

MEMORANDUM

January 15, 1951

To: The Chairman

Re: Canadian Situation

Pursuant to Ben Wigder's request to you we have prepared this memorandum relating to illegal offerings of Canadian securities in this country. As you know, all of us feel that publicity is one of the most effective sanctions available to us in this area of law violation. Newspapers can perform a real service by publicizing the problem and demonstrating how the odds generally are stacked against the investor who succumbs to the blandishments of this group of offenders. The memorandum has not been prepared for the purpose of direct quotation except as noted, but rather for Mr. Wigder's use as background information.

The Commission's general position on the problem is set forth on pages 170-171 of its 15th Annual Report, copy of which is attached. Although this particular report deals with our experience with the problem over a 5-year period, it is, of course, reflective of our overall experience. To detail the general views expressed in the report a bit further -- and we risk repeating what Charles Odenweller undoubtedly has told Mr. Wigder in the past -- we have been and still are most gravely concerned over the activities of a fringe group of stock promoters operating out of Toronto, Canada, who have been selling securities to residents of the United States in willful violation of our securities laws. These unlawful promotions are conducted by a numerically small group which is in no way representative of the vast majority of persons engaged in the securities business in Canada. Nevertheless, their activities have resulted in extremely large dollar amount losses to United States investors. We are reluctant to hazard any specific estimate of the amount of money these operators have extracted from the United States over the past 10 years. We think it sufficient to say that their take has been in the millions of dollars; and their practices are particularly reprehensible in that they generally are directed at inexperienced persons of small or moderate means -- segments of the population most clearly in need of the protection of our securities laws.

The question at once raised, of course, is what has the Commission done to protect our investors against these offenders. Briefly, we have done everything within our means to stop the flow of lurid sales literature, high pressure long distance phone

calls from Canada and resulting losses to our citizens. However, we would be less than frank if we did not admit that the means presently at our disposal are somewhat limited. This is not to say that our efforts have not had results. Indeed, the fraud orders that we shall mention later and newspaper publicity are believed to have brought about a substantial reduction in the "take" of the operators. But as I shall also point out, we could do a much more complete job of protecting our investors if adequate extradition arrangements were in force between this country and Canada.

For example, we have conducted numerous investigations and we can say that wherever it has been possible for us to conduct a full scale investigation we have found these illegal promotions to be attended by fraud and overreaching of our investors. As a result of our investigations, indictments, for the most part secret, have been obtained in a number of cases based primarily upon the employment of schemes to defraud in the sales of securities. Unfortunately, however, it has been virtually impossible to bring the criminal cases to trial since existing treaty arrangements between Canada and this country do not permit the extradition of the violators. Mr. Wigder is personally familiar with the only case of this type we have been able to bring to trial. That was U.S. v. Niditch and Kaufman which was tried in Detroit several years ago and resulted in convictions and severe sentences.

As far back as 1941 the Commission, recognized this weakness in enforcement structure and initiated efforts to secure a new treaty with Canada which would permit the extradition of such violators to this country for trial. The treaty was ratified by the United States in May 1942 but has not yet been ratified by the Canadian Parliament. Two cases in which indictments were returned, but which could not be brought to trial, were made public not too long ago. We believe these cases demonstrate forcibly the need for new extradition arrangements with Canada which would cover securities swindlers.

In U.S. v. Albert Edward DePalma and U.S. v. Noel V. Knowles indictments were returned in federal courts in Ohio and New York charging that the defendants had sold Canadian mining stocks to American investors by means of false representations and as part of a scheme to defraud. Thus, the indictment in the DePalma case charged, and the Government was prepared to prove, that DePalma had perpetrated a scheme to defraud in connection with the sale in this country of the stock of Peg Tantalum Mines Ltd. and Novell Porcupine Gold Mines Ltd. It was charged that he had falsely represented that the monies invested in these securities would go to the companies for development of their mining properties; that there was a good market for such securities; that the United States Government had agreed to purchase all of the tantalum that the Peg Tantalum mines could produce; that arrangements had been made to list the stock of Peg Tantalum on the Toronto Stock Exchange; that the corporation had good commercial ore on its properties; that the stock of Novell Porcupine Gold Mines Ltd. had been listed; that Novell Porcupine was surrounded by producing mines; that the shares could be sold at a profit and investors could not lose on their investments.

Similarly, in the Knowles case the indictment charged that Knowles had made numerous false and fraudulent representations in the sale of the stock of LaSalle Yellow Knife Gold Mines Ltd. including, among others, that the corporation was fully qualified and was lawfully authorized to sell its shares within the State of New York and the other states of the United States; that arrangements had been made to list the shares of the corporation on the Toronto Stock Exchange; that the monies received from investors for stock of the corporation would be used for the development of its mining properties; that these shares of stock could be sold at any time at a profit; that the corporation was in production and that it was producing ore profitably; that the corporation had a mill on its property; and that assays taken from its properties showed high values which warranted success of the mine.

Both DePalma and Knowles, who are residents of Canada, were finally apprehended within the United States and released on bonds of \$50,000 and \$25,000 respectively. Both defendants, however, forfeited their heavy bail, fleeing to Canada rather than stand trial on these very specific fraud charges; and, of course, under our existing treaty with Canada, we cannot secure their return to this country for trial. It, of course, is hard to understand why our country must find itself unable to secure the rendition of the persons who have thus committed the frauds upon its citizens.

With our hands tied as to criminal prosecution, we have utilized other sanctions. First, we have endeavored -- and with some success -- to prevent the losses caused by these illegal mass mail campaigns by turning over to the United States postal authorities information gathered in the course of our investigations. As a result the United States Post Office Department has issued a number of "fictitious name and fraud orders" which in effect close the mails to communications addressed to the violators covered by the orders. Fictitious name orders are issued where the mails are used in connection with a violation of the laws of this country (e.g., the registration provisions of our Securities Act), by someone operating under a name which is not that of a natural person or corporation. Fraud orders are issued where it is found by the Post Office upon suitable evidence that the mails are used in connection with a scheme to defraud. Where such orders are issued any communications addressed to persons subject to the order are intercepted by the Post Office, marked "Fictitious" or "Fraudulent" as the case may be, and returned to the sender. In this way the violators are prevented from receiving many letters containing cash, checks or money orders, and the "gravity" is removed from the operation.

A complete list of the orders of this type which have been issued up to the first of the year is being made available to Mr. Wigder as are copies of some of the actual orders which detail the fraud found by the Post Office to exist in particular cases. I think that Mr. Wigder's readers will be interested in learning of the type of scheme employed as stated in the findings of the Post Office. The order issued in the Palomino Gold Mines case is particularly interesting since it refers to DePalma and shows that the promotion involved the very same claims (Novell Porcupine Gold Mines) that were the subject of the indictment returned against DePalma and referred to above.

Although the postal orders have been substantially effective and have cut down the "take" in these cases, the very large volume of mailings involved -- and it should be noted that millions of pieces of literature are sent to various parts of this country each year -- make this an extremely difficult field to police. Moreover, there have been opportunities for at least temporary evasion of the orders by the violators who have utilized various subterfuges for this purpose. We shall provide Mr. Wigder with copies of some of the Supplemental Orders issued by the Post Office in this connection. These Supplemental Orders refer to certain of the evasive practices employed by the violators. Here again is dramatic proof of the caliber of the persons with whom we were concerned.

We think it plain that the Commission will not be able to afford fully effective protection to our investors until such time as existing extradition arrangements with Canada are revised so as to cover securities frauds originating in Canada.

Another useful sanction has been that of publicity. The more our citizens hear of these things the less likely it is that they will succumb to the wiles of the promoters. Therefore, it is suggested that if Mr. Wigder should run any stories on this situation he might consider including a warning which could come from Charles J. Odenweller as our Regional Administrator in the Detroit area. Something like this would suffice: "I earnestly urge that any American investor who is solicited through the mails, or by long distance telephone calls from Canada, to purchase promotional stocks of Canadian issuers, should at once determine whether the securities and the person selling them are properly registered under the securities laws. Write me at 1370 Ontario Street, Cleveland 13, Ohio, or call me at Tower 1-5939, or you may call our local office in Detroit at Woodward 3-9330. By doing so you may save yourself a good deal of money."

As you know, much has been written on this general subject. For example, see the recent article in the American Weekly for December 10, 1950. Also, your comments made in the Investment Dealers Digest, June 19, 1950, should be of interest. A photostatic copy of your article is attached.

I understand that Mr. Callahan will be in Detroit next week and will turn this material over to Mr. Wigder.