries, Natural Resources Fund, Inc. ("NRF"), is the general partner in six limited partnerships formed for the purpose of exploring, drilling, and operating oil and gas properties. About 5,500 investors contributed in excess of $27 million for interests in the six limited partnerships.

The trustee submitted a plan of reorganization which calls for the sale of the principal debtor corporations. Administration costs and secured creditors will be paid in full with any balance remaining to be distributed pro rata to the unsecured creditors. Shareholders will not participate under the plan since the debtor is insolvent. With respect to the limited partners of NRF, the trustee will make an offer to purchase the individual partnership interests based on the cash liquidating value as computed under the original partnership agreement.

The Commission advised the court, *inter alia*, that the plan was unfair to the limited partners since it ignored their right under two separate provisions of the partnership agreements to liquidate the partnership properties for their own account without being limited to the cash liquidating value relied on in the plan. The court approved the plan.

Showcase Corp.[45]—The trustee filed a plan of reorganization for this small publicly-held company whose business is leasing microfilm libraries of construction materials. The plan made provision for shareholders even though the debtor was found to be insolvent; shareholders were offered the right to purchase stock of the reorganized company for cash in exchange for their old shares. The money from the offering was to be used to pay about $500,000 of administrative, priority and secured indebtedness. The court concluded that under Section 264(a)(2) of Chapter X the shares to be offered to the public shareholders were exempt from registration under the Securities Act of 1933. The Commission objected, urging that Section 264(a)(2) did not apply.

The Commission argued that Section 264(a)(2) by its terms requires that securities issued pursuant to a plan of reorganization be *in exchange*, at least in part, for securities of or claims against the debtor. The legislative history of Chapter X clearly shows that new securities not so issued are not exempt from registration merely because issued pursuant to a plan of reorganization.[46] Several district courts have so interpreted Section 393a(2) of Chapter XI[47] and Section 3(a)(10) of the Securities Act of 1933,[48] which also provide exemptions for securities issued in bankruptcy proceedings.

The Commission also urged that for the "exchange" to come within Section 264a(2), the old stock must have some subsisting value. It has no value when the debtor is insolvent.

The Commission had intervened in the proceeding as the agency charged with the enforcement of the Federal securities laws, and in that capacity appealed the court's ruling on the exemption. Subsequently, the trustee amended the plan to provide for registration of the securities to be offered for sale to the old shareholders. The Commission will withdraw its appeal if the amended plan is confirmed.

Waltham Industries Corporation.[49]—The trustee's plan of reorganization, confirmed by the court, provided for an orderly liquidation of the debtor's assets. The most important feature was a settlement with debtor's major secured creditor who is to receive the stock of the debtor's most substantial subsidiary in exchange for its entire claim.

Under the settlement the major creditor also is to pay $625,000 to the estate which when added to the funds already on hand will permit the trustee after payment of all priority and administrative claims to make a pro rata distribution estimated at 17 percent to the debtor's other creditors. Since the debtor is insolvent, its common shareholders were excluded from participation.

Eastern Credit Corporation.[50]—The equity receivership, which originated from an injunctive action by the Commission,[51] was superseded by a Chapter X proceeding after the receiver had determined that a sale of the debtor as a going-concern could best be effected by a Chapter X plan of reorganization.

The debtor's preferred stock and about 89 percent of its common stock are owned by Eastern Finance Corporation and the re-

maining 11 percent of the common stock by about 120 persons. Since the debtor was solvent, funds from the sale would be available for distribution to Eastern Finance and to the public holders of common stock. The reorganization was concluded in about four months from the date the Chapter X petition was filed.[52]

ACTIVITIES WITH REGARD TO ALLOWANCES

Every reorganization case ultimately presents the difficult problem of determining the compensation to be paid to the various parties for services rendered and for expenses incurred in the proceeding. The Commission, which under Section 242 of the Bankruptcy Act may not receive any allowance for the service it renders, has sought to assist the courts in assuring economy of administration and in allocating compensation equitably on the basis of the claimants' contributions to the administration of estates and the formulation of plans. During the fiscal year 319 applications for compensation totaling about $11 million were reviewed.

Yale Express System, Inc.[53]—Twelve applicants sought final allowances (including amounts previously paid), and reimbursement of expenses aggregating about $2,696,000. The Commission recommended payment of about $1,654,000. The court awarded fees and expenses totaling about $1,684,000.[54]

Two applicants, a former trustee and trustee's counsel, requested interest at the rate of 6½ percent per annum on the unpaid portion of their respective allowances. That was the rate applied to the claims of Yale's creditors under the confirmed plan of reorganization. The court, as urged by the Commission, did not award interest to these applicants. The court noted that they had no specific claim to fees and that they did not have the same status as Yale's creditors.[55]

Cybern Education, Inc.[56]—The court of appeals vacated an order awarding the trustee and his counsel fees that equalled the cash remaining in the debtor's estate after liquidation of all its assets.[57] On remand, counsel for the trustee requested a final allowance of $30,000, and trustee waived any further allowance to himself. The district court in awarding only $10,000 to counsel for the trustee stated that "[a] request for one-half of an estate is not for the benefit of the debtor or the creditors, but is for the attorneys' benefit, and cannot be allowed." In addition, the district court ordered that counsel for the debtor who had filed the debtor's Chapter X petition return to the estate $4,800 of a $6,000 fee received prior to the institution of these proceedings.

The district court confirmed the trustee's plan of liquidation which provided for distribution of the remaining cash for administrative costs and tax claims. A final decree closing the proceeding was entered after the end of the fiscal year.

INTERVENTION IN CHAPTER XI

Chapter XI of the Bankruptcy Act provides a procedure by which debtors can effect arrangements with respect to their unsecured debts under court supervision. Where a proceeding is brought under that Chapter but the facts indicate that it should have been brought under Chapter X, Section 328 of Chapter XI authorizes the Commission or any other party in interest to make application to the court to dismiss the Chapter XI proceeding unless the debtor's petition is amended to comply with the requirements of Chapter X, or a creditors' petition under Chapter X is filed.

The Supreme Court adopted Chapter XI rules effective as of July 1, 1974. Under Rule 11–15, which governs the filing of Section 328 motions, the Commission as well as other parties in interest, except the debtor, have 120 days from the first date set for the first meeting of creditors to file a motion. The time may be extended for good cause. A motion made by the debtor for transfer, however, may be made at any time. The rule also requires a showing that a Chapter X reorganization is feasible. This in effect means that a motion can be granted only if the Court finds both that Chapter XI is inadequate and reorganization under Chapter X is possible. The prior procedure for filing a Chapter X petition after the granting of the motion and a separate hearing on the petition have been abolished.

Attempts are sometimes made to misuse

Chapter XI so as to deprive investors of the protection which the Securities Act of 1933 and the Securities Exchange Act of 1934 are designed to provide.[58] In such cases the Commission's staff normally attempts to resolve the problem by informal negotiations. If this proves fruitless, the Commission intervenes in the Chapter XI proceeding to develop an adequate record and to direct the court's attention to the applicable provisions of the Federal securities laws and their bearing upon the particular case.

Arlan's Dept. Stores, Inc.[59]—The company operates a chain of discount stores. For the two and one-quarter years prior to the Chapter XI proceedings, it reported losses in excess of $45 million. The company's capitalization includes $15 million in subordinated convertible debentures held by 775 public investors. The Commission in its motion pursuant to Section 328 urged, among other things, that rehabilitation of the company required a substantial adjustment of widely-held public debt. The court granted the Commission's motion,[60] and subsequently a voluntary Chapter X petition was approved and a trustee appointed.

Lyntex Corporation.[61]—The company is a wholesale distributor of sewing materials. For the two and three-quarter years prior to the Chapter XI proceedings, it reported losses in excess of $19 million. Shortly before the inception of the Chapter XI proceedings, the company's financial statements reflected a deficit net worth of $10.5 million. The company's capitalization includes $13.7 million in subordinated convertible debentures held by 1,450 public investors. The Commission in its Section 328 motion urged, among other things, that there was a need for a thorough investigation by an independent trustee and that rehabilitation of the company required a substantial adjustment of widely-held public debt. The court granted the Commission's motion. A Chapter X petition was thereafter filed and approved, and a trustee appointed.

Welfare Finance Corporation.[62]—The debtor is engaged in the small loan business. It had financed its operations through the sale of over $63 million in debt instruments to about 8,000 persons. In filing a Section 328 motion, the Commission urged that the financial condition of the debtor called for more than a simple composition of unsecured debt, and that a disinterested trustee was needed to investigate potential causes of action against certain officers and directors of the debtor.

A plan of arrangement was filed before the motion was acted upon. It provided for a sale of the debtor to an unaffiliated publicly-held corporation. Public creditors will be paid $50 million, $10 million in cash at confirmation, and $40 million in various debt issues of the purchaser bearing interest at different rates and maturing over a 16-year period. The Commission raised questions as to whether the debtor had accepted the best offer. Thereupon, the court appointed an investment banking firm to evaluate the purchase offers made by the three bidders, all substantial publicly-held corporations. As a result, the proponent improved his original offer by over $1 million. The plan also provides for new management; assignment of causes of action against certain officers and directors to a special designee who will pursue them for the benefit of the public investors; and effectively eliminates any participation by past management. Under these circumstances, the Commission withdrew its Section 328 motion.

North Western Mortgage Investors Corporation.[63]—Over 1,700 persons purchased from the debtor, corporate notes secured by fractional interests in over 100 mortgages, real estate contracts, and parcels of real property. The debtor's sole shareholder filed a preliminary plan that sought in essence to retain his control over the corporation while creditors, including the public secured creditors, would be asked to wait for up to three years for payment. The Commission, supporting a creditor's Section 328 motion, urged that there was a need for a new management and a disinterested investigation into the prior acts of management. It also urged that the security was so fractionalized that the reorganization machinery was essential to preserve its value for public creditors. The motion was granted. Thereafter, the court approved an involuntary Chapter X petition that had been previously filed by creditors and appointed a trustee.

Puts & Call, Inc.[64]—The company was en-

gaged in the business of issuing and brokering commodity option contracts on unregulated commodities. After the commencement of the Chapter XI proceeding, a California state court found that debtor had been selling a security and enjoined the further sale of commodity futures contracts until qualified under California law.[65] This effectively put the debtor out of business, although it had conducted no operations since the Chapter XI proceeding began.

The debtor's assets were liquidated leavin $600,000 in cash. More than 4,000 creditors, mostly customers, held claims exceeding $26 million. A plan of arrangement was proposed which provided for a privately-held commodity broker to acquire debtor's assets, for which it would pay a modest amount in cash and issue its stock in exchange for claims against the debtor.

The court granted the Commission's motion to intervene specially to enforce the Federal securities laws.[66] The purpose of the intervention was to develop the record as to the adequacy of the disclosure of material facts and to assist the court in its task of scrutinizing securities which were to be issued pursuant to the arrangement and thus prevent the distribution of stock of doubtful value to an unsuspecting public.[67] During the hearing, the proposed arrangement was withdrawn.

Section 393a(2) of Chapter XI provides an exemption from the registration provisions of the Securities Act for "any transaction in any security issued pursuant to an arrangement in exchange for claims against the debtor. . . ." Since the debtor had ceased its operations, it was the Commission's view that there was no business to rehabilitate in Chapter XI, and that the claimed exemption would serve no purpose other than a public distribution of the non-debtor's stock without registration.[68]

Digital Application, Inc.[69]—The debtor, a publicly-held manufacturer of certain electronic equipment (printed circuit boards), proposed a Chapter XI arrangement with its unsecured creditors whereby another public company would purchase through a newly created subsidiary all the assets of the debtor. Creditors will be offered cash or common stock of the subsidiary in exchange for their claims. The public shareholders, in exchange for their common stock in the debtor, will receive 20 to 25 percent of the common stock of the newly created corporation, depending on the amount of stock creditors choose to accept. In order to comply with the registration provisions of the Securities Act for these securities, the issuer filed with the Commission a combination registration, prospectus and proxy pursuant to Rule 145 under the Securities Act.

NOTES TO PART 7

[1] A table listing all reorganization proceedings in which the Commission was a party during the year is contained in Part 9.

[2] S.D. Ill., No. RI-Bk-73-295.

[3] D.C. N.J., No. B-656-65. Previously reported in 39th Annual Report, pp. 124–125; 38th Annual Report, pp. 117, 122, 125; 36th Annual Report, pp. 176–177, 190; 35th Annual Report, p. 161; 33rd Annual Report, pp. 132, 137; 32nd Annual Report, p. 94.

[4] Previously reported in 38th Annual Report, p. 117.

[5] 346 F. Supp. 500 (D. N.J., 1972).

[6] 481 F. 2d 41 (C.A. 3), *cert. denied*, 94 S.Ct. 68, 71 (1973).

[7] 486 F. 2d 297, 298 (C.A. 3, 1973).

[8] W.D. Okla, No. Bk-72-644.

[9] See 39th Annual Report, p. 120.

[10] C.D. Calif., No. 73-03467. Previously reported in 39th Annual Report, p. 73.

[11] *Lowden* v. *Northwestern National Bank & Trust Co.*, 298 U.S. 160 (1936); *Susquehanna Chemical Corp.* v. *Producers Bank & Trust Co.*, 174 F.2d 783 (C.A. 2, 1949); *In re Yale Express Systems, Inc.*, 362 F. 2d 111 (C.A. 2, 1966); *In re Penn Central Transportation Company*, 453 F. 2d 520 (C.A. 3, 1972).

[12] *Baker* V. *Gold Seal Liquors, Inc.*, 417 U.S. 467, 474 (1974).

[13] For a full discussion of the Commission's position on sales of major assets, see 39th Annual Report, pp. 120–121.

[14] *In re Equity Funding Corp. of America*, 492 F. 2d 793 (C.A. 9, 1974).

[15] D. Kans., No. 24075-B-2.

[16] In June 1973, the Commission revoked the registration of Bush & Co., as a broker-dealer for its activities in connection with the sale of FHI securities. The individual respondents have all consented to the imposition of sanctions.

[17] Cf. *Halsted* v. *Securities and Exchange Commission*, 182 F. 2d 660, 663–664 (C.A. D.C.), *cert. denied*, 340 U.S. 834 (1950). Similar matters otherwise unreported may be found in the 39th Annual Report, p. 119;

38th Annual Report, pp. 117–118; 31st Annual Report, p. 98; and 30th Annual Report, p. 100.

[18] *In re First Home Investment Co. of Kansas, Inc.*, 368 F. Supp. 597 (D. Kan., 1973).

[19] E.D. Va., Nos. 17–71–A, 256–71–A and 257–71–A. Previously reported in 39th Annual Report, pp. 123–124; 38th Annual Report, p. 118.

[20] *City of New York* v. *New York, New Haven & Hartford RR Co.*, 344 U.S. 293, 297 (1953); *Mullane* v. *Central Hanover Bank & Trust Co.*, 339 U.S. 306, 314–316 (1950); *In re Intaco Puerto Rico*, 494 F. 2d 94, 97–99 (C.A. 1, 1974); *In re Harbor Tank Storage Co., Inc.*, 385 F. 2d 111, 115 (C.A. 3, 1967).

[21] See *supra*, p. 124.

[22] *S.E.C.* v. *Equity Funding Corp. of America*, C.D. Calif., No. 73–714.

[23] S.D. Texas, No. 66–H–62. Previously reported in 38th Annual Report, p. 119; 35th Annual Report, pp. 163–164; 34th Annual Report, pp. 150, 152, 158; 33d Annual Report, p. 131.

[24] *Carpenter* v. *Hall*, No. 688738. See 38th Annual Report, p. 119.

[25] S.D.N.Y., No. 69–B–461. Previously reported in 37th Annual Report, pp. 183, 194–195; 36th Annual Report, p. 179.

[26] See *Protective Committee* v. *Anderson*, 390 U.S. 414, 424 (1968).

[27] D. Colo., No. 71–B–2921. Previously reported in 39th Annual Report pp. 121–122.

[28] S.D. W. Va., No. 74–71–CH.

[29] Kentucky subsidiaries—Fayette Loan & Thrift, E.D. Ky., No. 74–22. Tennessee subsidiary—Commonwealth Loan & Thrift, E.D. Tenn., No. Bk–2–74–6.

[30] On January 3, 1974, the Virginia Circuit Court of Chesterfield County, appointed two receivers to take charge of the affairs of the two subsidiaries in Virginia—Richmond Industrial Loan & Thrift and Roanoke Industrial Loan & Thrift.

[31] *In re Imperial '400' National, Inc.*, Corporate Reorganization Release Nos. 313 (August 29, 1973) 2 SEC Docket 377 and 314 (May 15, 1974), 4 SEC Docket 339.

[32] *In re Atlanta International Raceway, Inc.*, N.D. Ga., No. 7056; *In re Eastern Credit Corporation*, E.D. Va., No. Bk–74–154–N; *In re Pan American Financial Corporation*, D. Hawaii, No. 72–280; *In re Tilco, Inc.*, D. Kansas, No. 23662; *In re TMT Trailer Ferry, Inc.*, S.D. Fla., No. 3659–M–Bk–WM; and *In re Waltham Industries Corporation*, C.D. Calif., No. 94420–CC.

[33] D.C. N.J., No. B–656–65. Previously reported in 39th Annual Report, pp. 124–125; 38th Annual Report, pp. 117, 122, 125; 36th Annual Report, pp. 176–177, 190; 35th Annual Report, p. 161; 33d Annual Report, pp. 132, 137; 32d Annual Report, p. 94.

[34] 487 F. 2d 1394.

[35] 374 F. Supp. 949, 954–956 (D. N.J., 1974).

[36] *Imperial '400' National, Inc., et al.*, Corporate Reorganization Release No. 313 (August 29, 1973), pp. 21–26; 2 S.E.C. Docket 377, 384–386. See also, Corporate Reorganization Release No. 314 (May 15, 1974), 4 SEC Docket 339.

[37] 374 F.Supp. at 972–979.

[38] C.A. 3, 74–1666.

[39] 374 F.Supp. at 957–960.

[40] C.A. 3, No. 74–1853.

[41] S.D. Fla., No. 3659–M–Bk–WM. Previously reported in 39th Annual Report, pp. 119, 122–123; 38th Annual Report, pp. 125–126; 37th Annual Report, pp. 191–193; 36th Annual Report, pp. 179–180; 35th Annual Report, pp. 160, 168; 34th Annual Report, p. 153; 33d Annual Report, p. 135; 32d Annual Report, pp. 92–93; 31st Annual Report, p. 100; 30th Annual Report, p. 105; 29th Annual Report, pp. 91–92; 28th Annual Report, p. 100; 27th Annual Report, pp. 132, 134; 26th Annual Report, pp. 155, 158, 160.

[42] N.D. Ga., No. 70556.

[43] C.A. 5, No. 74–1974.

[44] D. Kansas, No. 23662. Previously reported in 39th Annual Report, pp. 118–119.

[45] E.D. Mich., No. 71–2899.

[46] S.Rep. No. 1916 on H.R. 8046, 75th Cong., 3d Sess. (1938) 38–39, states: "Under this provision [Section 264a(2)] no registration in compliance with the Securities Act of 1933 is required for the issuance of securities to the security holders or creditors of the debtor in whole or part exchange for their old securities or claims. However, new issues sold by the reorganized company for cash are required to be registered under the Securities Act just as any other new issues of securities, in order that prospective investors may have all material information before buying."

[47] The Southern District of New York has interpreted Section 393a(2) to mean that: "Stock issued entirely for cash does not meet the requirements of the statute on its face. To be exempt the stock must be partly or completely in exchange for claims against the arrangement debtor, and cannot be completely in exchange for cash." *S.E.C.* v. *Century Investment Transfer Corp.* CCH Fed. Sec. L.Rep. Para. 93,232 at p. 91442 (1971). See also *S.E.C* v. *Granco Products Inc.*, 236 F.Supp. 968 (S.D.N.Y., 1964), where the district court held that registration was necessary for a sale to the public at large of securities to be issued to creditors under the Chapter XI arrangement.

[48] In *S.E.C.* v. *Philip S. Budin & Co., Inc.*, the court stated: "However, I find that the wording of Section 3(a)(10) does not exempt from registration new issues *purchased* entirely for *cash* from a reorganized company. That section is intended to exempt only exchanges of old stock or claims or part cash and part stocks or claims." CCH Fed. Sec. L. Rep. Para. 93,088 at p. 91005 (1971). [emphasis in original]

[49] C.D. Calif., No. 94420–CC. Previously

reported in 38th Annual Report, p. 114.

[50] E.D. Va., No. Bk–74–154–N. See 39th Annual Report, p. 123 for reorganization of American Loan & Finance Company, an associate company.

[51] See *Securities and Exchange Commission* v. *F. Wallace Bowler*, 427 F.2d 190 (C.A. 4, 1970).

[52] The receiver expects to liquidate Eastern Finance, which appears to be insolvent. It was a holding company, with no significant operations of its own.

[53] S.D.N.Y., No. 65–B–404. Previously reported in 38th Annual Report, pp. 121–122; 34th Annual Report, pp. 149, 153–154; 33d Annual Report, p. 133; 32d Annual Report, pp. 88–89.

[54] 366 F.Supp. 1376 (S.D.N.Y., 1973).

[55] 366 F.Supp. at 1382.

[56] N.D. Ill., No. 70–B–5299. Previously reported in the 39th Annual Report, p. 125; 38th Annual Report, p. 125.

[57] *In re Cybern Education, Inc.*, 478 F.2d 1340 (C.A. 7, 1973).

[58] See 39th Annual Report, p. 127; 38th Annual Report, p. 126; 37th Annual Report, p. 138; 36th Annual Report, p. 197.

[59] S.D.N.Y., No. 73–B–468.

[60] 353 F.Supp. 523 (S.D.N.Y., 1974).

[61] S.D.N.Y., No. 73–B–751.

[62] S.D. Ohio, Nos. 69085–6.

[63] W.D. Wash., No. 642–73–B–2.

[64] C.D. Cal., No. 73–03706.

[65] *Van Camp* v. *Puts & Calls, Inc.*, No. C–51071 (Superior Court of the State of California for the County of Los Angeles, dated August 6, 1973).

[66] The Supreme Court has held that the Commission's right to intervene in Chapter XI proceedings is not limited solely to moving under Section 328 for a transfer to Chapter X. *Securities and Exchange Commission* v. *American Trailer Rentals Co.*, 379 U.S. 594, 612–613 (1965).

[67] *In re Synergistics, Inc.*, No. 70–1251 (D. Mass., confirmation order dated December 22, 1971), previously reported in 38th Annual Report, p. 126; *In re Transystems, Inc.*, No. 71–164–Bk–JE–Y, (S.D. Fla., filed September 28, 1971), previously reported in 37th Annual Report, pp. 199–200. See also in this connection *In re Barlum Realty Co.*, 62 F.Supp. 81, 88 (E.D. Mich., 1945); *In re American Department Stores Corp.*, 16 F.Supp. 977, 979–980 (D. Del., 1936).

[68] *In re American Trailer Rentals Co.*, 325 F.2d 47, 52–53 (C.A. 10, 1963), *rev'd on other grounds*, 379 U.S. 594 (1965).

[69] S.D. Texas, No. 73–H–381.

PART 8

SEC MANAGEMENT OPERATIONS

PART 8

SEC MANAGEMENT OPERATIONS

1974 was another year in which the Commission made optimum use of its money and personnel for the public interest.

ORGANIZATIONAL CHANGES

The Commission effected some organizational changes to ensure the best possible application of its resources. The more significant changes are mentioned below.

Three new specialized offices were created in the Division of Enforcement: a Branch of Investment Management Enforcement to handle proceedings against investment companies and advisers; a Branch of Program Management to handle special projects such as a tax shelter study and a program on delinquent filings; and a Chief Counsel's Office to render legal advice to the staff, regions, and other Federal agencies on enforcement matters. In addition, the Division's organizational structure was modified to provide that the only persons reporting directly to the Director are its three Associate Directors.

Changes were made in the structure of several of the Regional Offices to give all nine offices parallel organizations. The staff in each office has been divided between the two program areas, enforcement and regulation, with one senior official reporting directly to the Administrator on each program.

The Executive Director added a senior level official to his staff to serve as Regional Office Coordinator. The coordinator's position was established to insure uniformity among the Regional Offices in program objectives and resource availability, to improve communication, and to give those offices a voice at headquarters.

EXECUTIVE MANAGEMENT CONFERENCE

The Commission held its first executive management conference in October 1973. In announcing the conference, the Chairman stated that its purpose was "to assemble the SEC's top management team . . . for a concentrated discussion of our priorities and objectives for the next two or three years." The conference was an attempt to avoid "the constant danger of becoming so engulfed in critical day-to-day decisions that we may not adequately focus upon the necessarily broad perspective of our overall objectives and Congressional mandates." The eight conference sessions focused on current Commission responsibilities, probable future responsibilities, and the agency's management process. Since October, each of the major Divisions has had the opportunity to meet with the Commission for an informal discussion of projects, priorities, and special areas of concern.

The need for improved communications among the Regional Offices themselves and between the Offices and Headquarters was recognized as paramount. West Coast and East Coast conferences of Regional Administrators were scheduled later in the year. The topics discussed at these confer-

ences included case referrals, examination programs, the manpower reporting system, equipment budgets, training, and grade structures.

PERSONNEL MANAGEMENT

The permanent personnel strength of the Commission totalled 1,814 employees on June 30, 1974, as shown by the table below:

Commissioners	5
Staff	
Headquarters Office	1,140
Regional Offices	669
Total Staff	1,809
Grand Total	1,814

Recruitment

With the Congressional authorization of 263 additional positions during the fiscal year, the Commission launched an intensive recruitment program. Attorney recruiting trips to schools from New England to California resulted in applications from many highly qualified students. Special efforts were made to identify senior accountants for a variety of staff positions. More than 200 responses were received from a notice placed in the CPA Bulletin. Many of those responding received eligible ratings in the senior level civil service examination. In addition to filling the Commission's own needs, this nationwide effort resulted in greatly increasing the number of accountants on the register who are now available to other Federal agencies. Extensive efforts were also made to recruit secretaries, including trips to business schools in several states outside the immediate Washington, D.C. area.

During all of the recruitment efforts, the Commission's commitment to increase opportunities for minorities and women was emphasized. Of all new and vacant positions which were filled during the year 19 percent were filled by women and minorities. Of attorneys hired, 23 percent were women or minority group members.

Training and Development

Two new upward mobility programs were initiated during the year. Under a pilot Tuition Support Program, many employees who enroll in college degree programs may receive tuition assistance for those courses which relate to their present positions or the Commission's general area of work. At the same time a Career Opportunities Program is enabling an initial group of 10 employees to receive training in typing, English, and office skills to qualify them to move out of their present clerical jobs.

Seminars, conducted by the staff on a variety of subjects, were offered to the Commission staff as well as the staffs of companion Federal, state, and industry agencies. Eight of the Regional Offices sponsored three to five day seminars on enforcement and regulatory matters, encouraging cooperation and developing expertise among all area officials. On a larger scale, two of the major Divisions sponsored seminars for enforcement officers and securities compliance examinars, respectively. These programs included mock trials and analysis workshops.

Personnel Management Evaluation

In February 1974, the Civil Service Commission initiated a nationwide review and evaluation of the Commission's personnel management program. CSC evaluators visited nine regional and three branch offices during the following three months. Members of the Office of Personnel assisted the regional and branch offices in preparing for the evaluations and participated in the oral close-out presentations made by Civil Service Commission personnel. The Headquarters Office review was scheduled for October 1974.

INFORMATION DISSEMINATION

The full disclosure program requires that an active program of information dissemination be maintained by the Commission. Public information is made available through a variety of services and publications.

As noted above, the Commission has Public Reference Rooms in Washington, D.C., New York, Chicago, and Los Angeles, where members of the public may examine Commission records. Because of space

shortages, the Washington Public Reference Room was moved from the headquarters building to Eleventh and L Streets, N.W. Despite some temporary confusion, visitors now find a greater availability of carrels, microfiche readers and reader/printers, and Xerox machines than before.

Microfiche copies of reports filed with the Commission are made available to the public under a contract which was awarded at no cost to the government. During the second year of that contract, several services have been expanded. Exhibits which are filed with registration statements and various other reports filed with the Commission are now being filmed with the basic document. A comprehensive financial thesaurus and other research tools which are of great assistance in accessing the files were also developed during 1974.

Subscriptions to the SEC Docket, a weekly compilation of Commission releases numbered 10,000 by year end. A decision was made in June to change the format of all releases in early 1975 so that Act, Rule and Regulation citations are consistent with those used in the Code of Federal Regulations and the Federal Register.

AUTOMATED INFORMATION SYSTEMS

Significant progress was made during the year with respect to improving the SEC's research and reporting capabilities.

The capacity of the Commission's own computer was increased by the installation of additional core storage and several disk drives. This equipment provides for a larger memory and direct access capability, allowing more jobs to be run simultaneously and eliminating costly processing time involved in sequential access systems.

The Office of Data Processing developed several new products during the year. A system was developed from which a Public Delinquency List will be published periodically, identifying firms which have failed to timely file required reports. In July 1973, a system designed to coordinate Broker/Dealer examinations conducted by the Commission, SIPC, and the industry's self-regulatory organizations, became operational. The system provides information to the examining authorities which enables them to perform more effective examinations.

One other new product from the Office of Data Processing was Computer Output Microfiche (COM). This process, by which computer output is filmed rather than printed, is cheaper, more durable, and requires far less storage space than traditional printed computer reports. Expanded use of this technique will be continued in 1975.

A joint NASD/SEC Task Team during the year explored the potential use of computer technology for improving the surveillance and enforcement programs.

Some experience with time-sharing and other types of hardware was also acquired during the year. A programmable calculator was purchased for the Office of Economic Research. The calculator can satisfy many of OER's analysis needs at less cost than the computer and without delay. In order to respond to the needs of the Central Market System Advisory Committee for fast, sophisticated analyses, an account was established with the National Institutes of Health. The Commission is thus able to use existing soft-ware and obtain instant feedback. Two automated systems, one for accounting and the second for legal research were reviewed during the year to determine their cost effectiveness as research tools.

FINANCIAL MANAGEMENT

Fees collected by the Commission in fiscal 1974 amounted to 60 percent of funds appropriated by the Congress for Commission operations.[1] The Commission is required by law to collect fees for (1) registration of securities issued; (2) qualification of trust indentures; (3) registration of exchanges; (4) registration of brokers and dealers who are registered with the Commission but are not members of the NASD; and (5) certification of documents filed with the Commission. In addition, by fee schedule, the Commission imposes fees for certain filings and services such as the filing of annual reports and proxy material.

With reference to the fee schedule, on March 29, 1974, the Commission announced the repeal of certain provisions of

Rule 203–3 under the Investment Advisers Act of 1940. One of the paragraphs repealed, Rule 203–3(b), required each registered investment adviser to pay a $100 annual fee to the Commission during the period of its registration. The action was taken following the Commission's consideration of recent decisions of the United States Supreme Court[2] with respect to the Independent Offices Appropriation Act of 1952, 31 U.S.C. 483(a), which was thought to provide the statutory basis for establishing these fees. The Commission is presently reviewing all other fees imposed pursuant to the same Act.

NOTES TO PART 8

[1] See p. 181, *supra*.

[2] National Cable Television Assn., Inc. v. United States, 415 U.S. 336 (1974); Federal Power Commission v. New England Power Co., 415 U.S. 345 (1974).

PART 9

STATISTICS

PART 9

STATISTICS

THE SECURITIES INDUSTRY

Income and Expenses

Gross revenue of broker-dealers from all activities fell 21 percent to $5.5 billion in 1973 from $7.0 billion in 1972. Except for interest income on customers' accounts, commodities income and other business, all income sources registered sizeable declines compared to 1972. Revenue derived from over-the-counter market making, trading in non-exempt securities and underwriting activities fell more sharply than the other revenue items. (Note: A small number of firms principally engaged in the insurance business have been deleted from all years on this table to eliminate distortions created by the disproportionately large amounts of their other income unrelated to the securities business.)

Total expenses decreased 9 percent to $5.5 billion in 1973 from $6.0 billion in 1972. Registered representatives' compensation and clerical and administrative employees costs accounted for nearly all of the $559 million decrease. In contrast, commissions paid to other brokers and interest expenses increased $188 million in 1973. Broker-dealers' operating income, before partners' compensation and taxes amounted to $57 million in 1973 compared with $976 million in 1972.

Table 1

BROKER-DEALERS INCOME AND EXPENSES[1]

(Millions of Dollars)

Revenue	1969[r]	1970[r]	1971[r]	1972[r]	1973[p]
Securities commission business	$2,930	$2,185	$3,405	$3,533	$2,954
Exchange commission business	2,268	1,756	2,761	2,778	2,429
Floor Activities	86	74	94	94	69
Over-the-counter business	576	355	550	661	456
Interest income on customers' accounts	474	380	364	527	621
Dealer business and/or trading activities	706	847	1,101	1,039	606
Over-the-counter market makers	400	289	463	493	240
Municipal and government bond dealers	210	435	440	350	312
Traders in non-exempted securities	96	123	198	196	54
Underwriting business	645	625	982	939	509
Investment company securities	384	223	234	189	179
Investment advisory fees	80	67	86	101	86
Commodities business	90	88	99	125	178
Gain or loss in firm investment	151	66	251	210	14
Other business	362	319	347	359	397
Gross revenue	5,822	4,800	6,869	7,022	5,544
Expenses					
Commissions paid to other brokers	182	132	197	205	224
Floor brokerage, clearance, commission fees	228	191	250	257	227
Registered representatives' compensation	1,192	903	1,297	1,363	1,076
Interest	581	553	528	641	810
Clerical and administrative employees	1,571	1,356	1,651	1,770	1,517
Communication	446	389	451	504	479
Occupancy and equipment[2]	351	372	434	480	453
Promotional	216	173	201	227	199
Other	494	460	581	599	502
Total expenses	5,261	4,529	5,590	6,046	5,487
Operating income or loss before taxes[3]	561	271	1,279	976	57
Number of firms	2,619	2,332	2,539	2,512	2,164

[1] Broker-dealers with gross securities income of $20,000 and over Excludes life insurance companies with over $100 million in assets not related to the securities or commodities business
[2] Includes depreciation and amortization
[3] Before partners' compensation
[r] Revised
[p] Preliminary
Source SEC X-17A-10 Reports

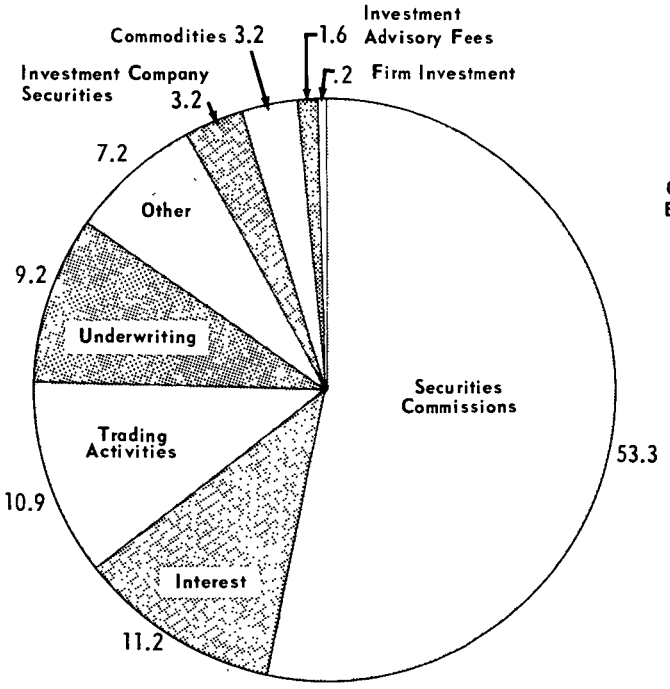
Securities Industry Dollar

Of each dollar received by broker-dealers in calendar 1973 a total of 53.3 cents was derived from the securities commission business, 10.9 cents from trading activities, 9.2 cents from the underwriting business and the remaining 26.6 from secondary sources of revenue such as interest income on customers' accounts, sale of investment company securities and gain or loss from firm investments.

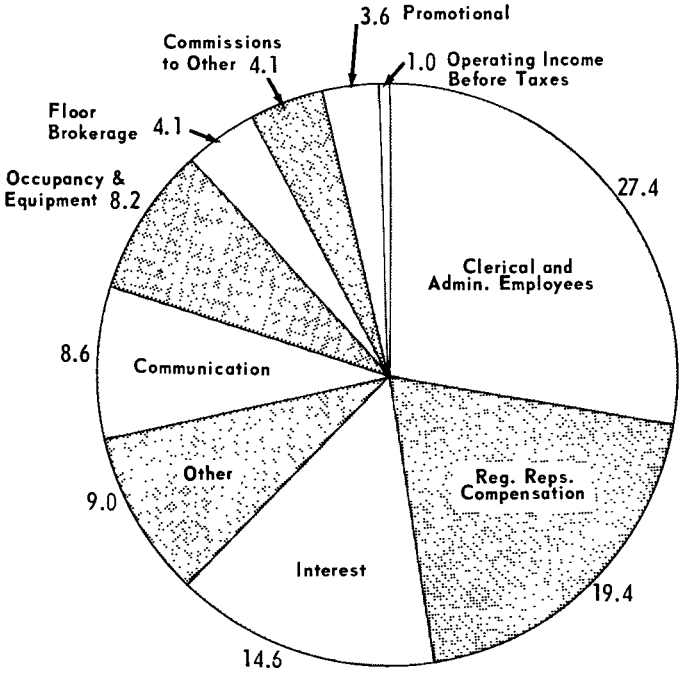
Total expenses amounted to 99.0 cents of each securities industry dollar. The two largest components of expenses were registered representatives' compensation, 19.4 cents per dollar, and clerical and administrative employee costs, 27.4¢ per dollar of revenue. Operating income before partners' compensation and taxes accounted for 1.0 cent of the average securities industry dollar.

SECURITIES INDUSTRY DOLLAR: 1973

SOURCES OF REVENUE



EXPENSES AND OPERATING INCOME



DS-5050

SOURCE X-17A-10
BRANCH OF FINANCIAL REPORTS
OFFICE OF ECONOMIC RESEARCH

Table 2
ASSETS AND LIABILITIES OF BROKER-DEALERS[1]

(Millions of Dollars)

ASSETS	1969[r]	1970[r]	1971[r]	1972[r]	1973[p]
Cash	$ 1,378	$ 1,056	$ 1,097	$ 1,081	$ 854
Deposits subject to withdrawal restrictions					
Securities	123	128	140	149	176
Commodities	113	118	105	171	236
Securities borrowed	1,075	871	1,027	1,367	1,100
Securities failed to deliver	3,112	2,469	2,371	2,688	1,922
Receivables from other broker-dealers					
Securities accounts	244	200	289	358	286
Commodities accounts	19	17	22	38	57
Total net debit balances carried for customers					
Securities accounts	8,428	7,156	9,762	13,423	9,050
Commodities accounts	48	32	6	62	99
Net debit balances in general partners' accounts not covered by equity agreements	88	96	157	91	60
Long positions in securities and commodities	7,777	10,634	11,932	12,165	10,037
Secured demand notes	151	107	116	300	420
Securities exchange membership	346	242	222	226	137
Fixed assets	232	247	292	317	293
Other assets:					
Investment in unconsolidated Subsidiaries	44	66	94	136	186
Securities business	478	428	477	632	658
Commodities business	14	11	7	13	20
Assets not related to the securities or commodities business	543	564	589	511	357
Total assets	24,213	24,442	28,705	33,728	25,948
Number of Firms	2,619	2,332	2,539	2,512	2,164

LIABILITIES	1969[r]	1970[r]	1971[r]	1972[r]	1973[p]
Money borrowed	$ 6,646	$ 9,123	$11,370	$14,499	$10,005
Securities loaned	1,064	838	986	1,285	848
Securities failed to receive	3,242	2,800	2,570	2,857	1,823
Payables to other broker-dealers					
Securities accounts	334	265	342	350	337
Commodities accounts	13	8	12	12	33
Total net credit balances carried for customers					
Securities accounts:					
Free credit balances	2,972	2,194	2,170	2,212	2,220
Other credit balances	2,384	1,977	2,483	2,831	2,406
Commodities accounts:					
Free credit balances	36	30	35	41	84
Other credit balances	154	145	152	249	335
Other liabilities to customers	109	357	357	55	154
Net credit balances in accounts of general partners not covered by equity agreements	81	63	75	98	95
Short positions in securities and commodities	865	725	917	1,534	1,168
Other liabilities					
Securities business	895	866	1,385	1,527	1,304
Commodities business	35	5	6	12	12
Liabilities not related to the securities or commodities business	539	516	556	524	471
Total liabilities	19,369	19,912	23,416	28,086	21,295
Capital and Subordinated Accounts					
Subordinated loans and accounts	670	677	771	801	678
Accounts covered by equity or subordinated agreements	708	543	468	301	151
Secured demand notes contributed as capital	151	101	111	299	435
Equity capital	3,315	3,209	3,939	4,241	3,389
Total liabilities and capital	$24,213	$24,442	$28,705	$33,728	$25,948

[1] Broker-dealers with gross securities income of $20,000 and over. Excludes life insurance companies with over $100 million in assets not related to the securities or commodities business.

[r] Revised [p] Preliminary Source. SEC X-17A-10 Reports

Assets and Liabilities

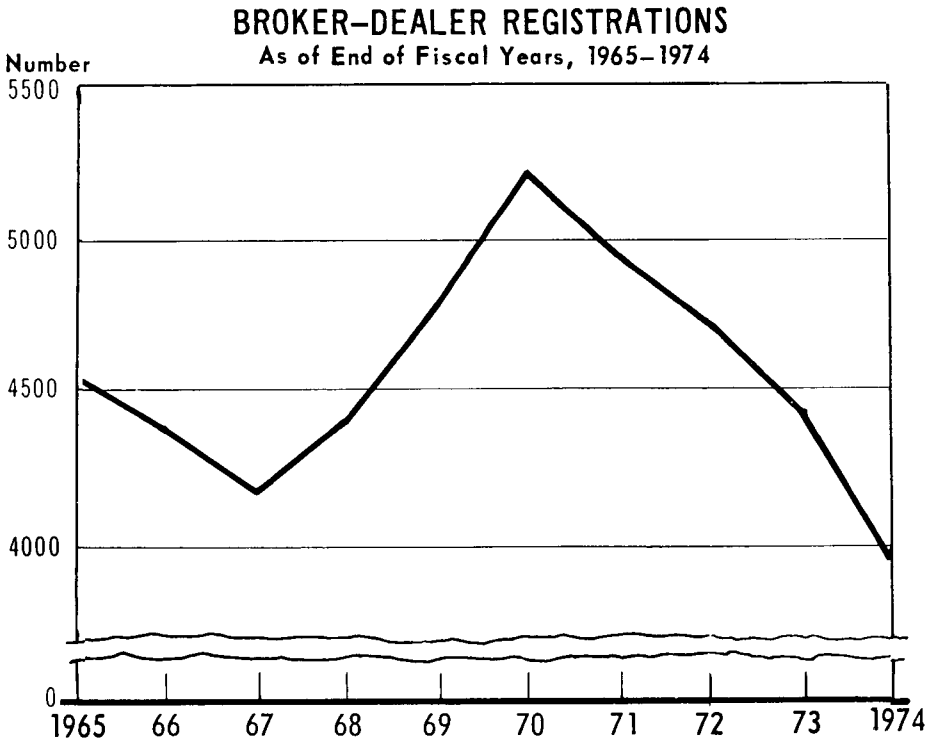
Broker-dealers' reported assets total $25.9 billion at year-end 1973 compared with $33.7 billion at year-end 1972. This 23 percent decline in total assets was attributable to the 28 percent drop in securities failed to deliver to $1.9 billion, the 33 percent drop in debit balances carried for customers securities accounts (including both cash and margin accounts), and the 17 percent drop in long positions in securities and commodities to $10.0 billion. The 14 percent decrease in the number of reporting firms to 2,164 accounted for much of the decline in these assets. (NOTE: A small number of firms principally engaged in the insurance business have been deleted from all years shown on this table to eliminate distortions created by the disproportionately large amounts of their assets unrelated to the securities business.)

Total liabilities, not including subordinated borrowings, were $21.3 billion at year-end 1973 compared with $28.1 billion at year-end 1972, which represented a 24 percent decline. Money borrowed, the largest component, fell 31 percent to $10.0 billion; securities failed to receive fell 36 percent to $1.8 billion; while free credit and other credit balances owed securities customers declined only 8 percent to $4.6 billion.

Total capital aggregated $4.7 billion at year-end 1973 compared with $5.6 billion at year-end 1972, a decline of 18 percent. Subordinated borrowings for capital purposes —including subordinated loans, accounts covered by equity or subordination agreements and secured demand notes—declined 10 percent to $1.3 billion. Equity capital declined 20 percent to $3.4 billion.

Registered Broker-Dealers

As of June 30, 1974, there were 3,982 broker-dealers registered, compared with 4,407 a year earlier. This represents a decrease of 425, or 9 percent, since June 30, 1973. During the year 766 registrations were terminated, 702 new applications were re-



ceived, 341 applications were made effective, and 363 applications were returned, denied or withdrawn. Approximately 689, or 89 percent, of the 766 terminations were requested by the registrants for a variety of reasons, while 77, or 11 percent, were the result of Commission action (cancellation or revocation).

Table 3

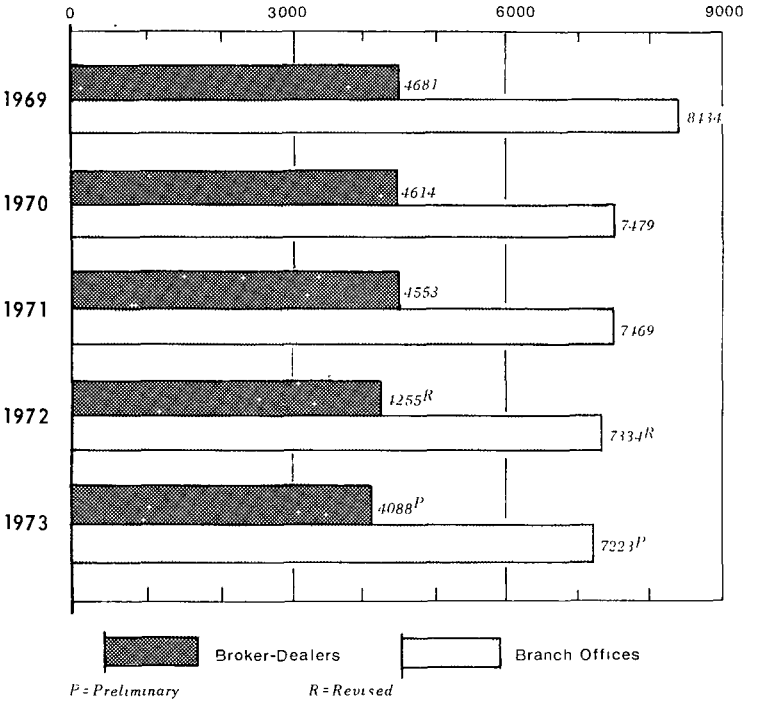
LOCATION OF BROKER-DEALERS

[June 30, 1974]

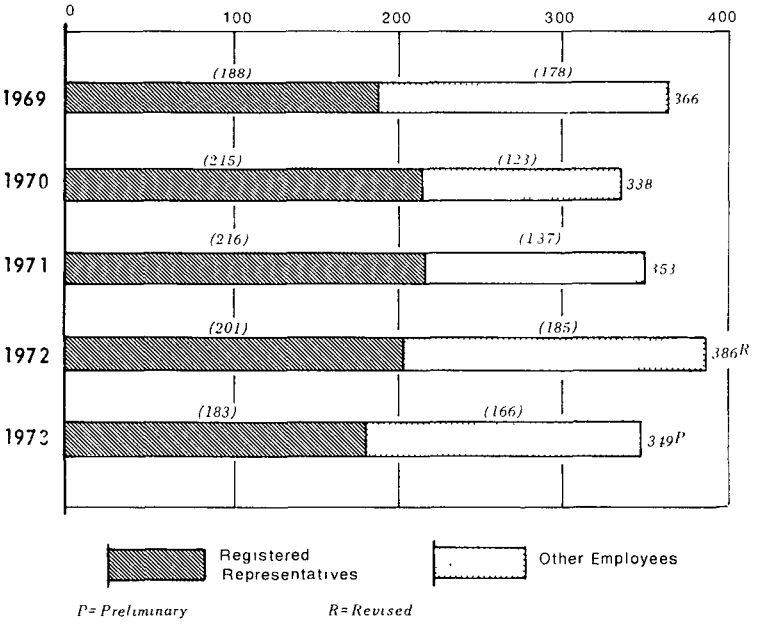
Location of principal office	Number of registrants				Number of proprietors, partners, officers, etc.[2,3]			
	Total	Sole proprietorships	Partnerships	Corporations[4]	Total	Sole proprietorships	Partnerships	Corporations[4]
Alabama	25	3	2	20	132	3	5	124
Alaska	1	1	0	0	1	1	0	0
Arizona	18	3	0	15	62	3	0	59
Arkansas	19	3	2	14	89	3	7	79
California	428	80	28	320	2,925	83	288	2,554
Colorado	66	9	3	54	420	9	60	351
Connecticut	58	4	7	47	480	4	120	356
Delaware	14	2	0	12	38	2	0	36
District of Columbia	37	5	6	26	345	5	53	287
Florida	113	13	4	96	444	13	9	422
Georgia	44	1	2	41	396	1	4	391
Hawaii	23	1	0	22	106	1	0	105
Idaho	6	0	0	6	20	0	0	20
Illinois	178	15	30	133	1,412	15	238	1,159
Indiana	49	8	1	40	284	8	2	274
Iowa	42	2	3	37	225	2	11	212
Kansas	23	2	2	19	145	2	9	134
Kentucky	11	3	0	8	73	3	0	70
Louisiana	23	8	4	11	175	8	16	151
Maine	12	1	2	9	41	1	9	31
Maryland	38	6	5	27	253	6	69	178
Massachusetts	167	34	19	114	1,151	34	127	990
Michigan	63	8	3	52	421	8	100	313
Minnesota	85	3	2	80	654	3	4	647
Mississippi	14	2	5	7	60	2	13	45
Missouri	66	3	8	55	712	3	119	590
Montana	5	2	0	3	16	2	0	14
Nebraska	21	1	0	20	200	1	0	199
Nevada	7	2	0	5	19	2	0	17
New Hampshire	4	1	0	3	12	1	0	11
New Jersey	178	39	23	116	577	39	63	475
New Mexico	5	1	0	4	27	1	0	26
New York (excluding New York City)	345	105	33	207	1,032	105	260	667
North Carolina	29	8	2	19	148	8	4	136
North Dakota	6	0	0	6	30	0	0	30
Ohio	87	6	16	65	726	6	226	494
Oklahoma	25	7	0	18	119	7	0	112
Oregon	33	4	1	28	146	4	3	139
Pennsylvania	193	23	33	137	1,236	23	222	991
Rhode Island	21	5	2	14	50	5	10	35
South Carolina	15	0	2	13	70	0	9	61
South Dakota	3	2	0	1	13	2	0	11
Tennessee	42	3	1	38	253	3	27	223
Texas	148	21	4	123	997	21	21	955
Utah	53	3	4	46	187	3	12	172
Vermont	6	3	0	3	26	3	0	23
Virginia	45	7	5	33	336	7	35	294
Washington	66	8	4	54	304	8	10	286
West Virginia	6	2	0	4	23	2	0	21
Wisconsin	39	3	0	36	314	3	0	311
Wyoming	7	2	1	4	21	2	2	17
Total (excluding New York City)	3,012	478	269	2,265	17,946	481	2,167	15,298
New York City	937	71	222	644	11,506	71	2,480	8,955
Sub Total	3,949	549	491	2,909	29,452	552	4,647	24,253
Foreign[1]	33	3	1	29	314	3	2	309
Grand Total	3,982	552	492	2,938	29,766	555	4,649	24,562

[1] Registrants whose principal offices are located in foreign countries or other jurisdictions not listed
[2] Includes directors, officers, trustees and all other persons occupying similar status or performing similar functions
[3] Allocations made on the basis of location of principal offices of registrants, not actual locations of persons
[4] Includes all forms of organizations other than sole proprietorships and partnerships

BROKER-DEALERS AND BRANCH OFFICES



EMPLOYEES
(Thousands)



SOURCE X-17A-10 REPORTS
BRANCH OF FINANCIAL REPORTS
OFFICE OF ECONOMIC RESEARCH

DS-5051

Broker-Dealers, Branch Offices, Employees

The numbers of broker-dealers and branch offices have declined in each successive year since 1969. The number of employees declined between 1969 and 1970, increased during 1971 and 1972, and then decreased again during 1973. There were about 349 thousand employees at year-end 1973. Registered representatives employed by the securities industry totaled 183 thousand, or about 52 percent of total employment.

SECO Broker-Dealers

The number of broker-dealers who are not members of a registered national securities association increased from 276 to 300 during the past fiscal year. The largest increases were in real estate syndicators and rental pool condominium dealers while the largest decreases were in put and call brokers and dealers and exchange specialists. This year was the first since 1968 in which the number of SECO broker-dealers increased; the increase was due primarily to the registration as broker-dealers of specialized firms which attain fewer competitive advantages in joining the NASD than do traditional broker-dealers.

Table 4

PRINCIPAL BUSINESS OF SECO BROKER-DEALERS

	Fiscal year-end				
	1970	1971	1972	1973	1974
Exchange member primarily engaged in floor activities	18	16	15	17	17
Exchange member primarily engaged in exchange commission business	32	37	33	28	20
Broker or dealer in general securities business	82	79	69	66	65
Mutual fund underwriter and distributor	35	27	27	24	18
Broker or dealer selling variable annuities	15	22	21	18	18
Solicitor of savings and loan accounts	19	15	10	9	7
Real estate syndicator and mortgage broker and banker	20	16	18	21	33
Broker or dealer selling oil and gas interests	4	4	3	3	6
Put and call broker or dealer or option writer	27	23	22	20	15
Broker or dealer selling securities of only one issuer or associated issuers (other than mutual funds)	16	15	17	18	19
Broker or dealer selling church securities	20	21	15	16	17
Government bond dealer	24	4	3	3	7
Broker or dealer in other securities business	21	19	30	26	31
Broker or dealer in interests in condominiums	*	*	*	*	14
Inactive	4	3	11	7	13
Total	336	301	294	276	300

*Not separately tabulated in prior years.

FINANCIAL INSTITUTIONS

Stock Transactions

During 1973, private noninsured pension funds, open-end investment companies, life insurance companies, and property-liability insurance companies purchased $46.7 billion of common stock and sold $39.2 billion, resulting in net purchases of $7.5 billion. This compares with purchases of $56.2 billion, sales of $45.4 billion, and net purchases of $10.8 billion in 1972. Their common stock activity rate, defined as the average of gross purchases and sales divided by the average market value of holdings, fell to 22.9 percent from 27.8 percent a year earlier.

Table 5

COMMON STOCK TRANSACTIONS AND ACTIVITY RATES OF SELECTED FINANCIAL INSTITUTIONS: 1965-1973

(Millions of Dollars)

	1965	1966	1967	1968	1969	1970	1971	1972	1973
Private noninsured pension funds[1]									
Purchases	5,585	6,610	10,035	12,285	15,230	13,955	21,685	23,220	20,325
Sales	2,560	3,165	5,655	7,815	10,270	9,370	12,800	15,650	14,790
Net purchases	3,025	3,445	4,380	4,470	4,960	4,585	8,885	7,570	5,535
Activity rate*	11.4	12.6	17.2	18 7	21 3	20 5	22 1	19.7	16 5
Open-End investment companies[2]									
Purchases	6,530	10,365	14,925	20,100	22,060	17,130	21,555	20,945	15,560
Sales	5,165	9,320	13,325	18,495	19,850	15,900	21,175	22,550	17,505
Net purchases	1,365	1,045	1,600	1,605	2,205	1,225	380	−1,610	−1,945
Activity rate*	21 8	34.0	40 7	48 4	51 0	45 6	48 2	44 8	39 0
Life insurance companies[3]									
Purchases	985	1,110	1,685	2,930	3,705	3,770	6,230	6,910	6,320
Sales	600	825	875	1,725	2,185	1,975	2,775	4,425	4,035
Net purchases	390	285	805	1,205	1,520	1,795	3,455	2,485	2,290
Activity rate*	13 8	16.0	18 2	26 8	29.4	27.8	31 0	29 6	24 8
Property-liability insurance companies									
Purchases	770	900	1,165	2,245	3,780	3,615	4,170	5,130	4,520
Sales	965	825	980	1,645	2,880	2,720	1,945	2,740	2,855
Net purchases	−190	80	185	600	900	890	2,225	2,390	1,665
Activity rate*	8.2	8 6	9.7	16 0	26.7	28 1	23 2	23 8	20.3
Total selected institutions									
Purchases	13,875	18,985	27,810	37,565	44,775	38,465	53,645	56,205	46,725
Sales	9,285	14,135	20,835	29,680	35,185	29,970	38,695	45,370	39,185
Net purchases	4,585	4,850	6,975	7,885	9,590	8,500	14,950	10,835	7,545
Activity rate*	14 7	19 8	24.7	29.4	32.4	29 8	30 8	27.8	22.9
Foreign investors[4]									
Purchases	3,720	4,740	8,035	13,120	12,430	8,925	11,625	14,360	12,760
Sales	4,135	5,075	7,275	10,850	10,940	8,300	10,895	12,175	9,955
Net purchases	−415	−335	755	2,270	1,485	625	730	2,185	2,805

[1] Includes funds of corporations, unions, and multiemployer groups, and nonprofit organizations, also deferred profit sharing funds.

[2] Mutual funds reporting to Investment Company Institute, a group whose assets constitute about ninety percent of the assets of all open-end investment companies

[3] Includes both general and separate accounts.

[4] Transactions of foreign individuals and institutions in domestic common and preferred stocks Activity rates for foreign investors are not calculable.

NOTE. Transactions may not add to totals because figures are rounded to nearest $5 million.

* Activity rate is defined as the average of purchases and sales divided by average market value of stockholdings, stated as an annual rate Annual activity rates presented above differ slightly from those previously published by the Securities and Exchange Commission Under the old activity rate method, average market value of stockholdings was based on valuation at beginning and end of the year The new activity rate computations utilize the mean values of four quarters for the average market value of stockholdings, this method is believed to be more representative Quarterly activity rates are not affected by this change

SOURCE: Pension funds and property-liability insurance companies, SEC; investment companies, Investment Company Institute, life insurance companies, Institute of Life Insurance, foreign investors, Treasury Department

Stockholdings

At year-end 1973, the institutional groups listed in the table below held $335 billion of corporate stock, both common and preferred, versus $397 billion a year earlier. Even though the value of stock held by these institutions declined 15.6 percent, their share of total stock outstanding rose from 34.1 percent in 1972 to 36.3 percent at the close of 1973. During the same period, the share held by other domestic investors, individuals and institutions not listed, declined from 62.8 percent to 59.8 percent while foreign investors increased their share from 3.1 percent to 3.9 percent.

Table 6

STOCKHOLDINGS OF INSTITUTIONAL INVESTORS AND OTHERS: 1965-1973

(Billions of Dollars, End of Year)

	1965	1966	1967	1968	1969	1970	1971	1972	1973
1 Private noninsured pension funds	$ 40 8	$ 39.5	$ 51.1	$ 61 5	$ 61.4	$ 67.1	$ 88 6	$115.2	$ 89 0
2 Open-end investment companies	33.5	31.2	42 8	50 9	45.0	43 9	52 6	58 0	43.3
3. Other investment companies	7.6	6 2	8.2	8.2	6.6	6.2	6.9	7.4	6 6
4. Life insurance companies	9 1	8 8	10.9	13.2	13 7	15 4	20.6	26 8	25 9
5 Property-liability insurance companies[1]	12 0	11 0	13 0	14.6	13 3	13 2	16.6	21 8	19 6
6 Common trust funds	3 5	3.3	3.9	4 8	4 6	4 6	5.8	7 3	6 3
7 Personal trust funds	69.7	66.7	75 9	83.6	79.6	78 6	94 1	110 2	95 5
8 Mutual savings banks	1 5	1.5	1.7	2 0	2.2	2 5	3 0	3 6	4 0
9 State & local retirement funds	1 6	2.1	2.8	4 1	5 9	8.0	11 2	14 2	17 8
10 Foundations	19 5	18.7	20.2	22.0	20.0	22.0	25 0	28.5	24.5
11 Educational endowments	7 0	6 2	7 7	8 5	7 6	7 8	9.0	10 7	8 8
12 Subtotal	205.8	195.2	238 2	273 4	259 9	269 3	333.4	403.7	341.3
13. Less Institutional holdings of investment company shares	2.0	2 1	2 8	3 4	4 0	4.9	6 0	7 1	6.7
14 Total institutional investors	203.8	193.1	235 4	270 0	255.9	264.4	327 4	396 6	334 6
15. Foreign investors[2]	19.9	18.1	21 5	26.0	25.2	26.7	29.4	36 4	35.5
16 Domestic individuals[3]	490 0	436 6	567.9	679.0	578 3	561 8	632.6	730 2	550 6
17 Total stock outstanding[4]	713 7	647 8	824 8	975.0	859 4	852 9	989.4	1,163 2	920 7

[1] Excludes holdings of insurance company stock.
[2] Includes estimate of stock held as direct investment.
[3] Computed at residual (line 16=17−14−15). Includes both individuals and institutional groups not listed above.
[4] Includes both common and preferred stock Excludes investment company shares but includes foreign issues outstanding in the U S

Number and Assets of Registered Investment Companies

As of the end of the 1974 fiscal year, 1,377 investment companies were registered with the Commission, an increase of 16 from the number of one year earlier. Of the registered companies, 89 were classified as "inactive." Approximately 62 percent of the active companies were management open-end companies ("mutual funds").

The 1,288 active companies had total assets having an approximate market value of $62 billion, with mutual funds accounting for about 74 percent of that value. The $62 billion figure respresents about an 18 percent decline from the $73.1 billion total at the end of the last fiscal year. Despite this decline, the investment company industry has experienced tremendous growth in the years since the Investment Company Act was enacted, a fact which can be appreciated by noting that in 1950 there were 366 investment companies with total assets of about $4.7 billion, and that, as recently as 1960, there were only 570 companies with assets of $23.5 billion.

Table 7

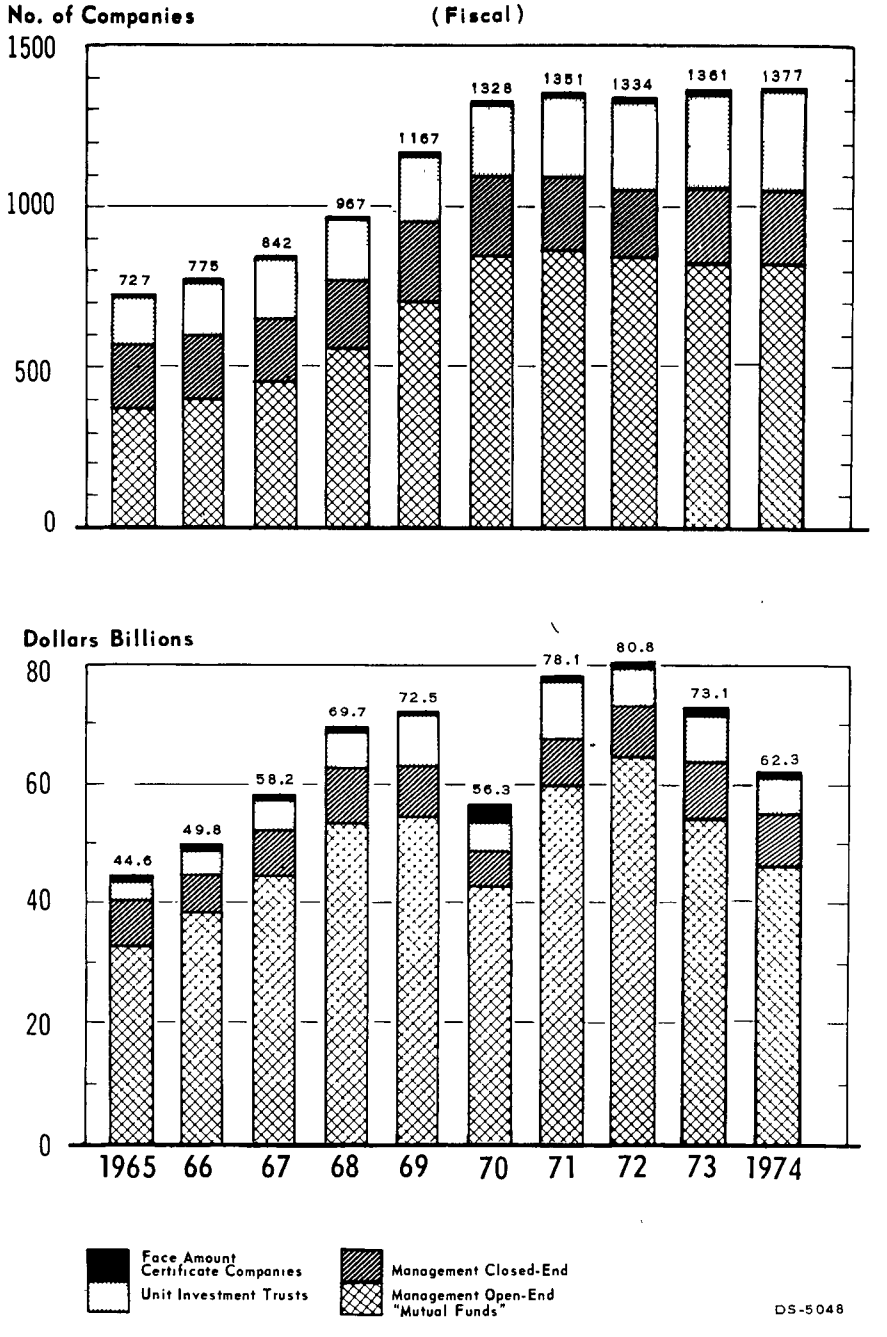
COMPANIES REGISTERED UNDER THE INVESTMENT COMPANY ACT OF 1940 AS OF JUNE 30, 1974

	Number of registered companies			Approximate market value of assets of active companies (millions)
	Active	Inactive[a]	Total	
Management open-end ("Mutual Funds")	798	28	826	46,110
Funds having no load	233			6,382
Variable annuity-separate accounts	55			1,013
Capital leverage companies	7			262
All other load funds	503			38,453
Management closed-end	197	36	233	8,954
Small business investment companies	38			251
Capital leverage companies	2			40
All other closed-end companies	157			8,663
Unit investment trusts	288	22	310	6,167[b]
Variable annuity-separate accounts	47			150
All other unit investment trusts	241			6,017
Face-amount certificate companies	5	3	8	1,056
Total	1,288	89	1,377	62,287

[a] "Inactive" refers to registered companies which as of June 30, 1974, were in the process of being liquidated or merged, or have filed an application pursuant to Section 8(f) of the Act for deregistration, or which have otherwise gone out of existence and remain registered only until such time as the Commission issues order under Section 8(f) terminating their registration

[b] Includes about $3 1 billion of assets of trusts which invest in securities of other investment companies, substantially all of them mutual funds

NUMBER AND ASSETS OF REGISTERED INVESTMENT COMPANIES



Investment Company Registrations

During fiscal 1974, 106 new investment companies registered, an increase of 15 from the previous fiscal year. This marked the first time since 1969 that the number of new registrations in a fiscal year exceeded the number of new registrations in the previous fiscal year. However, the number of existing companies terminating their registrations increased from 64 in fiscal 1973 to 90 in fiscal 1974, resulting in a net gain of only 16 companies.

Table 8

NEW INVESTMENT COMPANY REGISTRATIONS

	1974
Management open-end	
No-loads	16
Variable annuities	3
All others	41
Sub-total	60
Management closed-end	
SBIC's	0
All others	19
Sub-total	19
Unit investment trust	
Variable annuities	11
All others	16
Sub-total	27
Face amount certificates	0
Total Registered	106

Table 9

INVESTMENT COMPANY REGISTRATIONS TERMINATED

	1974
Management open-end	
No-loads	15
Variable annuities	0
All others	45
Sub-total	60
Management closed-end	
SBIC's	4
All others	20
Sub-total	24
Unit Investment Trust	
Variable annuities	2
All others	4
Sub-total	6
Face amount certificates	0
Total Terminated	90

Private Noninsured Pension Funds: Assets

On December 31, 1973, total assets of private noninsured pension funds were $124.4 billion at book value and $129.9 billion at market value. A year earlier their total assets were $117.5 billion (book) and $154.3 billion (market). The book value of common stockholdings rose from $74.6 billion in 1972 to $79.2 billion while the market value fell from $113.4 billion to $88.0 billion.

Private Noninsured Pension Funds: Receipts and Disbursements

Information on the receipts and disbursements of private noninsured pension funds for 1973 is not available. In 1972, net receipts were $11.6 billion. Of the $20.1 billion in total receipts, $12.7 billion was contributed by employers and $1.2 billion by employees. Investment income (interest, dividends, and rent) and net profit on sale of assets added $4.3 billion and $1.7 billion, respectively. Of the $8.5 billion in total disbursements, $8.3 billion was paid out to beneficiaries.

Table 10

ASSETS OF PRIVATE NONINSURED PENSION FUNDS: 1963-1973

(Millions of Dollars, End of Year)

Book Value	1963	1964	1965	1966	1967	1968	1969	1970	1971	1972	1973
Cash and deposits	770	890	940	900	1,320	1,590	1,620	1,800	1,640	1,860	2,300
U S Government securities	3,050	3,190	2,990	2,750	2,320	2,760	2,790	3,030	2,730	3,690	4,330
Corporate and other bonds	19,560	21,420	23,130	25,230	26,360	27,000	27,610	29,670	29,010	28,210	29,810
Preferred stock	710	650	750	790	980	1,330	1,760	1,740	1,770	1,480	1,240
Common stock	18,120	20,950	25,120	29,070	34,950	41,740	47,860	51,740	62,780	74,580	79,200
Own company	1,340	1,550	1,830	2,090	2,560	2,800	3,020	3,270	3,520	3,880	n a.
Other companies	16,780	19,400	23,290	26,980	32,380	38,940	44,840	48,480	59,260	70,710	n.a
Mortgages	2,220	2,780	3,380	3,910	4,080	4,070	4,220	4,300	3,680	3,000	2,710
Other assets	2,120	2,540	2,870	3,520	4,230	4,580	4,720	4,730	4,800	4,710	4,770
Total assets	46,550	52,420	59,180	66,170	74,240	83,070	90,580	97,010	106,420	117,530	124,360
Market Value											
Cash and deposits	800	900	900	900	1,300	1,600	1,600	1,800	1,600	1,900	2,300
U S. Government securities	3,000	3,200	2,900	2,700	2,200	2,600	2,600	3,000	2,800	3,700	4,400
Corporate and other bonds	18,800	20,700	21,900	22,500	22,600	22,400	21,300	24,900	26,100	26,200	27,200
Preferred stock	700	700	800	800	1,000	1,400	1,600	1,600	2,000	1,900	1,000
Common stock	27,000	33,000	40,000	38,700	50,100	60,100	59,800	65,500	86,600	113,400	88,000
Own company	3,100	4,000	4,400	3,500	5,000	5,700	5,700	5,900	7,500	8,800	n a
Other companies	23,800	29,000	35,600	35,200	45,100	54,400	54,200	59,500	79,100	104,600	n a
Mortgages	2,200	2,800	3,400	3,800	4,000	3,600	3,500	3,600	3,200	2,700	2,400
Other assets	2,200	2,600	3,000	3,500	4,200	4,300	4,300	4,300	4,500	4,600	4,700
Total assets	54,600	63,900	72,900	72,800	85,500	96,000	94,600	104,700	126,900	154,300	129,900

n a Not available

NOTE: Includes deferred profit sharing funds and pension funds of corporations, unions, multiemployer groups, and nonprofit organizations Figures may not add to totals because of rounding

Table 11

RECEIPTS AND DISBURSEMENTS OF PRIVATE NONINSURED PENSION FUNDS: 1963-1973

(Millions of Dollars)

	1963	1964	1965	1966	1967	1968	1969	1970	1971	1972	1973*
Total receipts	6,780	7,940	9,280	10,330	11,820	13,150	14,150	13,200	17,540	20,070	
Employer contributions	4,170	4,850	5,600	6,360	7,040	7,700	8,490	9,720	11,320	12,740	
Employee contributions	560	600	670	710	790	890	1,010	1,070	1,120	1,200	
Investment income	1,790	2,050	2,390	2,670	2,940	3,190	3,550	3,870	4,100	4,300	
Net profit on sale of assets	230	400	570	520	1,000	1,260	990	−1,590	900	1,720	
Other receipts	40	40	50	70	60	100	110	130	100	100	
Total disbursements	2,090	2,420	2,880	3,480	3,990	4,620	5,430	6,180	7,260	8,490	
Benefits paid out	2,020	2,350	2,800	3,380	3,880	4,500	5,290	6,030	7,080	8,300	
Expenses and other disbursements	70	80	90	110	120	120	140	150	180	200	
Net receipts	4,700	5,510	6,400	6,840	7,830	8,530	8,720	7,020	10,280	11,580	

* Not available

NOTE Includes deferred profit sharing funds and pension funds of corporations, unions, multiemployer groups and nonprofit organizations Figures may not add to totals because of rounding

SECURITIES ON EXCHANGES

Exchange Volume

Dollar volume of all securities transactions on registered exchanges totaled $187.2 billion in 1973, down 13 percent from the $215.5 billion volume in 1972. Of this total, $177.9 billion represented stock trading, $8.3 billion, bond trading, and the balance, trading in rights and warrants. The value of New York Stock Exchange transactions, was $154.7 billion in 1973. This figure represents a decline of 8.4 percent from 1972. NYSE share volume declined 3.5 percent from its record high of $4.5 billion in 1972. On the American Stock Exchange, value of shares traded dropped 50 percent to $10.3 billion. The AMEX share volume of 734 million shares was off 33.4 percent from the 1972 figure. Share volume on the regional exchanges declined 8.2 percent from the 1972 figure to 652.1 million shares, valued at $21.2 billion.

Table 12

EXCHANGE VOLUME: 1973

(Data in thousands)

	Total dollar volume	Bonds		Stocks		Rights and warrants	
		Dollar volume	Principal amount	Dollar volume	Share volume	Dollar volume	Number of units
All registered exchanges	187,156,719	8,294,994	9,420,762	177,877,567	5,723,164	984,158	176,254
American	11,247,018	399,269	633,018	10,269,776	734,499	577,973	76,959
Boston	1,793,049	0	0	1,792,908	42,171	141	30
Chicago Board of Trade	0	0	0	0	0	0	0
Cincinnati	118,869	20	29	118,849	2,838	0	0
Detroit	380,589	0	0	380,532	10,676	57	12
Midwest	8,136,948	653	1,213	8,131,114	240,415	5,181	1,350
National	23,987	24	145	23,896	7,462	67	471
New York	154,664,323	7,865,380	8,736,821	146,450,834	4,336,581	348,109	84,008
Pacific Coast	6,388,529	28,934	48,154	6,315,636	206,234	43,959	10,886
Philadelphia-Baltimore-Washington	4,395,727	715	1,382	4,386,341	126,991	8,671	2,538
Intermountain	996	0	0	996	2,262	0	0
Spokane	6,685	0	0	6,685	13,031	0	0
Exempted Exchange—Honolulu	1,899	2	1	1,897	260	0	0

NASDAQ Volume

NASDAQ share volume and price information for over-the-counter trading has been reported on a daily basis since November 1, 1971. At the end of 1973 there were 2932 issues in the NASDAQ system. Volume for 1973 was 1.6 billion shares, down 27 percent from 1972. This trading volume reflects the number of shares bought and sold by market makers plus their net inventory changes.

Table 13

SHARE VOLUME BY EXCHANGES[1]

Year	Total Share Volume (Thousands)	In Percentage								
		NYSE	AMEX	MIDW	PCSE	PBWE	BOSE	DTSE	CNSE	Others[2]
1935	681,971	73 13	12 42	1.91	2 69	1.10	.96	85	.03	6 91
1940	377,897	75 44	13.20	2 11	2 78	1.33	1 19	.82	08	3 05
1945	769,018	65 87	21.31	1.77	2.98	1.06	.66	79	.05	5 51
1950	893,320	76.32	13.54	2 16	3.11	97	65	.55	09	2.61
1955	1,321,401	68.85	19 19	2 09	3 08	85	48	.39	.05	5.02
1956	1,182,487	66.31	21.01	2 32	3 25	83	.47	49	05	5 27
1957	1,293,022	70 70	18 14	2 33	2.73	1 11	.40	39	06	4.14
1958	1,400,579	71 31	19 14	2.13	2 99	.84	.45	35	.05	2 74
1959	1,699,697	65 59	24 50	2 00	2 81	97	37	.31	04	3 41
1960[3]	1,428,552	69.08	22 46	2 22	3 14	89	39	34	05	1 41
1961	2,121,050	65 66	25.84	2 25	3 45	.80	31	.31	04	1.34
1962	1,699,346	71.84	20 26	2.36	2.98	88	.32	37	05	.95
1963	1,874,718	73.17	18 90	2 34	2 83	.84	30	.47	04	1.11
1964	2,118,326	72.81	19 42	2.44	2.65	93	.29	55	.04	86
1965	2,663,495	70 10	22 60	2 64	2.34	.82	.27	53	05	.64
1966	3,306,386	69 54	22.89	2 57	2.69	86	40	46	06	52
1967	4,641,215	64.48	28 45	2.36	2 46	.88	.43	.33	03	58
1968	5,406,582	62 00	29 75	2 63	2.65	90	79	.32	01	96
1969	5,133,498	63 18	27.62	2 85	3 48	1.23	51	13	.01	1.00
1970	4,834,523	71 29	19 03	3.16	3 68	1 63	.52	11	.02	55
1971	6,172,668	71 34	18.43	3 53	3.72	1.92	43	16	03	.44
1972	6,518,132	70 48	18 23	3 71	4.13	2 22	.59	15	.04	45
1973	5,899,419	74 93	13 75	4.10	3 68	2.20	72	18	.05	39

[1] Share Volume for Exchanges includes Stocks, Rights and Warrants
[2] Others include Intermountain Stock Exchange, Spokane Stock Exchange, National Stock Exchange and Honolulu Stock Exchange
[3] Data revised as of 1960

DOLLAR VOLUME BY EXCHANGES[1]

Year	Dollar Volume ($ Thousands)	In Percentage								
		NYSE	AMEX	MIDW	PCSE	PBWE	BOSE	DTSE	CNSE	Others[2]
1935	$ 15,396,139	86.64	7.83	1 32	1 39	88	1 34	40	04	16
1940	8,419,772	85.17	7 68	2.07	1.52	1.11	1 91	36	09	09
1945	16,284,552	82 75	10.81	2.00	1 78	.96	1 16	.35	06	.13
1950	21,808,284	85 91	6 85	2 35	2 19	1 03	1.12	.39	.11	05
1955	38,039,107	86 31	6.98	2 44	1.90	1.03	78	.39	09	.08
1956	35,143,115	84.95	7.77	2 75	2.08	1.08	.80	.42	08	.07
1957	32,214,846	85 51	7 33	2.69	2.02	1.12	.76	42	08	07
1958	38,419,560	85.42	7.45	2 71	2.11	1 10	71	.37	.08	05
1959	52,001,255	83 66	9 53	2 67	1 94	1 09	.66	33	.07	05
1960[3]	45,276,616	83.87	9.36	2.73	1 95	1.04	.60	34	08	.04
1961	64,032,924	82 49	10.72	2 76	2.00	1 04	50	38	.07	.05
1962	54,823,153	86.38	6.82	2 76	2.00	1.05	.46	.42	.07	05
1963	64,403,991	85 24	7 52	2.73	2 40	1 07	.42	52	06	04
1964	72,415,297	83 55	8 46	3.16	2.49	1.15	43	67	06	04
1965	89,498,711	81 83	9 92	3.45	2 44	1.13	43	70	.08	.03
1966	123,643,475	79 81	11 85	3.14	2.85	1.11	57	57	.08	02
1967	162,136,387	77.32	14.49	3 08	2.80	1.13	.67	44	.04	.04
1968	197,061,776	73.58	18.00	3 12	2.66	1 14	1 04	35	.02	.09
1969	176,343,147	73 51	17 60	3 40	3.13	1 44	68	12	01	.13
1970	131,708,798	78.45	11 11	3 76	3 81	2 00	.68	11	03	05
1971	186,375,172	79 07	9 98	4.00	3 79	2 29	59	19	05	04
1972	205,956,263	77 77	10.38	4 29	3.95	2 57	76	18	05	06
1973	178,861,725	82.07	6.06	4.55	3 56	2 46	1.00	21	.07	02

[1] Dollar Volume for Exchanges includes Stocks, Rights and Warrants
[2] Others include Intermountain Stock Exchange, Spokane Stock Exchange, National Stock Exchange and Honolulu Stock Exchange
[3] Data revised as of 1960

Third Market Volume

Over-the-counter volume in common stocks listed on the New York Stock Exchange was 249 million shares in 1973. This represented a decline of 24 percent from the record volume attained in 1972 and was the only decline in third market volume since reports on these transactions were first required by the Commission in 1965. Dollar volume of over-the-counter transactions declined 25 percent in 1973 to $10.2 billion.

In 1973, the ratio of over-the-counter share volume to total NYSE share volume was 5.8 percent compared to 7.3 percent in 1972. Dollar volume of over-the-counter transactions was 7.0 percent of total NYSE dollar volume in 1973, compared to 8.5 percent, the previous year.

'THIRD MARKET' VOLUME IN NYSE STOCKS

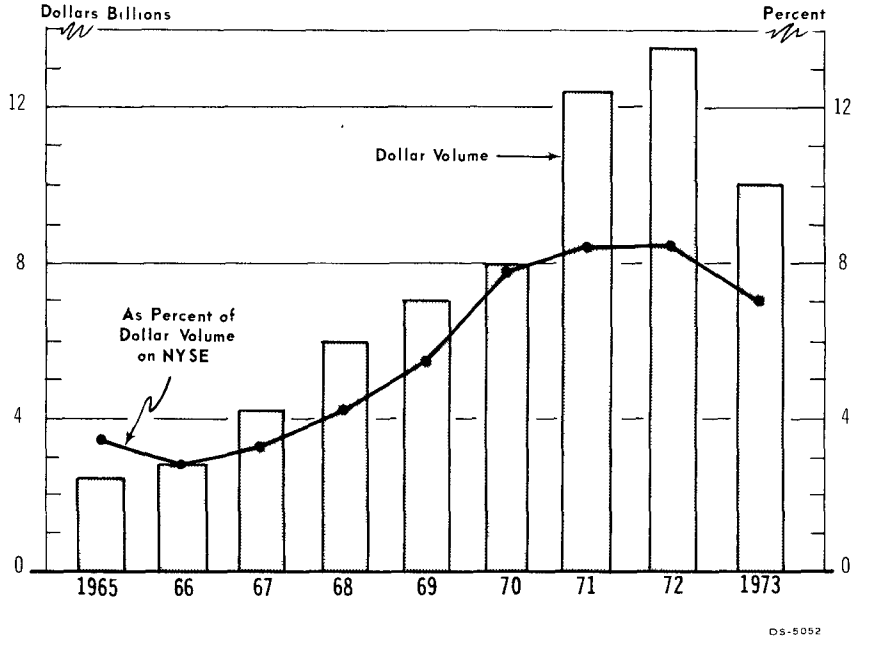


Table 14

COMPARISON OF THIRD MARKET AND NYSE VOLUME

Year	Over-the-counter sales of NYSE-listed common stocks	New York Stock Exchange volume	Ratio of over-the-counter sales to New York Stock Exchange volume (percent)
	Share volume (thousands)		
1965	48,361	1,809,351	2.7
1966	58,198	2,204,761	2 6
1967	85,081	2,885,748	2 9
1968	119,730	3,298,665	3 6
1969	155,437	3,173,564	4.9
1970	210,067	3,213,069	6 5
1971	297,850	4,265,279	7 0
1972	327,031	4,496,187	7.3
1973	249,387	4,336,581	5.8
	Dollar volume (thousands)		
1965	2,500,416	73,199,997	3 4
1966	2,872,660	98,565,294	2 9
1967	4,151,917	125,329,106	3 3
1968	5,983,041	144,978,410	4 2
1969	7,127,834	129,603,420	5.5
1970	8,020,839	103,063,237	7.8
1971	12,383,965	147,098,396	8 4
1972	13,580,785	159,700,186	8.5
1973	10,186,256	146,450,834	7 0

Special Block Distributions

In 1973, the total number of special block distributions declined 9.8 percent. However, the value of these distributions declined 62 percent to $1.2 billion.

Secondary distributions accounted for more than half of the total number of special block distributions in 1973 and 93 percent of the total value of these distributions. However, the number of secondary distributions, which reached a record high of 229 in 1972, declined 48 percent to 120 in 1973. The value of secondary distributions was 64 percent lower in 1973.

The Special Offering method, employed only once since 1962, was used *91* times in 1973 and accounted for 40 percent of the total number of all special block distributions in 1973, but at $79.9 million, accounted for only 3.9 percent of the value of all special block distributions.

The number of exchange distributions, declining since 1964, fell 27 percent in 1973. The value of exchange distributions was $9.1 million, representing a decline of 70 percent from the 1972 figure.

Table 15

SPECIAL BLOCK DISTRIBUTIONS REPORTED BY EXCHANGES

(value & volume in thousands)

Year	Secondary distributions			Exchange distributions			Special offerings		
	Number	Shares sold	Value	Number	Shares sold	Value	Number	Shares sold	Value
1942	116	2,397,454	$ 82,840				79	812,390	$22,694
1943	81	4,270,580	127,462				80	1,097,338	31,054
1944	94	4,097,298	135,760				87	1,053,667	32,454
1945	115	9,457,358	191,961				79	947,231	29,878
1946	100	6,481,291	232,398				23	308,134	11,002
1947	73	3,961,572	124,671				24	314,270	9,133
1948	95	7,302,420	175,991				21	238,879	5,466
1949	86	3,737,249	104,062				32	500,211	10,956
1950	77	4,280,681	88,743				20	150,308	4,940
1951	88	5,193,756	146,459				27	323,013	10,751
1952	76	4,223,258	149,117				22	357,897	9,931
1953	68	6,906,017	108,229				17	380,680	10,486
1954	84	5,738,359	218,490	57	705,781	$ 24,664	14	189,772	6,670
1955	116	6,756,767	344,871	19	258,348	10,211	9	161,850	7,223
1956	146	11,696,174	520,966	17	156,481	4,645	8	131,755	4,557
1957	99	9,324,599	339,062	33	390,832	15,855	5	63,408	1,845
1958	122	9,508,505	361,886	38	619,876	29,454	5	88,152	3,286
1959	148	17,330,941	822,336	28	545,038	26,491	3	33,500	3,730
1960	92	11,439,065	424,688	20	441,644	11,108	3	63,663	5,439
1961	130	19,910,013	926,514	33	1,127,266	58,072	2	35,000	1,504
1962	59	12,143,656	658,780	41	2,345,076	65,459	2	48,200	588
1963	100	18,937,935	814,984	72	2,892,233	107,498	0	0	0
1964	110	19,462,343	909,821	68	2,553,237	97,711	0	0	0
1965	142	31,153,319	1,603,107	57	2,334,277	86,479	0	0	0
1966	126	29,045,038	1,523,373	52	3,042,599	118,349	0	0	0
1967	143	30,783,604	1,154,479	51	3,452,856	125,404	0	0	0
1968	174	36,110,489	1,571,600	35	2,669,938	93,528	1	3,352	63
1969	142	38,224,799	1,244,186	32	1,706,572	52,198	0	0	0
1970	72	17,830,008	504,562	35	2,066,590	48,218	0	0	0
1971	204	72,801,243	2,007,517	30	2,595,104	65,765	0	0	0
1972	229	82,365,749	3,216,126	26	1,469,666	30,156	0	0	0
1973	120	30,825,890	1,151,087	19	802,322	9,140	91	6,662,111	79,889

Value and Number of Securities Listed on Exchanges

The market value of stocks and bonds on U.S. stock exchanges at year-end 1973 was $888 billion, a decrease of 15 percent over the previous year-end figure of $1,047 billion. The total was comprised of $764 billion in stocks and $124 billion in bonds. The value of listed stocks declined by 20 percent in 1973 and the value of listed bonds increased nearly 29 percent. Stocks with primary listing on the New York Stock Exchange were valued at $721 billion and represented 94 percent of the common and preferred stock. The value of NYSE-listed stocks declined from their 1972 year-end total by $166 billion or 19 percent. Stocks with primary listing on the AMEX accounted for 5 percent of the total and were valued at $39 billion. The value of AMEX stocks declined $20 billion or 34 percent in 1973. Stocks with primary listing on all other exchanges were valued at $4.1 billion and declined 28 percent over the 1972 total.

The net number of stocks and bonds listed on exchanges increased by 230 issues or 4 percent in 1973. The largest gain was recorded on the NYSE, where listings increased by 263 issues. Data on the number and value of foreign securities are in a footnote following Table 16.

Table 16

SECURITIES LISTED ON EXCHANGES[1]

(December 31, 1973)

Exchange	Common		Preferred		Bonds		Total Securities	
	Number	Market Value (Millions)	Number	Market Value (Millions)	Number	Market Value (Millions)	Number	Market Value (Millions)
Registered								
American	1,279	$ 37,376	81	$ 1,346	190	$ 2,801	1,550	$ 41,523
Boston	41	159	2	1	1	3	44	163
Cincinnati	8	27	3	6	3	30	14	63
Detroit	5	11	1	*	0	0	6	11
Midwest	29	617	8	81	1	10	38	708
National	107	346	0	0	4	50	111	396
New York	1,536	697,996	522	23,016	2,188	120,536	4,246	841,548
Pacific Coast	44	1,381	7	48	16	415	67	1,844
P-B-W	33	216	98	829	6	41	137	1,086
Intermountain	44	28	0	0	0	0	44	28
Spokane	23	22	0	0	0	0	23	22
Exempted								
Honolulu	19	348	7	9	5	2	31	359
Total	3,168	$738,527	729	$25,336	2,414	$123,888	6,311	$887,751

*Less than 5 million but greater than zero

[1]Excludes securities which were suspended from trading at the end of the year, and securities which because of inactivity had no available quotes. Includes the following foreign stocks:

Exchange	Number	Market Value (Millions)
New York	33	$17,693
American	69	15,600
P-B-W	2	7
National	4	174
Honolulu	2	7
Total	110	$33,481

MARKET VALUE OF SECURITIES TRADED ON ALL U. S. STOCK EXCHANGES

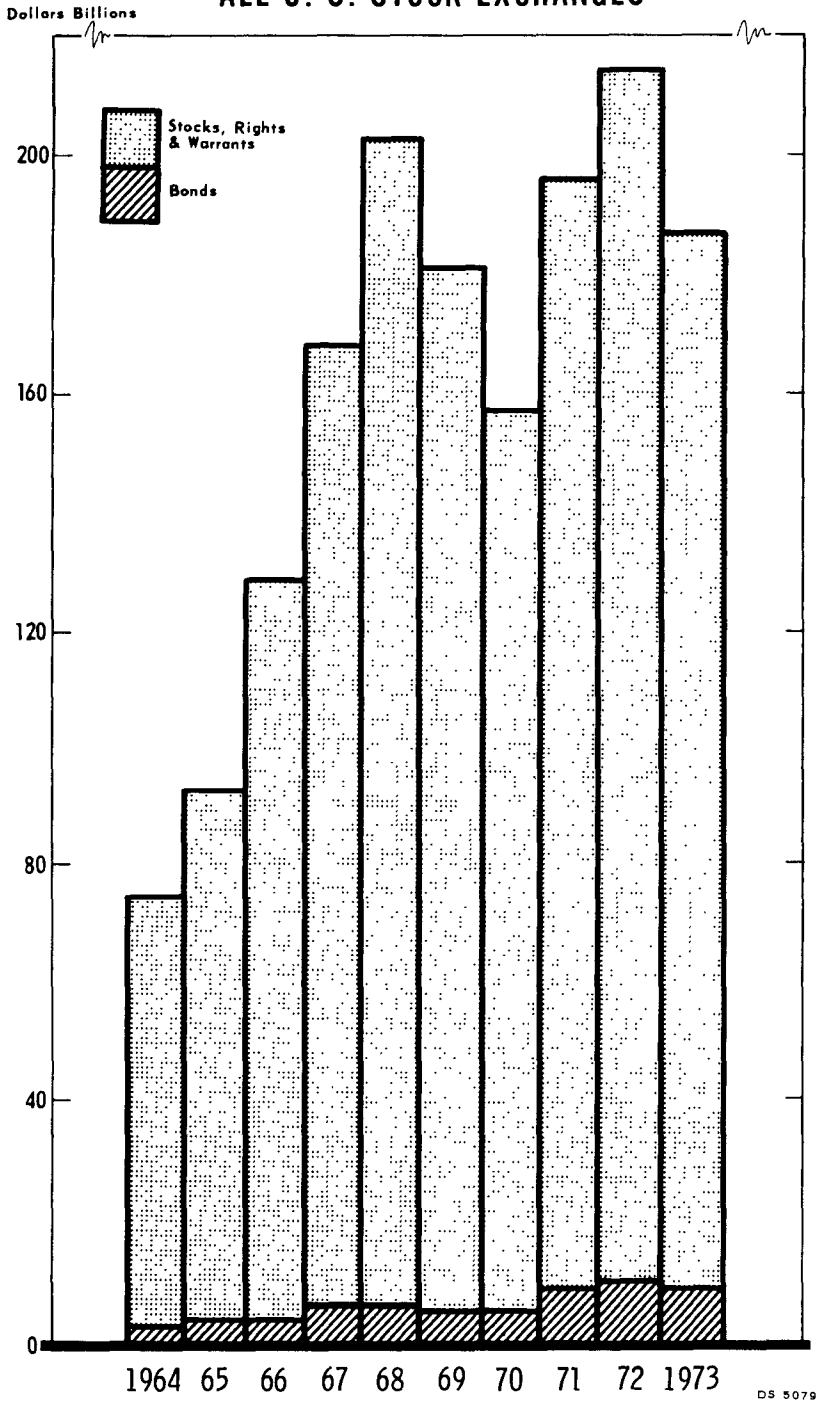


Table 17

VALUE OF STOCKS LISTED ON EXCHANGES

(Dollars in billions)

Dec. 31	New York Stock Exchange	American Stock Exchange	Exclusively on other Exchanges	Totals
1936	$ 59.9	$14.8		$ 74 7
1937	38.9	10 2		49 1
1938	47 5	10 8		58.3
1939	46 5	10.1		56 6
1940	41.9	8.6		50.5
1941	35 8	7.4		43.2
1942	38 8	7 8		46 6
1943	47 6	9 9		57 5
1944	55.5	11.2		66 7
1945	73 8	14.4		88.2
1046	68 6	13.2		81 8
1947	68.3	12 1		80 4
1948	67.0	11.9	$3.0	81.9
1949	76.3	12.2	3 1	91 6
1950	93 8	13.9	3.3	111.0
1951	109 5	16.5	3 2	129.2
1952	120 5	16 9	3 1	140 5
1953	117 3	15 3	2.8	135 4
1954	169 1	22 1	3.6	194.8
1955	207 7	27.1	4 0	238.8
1956	219.2	31 0	3 8	254 0
1957	195 6	25.5	3.1	224.2
1958	276.7	31 7	4 3	312 7
1959	307 7	25 4	4 2	337.3
1960	307.0	24.2	4 1	335.3
1961	387 8	33.0	5 3	426.1
1962	345 8	24 4	4 0	374 2
1963	411.3	26.1	4.3	441.7
1964	474 3	28 2	4.3	506 8
1965	537 5	30.9	4 7	573.1
1966	482 5	27.9	4 0	514.4
1967	605 8	43 0	3.9	652 7
1968	692 3	61 2	6.0	759 5
1969	629 5	47 7	5 4	682 6
1970	636.4	39.5	4.8	680.7
1971	741 8	49 1	4 7	795.6
1972	871 5[r]	55 6[r]	5 6[r]	932.7[r]
1973	721.0	38 7	4.1	763.8

[r] Revised.

Securities on Exchanges

As of June 30, 1974, a total of 6,459 securities, representing 3,482 issuers, were admitted to trading on securities exchanges in the United States. This compares with 6,353 issues, involving 3,475 issuers, a year earlier. Over 4,300 issues were listed and registered on the New York Stock Exchange, accounting for 53.5 percent of the stock issues and 90 percent of the bond issues. Data below on "Securities Traded on Exchanges" involves some duplication since it includes both solely and dually listed securities.

Table 18

UNDUPLICATED COUNT OF SECURITIES ON EXCHANGES

(June 30, 1974)

Registered exchanges	Stocks	Bonds	Total	Issuers involved
Registered and listed	3,920	2,452	6,372	3,421
Temporarily exempted from registration	3	2	5	2
Admitted to unlisted trading privileges	44	3	47	36
Exempted exchanges:				
Listed	23	5	28	16
Admitted to unlisted trading privileges	7	0	7	7
Total	3,997	2,462	6,459	3,482

Table 19

SECURITIES TRADED ON EXCHANGES

	Issuers	Stocks				Bonds[1]
		Registered	Temporarily exempted	Unlisted	Total	
American	1,287	1,314	1	50	1,365	201
Boston	819	107		747	854	15
Chicago Board Options	1	1			1	
Chicago Board of Trade	3	1		2	3	
Cincinnati	333	26		314	340	14
Detroit	384	68		335	403	
Honolulu[2]	37				46	5
Intermountain	56	54		2	56	
Midwest	624	385	1	323	709	13
National	106	108			108	4
New York	1,865	2,096	3		2,099	2,211
Pacific Coast	864	848		185	1,033	77
PBW	992	280		889	1,169	59
Spokane	37	35		5	40	

[1] Issues exempted under Section 3(a)(12) of the Act, such as obligations of U.S. Government, the states, and cities, are not included in this table

[2] Exempted exchange had 39 listed stocks and 7 admitted to unlisted trading

1933 ACT REGISTRATIONS

Effective Registrations; Statements Filed

During fiscal year 1974, 2,890 securities registrations valued at $57 billion became effective. The number of effective registrations fell 12 percent from fiscal 1973 and the dollar value declined 4 percent. These decreases reflect fewer small equity registrations and more registered debt.

The number, dollar value and type of registration statement filed with the Commission offer further insight into the decline in the numbers of small issues during fiscal 1974. There was a 16 percent decrease in the number of registration filings, from 3,744 in fiscal 1973 to 3,149 in fiscal 1974. The dollar value was the same for both years—$63 billion. Among these statements, there were 1,309 first-time registrants in fiscal 1973 and substantially fewer, 731, in fiscal 1974. Thus, almost all the decline in the numbers of filings is accounted for in the drop-off of first-time registrants.

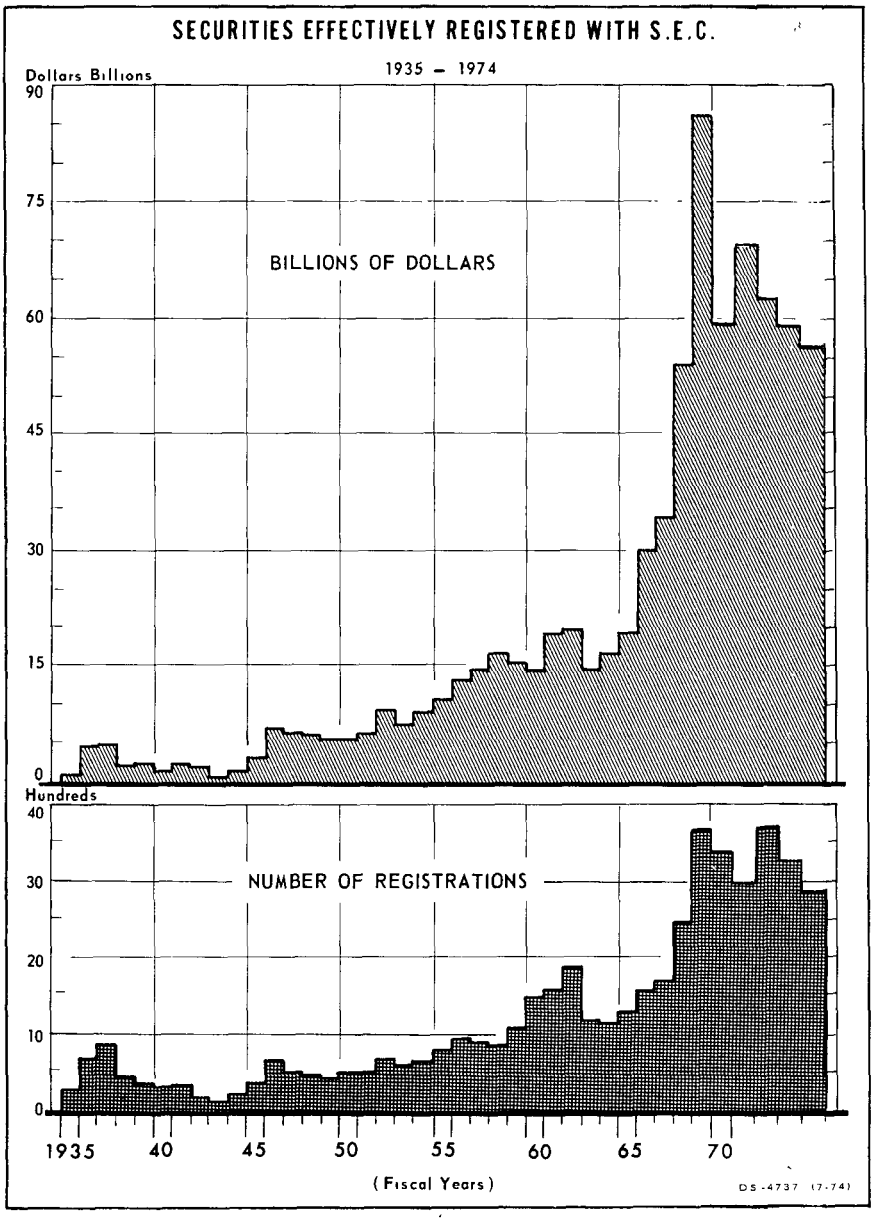
Table 20

EFFECTIVE REGISTRATIONS

(Dollars in millions)

Fiscal year ended June 30	Total		Cash sale for account of issuers			
	Number	Value	Common stock	Bonds, debentures, and notes	Preferred stock	Total
1935[1]	284	$ 913	$ 168	$ 490	$ 28	$ 686
1936	689	4,835	531	3,153	252	3,936
1937	840	4,851	802	2,426	406	3,635
1938	412	2,101	474	666	209	1,349
1939	344	2,579	318	1,593	109	2,020
1940	306	1,787	210	1,112	110	1,433
1941	313	2,611	196	1,721	164	2,081
1942	193	2,003	263	1,041	162	1,465
1943	123	659	137	316	32	486
1944	221	1,760	272	732	343	1,347
1945	340	3,225	456	1,851	407	2,715
1946	661	7,073	1,331	3,102	991	5,424
1947	493	6,732	1,150	2,937	787	4,874
1948	435	6,405	1,678	2,817	537	5,032
1949	429	5,333	1,083	2,795	326	4,204
1950	487	5,307	1,786	2,127	468	4,381
1951	487	6,459	1,904	2,838	427	5,169
1952	635	9,500	3,332	3,346	851	7,529
1953	593	7,507	2,808	3,093	424	6,326
1954	631	9,174	2,610	4,240	531	7,381
1955	779	10,960	3,864	3,951	462	8,277
1956	906	13,096	4,544	4,123	539	9,206
1957	876	14,624	5,858	5,689	472	12,019
1958	813	16,490	5,998	6,857	427	13,281
1959	1,070	15,657	6,387	5,265	443	12,095
1960	1,426	14,367	7,260	4,224	253	11,738
1961	1,550	19,070	9,850	6,162	248	16,260
1962	1,844	19,547	11,521	4,512	253	16,286
1963	1,157	14,790	7,227	4,372	270	11,869
1964	1,121	16,860	10,006	4,554	224	14,784
1965	1,266	19,437	10,638	3,710	307	14,656
1966	1,523	30,109	18,218	7,061	444	25,723
1967	1,649	34,218	15,083	12,309	558	27,950
1968	[2]2,417	[2]54,076	22,092	14,036	1,140	37,269
1969	[2]3,645	[2]86,810	39,614	11,674	751	52,039
1970	[2]3,389	[2]59,137	28,939	18,436	823	48,198
1971	[2]2,989	[2]69,562	27,455	27,637	3,360	58,452
1972	3,712	62,487	26,518	20,127	3,237	49,882
1973	3,285	59,310	26,615	14,841	2,578	44,034
1974	2,890	56,924	19,811	20,997	2,274	43,082
Cumulative total	47,223	778,345	329,007	242,933	26,627	598,573

[1] For 10 months ended June 30, 1935.
[2] Includes registered lease obligations related to industrial revenue bonds.


SECURITIES EFFECTIVELY REGISTERED WITH S.E.C.
1935 – 1974
Dollars Billions
90
75
60
45
30
15
0
BILLIONS OF DOLLARS
Hundreds
40
30
20
10
0
NUMBER OF REGISTRATIONS
1935
40
45
50
55
60
65
70
(Fiscal Years)
DS-4737 (7-74)

Purpose of Registration

Effective registrations for the purpose of cash sale for the account of issuers declined two percent, but within this category there were substantial changes in the composition of securities offered. Equity offerings dropped from $29.2 billion in 1973 to $22.1 billion in fiscal 1974. Debt offerings rose from $14.8 to $21.0 billion during the same time interval.

Among the securities registered for cash sale, almost all debt issues were for immediate offering. However, two-thirds of the equity registrations were for extended cash sale. Registrations of extended offerings totaled approximately $14.5 billion in fiscal 1974. Within this amount investment companies accounted for $7.5 billion and employee plans $6.8 billion. Corporate equity registrations accounted for 29 percent of immediate cash sale registrations, down from 48 percent in 1973 and 40 percent in fiscal 1972.

Securities registered by an issuer, but not for cash sale are primarily common stock issues for mergers and consolidations. At a level of $12.2 billion these registrations were 41 percent greater in 1974 than fiscal 1973.

Registrations for the purpose of secondary offerings (proceeds going to selling security holders) typically involve sales of common stock. In fiscal 1974, these registrations amounted to about $1.6 billion representing a 66 percent decline from fiscal 1973.

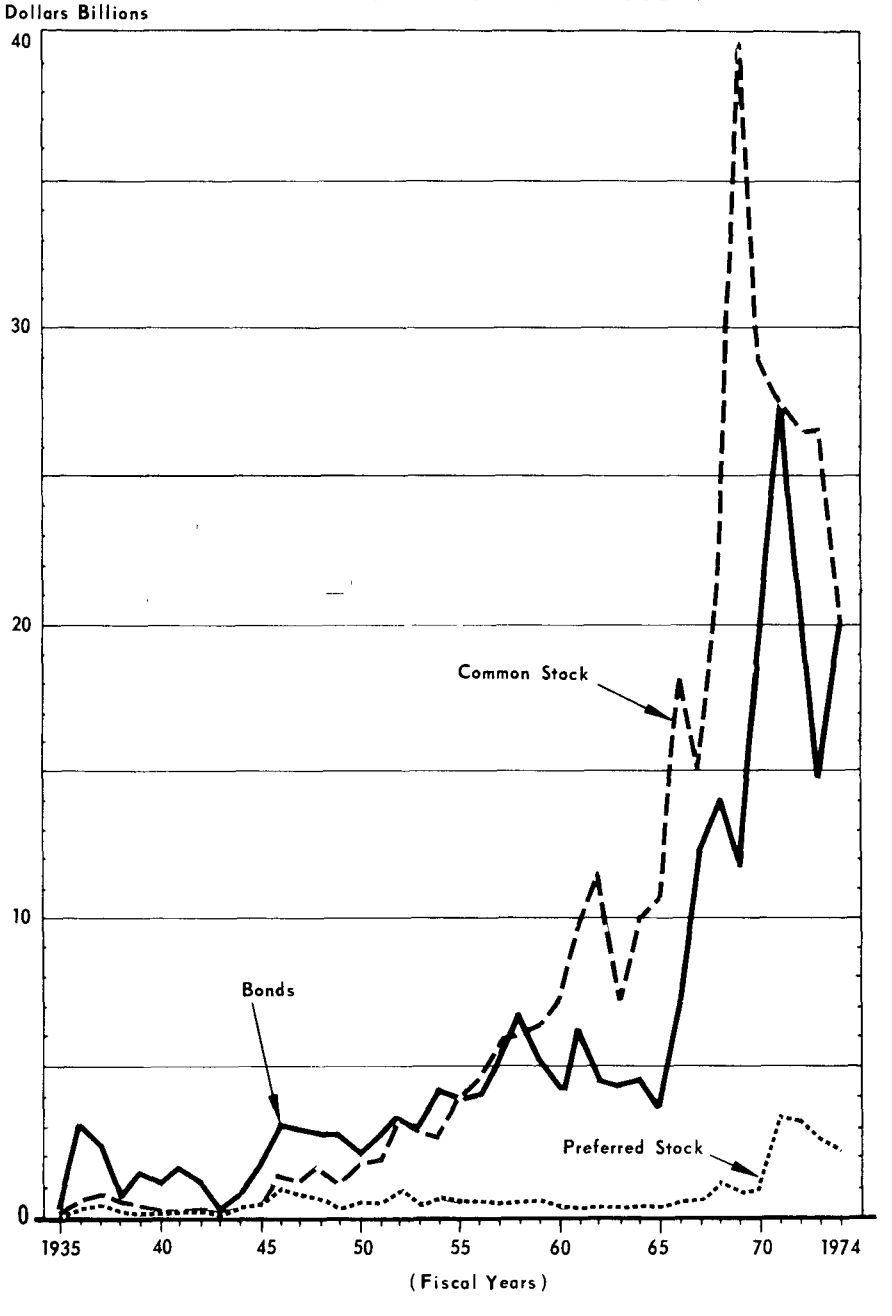
Table 21

EFFECTIVE REGISTRATIONS BY PURPOSE AND TYPE OF SECURITY: FISCAL 1974

(Dollars in millions)

Purpose of registration	Total	Type of security		
		Bonds, debentures, and notes	Preferred stock	Common stock
All registrations (estimated value)	56,924	22,654	2,896	31,373
For account of issuer for cash sale	43,082	20,997	2,274	19,811
Immediate offering	28,429	20,802	2,268	5,359
Corporate	26,417	18,801	2,257	5,359
Offered to:				
General public	25,442	18,786	2,257	4,399
Security holders	975	15	0	0
Foreign governments	2,012	2,001	11	960
Extended cash sale and other issues	14,653	195	6	14,452
For account of issuer for other than cash sale	12,216	1,529	610	10,077
Secondary offerings	1,626	129	12	1,485
Cash sale	615	3	0	613
Other	1,011	126	12	872

EFFECTIVE REGISTRATIONS
CASH SALE FOR ACCOUNT OF ISSUERS



Regulation A Offerings

During fiscal year 1974, 438 notifications were filed for proposed offerings under Regulation A. Issues between $400,000 and $500,000 in size predominated.

Table 22

OFFERINGS UNDER REGULATION A

	1962–71 annual average	Fiscal Year 1974	1973	1972
Size				
$100,000 or less	109	40	69	52
$100,000 to $200,000	111	79	107	46
$200,000 to $300,000	429	66	96	118
$300,000 to $400,000	12	39	86	182
$400,000 to $500,000	12	214	459	689
Total	673	438	817	1,087
Underwriters				
Used	237	115	402	590
Not used	436	323	415	497
Total	673	438	817	1,087
Offerors				
Issuing companies	644	394	787	1,052
Stockholders	20	34	18	28
Issuers and stockholders jointly	9	10	12	7
Total	673	438	817	1,087

ENFORCEMENT

Types of Proceedings

As the table below reflects, the securities laws provide for a wide range of enforcement actions by the Commission. The most common types of actions are injunctive proceedings instituted in the Federal district courts to enjoin continued or threatened securities law violators, and administrative proceedings pertaining to broker-dealer firms and/or individuals associated with such firms which may lead to various remedial sanctions as required in the public interest. When an injunction is entered by a court, violation of the court's decree is a basis for criminal contempt action against the violator.

Table 23

TYPES OF PROCEEDINGS

I. Administrative Proceedings

Basis for enforcement action	Sanction or relief
Broker-dealer, investment adviser or associated person	
Willful violation of securities acts provision or rule; aiding or abetting of such violation, failure reasonably to supervise others, willful misstatement in filing with Commission, conviction of or injunction against certain securities, or securities-related, violations	Revocation, suspension, or denial of broker-dealer or investment adviser registration, or censure of broker-dealer or investment adviser (1934 act, sec 15(b)(5); Advisers Act, sec 203(d))
Member of registered securities association	
Violation of 1934 act or rule thereunder; willful violation of 1933 act or rule thereunder	Expulsion or suspension from association (1934 act, sec. 15A(1)(2)).
Member of national securities exchange	
Violation of 1934 act or rule thereunder	Expulsion or suspension from exchange (1934 act, sec 19(a)(3))
Any person	
Same as first item.	Bar or suspension from association with a broker-dealer or investment adviser, or censure (1934 act, sec. 15(b)(7), Adviser Act, sec 203(f))
Violation of 1934 act or rule thereunder; willful violation of 1933 act or rule thereunder.	Bar or suspension from association with member of registered securities association. (1934 act, sec 15A(1)(2))
Willful violation of securities acts provision or rule; aiding or abetting of such violation; willful misstatement in filing with Commission.	Prohibition, permanently or temporarily, from serving in certain capacities for a registered investment company. (Investment Co. Act, sec. 9(b)).
Principal of broker-dealer	
Appointment of SIPC trustee for broker-dealer	Bar or suspension from association with a broker-dealer. (Securities Investor Protection Act, sec. 10(b))
Registered securities association	
Rules do not conform to statutory requirements	Suspension of registration (1934 act, sec. 15A(b)).
Violation of 1934 act or rule thereunder; failure to enforce compliance with own rules, engaging in activity tending to defeat purposes of provision of 1934 act authorizing national securities associations.	Revocation or suspension of registration (1934 act, sec. 15A(1)(1)).

Table 23—Continued

Basis for enforcement action	Sanction or relief
National securities exchange	
Violation of 1934 act or rule thereunder, failure to enforce compliance therewith by member of issuer of registered securities.	Withdrawal or suspension of registration (1934 act, sec. 19(a)(1))
Officer or director of registered securities association	
Willful failure to enforce association rules or willful abuse of authority	Removal from office (1934 act, sec 15A(1)(3))
Officer of national securities exchange	
Violation of 1934 act or rule thereunder	Expulsion or suspension from exchange (1934 act, sec 19(a)(3))
1933 Act registration statement	
Statement materially inaccurate or incomplete	Stop order suspending effectiveness (1933 act, sec 8(d))
Investment company has not attained $100,000 net worth 90 days after statement became effective	Stop order (Investment Co Act, sec 14(a))
1934 Act reporting requirements	
Material noncompliance	Order directing compliance (1934 act, sec 15(c)(4))
Securities issue	
Noncompliance by issuer with 1934 act or rules thereunder	Denial, suspension of effective date, suspension or withdrawal of registration on national securities exchange (1934 act, sec 19(a)(2))
Public interest requires trading suspension	Summary suspension of over-the-counter or exchange trading (1934 act, secs 15(c)(5) and 19(a)(4))
Registered investment company	
Failure to file 1940 act registration statement or required report, filing materially incomplete or misleading statement or report	Revocation or suspension of registration (Investment Co Act, sec. 8(e))
Company has not attained $100,000 net worth 90 days after 1933 act registration statement became effective	Revocation or suspension of registration (Investment Co Act, sec 14(a))
Name of company, or of security issued by it, deceptive or misleading	Prohibition of adoption of such name (Investment Co. Act, sec 35(d))
Attorney, accountant, or other professional or expert	
Lack of requisite qualifications to represent others; lacking in character or integrity, unethical or improper professional conduct, willful violation of securities laws or rules, or aiding and abetting of such violation	Permanent or temporary denial of privilege to appear or practice before Commission (Rules of Practice, Rule 2(e)(1))
Attorney suspended or disbarred by court, expert's license revoked or suspended, conviction of felony or misdemeanor involving moral turpitude	Automatic suspension from appearance or practice before Commission (Rules of Practice, Rule 2(e)(2))
Permanent injunction or finding of violation in Commission—instituted action, finding of violation by Commission in administrative proceeding	Temporary suspension from appearance or practice before Commission (Rules of Practice, Rule 2(e)(3)

II Civil Proceedings in Federal District Courts	
Basis for enforcement action	Sanction or relief
Any person	
Person engaging or about to engage in acts or practices violating securities acts or rules thereunder	Injunction against acts or practices which constitute or would constitute violations (plus ancillary relief under court's general equity powers) (1933 act, sec 20(b); 1934 act, sec 21(e), 1935 act, sec 18(f), Investment Co Act, sec 42(e), Advisers Act, sec 209(e))
Noncompliance with provision of law, rule, or regulation under 1935 act, order issued by Commission, or undertaking in a registration statement	Writ of mandamus directing compliance (1933 act, sec 20(c), 1934 act, sec 21(f), 1935 act, sec 18(g))
Issuer subject to reporting requirements	
Failure to file reports required under section 15(d) of 1934 act	Forfeiture of $100 per day (1934 act, sec. 32(b))
Registered investment company or affiliate	
Name of company or of security issued by it deceptive or misleading	Injunction against use of name (Investment Co Act, sec 35(d))
Officer, director, adviser, or underwriter engaging or about to engage in act or practice constituting breach of fiduciary duty involving personal misconduct.	Injunction against acting in certain capacities for investment company (Investment Co Act, sec 36(a)).
Breach of fiduciary duty respecting receipt of compensation from investment company, by any person having such duty	Award of damages (Investment Co Act, sec 36(b)).

III Referral to Attorney General for Criminal Prosecution	
Basis for enforcement action	Sanction or relief
Any person	
Willful violation of securities acts or rules thereunder.	Maximum penalties. $5,000 fine and 5 years' imprisonment under 1933 and 1939 acts, $10,000 fine and 2 years' imprisonment under other acts. An exchange may be fined up to $500,000, a public-utility holding company up to $200,000. (1933 act, secs. 20(b), 24; 1934 act, secs. 21(e), 32(a); 1935 act, secs 18(f), 29, 1939 act, sec 325, Investment Co Act, secs , 42(e), 49, Advisers Act, secs 209(e), 217).

Enforcement Proceedings

During fiscal 1974, the Commission instituted a total of 148 injunctive actions. In addition, 15 miscellaneous actions were instituted by the Commission and 19 actions were brought against it in United States District Courts. During the year 23 appellate cases involving petitions for review of Commission decisions were handled, as well as 60 appeals in injunctive and miscellaneous actions and 8 appeals in reorganization cases.

Table 24

ADMINISTRATIVE PROCEEDINGS

Fiscal year	Broker-dealer cases	Investment adviser cases	Stop order, Regulation A suspension and other disclosure cases
1965	103	2	26
1966	43	8	13
1967	33	3	16
1968	32	4	6
1969	103	10	20
1970	90	12	36
1971	167	22	28
1972	122	11	32
1973	151	20	27
1974	138	12	25

Table 25

INJUNCTIVE ACTIONS

Fiscal year	Cases instituted	Injunctions ordered	Defendants enjoined
1965	71	71	265
1966	67	63	258
1967	68	56	189
1968	93	98	384
1969	94	102	509
1970	111	97	448
1971	140	114	495
1972	119	113	511
1973	178	145	654
1974	148	289	613

Table 26

CRIMINAL CASES

Fiscal year	Number of cases referred to justice dept	Number of indictments	Defendants indicted	Convictions
1965	52	34	208	106
1966	44	50	193	76
1967	44	53	213	127
1968	40	42	123	84
1969	37	64	213	83
1970	35	36	102	55
1971	22	16	83	89
1972	38	28	67	75
1973	49	40	178	83
1974	67	40	169	81

PUBLIC UTILITY HOLDING COMPANIES

Assets

At fiscal year-end there were 20 active holding companies registered under the 1935 Public Utility Holding Company Act. The 17 active holding company systems in which those companies are included represent a total of 177 companies. Aggregate consolidated assets, less valuation reserves, approximated $33.6 billion at December 31, 1974.

Table 27

PUBLIC-UTILITY HOLDING COMPANY SYSTEMS

	Solely registered holding companies	Registered holding operating companies	Electric and/or gas utility subsidiaries	Nonutility sub sidiaries	Inactive com-panies	Total com-panies	Aggregate system assets less valuation reserves, at Dec 31, 1973[1]
Allegheny Power System, Inc	1	2	5	4	0	12	$1,622,440,000
American Electric Power Co , Inc	1	0	9	17	2	29	5,071,320,000
American Natural Gas Co	1	0	2	5	0	8	2,113,781,000
Central & Southwest Corp	1	1	4	1	1	8	1,579,583,000
Columbia Gas System, Inc., The	1	0	9	10	0	20	2,596,856,000
Consolidated Natural Gas Co	1	0	5	4	0	10	1,503,865,000
Delmarva Power & Light Co	0	1	2	0	0	3	702,253,000
Eastern Utilities Associates	1	0	4	1	2	8	222,314,000
General Public Utilities Corp	1	0	4	4	1	10	3,034,065,000
Middle South Utilities, Inc	1	0	6	4	3	14	2,712,788,000
National Fuel Gas Co	1	0	3	2	0	6	404,221,000
New England Electric System	1	0	4	1	0	6	1,373,519,000
Northeast Utilities	1	0	5	8	6	20	2,255,528,000
Ohio Edison Co	0	1	1	0	0	2	1,498,996,000
Philadelphia Electric Power Co	0	1	1	0	1	3	57,818,000
Southern Co., The	1	0	5	2	0	8	5,378,299,000
Utah Power & Light Co	0	1	1	0	0	2	684,203,000
Subtotals	13	7	70	63	16	169	32,811,849,000
Adjustments (a) to take account of jointly owned companies, (b) to add net assets of 8 jointly owned companies not included above[2]	0	0	(a) +8	0	0	(a) +8	(b) 808,179,000
Total companies and assets in active systems	13	7	78	63	16	177	$33,620,028,000

[1] Represents the consolidated assets, less valuation reserves, of each of system as reported to the Commission on form U5S for the year 1973

[2] These 8 companies are Beechbottom Power Co , Inc , which is an indirect subsidiary of American Electric Power Co , Inc and Allegheny Power System, Inc , Ohio Valley Electric Corp , and its subsidiary, Indiana-Kentucky Electric Corp , which are owned 37 8 percent by American Electric Power Co , Inc , 16.5 percent by Ohio Edison Co , 12 5 percent by Allegheny Power System, Inc , and 33 2 percent by other companies, The Arklahoma Corp., which is owned 32 percent by Central & Southwest Corp system, 34 percent by Middle South Utilities, Inc system, and 34 percent by an electric utility company not associated with a registered system, Yankee Atomic Electric Co., Connecticut Yankee Atomic Power Co , Vermont Yankee Nuclear Power Corp , and Maine Yankee Atomic Power Co , which are statutory utility subsidiaries of Northeast Utilities and New England Electric System

Financing

The volume of external financing by these companies aggregated $2.56 billion in fiscal 1974, a decrease of 5.7 percent from the previous year. Bonds issued and sold increased 20 percent, and preferred stock 43 percent. However, the amount of common stock and debentures issued and sold decreased 50 percent and 59 percent, respectively.

Table 28

FINANCING OF HOLDING-COMPANY SYSTEMS[1]
(Fiscal 1974)

Holding-company systems	In millions of dollars[2]			
	Bonds	Debentures	Preferred stock	Common stock
Alleghany Power System Inc				$ 49.4
Monongahela Power Co			$ 10.2	
Potomac Edison Co	$ 15 1			
American Electric Power Co				16 3
Appalachian Power Co.	50 0		20 2	
Indiana & Michigan Electric Co.	[3]109.8		30 3	
Ohio Power Co	[3]139.2		30.5	
American Natural Gas Co.				
Michigan Consolidated Gas Co	34.7			
Michigan Wisconsin Pipe Line Co	[3]98 7			
Central and South West Corp				
Central Power & Light Co	[3]85 4			
West Texas Utilities Co.	23 0			
Columbia Gas Co		$ 39 5		
Consolidated Natural Gas Co		49 5		
Delmarva Power & Light Co.	34.7		15 2	19 3
Eastern Utilities Associates				
Brockton Edison Co	10.1		3.0	
General Public Utilities Corp.				49 9
Jersey Central Power & Light Co.	50 1			
Metropolitan Edison Co	20 0	20 0	15 2	
Pennsylvania Electric Co	[3]80 2			
Middle South Utilities				
Arkansas Power & Light Co	[3]80 3		15 2	
Louisiana Power & Light Co	45.2		10 1	
Mississippi Power & Light Co	[3]45 5			
New Orleans Public Service, Inc	35.3			
New England Electric System				27.5
Massachusetts Electric Co			20 2	
New England Power Co	[3]80 8			
Northeast Utilities				
Connecticut Light & Power Co , The	64 6		50.9	
Hartford Electric Light Co , The	29 9		15 3	
Ohio Edison Co	75 3		45.6	48 0
Pennsylvania Power Co			8 1	
Southern Co., The				156 2
Alabama Power Co	[3]274.1		[3]86.2	
Georgia Power Co	149.1			
Mississippi Power Co.			15 2	
Utah Power & Light Co			35.6	27 8
Total	1,631.1	109.0	427 0	394.4

[1] The table does not include securities issued and sold by subsidiaries to their parent holding companies, short-term notes sold to banks, portfolio sales by any of the system companies, or securities issued for stock or assets of nonaffiliated companies Transactions of this nature also require authorization by the Commission except, as provided by Sec 6(b) of the Act, the issuance of notes having a maturity of 9 months or less where the aggregate amount does not exceed 5 percent of the principal amount and par value of the other securities of the issuer then outstanding

[2] Debt securities are computed at price to company, preferred stock at offering price, common stock at offering or subscription price

[3] Two or more issues

CORPORATE REORGANIZATIONS

Commission Participation

During fiscal 1974, the Commission was a party in a total of 132 reorganization proceedings under Chapter X of the Bankruptcy Act. These were scattered among district courts in 35 states, the District of Columbia, and 1 territory. In 23 proceedings, the Commission first entered its appearance during the year; 17 proceedings were closed.

Table 29

REORGANIZATION PROCEEDINGS UNDER CHAPTER X OF THE BANKRUPTCY ACT IN WHICH THE COMMISSION PARTICIPATED

(Fiscal year 1974)

Debtor	District court	Petition filed	SEC notice of appearance filed
Air Industrial Research, Inc [1]	N.D. Cal.	March 14, 1974	May 6, 1974
American Associated Systems, Inc	E.D Ky	Dec. 24, 1970	Feb. 26, 1971
American Land Corp [1]	S.D. Ohio	Aug. 8, 1973	Sept 25, 1973
American Loan & Finance Co.[3]	E D. Va	July 31, 1972	Aug 30, 1972
American National Trust	S.D Ind	Feb 13, 1968	March 27, 1968
Arizona Lutheran Hospital[3]	D Ariz	May 11, 1970	May 25, 1970
Arlan's Department Stores, Inc [1]	S D N Y.	March 8, 1974	March 8, 1974
Atlanta International Raceway, Inc.	N D. Ga	Jan 18, 1971	Feb 3, 1971
Bankers Trust[3]	S D Ind.	Oct 7, 1966	Nov 1,1966
Beck Industries, Inc	S.D. N Y	May 27, 1971	July 30, 1971
Bermec Corp	S.D N Y.	April 16, 1971	April 19, 1971
Beverly Hills Bancorp[1]	C.D. Cal.	April 11, 1974	May 14, 1974
Bubble Up Delaware, Inc	C D. Cal.	Aug 31, 1970	Oct. 19, 1970
Burton's In The Round, Inc [2]	N.D. Ill.	March 23, 1970	April 1, 1970
BXP Construction Corp [1]	S.D. N Y.	Jan 15, 1974	Feb. 20, 1974
Caribbean Shoe Corp.[1&2]	S.D Fla	Dec. 21, 1973	Jan. 9, 1974
Coast Investors, Inc.[3]	W D Wash	April 1, 1964	June 10, 1964
Coffeyville Loan & Investment[3]	D. Kans.	July 17, 1959	Aug. 10, 1959
Combined Metals Reduction Co	D Nev	Sept. 30, 1970	Sept. 7, 1972
Commonwealth Financial Corp.[3]	E.D Pa	Dec 4, 1967	Dec 13, 1967
Community Business Services Inc	E D Cal	June 8, 1972	April 30, 1973
Congaree Iron & Steel Co., Inc.[2]	D. S.C.	April 12, 1972	Aug. 17, 1972
Continental Vending Maching Corp [2]	E D N Y.	July 10, 1963	Aug 7, 1963
Cosmo Capital Inc.[3]	N D. Ill.	April 22, 1963	April 26, 1963
Cybern Education, Inc [3]	N.D. Ill.	Sept 11, 1970	Sept 25, 1970
Davenport Hotel, Inc	E D. Wash	Dec 20, 1972	Jan. 26, 1973
Diversified Mountaineer Corp.[1]	S.D W.Va	Feb 8, 1974	April 24, 1974
Dumont-Airplane & Marine[3]	S D N Y.	Oct 22, 1958	Nov 10, 1958
Eastern Credito Corp [1]	E D. Va	March 4, 1974	April 22, 1974
East Moline Downs, Inc [1]	S.D. Ill	Sept. 11, 1973	Oct 17, 1973
Educational Computer Systems	D. Ariz	April 26, 1972	Nov 3, 1972
Eichler Corp [3]	N D Cal	Oct 11, 1967	Oct 11, 1967
El-Tronics, Inc [3]	E D Pa	Nov. 25, 1958	Jan 16, 1959
Equitable Plan Co [3]	S D Cal	March 17, 1958	March 24, 1958
Equity Funding Corp. of America	C.D. Cal	April 5, 1973	April 9, 1973
Farrington Manufacturing Co.	E D. Va.	Dec. 22, 1970	Jan. 14, 1971
Federal Coal Co [2]	S.D W.Va	Jan 29, 1971	Jan 29, 1971
First Baptist Church, Inc of Margate Florida[1]	S D Fla	Sept 10, 1973	Oct. 1, 1973
First Holding Corp [2]	S.D Ind	Oct. 7, 1969	Dec 10, 1969
First Home Investment Co. of Kansas	D Kans	April 24, 1973	April 24, 1973
First Research Corp	S D Fla.	March 2, 1970	April 14, 1970
Flying W Airways, Inc [2]	E D Pa	Sept 23, 1970	Dec. 15, 1970
Food Town, Inc [2]	D Md.	July 28, 1959	Aug. 10, 1959
Four Seasons Nursing Centers of America, Inc [2]	W.D. Okla.	June 26, 1970	July 13, 1970
Wm Gluckin Company, Ltd.	S D N.Y	Feb. 22, 1973	March 6, 1973
Gro-Plant Industries, Inc.	N D. Fla	Aug. 30, 1972	Sept 13, 1972
Gulfco Investment Corp [1]	W D Okla	March 22, 1974	March 28, 1974
Harmony Loan Inc.	E.D Ky.	Jan 31, 1973	Jan 31, 1973
Hawkeye Land, Ltd.[1]	S D Iowa	Dec 19, 1973	Jan 21, 1974
R. Hoe & Co., Inc	S.D. N Y	July 7, 1969	July 14, 1969

Debtor	District court	Petition filed	SEC notice of appearance filed
Home Stake Production Co [1]	N D Okla	Sept 20, 1973	Oct 2, 1973
Houston Educational Foundation, Inc	S.D. Tex	Feb. 16, 1971	March 2, 1971
Hughes Homes, Inc [2]	D Mont	Sept 8, 1961	Oct. 5, 1961
Human Relations Research Foundation [3]	S D Cal.	Jan 31, 1964	Feb 14, 1964
Imperial-American Resources Fund, Inc [3]	D Colo.	Feb 25, 1972	March 6, 1972
Imperial '400' National, Inc	D N J	Feb 18, 1966	Feb. 23, 1966
Indiana Business & Investment Trust	S D Ind	Oct 10, 1966	Nov 4, 1966
Interstate Stores, Inc [1]	S D N.Y	June 13, 1974	June 13, 1974
Investors Associated, Inc [3]	W D Wash.	March 3, 1965	March 17, 1965
Jade Oil & Gas Co [3]	C D Cal	June 28, 1967	Aug 16, 1967
J D Jewell, Inc	N D Ga	Oct 20, 1972	Nov. 7, 1972
King Resources Co.	D Colo	Aug. 16, 1971	Oct 19, 1971
Kirchofer & Arnold [3]	E D N C	Nov 9, 1959	Nov 12, 1959
Lake Winnebago Development Co., Inc	W.D Mo	Oct 14, 1970	Oct. 26, 1970
Landmark Inns of Durham, Inc [2]	M D N C	Sept 3, 1969	Dec. 10, 1969
Little Missouri Minerals Association, Inc	D N D.	July 18, 1966	Jan 29, 1968
Los Angeles Land & Investments, Ltd	D Hawaii	Oct. 24, 1967	Nov 28, 1967
Louisiana Loan & Thrift Inc	E D La	Oct 8, 1968	Oct 8, 1968
Lusk Corp	D Ariz	Oct 28, 1965	Nov 15, 1965
Lyntex Corp.[1]	S D N Y	April 15, 1974	Jan. 28, 1974
Dolly Madison Industries, Inc	E D. Pa	June 23, 1970	July 6, 1970
Magnolia Funds, Inc.	E D La	Nov. 18, 1968	May 26, 1969
Mammoth Mountain Inn Corp	C D Cal	Sept. 16, 1969	Feb 6, 1970
Manufacturers Credit Corp.[3]	D N.J	Aug 1, 1967	July 30, 1968
Maryvale Community Hospital [3]	D Ariz	Aug 1, 1963	Sept 11, 1963
Mayer Central Building [3]	D Ariz.	July 15, 1965	Jan 19, 1966
Mid-City Baptist Church	E D La	July 30, 1968	Oct 23, 1968
Morehead City Shipbuilding [3]	E D N C	Nov. 9, 1959	Nov 12, 1959
Moulded Products, Inc [2]	D Minn.	July 6, 1971	Aug 6, 1971
Mount Everest Corp.[1]	E D Pa	May 29, 1974	June 28, 1974
National Video Corp [3]	N D Ill	Feb 26, 1969	March 26, 1969
Nevada Industrial Guaranty Co	D. Nev.	May 7, 1963	July 2, 1963
North American Acceptance Corp [1]	N D Ga	March 5, 1974	March 28, 1974
North Western Mortgage Investors [1]	W D Wash	Dec 12, 1973	Dec 12, 1973
Pan American Financial Corp	D Hawaii	Oct 2, 1972	Jan 9, 1973
Parkview Gem, Inc [1]	W D Mo	Dec 18, 1973	Dec 28, 1973
Parkwood Inc.[3]	D D C	June 13, 1966	June 17, 1966
Peoples Loan & Investment Co [2]	W D Ark.	May 13, 1969	May 21, 1969
Phoenix Mortgage Co	D Ariz.	Aug 14, 1967	April 17, 1968
RIC International Industries, Inc	N D Tex	Sept. 16, 1970	Sept. 23, 1970
John Rich Enterprises, Inc	D. Utah	Jan 16, 1970	Feb 6, 1970
Riker Delaware Corp [3]	D N J	April 21, 1967	May 23, 1967
Roberts Company [3]	M D N C	Feb. 12, 1970	March 23, 1970
San Francisco & Oakland Helicopter Airlines, Inc [2]	N.D Cal	July 31, 1970	Aug 11, 1970
Scranton Corp.[3]	M D Pa.	April 3, 1959	April 15, 1959
Sequoyah Industries Inc.[1]	W.D. Okla	Jan 21, 1974	Jan. 30, 1974
Edward N Siegler & Co [3]	N.D Ohio	May 23, 1966	June 7, 1966
Sierra Trading Corp [3]	D Colo	July 7, 1970	July 22, 1970
Sire Plan, Inc [2]	S D N.Y	Feb 16, 1963	Feb 18, 1963
Sire Plan Management Corp [2]	S D N Y	March 4, 1963	April 5, 1963
60 Minute Systems, Inc.	M D Fla	July 17, 1970	July 29, 1970
Sound Mortgage Co , Inc [3]	W D Wash	July 27, 1965	Aug. 31, 1965
Southern Land Title Corp [3]	E D La.	Dec 7, 1966	Dec 31, 1966
Stanndco Developers, Inc [1]	W.D N.Y	Feb. 5, 1974	March 7, 1974
Stirling Homex Corp	W D N.Y.	July 11, 1972	July 24, 1972
Sunset International Petroleum [3]	N.D. Tex.	May 27, 1970	June 10, 1970
Swan-Finch Oil Corp [3]	S.D N.Y.	Jan. 2, 1958	Jan 23, 1958
Tele-Tronics Co	E.D. Pa	July 26, 1962	Sept 12, 1962
Texas Independent Coffee Organization [3]	S.D. Tex	Jan. 5, 1965	Jan. 13, 1965
Tilco, Inc	D Kans	Feb. 7, 1973	Feb 22, 1973
TMT Trailer Ferry, Inc	S.D Fla.	June 27, 1957	Nov 22, 1957
Tower Credit Corp [3]	M.D Fla	April 13, 1966	Sept 6, 1966
Traders Compress Co.	W D Okla	May 12, 1972	June 6, 1972
Trans East Air Inc.	D Me.	Aug. 29, 1972	Feb 22, 1973
Trans-International Computer Investment	N D Cal	March 22, 1971	July 26, 1971
Trustors' Corp [3]	C D Cal	Sept. 13, 1961	Oct. 9, 1961
Twentieth Century Foods Corp [2]	E.D Ark	Oct 30, 1961	Feb 5, 1962
Union Investments, Inc.[2]	D Hawaii	Feb 2, 1970	March 12, 1970
Uniservices, Inc	S.D Ind	Dec 4, 1970	Jan 28, 1971
Viatron Computer Systems Corp	D Mass	April 29, 1971	April 29, 1971

Debtor	District court	Petition filed	SEC notice of appearance filed
Vinco Corp.[3]	E.D Mich.	March 29, 1963	April 9, 1963
Virgin Island Properties, Inc.	D. V.I	Oct. 22, 1971	April 11, 1972
Waltham Industries Corp	C D Cal.	July 14, 1971	Aug. 19, 1971
Webb & Knapp, Inc.	S.D N Y	May 7, 1965	May 11, 1965
H. R. Weissberg Corp [3]	N D Ill	March 5, 1968	April 3, 1968
Westec Corp [3]	S.D. Tex	Sept. 26, 1966	Oct. 4, 1966
Western Growth Capital Corp.	D. Ariz	Feb. 10, 1967	May 16, 1968
Western National Investment Corp [3]	D Utah	Jan 4, 1968	March 11, 1968
Westgate California Corp [1]	S.D Cal.	Feb 26, 1974	March 8, 1974
Wonderbowl, Inc	C D. Cal	March 10, 1967	June 7, 1967
Woodmoor Corp [1]	D. Colo.	Feb 25, 1974	March 25, 1974
Yale Express System Inc.[3]	S D. N Y	May 24, 1965	May 28, 1965

[1] Commission filed notice of appearance in fiscal year 1974.
[2] Reorganization proceedings closed during fiscal year 1974.
[3] Plan has been substantially consummated but no final decree has been entered because of pending matters.

SEC OPERATIONS

Net Cost

Fees collected by the Commission in fiscal 1974 amounted to 60 percent of funds appropriated by the Congress for Commission operations. The Commission is required by law to collect fees for (1) registration of securities issued; (2) qualification of trust indentures; (3) registration of exchanges; (4) brokers and dealers who are registered with the Commission but are not members of the NASD; and (5) certification of documents filed with the Commission. In addition, by fee schedule, the Commission imposes fees for certain filings and services such as the filing of annual reports and proxy material. With reference to the fee schedule, on March 29, 1974, the Commission announced the repeal of certain provisions of Rule 203–3 under the Investment Advisers Act of 1940. One of the paragraphs repealed, Rule 203–3(b), required registered investment advisers to pay a $100 annual fee to the Commission during the period of their registration. The action was taken following the Commission's consideration of recent decisions of the United States Supreme Court with respect to the Independent Offices Appropriation Act of 1952, 31 U.S.C. 483(a), which had provided the statutory basis for establishing these fees. The Commission is presently reviewing all other fees imposed pursuant to the same Act.

APPROPRIATED FUNDS vs FEES COLLECTED

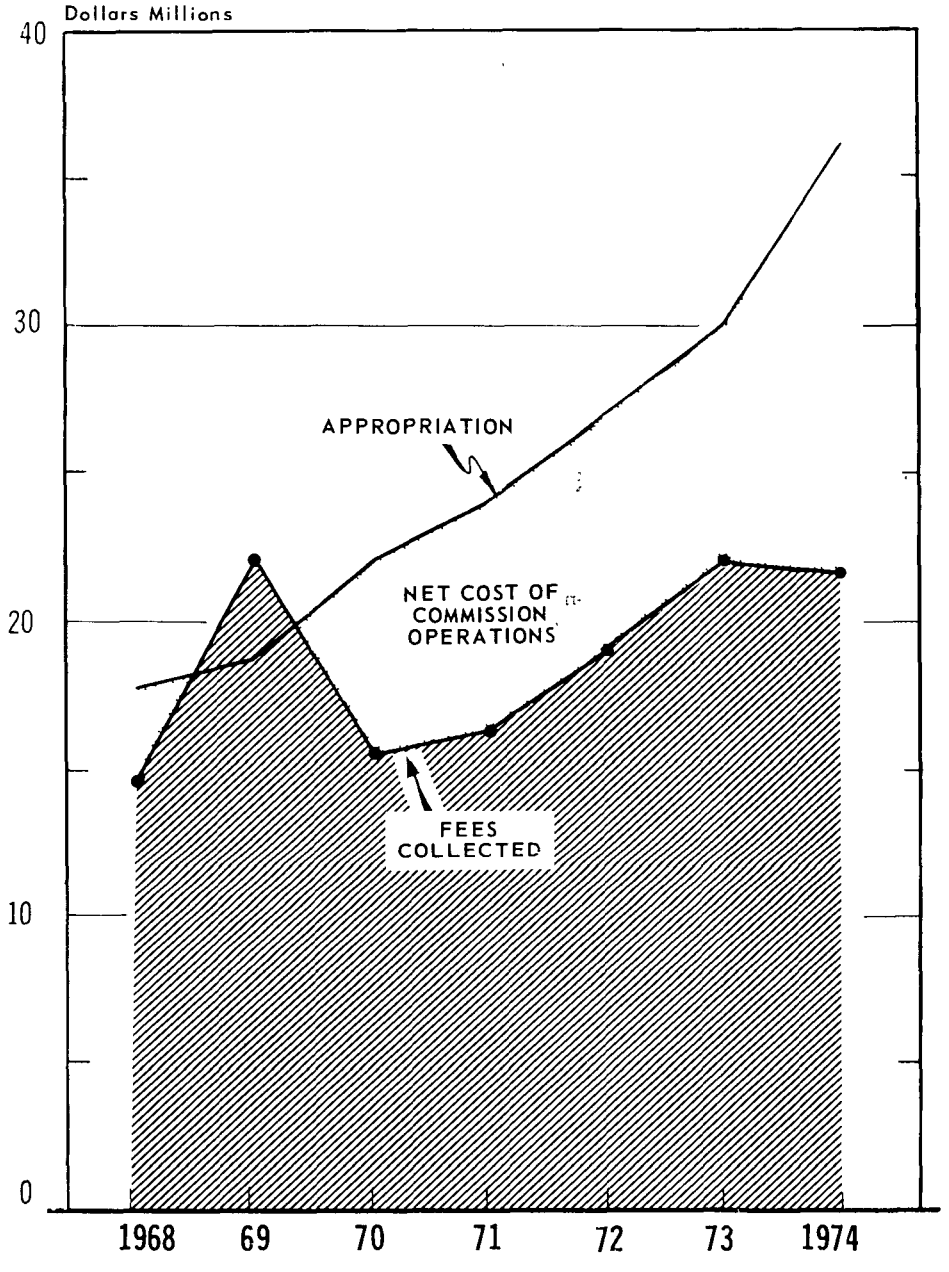


Table 30

BUDGET ESTIMATES AND APPROPRIATION

Action	Fiscal 1970		Fiscal 1971		Fiscal 1972		Fiscal 1973		Fiscal 1974		Fiscal 1975	
	Positions	Money	Positions	Money	Positions	Money	Positions	Money	Positions	Money	Positions	Money
Estimate submitted to the Office of Management and Budget	1,467	$20,788,000	1,532	$22,463,000	1,875	$28,728,000	1,939	$33,691,000	1,919	$34,027,000	2,219	$43,674,000
Action by the Office of Management and Budget	−35	−372,000	−65	−463,000	−313	−2,411,000	−283	−3,930,000	−204	−2,817,000	−225	−1,543,000
Amount allowed by the Office of Management and Budget	1,432	20,416,000	1,467	22,000,000	1,562	26,317,000	1,656	29,761,000	1,715	31,210,000	1,994	42,131,000
Action by the House of Representatives	−42	−666,000	−57	−200,000	...	...	...	...	+204	+2,817,000	+150	+946,000
Subtotal	1,390	19,750,000	1,410	21,800,000	1,562	26,317,000	1,656	29,761,000	1,919	34,027,000	2,144	43,077,000
Action by the Senate	+42	+666,000	...	...	...	...	...	...	...	...	...	...
Subtotal	1,432	20,416,000	1,410	21,800,000	1,562	26,317,000	1,656	29,761,000	1,919	34,027,000	...	...
Action by conferees	...	...	...	...	...	...	...	...	...	...	...	...
Annual appropriation	1,432	20,416,000	1,410	21,800,000	1,562	26,317,000	1,656	29,761,000	1,919	34,027,000	...	...
Supplemental appropriation for statutory pay increase	...	1,488,977	...	1,815,000	...	500,000	...	532,000	...	2,200,000	...	...
Total appropriation	1,432	21,904,977	1,410	23,615,000	1,562	26,817,000	1,656	30,293,000	1,919	36,227,000	...	...