36th Annual Report

SECURITIES AND EXCHANGE COMMISSION

1970

For the Fiscal Year Ended June 30th

SECURITIES AND EXCHANGE COMMISSION

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

COMMISSIONERS

HAMER H. BUDGE, *Chairman**
HUGH F. OWENS
RICHARD B. SMITH
JAMES J. NEEDHAM
A. SYDNEY HERLONG, JR.

ORVAL L. DUBOIS, *Secretary*

*Chairman Budge announced his resignation, effective at the end of the 91st Congress, on November 13, 1970.

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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 Thirty-Sixth Annual Report of the Commission covering the fiscal year July 1, 1969 to June 30, 1970, 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,

HUGH F. OWENS,
Commissioner.

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

COMMISSIONERS AND PRINCIPAL STAFF OFFICERS

(As of December 1, 1970)

Commissioners	*Term expires June 5*
HAMER H. BUDGE of Idaho, Chairman	1974
HUGH F. OWENS of Oklahoma	1975
RICHARD B. SMITH of New York	1972
JAMES J. NEEDHAM of New York	1973
A. SYDNEY HERLONG, Jr. of Florida	1971

Secretary: ORVAL L. DUBOIS

Executive Assistant to the Chairman: TIMOTHY G. GREENE

Principal Staff Officers

ALAN B. LEVENSON, Director, Division of Corporation Finance.
THOMAS N. HOLLOWAY, Associate Director.
RALPH C. HOCKER, Associate Director.
SOLOMON FREEDMAN, Director, Division of Corporate Regulation.
AARON LEVY, Associate Director.
ALLAN S. MOSTOFF, Associate Director.
IRVING M. POLLACK, Director, Division of Trading and Markets.
SHELDON RAPPAPORT, Associate Director.
STANLEY SPORKIN, Associate Director.
PHILIP A. LOOMIS, Jr., General Counsel.
DAVID FERBER, Solicitor.
WALTER P. NORTH, Associate General Counsel.
ANDREW BARR, Chief Accountant.
A. CLARENCE SAMPSON, Jr., Associate Chief Accountant.
GENE L. FINN, Chief Economist, Office of Policy Research.
LEONARD HELFENSTEIN, Director, Office of Opinions and Review.
W. VICTOR RODIN, Associate Director.
ALFRED LETZLER, Associate Director.
WILLIAM E. BECKER, Chief Management Analyst.
FRANK J. DONATY, Comptroller.
ERNEST L. DESSECKER, Records and Service Officer.
HARRY POLLACK, Director of Personnel.
RALPH L. BELL, EDP Manager.

REGIONAL AND BRANCH OFFICES

Regional Offices and Regional Administrators

Region 1. New York, New Jersey.—Kevin Thomas Duffy, 26 Federal Plaza, New York, New York 10007.

Region 2. Massachusetts, Connecticut, Rhode Island, Vermont, New Hampshire, Maine.—Floyd H. Gilbert, Suite 2203, John F. Kennedy Federal Bldg., Government Center, Boston, Mass. 02203.

Region 3. Tennessee, Virgin Islands, Puerto Rico, North Carolina, South Carolina, Georgia, Alabama, Mississippi, Florida, that part of Louisiana lying east of the Atchafalaya River.—Jule B. Greene, Suite 138, 1371 Peachtree Street, N. E., Atlanta, Georgia 30309.

Region 4. Illinois, Indiana, Iowa, Kansas City (Kansas), Kentucky, Michigan, Minnesota, Missouri, Ohio, Wisconsin.—John I. Mayer, Room 1708, Everett McKinley Dirksen Bldg., 219 South Dearborn Street, Chicago, Illinois 60604.

Region 5. Oklahoma, Arkansas, Texas, that part of Louisiana lying west of the Atchafalaya River, and Kansas (except Kansas City).—Gerald E. Boltz, 503 U.S. Court House, 10th & Lamar Streets, Fort Worth, Texas 76102.

Region 6. Wyoming, Colorado, New Mexico, Nebraska, North Dakota, South Dakota, Utah.—Donald J. Stocking, 7224 Federal Bldg., 1961 Stout Street, Denver, Colorado 80202.

Region 7. California, Nevada, Arizona, Hawaii, Guam.—Arthur E. Pennekamp, 450 Golden Gate Avenue, Box 36042, San Francisco, California 94102.

Region 8. Washington, Oregon, Idaho, Montana, Alaska.—James E. Newton, 900 Hoge Bldg., Seattle, Washington 98104.

Region 9. Pennsylvania, Maryland, Virginia, West Virginia, Delaware, District of Columbia.—Alexander J. Brown, Jr., Room 532, Crystal Mall No. 2 Bldg., 1921 Jefferson Highway, P.O. Box 2247, Arlington, Va. 22202.

Branch Offices

Cleveland, Ohio 44199.—Room 899, Federal Office Bldg., 1240 E. 9th at Lakeside.

Detroit, Michigan 48226.—230 Federal Bldg.

Houston, Texas 77022.—Room 6617 Federal Office & Courts Bldg., 515 Rusk Ave.

Los Angeles, California 90012.—Room 1043, U.S. Courthouse, 312 North Spring Street.

Miami, Florida 33130.—Room 1504, Federal Office Bldg., 51 S.W., First Ave.

St. Louis, Missouri 63102.—Room 1452, 210 North Twelfth Street.

Salt Lake City, Utah 84111.—Room 6004, Federal Bldg., 125 South State Street.

COMMISSIONERS

Hamer H. Budge, *Chairman*

Chairman Budge was born in Pocatello, Idaho, on November 21, 1910. He attended the College of Idaho, Caldwell, Idaho, and received an A.B. degree from Stanford University, Palo Alto, California, majoring in political science, and an LL.B. degree from the University of Idaho in Moscow, Idaho. He is admitted to practice before the Supreme Court of Idaho and the Supreme Court of the United States and practiced law in the city of Boise, Idaho, from 1936 to 1951, except for 3½ years in the United States Navy (1942–1945), with final discharge as Lieutenant Commander. Elected to the Idaho State Legislature, he served three sessions, two as assistant Republican floor leader and and one as majority floor leader. First elected to Congress in November 1950, he represented Idaho's Second Congressional District in the U.S. House of Representatives during the 82d, 83d, 84th, 85th, and 86th Congresses. In the House he was a member of the Rules Committee, Appropriations Committee, and Interior Committee. During the period from 1961 until his appointment to the Commission he was District Judge in Boise. He took office as a member of the Commission on July 8, 1964, for the term expiring June 5, 1969, and was reappointed for the term expiring June 5, 1974. He was designated Chairman of the Commission on February 22, 1969.

Hugh F. Owens

Commissioner Owens was born in Muskogee, Oklahoma, on October 15, 1909, and moved to Oklahoma City in 1918. He graduated from Georgetown Preparatory School, Washington, D.C., in 1927, and received his A.B. degree from the University of Illinois in 1931. In 1934, he received his LL.B. degree from the University of Oklahoma College of Law, and became associated with a Chicago law firm specializing in securities law. He returned to Oklahoma City in January 1936, to become associated with the firm of Rainey, Flynn, Green and Anderson. From 1940 to 1941, he was vice president of the United States Junior Chamber of Commerce. During World War II he attained the rank of Lieutenant Commander, U.S.N.R., and served as Executive Officer of a Pacific Fleet destroyer. In 1948, he became a partner in the firm of Hervey, May and Owens. From 1951 to 1953, he served as counsel for the Superior Oil Company in

Midland, Texas, and thereafter returned to Oklahoma City, where he engaged in the general practice of law under his own name. He also served as a part-time faculty member of the School of Law of Oklahoma City University. In October 1959, he was appointed Administrator of the then newly enacted Oklahoma Securities Act and was active in the work of the North American Securities Administrators, serving as vice president and a member of the executive committee of that Association. He took office as a member of the Securities and Exchange Commission on March 23, 1964, for the term expiring June 5, 1965, and was reappointed for the terms expiring June 5, 1970 and 1975. Since June 1964, he has served on the executive committee of the National Association of Regulatory Utility Commissioners.

Richard B. Smith

Commissioner Smith was born in Lancaster, Pennsylvania, on July 9, 1928, and attended public schools there. He received a B.A. degree from Yale University in 1949 and an LL.B. degree in 1953 from the University of Pennsylvania, where he was a Law Review editor. Upon graduation he became associated with the New York City law firm of Reavis & McGrath (then Hodges, Reavis, McGrath, Pantaleoni & Downey). He remained with that firm from 1953, except for a period with the legal department of W. R. Grace & Co. in 1956–57, until his appointment to the Commission, having become a partner of the firm in 1963. Commissioner Smith is a member of The Association of the Bar of the City of New York (Chairman, Committee on Aeronautics, 1963–66), the New York State Bar Association, the American Bar Association and the American Law Institute. He took office as a member of the Commission on May 1, 1967, for the term expiring June 5, 1967, and was reappointed to a 5-year term ending June 5, 1972.

James J. Needham

Commissioner Needham was born in Woodhaven, New York, on August 18, 1926. He received a B.B.A. in 1951 from St. John's University. During 1944–46, he was in the Naval V–5 Program at Cornell University. At the time of his appointment to the Commission, Commissioner Needham, a Certified Public Accountant, was associated with A. M. Pullen & Company, based in Greensboro, North Carolina, serving as partner in charge of its New York office, and as a member of the firm's Executive Committee. Previously, he was associated with Raymond T. Hyer & Company and with Price, Waterhouse & Co. Commissioner Needham has been active in professional and business organizations, including the American Institute of Cer-

tified Public Accountants (as a member of Council); the New York State Society of Certified Public Accountants (including service as Treasurer and as a member of its Board of Directors and Executive Committee); the New York Chamber of Commerce; and the Accountants Club of America, Inc. He also has participated actively in many community organizations. Prior to assuming office on July 10, 1969, for the term expiring June 5, 1973, he resided in Plainview, New York.

A. Sydney Herlong, Jr.

Commissioner Herlong was born in Manistee, Alabama, on February 14, 1909, and in 1912 moved to Sumter County, Florida, and later to Lake County, Florida, where he attended public schools. He received an LL.B. degree from the University of Florida, Gainesville, Florida, in 1930, and commenced practicing law in his home town of Leesburg, Florida. Commissioner Herlong continued practicing law until 1937 when he was elected County Judge of Lake County, Florida. He continued serving as County Judge until 1948 when he was elected to the U.S. House of Representatives, in which body he served until January 1969, when he voluntarily retired. While serving in Congress, Mr. Herlong was a member of the Post Office and Civil Service Committee, the Agriculture Committee, and, for the last seven terms, the Ways and Means Committee. Upon retirement from Congress, he became a consultant to the Association of Southeastern Railroads. He is a past president of the Florida County Judges Association, the University of Florida Alumni Association and the Florida State Baseball League. Mr. Herlong received the Good Government Award from the Florida Junior Chamber of Commerce and the Distinguished Alumni Award from the University of Florida. He took office as a member of the Securities and Exchange Commission on October 29, 1969, for the term of office expiring June 5, 1971.

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PART I

IMPORTANT RECENT DEVELOPMENTS

Recent Market Trends

Between 1964 and 1968, the securities industry experienced an enormous and largely unanticipated increase in the volume of trading, with annual share volume on all registered stock exchanges rising from 2 to 5.3 billion shares. Since then, however, trading has subsided and volume during the first half of 1970 was down 18 percent from the comparable 1968 period. The reduced trading volume has been accompanied by substantial declines in stock prices and in the number of new issues offered for distribution. There has also been since 1964 a significant change in trading patterns, characterized by an increased participation by financial institutions in equity markets and a proportionately decreased participation by individual investors. Block transactions, or trades involving a large number of shares, have increased along with the rise in institutional activity.

The rapid growth in trading in the mid-1960's caused serious operational problems throughout the brokerage industry. To cope with these back-office problems, many firms made substantial investments in automated equipment and hired new employees. These expenditures and a general inflation in operational costs accentuated the loss of revenue that accompanied the decline in stock prices and trading volume in 1969 and 1970. The rather extensive losses incurred by many broker-dealers forced some firms into bankruptcy or liquidation and a number of others have merged in an attempt to improve their financial condition and operations.

Much of the Commission's time and attention has been devoted to the problems created by these recent market developments. For example, the Commission has conducted extensive hearings concerning the commission rate structure and has participated in drafting legislation to provide increased protection against broker-dealer insolvency. The Commission has also been developing procedures to accommodate the new automated trading systems and improved clearing procedures being introduced in the securities industry. Many of these activities are described in greater detail in the following sections of this Report.

409-865—71——2

Operating and Financial Condition of Broker-Dealer Firms

The "back office" problems which beset the securities industry in 1969,[1] while still not completely resolved, have been overshadowed during the past year by the serious financial difficulties experienced by many firms. In part, the current financial squeeze grew out of efforts to meet the unprecedented trading volume of prior years through the expansion of firms and the automation of facilities. Some firms, wishing to take advantage of the increased trading volume, opened offices in locations which could not in normal times produce the amount of business needed for profitable operations. Other firms experienced severe difficulties in attempting to go from manual record keeping and securities handling procedures to automated systems. When volume on the exchanges and in the over-the-counter marked dropped, firms were forced to retrench by reducing the number of branch offices and by cutting back sales and clerical personnel. Operating losses were widespread throughout the industry, and some of the larger firms were sustaining large and consistent losses.

The continuing decline in securities prices in 1970, following that of 1969, had an adverse effect on the financial condition of broker-dealers in two ways: first, it contributed to the decline in trading volume; and second, it diminished the capital of firms both by lowering the value of trading and investment positions and by making it more difficult for firms to sell restricted securities or large positions of thinly-traded securities. In view of the declining profit margins and shrinking security prices, many firms were unable to replenish depletions of capital caused by the death or withdrawal of partners or by the failure of subordinated lenders to renew their loans.

A number of firms have merged in an effort to improve their financial condition. Other firms have been forced into liquidation because they could no longer comply with the financial responsibility requirements of the Commission and the exchanges.

During the last fiscal year the Commission took action in a number of cases to enforce compliance with its net capital rule and other rules designed for the protection of investors' funds and securities. The net capital rule, which requires that broker-dealers have at least $1 in net capital for every $20 in aggregate indebtedness, is designed to assure that firms will maintain enough liquid assets to meet normal demands from customers for the delivery of their funds and securities. The various measures taken when it appeared that these rules were being violated included the institution of 45 administra-

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[1] See 35th Annual Report, pp. 1–4.

tive proceedings and 29 injunctive actions; the Commission obtained the appointment of receivers in 21 of the injunctive proceedings. Certain of the exchanges also took action against their members to enforce compliance with similar rules, and they forced other firms to merge or to liquidate their business.

The New York Stock Exchange made commitments from its Special Trust Fund to protect the customers of troubled member firms, and certain other exchanges with trust funds also acted to assume responsibility for the obligations of certain of their members who had become insolvent. However, by the spring of 1970 the amount of money remaining uncommitted in various exchange trust funds appeared to be inadequate to do more than indemnify the customers of those firms which were at that time already in serious financial difficulty. Consequently, both the Commission and the Administration engaged in intensive efforts to secure adoption of legislation which would insure funds and securities of customers of brokerage firms against future insolvencies much as bank deposits are insured.

Proposed Legislation To Provide Increased Protection Against Broker-Dealer Insolvency

The first legislative proposals for broker-dealer insurance were introduced by Senator Muskie of Maine in June 1969. Congressional hearings on these and similar legislative proposals were held beginning in April 1970. With the encouragement of the Congressional committees concerned, the Commission joined with representatives of the securities industry, the Treasury Department and other government agencies to draft revised legislation which would meet certain objections to the original proposals. A "consensus" bill, which was submitted in July 1970 to Congressional subcommittees, provided for the creation of a nonprofit membership corporation, to be known as Securities Investor Protection Corporation (SIPC), to administer the insurance program. At the date of writing in October 1970, the appropriate committees of both houses of Congress had approved versions of the bill and it awaits a floor vote in each house. The versions approved by the House and Senate Committees differ from the consensus bill as well as from each other. However, the basic program and the overall plan of implementation, as proposed in the consensus bill, remain.*

*A bill embodying this proposed legislation, H.R. 19333, was passed by the House on December 1, 1970. The bill, with added amendments, was passed by the Senate on December 10, 1970 and then went to a Conference Committee which issued a report (H. Rept. No. 91-1788) on December 18, 1970. The Conference version of the bill was passed by the House on December 21, 1970 and by the Senate on December 22, 1970. The enrolled bill was signed by the President on December 30, 1970 and is now Public Law 91-598.

Under both bills, all registered broker-dealers and all members of national securities exchanges would be members of the Corporation unless exempted. The bills would provide insurance coverage of up to $50,000 per customer in the event of failure of a broker-dealer. The insurance program would be funded by the industry, with $1 billion in standby credit from the United States Treasury. A fund of at least $75 million, to be raised from the industry by assessments on its members and by bank lines of credit, would be available within 120 days of enactment of the legislation. Broker-dealers would be assessed annually ½ of 1 percent of their gross revenues from the securities business until such time as the fund reached $150 million. Thereafter, assessments could fall to ¼ of 1 percent until all lines of credit were phased out. If at any time the fund were to fall below $100 million, the ½ of 1 percent assessment would be reinstated. Securities exchanges would be able to transfer trust funds they maintain for the protection of customers of their members to the Corporation as a credit against future assessments on their members.

If the fund accumulated by the assessments and bank lines of credit should prove to be insufficient, the Commission could borrow up to $1 billion from the Treasury and advance these funds to the Corporation. As a condition of any such loan, the Commission would have to certify to the Secretary of the Treasury that the loan is necessary to protect investors and maintain confidence in United States securities markets and that the Corporation has submitted a plan providing a reasonable assurance of prompt repayment through the imposition of additional assessments. The Commission could impose a transaction fee (up to a specified percentage of the purchase price) on equity securities purchases of $5,000 or more if necessary to satisfactorily repay the loan.

Under the proposed legislation, the existing self-regulatory organizations would continue to inspect their members for compliance with "financial responsibility rules" and make such reports on these inspections as the Corporation might require. The Commission, moreover, would have additional powers to require any self-regulatory organization to (1) alter or supplement rules relating to the frequency and scope of inspection of the financial condition of its members, (2) furnish the Corporation and the Commission with reports relating to such financial condition, and (3) inspect members in relation to their financial condition.

The legislation would authorize the Corporation to apply to a court for a decree adjudicating that customers of a broker-dealer member are in need of protection whenever it appears to the Corporation that a member has failed or is in danger of failing to meet its

obligations to customers. If one or more specified conditions were found by the court to exist, an application would have to be granted and a trustee appointed to liquidate the broker-dealer. The trustee would have the same powers as a trustee in bankruptcy and a trustee under Chapter X of the Bankruptcy Act. He would promptly return specifically identifiable property to customers. It is made clear that securities held in bulk segregation or as part of a central certificate service are to be considered to be specifically identified. In addition, the trustee would be required to pay any remaining claims of customers up to the $50,000 limit with funds advanced by the Corporation and to supervise the liquidation and winding up of the broker-dealer.

The legislation would also amend Section 15(c)(3) of the Securities Exchange Act of 1934 to extend the coverage of that section to broker-dealers who do business only on an exchange and to eliminate certain doubts regarding the Commission's power to provide safeguards with respect to the financial responsibility of broker-dealers to whatever extent the public interest requires, whether by capital requirement rules or otherwise.

Structure and Level of Commission Rates

1. History of the Current Proceedings

In May 1968 the Commission requested the New York Stock Exchange to adopt an interim rate structure with a volume discount or, as an alternative, to eliminate fixed rates of commission for large transactions. This step was taken to correct apparent inequities in the rate structure in effect at that time. At the same time, the Commission announced that it would institute public investigatory hearings to consider long-term changes in the stock exchange commission rate structure and related matters including: (1) commission rate levels for nonmembers and for members; (2) the services for which commissions pay and the costs allocated thereto; (3) give-ups and reciprocal practices among different categories of members and nonmembers; (4) membership for financial institutions on exchanges; (5) economic access to exchange markets by nonmember broker-dealers; (6) competition among exchanges and other markets; and (7) access of exchange members to the third market. These hearings were begun in July 1968.

In August 1968 the New York Stock Exchange submitted to the Commission a proposal to amend its constitution and rules to provide for reductions in (i) minimum commission rates paid by nonmembers on that portion of orders which involve more than 1,000 shares and in (ii) intra-member commission rates, and (iii) to prohibit the so-called "customer-directed give-up." This proposal was approved by the Commission pending completion of the hearings

and the development of long-term solutions. A new schedule under the interim plan became effective December 5, 1968.[2]

In September 1968, the New York Stock Exchange contracted to have National Economic Research Associates (NERA), an economic consulting firm, undertake such research as it deemed necessary for the purpose of proposing a revised schedule of commission rates. The premises and methodology of this study and, later, its results were considered by the Exchange's Costs and Revenues Committee. The completed study provided a basis for the proposed new minimum commission rate schedule presented by the Exchange to the Commission on June 30, 1970. According to the Exchange, the schedule was keyed to industry costs and was designed to meet relatively long-term financial requirements of the industry. In addition, the Exchange proposed a review of rates every 2 years—and as frequently as every 6 months if warranted by changing conditions.

In response to the Exchange's proposals, the Commission reconvened its commission rate hearings from July 20 through August 7, 1970, to receive testimony and other relevant data concerning such proposals.[3] After reviewing these materials, the Commission announced on October 22, 1970, that it would not object if the proposed schedules were adopted, with certain modifications, upon the understanding that the Exchange would take specified steps to provide a better basis for the determination of future commission rates. The Commission concluded (i) that the proposed increases in rates for round-lot orders of 100 through 400 shares were unreasonable and (ii) that the proposed rate schedule was unreasonable to the extent that it fixed charges for that portion of an order in excess of $100,000. Modification of the proposed rate schedule would, therefore, be required in these areas. The Commission's action was also conditioned on the understanding that no member firm which traditionally has accepted small customer accounts will impose or continue any limitation on the size of such customer's order or account and that in connection with such business the firm will not charge fees in excess of the proposed rates.

The Commission has requested the Exchange to present on or before June 30, 1971, a new rate structure based on a percentage scale of the money involved in an order, a proposed revision of the intramember charges for floor brokerage and clearance, and a proposal for reasonable nonmember access. The Exchange was also requested

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[2] See 35th Annual Report, pp. 6–7, and 34th Annual Report, pp. 1–2.

[3] Securities Exchange Act Release No. 8924 (July 2, 1970).

to develop a uniform system of accounts and uniform methods of cost allocation by May 31, 1971.[4]

2. Interim Surcharge

On March 19, 1970, the New York Stock Exchange reported to the Commission that many of its member organizations which do a public business had sustained substantial losses in 1969 and that the situation had further deteriorated in the first quarter of 1970. In an attempt to provide interim financial relief to its members prior to any final action by the Commission regarding a permanent rate structure, the Exchange proposed a rule which would require member organizations to impose a surcharge in the form of a service fee of $15 or fifty percent of the applicable minimum commission, whichever is less, on orders of one thousand shares or less.

After an analysis of data submitted by the Exchange and additional data obtained by the staff, the Commission allowed the interim surcharge to take effect on a temporary basis (90 days). The Commission's action was taken on the condition that full brokerage services (some of which had recently been denied the small investor) would be restored and that investors would not be charged more than the minimum commission plus the surcharge. It was expected that the additional revenues would be employed by member organizations to improve their operations and financial position. The Commission made it clear that any continuance of the surcharge beyond the 90-day period would require a review of the economic conditions, including transaction volume levels, existing at that time.[5] On June 29, 1970, the Exchange submitted to the Commission a request for an extension of the surcharge.

On July 2, 1970, the Commission announced that the commission rate hearings would be reconvened on July 13, 1970, to receive evidence pertinent to the question of whether the interim service charge should be continued. The Commission further indicated that it would not take action to prevent the temporary continuation of the surcharge pending consideration of the evidence to be developed.[6] The hearings were conducted from July 13 through July 17, 1970. Upon the basis of its review of monitoring program data and other relevant information developed in the commission rate hearings, the Commission on August 31, 1970, announced that conditions did not warrant termination of the service charge at that time and the surcharge would, therefore, be permitted to continue until such time as

[4] Securities Exchange Act Release No. 9007 (October 22, 1970).

[5] Securities Exchange Act Release No. 8860 (April 2, 1970).

[6] Securities Exchange Act Release No. 8923 (July 2, 1970).

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circumstances warrant its termination.[7] With the exception of the 90-day limitation, the conditions imposed by the Commission when the surcharge originally became effective were maintained upon continuance of the surcharge.

Institutional Investor Study

The Institutional Investor Study, which resulted from the Congressional directive to the Commission to study the impact on the nation's economy of all types of institutional investors, has continued throughout the year.[8] Both the language and the legislative background of Public Law 90-438 authorizing the Study make clear that the Congress expects a comprehensive economic study, whose first task will be to remedy sizable gaps in information about the activities of institutional investors and their impacts on both the securities markets and corporate issuers.

From the beginning, the Study has been envisioned as a massive fact-finding effort whose talents, energies and resources would be concentrated on the collection and analysis of information about institutional investors that has not been available before. The primary vehicles used for this purpose have been detailed questionnaires, supplemented by interviews, on the organization and operation of institutional investors and securities firms and on their holdings and transactions in portfolio securities.

The Study has developed, distributed, collected, corrected and analyzed data from 55 separate questionnaires, each of which covers as many as 14 separate types of respondent institutions, some of which include as many as 1,000 responding firms. Each of these questionnaires was developed in consultation with *ad hoc* technical committees voluntarily formed by the industries studied. The first of these questionnaires was mailed to respondents during September 1969, and the final questionnaire was mailed in April 1970.

The second stage of the major data collection effort by the Study has involved the collection, editing, correction and preparation for machine processing of questionnaire returns. The extent of industry cooperation with the Commission is demonstrated by the willingness of the great majority of respondents to return the data in machine-readable forms. More than 700,000 punched-card responses have been returned by private persons or firms. In addition, other agencies of the government have made important contributions to this effort. Analyses are being conducted on large, high-speed computers pro-

[7] Securities Exchange Act Release No. 8969 (August 31, 1970).

[8] For a detailed summary of the background design of the Study, see the 35th Annual Report, pp. 9-12.

vided by the Federal Deposit Insurance Corporation and the Federal Reserve Board.

A primary interest of the Study has been the extent to which the performance phenomenon has spread to different sectors of the money management industry, and what its implications have been for the structure of our securities markets, brokerage firms, corporate issuers and individual investors. Much of the data collected and analyzed by the Study bear directly on this important phenomenon.

The Congress, by Joint Resolution, recently extended the reporting date of the Institutional Investor Study to December 31, 1970.[9]

Implementation of the Recommendations of the Disclosure Policy Study

During the fiscal year the Commission published for public comment proposals to implement a number of the recommendations made in the Report of the Disclosure Policy Study.[10] There were 349 letters of comment, covering 1,165 pages, in response to these proposals, all of which were considered by the staff and the Commission. As described below, the Commission has recently made certain determinations on a number of the proposals.

The Commission decided not to adopt the proposed 160 series of rules relating to underwriters, nonpublic offerings, and brokers' transactions and, as an alternative, has proposed to adopt Rule 144.[11] The proposed rule would provide that any affiliate of a company (i.e., any person in a control relationship with the company) who offers or sells securities of such company in accordance with the terms and conditions of the rule is presumed not to be an underwriter of the securities within the meaning of Section 2 (11) of the Securities Act of 1933 and is further presumed not to be an "issuer" within the meaning of the last sentence of that section, which would make his selling broker an underwriter. There would also be a presumption that any other person who, in accordance with the terms and conditions of the rule, offers or sells securities which he acquired from the issuer or from an affiliate of such issuer in a nonpublic transaction is not an underwriter of the securities within the meaning of Section 2(11).

Under the proposed rule, the person making the offering must have owned the securities at least 18 months; however, the estate of a deceased owner of securities, if not affiliated with the issuer, need not conform to any holding period.

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[9] Public Law 91-410.

[10] See 35th Annual Report, pp. 18-22. See also 34th Annual Report, pp. 12-13.

[11] Securities Act Release No. 5087 (September 22, 1970).

The proposed rule also provides that there must be publicly available current financial and other information concerning the issuer. There is a presumption under the proposed rule that the required information is available with respect to an issuer which is required to and does file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. With respect to other issuers, the seller of the securities and the brokers involved in the transaction would have the obligation to determine whether adequate current information is publicly available. Factors that would have to be considered in making such determination are whether a reasonably current balance sheet and a profit and loss statement and current material information about the issuer's business and management have been published or furnished to security holders.

The proposed rule further provides that, after the requisite holding period, the securities may be sold only in brokers' transactions and only in limited quantities in any 12-month period. The quantity limitations are related to the amount of the class of securities outstanding or, if the security is traded on a securities exchange, to recent trading volume. Sales by members of a person's family and other associates would be considered sales by that person for purposes of determining the quantity he may sell during the relevant period.

Should proposed Rule 144 be adopted, the staff of the Commission will not thereafter issue "no action" letters with respect to matters covered by the provisions of the rule. The burden will be on the sellers of securities to ascertain that an exemption is available.

The Commission also revised certain of the registration and reporting forms under the Securities Exchange Act, including Form 10, the general form for the registration of securities of commercial and industrial companies pursuant to Section 12 of the Act.[12] To a large extent the revision of that form consists of amplification of the instructions to indicate more precisely the information required to be given. In addition, a new item has been added to the form calling for a summary of operations for the past 5 years, similar to the summary required in registration statements under the Securities Act of 1933. The item relating to the registrant's business calls for disclosure of certain information as to backlog of orders, if applicable and material to an understanding of the business, and for the estimated dollar amount spent during each of the last 2 fiscal years on material research activities.

The disclosure requirements relating to management, remuneration and transactions with insiders were revised so as to bring them into

[12] Securities Exchange Act Release No. 8996 (October 14, 1970).

accord with the corresponding requirements under the Commission's proxy rules. In addition, a statement of source and application of funds for each of the 3 fiscal years for which a profit and loss statement is required must be included with the financial statements. Although the draft of the proposed form as published for comment would have required certain additional information in regard to operations of companies in extractive industries, the Commission determined not to adopt these revisions at this time.

Form 10-K, the annual report for companies which are required to file reports pursuant to Sections 13(a) or 15(d) of the Securities Exchange Act, has also been revised.[13] The purpose of the revisions is to provide on an annual basis information which, together with that contained in the proxy or information statement sent to security holders, will provide a reasonably complete and up-to-date statement of the business and operations of the registrant.

Primarily, the revised form provides for more detailed disclosure by companies engaged in more than one line of business; [14] requires a summary of operations for the past 5 years similar to that required under revised Form 10; and calls for a description of the properties of the registrant and its subsidiaries. The items relating to management, remuneration and transactions with insiders contained in Part II of the form have been revised to bring them into accord with the corresponding requirements of the Commission's proxy rules. The instructions as to financial statements have been revised to require comparative financial statements, including a source and application of funds statement, for the last 2 fiscal years.

A new form for quarterly reports under the Securities Exchange Act, Form 10-Q, was adopted to replace Form 9-K which has been rescinded.[15] Reports on Form 10-Q are to be filed within 45 days after the end of each of the first three fiscal quarters of each fiscal year by issuers which file annual reports on Form 10-K, 12-K or U5S.

The form calls for summarized financial information which is not required to be certified. Profit and loss information in more detail than was required by Form 9-K must also be furnished, including data on earnings per share. In addition, information is required in regard to the registrant's capitalization and stockholders' equity. Reports on Form 10-Q are not deemed to be "filed" for the purpose of

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[13] Securities Exchange Act Release No. 9000 (October 21, 1970).

[14] A similar requirement had previously been added to Form 10 and certain registration forms under the Securities Act of 1933. See 35th Annual Report, pp. 22-24.

[15] Securities Exchange Act Release No. 9004 (October 28, 1970).

the liability provisions of Section 18 of the Act but are subject to all other provisions of the Act.

The proposed Form 10-Q which was published for comment[16] would have required the reporting on a quarterly basis of certain specified events similar to those required to be reported on Form 8-K. The form would also have required the prompt reporting of any significant acquisitions of assets or businesses along with financial statements of businesses acquired. After further consideration, the Commission determined not to rescind Form 8-K at this time and to adopt as Form 10-Q only that portion of the proposed form which relates to the quarterly reporting of summarized financial information.

A new Form 7-Q, to replace Form 7-K which has been rescinded, was adopted for quarterly reports of certain real estate companies under the Securities Exchange Act.[17] It provides for the furnishing of the same type of financial information as Form 10-Q.

The Commission also adopted certain amendments to Form S-7 under the Securities Act of 1933.[18] This is a short form which may be used for registration of securities to be offered to the public for cash by companies having established records of earnings and stability of management and business. The amendments are primarily designed to broaden the availability of Form S-7 by relaxing the qualifying conditions which have been placed upon its use.

Heretofore, in order to use the form, a registrant, among other things, must have been subject to and complied with the requirements of Sections 13 and 14 of the Securities Exchange Act for a period of at least 5 fiscal years. This period has been reduced to 3 fiscal years. Further, the precondition that the registrant must have been engaged in a business of substantially the same character for its last 5 fiscal years has been deleted; additional information must now be supplied as to material changes, if any, in the general character of the business during the 5-year period.

The previous condition that a majority of the existing directors of the registrant must have been directors during each of the last 3 fiscal years has been amended to require that a majority of the existing board must have been directors of the registrant *or a predecessor* during each of the last 3 fiscal years.

In another area, it was previously required that the registrant and its consolidated subsidiaries must have had sales or gross revenues of at least $50 million for the last fiscal year and net income of at least

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[16] Securities Exchange Act Release No. 8683 (September 15, 1969).

[17] Securities Exchange Act Release No. 9005 (November 2, 1970).

[18] Securities Act Release No. 5100 (November 12, 1970).

$2.5 million for such fiscal year and $1 million for each of the preceding 4 fiscal years. The revised form deletes the requirement with respect to sales or gross revenues and provides that the registrant need only have had a net income after taxes, but before extraordinary items, of at least $500,000 for each of the last 5 fiscal years.

Finally, the form was amended to require a source and application of funds statement for each fiscal year or other period for which an income statement is required.

Legislative Reform of the Investment Company Act

Efforts to obtain much needed reform of the Investment Company Act of 1940 have continued in the Second Session of the 91st Congress. As described in previous Annual Reports, legislation which would have implemented proposals of the Commission was originally introduced in May 1967.[19] The principal Commission proposals involved the reduction of sales loads imposed on the acquisition of fund shares, the elimination of the so-called "front-end load," and establishment of a means to test the fairness of management fees. The proposals also dealt with a number of other areas which in the Commission's opinion required legislative action.

As noted in the Commission's last Annual Report, on June 10, 1969, Chairman Moss of the Subcommittee on Commerce and Finance of the Committee on Interstate and Foreign Commerce introduced H.R. 11995 (91st Cong., 1st Sess.). This bill, which is identical to the bill that had passed the Senate in May 1969, S. 2224 (91st Cong., 1st Sess.), embodied many of the Commission's original legislative recommendations. In November and December, 1969, the above Subcommittee held hearings on H.R. 11995, as well as on H.R. 14737 introduced by Congressman W. S. Stuckey on November 6, 1969, and a similar bill, H.R. 12867, previously introduced by Congressman Stuckey. On April 29, 1970, Congressman Harley O. Staggers introduced another bill, H.R. 17333 (91st Cong., 2nd Sess.), which was similar to the Stuckey bills, and on that date the Subcommittee reported that bill, rather than H.R. 11995, to the full Committee on Interstate and Foreign Commerce. After further consideration, the full Committee approved several amendments to conform H.R. 17333 more closely to S. 2224 and favorably reported it to the House. On September 23, 1970, the House passed H.R. 17333 by voice vote with a minor amendment. The House and Senate then appointed conferees to meet and attempt to agree on a version acceptable to both

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[19] See 35th Annual Report, pp. 12–18. See also 34th Annual Report, pp. 4–6, and 33rd Annual Report, pp. 1–6.

Houses. At the writing of this Report in October 1970, the conferees had not yet met and the legislation was still pending.*

In proposing mutual fund legislation in 1967, the Commission recognized that most of the specific abuses aimed at in the Investment Company Act had been substantially eliminated. However, the dramatic growth of the industry and accompanying changes have created new situations which were not anticipated in 1940. While the industry accepted or even welcomed many of the changes proposed by the Commission, it took exception to the principal recommendations of the Commission, and as a result these have been modified in the pending legislation. And, while many of the provisions of H.R. 17333 are the same as those found in S. 2224, there are significant differences, described below.

1. Investment Advisory Fees

The Commission had recommended that the Act be amended to provide expressly that compensation received by investment advisers and other persons affiliated with investment companies shall be "reasonable" and that there be opportunity for judicial enforcement of this standard. This recommendation reflected the Commission's view that a requirement that compensation not be unreasonable was inherent in the fiduciary relationship existing between an investment company and its manager or adviser. The Commission also considered that the Federal courts would provide an appropriate forum in which the reasonableness of compensation could be tested.

S. 3724 (90th Cong., 2nd Sess.), a bill which had passed the Senate in July 1968, substantially adopted these recommendations, with certain changes designed to meet some of the industry's objections. However, the industry, while not objecting to the concept that compensation should be reasonable, continued to oppose the form of the amendments. Following the April 1969 Senate hearings, the Commission and industry representatives resumed their discussions of this matter and in May 1969 agreed on and jointly submitted to the Senate Committee a substitute provision which specified that an investment adviser has a fiduciary duty with respect to such compensation. This was in accord with the Commission's recommendation that the presently applicable standards of "waste" and "gross abuse of trust" as applied to management fees be replaced with a more meaningful standard. The Senate Committee and the Senate adopted

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*Amended versions of S. 2224 were passed by both the Senate and the House and then went to a Conference Committee. The Committee's report (H. Rept. No. 91-1631) of November 25, 1970 was accepted in both houses and the enrolled bill was signed by the President on December 14, 1970 as Public Law 91-547.

in S. 2224 the management fee proposal in substantially the language proposed by the Commission and the industry representatives.

H.R. 17333, like S. 2224, contains, in Section 20 of the bill, a provision declaring that the investment adviser of a registered investment company has a fiduciary duty with respect to the receipt of compensation and authorizing the Commission, or a security holder of the investment company, to bring an action in court for breach of this fiduciary duty. The provisions in both bills on this subject are much the same, although H.R. 17333 requires a security holder to be "acting in good faith and with justifiable cause" while S. 2224 contains no such restriction.

2. Performance Fees

Performance-based fees are a specialized type of advisory compensation which have been used increasingly in recent years. This type of compensation arrangement generally relates the adviser's compensation either to the realized or unrealized appreciation of the client's portfolio or to the performance of a specified securities index. The proposed legislation, in addition to subjecting such arrangements to the fiduciary standards of Section 36(b), includes provisions specifically directed to performance-based fees. The Commission originally proposed that the prohibition of performance-based fees now applicable to advisers of private clients be extended to advisers of registered investment companies. However, after discussion with industry representatives, a modified provision, permitting a limited type of performance fee, was incorporated into S. 2224 and H.R. 17333. Under that provision, contracts which base any part of the adviser's fee on a specified percentage of the company's capital appreciation would be prohibited. On the other hand, fees which increase and decrease proportionately on the basis of investment performance measured against an appropriate index of securities prices or other appropriate measure of performance would be permissible. The "base" or "standard" fee would be permitted only at the point that the fund's performance equals that of the index.

However, H.R. 17333 would make this prohibition of performance fees inapplicable to contracts made by registered investment advisers with certain types of "off-shore" funds.

3. The Front-End Load on Contractual Plans

The Commission had recommended the abolition of the so-called "front-end load" on periodic payment plan certificates (i.e., certificates issued in connection with contractual plans for the accumulation of fund shares on an installment basis) under which as much as 50 percent of the payments made by the investor during the first

year may be deducted for sales charges. S. 2224 and H.R. 17333 permit a front-end load under two alternative methods. Under the first alternative provided in S. 2224, periodic payment plan certificates could be sold with the presently authorized 50 percent front-end load, provided that, if the investor elected for any reason to redeem his certificate for cash during the first 3 years after its issuance, he would be entitled to receive a refund of the net asset value of his certificate plus the difference between the total sales charges paid by him and 15 percent of such payments. H.R. 17333, however, would permit a refund only within the first year and then only of the excess sales charge over 20 percent. Under both bills, the Commission would be authorized to adopt rules and regulations specifying the form of refund notice and setting forth reserve requirements so that sellers could meet their obligations.

The other alternative, provided by both bills, would permit sellers of periodic payment plan certificates to charge a sales load which does not exceed 20 percent of any payment nor average more than 16 percent over the first four years.

4. Levels of Sales Charges

The Commission had originally proposed that a 5 percent ceiling be placed on the charge for mutual fund sales subject to authority in the Commission to approve appropriate higher ceilings. S. 2224 and H.R. 17333 would give the National Association of Securities Dealers ("NASD") authority to make rules to prevent excessive sales charges, subject to Commission oversight.

5. Bank and Savings and Loan Administered Investment Companies

S. 2224 expressly permits the operation by banks of so-called "commingled managing agency accounts," functionally identical to mutual funds. That bill, as well as H.R. 17333, permits the commingled agency account to have a majority of its directors affiliated with the bank or the savings and loan association. Both bills also impose specific restrictions on the operation of such accounts including a prohibition on the charging of any sales load. However, H.R. 17333 would not expressly permit the operation of such investment companies, but would make their operation subject to the provisions and restrictions of other state and Federal law. Thus, under H.R. 17333 the right of banks and savings and loan associations to operate registered investment companies would be determined either by subsequent legislation or by interpretation of existing legislation, primarily the national banking laws. The question of whether banks may operate such funds consistent with the national banking laws is now pending in the United States Supreme Court in *Investment Company Institute* v. *Camp* (No. 61, October Term 1970).

6. Oil and Gas Drilling Funds

S. 2224 would amend Section 3(c)(11) of the Act to terminate the exclusion from the Act of those oil and gas funds which issue redeemable securities or sell their securities on the installment plan. Oil and gas funds in which investors make only a single payment and do not receive a redeemable security would still be excluded from the definition of investment company.

The new provision would not become effective until 18 months after passage. The discussion on the floor of the Senate regarding S. 2224 makes it clear that it is intended that the Commission and oil and gas industry representatives confer during that interval to work out an equitable arrangement for regulation which would protect investors and not impose an unreasonable burden on the industry.

Subsequent to the passage of S. 2224, the Commission staff conferred with representatives of the oil and gas industry. During hearings before the House Subcommittee in December 1969, the Commission confirmed its original view that there is a need for regulation to some degree of the type provided in the Investment Company Act for this industry but that such regulation would appear to present certain real problems for the industry, primarily because of the difficulty of accommodating the industry structure contemplated by the Investment Company Act with the structure in fact adopted by this industry in order to provide favorable treatment for its investors under the Internal Revenue Code.

Therefore, the Commission stated to the House Subcommittee that if the Committee wished to delete the oil and gas amendment from the bill, the Commission would not object. The Commission stated that it made this suggestion on the assumption that representatives of the oil and gas industry would cooperate with the Commission in drafting a reasonable regulatory statute consistent with the protection of investors for submission to Congress within 18 months after passage of the mutual fund legislation. Subsequently, in reporting H.R. 17333 to the House of Representatives, the Committee on Interstate and Foreign Commerce deleted the amendment, explaining that it had done so because of the assurance of the Commission and industry representatives that they will work diligently and expeditiously toward the goal of recommending an effective scheme for providing investor protection in this area and that those recommendations will be available to the Congress before 18 months after the enactment of mutual fund legislation. In the event this goal is not achieved, the Commission will submit appropriate legislation in the next Congress to provide necessary investor protection in this area.

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7. Fund Holding Companies

The Commission originally recommended and has always adhered to the view that fund holding companies should be prohibited.[20] Nevertheless, S. 2224 and H.R. 17333 permit the operation of fund holding companies subject to specified restrictions, of which the most significant are the requirement that not more than 3 percent of any stock of any individual investment company may be owned by such a holding company and that only one percent of the securities of any portfolio fund may be redeemed in any period of less than 30 days. S. 2224 provides that the sales load of the holding company cannot exceed 1½ percent, but H.R. 17333 diverges from this requirement by permitting any sales load which, when added to the sales load for acquisition of stock in any portfolio fund, is not excessive under Section 22(b) of the Act and applicable NASD or Commission rules.

8. The Front-End Load on Face-Amount Certificates

On August 27, 1969, the Commission submitted to the Senate Committee on Banking and Currency a "Report on Face-Amount Certificate Companies," the result of an in-depth study conducted at the request of the Committee.[21] In this Report, the Commission reasserted the position taken in its 1966 report that the imposition of the front-end load on installment face-amount certificates (i.e., certificates which have a fixed ultimate value and a reduced rate of return if redeemed prior to maturity) is contrary to the public interest and the interest of investors. It recommended that such practice, as well as the practice of imposing equivalent surrender charges, be discontinued. A bill, H.R. 13754, which would implement the Commission's recommendation, was introduced in the House of Representatives on September 11, 1969.

While H.R. 13754 was not reported to the House of Representatives by the Committee on Interstate and Foreign Commerce, H.R. 17333 would provide for a type of spread load for sales charges on face-amount certificates. It would require that the front-end load be spread over the first 5 years of the plan so that, in effect, a 20 percent load would be taken in each of the first 3 years, a 10 percent load in the fourth year, a 7 percent load in the fifth year, and no more than a 4 percent load in all subsequent years. This change, for

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[20] *SEC, Public Policy Implications of Investment Company Growth* (1966), pp. 311–324.

[21] A summary of the salient conclusions of this Report may be found in the 35th Annual Report, pp. 16–17.

the most part, reflects existing industry practice. Over 95 percent of face-amount certificate sales are now being made within this proposed limitation.

Other Pending Legislation

1. Increase in Exemption for Small Issues of Securities

S. 336, which would amend Section 3(b) of the Securities Act of 1933 to increase from $300,000 to $500,000 the maximum aggregate amount of securities which may be exempted from registration under the Act pursuant to rules and regulations of the Commission (the most widely used of which is Regulation A), was introduced in the Senate on January 16, 1969.

When the Act was passed in 1933, the limitation under Section 3(b) was set at $100,000. A 1945 amendment increased the amount to $300,000. Costs have risen throughout the economy since the last amendment with the result that the $300,000 of 1945 has substantially less purchasing power today. In many cases it is an inadequate amount to finance properly either a small established business seeking to modernize or expand, or a newly organized venture requiring a substantial amount of seed capital. Since the original purpose of Section 3(b) was to aid small businesses in raising capital, the Commission believes that a further increase in the exemption is appropriate at this time and it has accordingly supported the bill.

S. 336 was passed by the Senate on August 13, 1970, and was transmitted to the House where it is pending before the Committee on Interstate and Foreign Commerce. Hearings on the bill were held before the House Committee on October 12, 1970.*

2. Amendment to Take-Over Bid Law

The take-over bid law (commonly referred to as the Williams Bill), which was enacted on July 29, 1968, was designed to provide for appropriate disclosure in connection with the solicitation of tender offers for securities and other large securities acquisitions and to give the Commission additional powers to prevent improper practices in those contexts. The experience gained in administering this law has demonstrated certain areas in which the Commission believes its effectiveness could be improved. At the request of the Securities Subcommittee of the Senate Banking and Currency Committee, the Commission prepared a draft bill covering these areas, and Senator Harrison A. Williams, Jr., the Chairman of that Sub-

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*S. 336 was passed by the House on December 7, 1970. The enrolled bill was signed by the President on December 19, 1970 and is now Public Law 91-565.

committee and the sponsor of the original law, introduced this draft bill as S. 3431 on February 10, 1970.

S. 3431 would revise the take-over law in five respects. The most important of these would be to decrease from 10 percent to 5 percent the amount of stock ownership which would bring the law's provisions into play. The principal reason for this proposed revision is that there is evidence that disclosure has frequently been avoided by limiting acquisitions of a company's securities to around nine percent. The other revisions would extend the coverage of the law to insurance companies; would require disclosure where the take-over is effected by means of an exchange of securities and not only, as under present law, where it is effected by cash purchase of shares; and would generally broaden the Commission's rule-making power in the take-over area.

S. 3431 was passed by the Senate on August 18, 1970, and was transmitted to the House of Representatives where hearings were held on October 12, 1970, before the House Committee on Interstate and Foreign Commerce. Chairman Budge testified in support of the bill on the Senate side on March 25, 1970, and on the House side on October 12, 1970.*

3. Transfer of Public Utility Holding Company Act Functions to Federal Power Commission

On December 2, 1969, the Commission transmitted to the Congress a draft bill which would transfer to the Federal Power Commission most of the jurisdiction of the Securities and Exchange Commission under the Public Utility Holding Company Act of 1935. Under this bill the SEC would retain only the types of responsibilities with respect to such holding companies which it now exercises as to publicly owned corporations generally, such as those relating to proxy solicitations, periodic reports, and insider trading. Jurisdiction over such companies would also be retained under the Securities Act of 1933 and the Trust Indenture Act of 1939.

Congressman Staggers introduced the bill in the House of Representatives on January 22, 1970, as H.R. 15516, and it was referred to the Committee on Interstate and Foreign Commerce where it is still pending. The Commission favors the bill on the ground that the principal mission entrusted to it of eliminating or reorganizing the

*S. 3431, with added amendments, was passed by the House on December 7, 1970. The final version of the bill was passed by the Senate and the House, respectively, on December 9 and 10, 1970. The enrolled bill was signed by the President on December 22, 1970 and is now Public Law 91-567.

complex, unwieldy, and unsound holding company structures has largely been accomplished and the present problems of the industry relate primarily to technological developments as to which the Federal Power Commission has more familiarity.*

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*As this report goes to press, H.R. 15516 is still in Committee on the House side and no corresponding bill has ever been introduced in the Senate.

PART II

FULL DISCLOSURE OF INFORMATION ABOUT THE ISSUERS OF SECURITIES

One basic purpose of the Federal securities laws administered by the Commission, in particular the Securities Act of 1933 and the Securities Exchange Act of 1934, is to provide disclosure of financial and other information about publicly held companies and those companies seeking to raise capital through the public offering of their securities, so as to enable public investors to evaluate the securities of these companies on an informed and realistic basis. To this end, the Securities Act, generally speaking, requires a company proposing to offer its securities to the public to file a registration statement with the Commission disclosing prescribed categories of financial and other information and further requires that in connection with the sale of the securities investors be furnished a prospectus containing the most significant information set forth in the registration statement. The Securities Exchange Act, which deals in large part with securities already outstanding, requires the registration of securities listed on a national securities exchange as well as of over-the-counter securities in which there is a substantial public interest. It also requires the issuers of such securities to file annual and other periodic reports which are designed to keep the information in the Exchange Act registration statement current. That Act also requires disclosure of material information to holders of registered securities in connection with the solicitation of proxies for the election of directors or the approval of corporate action at a stockholders' meeting, and in connection with attempts to acquire control of a company through a tender offer or other planned stock acquisition, and it requires "insiders" of companies whose equity securities are registered to report their holdings of and transactions in all equity securities of the company with which they are affiliated.

A. DISCLOSURE IN CONNECTION WITH PUBLIC OFFERINGS

In order to provide disclosure with respect to securities to be offered for public sale, either by an issuing company or a person in a control relationship to such company, the Securities Act requires that, unless an exemption is available for the securities or the partic-

ular offering, (1) a registration statement containing certain required financial and other information be filed with the Commission, and (2) a prospectus which is a part of the registration statement and contains the more significant data set forth in that statement be furnished to investors so as to enable them to evaluate the securities and make an informed investment decision.

The registration statement is available for public inspection as soon as it is filed. Although the securities may be offered for sale upon filing of the statement under prescribed limitations, actual sales may not be made until the statement has become effective. The Commission has no authority to pass on the merits of the securities to be offered or the fairness of the terms of distribution. In fact, the Act makes it unlawful to represent to investors that the Commission has approved or otherwise passed on the merits of registered securities.

Type of Information Included in Registration Statement

Generally speaking, a registration statement relating to securities issued by a corporation or other private issuer must contain the information specified in Schedule A of the Act, while a statement relating to securities issued by a foreign government must include the information specified in Schedule B. The Act empowers the Commission to classify issues, issuers and prospectuses, to prescribe appropriate forms, and to increase, or in certain instances vary or diminish, the particular items of information required to be disclosed as the Commission deems appropriate in the public interest or for the protection of investors. To facilitate the registration of securities by different types of issuing companies, the Commission has prepared 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 general, the registration statement of an issuer other than a foreign government must disclose such matters as the names of persons who participate in the management or control of the issuer's business; the security holdings and remuneration of such persons; the general character of the business, its capital structure, past history and earnings; underwriters' commissions; payments to promoters made within 2 years or intended to be made; the interest of directors, officers and principal stockholders in material transactions with the issuer; pending legal proceedings; and the purposes to which the proceeds of the offering are to be applied, and must include financial statements certified by an independent accountant.

The registration statement of a foreign government must contain information concerning the purposes for which the proceeds of the offering are to be used, the natural and industrial resources of the issuer, its revenues, obligations and expenses, the underwriting and distribution of the securities being registered, and other material matters, but need not contain certified financial statements.

Guides for Preparation and Filing of Registration Statements

During the fiscal year, the Commission continued its publication of guides for the preparation and filing of registration statements under the Securities Act. These guides represent policies and practices followed by the Commission's Division of Corporation Finance in the administration of the registration requirements of the Act. They do not, however, purport to furnish complete criteria for the preparation of registration statements.

One guide adopted during the year, relating to the misleading character of certain registrants' names, was discussed in the 35th Annual Report.[1] In January 1970, a guide concerning the preparation of prospectuses relating to interests in oil and gas programs was published.[2] The guide indicated the general content of disclosures to be made in such prospectuses, and the sequence in which they should appear. It is designed to obtain, to the extent feasible, uniformity in both the sequence and general content of disclosure, and should serve to assist issuers in the preparation of registration statements on Form S-1 as well as offering circulars under Regulation A involving oil and gas drilling programs and to facilitate the understanding and analysis of such programs by investors.

In March 1970, a proposed guide relating to the interests of counsel and experts in the registrant was published.[3] The release stated that it had come to the attention of the Division that persons who are named in the prospectus as counsel for the issuer or underwriter with respect to a registration statement, as well as counsel who pass upon the legality of the securities being registered, are in some cases owners of securities of the registrant or are to receive such securities or rights to subscribe thereto, or are associated with owners of such securities or rights. The proposed guide would point out that in such cases the interest of these persons and their associates in the registrant and the offering should be disclosed. It would also draw atten-

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[1] Page 29.

[2] Securities Act Release No. 5036 (January 19, 1970).

[3] Securities Act Release No. 5051 (March 16, 1970). Subsequent to the end of the fiscal year, the proposed guide was adopted substantially as proposed. Securities Act Release No. 5094 (October 21, 1970).

tion to the fact that counsel's interest in the issuer or participation in its affairs may constitute him a promoter, finder, or executive officer, in which case specific disclosures with respect to such relationship are required by the registration forms. The guide would also point out that similar considerations may apply to persons named as experts in the prospectus.

Amendment of Rules Relating to Industrial Revenue Bonds

Rule 131 under the Securities Act and Rule 3b-5 under the Securities Exchange Act of 1934 relating to "industrial revenue bonds" were amended during the fiscal year.[4] These rules are designed to define the circumstances under which bonds issued by a municipality or other governmental unit are deemed to involve the issuance of a separate security by an industrial or commercial enterprise under a lease, sale or loan arrangement. The purpose of the amendment was to clarify exclusionary paragraphs describing certain situations where no such separate security is deemed to be involved.

Questions had been raised whether such a security was involved where bonds were issued by municipal and other governmental units to finance airport improvements for leasing to airlines serving their areas. In view of the concern expressed that the exclusionary paragraphs in their original form might be construed as being applicable only if a particular airport facility, such as a hangar, were to be operated and controlled by or on behalf of a governmental unit, the Commission amended these paragraphs to make it clear that it is not their purpose to require that each separate facility constituting part of a public project be operated and controlled by a governmental unit if the project as a whole is owned by and under the general control of a governmental unit or instrumentality thereof.

The amendment also made it explicit that the rules do not apply to any obligation which is payable not only out of the payments from the lease or other arrangements with an industrial or commercial enterprise but also from other substantial sources of revenue of the governmental unit.

Amendments of Rules Relating to Mechanics of Filing

The Commission adopted certain amendments to Rules 402, 424, 470 and 472 under the Securities Act, which relate to the mechanics

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[4] Securities Act Release No. 5055 (March 31, 1970). For a discussion of these rules as originally adopted, see 34th Annual Report, pp. 21-22. Under Public Law 91-567 (December 22, 1970), certain industrial development bonds are exempt from the registration provisions of the Securities Act and Securities Exchange Act and the provisions of the Trust Indenture Act of 1939.

of filing registration statements and amendments to such statements, so as to facilitate compliance with the rules and expedite the filing and examination of such documents.[5] The amendments related principally to the number of copies which must be filed.

Amendment of Form S-7

Section 10(b) of the Securities Act authorizes the Commission to provide for the use of a summary prospectus which may be readily transmitted through the mail or published in certain periodicals. It is intended to enable an issuer or underwriter to secure indications of interest prior to furnishing the complete prospectus. However, a copy of the complete prospectus must be furnished upon consummation of any sale of the securities. Rule 434A under the Act permits the use of summary prospectuses if the form used for registration of the securities to be offered provides for the use of such a prospectus and if the registrant files reports with the Commission pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 or meets certain other conditions specified in the rule. Form S-7, which had not previously contained instructions permitting the use of summary prospectuses, was amended to add such instructions.[6]

Whisky Warehouse Receipts as Securities

Faced with an increase in the public promotion and distribution of whisky warehouse receipts, the Commission during the year called attention to the fact that the promotion and sale of such receipts may involve an offering of a security in the form of an investment contract within the meaning of the Securities Act and the Securities Exchange Act and that any public offering of such securities must comply with the disclosure and antifraud provisions of those acts.[7]

In most cases, the whisky warehouse receipts have been sold in order to finance risks involved in the final production of a blended whisky. A receipt ordinarily covers casks of unblended whisky being aged in warehouses, and the sales arrangement generally contemplates that the whisky will continue to be stored until it is aged and will eventually be sold for the purchaser to blenders. The Commission pointed out that a purchaser was not being offered or sold such receipts with a view to acquiring and taking possession of the whisky, but was making an investment under an arrangement which

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[5] Securities Act Release No. 5058 (April 7, 1970).

[6] Securities Act Release No. 5046 (February 12, 1970). For a discussion of recent revisions of Form S-7 expanding the categories of issuers which may use that form, see pp. 12-13, *supra*.

[7] Securities Act Release No. 5018 (November 4, 1969).

contemplates that others will perform services to increase the value of the whisky and eventually sell the whisky under circumstances expected to result in a profit to him. In this connection, it referred to the Supreme Court's decision in *S.E.C.* v. *W. J. Howey Co.*, 328 U.S. 293, 301 (1946) that the test of whether or not a "security" is being offered "is whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others. If that test be satisfied, it is immaterial whether the enterprise is speculative or non-speculative, or whether there is a sale of property with or without intrinsic value. The statutory policy of affording broad protection to investors is not to be thwarted by unrealistic and irrelevant formulae."

Requirement of Deposit on Purchase Price of Stock Prior to Effective Date of Registration

During the fiscal year the Commission issued a release expressing its concern that Section 5(a) of the Securities Act was being violated in connection with some public offerings in which portions of the issue were reserved for employees or other designees of the registrant and deposits were solicited from them in advance of the effective date of the registration statement.[8]

The Commission reiterated that the time between the filing of a registration statement and its effective date is a waiting period designed to enable dealers and investors to become familiar with the securities issue and arrive at "an unhurried decision" as to its merits. The purchase price may not be paid or received during that period and no contracts of sale can be made. These requirements, the Commission pointed out, apply to the offer and sale of securities reserved for employees and other designees of management as well as to the balance of the registered offering.

Staff Examination of Registration Statements

Registration statements filed with the Commission are examined by its staff for compliance with the standards of adequate and accurate disclosure. This examination is primarily the responsibility of the Division of Corporation Finance.[9] Expedited review procedures adopted in November 1968 to cope with the tremendous volume of registration statements filed were described on pages 11–12 of the

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[8] Securities Act Release No. 5071 (June 29, 1970).

[9] Statements filed by investment companies registered under the Investment Company Act of 1940 are examined by the Division of Corporate Regulation. See Part V for further discussion of the processing of investment company registration statements.

34th Annual Report. Generally speaking, if it appears that a statement fails to conform, in material respects, with the applicable requirements, the issuing company is notified by a letter of comment and is afforded an opportunity to file correcting or clarifying amendments. The Commission also has the power, after notice and opportunity for hearing, to issue a "stop-order" suspending the effectiveness of a registration statement if it finds that material representations are misleading, inaccurate or incomplete. In certain instances, such as where the deficiencies in a registration statement appear to stem from careless disregard of applicable requirements or from a deliberate attempt to conceal or mislead, a letter of comment is not sent and the Commission either conducts an investigation to determine whether "stop-order" proceedings should be instituted or immediately institutes such proceedings. The exercise of the "stop-order" power during fiscal year 1970 is discussed on pages 34–36.

Time Required To Complete Registration

The Commission's staff endeavors to complete its examination of registration statements in as short a time as possible. The 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 thereto). Since most registration statements require one or more amendments, they usually do not become effective until some time after the original 20-day period. The period between filing and effective date is intended to afford 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 so as to shorten the 20-day waiting period, taking into account, among other things, the adequacy of the information respecting the issuer theretofore available to the public and the facility with which the facts about the offering can be understood.

During the fiscal year, 3,393 registration statements became effective. Of these, 272 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. With respect to the remaining 3,121 statements, as a result of the continuing high number of filings and the resulting backlog the median time from the date of original

filing to effective date rose to 70 calendar days, from 65 days for 3,316 registration statements in fiscal year 1969 and 44 days for 2,131 registration statements in fiscal year 1968.

The following table shows by months during the 1970 fiscal year the number of registration statements which became effective, and the number of calendar days elapsed during the registration process for the median registration statement.

Time in Registration Under the Securities Act of 1933 by Months During the Fiscal Year Ended June 30, 1970

NUMBER OF CALENDAR DAYS

Months	Number of registration statements effective [a]	Total number of days in registration	Months	Number of registration statements effective [a]	Total number of days in registration
1969			*1970*—Continued		
July	273	63	February	176	83
August	228	65	March	236	76
September	280	83	April	308	39
October	342	95	May	227	36
November	261	76	June	250	40
December	319	70			
1970					
January	221	110	Fiscal 1970 for median effective registration statement	3,121	70

[a] This figure excludes 272 amendments filed by investment companies pursuant to Section 24(e) of the Investment Company Act of 1940.

Statistics Regarding Registration Statements Filed

During the 1970 fiscal year, 4,314 registration statements were filed for offerings of securities aggregating $66.9 billion, as compared with 4,706 registration statements filed during the 1969 fiscal year for offerings amounting to $86.8 billion. This represents a decrease of 8.3 percent in the number of statements filed and 23.0 percent in the dollar amount involved.

Of the 4,314 registration statements filed in the 1970 fiscal year, 2,071, or 48 percent, were filed by companies that had not previously filed registration statements under the Securities Act of 1933. Comparable figures for the 1969 and 1968 fiscal years were 2,350, or 50 percent, and 893, or 34 percent, respectively.

A cumulative total of 40,881 registration statements has been filed under the Act by 17,819 different issuers covering proposed offerings of securities aggregating over $552.8 billion from the effective date of the Securities Act of 1933 to June 30, 1970.

Particulars regarding the disposition of all registration statements filed under the Act to June 30, 1970, are summarized in the following table:

Number and Disposition of Registration Statements Filed

	Prior to July 1, 1969	July 1, 1969 to June 30, 1970	Total June 30, 1970
Registration statements:			
Filed	36,567	(a) 4,314	40,881
Disposition:			
Effective (net)	31,171	(b) 3,329	(c) 34,480
Under stop or refusal order	229	9	(d) 235
Withdrawn	3,470	650	4,120
Pending at June 30, 1969	1,697		
Pending at June 30, 1970			2,046
Total	36,567		40,881
Aggregate dollar amount:			
As filed (in billions)	$485.9	$66.9	$552.8
As effective (in billions)	472.1	59.1	531.2

(a) Includes 276 registration statements covering proposed offerings totalling $9,795,139,246 filed by investment companies under Section 24(e)(1) of the Investment Company Act of 1940 which permits registration by amendment to a previously effective registration statement.

(b) Excludes 64 registration statements that became effective during the year but were subsequently withdrawn; these 64 statements are included in the 650 statements withdrawn during the year.

(c) Excludes 20 registration statements effective prior to July 1, 1969 which were withdrawn during the year; these 20 statements are reflected under withdrawn.

(d) Excludes two registration statements which became effective after lifting of stop orders which had been issued during the year and one registration statement previously effective on which a stop order was placed and then lifted. These three statements are reflected in effectives.

The reasons given by registrants for requesting withdrawal of the 650 registration statements that were withdrawn during the 1970 fiscal year are shown in the following table:

Reason for registrant's withdrawal request	Number of statements withdrawn	Percent of total withdrawn
1. Withdrawal requested after receipt of the staff's comments	56	8.6
2. Change in financing plans	276	42.5
3. Change in market conditions	258	39.6
4. Registrant was unable to negotiate acceptable agreement with underwriter	27	4.2
5. Will file on proper form	3	.4
6. Will file new registration statement	28	4.4
7. Exemptions available	2	.3
Total	650	100.0

Statistics Regarding Securities Registered

During the fiscal year 1970, a total of 3,389 registrations of securities in the amount of $59.1 billion became effective under the Securities Act.[10] While the number of statements showed a moderate decline from the previous year, the dollar amount of registrations was down 32 percent from the record 1969 fiscal year. The chart on page 32 shows the number and dollar amounts of fully effective registrations from 1935 to 1970.

The above figures cover all effective registrations including secondary distributions, securities registered for other than cash sale, and issues reserved for conversion or for options. Of the dollar amount of securities registered in 1970, 82 percent was for the account of the issuer for cash sale, 12 percent for the account of the issuer for other than cash sale, and 6 percent for the amount of others.

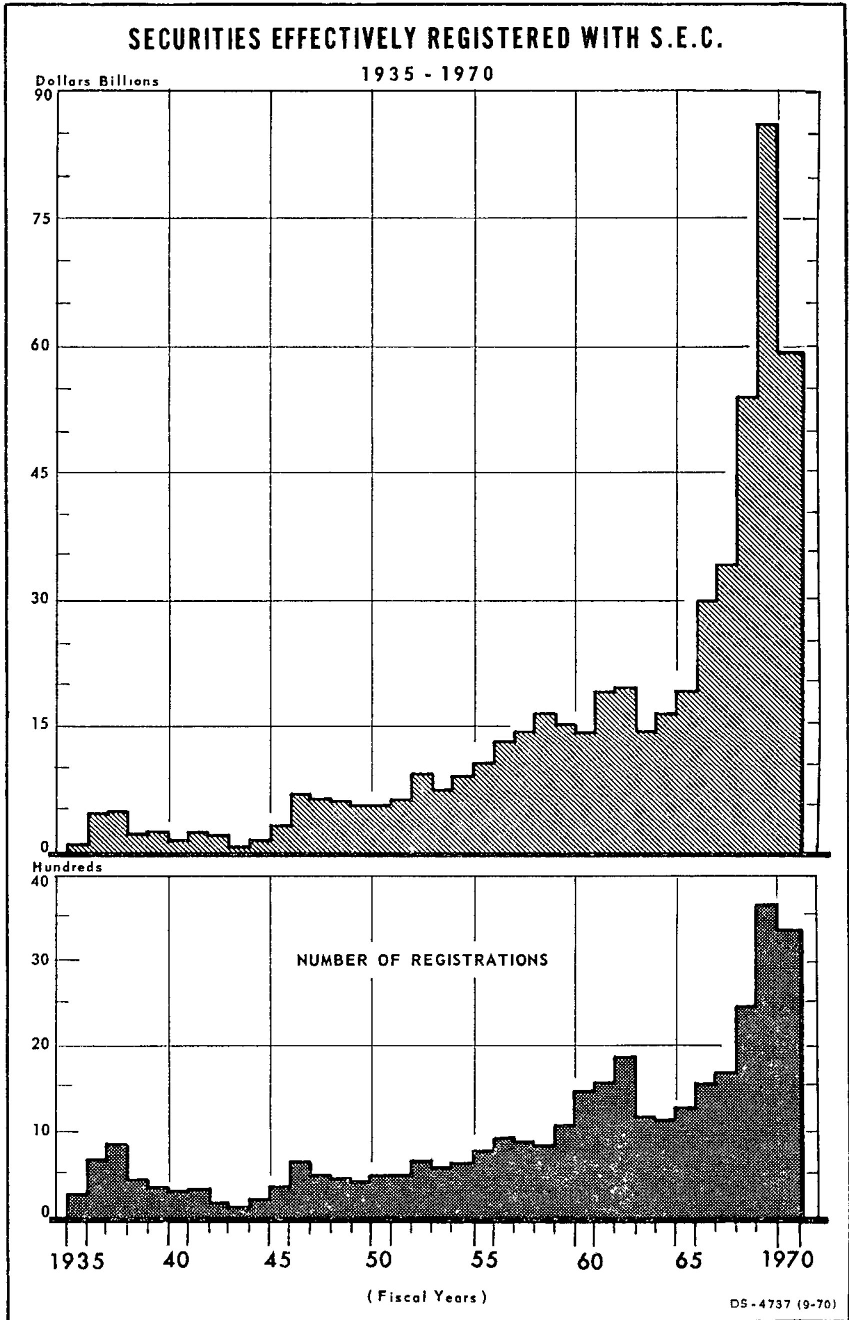
The following table compares the volume of securities registered for the account of the issuer and for the account of others for the past three fiscal years.

	(Millions of dollars)		
	1970	1969	1968
For account of issuer for cash sale	48,198	52,039	37,269
For account of issuer, other than cash sale	7,355	29,577	13,530
For account of other than issuer	3,563	4,841	3,137
Total	[a] 59,116	[b] 86,456	53,936

[a] This figure excludes lease obligations relating to industrial bonds of $21 million which were registered during the 1970 fiscal year.

[b] This figure excludes lease obligations relating to industrial bonds of $354 million which were registered during the 1969 fiscal year.

[10] For a reconciliation of the figures as to effective registration statements referred to above and on pp. 28 and 30, see appendix table 2.



SECURITIES EFFECTIVELY REGISTERED WITH S.E.C.
1935 - 1970
Dollars Billions
90
75
60
45
30
15
0
Hundreds
40
30
20
10
0
NUMBER OF REGISTRATIONS
1935
40
45
50
55
60
65
1970
(Fiscal Years)
DS-4737 (9-70)

As the above table shows, the amount of securities offered for cash sale for the account of the issuer was $3.8 billion less than in the preceding fiscal year. Registration of securities for the account of the issuer for other than cash sale was sharply lower than the record amount of $29.6 billion for this category set in the previous fiscal year. This decrease primarily reflects the substantial decline in the volume of securities registered for purposes of exchange; only $2.0 billion of securities were registered during fiscal year 1970 for exchange purposes, as compared to $17.8 billion during the prior year. Registrations of secondary offerings totaled $3.6 billion, $1.2 billion less than in the preceding fiscal year. Appendix Table 1 shows the number of statements which became effective and total dollar amounts registered for each of the fiscal years 1935–1970, and contains a classification by type of security of issues to be offered for cash sale for account of issuers during those years. More detailed information for 1970 may be found in Table 2.

Corporate issues intended for immediate cash sale totaled $26.0 billion, an increase of $8.7 billion over the preceding year. New corporate debt aggregated a record $17.8 billion, as compared to $10.8 billion registered in fiscal year 1969, and was $5.2 billion more than in 1968, the previous record. Common stock accounted for $7.4 billion of the 1970 volume while preferred stock totaled $768 million. Most of the issues offered over an extended period were common stocks. These included investment company issues, stock to be issued under employee purchase plans and stock called for by warrants and options.

The following table shows the distribution of issues registered during the last 3 fiscal years for the account of issuers to be offered for cash sale:

	(Millions of dollars)		
	1970	1969	1968
Issues offered for immediate sale:			
Bonds, notes and debentures	17,825	10,818	12,603
Preferred stock	768	515	906
Common stock	7,382	5,949	2,854
Total	25,975	17,282	16,363
Foreign government	495	711	1,157
Total for immediate sale	26,470	17,993	17,520
Issues offered over an extended period	21,728	34,046	19,749
Total for cash sale for account of issuers	48,198	52,039	37,269

Registration of issues to be offered over an extended period amounted to $21.7 billion, down $12.3 billion from the record amount in fiscal year 1969. These issues are classified below:

	(Millions of dollars)		
	1970	1969	1968
Investment Company issues:			
Management open-end	11,090	16,129	11,851
Management closed-end	131	594	119
Unit investment trust	2,274	2,279	1,562
Face-amount certificates	116	126	273
Total investment companies	13,611	19,128	13,804
Employee saving plan certificates	1,677	1,850	1,461
Securities for employees stock option plans	3,103	5,610	3,361
Other, including stock for warrants and options	3,337	7,458	1,122
Total	21,728	34,046	19,749

Examinations and Investigations

The Commission is authorized by Section 8(e) of the Securities Act to make an examination in order to determine whether a stop order proceeding should be instituted under Section 8(d) and in connection therewith is empowered to examine witnesses and require the production of pertinent documents. In addition, investigations into the adequacy and accuracy of registration statements may be conducted pursuant to Section 20(a) of the Act which authorizes the Commission to conduct an investigation to determine whether any provision of the Act or any rule or regulation prescribed thereunder has been or is about to be violated. The following tabulation shows the number of examinations and investigations relating to registration statements which were in progress during the year:

Pending at beginning of fiscal year	42	
Initiated during fiscal year	28	
		70
Closed during fiscal year		27
Pending at close of fiscal year		43

Stop Order Proceedings

Section 8(d) of the Securities Act gives the Commission the power, after notice and opportunity for hearing, to issue a stop order "suspending" the effectiveness of a registration statement which includes an untrue statement of a material fact or omits to state any material fact required to be stated therein or necessary to make the statements therein not misleading. The effect of a stop order, which may be issued even after the sale of securities has begun, is to bar distribution of the securities so long as the order remains in effect. Although losses which may have been suffered by

investors before issuance of the order are not restored to them by a stop order, the Commission's decision and the evidence on which it is based may serve to put them on notice of their rights and aid in their own recovery suits. As provided by the Act, a stop order is lifted when the registration statement has been amended to correct the deficiencies.

At the beginning of the fiscal year, three stop order proceedings were pending and during the year six additional proceedings were instituted. Six of the proceedings were terminated through the issuance of stop orders, in each instance pursuant to an offer of settlement by the registrant consenting to entry of a stop order and, solely for purposes of the stop order proceeding, to findings of certain deficiencies in its registration statement. One proceeding was discontinued subject to certain conditions, and two proceedings remained pending as of the end of the year.

In the cases where stop orders were issued, the deficiencies involved

–failure to disclose that the issuer was surety on a personal promissory note of its president.[11]

–failure to disclose that the issuer had sold unregistered promissory notes and that such sales, which were in violation of Section 5 of the Securities Act, gave rise to a contingent liability to the purchasers of the notes (an additional ground for issuance of the stop order here was the issuer's failure to cooperate in the examination pursuant to Section 8(e) preceding institution of the stop order proceedings).[12]

–failure to disclose accurately the principal products which the issuer intended to develop and produce, the planned use of the proceeds of the proposed stock offering and the cost to its president of assets he transferred to the issuer in exchange for stock.[13]

–failure adequately and accurately to disclose the educational and business background of the issuer's president, the fact that a similar company while operated by him sustained extensive losses and had been subject to a suspension ordered by the Com-

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[11] *Philadelphia Bronze Corporation*, Securities Act Release No. 5000 (August 22, 1969).

[12] *Scientific Research Development Co.*, Securities Act Release No. 5040 (January 26, 1970).

[13] *International Patents and Development Corp.*, Securities Act Release No. 5006 (September 22, 1969). Pursuant to its settlement, the issuer filed an amendment correcting the deficiencies in the registration statement, which had not become effective, and the statement as amended became effective five days after entry of the stop order.

mission pursuant to Regulation A of the Securities Act, and the fact that the issuer had no patent, prototype or production equipment for a device for which a major portion of the proceeds was designated.[14]

–failure to disclose, in a registration statement covering limited partnership interests, material facts regarding the history, business and control of the parent company of the general partner for whose stock the limited partnership interests were to be exchangeable in the future.[15]

–failure to disclose adequately and accurately the executive functions of a person not named as an officer, the interests of management in certain loans made by the issuer and circumstances surrounding the sale of unregistered securities.[16]

In Doctor Dolittle Animal Fairs, Inc.,[17] the Commission found that the registration statement filed by the issuer, a newly organized franchise corporation, was materially deficient in describing the experience and background of its president who was the only full-time executive employee and the only officer represented to have any franchise experience. However, during the pendency of the proceeding the issuer filed an amendment which described the institution of the proceeding, cured the deficiencies and reported that the president was no longer associated with the company. Under all the circumstances, including the facts that none of the securities had been sold to the public and that there appeared to be no fraudulent intent by the issuer's management, the Commission found it appropriate to discontinue the proceeding on the condition that a final corrected prospectus describing the proceeding and its disposition and a copy of the Commission's findings and opinion be furnished to all persons who had received copies of the deficient preliminary prospectus.

EXEMPTION FROM REGISTRATION OF SMALL ISSUES

The Commission is authorized under Section 3(b) of the Securities Act to exempt, by its rules and regulations and subject to such terms and conditions as it may prescribe therein, any class of securities from registration under the Act, if it finds that the enforcement of the registration provisions of the Act with respect to such securities is not necessary in the public interest and for the protection of

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[14] *Laser Nucleonics, Inc.*, Securities Act Release No. 5041 (February 2, 1970).

[15] *First Dyna Ray Exploration Fund—1969*, Securities Act Release No. 5023 (November 18, 1969).

[16] *Creative Financing, Inc.*, Securities Act Release No. 5048 (February 18, 1970).

[17] Securities Act Release No. 5062 (April 24, 1970).

investors by reason of the small amount involved or the limited character of the public offering. The statute imposes a maximum limitation of $300,000 upon the size of the issues which may be exempted by the Commission in the exercise of this power.[18]

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

Rule 234: Exemption of first lien notes.
Rule 235: Exemption of securities of cooperative housing corporations.
Rule 236: Exemption of shares offered in connection with certain transactions.
Regulation A: General exemption for U.S. and Canadian issues up to $300,000.
Regulation B: Exemption for fractional undivided interests in oil or gas rights up to $100,000.
Regulation F: Exemption for assessments on assessable stock and for assessable stock offered or sold to realize the amount of assessment thereon.

Under Section 3(c) of the Securities Act, which was added by Section 307(a) of the Small Business Investment Act of 1958, the Commission is authorized to adopt rules and regulations exempting securities issued by a small business investment company under the Small Business Investment Act. Acting pursuant to this authority the Commission has adopted Regulation E, which is described below.

Exemption from registration under Section 3(b) or 3(c) of the Act does not carry any exemption from the provisions of the Act prohibiting fraudulent conduct in the offer or sale of securities and imposing civil liability or criminal responsibility for such conduct.

Exempt Offerings Under Regulation A

Regulation A permits a company to obtain capital not in excess of $300,000 (including underwriting commissions) in any one year from a public offering of its securities without registration, provided specified conditions are met. These include the filing of a notification supplying basic information about the company with the Regional Office of the Commission in the region in which the company has its principal place of business, and the filing and use in the offering of an offering circular. However, an offering circular need not be filed or used in connection with an offering not in excess of $50,000 by a company with earnings in one of the last 2 years.

During the 1970 fiscal year, 1104 notifications were filed under Regulation A, covering proposed offerings of $293,666,784, compared with 1043 notifications covering proposed offerings of $267,074,784 in the 1969 fiscal year.

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[18] A bill (S. 336) which raises the maximum to $500,000 was enacted in December 1970. See p. 19, *supra*.

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

Offerings Under Regulation A

	Fiscal year		
	1970	1969	1968
Size:			
$100,000 or less	90	90	102
$100,000-$200,000	92	114	97
$200,000-$300,000	922	839	316
Total	1,104	1,043	515
Underwriters:			
Used	510	458	144
Not used	594	585	371
Offerors:			
Issuing companies	1,101	1,021	486
Stockholders	2	15	22
Issuers and stockholders jointly	1	7	7

Reports of Sales.—Regulation A provides that within 30 days after the end of each 6-month period following the date of the original offering circular required by Rule 256, or the statement required by Rule 257, the issuer or other person for whose account the securities are offered must file a report of sales containing specified information. A final report must be filed upon completion or termination of the offering.

During the fiscal year 1970, 1394 reports of sales were filed reporting aggregate sales of $116,399,452.

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

During the 1970 fiscal year, temporary suspension orders were issued in 29 cases, which, added to the 8 cases pending at the beginning of the fiscal year, resulted in a total of 37 cases for disposition. Of these, the temporary suspension order became permanent in 18 cases: in 11 by lapse of time, in 6 by withdrawal of a request for hearing, and in 1 by acceptance of an offer of settlement. The remaining 19 cases were pending at the end of the fiscal year.

Exempt Offerings Under Regulation B

During the fiscal year ended June 30, 1970, 749 offering sheets and 572 amendments thereto were filed pursuant to Regulation B and were examined by the Oil and Gas Section of the Commission's Division of Corporation Finance. During the 1969 and 1968 fiscal years, 613 and 453 offering sheets, respectively, were filed. The following table indicates the nature and number of Commission orders issued in connection with such filings during the fiscal years 1968–70. The balance of the offering sheets filed became effective without order.

Action Taken on Offering Sheets Filed Under Regulation B

	Fiscal year		
	1970	1969	1968
Temporary suspension orders (under Rule 340(a))	4	3	10
Orders terminating proceeding after amendment	1	3	6
Orders terminating effectiveness of offering sheet	0	0	0
Orders fixing effective date of amendment (no proceeding pending)	470	376	344
Orders consenting to withdrawal of offering sheet and terminating proceeding	0	0	0
Orders consenting to withdrawal of offering sheet (no proceeding pending)	10	7	8
Total number of orders	485	389	368

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

Reports of Sales Under Regulation B

	1970	1969	1968
Number of sales reports filed	8,136	9,012	5,863
Aggregate dollar amount of sales reported	$11,757,060.32	$11,221,563.80	$7,034,723.31

Exempt Offerings Under Regulation E

Regulation E provides a conditional exemption from registration under the Securities Act for securities of small business investment companies which are licensed under the Small Business Investment Act of 1958 or which have received the preliminary approval of the Small Business Administration and have been notified by the Administration that they may submit an application for such a license.

The regulation, which is similar in many respects to the general

exemption provided by Regulation A, requires the filing of a notification with the Commission and, except in the case of offerings not in excess of $50,000, the filing and use of an offering circular containing certain specified information.

Regulation E also authorizes the Commission to suspend an exemption, substantially on the same grounds as those specified in Regulation A.

No notifications were filed under Regulation E during the 1970 fiscal year.

Exempt Offerings Under Regulation F

Regulation F provides an exemption for assessments levied upon assessable stock and for delinquent assessment sales in amounts not exceeding $300,000 in any one year. It requires the filing of a simple notification giving brief information with respect to the issuer, its management, principal security holders, recent and proposed assessments and other security issues. The regulation requires a company to send to its stockholders, or otherwise publish, a statement of the purposes for which the proceeds of the assessment are proposed to be used. Copies of any other sales literature used in connection with the assessment must be filed. Like Regulation A, Regulation F provides for the suspension of an exemption thereunder where the regulation provides no exemption or where the offering is not made in accordance with the terms and conditions of the regulation or in accordance with prescribed disclosure standards.

During the 1970 fiscal year, 19 notifications were filed under Regulation F, covering assessments of $498,220, compared with 18 notifications covering assessments of $492,076 filed in the 1969 fiscal year. These notifications were filed in three of the nine regional offices of the Commission: Denver, San Francisco and Seattle. Underwriters were not employed in any of the Regulation F assessments. No Regulation F exemption was suspended during the fiscal year.

B. CONTINUING DISCLOSURE REQUIREMENTS

The Securities Exchange Act of 1934, as amended, contains a number of significant disclosure provisions with respect to securities traded in the securities markets. These provisions, applicable in general to issuers of securities listed on exchanges and issuers of securities traded over-the-counter which meet minimum asset and number of stockholder tests, include requirements for the registration of securities with the Commission and for periodic reports, as well as for

appropriate disclosure in connection with the exercise of stockholders' voting rights, takeover bids and insiders' securities transactions.

Registration of Securities on Exchanges

Unless a security is registered on a national securities exchange under Section 12(b) of the Exchange Act or is exempt from registration, it is unlawful for a member of such exchange or any broker or dealer to effect any transaction in the security on the exchange. In general, the Act exempts from registration obligations issued or guaranteed by a State or the Federal Government or by certain subdivisions or agencies thereof and authorizes the Commission to adopt rules and regulations exempting such other securities as the Commission may find necessary or appropriate to exempt in the public interest or for the protection of investors. Under this authority the Commission has exempted securities of certain banks, certain securities secured by property or leasehold interests, certain warrants and, on a temporary basis, certain securities issued in substitution for or in addition to listed securities.

Pursuant to Section 12(b) of the Exchange Act, an issuer may, if it meets the requirements of the exchange, register a class of securities on an exchange by filing with the Commission and the exchange an application which discloses pertinent information concerning the issuer and its affairs. Information must be furnished regarding the issuer's business, its capital structure, the terms of its securities, the persons who manage or control its affairs, the remuneration paid to its officers and directors, and the allotment of options, bonuses and profit-sharing plans. Financial statements certified by an independent accountant must be filed as part of the application.

Form 10 is the form used for registration by most commercial and industrial companies.[19] There are specialized forms for certain types of securities, such as voting trust certificates, certificates of deposit and securities of foreign governments.

Statistics regarding securities traded on exchanges may be found in Part III of this report and in Appendix Tables 4–9.

Registration of Over-the-Counter Securities

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

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[19] Form 10 was revised following the close of the fiscal year. See pp. 10–11, *supra*.

available,[20] or the Commission issues an exemptive order under Section 12(h).

During the fiscal year, 1,157 registration statements were filed under Section 12(g). This makes a total, from the enactment of Section 12(g) in 1964, through June 30, 1970, of 4,976 registration statements filed. Nine of these statements were withdrawn before they had become effective upon determination that they were not required to be filed under the Act.

Of the 1,157 registration statements filed under Section 12(g) in fiscal year 1970, 670 were filed by issuers already subject to the reporting requirements of Section 13 or 15(d) of the Act. The latter figure includes 28 registration statements filed by issuers with another security registered on a national securities exchange, and 642 filed by issuers subject to the reporting requirements of Section 15(d) because they had registered securities under the Securities Act. These latter companies, however, had not been subject to the proxy solicitation and other disclosure and insider trading provisions of Sections 14 and 16 of the Exchange Act. The remaining 487 issuers which filed registration statements had not been subject to any of the disclosure or insider trading provisions and became subject to them through registration.

Exemptions From Registration.—Section 12(h) of the Act authorizes the Commission, either by rules and regulations or by order upon application of an interested person, to grant a complete or partial exemption from the provisions of Sections 12(g), 13, 14, 15(d), or 16 if the Commission finds that because of the number of public investors, the amount of trading interest in the securities, the nature and extent of the activities of the issuer, the income or assets of the issuer, or otherwise, the exemption is not inconsistent with the public interest or the protection of investors.

At the beginning of the fiscal year 8 applications were pending and 5 were filed during the year. Of these 13 applications, 2 were withdrawn and 2 were granted. The remaining 9 applications were pending at the end of the fiscal year.

Periodic Reports

Section 13 of the Exchange Act requires issuers of securities registered pursuant to Section 12(b) or 12(g) to file periodic reports keeping current the information contained in the application for

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[20] Section 12(g) contains various exemptive provisions with respect to certain types of securities. Of particular significance are the provisions relating to securities issued by insurance companies and securities of foreign issuers. See discussions in 32nd Annual Report, p. 13, and 33rd Annual Report, pp. 13–14, respectively.

registration or registration statement. These periodic reports include annual, semi-annual, and current reports. The principal annual report form is Form 10-K, which is designed to give current information regarding the matters covered in the original filing. Semi-annual reports required to be filed on Form 9-K are devoted chiefly to furnishing mid-year financial data. Current reports on Form 8-K are required to be filed for each month in which any of certain specified events of immediate interest to investors has occurred. A report on this form deals with matters such as changes in control of the registrant, important acquisitions or dispositions of assets, the institution or termination of important legal proceedings and important changes in the issuer's securities. Certain real estate companies are required to file quarterly reports on Form 7-K. Section 15(d) of the Exchange Act, generally speaking, requires issuers which have registered securities under the Securities Act of 1933 and which have no securities registered under Section 12 to file the reports described above.[21]

The following table shows the number of reports filed during the fiscal year pursuant to Sections 13 and 15(d) of the Exchange Act. As of June 30, 1970, there were 2,980 issuers having securities listed on a national securities exchange and registered under Section 12(b) of the Act, 3,963 issuers having securities registered under Section 12(g), and 2,414 additional issuers which were subject to the reporting requirements of Section 15(d) of the Act.

Number of annual and other periodic reports filed by issuers under the Securities Exchange Act of 1934 during the fiscal year ended June 30, 1970

Type of reports	Issuers filing reports under Sections 13 & 15(d)
Annual reports	7,057
Semi-annual reports	5,072
Current reports	11,791
Quarterly reports	428
Total reports filed	24,348

Administrative Proceedings To Obtain Compliance With Exchange Act Registration or Reporting Requirements

Section 15(c)(4) of the Exchange Act empowers the Commission to find, after notice and opportunity for hearing, that any person subject to the provisions of Section 12, 13 or 15(d) of the Act or the rules thereunder has failed in any material respect to comply with any of those provisions. It thus provides an administrative proce-

[21] Certain of the above forms were revised or rescinded following the close of the fiscal year. See pp. 11-12, *supra*.

dure, similar to that provided by Section 19(a)(2) of the Act with respect to proceedings to delist securities, for apprising investors of materially misleading filings and for the resolution of accounting and other complex and technical questions involving the disclosure provisions of the Act. Under Section 15(c)(4) the Commission can publish its findings and issue an order requiring compliance and, when the circumstances of a particular case so warrant, apply to a U.S. district court for enforcement of its order.

At the beginning of the fiscal year, two proceedings pursuant to Section 15(c)(4) of the Securities Exchange Act were pending and during the year one additional proceeding was instituted. The Commission issued decisions in two of the proceedings during the year and issued a decision in the third proceeding shortly after the end of the year.

The Susquehanna Corporation [22] involved the adequacy of disclosure contained in a Schedule 13D statement filed by Susquehanna in connection with its tender offer to purchase common stock of Pan American Sulphur Company. This was the first administrative proceeding arising out of the "Takeover Bid Bill" enacted in July 1968.[23]

In response to a requirement that the tender offeror disclose any plans to make a major change in the business of the target company, the schedule stated, among other things, that

> "Susquehanna does not plan or propose to liquidate Pan American, to sell its assets to, or merge it with, any other person, or to make any other major change in its business or corporate structure. However, if, at some subsequent time, it should appear the interests of the Pan American stockholders would be better served by any of the foregoing courses of action, Susquehanna may propose or adopt such course."

The Commission found this statement to be materially false and misleading in failing to disclose that at the time of filing Susquehanna planned, upon acquiring control, to use the assets of Pan American to effect acquisitions or mergers. The Commission ordered Susquehanna to amend its Schedule 13D statement to disclose such plan. An amended statement was subsequently filed.

The other two cases were disposed of on the basis of offers of settlement, under which the respective companies consented to findings that reports filed by them with the Commission were misleading and otherwise deficient, and agreed to correct such reports and to advise their shareholders of the proceedings. In *Great Northern Manage-*

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[22] Securities Exchange Act Release No. 8933 (July 17, 1970).

[23] See pp. 50–51, *infra*.

ment Company, Inc.,[24] the Commission found that annual reports on Form 10-K for the years ended December 31, 1965 and 1966 and a current report on Form 8-K for October 1967 which were filed by Great Northern (registrant) were materially misleading and deficient, in that they failed adequately or accurately to disclose that registrant's initial capitalization had consisted in part of debt obligations which were to be repaid out of the proceeds of the public sale of registrant's stock purportedly offered by selling stockholders; that registrant had made public offerings of unregistered securities and incurred contingent liabilities thereby; that a purportedly unaffiliated company had been organized and dominated by persons in control of registrant and used to sell registrant's stock; and that proceeds from such sales and other funds derived from registrant were used by such controlling persons to purchase, through nominees and another purportedly unaffiliated company in fact controlled by the same persons, shares of another issuer. The Commission concluded that no further action by it was necessary because Great Northern had filed correcting amendments to its reports.

In *Federated Purchaser, Inc.*,[25] the Commission found among other things that an annual report on Form 10-K filed by Federated was misleading and deficient in that it contained a certified balance sheet showing substantial value for a promissory note received from an affiliated company in exchange for assets carried at no value and failed to disclose that the basis on which the accountants certified such balance sheet had ceased to exist prior to the filing of the report. The Commission ordered Federated to file correcting amendments and to send copies of its Findings, Opinion and Order to all shareholders.

Proxy Solicitations

Scope and Nature of Proxy Regulation.—Regulation 14A under the Exchange Act, implementing Section 14(a) of that Act, governs the manner in which proxies or other authorizations may be solicited from the holders of securities registered under Section 12 of that Act, whether for the election of directors, approval of other corporate action, or some other purpose.[26] It requires that in any such solicitation, whether by the management or minority groups, disclo-

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[24] Securities Exchange Act Release No. 8856 (April 3, 1970).

[25] Securities Exchange Act Release No. 8848 (March 30, 1970).

[26] This regulation also applies to securities holders of registered public-utility holding companies, their subsidiaries and registered investment companies.

sure must be made of all material facts concerning the matters on which security holders are asked to vote, and they must be afforded an opportunity to vote "yes" or "no" on each matter other than elections. The regulation also provides, among other things, that where the management is soliciting proxies, a security holder desiring to communicate with other security holders may require the management to furnish him with a list of all security holders or to mail his communication to security holders for him. A security holder may also, subject to certain limitations, require the management to include in its proxy material any appropriate proposal which he wants to submit to a vote of security holders. Any security holder or group of security holders may at any time make an independent proxy solicitation upon compliance with the proxy rules, whether or not the management is making a solicitation. Certain additional provisions of the regulation apply where a contest for control of the management of an issuer or representation on the board is involved.

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.

Under Section 14(c) of the Act, issuers of securities registered under Section 12 must, in accordance with rules and regulations prescribed by the Commission, transmit information comparable to proxy material to security holders from whom proxies are not solicited with respect to a stockholders' meeting. Regulation 14C implements this provision by setting forth the requirements for "information statements."

Statistics Relating to Proxy and Information Statements.—During the 1970 fiscal year, 5,595 proxy statements in definitive form were filed, 5,581 by management and 14 by nonmanagement groups or individual stockholders. In addition, 114 information statements were filed. The proxy and information statements related to 5,390 companies, some 319 of which had a second solicitation during the year, generally for a special meeting not involving the election of directors.

There were 5,095 solicitations of proxies for the election of directors, 487 for special meetings not involving the election of directors, and 13 for assents and authorizations.

The votes of security holders were solicited with respect to the following types of matters, other than the election of directors:

Mergers, consolidations, acquisitions of businesses, purchases and sales of property, and dissolution of companies	568
Authorizations of new or additional securities, modifications of existing securities, and recapitalization plans (other than mergers, consolidations, etc.)	1,706
Employee pension and retirement plans (including amendments to existing plans)	80
Bonus or profit-sharing and deferred compensation arrangements (including amendments to existing plans and arrangements)	146
Stock option plans (including amendments to existing plans)	964
Stockholder approval of the selection by management of independent auditors	2,117
Miscellaneous amendments to charters and by-laws, and miscellaneous other matters (excluding those listed above)	2,258

Stockholders' Proposals.—During the 1970 fiscal year, 241 proposals submitted by 25 stockholders were included in the proxy statements of 150 companies under Rule 14a–8 of Regulation 14A.

Typical of such stockholder proposals submitted to a vote of security holders were resolutions relating to amendments to charters or by-laws to provide for cumulative voting for the election of directors, 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 52 additional proposals submitted by 24 stockholders was omitted from the proxy statements of 31 companies in accordance with Rule 14a–8. The principal reasons for such omissions and the number of times each such reason was involved (counting only one reason for omission for each proposal even though it may have been omitted under more than one provision of Rule 14a–8) were as follows:

Reason for Omission of Proposals

	Number
Concerned a personal grievance against the company	22
Withdrawn by proponent	17
Not a proper subject matter under State law	3
Related to the ordinary conduct of the company's business	5
Outside scope of rules	1
Not timely submitted	3
Insufficient vote at prior meetings	1

Ratio of Soliciting to Nonsoliciting Companies.—Of the 2,980 issuers that had securities listed and registered on national securities exchanges as of June 30, 1970, 2,732 had voting securities so listed

and registered. Of these 2,732 issuers, 2,486, or 91 percent, solicited proxies under the Commission's proxy rules during the 1970 fiscal year for the election of directors.

Proxy Contests.—During the 1970 fiscal year, 24 companies were involved in proxy contests for the election of directors. A total of 550 persons, both management and non-management, filed detailed statements as participants under the requirements of Rule 14a–11. Proxy statements in 20 cases involved contests for control of the board of directors and those in 4 cases involved contests for representation on the board.

Management retained control in 9 of the 20 contests for control of the board of directors, 2 were settled by negotiation, non-management persons won 3, and 6 were pending as of June 30, 1970. Of the four cases where representation on the board of directors was involved, management retained all places on the board in one contest and opposition won places on the board in three cases.

Litigation Relating to Proxy Rules.—Two recent judicial decisions have important implications with respect to private actions instituted to enforce duties arising under the proxy rules that the Commission has promulgated pursuant to Section 14(a) of the Securities Exchange Act.

In *Mills* v. *The Electric Auto-Lite Co.*,[27] a misleading proxy statement was found to have been issued to Auto-Lite shareholders in an attempt to induce them to vote for a merger of Auto-Lite with Mergenthaler Linotype Company. With regard to the determination concerning a "causal relationship of the proxy material and the merger," which is required under *J. I. Case Co. v. Borak*,[28] the Supreme Court held:

> Where there has been a finding of materiality, a shareholder has made a sufficient showing of causal relationship between the violation and the injury for which he seeks redress if, as here, he proves that the proxy solicitation itself, rather than the particular defect in the solicitation materials, was an essential link in the accomplishment of the transaction."[29]

The Court, as urged by the Commission, *amicus curiae*, rejected the holding of the court of appeals that if the defendants could prove that the terms of the merger were fair, there could be no liability, although the Court noted in regard to the appropriate relief that the fairness of the merger terms may be an important factor.[30] In this connection the Court held, in accordance with the Commission's suggestion, that violation of the Commission's proxy rules to

[27] 396 U.S. 375 (1970).

[28] 377 U.S. 426, 431 (1964).

[29] 396 U.S. at 385.

[30] 396 U.S. at 389–397.

effect shareholder approval of a proposed merger does not necessarily require that the merger be voided. While such relief was not ruled out, the Court reiterated its statement in *Borak* that the lower courts are "to be alert to provide such remedies as are necessary to make effective the congressional purpose." [31] The Court also adopted the Commission's recommendation that proof of violation of the proxy rules entitled the plaintiff to an interim award of litigation expenses and reasonable attorneys' fees.[32]

Shortly after the close of the fiscal year, the Court of Appeals for the District of Columbia Circuit decided a case affecting the remedies available to a shareholder where a corporate management has refused to include in the company's proxy statement a proposal timely submitted by the shareholder pursuant to Rule 14a-8 under the Securities Exchange Act. A determination by the Commission not to take enforcement action with respect to such a matter was held to be partially subject to judicial review in *Medical Committee for Human Rights* v. *S.E.C.*[33] The Medical Committee, a shareholder of the Dow Chemical Company, had requested Dow to submit to its shareholders a resolution concerning its sale of napalm. In accordance with Rule 14a-8(d) Dow had advised the Medical Committee and the Commission's staff that it did not intend to include the Committee's proposal in its proxy statement since it did not believe that it was required to do so. After the Commission's staff indicated that it concurred in Dow's legal analysis, the Commission, at the Committee's request, considered whether enforcement action would be appropriate should the company omit the proposal from the proxy materials. The Commission determined that it "would raise no objection" if the proposal were omitted; it did not articulate any basis for its decision or express any view on the merits of its staff's legal interpretation.

The court of appeals rejected the Commission's contention that because no order had been entered the court lacked jurisdiction of a petition for review. Instead, it took the position that the Committee had been compelled to bring its controversy with Dow to the Commission and to exhaust whatever administrative remedies were available and that an adverse decision by the Commission on the merits could be determinative should the Committee subsequently seek to

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[31] 396 U.S. at 386, *quoting* 377 U.S. at 433, 434.

[32] Since the question of ultimate relief was not before the Court, the Court declined to express a view on the Commission's additional suggestion that plaintiffs also be reimbursed for the litigation expenses and attorneys' fees to be incurred in litigating the question of relief.

[33] 432 F.2d 659 (1970), *petition for certiorari* filed December 24, 1970.

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litigate its dispute with Dow in the district court. Primarily because of this analysis, and because the court found the Commission's procedures to be sufficiently formal and adversary in character, it held that the determination by the Commission was reviewable to the extent that it embodied a view of the legal merits of Dow's position. After offering extensive *dicta* on the meaning of the Commission's shareholder-proposal rules, the court remanded the matter to the Commission for an exposition of the rationale behind the Commission's determination to take no action in the circumstances.

The court of appeals thereafter denied the Commission's petition for rehearing, which suggested that no procedures existed to be exhausted and that the kind of decision made by the Commission was not of a character entitled to significant deference in judicial proceedings.

Disclosure in Connection With Takeover Bids and Other Large Acquisitions

Sections 13(d) and (e) and 14(d), (e) and (f) of the Securities Exchange Act, which were enacted in July 1968, as implemented by temporary rules and regulations adopted by the Commission, provide among other things for full disclosure in connection with cash tender offers and other stock acquisitions which may cause a shift in control. These provisions were designed to close gaps in the full disclosure provisions of the securities laws and to safeguard the interests of persons who tender their securities in response to a tender offer.[34]

Rule 13d-1 under the Act requires the filing with the Commission of a Schedule 13D report by a person or group which acquires any of a class of equity securities registered pursuant to Section 12 of the Act or issued by a closed-end investment company registered under the Investment Company Act of 1940, if such acquisition results in the ownership by such person or group of more than 10 percent of such class of securities. During the 1970 fiscal year 291 Schedule 13D acquisition reports were filed. Rule 14d-1 requires the filing of a Schedule 13D report by a person or group making a tender offer (other than an exchange offer pursuant to a registration statement under the Securities Act of 1933) which, if successful, would result in such person or group owning more than 10 percent of any class of equity securities subject to Section 14(d). Thirty-four Schedule 13D tender offer notices were filed during the fiscal year.

In addition, 27 Schedule 14D reports were filed pursuant to Rule 14d-4 involving solicitations or recommendations in connection

[34] Legislation to enlarge the coverage of these provisions (S. 3431) was enacted in December 1970. See pp. 19-20, *supra*.

with a tender offer by other than the maker of the offer, and 10 statements were filed pursuant to Rule 14f–1. The latter relate to the replacement of a majority of the board of directors otherwise than by stockholder vote pursuant to an arrangement or understanding with the person or persons acquiring securities in a transaction subject to Section 13(d) or 14(d) of the Act. One statement was filed pursuant to Rule 13e–1 relating to corporate reacquisitions of securities while the issuer is the target of a cash tender offer.

In a related area the Commission during the fiscal year adopted Rule 10b–13,[35] which prohibits a person making a cash tender offer or an exchange offer from purchasing equity securities of the same class (or any other security immediately convertible into or exchangeable for that security) during the period after the announcement of a tender or exchange offer until the close of the tender or exchange period, otherwise than pursuant to the offer itself. The Commission pointed out that other purchases were often fraudulent and manipulative in nature and could deceive the investing public as to the true state of affairs, and it stated that the rule would safeguard the interests of persons who have tendered their securities in response to a cash tender or exchange offer.

Insiders' Security Holdings and Transactions

Section 16 of the Securities Exchange Act and corresponding provisions in Section 17 of the Public Utility Holding Company Act of 1935 and Section 30(f) of the Investment Company Act of 1940 are designed to provide other stockholders and investors generally with information as to insiders' securities transactions and holdings, and to prevent the unfair use of confidential information by insiders to profit from short-term trading in a company's securities.

Ownership Reports.—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 also be filed with exchanges on which securities are listed. Similar provisions applicable to insiders of registered public-utility holding companies and registered closed-end investment companies are contained in Section 17(a) of the Public Utility Holding Company Act and Section 30(f) of the Investment Company Act.[36]

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[35] Securities Exchange Act Release No. 8712 (October 8, 1969).

[36] Amendments to Rule 16a–1 adopted during the fiscal year were discussed in the 35th Annual Report, at pp. 50–51.

During the fiscal year, 95,952 ownership reports (21,337 initial statements of ownership on Form 3 and 74,615 statements of changes in ownership on Form 4) were filed with the Commission. By comparison, during fiscal year 1969, 93,708 such reports were filed (16,036 initial statements and 77,672 statements of changes).

All ownership reports are made available for public inspection as soon as they are 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 more than 20,000 subscribers.

Recovery of Short-Swing Trading Profits.—In order to prevent insiders from making unfair use of information which they may have obtained by reason of their relationship with a company, Section 16(b) of the Exchange Act, Section 17(b) of the Holding Company Act, and Section 30(f) of the Investment Company Act provide for the recovery by or on behalf of the issuer of any profit realized by insiders (in the categories listed above) from certain purchases and sales, or sales and purchases, of securities of the company within any period of less than 6 months. The Commission at times participates as *amicus curiae* in actions to recover such profits when it deems it important to present its views regarding the interpretation of the statutory provisions or of the exemptive rules adopted by the Commission thereunder.

Investigations With Respect to Reporting and Proxy Provisions

Sections 21(a) of the Exchange Act authorizes the Commission to make such investigations as it deems necessary to determine whether any person has violated or is about to violate any provision of the Act or any rule or regulation thereunder. The Commission is authorized, for this purpose, to administer oaths, subpoena witnesses, compel their attendance, take evidence and require the production of records. The following investigations were undertaken pursuant to Section 21(a) in connection with the enforcement of the reporting provisions of Sections 12, 13, 14 and 15(d) of the Act and the rules thereunder, particularly those provisions relating to the filing of annual and other periodic reports and proxy material:

Investigations pending at beginning of fiscal year	49
Investigations initiated during fiscal year	31
	80
Investigations closed during the fiscal year	26
Investigations pending at close of fiscal year	54

Summary Suspension of Trading

Section 19(a)(4) of the Exchange Act authorizes the Commission to suspend summarily exchange trading in a security listed on a national securities exchange for up to 10 days if in its opinion the public interest so requires. Under Section 15(c)(5) of that Act the Commission may summarily suspend over-the-counter trading in any non-exempt security for up to 10 days if it believes that such action is required in the public interest and for the protection of investors.

During the 1970 fiscal year, the Commission temporarily suspended trading in 55 securities, compared to 33 in fiscal 1969 and 39 in fiscal 1968. In seven instances, exchange-listed securities were involved.[37] In each of these cases, the exchange on which the securities were listed had previously halted trading.

As in the past, the principal ground for suspension in most instances was the unavailability to investors of accurate and complete information concerning the issuer and its securities. Other grounds for suspension included dissemination of inaccurate and misleading financial information, a need for clarification of certain corporate events, and investors' need to be apprised of a Commission-instituted court action.

A number of the suspensions involved the securities of "shell" corporations—companies which are essentially defunct, with no assets or earnings.[38] On several occasions, the Commission announced the suspension of trading in a number of securities of "shells" simultaneously, when it appeared that the "shells" were being reactivated by promoters who circulated inadequate and inaccurate information concerning them.[39]

The suspensions involved a wide variety of factual circumstances. In the case of Arkansas Valley Industries, Inc., the suspension was ordered at the request of the company so that it could issue a statement to clarify the extent of the impact of a U.S. Department of Agriculture announcement.[40] The Department had announced that it had found pesticide residues in turkeys produced by Arkansas Valley; that it was not allowing the marketing of turkeys and turkey

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[37] Securities Exchange Act Release Nos. 8646 (July 2, 1969), 8663 (August 1, 1969), 8665 (August 6, 1969), 8754 (November 11, 1969), 8810 (January 30, 1970), 8883 (May 13, 1970) and 8913 (June 25, 1970).

[38] See the discussion of proposed Rule 15c2-11 in part III, pp. 86-87.

[39] Securities Exchange Act Release Nos. 8724, 8725, 8726, and 8727 (October 21, 1969); Securities Exchange Act Release Nos. 8766, 8767, 8768 (December 4, 1969); Securities Exchange Act Release Nos. 8793 (January 7, 1970), 8800 (January 12, 1970), 8842 (March 17, 1970), 8857 (April 2, 1970), and 8903 (June 15, 1970).

[40] Securities Exchange Act Release No. 8747 (November 10, 1969).

products either known or suspected to contain this pesticide; and that it was investigating whether live turkeys had also been contaminated.

In the case of Professional Health Services, the Commission suspended trading by reason of the absence of complete and accurate information about the company and to provide an opportunity for the dissemination of clarifying information prior to the resumption of trading. Certain New York State agencies had declined to pay Medicaid claims factored by that company, which had been listed as a major part of the company's receivables. Further, the company and certain of its principals had been indicted for violations of and conspiracy to violate Sections 5(b) and 17(a) of the Securities Act, the indictment alleging the use of false and misleading statements in a prospectus used in the company's public stock offering.[41]

The temporary suspension of over-the-counter trading in the securities of Health Evaluation Systems, Inc.[42] was ordered because of the inadequacy of available information about the issuer and because of a recent, rapid rise in the price of the common stock which, according to management, was not justified by any developments in the business or by any improved prospects for the corporation. A foreign-based mutual fund had purchased in a short period of time about one-half of all publicly traded Health Evaluation System shares, which apparently created the substantial rise in the price of the stock. The company, which purported to be engaged in providing health examinations through the use of instruments, technicians and nurses rather than medical doctors, reported that it had little revenue and was currently operating at a loss.

During the fiscal year, several injunctive proceedings and criminal actions were instituted involving securities which had been the subject of trading suspensions.[43]

Commission releases announcing the terminations of trading suspensions frequently carry a warning to investors to exercise care in transactions involving the securities in question, and remind brokers and dealers of their responsibilities under the Federal securities laws for full disclosure of all material facts in connection with the execution of securities transactions.

C. ACCOUNTING AND AUDITING MATTERS

The several Acts administered by the Commission reflect a recognition by Congress that dependable financial statements of a com-

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[41] Securities Exchange Act Release No. 8749 (November 13, 1969).

[42] Securities Exchange Act Release No. 8913 (June 25, 1970).

[43] See the discussion of remedial and enforcement action in Part IV, infra.

pany are indispensable to an informed investment decision regarding its securities. The value of such statements is directly dependent on the soundness of the judgment exercised in applying accounting principles and practices in their preparation, and on the adequacy and reliability of the work done by public accountants who certify the statements. A major objective of the Commission has been to improve accounting and auditing standards and to assist in the establishment and maintenance of high standards of professional conduct by certifying accountants. The primary responsibility for this program rests with the Chief Accountant of the Commission.

Pursuant to the Commission's broad rulemaking power regarding the preparation and presentation of financial information, 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 statutes administered by the Commission. The Commission has also formulated rules with respect to accounting for and auditing of brokers and dealers and has prescribed uniform systems of accounts for companies subject to the Public Utility Holding Company Act of 1935. The accounting rules and the 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.

The rules and regulations thus established, 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 certificate 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 which are recognized as sound and which have attained general acceptance. The requirement that the opinion be rendered by an independent accountant is designed to secure for the benefit of public investors the detached objectivity of a knowledgeable professional person not connected with the management.

The accounting staff examines 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, the formation of new types of business, the large number of combinations of old businesses, the use of more sophisticated securities, and other innovations, create accounting problems which require a constant reappraisal of the procedures.

Relations With the Accounting Profession and the Public

In order to keep abreast of such changes and new developments and in recognition of the need for a continuous exchange of views and information between the Commission's staff and outside accountants regarding appropriate accounting and auditing policies, procedures and practices for the protection of investors, the staff maintains continuing contact with individual accountants, other government agencies, and various professional organizations. These include the American Accounting Association, the American Institute of Certified Public Accountants, the American Petroleum Institute, the Financial Analysts Federation, the Financial Executives Institute, the National Association of Accountants, and the National Association of Railroad and Utilities Commissioners. Since the American Institute of Certified Public Accountants is the principal professional organization involved in the development and improvement of accounting and auditing standards and practices, regular liaison is maintained with it through its Committee on Relations with Securities and Exchange Commission and Stock Exchanges. Conferences are held from time to time at which the staff is briefed on the work being done by the Institute's Committees on Ethics and Auditing Procedures and the Accounting Principles Board and problems of mutual interest are discussed. The Commission's accounting staff also meets with the Committee on Corporate Reporting of the Financial Executives Institute to coordinate efforts toward the improvement of standards.

As part of the Commission's effort to maintain a continuing exchange of views with the accounting profession, the Chairman, other Commissioners, the Chief Accountant and other members of the accounting staff from time to time address, or participate in panel discussions at, professional society meetings. In this way the Commission can indicate problem areas in accounting where it believes the profession can aid in developing solutions. As an example, both the Chairman and the Chief Accountant urged the profession to restudy the accounting principles applicable to business acquisitions or combinations in order to develop criteria which will prevent abuses arising from inadequate restrictions on the choice between the alternatives of purchase or pooling-of-interests accounting to be accorded

such transactions. (The Chairman also commented on this matter in testimony before Committees of the Congress.[44]) The Chief Accountant also accepts engagements to explain the work of the Commission at colleges and universities throughout the country.

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 accounting conferences or writes for foreign professional journals. In September 1970 he presented a paper at the First Annual Conference of the British Accounting and Finance Association in Edinburgh, Scotland.

The Work of the Accounting Principles Board and Committees of the AICPA

The Accounting Principles Board sponsors research studies of problem areas in accounting and formulates formal opinions and advisory statements for the improvement of accounting standards and practices. The advisory statements contain recommendations of the Board which companies may adopt voluntarily. In furtherance of the policy of cooperation between professional organizations and the Commission, the Board submits drafts of these studies, opinions and statements to the Chief Accountant for review and comment prior to publication, and representatives of the Board confer with him on projects in progress or under consideration. Standing committees of the AICPA develop statements on auditing standards and procedures for the guidance of the profession in much the same manner that APB opinions are developed.

In July 1969 the Board issued a Statement on "Financial Statements Restated for General Price-Level Changes" in which the benefits of such statements when presented on a supplemental basis are discussed, but which recommends against their substitution for the basic historical dollar financial statements. The Board issued exposure drafts of two opinions in February 1970 entitled "Accounting Methods and Estimates" and "Business Combinations and Intangible Assets." It adopted separate definitive opinions on "Business Combinations" and "Intangible Assets" in July 1970.

Other topics on which the Board or its subcommittees are working with a view to issuing opinions are: the equity method of account-

[44] Subcommittee on Antitrust and Monopoly of the Senate Committee on the Judiciary, February 18, 1970; Antitrust Subcommittee of the Committee on the Judiciary of the House of Representatives, May 14, 1970; Joint Economic Committee of the United States Congress, July 10, 1970.

ing for intercorporate investments, segmented data in the financial statements of diversified companies, capitalization of leases, preparation of interim financial statements, and components of a business enterprise. Subcommittees are also developing a document pertaining to basic concepts and accounting principles underlying financial statements of business enterprises and a statement urging that companies include a statement of their accounting principles in their annual reports.

An Accounting Research Study, "Financial Reporting in the Extractive Industries," was published in November 1969. Other research studies are being conducted on the subjects of materiality, research and development, foreign operations, stockholder equities, asset and liability valuation in income determination, inventory pricing, and depreciation methods.

In connection with the development of opinions in major problem areas, the Board sponsors symposiums which are attended by representatives of all professional groups, including the SEC, concerned with the particular accounting problems, in order to foster a better understanding of the problems and agreement on the proposed solutions.

The AICPA Committee on Bank Accounting and Auditing issued a supplement to the guide "Audits of Banks" in November 1969 which incorporates specific standards in previously unsettled areas which were agreed upon by representatives of the banks, the federal regulatory agencies and the Institute committee.

The AICPA Committee on Auditing Procedure issued Statements on Auditing Procedure pertaining to "Subsequent Discovery of Facts Existing at the Date of the Auditor's Report" and "Reporting When a Certified Public Accountant is Not Independent" in October and November 1969, respectively. This committee is also developing a Statement on Auditing Procedure on "Confirmation of Receivables and Observation of Inventories."

Other Current Developments

The Chief Accountant's office has submitted proposed revisions of Articles 1, 2, 3, 4, 5, and 11 and Rules 12–01 through 12–17 of Regulation S–X, the Commission's basic accounting regulation, to certain professional groups for an informal review prior to their being issued for public comment. These general revisions, the first since 1950, represent changes, additions or eliminations that have become necessary as a result of changing conditions over the years. A committee of the AICPA had submitted many helpful suggestions, and more recently the Commission's Disclosure Study Group recom-

mended certain revisions of Regulation S–X, particularly with respect to the required schedules.

The Commission issued a proposal in September 1969 [45] to include in Regulation S–X a section which would specify the content of a statement of source and applications of funds. This proposal reflected recommendations by the Study Group, as well as by the AICPA and other professional groups, that such statements be required in certain filings made by registrants. At that time the Commission also issued proposals [46] to require such statements in certain registration statements and annual reports filed under the securities acts. Following consideration of comments received, the Commission, in the fall of 1970, adopted amendments with respect to these matters.[47]

During the fiscal year four Accounting Series Releases were issued, three of which related to investment companies. One release [48] dealt with the problems of valuation of restricted securities held by registered investment companies. Another release [49] clarified disclosure requirements concerning restricted securities. These two releases are discussed in greater detail in Part V of this report.[50] The third release [51] announced the adoption of amendments of rules in Regulation S–X and under the Investment Company Act of 1940 with respect to provision by registered investment companies for Federal income taxes.

During the fiscal year a number of registration statements were filed which included accountants' opinions that were qualified regarding the registrant's ability to attain profitable operations and/or successfully to obtain additional capital, matters of such significance to the registrants that there was a serious question whether the opinions met the Commission's certification requirements. The Commission issued an Accounting Series Release [52] which specified, in part, that "an accountant's report cannot meet the certification requirements of the 1933 Act unless the registrant can arrange its financial affairs so that the immediate threat to continuation as a going business is removed. The independent accountant must be satisfied that

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[45] Securities Act Release No. 4998 (September 15, 1969).

[46] Securities Exchange Act Release Nos. 8681 and 8682 and Securities Act Release No. 4996 (September 15, 1969).

[47] Securities Act Release Nos. 5090 (October 14, 1970) and 5100 (November 12, 1970); Securities Exchange Act Release Nos. 8996 (October 14, 1970) and 9000 (October 21, 1970).

[48] Accounting Series Release No. 113 (October 21, 1969).

[49] Accounting Series Release No. 116 (April 13, 1970).

[50] See page 138, *infra*.

[51] Accounting Series Release No. 114 (December 31, 1969).

[52] Accounting Series Release No. 115 (February 19, 1970).

it is appropriate to use conventional principles and practices for stating the accounts on a going concern basis before a registration statement under the 1933 Act can be declared effective."

D. EXEMPTIONS FOR SECURITIES OF INTERNATIONAL BANKS

International Bank for Reconstruction and Development

Section 15 of the Bretton Woods Agreement Act, as amended, exempts from registration under both the Securities Act and the Securities Exchange Act 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 with respect to such securities as the Commission determines to be appropriate in view of the special character of the Bank and its operations, and necessary in the public interest or for the protection of investors. Pursuant to this authority, the Commission has adopted rules requiring the Bank to file quarterly reports and also to file copies of each annual report of the Bank to its Board of Governors. The Bank is also required to file reports with the Commission in advance of any distribution in the United States of its primary obligations. The Commission, acting in consultation with the National Advisory Board on International Monetary and Financial Problems, is authorized to suspend the exemption at any time as to any or all securities issued or guaranteed by the Bank during the period of such suspension. The following summary of the Bank's activities reflects information obtained from the Bank.

During the fiscal year ended June 30, 1970, the Bank made 69 loans totaling $1,580 million in 39 countries, compared with a total of $1,399 million the previous year. In addition, in fiscal 1970, the Bank lent $100 million to its affiliate, the International Finance Corporation, to assist in financing the Corporation's loans and investments in private enterprises.

Net income for the year was a record high of $213 million, a gain of $41.5 million over net income reported for fiscal 1969. The Bank's Executive Directors have recommended to its Board of Governors that $100 million of net income be transferred as a grant to its affiliate, the International Development Association. The remainder will be transferred to the Bank's Supplemental Reserve, increasing it to $1,150 million. Total reserves of the Bank, including the Special Reserve, will amount to $1,442 million.

Gross income for fiscal 1970 aggregated $504 million including $149 million income from investments, $344 million income from

loans and $11 million income from other sources. As compared to the prior year, income from investments was $61 million higher in the year as a result of both a higher level of investments and higher yields. Income from loans was $30 million higher primarily due to expansion of the Bank's loan portfolio. The interest charged on new loans increased during the fiscal year from 6½ percent to 7 percent.

Expenses in fiscal 1970 totaled $291 million compared with $239 million the previous year. Interest on the Bank's own bonds and other financial costs amounted to $246 million, an increase of $49 million over fiscal 1969 reflecting both increased borrowings and higher interest rates. Administrative expenses were $4 million higher at a total of $45 million, after deduction of $15.8 million in management fees charged to the International Development Association.

The Bank increased its investments in liquid securities during the year by $344 million to an aggregate of $1,720 million at June 30, 1970. Other liquid investments held in the Bank's Special Reserve, on the same date, amounted to $292 million, bringing its liquid securities to a total of $2,012 million. This compares with a total of $1,667 million in similar holdings at June 30, 1969.

Repayments of principal on loans received by the Bank during the year amounted to $329 million; and a further $113 million was repaid to purchasers of parts of loans. Total principal repayments to the Bank through June 30, 1970, aggregated $3,763 million, including $2,126 million repaid to the Bank and $1,637 million repaid to purchasers of borrowers' obligations sold by the Bank.

Outstanding funded debt of the Bank was $4,568 million on June 30, 1970. During the year the Bank borrowed $349.5 million through the issuance of 2-year U.S. dollar bonds to Central Banks and other governmental agencies in more than 60 countries; 72 billion yen (U.S. $200 million), the first sale of Yen obligations by the World Bank; and DM 719 million (U.S. $185.5 million) in Germany. The Bank also issued $97.6 million of bonds that had been sold previously under delayed delivery contracts.

These borrowings, in part, refunded maturing issues amounting to the equivalent of $377 million. After the retirement of U.S. $58.8 million equivalent of obligations retired through sinking fund and purchase fund operations, the Bank's outstanding funded debt showed an increase of $487 million from the previous year.

Southern Yemen, Swaziland and the Yemen Arab Republic became members in the year, bringing total membership to 113 countries on June 30, 1970. The Democratic Republic of Congo, Jamaica and Nigeria increased their subscriptions to the Bank's capital. On

June 30, 1970 aggregate subscribed capital of the Bank was $23,158.8 million of which the equivalent of $2,315.9 million had been paid in to the Bank and the remaining $20,842.9 million was subject to call only to meet the obligations of the Bank.

Inter-American Development Bank

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 information, documents and reports as are required from the International Bank for Reconstruction and Development. The following summary of the Bank's activities reflects information submitted by the Bank to the Commission.

During the year ended June 30, 1970, the Bank made 21 loans totaling the equivalent of $223,823,000 from its Ordinary Capital resources, bringing the net total of loan commitments outstanding, after cancellations, to 193, aggregating $1,327,312,073. During the year, the Bank sold or agreed to sell $1,166,187 in participations in the aforesaid loans, all such participations being without the guarantee of the Bank. The loans from the Bank's Ordinary Capital resources were made in Argentina, Brazil, Chile, Costa Rica, Ecuador, Mexico, Peru, Uruguay and Venezuela.

During the year the Bank also made 39 loans totaling the equivalent of $451,660,000 from its Fund for Special Operations, bringing the gross total of loan commitments outstanding to 257, aggregating $1,807,152,484. The Bank made no loans during the year from the Social Progress Trust Fund, which it administers under an agreement with the United States, leaving the gross total of loan commitments outstanding from that Fund at 116, aggregating $495,333,014.

On June 30, 1970, the outstanding funded debt of the Ordinary Capital resources of the Bank was the equivalent of $774,561,704 reflecting a net increase in the past year of the equivalent of $60,490,206. During the year the funded debt was increased through public bond issues in Austria and Germany, AS 150,000,000 (US $5,769,000) and DM 100,000,000 (US $27,322,000), respectively, as well as private placements in Japan, Latin America, Switzerland and the United Kingdom in the aggregate U.S. equivalent of $61,389,000. The revaluation of the Deutsche Mark in October 1969 resulted in an increase in the funded debt in the U.S. dollar equiva-

lent of $8,825,000. The funded debt was decreased through the retirement of $25,350,000 of short-term dollar bonds and $17,465,000 through sinking fund purchases.

The subscribed ordinary capital of the Bank on June 30, 1970 was the equivalent of $2,282,255,000 of which $1,893,775,000 represented callable capital.

Asian Development Bank

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 information, documents and reports as are required from these Banks. Approval during the fiscal year of the applications of Fiji and France for membership in the Bank, with subscriptions of $1 million and $25 million, respectively, brought the Bank's total membership to 35, including 21 countries in the region and 14 nonregional developed countries, with subscriptions totaling $1,004 million.

The fourth of the United States' five $20 million installments on its paid-in capital subscription was paid in August 1969 and consisted of $10 million in cash and $10 million in the form of a non-interest-bearing letter of credit which may be drawn on in the future when required by the Bank for disbursement. Of the $489.5 million subscriptions on paid-in capital for all members as of June 30, 1970, installments totaling $389.6 million had matured as of that date.

As of June 30, 1970, Australia, Canada, Denmark, Japan, the Netherlands and the United Kingdom had offered to contribute a total of $159.45 million to the Bank's Special Funds, of which $72.5 million had been made available to the Bank. In addition, the $14.575 million set aside from Ordinary Capital in 1969 by the Board of Governors for Special Funds purposes is also available for such lending. On February 25, 1970, President Nixon submitted to the Congress a proposal for a $100 million United States contribution to the Bank's Special Funds over a period of 3 years. The proposed legislation is pending before the Congress.

In September 1969 the Bank sold DM 60 million ($15 million) 7 percent Deutsch Mark bonds in the Federal Republic of Germany. In April 1970 the Bank sold AS 130 million ($5 million) Austrian

schilling 7 percent bonds in Austria. As of June 30, 1970, these constituted the Bank's only borrowings.

During the year ending June 30, 1970, the Asian Development Bank approved 12 loans amounting to $62.035 million from its Ordinary Capital resources and 8 loans amounting to $33.658 million from its Special Funds resources. This brought the Bank's loans since its inception to a total of 25 from Ordinary Capital amounting to $138.435 million, and to 9 from Special Funds amounting to $34.648 million. As of June 30, 1970, the Bank had undertaken 27 technical assistance projects in 13 countries, as well as important regional activities.

E. 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 their trusts. It requires that the indenture trustee be free of conflicting interests which might interfere with the faithful exercise of its duties in behalf of the purchasers of the securities. It requires also that the trustee be a corporation with a minimum combined capital and surplus; imposes high standards of conduct and responsibility on the trustee; precludes preferential collection of certain claims owing to the trustee by the issuer in the event of default; provides for the issuer's supplying evidence to the trustee of compliance with indenture terms and conditions such as those relating to the release or substitution of mortgaged property, issuance of new securities or satisfaction of the indenture; and provides for reports and notices by the trustee to security holders. Other provisions of the Act prohibit impairment of the security holders' right to sue individually for principal and interest except under certain circumstances, and

require the maintenance of a list of security holders which may be used by them to communicate with each other regarding their rights.

Number of Indentures Filed Under the Trust Indenture Act of 1939

	Number filed	Aggregate amount
Indentures pending June 30, 1969	100	$1,732,367,885
Indentures filed during the fiscal year	547	21,214,542,669
Total for disposal	647	22,946,910,554
Disposition during fiscal year:		
Indentures qualified	435	18,486,550,255
Indentures deleted by amendment or withdrawn	77	1,119,317,682
Indentures pending June 30, 1970	135	3,341,042,617
Total	647	22,946,910,554

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PART III

REGULATION OF SECURITIES MARKETS

In addition to the disclosure provisions discussed in Part II of this report, the Securities Exchange Act of 1934 gives the Commission significant responsibilities with respect to the securities markets and persons engaged in the securities business. Among other things, it requires securities exchanges to register with the Commission and provides for Commission supervision of the self-regulatory responsibilities conferred on registered exchanges. The Act also provides for the registration and regulation of brokers and dealers doing business in the over-the-counter markets, and grants to registered associations of brokers or dealers self-regulatory functions under the Commission's supervision. In addition, it contains provisions designed to prevent fraudulent, deceptive, and manipulative acts and practices on the exchanges and in the over-the-counter markets.

This and the next part of the report deal with developments and actions taken in these areas during the 1970 fiscal year. Statistical information concerning the securities markets is presented in this part. Certain recent developments of particular significance are discussed in Part I.

REGULATION OF EXCHANGES

Registration and Exemption of Exchanges

The Securities Exchange Act requires an exchange to be registered with the Commission as a national securities exchange unless the Commission exempts it from registration because of the limited volume of transactions effected. As of June 30, 1970, the following 12 stock exchanges were registered:

American Stock Exchange
Boston Stock Exchange
Chicago Board of Trade
Cincinnati Stock Exchange
Detroit Stock Exchange
Midwest Stock Exchange
National Stock Exchange
New York Stock Exchange
Pacific Coast Stock Exchange
Philadelphia-Baltimore-Washington Stock Exchange
Salt Lake Stock Exchange
Spokane Stock Exchange

Effective December 30, 1969, the Pittsburgh Stock Exchange was acquired by and merged into the Philadelphia-Baltimore-Washington

Stock Exchange.[1] The Honolulu Stock Exchange and the Richmond Stock Exchange were exempt from registration during the fiscal year.

Review of Exchange Rules and Procedures

A major aspect of the Commission's supervisory function with respect to national securities exchanges is the continuous review by its Division of Trading and Markets of the existing rules, regulations, procedures, forms, and practices of all exchanges. Such review is necessary in order to: (1) ascertain the effectiveness of the application and enforcement by the exchanges of their rules; (2) determine the adequacy of exchange rules and of related statutory provisions and rules administered by the Commission in light of changing market conditions; and (3) anticipate and define problem areas so that members of the Commission's staff can meet with exchange representatives to work out salutary procedures within the framework of cooperative regulation. In addition, Rule 17a–8 under the Exchange Act provides that each national securities exchange must file with the Commission a report of any proposed amendment or repeal of, or addition to, its rules and practices not less than 3 weeks (or such shorter period as the Commission may authorize) before taking any action to effectuate the change. These proposals are submitted for review and comment to the Branch of Regulation and Inspections of the Division of Trading and Markets.

During the 1970 fiscal year, 134 changes in exchange rules and practices were submitted to the Commission pursuant to Rule 17a–8. Among the more significant were:

1. Amendments to the New York, American, Midwest and Pacific Coast Stock Exchange Constitutions and Rules to permit limited public ownership of member organizations. To minimize inherent conflict of interest problems involved in public ownership, the amendments, with certain exceptions, prohibited member organizations from trading in their own securities.[2]

2. The adoption of a new rule by the Midwest Stock Exchange which gives the Exchange's president, or by delegated authority a senior vice president, the power to impose such conditions and restrictions on member organizations as may be suitable and reasonable to avoid violations of the Exchange's net capital and aggregate indebtedness ratio requirements or to avoid development of an unhealthy financial condition by a member organization.

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[1] Securities Exchange Act Release No. 8789 (December 24, 1969). See 35th Annual Report, p. 69, note 1.

[2] A registration statement covering a common stock offering by a New York Stock Exchange member firm, Donaldson, Lufkin and Jenrette, Inc., became effective on April 10, 1970.

3. Changes in the policies of the American Stock Exchange which clarify the reporting and disclosure responsibilities of listed companies and set forth expanded and more detailed disclosure guidelines.

4. An amendment of the Pacific Coast Stock Exchange Rules raising the minimum capital requirement for specialists from $100,000 in cash or liquid assets for each post at which a specialist is registered to the greater of $100,000 in cash or marketable securities or 25 percent of the sum of the market value of its securities positions both long and short.

5. Amendments to the New York Stock Exchange and American Stock Exchange Constitutions requiring that all certificates for listed securities issued on or after January 1, 1971, carry the appropriate CUSIP Identification number. CUSIP is a numbering system for securities which specifically, uniformly and permanently identifies both the issuer of a security and the particular issue by an eight-character code number.

Inspections of Exchanges

Pursuant to the regulatory scheme of the Exchange Act, the Commission actively oversees the discharge by the national securities exchanges of their self-regulatory responsibilities. As part of the program, the Branch of Regulation and Inspections in the Division of Trading and Markets conducts regular inspections of various phases of exchange activity. These inspections are a means of ensuring exchange performance of regulatory responsibilities and enable the Commission to recommend, where appropriate, improvements and refinements designed to increase the effectiveness of self-regulation.

In cases where it appears that revisions in internal policies are desirable in order to improve an exchange's performance, the Commission's staff communicates its views to the particular exchange and discusses the matters with exchange personnel to arrive at appropriate solutions.

In fiscal 1970, the Branch of Regulation and Inspections conducted eighteen formal inspections. General inspections of the Midwest, National and Pacific Coast Stock Exchanges were conducted, while inspections of the New York, American and Philadelphia-Baltimore-Washington Stock Exchanges were limited to exchange activities in specific areas.

In May 1970, following wide price fluctuations in certain securities, the Commission examined the activities of the specialists on the New York and American Stock Exchanges. The inspections concentrated upon but were not limited to the performance of the specialists during the period of these fluctuations. Each specialist's daily net sale or purchase balances in particular stocks were com-

pared with the daily price change for that stock. This is termed the "net balance destabilizing test" and is one of the means utilized to determine the effectiveness of the specialist in helping to maintain an orderly, fair and stable market. The Commission's staff also studied other aspects of the specialists' performance and gathered information concerning the capital and financing arrangements of specialists. Recommendations based on these inspections are being prepared by the staff.

Recent market activity which affected the financial condition of many broker-dealers prompted the staff to inspect the administration and interpretation by the New York Stock Exchange of its net capital rule.[3] The net capital rules of the Commission and the various exchanges are designed to provide safeguards for public investors by setting standards of financial responsibility for brokers and dealers. Members in good standing and subject to the capital rules of the New York Stock Exchange and other major exchanges are exempt from the Commission's rule. The basic concept of the net capital rules is adequate liquidity; they are intended to require that the broker or dealer maintain sufficient liquid assets to cover his current indebtedness at all times. An adequate net capital rule, properly enforced, is, therefore, an important aspect of the regulation of brokers and dealers in the public interest and for the protection of investors. The results of this special inspection are being evaluated.

As a result of an examination by the Commission staff of the procedures of the Philadelphia-Baltimore-Washington Stock Exchange for evaluating the financial condition of its members, particularly odd-lot dealer-specialists, significant rule and policy changes were implemented by the Exchange. These changes included more stringent reporting requirements for members so as to provide more frequent and complete records of the financial condition of odd-lot dealer-specialists. In addition, procedural changes to eliminate certain floor activities that resulted in the reporting of double volume figures in certain securities transactions were instituted.

Delisting of Securities From Exchanges

Under Section 12(d) of the Securities Exchange Act and the Commission's Rule 12d2–2 thereunder, securities may be stricken from listing and registration upon application 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.

[3] See Part I for further discussion of problems relating to the financial responsibility of brokers and dealers, and of measures being taken to deal with these problems.

During the fiscal year ended June 30, 1970, the Commission granted applications for the removal of 57 stock issues, representing 53 issuers, and 2 bond issues from listing and registration. Since 3 stocks were each delisted by two exchanges and 1 stock was delisted by three exchanges, the total of stock removals was 62. The distribution of these removals among exchanges was as follows:

	Stocks	*Bonds*
American Stock Exchange	21	2
Cincinnati Stock Exchange	2	—
Detroit Stock Exchange	1	—
Midwest Stock Exchange	8	—
National Stock Exchange	4	—
New York Stock Exchange	20	—
Pacific Coast Stock Exchange	6	—
Total	62	2

Delisting applications by exchanges are generally based on the ground that continued listing is no longer appropriate because of a reduced number of shares of the issue in public hands or an insufficient number of shareholders (sometimes resulting from acquisitions or mergers); the low market value of outstanding shares; insufficient trading volume on the exchange; failure to meet the exchange's requirements as to earnings or financial condition; failure to file required reports with the exchange; cessation of operations by the issuer; or a combination of these factors.

During the fiscal year, the Commission in two instances granted delisting applications by the American Stock Exchange which were opposed by issuers. In *Intercontinental Industries, Inc.* ("INI"),[4] the Exchange had found that INI disseminated or permitted the dissemination of inaccurate or misleading information concerning corporate developments. Its application was based primarily on an Exchange delisting guideline that securities of a company which fails to comply with its listing agreement with the Exchange (requiring among other things prompt disclosure of material developments) are subject to suspension and, "unless prompt corrective action is taken, removal from listing."

INI contended, among other things, that the delisting guideline relied on by the Exchange permits removal only if following a suspension of trading prompt corrective action is not taken, and pointed to instances of suspensions based on misrepresentations where the Exchange permitted resumption of trading after corrective action had been taken. It further contended that the Exchange's rules should be construed to permit delisting only where there had

[4] Securities Exchange Act Release No. 8858 (April 3, 1970).

been a continuous pattern of misrepresentations amounting to willful fraud, and it stressed that unlike the situation in other delisting cases it met the Exchange's criteria for listing.

The Commission rejected these arguments and granted the Exchange's application. Stressing the importance of prompt and accurate disclosure of material corporate developments, it held among other things that it could not find unreasonable the Exchange's interpretation of its rules as requiring that an issuer take corrective action promptly, and not merely, as contended by INI, promptly after the Exchange has had to resort to a suspension of trading. The Commission noted that over 2 months had elapsed from the time INI disseminated misleading information until it had published a clarification, despite a marked increase in the price of, and volume of trading in, INI stock, and inquiries by the Exchange as to the cause of such increase.[5]

In the other case, *Lee Motor Products, Inc.*,[6] the Exchange's action was based on Lee's failure to meet assets and earnings tests specified in the Exchange's delisting guidelines. The Commission, in granting the application, held among other things that the Exchange's failure to find or assert noncompliance with general factors recited in the introductory section of its delisting guide did not require denial of the application; that the Exchange properly acted on the basis of established facts rather than on the basis of a *pro forma* situation assuming consummation of certain proposed acquisitions by Lee; and that it was not improper for the Exchange to consider losses incurred prior to the date of guideline revisions.

Automated Trading Information Systems

During the 1970 fiscal year three automated trading information systems developed primarily to facilitate trading in large blocks of securities commenced operations. These systems are Instinet, Autex and the Block Automation System (BAS) of the New York Stock Exchange.[7] Instinet's system is designed so that it can operate without the services of separate brokers acting as intermediaries for large purchasers and sellers of securities, particularly institutions, and permits the conduct of negotiations via its computer. Autex and BAS, on the other hand, also provide information as to the available markets for the securities in the system but rely on the services of intermediary brokers to handle negotiations and executions outside of the system. The BAS system has been limited to displaying inter-

[5] A petition for review of the Commission's order is pending before the U.S. Court of Appeals for the Fifth Circuit. (Docket No. 29861).

[6] Securities Exchange Act Release No. 8672 (August 25, 1969).

[7] See 35th Annual Report, pp. 4–6, for a further discussion of these systems.

est messages in New York Stock Exchange listed stocks, but the Exchange has announced plans to include American Stock Exchange securities in the near future.

During the fiscal year the staff visited the main offices of Instinet, Autex and BAS. These visits were designed to further acquaint the Commission with the individual systems and to enable the Commission to better evaluate possible regulatory approaches to them. As noted in the 35th Annual Report,[8] proposed Rule 15c2–10 under the Exchange Act, which would provide a regulatory framework for automated trading information systems that are not within the existing scope of regulation of exchanges and national securities associations,[9] was published for comment last year. The comments on this proposal that were received are under review.

STATISTICS RELATING TO SECURITIES TRADED ON EXCHANGES

Number of Issuers and Securities

As of June 30, 1970, 5382 stock and bond issues, representing 3073 issuers, were admitted to trading on securities exchanges in the United States. Of these, 5245 securities issues (3459 stock issues and 1786 bond issues), representing 2980 issuers, were listed and registered on national securities exchanges, the balance consisting primarily of securities admitted to unlisted trading privileges and securities listed on exempted exchanges. The listed and registered issues included 1811 stock issues and 1515 bond issues, representing 1592 issuers, listed and registered on the New York Stock Exchange. Thus, with reference to listed and registered securities, 51.8 percent of the issuers, 52.4 percent of the stock issues and 84.8 percent of the bond issues were on the New York Stock Exchange. Table 4 in the appendix to this report contains comprehensive statistics as to the number of securities issues admitted to exchange trading and the number of issuers involved.

During the 1970 fiscal year, 346 issuers listed and registered securities on a national securities exchange for the first time, while the registration of all securities of 130 issuers was terminated. A total of 710 applications for registration of securities on exchanges was filed.

Market Value of Securities Available for Trading

As of December 31, 1969, the market value of stocks and bonds admitted to trading on U.S. stock exchanges was approximately $786 billion. The tables below show various components of this figure.

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[8] 35th Annual Report, pp. 5.

[9] See Securities Exchange Act Release No. 8661 (August 4, 1969).

With reference to the tables, it should be noted that issues are not traded on both the New York and American Stock Exchanges and that the figures below for "other exchanges" do not include issues also traded on the New York or American Stock Exchanges. Accordingly, the total figure reflects the number of separate issues admitted to trading on national securities exchanges. The figures exclude issues suspended from trading and a few inactively traded issues for which quotations were not available.

	Number of issues	Market value Dec. 31, 1969 (millions)
Stocks:		
New York Stock Exchange	1,789	$629,453
American Stock Exchange	1,152	47,716
Exclusively on other exchanges	435	5,435
Total stocks	3,376	682,604
Bonds:		
New York Stock Exchange	1,574	100,618
American Stock Exchange	175	2,202
Exclusively on other exchanges	24	287
Total bonds	1,773	103,107
Total stocks and bonds	5,149	785,711

The number and market value as of December 31, 1969 of preferred and common stocks separately were as follows:

	Preferred stocks		Common stocks	
	Number	Market value (millions)	Number	Market value (millions)
New York Stock Exchange	499	$22,630	1,290	$606,823
American Stock Exchange	73	988	1,079	46,728
Exclusively on other exchanges	119	258	316	5,177
Total	691	23,876	2,685	658,728

The 3,376 common and preferred stock issues represented over 18.2 billion shares.

The New York Stock Exchange has reported aggregate market value of all stocks listed thereon monthly since December 31, 1924, when the figure was $27.1 billion. The American Stock Exchange has reported totals as of December 31 annually since 1936. Aggregates for stocks exclusively on the remaining exchanges have been compiled as of December 31 annually since 1948. The available data since 1936 appear in Table 5 in the Appendix of this Annual Report. It should be noted that changes in aggregate market value over the years reflect not only changes in prices of stocks but also such factors as new listings, mergers into listed companies, removals from listing and issuance of additional shares of a listed security.

Volume of Securities Traded

The total volume of securities traded on all exchanges in calendar year 1969 was 5.1 billion shares, including stocks, rights and warrants, and $5.1 billion principal amount of bonds. The 1969 total dollar value of all issues traded was $181 billion. Trading in stocks declined 7 percent in share volume and 11 percent in dollar value over 1968. Furthermore, during the first 6 months of 1970, stock trading volume declined somewhat from the 1969 pace.

The figures below show the volume and value of securities traded on all stock exchanges (registered and exempted) during the calendar year 1969, and the first 6 months of 1970. Tables 6 and 7 in the Appendix of this Annual Report contain more comprehensive statistics on volume, by exchanges.

Volume and Value of Trading on all Exchanges

(Amounts in Thousands)

	Calendar year 1969	First 6 months 1970
Volume.		
Stocks (shares)	4,964,191	2,221,017
Rights and Warrants (units)	170,804	189,849
Bonds (principal amount in dollars) [a]	5,123,542	2,929,710
Market Value (dollars).		
Stocks	175,311,003	68,176,898
Rights and Warrants	1,078,757	244,973
Bonds [a]	4,501,268	2,216,279
Total [a]	180,891,028	70,638,150

[a] Does not include U.S. Government Bonds.

Foreign Stocks on Exchanges

The estimated market value on December 31, 1969 of all shares and certificates representing foreign stocks on U.S. stock exchanges was $18.8 billion, of which $14.3 billion represented Canadian and $4.5 billion represented other foreign stocks.

Foreign Stocks on Exchanges

December 31, 1969	Canadian		Other foreign		Total	
	Issues	Value	Issues	Value	Issues	Value
Exchange:						
New York	18	$8,847,757,000	10	$3,103,597,000	28	$11,951,354,000
American	46	5,330,712,700	27	1,429,985,430	73	6,760,698,130
Others only	3	77,142,339	2	7,400,000	5	84,542,339
Total	67	14,255,612,039	39	4,540,982,430	106	18,796,594,469

The number of foreign stocks on the exchanges declined from 115 in 1968 to 106 in 1969, continuing a steady decline which began in 1960 when 173 foreign issues were being traded. However, trading in foreign stocks on the American Stock Exchange represented 10.70 percent of aggregate share volume on that exchange in 1969 as com-

pared to 10.02 percent in 1968. On the New York Stock Exchange trading in foreign stocks in relation to aggregate volume also increased, from 2.4 percent in 1968 to 3.4 percent in 1969.

Comparative Exchange Statistics

During the fiscal year 1970, there was a moderate increase in the total number of stocks listed on exchanges. The increase in listings on the New York and American Stock Exchanges was consistent with the trend of recent years; the number of stocks listed exclusively on other exchanges increased for the second straight year, continuing the reversal of the downward trend that had prevailed for many years.

Net Number of Stocks on Exchanges

June 30	New York Stock Exchange	American Stock Exchange	Exclusively on other exchanges	Total stocks on exchanges
1940	1,242	1,079	1,289	3,610
1945	1,293	895	951	3,139
1950	1,484	779	775	3,038
1955	1,543	815	686	3,044
1960	1,532	931	555	3,018
1961	1,546	977	519	3,042
1962	1,565	1,033	493	3,091
1963	1,579	1,025	476	3,080
1964	1,613	1,023	463	3,099
1965	1,627	1,044	440	3,111
1966	1,656	1,054	429	3,139
1967	1,693	1,072	415	3,180
1968	1,764	1,097	405	3,266
1969	1,781	1,168	435	3,384
1970	1,819	1,194	566	3,579

The aggregate value of shares listed on the New York Stock Exchange relative to the total share value on all exchanges increased in 1969, while the percentage of the total share value accounted for by American Stock Exchange stocks declined. The percentage for stocks traded exclusively on other exchanges was unchanged from the 1968 level.

Value of Shares Listed on Exchanges, in Percentages

December 31	New York Stock Exchange	American Stock Exchange	Exclusively on other exchanges
1950	84.50	12.52	2.98
1955	86.98	11.35	1.67
1960	91.56	7.22	1.22
1961	91.02	7.74	1.24
1962	92.41	6.52	1.07
1963	93.12	5.91	0.97
1964	93.59	5.56	0.85
1965	93.77	5.41	0.82
1966	93.81	5.41	0.77
1967	92.82	6.58	0.60
1968	91.15	8.06	0.79
1969	92.22	6.99	0.79

The figures below show the annual volume of shares traded, including rights and warrants, on all exchanges during selected years since 1940. In 1969 both share and dollar volume of trading on all

exchanges halted their steady climb of the preceding 6 years and declined 5 and 11 percent, respectively. In the first 6 months of 1970, the rates of decline over the comparable period in 1969 were 10 percent for share volume and 27 percent for dollar value, with most of these reductions attributable to the marked decline in trading on the American Stock Exchange.

Share and Dollar Volume on Exchanges

Calendar year	New York Stock Exchange	American Stock Exchange	All other exchanges	Total
	Share volume (thousands)			
1940	285,059	49,882	42,957	377,898
1945	506,564	163,860	98,595	769,019
1950	681,806	120,908	90,606	893,320
1955	909,785	253,531	158,084	1,321,401
1960	986,878	320,906	133,263	1,441,048
1961	1,392,573	548,161	201,790	2,142,523
1962	1,220,854	344,347	146,744	1,711,945
1963	1,371,808	354,305	154,686	1,880,798
1964	1,542,373	411,450	172,551	2,126,374
1965	1,867,223	601,844	201,944	2,671,012
1966	2,297,884	766,942	257,558	3,312,383
1967	2,992,805	1,320,462	333,258	4,646,525
1968	3,352,169	1,608,325	448,244	5,408,737
1969	3,243,333	1,417,764	473,898	5,134,995
1970 (First 6 months)	1,684,731	501,071	225,063	2,410,866
	Dollar volume (thousands)			
1940	7,170,572	646,146	603,065	8,419,783
1945	13,474,271	1,759,899	1,020,382	16,254,552
1950	18,734,723	1,493,706	1,579,855	21,808,284
1955	32,830,838	2,657,016	2,551,253	38,039,107
1960	37,972,433	4,235,686	3,098,484	45,306,603
1961	52,820,306	6,863,110	4,388,207	64,071,623
1962	47,353,334	3,736,619	3,765,941	54,855,894
1963	54,897,096	4,844,912	4,696,065	64,488,073
1964	60,501,229	6,127,236	5,833,285	72,461,750
1965	73,234,393	8,874,875	7,439,825	89,549,093
1966	98,653,005	14,647,166	10,366,272	123,666,443
1967	125,362,700	23,491,312	13,335,199	162,189,211
1968	144,992,721	35,479,186	16,646,050	197,117,957
1969	129,622,648	31,036,896	15,730,215	176,389,759
1970 (First 6 months)	52,677,444	8,841,144	6,903,282	68,421,871

In 1969, the ratio of share volume on the New York Stock Exchange to the total on all exchanges reversed the declining trend of the past five years, but its value ratio declined slightly. On the American Stock Exchange, where the percentage of share and dollar volume had risen steadily since 1963, slight declines were registered. The regional exchange percentage of both share and dollar volume increased moderately in 1969. In the first 6 months of 1970, both the share volume and dollar volume ratios for the New York Stock Exchange increased markedly, while these ratios for the American Stock Exchange declined significantly. Both ratios for regional exchanges showed moderate gains. Stocks, rights and warrants are included in the following presentation. Annual data in more detail are shown in Appendix Table 7 of this report.

Annual Sales of Stock on Exchanges, in Percentages

Calendar year	Percent of share volume			Percent of dollar volume		
	New York	American	All other	New York	American	All other
1940	75.44	13.20	11.36	85.17	7.68	7.15
1945	65.87	21.31	12.82	82.75	10.81	6.44
1950	76.32	13.54	10.14	85.91	6.85	7.24
1955	68.85	19.19	11.96	86.31	6.98	6.71
1960	68.48	22.27	9.25	83.81	9.35	6.84
1961	64.99	25.58	9.43	82.44	10.71	6.85
1962	71.32	20.12	8.56	86.32	6.81	6.87
1963	72.94	18.84	8.22	85.19	7.52	7.29
1964	72.54	19.35	8.11	83.49	8.46	8.05
1965	69.91	22.53	7.56	81.78	9.91	8.31
1966	69.37	22.85	7.78	79.78	11.84	8.38
1967	64.41	28.42	7.17	77.30	14.48	8.22
1968	61.98	29.74	8.28	73.56	18.00	8.44
1969	63.16	27.61	9.23	73.49	17.60	8.91
1970 (First 6 months)	69.88	20.78	9.34	76.99	12.92	10.09

Block Distributions Reported by Exchanges

The usual method of distributing blocks of listed securities considered too large for the auction market on the floor of an exchange is to resort to "secondary distributions" over the counter after the close of exchange trading. There were 142 secondary distributions in 1969 compared to 174 in the preceding year. The dollar value of the shares sold in this manner declined 21 percent to $1,244.2 billion. During the first 6 months of 1970, there were 31 secondary distributions with a total value of $205.8 million.

Special Offering Plans were adopted by many of the exchanges in 1942, and Exchange Distribution Plans in 1953, in an effort to keep as much trading as possible on their floors. There were no special offerings last year. Exchange distributions continued to decline from the record of 72 in 1963 to 32 in 1969. The value of the 1969 exchange distributions fell 44 percent to $52.2 million.

Block Distributions of Stocks Reported by Exchanges

	Number	Shares in offer	Shares sold	Value (dollars)
	12 months ended December 31, 1969[a]			
Special offerings	0	0	0	0
Exchange distributions	32	2,143,565	1,706,572	52,198,372
Secondary distributions	142	37,189,104	38,224,799	1,244,186,322
	6 months ended June 30, 1970			
Special offerings	0	0	0	0
Exchange distributions	20	1,043,595	926,066	23,861,661
Secondary distributions	31	7,995,539	8,351,870	205,843,010

[a] Details of these distributions appear in the Commission's monthly Statistical Bulletins. Data for prior years are shown in Appendix Table 8 in this Annual Report.

Unlisted Trading Privileges on Exchanges

The number of stocks with unlisted trading privileges which are not listed and registered on other exchanges further declined during

the fiscal year from 89 to 62. The decline was accounted for by the removal of 25 such stocks by the American Stock Exchange, and of two by the Honolulu Stock Exchange. During the calendar year 1969, the reported volume of trading on the exchanges in stock with only unlisted trading privileges decreased to about 47,958,150 shares, or about 0.97 percent of the total volume on all exchanges, from about 52,321,064 shares, or about 0.98 percent of share volume, during calendar year 1968. About 98 percent of the 1969 volume was on the American Stock Exchange, while two other exchanges contributed the remaining 2 percent. The share volume in these stocks on the American Stock Exchange represented 3.5 percent of the total share volume on that exchange.

Unlisted trading privileges on exchanges in stocks listed and registered on other exchanges numbered 2,091 as of June 30, 1970. The volume of trading in these stocks for the calendar year 1969 was reported at about 168,901,733 shares. About 95.7 percent of this volume was on regional exchanges in stocks listed on the New York or American Stock Exchanges. The remaining 4.3 percent represented unlisted trading on the American Stock Exchange in issues which were listed on regional exchanges but as to which the primary market was the American Stock Exchange. While the 168,901,733 share volume amounted to only 3.5 percent of the total share volume on all exchanges, it represented a substantial portion of the share volume of most regional exchanges, as reflected in the following approximate percentages: Cincinnati 56.9 percent, Boston 77.9 percent, Pacific Coast 29.6 percent, Midwest 34.5 percent, and Pittsburgh 60.1 percent.[10]

Applications by exchanges for unlisted trading privileges in stocks listed on other exchanges, filed pursuant to Rule 12f-1 under Section 12(f)(1)(B) of the Securities Exchange Act, were granted by the Commission during the fiscal year ended June 30, 1970, as follows:

	Number of stocks
Boston	93
Cincinnati	1
Detroit	29
Midwest	56
Pacific Coast	21
Philadelphia-Baltimore-Washington	79
TOTAL	279

[10] The distribution of unlisted stocks among the exchanges and share volume therein are shown in Appendix Table 9.

SUPERVISION OF ACTIVITIES OF NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

Section 15A of the Exchange Act provides for registration with the Commission of national securities associations and establishes standards and requirements for such associations. The National Association of Securities Dealers, Inc. (NASD) is the only association registered under the Act. The Act contemplates that such associations will serve as a medium for self-regulation by over-the-counter brokers and dealers. Their rules must be designed to protect investors and the public interest, to promote just and equitable principles of trade, and to meet other statutory requirements. They are to operate under the general supervision of the Commission, which is authorized to review disciplinary actions taken by them,[11] to disapprove changes in their rules, and to alter or supplement their rules relating to specified matters. Review of NASD rules is carried out for similar purposes as the review of exchange rules described at page 67.

In adopting legislation permitting the formation and registration of national securities associations, Congress provided an incentive to membership by permitting such associations to adopt rules which preclude a member from dealing with a nonmember broker or dealer except on the same terms and conditions as the member affords the general public. The NASD has adopted such rules. As a result, membership is necessary to profitable participation in underwritings since members may properly grant price concessions, discounts and similar allowances only to other members.

At the close of the fiscal year the NASD had 4,482 members, reflecting a net increase of 380 members during the year. This increase was the net result of 712 admissions to and 332 terminations of membership. At the end of the year NASD member firms had 7,375 branch offices, reflecting a net increase of 276 offices during the year. This increase was the net result of the opening of 2,025 new offices and the closing of 1,749 offices. During the year the number of registered representatives and principals, which categories include all partners, officers, traders, salesmen and other persons employed by or affiliated with member firms in capacities which require registration, increased by 34,341 to stand at 193,370 as of June 30, 1970. This increase was the net result of 51,694 initial registrations, 31,331 re-registrations and 48,684 terminations of registrations during the year.

During this period the NASD administered 105,574 qualification examinations, of which approximately 73,095 were for NASD quali-

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[11] This aspect of the Commission's supervisory authority is discussed at pp. 125–126, *infra*.

fication and the balance for other agencies, including major exchanges, the Commission and various States.

Commission Review of NASD Rules and Policies

Under Section 15A(j) of the Exchange Act, the NASD must file for Commission review, 30 days in advance of their effectiveness, copies of any proposed rules or rule amendments; these may be disapproved by the Commission if not consistent with the requirements of the Act. In practice, the Commission also normally reviews in advance of publication general policy statements, directives, and interpretations proposed to be issued by the Association's board of governors pursuant to its powers to administer and interpret NASD rules.

During the fiscal year, numerous changes in or additions to NASD rules, policies and interpretations were submitted to the Commission pursuant to these procedures. Among the significant matters covered in such submissions were:

1. A revised interpretation of the Board of Governors concerning corporate financing and covering such matters as the fairness of underwriting arrangements and compensation; and a new statement of policy concerning venture capital and other investments by members prior to public offerings.

2. The establishment of and amendments to NASD Emergency Rules of Fair Practice to assist in alleviating members' back office and operational problems, particularly those regulating trading hours and undue delays in the delivery of securities; and related amendments to the NASD's Uniform Practice Code provisions governing procedures used in "buy-ins", and in ex-rights, ex-warrants, and ex-dividend trading. In addition, the National Clearing Corporation, developed as a subsidiary of the NASD, was created to facilitate nationwide stock clearing operations for NASD members in the over-the-counter market. In another related area, the NASD amended its standards for over-the-counter quotations published in news media so as to require issuers whose securities are so quoted to include CUSIP numbers (Committee on Uniform Securities Identification Procedures) on all stock certificates and bond instruments issued on or after January 1, 1971.

3. Amendment to Schedule "D" of the NASD by-laws to provide for: (a) the qualifications for securities to be included in

the association's automated quotations system (NASDAQ);[12] and (b) the establishment of high and low usage charge plans for NASDAQ Levels II and III service.[13]

OVER-THE-COUNTER TRADING IN COMMON STOCKS LISTED ON THE NEW YORK STOCK EXCHANGE

In accordance with Rule 17a-9 under the Exchange Act, since January 1965 brokers and dealers who make markets in common stocks listed on the New York Stock Exchange (sometimes referred to as the "third market") have been reporting their trading over the counter and on exchanges in those New York Stock Exchange common stocks in which they make markets. They also report certain off-board trading in other common stocks listed on the Exchange. Brokers-dealers who are not market makers report their large third market transactions. The reporting system is designed to reflect all sales to persons other than broker-dealers, i.e., to individuals and institutions. Prior to 1967, reports were also required for common stocks listed on other registered securities exchanges. This requirement was discontinued, however, since about 98 percent of over-the-counter volume in listed common stocks is in New York Stock Exchange issues.

During the calendar year 1969, total over-the-counter sales of common stocks listed on the New York Stock Exchange continued to increase as they have in every year since 1965. Third market sales in 1969 amounted to 155.4 million shares, valued at $7,128 million. Third market volume also continued to increase at a greater rate than Exchange volume. As a result, over-the-counter dollar volume in New York Stock Exchange common stocks amounted to 5.5 percent of the dollar volume in common and preferred issues on the Exchange, a new high ratio.

In the first half of 1970, volume in the third market declined but not as sharply as Exchange volume. Consequently, over-the-counter dollar volume in New York Stock Exchange common stocks rose to a record high of 7.1 percent of the dollar volume on the Exchange

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[12] For a description of NASDAQ, see 35th Annual Report, pp. 5–6. NASDAQ is expected to become operational in December 1970.

[13] Level II service will supply trading departments of securities firms and such other persons as the NASD's Board of Governors may authorize with actual current quotations of over-the-counter market makers for securities included in the system. Level III service is similar to that of Level II except that it will be available only to market makers registered with the NASD and will include input devices to enable market makers to insert their current quotations into the system.

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Over-the-Counter Volume in Common Stocks Listed on the New York Stock Exchange

	Over-the-counter sales of 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 (First 6 months)	94,602	1,529,889	6.2
	Dollar volume (thousands)		
1965	2,500,416	73,199,907	3.4
1966	2,872,660	98,565,294	2.9
1967	4,151,917	125,329,106	3.3
1968	5,983,041	144,978,416	4.2
1969	7,127,834	129,603,420	5.5
1970 (First 6 months)	3,711,825	52,614,986	7.1

REGULATION OF BROKER-DEALERS AND INVESTMENT ADVISERS

Registration

Subject to limited exemptions, the Securities Exchange Act requires all brokers and dealers who use the mails or the means of interstate commerce in the conduct of an over-the-counter securities business to register with the Commission. Similarly, investment advisers (with certain exceptions) must register under the Investment Advisers Act of 1940, which establishes a pattern of regulation comparable to that established by the Exchange Act with respect to brokers and dealers. Applicants for registration which are subject to a statutory disqualification may be denied registration, and misconduct following registration may result in suspension or revocation of the registration.[14]

As of June 30, 1970, 5,224 broker-dealers and 3,060 investment advisers were registered. These figures reflect substantial increases in both categories during the year.

The following tabulation reflects various data with respect to registrations of brokers and dealers and investment advisers during the 1970 fiscal year:

[14] For a discussion of the various types of disqualifications and of enforcement actions taken by the Commission and the self-regulatory agencies with respect to broker-dealers and investment advisers, see Part IV of this report.

Broker-Dealers

Effective registrations at close of preceding year	4,793
Applications pending at close of preceding year	82
Applications filed during year	952
Total	5,827
Applications denied	0
Applications withdrawn	9
Registrations withdrawn	493
Registrations canceled	23
Registrations revoked	12
Registrations suspended	1
Registrations effective at end of year	5,224
Applications pending at end of year	65
Total	5,827

Investment Advisers

Effective registrations at close of preceding year	2,476
Applications pending at close of preceding year	67
Applications filed during year	822
Total	3,365
Registrations canceled or withdrawn	208
Registrations denied or revoked	3
Applications withdrawn	15
Registrations effective at end of year	3,060
Applications pending at end of year	79
Total	3,365

Microfilming of Records

The Commission has encouraged the use of automation in many facets of the securities business, including the maintenance of books and records, so as to promote economies and efficiencies as well as improved service for the public. Rule 17a-4 under the Exchange Act, prior to its amendment during the fiscal year, required preservation of records in hard copy form except that it permitted the substitution of a photograph on film after a period of two years following creation of the record. The Commission amended Rule 17a-4 [15] to permit records to be immediately produced on microfilm and maintained and preserved in that form, provided that a broker-dealer using the microfilm record has readily available at all times appropriate equipment for Commission examination of the records

[15] Securities Exchange Act Release No. 8875 (April 30, 1970).

and for the prompt production of such records in "hard copy" form upon request of the Commission. In addition, as protection against possible loss of records, the amendment provides that duplicate copies must be made of all microfilm records on a current basis and stored separately.

Financial Reports of Broker-Dealers

Rule 17a-5 under the Exchange Act requires registered broker-dealers to file annual reports of financial condition with the Commission. These reports must be certified by a certified public accountant or public accountant who is in fact independent, with certain limited exemptions applicable to situations where certification does not appear necessary for customer protection. During the fiscal year 4,459 reports were filed with the Commission.

These reports enable the Commission and the public to determine the financial position of broker-dealers. They provide one means by which the staff of the Commission can determine whether a broker-dealer is in compliance with the net capital rule. Failure to file required reports may result in the institution of administrative proceedings to determine whether the public interest requires remedial action against the registrant, as well as possible injunctive or criminal action.

Form X-17A-5, the form for filing annual broker-dealer financial reports, was amended during the fiscal year to require that securities listed in "failed to deliver" accounts with respect to transactions which had been outstanding 30 days or more be classified according to the length of time that the transactions had been outstanding.[16] This amendment corresponds to the amendment of the net capital rule during the previous fiscal year [17] which required that in computing net capital, deductions be made based on outstanding items in the "failed to deliver" account.

Broker-Dealer Income and Expense Reports

In order to obtain improved financial information concerning the securities industry, the Commission, in June 1968, adopted Rule 17a-10 under the Securities Exchange Act, effective January 1, 1969.[18] This rule requires registered broker-dealers and exchange members to file income and expense reports for each calendar year with the Commission or with a registered self-regulatory organization [an exchange or the National Association of Securities Dealers, Inc. (NASD)] which has qualified a plan pursuant to paragraph

[16] Securities Exchange Act Release No. 8825 (February 20, 1970).

[17] See 35th Annual Report, pp. 85-86.

[18] Securities Exchange Act Release No. 8347 (June 28, 1968); also see 34th Annual Report, pp. 14-15.

(b) of the rule. The self-regulatory organization is to transmit copies of such reports to the Commission. All reports are submitted to the Commission on a confidential basis.

Since the end of the 1969 fiscal year, the Commission has approved the plans of the NASD, and the American, Midwest, and Philadelphia-Baltimore-Washington Stock Exchanges under paragraph (b) of the rule.[19] In summary, these plans provide that the self-regulatory organization will (1) adopt and implement appropriate internal procedures for review of the reports submitted by members, (2) review all reports filed for reasonableness and accuracy, (3) transmit edited reports to the Commission (excluding the names and addresses of the respective firms), and (4) undertake certain other obligations.

The reports covering calendar year 1969 of SECO broker-dealers[20] and non-NASD members of those exchanges which have not qualified a plan have been received and reviewed by the Commission. The 1969 reports of all NASD members and of non-NASD members of those exchanges which have qualified a plan have been received by the Commission from the respective self-regulatory organizations. It is anticipated that the Commission or the NASD will publish aggregate information based on all the data received.

During the fiscal year, the Commission amended Rule 17a-10 to extend the time within which the required reports must be filed. As amended, the rule requires reports to be filed within 120 days after the close of the calendar year instead of the 90-day period previously provided. This amendment was adopted because the program is new and it appeared that a number of firms would have difficulty in meeting the previous time schedule.[21] The rule was also amended to provide an orderly procedure for obtaining extensions of time (for a maximum of 30 days) for filing the report in cases of undue hardship.[22]

The Commission also amended the income and expense report form (Form X-17A-10) in certain respects. The changes were largely technical in nature and did not require the filing of additional financial information. They were designed primarily to aid in maintaining the statistical continuity of the data to be compiled

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[19] Securities Exchange Act Release Nos. 8876 (April 30, 1970); 8896 (May 28, 1970); 8946 (July 28, 1970); and 8954 (August 11, 1970).

[20] Those registered broker-dealers who are not members of the NASD are commonly referred to as SECO broker-dealers.

[21] Securities Exchange Act Release No. 8812 (February 9, 1970).

[22] *Ibid.*

from the reports over a period of time and to clarify questions which had arisen regarding the reporting requirements.[23]

Disclosure of Credit Terms in Margin Transactions

The "Truth in Lending Act" specifically exempts brokers' margin loans to customers from its disclosure requirements. The Commission had advised Congress that it had adequate authority under the Securities Exchange Act to require disclosure of the cost of credit, and the Senate Committee on Banking and Currency, in its report on the legislation, stated that it intended that the Commission adopt appropriate regulations as soon as possible. In response to this mandate the Commission, in December 1969, adopted Rule 10b–16 under the Securities Exchange Act to require meaningful disclosure of the credit terms to securities customers in margin transactions.[24] The Rule requires broker-dealers who extend credit to customers to finance securities transactions to furnish specified information with respect to the amount of and reasons for the credit charges, including an initial disclosure and periodic subsequent disclosures. The initial disclosure is designed to insure that the investor, before his account is opened, understands the terms and conditions under which credit charges will be made. This will enable him to compare the various credit terms available to him and to understand the methods used in computing the actual credit charges. The purpose of the periodic statement is to inform the investor of the actual cost of credit and, with the aid of the initial disclosure, enable him to accurately assess that cost.

Factual Basis for Securities Quotations

The Commission is constantly concerned about practices which result in substantial amounts of unregistered securities entering the public market in the absence of any reliable information regarding the issuer and at prices for which there is no reasonable basis. As discussed in last year's report,[25] on July 2, 1969, the Commission issued a release drawing particular attention to situations involving "spin offs" of securities and trading in the securities of shell corporations.[26]

The Commission pointed out in that release that the unlawful practices there described depended for their consummation in many

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[23] *Ibid.*

[24] The Commission postponed the effective date of the Rule from April 1, 1970, to July 1, 1970, when it was advised that operational problems would make it difficult for a number of firms to comply by April 1. Securities Exchange Act Release No. 8844 (March 18, 1970).

[25] 35th Annual Report, pp. 30–31.

[26] Securities Act Release No. 4982, Securities Exchange Act Release No. 8638.

instances on the activities of brokers and dealers, who were reminded of their obligation "to make diligent inquiry concerning the issuer and [obtain] sufficient information to justify their activity in the security." The broker-dealer conduct in question, which has also occurred in other settings, has included "the hasty submission of quotations in the daily sheets of the National Quotation Service, Inc. in the absence of any information about the security or the issuer and before an opportunity is afforded to public investors to acquire such information in order to make an informed investment judgment. In many cases this practice has resulted in an irresponsible 'numbers' game which, apart from having the effect of foisting unseasoned securities on the investing public, is not only disruptive of the market but fraught with manipulative potential." [27]

To furnish appropriate safeguards in these respects, the Commission announced a proposal to adopt Rule 15c2-11 under the Exchange Act.[28] The rule would provide that a broker-dealer may not submit a quotation to an inter-dealer-quotation-system for a security which has not been the subject of quotations on a regular basis during the previous 30 days or which is not currently subject to and meeting certain statutory disclosure or reporting requirements unless the broker-dealer has furnished certain specified financial and other pertinent information to the inter-dealer-quotation-system at the time of the submission of the quotation and makes that information available to anyone expressing an interest in the security.

Regulation of Broker-Dealers Who Are Not Members of a Registered Securities Association

Under the Exchange Act, as amended in 1964, the Commission has the responsibility for establishing and administering rules relating to qualification standards and business conduct of broker-dealers who are not members of the National Association of Securities Dealers, Inc. (NASD) [29] and persons associated with them, so as to provide regulation for these nonmember broker-dealers (also referred to as "SECO" broker-dealers) comparable to that provided by the NASD for its members.[30]

During the fiscal year, the number of nonmember broker-dealers decreased from 455 to 336 and the number of associated persons of such firms (which includes principally partners, officers, directors,

[27] Securities Exchange Act Release No. 8909 (June 24, 1970).

[28] *Ibid.*

[29] The Act does not specifically refer to the NASD, but to broker-dealers who are not members of a registered "national securities association." However, the NASD is the only such association.

[30] See pp. 79-81 for the discussion of NASD regulation.

and employees not engaged in merely clerical or ministerial functions) decreased from 19,750 to 19,504.[31] The principal reason for the decrease in the number of nonmember broker-dealers was the deregistration of 94 general agent broker-dealers engaged in the marketing of variable annuities, who subsequently became associated persons of a single nonmember broker-dealer.

Number of Nonmember Broker-Dealers by Principal Type of Business as of June 30, 1970

Principal type of business	Number
Exchange member primarily engaged in floor activities	[a] 32
Exchange member primarily engaged in exchange commission business	[b] 18
Broker or dealer in general securities business	82
Mutual fund underwriter and distributor	35
Broker or dealer selling variable annuities	15
Solicitor of savings and loan accounts	19
Real estate syndicator or mortgage broker and banker	20
Broker or dealer selling oil and gas interests	4
Put and call broker or dealer or option writer	27
Broker or dealer selling securities of only one issuer or associated issuers	16
Broker or dealer selling church securities	20
Government bond dealer	24
Broker or dealer in other securities business [c]	21
Inactive in securities business	4
Total	336

[a] Includes 13 New York Stock Exchange members and 10 American Stock Exchange members.
[b] Includes 3 New York Stock Exchange members and 4 American Stock Exchange members.
[c] Includes, among others, finders in mergers and acquisitions, sellers of theatrical participations, a private banker and appraisers of estates.

Various rules have been adopted by the Commission since 1964 in the development of its regulatory program for nonmember broker-dealers.[32] One of the requirements is that each associated person engaged in specified securities activities successfully complete the Commission's General Securities Examination or an examination deemed by the Commission to be a satisfactory alternative. Alternative examinations include those given by the NASD, by certain of the national securities exchanges and by many states. During the fiscal year the list of states administering acceptable alternative examinations was updated as the result of a survey conducted by the Commission's staff.[33] The Commission also discontinued its recognition of Part I of the National Association of Insurance Commissioners (NAIC) examination as an acceptable alternative for variable annuities salesmen.[34] The NAIC had requested such action.

Rule 15b9-2 under the Act provides for an annual assessment to be paid by nonmember broker-dealers to defray the costs of regula-

[31] Nonmember broker-dealers must file a prescribed form (Form SECO-2) with the Commission for each associated person.

[32] See 31st Annual Report, pp. 11-13; 32nd Annual Report, pp. 16-18; 33rd Annual Report, pp. 15-18; 34th Annual Report, pp. 83-85; 35th Annual Report, pp. 86-88.

[33] See Securities Exchange Act Release No. 8935 (July 21, 1970).

[34] Securities Exchange Act Release No. 8915 (June 26, 1970).

tion. It includes a base fee, a charge for each office, and a charge for each associated person. The rule also provides that the maximum amount payable by any one SECO member is set each year on the assessment form which must be filed by each firm. The maximum for fiscal year 1970 was raised from $20,000 to $25,000.[35]

Pursuant to the inspection program for nonmember broker-dealers, 48 inspections were conducted during the fiscal year. These inspections were designed to determine compliance with applicable Commission rules and to obtain information which will prove helpful in the further development of the SECO program.

STATISTICAL STUDIES

The regular statistical activities of the Commission and its participation in the overall Government statistical program under the direction of the Office of Statistical Standards, Office of Management and Budget, were continued during fiscal 1970 in the Commission's Office of Policy Research. The statistical series described below are published in the Commission's monthly Statistical Bulletin. In addition, current figures and analyses of data are published quarterly on new securities offerings, stock transactions of financial institutions, the financial position of corporations, and plant and equipment expenditures.

Issues Registered Under the Securities Act of 1933

Monthly statistics are compiled on the number and volume of registered securities. Summary statistics for the years 1935–70 are given in Appendix Table 1 and detailed statistics for the fiscal year 1970 appear in Appendix Table 2.

New Securities Offerings

Monthly and quarterly data are compiled covering all new corporate and noncorporate issues offered for cash sale in the United States. The series includes not only issues publicly offered but also issues privately placed, as well as other issues exempt from registration under the Securities Act, such as intrastate offerings and offerings of railroad securities. The offerings series include only securities actually offered for cash sale, and only issues offered for the account of issuers.

Estimates of the net cash flow through securities transactions are prepared quarterly and are derived by deducting, from the amount of estimated gross proceeds received by corporations through the sale of securities, the amount of estimated gross payments by corporations to investors for securities retired. Data on gross issues, re-

[35] Securities Exchange Act Release No. 8893 (May 27, 1970).

tirements and net change in securities outstanding are presented for all corporations and for the principal industry groups.

Individuals' Saving

The Commission no longer compiles quarterly estimates of the Volume and Composition of Individuals' Saving in the United States. During the fiscal year 1970 these savings statistics were made consistent with those published by the Federal Reserve Board, and the Board now produces and publishes saving statistics as part of its flow-of-funds statistical program, including seasonally adjusted as well as unadjusted data.

Private Noninsured Pension Funds

An annual survey is published of private pension funds other than those administered by insurance companies, showing the flow of money into these funds, the types of assets in which the funds are invested and the principal items of income and expenditures. Quarterly data on assets of these funds are published in the Statistical Bulletin.

Stock Transactions of Financial Institutions

A statistical series containing data on stock trading of four principal types of financial institutions is published quarterly. Information on purchases and sales of common stock by private noninsured pension funds and nonlife insurance companies has been collected on a quarterly basis by the Commission since 1964; these data are combined with similar statistics prepared for mutual funds by the Investment Company Institute and for life insurance companies by the Institute of Life Insurance.

Financial Position of Corporations

The series on the working capital position of all U.S. corporations, excluding banks, insurance companies, investment companies and savings and loan associations, shows the principal components of current assets and liabilities, and also contains an abbreviated analysis of the sources and uses of corporate funds.

The Commission, jointly with the Federal Trade Commision, compiles a quarterly financial report of all U.S. manufacturing concerns. This report gives complete balance sheet data and an abbreviated income account, data being classified by industry and size of company.

Plant and Equipment Expenditures

The Commission, together with the Department of Commerce, conducts quarterly and annual surveys of actual and anticipated plant and equipment expenditures of all U.S. business, exclusive of agriculture. After the close of each quarter, data are released on ac-

tual capital expenditures of that quarter and anticipated expenditures for the next two quarters. In addition, a survey is made at the beginning of each year of the plans for business expansion during that year.

Directory of Registered Companies

The Commission annually publishes a list of companies required to file annual reports under the Securities Exchange Act of 1934. In addition to an alphabetical listing, there is a listing of companies by industry group classified according to The Standard Industrial Classification Manual.

Stock Market Data

The Commission regularly compiles statistics on the market value and volume of sales on registered and exempted securities exchanges, round-lot stock transactions on the New York and American Stock Exchanges for account of members and nonmembers, odd-lot transactions in 100 selected stocks on the New York Stock Exchange and block distributions of exchange stocks. Since January 1965, the Commission has been compiling statistics on volume of over-the-counter trading in common stocks listed on national securities exchanges (the so-called "third market") based on reports filed under Rule 17a–9 of the Securities Exchange Act.

Data on round-lot and odd-lot trading on the New York and American Stock Exchanges are released weekly. The other stock market data mentioned above, as well as these weekly series, are published regularly in the Commission's Statistical Bulletin.

PART IV

CONTROL OF IMPROPER PRACTICES

One of the major areas of the Commission's work is its enforcement activities, which encompass the detection and investigation of possible violations of the Federal securities laws and the taking of appropriate action to curtail fraudulent and other improper activities. The Commission's enforcement program is designed to achieve a broad regulatory impact within the framework of its limited manpower. In addition to direct action by the Commission, the various self-regulatory organizations have a responsibility (subject to Commission oversight) to ferret out and take appropriate action with respect to improper practices by their respective members. Moreover, there is a significant degree of coordination between the enforcement activities of the Commission, the self-regulatory agencies, the various states, and certain foreign securities agencies.

This part of the report deals with some of the more significant aspects of these enforcement activities conducted during the fiscal year [1] and with developments in litigation arising out of prior enforcement actions. It also summarizes certain noteworthy cases involving private litigation under the securities acts in which the Commission participated as *amicus curiae.*

DETECTION OF IMPROPER PRACTICES

Public Complaints and Inquiries

The Commission receives many communications from the public, consisting predominantly of complaints against members of the securities industry and requests for information about issuers. These complaints and inquiries are given careful attention. In most instances the matters raised can be informally resolved. However, where violations of the Federal securities laws are indicated, the matters are referred to the enforcement officials of the Commission for appropriate action. The Commission may also refer matters to the stock exchanges or the National Association of Securities Dealers, Inc. (NASD). Analysis of complaints and inquiries helps the Commission to recognize problems being experienced by a particular firm or by the industry in general.

[1] Enforcement activities related to investment companies are discussed in Part V, at pp. 149–157.

During fiscal 1970 the Commission received some 15,000 written and telephonic complaints and inquiries from the public relating specifically to broker-dealers, of which about 85 percent involved back-office problems. The remainder were divided between complaints of improper conduct and inquiries regarding various industry practices.

Other sources of information regarding possible securities violations include information received from stock exchanges, the NASD, brokerage firms, State and Canadian securities authorities, better business bureaus, and various law enforcement agencies.

Inspections

The program of surprise inspections of broker-dealers and investment advisers by the Commission's staff is another important device for the detection of improper practices. During fiscal 1970, the staff conducted 707 broker-dealer inspections (as compared with 732 the previous year) and 96 inspections of investment advisers (as compared to 128 during the previous year).

The table below shows the types of infractions indicated by the inspections conducted during the fiscal year:

Broker-Dealers

Type	*Number of Broker-Dealers*
Insufficient net capital	115
Improper hypothecation	7
Unreasonable prices in securities purchases and sales	21
Noncompliance with Regulation T	49
"Secret Profits"	2
Noncompliance with confirmation and bookkeeping rules	186
Other	180
Total indicated violations	560

Investment Advisers

Type	*Number of Investment Advisers*
Books and records deficient	18
Registration application inaccurate	10
False, misleading, or otherwise prohibited advertising	10
Improper "hedge clause" *	12
Failure to provide for nonassignability in investment advisory contract	7
Other	8
Total indicated violations	65

* "Hedge clauses" used in literature distributed by investment advisers generally state in substance that the information furnished is obtained from sources believed to be reliable, but that no assurance can be given as to its accuracy. A clause of this nature may be improper where the recipient may be led to believe that he has waived any right of action against the investment adviser.

Market Surveillance

In order to enable the Commission to meet its responsibilities for the surveillance of the securities markets, the market surveillance staff has devised a number of procedures to identify possible manipulative activities. A program has been adopted with respect to surveillance over listed securities, in which the staff's activities are closely coordinated with the stock watching operations of the New York and American Stock Exchanges. Within this framework, the staff reviews the daily and periodic stock watch reports prepared by these exchanges and, on the basis of its analysis of the information developed by the exchanges and other sources, determines matters of interest, possible violations of applicable law, and the appropriate action to be taken.

In addition, the market surveillance staff maintains a continuous ticker tape watch of transactions on the New York and American Stock Exchanges and the sales and quotation sheets of regional exchanges to observe any unusual or unexplained price variations or market activity. The financial news ticker, leading newspapers and various financial publications and statistical services are also closely followed.

If any of these sources reveals possible violations, the market surveillance staff conducts a preliminary inquiry into the matter. These inquiries, some of which are conducted with the cooperation of the exchange concerned, generally begin with the identification of the brokerage firms which were active in the security. The staff may communicate with partners, officers or registered representatives of the firm, with customers, or with officials of the company in question to determine the reasons for the activity or price change in the securities involved and whether violations may have occurred.

The Commission has also developed an over-the-counter surveillance program involving the use of automated equipment to provide more efficient and comprehensive surveillance. That equipment is programmed to identify, among other things, unlisted securities whose price movement or dealer interest varies beyond specified limits in a pre-established time period. When a security is so identified, the automated system prints out current and historic market information concerning it. This data, combined with other available information, is collated and analyzed to select those securities whose activity indicates the need for further inquiry or referral to the Commission's enforcement staff.

Use of Computer for Name Searches

The use of the Commission's computer for "name searches" in the enforcement program has resulted in a substantial increase in the

amount of information available and the speed with which it can be obtained. The names of suspected securities law violators are checked against the more than 1 million entries presently stored in the computer. Upon request, the Commission also performs "name searches" on prospective securities salesmen and others whose names are submitted by the exchanges, the NASD, and the State securities commissions. If the subject checked has been named in formal filings with the Commission, has been a party to a proceeding, or has been involved in an investigation, such information, together with pertinent dates, relationships, and cross references, is available immediately on a printout. Formerly a time-consuming manual search of indices and files was required.

INVESTIGATIONS

Each of the Acts administered by the Commission specifically authorizes it to conduct investigations to determine whether violations of the Federal securities laws have occurred.

The nine regional offices of the Commission are chiefly responsible for the conduct of investigations. In addition, the Office of Enforcement of the Division of Trading and Markets at the Commission's headquarters office conducts investigations dealing with matters of particular interest or urgency, either independently or with the assistance of the regional offices. The Office of Enforcement also exercises general supervision over and coordinates the investigative activities of the regional offices and recommends appropriate action to the Commission. Investigations are also conducted by the Divisions of Corporation Finance and Corporate Regulation in the areas under their respective jurisdictions.

It is the Commission's general policy to conduct its investigations on a confidential basis. Such a policy is necessary to effective law enforcement and to protect persons against whom unfounded or unconfirmed charges might be made. The Commission investigates many complaints where no violation is ultimately found to have occurred. To conduct such investigations publicly would ordinarily result in hardship or embarrassment to many interested persons and might affect the market for the securities involved, resulting in injury to investors with no countervailing public benefits. Moreover, members of the public would tend to be reluctant to furnish information concerning violations if they thought their personal affairs would be made public. Accordingly, the Commission does not generally divulge the existence or findings of a nonpublic investigation unless they are made a matter of public record in proceedings brought before the Commission or in the courts.

When it appears from a preliminary investigation that a serious violation of the Federal securities laws has occurred or is occurring, a full investigation is conducted. Under certain circumstances the Commission may issue a formal order of investigation which designates members of its staff as officers to issue subpoenas, take testimony under oath, and require the production of documents. During the fiscal year ended June 30, 1970, the Commission issued 176 such formal orders.

The following table reflects in summarized form the investigative activities of the Commission during fiscal 1970:

Investigations of Possible Violations of the Acts Administered by the Commission

Pending June 30, 1969	800
New Cases	408
Total	1208
Closed	346
Pending June 30, 1970	862

Enforcement of Investigative Subpoenas

In *S.E.C.* v. *Wall Street Transcript Corp.*,[2] the Court of Appeals for the Second Circuit, reversing the decision of the district court [3] previously reported,[4] ordered enforcement of an administrative subpoena duces tecum issued in the course of an investigation instituted to determine whether the Wall Street Transcript Corporation by publishing the *Wall Street Transcript* was an unregistered investment adviser. The court of appeals applied the general principle that whether a particular person or entity is or is not included within the coverage of a regulatory statute is a question properly to be determined by the regulatory agency in the first instance. It held:

> "So long as an agency establishes that an investigation 'will be conducted pursuant to a legitimate purpose, that the inquiry may be relevant to the purpose, that the information sought is not already within [its] possession, and that the administrative steps required . . . have been followed,' no showing of probable cause need be made to the district court unless a statute indicates otherwise." [5]

The court specifically rejected a contention that the express exclusion of the publishers of a "bona fide newspaper . . . or financial publication" from coverage under the Investment Advisers Act is based upon constitutional considerations. It stated:

> "The phrase 'bona fide' newspapers, in the context of this list [of exclusions from the definition of Investment Adviser], means those publications

[2] 422 F.2d 1371, *certiorari denied*, 398 U.S. 958 (1970).

[3] 294 F. Supp. 298 (S.D.N.Y., 1968).

[4] 35th Annual Report, p. 92.

[5] 422 F.2d at 1375.

which do not deviate from customary newspaper activities to such an extent that there is a likelihood that the wrongdoing which the Act was designed to prevent has occurred. The determination of whether or not a given publication fits within this exclusion must depend upon the nature of its practices rather than upon the purely formal 'indicia of a newspaper' which it exhibits on its face and in the size and nature of its subscription list" (footnotes omitted).[6]

The court noted that even newspapers are subject to governmental regulation and concluded that "[t]he Investment Advisers Act does not on its face abridge freedom of press simply because it may be applied to publications which are classified firmly as part of the 'press' for some purposes but are not 'bona fide newspapers' excluded under the Act."[7] In any event, the court found, a distinction must be drawn between political or social speech, on the one hand, and purely commercial speech, on the other, in determining the scope of First Amendment privileges.

No fault was found in the breadth of the Commission's subpoena, the court recognizing its similarity to the subpoena that had been sustained by the Supreme Court in *Oklahoma Press Publishing Co. v. Walling*.[8] And the court concluded that no showing had been made that either the Commission's investigation or the production contemplated by the subpoena would restrict the *Transcript's* freedom of expression. In rejecting the district court's view that the Commission's subpoena went to the "jugular of the *Transcript* as a publishing firm,"[9] the court of appeals found that the subpoena calls "for the production of certain correspondence and advertising materials which appear to be directly related to an investigation of the type of practices which might cause a newspaper to fall outside the Act's exclusion."[10]

ENFORCEMENT AND REMEDIAL ACTION

When the Commission determines, based upon staff investigation, that enforcement action appears appropriate, it may authorize the staff to institute civil court proceedings for injunctive relief, or, in particularly serious cases, it may refer the matter to the Justice Department with a recommendation for criminal prosecution. In the case of broker-dealers, persons associated with them, and investment advisers, the Commission may, on the basis of staff allegations, initiate administrative proceedings which can result in a Commission order imposing remedial sanctions on the respondent or respondents.

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[6] 422 F.2d at 1377.

[7] 422 F.2d at 1379.

[8] 327 U.S. 186 (1946).

[9] 422 F.2d at 1381.

[10] *Ibid.*

The Commission may also refer matters to state and local enforcement agencies or to industry self-regulatory organizations.

Administrative Proceedings

Under the Securities Exchange Act, as amended in 1964, the Commission has available to it a wide range of administrative sanctions which it may impose against brokers and dealers and persons associated with them. The Commission may deny a broker-dealer's application for registration. With respect to a broker-dealer already registered, it may impose sanctions ranging from censure through suspension of registration to revocation of registration. It may also suspend or terminate a broker-dealer's membership in a stock exchange or registered securities association. Associated persons of broker-dealers may be censured, suspended, or barred from association with any broker-dealer. Under the Investment Advisers Act, the Commission may impose comparable sanctions against investment advisers but has no authority to take direct disciplinary action against persons associated with investment advisers.

Generally speaking, the Commission may impose a sanction only if, after notice and opportunity for hearing, it finds (1) that the respondent willfully violated any provision of the securities acts or the rules thereunder; aided and abetted such violations by others; (in the case of broker-dealer proceedings) failed reasonably to supervise another person who committed such violations; or is subject to certain disqualifications, such as a conviction or injunction relating to specified types of misconduct; and (2) that a particular sanction is in the public interest.

While all respondents in broker-dealer and investment adviser proceedings are entitled to a hearing, such proceedings are frequently disposed of without hearings where respondents waive a hearing and consent to the imposition of certain sanctions or submit offers of settlement which the Commission accepts as an appropriate disposition of the proceedings. In those instances where hearings are held, the hearing officer who presides normally makes an initial decision, including an appropriate order, unless such decision is waived by the parties. If Commission review is not sought, and if the case is not called up for review on the Commission's own initiative, the initial decision becomes the final decision of the Commission, and the examiner's order becomes effective.

In those instances where it prepares its own decision upon review or waiver of an initial decision, the Commission is generally assisted by the Office of Opinions and Review. This Office is directly responsible to the Commission and is completely independent of the operating divisions of the Commission, consistent with the principle of separation

of functions embodied in the Admininistrative Procedure Act. Where the parties to a proceeding waive their right to such separation, the operating division which participated in the proceeding may assist in the drafting of the Commission's decision.

The Commission's opinions are publicly released and are distributed to the press and to persons on the Commission's mailing list. In addition, they are printed and published periodically by the Government Printing Office in bound volumes entitled "Securities and Exchange Commission Decisions and Reports."

Set forth below are statistics regarding administrative proceedings pending during fiscal 1970 with respect to brokers and dealers and investment advisers.

Broker-Dealers

Proceedings pending at beginning of fiscal year:	
Against broker-dealer registrants [a]	81
Against broker-dealer applicants [a]	2
Against nonregistered broker-dealers [a]	2
Against individuals only	8
Total	93
Proceedings instituted during fiscal year:	
Against broker-dealer registrants [a]	80
Against broker-dealer applicants [a]	3
Against nonregistered broker-dealers [a]	1
Against individuals only	6
Total	90
Total proceedings current during fiscal year	183
Disposition of proceedings: [b]	
Registration revoked	10
Registration revoked and firm expelled from NASD	3
Registration revoked and firm expelled from stock exchange	1
Registrant suspended from NASD for period of time	1
Registrant suspended from certain activities for period of time	39
Registrant censured	18
Registrant censured and suspended from NASD for period of time	1
All securities activities of registrant suspended for period of time	1
Withdrawal of registration permitted and proceedings discontinued	3
Withdrawal of application permitted and denial proceedings discontinued	1
Individuals barred or suspended	8
Total	86

[a] In most of these proceedings one or more individuals associated with the broker-dealer respondents, or other individuals or firms, were also named as respondents.

[b] For action taken in these cases as to respondents other than broker-dealers, where the only action indicated is against broker-dealers, see the table below.

Proceedings pending at end of fiscal year:	
Against broker-dealer registrants	76
Against broker-dealer applicants	3
Against nonregistered broker-dealers	2
Against individuals only	16
Total proceedings pending at end of year	97
Total proceedings accounted for	183

Action taken against individuals associated with broker-dealers included above or with broker-dealers previously sanctioned:

Barred	41
Suspended	65
Censured	22
Censured and suspended	4
Disassociated from registrant for periods of time	2
Censured and dissociated from registrant for period of time	1
Total	135

Investment Advisers

Proceedings pending at beginning of fiscal year:	
Against investment adviser registrants	5
Against investment adviser applicants	1
Total	6
Proceedings instituted during fiscal year:	
Against investment adviser registrants	11
Against investment adviser applicants	1
Total	12
Total proceedings current during fiscal year	18
Disposition of proceedings:	
Registration suspended	10
Registration revoked	2
Registration denied	1
Total	13
Proceedings pending at end of fiscal year:	
Against investment adviser registrants	4
Against investment adviser applicants	1
Total proceedings pending at end of year	5
Total proceedings accounted for	18

Certain of the more significant administrative decisions rendered during the fiscal year in broker-dealer proceedings are summarized below:

In *Jaffee & Company*,[11] the Commission found violations of its Rule 10b-6 under the Exchange Act in connection with a registered secondary offering of stock of Solitron Devices, Inc. Rule 10b-6 in substance prohibits participants in a distribution of securities from bidding for or purchasing such securities until their participation is completed.

M. L. Lee & Co., Inc. was the "exclusive agent" for the Solitron offering which covered 107,700 shares held by 34 stockholders, including Wilton L. Jaffee, Jr., principal partner of Jaffee & Company. The shares were to be offered by the sellers from time to time "in the proximate future" at then prevailing market prices. During the course of the offering, Greene & Company, through its trader, Bernard Horn, purchased over 25,000 shares of registered stock from Lee for resale. At the same time, although Greene and Horn were aware that the stock purchased from Lee was part of a registered offering, Greene, through Horn, continuously inserted bids for Solitron in the quotation sheets published by the National Quotation Bureau, Inc. and purchased Solitron stock that was not a part of the offering. Lee was aware that Greene was entering bids for Solitron in the sheets. Yet it continued to sell registered Solitron stock to Greene. Jaffee made purchases of Solitron stock for his own account during the offering and requested Horn to enter bids for the stock in the sheets.

The Commission held that an offering of stock pursuant to a registration statement by its very nature constitutes a distribution within the meaning of Rule 10b-6, and that the fact that the Solitron shareholders were able to control the timing of their sales "in no way obviated the need for the protections of the Rule or gave rise to any exemption from it." It stated that persons like Greene, engaging in market making activities in a security which at the same time is being offered in a registered distribution, must not participate in the distribution unless they have terminated their bidding and purchasing in the open market; that the Rule could be circumvented if Lee were permitted to sell stock to other broker-dealers engaged in bidding and purchasing activities although itself refraining from such conduct; and that Jaffee, having agreed to participate in the Solitron offering, became a participant in the distribution irrespective of any sales of his own registered shares, a participation which

[11] Securities Exchange Act Release No. 8866 (April 20, 1970). Petitions for review by Jaffee & Co. and W. L. Jaffee are pending (C.A. 2, No. 34859).

continued for so long as any of his shares remained unsold or until they were withdrawn from registration.

The Commission further held that Greene and Horn had violated Section 5(b)(2) of the Securities Act by failing to deliver Solitron prospectuses to certain customers. It imposed a thirty-day suspension on Horn, 20-day suspensions on Jaffee and Jaffee & Company, and censure on Greene and Lee.

Commissioner Smith dissented from the Commission's findings of violations of Rule 10b–6 by Greene, Horn, and Lee. He disagreed with the majority's determination that a registered offering was *per se* a "distribution" within the meaning of the Rule and concluded that a sufficient showing had not been made on the record that Greene and Horn had engaged in the kind of activity which would support a finding they were participants in a distribution for purposes of the Rule.

In *Richard N. Cea*,[12] the Commission, on the basis of findings of violations of antifraud provisions of the securities acts, barred several persons from further association with any broker-dealer and revoked the broker-dealer registration of a firm which was controlled by two of the respondents and which employed another respondent.

The Commission found that during the period January 1963 to October 1964 when they were employed as salesmen by another broker-dealer, the individual respondents, in the offer and sale of securities of Home Makers Savings Corporation ("HMS"), made optimistic representations and predictions concerning the financial condition and prospects of the company and a prospective rise in the market price of its stock despite knowledge that HMS had never operated at a profit, that its brief history was marked by continual losses and increasing deficits, and that its only product, an antacid tablet, had been seized by the Federal government in a condemnation proceeding in which the government alleged that the name of the product and the company's advertising material were false and misleading and violated the Federal Food, Drug and Cosmetic Act.

In addition, the Commission found that two of the respondents induced customers to engage in securities transactions which were excessive in size and frequency in light of the character of the customers' accounts, and that certain of them "falsely represented, expressly or impliedly," to customers who had disclosed their financial needs and investment objectives, that certain highly speculative securities met those needs and objectives. The Commission observed: "It was incumbent on the salesmen in these circumstances, as part of

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[12] Securities Exchange Act Release No. 8662 (August 6, 1969), petition for review dismissed (C.A.D.C., November 26, 1969).

their basic obligation to deal fairly with the investing public, to make only such recommendations as they had reasonable grounds to believe met the customers' expressed needs and objectives."

In *D. H. Blair and Co.*,[13] which involved extensive transactions through an account maintained at Blair in the stock of an obscure oil company with negligible operations, the Commission found that the account was used by a controlling person of the company to distribute unregistered stock and to manipulate the market in such stock. It held that the salesman who handled the account violated the registration, anti-fraud, and anti-manipulative provisions of the securities acts, and it barred him from association with any broker or dealer. Various other broker-dealer firms and individuals were also sanctioned for participation in the violations or inadequate supervision, certain of them pursuant to offers of settlement accepted by the Commission.

With respect to one of the respondent firms, which cleared Blair's accounts and which was found to have failed reasonably to supervise its margin and bookkeeping departments with a view to preventing violations of the Securities Act registration requirements, the Commission stated, in response to the firm's argument that clearing firms should not be required to exercise a general responsibility over the operations of their "correspondent" firms:

> "We do not undertake in this opinion to impose such a general obligation on a clearing firm. Arrangements between clearing and correspondent firms are a matter of contract between them, so long as the public customers' interests are not jeopardized. But where, as here, the record shows that personnel of the clearing firm were aware of serious irregularities in an account, it seems to us both reasonable and in the public interest to impose on that firm an independent obligation to make appropriate inquiry and take prompt steps to terminate any participation in activity violative of the securities laws."

In *Abbett, Sommer & Co., Inc.*,[14] the Commission found, among other things, that a broker-dealer, its controlling person and a corporation also controlled by him violated the registration provisions of the securities acts in connection with the offer and sale of certain mortgage notes. The respondents purchased these notes from, or sold them as agent for, a company engaged in the business of buying such notes at a discount from building contractors and others and reselling them "with recourse" against it in the event of default by the note maker. The Commission rejected the respondents' claim that the offer and sale of the notes were exempt from the registration require-

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[13] Securities Exchange Act Release No. 8888 (May 21, 1970).

[14] Securities Exchange Act Release No. 8741 (November 10, 1969), aff'd without opinion (C.A.D.C., September 25, 1970).

ments of the Securities Act by virtue of Rule 234 which exempts notes secured by a first lien on real estate if offered in accordance with specified terms and conditions. It found that an "investment contract" was involved in the offering of the notes and that, under the terms of the Rule, the exemption was therefore unavailable.

The Commission pointed out that prior judicial and Commission decisions had concluded that various contracts which in form involve nothing more than the sale of interests in real estate or chattels were in fact investment contracts and therefore securities because accompanied by an offer of or representation concerning services upon which the investor relied to obtain a profit on his purchase. In this case, the notes were sold pursuant to arrangements under which the note-discounter and the broker-dealer provided various services, including an investigation of the property and the mortgagor, the collection of monthly payments for investors, and an undertaking to some purchasers to repurchase the notes. The Commission stated that it did not

> "consider it significant that in the "investment contract" cases previously cited the services were designed to create a profit whereas in the present case the services were directed essentially toward minimizing the risks involved in the investment. In both types of situations, the investor relies upon the services and undertakings of others to secure the return of a profit to him."

The Commission also found that the respondents made misrepresentations in the sale of the mortgage notes and that the broker-dealer failed to maintain certain records as required. It revoked the broker-dealer's registration, found the other corporation a "cause" of the revocation, and barred the controlling person from association with a broker or dealer.

In *Alfred B. Tallman, Jr.*[15] the Commission addressed itself, among other things, to the obligation of broker-dealers to maintain effective mechanisms to insure compliance with applicable requirements. One of the respondents in the proceeding had been employed as a broker-dealer's compliance director. However, he was only 23 when he became so employed, and, although he was clothed with apparently broad compliance responsibilities, he in fact had very limited authority and was given inadequate assistance, and he did not effectively carry out the supervisory duties assigned to him.

The Commission stated:

> "Broker-dealers have a responsibility to take effective measures to insure compliance with the statutory standards and requirements. That responsibility is not discharged by the setting up of a compliance program with the creation of a position designated Compliance Director which does not con-

[15] Securities Exchange Act Release No. 8830 (March 2, 1970).

fer the authority and provide the personnel, procedures and means necessary to accomplish its objectives. In such case there is created merely an appearance of an effective compliance mechanism. Persons who are assigned to positions of Compliance Directors should be accorded the powers to initiate and implement steps required to achieve compliance."

Although this respondent consented, in an offer of settlement, to being censured, the Commission determined that under all the circumstances, including his young age and inexperience and the fact that this was the first case involving charges against a compliance employee as such, the public interest did not require that he be censured, and it discontinued the proceedings as to him.

In *Investors Management Co., Inc.*, a proceeding involving the obligations of persons who receive non-public material information from insiders, an initial decision was rendered during the fiscal year by a Commission hearing examiner censuring a number of such "tippees." The information in question, which related to a significant deterioration in the earnings of Douglas Aircraft Co., Inc., had been obtained by Merrill Lynch, Pierce, Fenner & Smith, Inc., in its capacity as managing underwriter of a proposed debenture offering by Douglas in 1966 and had been conveyed to certain large customers of Merrill Lynch who effected sales and short sales of Douglas stock prior to public disclosure of the earnings information and without making disclosure to purchasers.[16]

In his initial decision, the examiner censured 12 "tippee" respondents who he found had willfully violated antifraud provisions of the securities acts in effecting such sales.[17] The examiners held that persons other than traditional insiders who obtain material corporate non-public information and know or should know of its non-public nature must either disclose such information or abstain from trading in the securities of the corporation until it is public. He further held that these obligations exist notwithstanding the absence of any continuing or close relationship between the corporation or insider and the person using the information.

Neither the Commission's staff nor any of the respondents sought Commission review of the initial decision, and the Commission con-

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[16] With respect to disposition of the proceedings as against Merrill Lynch and certain persons associated with it, see Securities Exchange Act Release No. 8459 (November 25, 1968), discussed in the 34th Annual Report at pp. 8–9. See also *City Associates*, Securities Exchange Act Release No. 8509 (January 31, 1969).

[17] He ordered dismissal of the proceedings as to one respondent who he found made no use of the information obtained from Merrill Lynch and discontinuance as to two respondents who he found merely occupied control relationships to some of the violators and did not merit a sanction.

sidered that there was not sufficient reason to order review of that decision with respect to the examiner's factual findings and inferences, or with respect to the adequacy of the sanctions imposed or his determination to dismiss or discontinue the proceedings as to certain respondents. The Commission determined, however, to review on its own initiative the legal issues involved. It pointed out that such determination did not necessarily imply disagreement with the examiner's opinion, but was based on the fact that the issues respecting the obligations of "tippees" were important matters having significant implications as to which it was desirable that the Commission express its own views.

Judicial Review of Administrative Decisions.—In *Armstrong, Jones & Co.* v. *S.E.C.*,[18] the Court of Appeals for the Sixth Circuit affirmed an order of the Commission[19] which, as previously reported,[20] imposed sanctions upon Armstrong, Jones & Co., a broker-dealer, and Thomas W. Itin, its chief executive officer. The court held that substantial evidence supported the Commission's findings that the petitioners violated the registration provisions of the Securities Act when they effected sales of a Michigan insurance company's unregistered stock to non-Michigan residents shortly after the firm commenced trading in the stock. Although an intrastate exemption from registration was claimed, the Commission found that Itin had actively sought orders for the stock, to be executed immediately after trading in the stock began, from non-residents of Michigan and also that sales were made during this period to persons whom Itin knew or should have known were nominees for non-residents. In sustaining the Commission's finding that the firm willfully violated antifraud provisions of the Securities Act, the court approved "the position of the Commission that a broker-dealer may be sanctioned for the willful violations of its agents under the doctrine of *respondeat superior*." The applicability of that doctrine was held unaffected by "[t]he fact that Congress enacted an additional provision giving the Commission the power to impose a sanction on a broker-dealer for failure to adequately supervise its employees' acts . . ."[21] The court also rejected a contention that facts set forth in various public records could serve in lieu of the written notice of the fact of common control between the issuer of a security and the broker-dealer offering it for sale, which notice is required to be given to a cus-

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[18] 421 F.2d 359, *certiorari denied*, 398 U.S. 958 (1970).

[19] Securities Exchange Act Release No. 8420 (October 3, 1968), *rehearing denied*, Securities Exchange Act Release No. 8478 (December 27, 1968).

[20] 35th Annual Report, p. 97.

[21] 421 F.2d at 362.

tomer pursuant to Rule 15cl–5 under the Securities Exchange Act.[22] The court affirmed the Commission's holding that it was both fraud and a violation of record-keeping provisions for the firm to have confirmed sales of a new issue of securities to customers who had not in fact agreed to the purchases; the court did not reach the question whether an indication of interest, which had been given by all of these customers, could ever, without more, be considered a binding commitment to purchase securities.[23]

In three separate opinions, the Court of Appeals for the Second Circuit affirmed various aspects of the Commission's decision in *Richard Bruce and Co., Inc.*[24] In *Hiller* v. *S.E.C.*,[25] and *Gross* v. *S.E.C.*,[26] the court affirmed the imposition of sanctions upon two of the three principals of Bruce & Co., a broker-dealer firm. The court found, in the Hiller case, that Bruce & Co. had acted in disregard of the "basic obligation of fair dealing [which is] borne by those who engage in the sale of securities to the public" when it actively solicited purchases of certain speculative securities "without reasonable grounds for believing that reports disseminated in connection with such solicitation had a basis in fact."[27] The court held that there was substantial evidence in the record that Hiller, the firm's president, had authorized and even encouraged active solicitation of orders for stock on the basis of unconfirmed reports and rumors and, for that reason, had properly been held responsible for the firm's fraudulent course of conduct.

In affirming the Commission's determination that Gross, who had been vice-president and secretary of Bruce & Co., had aided and abetted violations of the antifraud provisions, the Court noted that Gross had been "aware of the inadequacy of the information available" concerning the company whose securities were being offered by the firm and had "also [been] aware of the active solicitation of . . . stock purchases by representatives of his firm notwithstanding the deficiency of information."[28] In *Fink* v. *S.E.C.*,[29] the court upheld imposition of sanctions upon one of the salesmen of Bruce & Co., reaffirming its holding in *Hanly* v. *S.E.C.*[30] that the Commission had the power to increase the sanction imposed by a hearing examiner.

[22] *Ibid.*

[23] 421 F.2d at 364.

[24] Securities Exchange Act Release No. 8303 (April 30, 1968), reported in the 34th Annual Report at pp. 92–93.

[25] 429 F.2d 856 (1970).

[26] 418 F.2d 103 (1969).

[27] 429 F.2d at 858.

[28] 418 F.2d at 107.

[29] 417 F.2d 1058 (1969).

[30] 415 F.2d 589 (1969), reported in the 35th Annual Report at p. 102.

In another review of a broker-dealer proceeding, the Court of Appeals for the Sixth Circuit, in *Klopp* v. *S.E.C.*,[31] reversed the Commission's finding, previously reported,[32] that a registered representative had violated the antifraud provisions of the Securities Act and the Securities Exchange Act. Specifically, the Commission found that Ralph M. Klopp, a salesman for Paine, Webber, Jackson & Curtis, induced excessive trading in the accounts of two customers by means of false representations concerning the securities activities of another customer. The court of appeals held that the Commission's decision was not supported by substantial evidence because the customer witnesses' testimony was not credible.

As previously reported,[33] in *Beck* v. *S.E.C.*,[34] the Court of Appeals for the Sixth Circuit upheld findings by the Commission of willful violations by Beck, a securities salesman, of the antifraud provisions of the securities acts, but it remanded the case to the Commission for further explanation of the reasons for the sanction imposed on Beck (a 4-month exclusion from the securities business with a requirement that subsequent employment be in a nonsupervisory capacity). The Commission thereafter issued an opinion containing such explanation.[35] After the close of the fiscal year, upon a renewed petition for review, the Court of Appeals set the sanction aside.[36] It held that the Commission abused its discretion when it ordered remedial sanctions based on the deterrent effect on Beck and on others in the securities industry. The court found "no reason to believe that . . . [Beck] is inclined to commit any further illegal or fraudulent acts,"[37] and expressed doubt concerning the authority of the Commission to impose sanctions on violators in order to deter others. It concluded that under the circumstances, the Commission's order was punitive, not remedial, and, as such, was not authorized.

Civil Proceedings

Each of the several statutes administered by the Commission authorizes the Commission to seek injunctions in the Federal district courts against continuing or threatened violations of those statutes or the Commission's rules thereunder. During the past fiscal year the Commission instituted a total of 111 injunctive actions.[38] A substan-

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[31] 427 F.2d 455 (1970), rehearing denied.

[32] 35th Annual Report, p. 97.

[33] 35th Annual Report, pp. 101–102.

[34] 413 F.2d 832 (1969).

[35] Securities Exchange Act Release No. 8720 (October 16, 1969).

[36] 430 F.2d 673 (1970).

[37] 430 F.2d at 674.

[38] More detailed statistics regarding the Commission's civil litigation activities are contained in Appendix tables 10–12.

tial number of these actions were designed to restrain further violations of the registration or antifraud provisions of the Securities Act and the Securities Exchange Act; many others sought injunctions against operation of broker-dealers in violation of net capital or other investor protection requirements.

The nature of some of the more noteworthy of these actions, and certain appellate decisions in injunctive proceedings, are summarized in the following pages.

In *S.E.C.* v. *Parvin Dohrmann Company*,[39] the Commission filed a complaint in October 1969 against 18 defendants seeking to enjoin further violations of the antifraud, reporting, proxy solicitation, and extension-of-credit provisions of the Securities Exchange Act in connection with the purchase and sale of securities of Parvin Dohrmann Company. It was alleged that one of the defendants, Delbert W. Coleman, had organized a group of investors for the purpose of acquiring sufficient stock to obtain control of Parvin Dohrmann and had filed untimely statements concerning the group with the Commission and the American Stock Exchange, pursuant to Section 13(d) of the Securities Exchange Act, which were false and misleading.

The complaint further alleged that after acquiring control of Parvin Dohrmann, Coleman and other defendants manipulated the market price of Parvin Dohrmann stock by, among other things: (i) purchasing substantial amounts of the stock for the purpose of creating actual and apparent market activity and thereby inducing purchases by others; (ii) restricting the floating supply of the stock and thereby causing a rise in its market price; (iii) touting the stock to certain large institutional and other investors, making available to them certain material, nonpublic information concerning the company; and (iv) arranging for purchases off the exchange market when it was learned that holders of large blocks of stock were about to sell their interests in open market transactions.

The complaint also alleged that pursuant to an exchange agreement negotiated by Parvin Dohrmann with defendant Denny's Restaurants, Inc., in early June 1969, each Parvin Dohrmann shareholder was to have received four shares of Denny's Restaurants stock in return for each Parvin Dohrmann share held. According to the complaint, the arrangement was thereafter renegotiated, however, to provide that certain defendants, all of whom were members of the Coleman "control" group, would receive cash and notes in the amount of $150 for each share of their Parvin Dohrmann stock, while the remaining shareholders would receive only 3⅓ shares of

[39] S.D.N.Y., 69 Civ. 4543 (ELP).

Denny's Restaurants (having a market value of $100 on July 10, 1969, the date of the public announcement of the renegotiated arrangement) for each of their Parvin Dohrmann shares. It was charged that these acts unfairly and fraudulently preferred the interests of certain defendants over those of the public shareholders of Parvin Dohrmann.

It was also alleged that Coleman, Sidney R. Korshak, Nathan Voloshen and other defendants acted to conceal these unlawful activities by filing false, misleading, and inaccurate reports with the Commission and the American Stock Exchange, by issuing and disseminating various false and misleading press releases, and otherwise by attempting to suppress and conceal the material facts. In this connection, it was alleged that Coleman, Korshak, and Voloshen, on the basis of a short press release that was totally uninformative, and while suppressing the true facts, attempted to induce the Commission immediately to terminate a trading suspension that had been imposed with respect to Parvin Dohrmann securities.

In addition to an injunction against future violations of the securities laws, the complaint requested that appropriate filings be directed to be made with the Commission and that the defendants be required to disgorge profits received as a result of their unlawful conduct.

In October and November 1969, the United States District Court for the Southern District of New York, upon their consent, entered final judgments of permanent injunction against Parvin Dohrmann, Coleman, William C. Scott and Denny's Restaurants. The judgment provided all the relief demanded in the complaint as to these defendants.

In *S.E.C.* v. *Madison Square Garden Corp.*[40] the United States District Court for the Southern District of New York entered a judgment of permanent injunction, by consent,[41] against all the defendants in an action instituted by the Commission in October 1969, against Madison Square Garden Corp. and a wholly owned subsidiary; Goldman, Sachs and Co., a New York broker-dealer; and a New York investment partnership. The action arose out of the alleged conduct of the defendants in connection with a tender offer that G & W Land and Development Corp. had made for 400,000 of the 1,300,000 outstanding shares of common stock of Roosevelt Raceway, Inc. At the time of that offer, Madison, through its subsidiary, held 348,200 Roosevelt shares and had announced its intention to acquire 100 percent ownership of Roosevelt.

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[40] S.D.N.Y., 69 Civ. 4364, April 29, 1970.

[41] The defendants did not admit the allegations of the complaint.

The Commission's complaint alleged that on the day after G & W formally made the tender offer, which had earlier been announced, Madison issued a press release stating that Madison had reached an agreement in principle with Goldman-Sachs whereby Goldman-Sachs and certain of its institutional clients would purchase up to 120,000 shares of Roosevelt common stock. Pursuant to the agreement, the stock acquired was to be held for 1 year, at which time the purchasers would have the right to require Madison to purchase the shares from them at 120 percent of their cost.[42] The complaint further alleged that the defendants' combined purchases caused the market price of Roosevelt common stock to exceed the tender offer price during the entire period of the tender offer.

The Commission claimed that by entering into the arrangement with Madison, Goldman-Sachs unlawfully extended and arranged for the extension of credit to Madison in violation of Regulation T, adopted by the Board of Governors of the Federal Reserve System under Section 7(c) of the Securities Exchange Act. It was further alleged that the defendants' conduct constituted a solicitation or recommendation to Roosevelt shareholders to reject the G & W tender offer and, in connection therewith, that the defendants had failed to file with the Commission a statement containing the information specified in Schedule 14D, as required by Section 14(d)(4) of the Act. The Commission also charged that the defendants had acted as a group for the purpose of acquiring, holding, or disposing of Roosevelt shares, which group, after acquiring Roosevelt shares, held more than 10 percent of that class of security, but that the group had not filed with the Commission a statement containing the information required by Schedule 13D, adopted pursuant to Section 13(d)(1) of the Exchange Act and Rule 13d-1 thereunder. Finally, the Commission asserted that the defendants had violated Section 10(b) and Rule 10b-5 thereunder as well as Section 14(e) of that Act.

In accordance with the relief demanded in the Commission's complaint, the consent judgment declared the agreement between Madison and Goldman-Sachs to be null and void. Goldman-Sachs was ordered to dispose in an orderly manner of the Roosevelt shares it had purchased in connection with that agreement under terms assuring that it could not profit thereby. The order also contemplated that clients of Goldman-Sachs, who had purchased Roosevelt shares in connection with the agreement, would not exercise any right against Madison that they might have acquired but would, instead, dispose

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[42] A few days later, Madison reached a similar agreement, concerning 10,000 shares, with the investment partnership named as a defendant.

of their holdings in the open market in an orderly manner. In addition, the defendants were enjoined from engaging in any act, practice or course of business—or entering any agreement so to engage—which operates or would or is intended to operate artificially to inflate the market price of Roosevelt securities in connection with any exchange or tender offer. And the judgment further enjoined the defendants from future violations of the filing requirements of Sections 13 and 14 of the Exchange Act with respect to Roosevelt securities and ordered them to file with the Commission statements on Schedules 13D and 14D with respect to the matters complained of.

In *S.E.C.* v. *Wriking Food Beverage Systems, Inc., et al.*,[43] an action directed against use of the "spin off" device in alleged violation of the Securities Act registration requirements,[44] the Commission charged in its complaint that Broadcast Industries Corporation, its president, and another individual had organized Wriking and shortly thereafter caused 275,000 shares of Wriking stock to be issued to Broadcast in exchange for a small cash payment and certain loan commitments; that, shortly after its receipt of the Wriking shares, Broadcast "spun off" 189,455 shares to Broadcast's shareholders; that such "spin off" caused an immediate public market to be developed for Wriking stock; that Broadcast's president sold 19,700 shares of Wriking stock through several broker-dealers in the over-the-counter market at prices ranging from $1 to $17 per share and sold another 7,000 shares to persons who subsequently sold the stock through brokers; that other officers and directors of Broadcast sold approximately 27,000 additional Wriking shares in the over-the-counter market; and that no registration statement was ever on file or in effect with the Commission covering the public distribution by the defendants of the Wriking shares issued in the "spin off." The defendants, without admitting the allegations of the complaint, consented to entry of a permanent injunction against further violation of the registration provisions.

"Spin offs" in violation of the registration provisions were also alleged in *S.E.C.* v. *Standard Computer & Pictures Corp., et al.*[45] and *S.E.C.* v. *Met Sports Centers, Inc., et al.*[46] In those cases the complaints additionally alleged violations of antifraud provisions of the securities acts resulting from the dissemination of false and misleading information concerning the issuers of the securities which had

[43] S.D.N.Y., 69 Civ. 3777.

[44] See the Commission's release concerning "spin offs" of securities and trading in the securities of inactive or shell corporations, Securities Act Release No. 4982 (July 2, 1969), summarized in the 35th Annual Report, pp. 30–31.

[45] S.D. Fla., 69–1522 – Civ–TC.

[46] S.D.N.Y., 69 Civ. 5410.

been spun off. Permanent injunctions were entered by consent in both cases.

During the fiscal year, a final judgment providing for injunctive and other relief with respect to alleged antifraud violations was also entered, by consent, in the previously reported case of *S.E.C.* v. *Golconda Mining Co.*[47] The judgment enjoins Golconda and Harry F. Magnuson, a controlling person of Golconda, from fraudulently using material information, not generally available to the public, that they may obtain by virtue of an insider relationship to any corporation, in connection with the purchase or sale of any security. In addition, they were required to disgorge, with interest, the profits which, according to the Commission's complaint, they obtained through unlawful use of inside information in violation of Rule 10b–5 under the Securities Exchange Act. A court-appointed trustee has, with the Commission's help, undertaken to locate those persons with whom the defendants dealt in order to pay them a share of the fund provided by the defendants pursuant to the decree.

In *S.E.C.* v. *Dupere*,[48] the Commission sought to enjoin a former staff attorney from disclosing to Memory Magnetics International confidential information obtained in the course of his employment with the Commission and from being employed by that company, which had been the subject of an investigation by the Commission. Relief was also sought against the company and its president to prevent them from obtaining confidential information from Dupere and from employing him. After a trial on the merits, but prior to a decision, the action was disposed of by an agreement between the parties, pursuant to which a decree was entered enjoining Dupere from divulging any confidential or non-public information. The decree further directed the defendants to comply with their undertaking, which recited that Dupere's employment by the company had terminated and that he would not be reemployed for 3 years or at any time when a proceeding under the Federal securities laws should be pending against the company or its president. At the same time, a counterclaim seeking to restrain the Commission and two employees from issuing false press releases and interfering with the company's business was dismissed, with prejudice, by an order entered upon consent.

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[47] S.D.N.Y., No. 65 Civ. 1512. The institution of this action is described in the 31st Annual Report, p. 123. The summary judgment granted to the Commission with respect to defendant Harry F. Magnuson's failure timely to file ownership reports pursuant to Section 16(a) of the Securities Exchange Act is described in the 35th Annual Report, pp. 59–60.

[48] C.D. Cal. No. 69–1025–HP.

In *S.E.C.* v. *North American Research and Development Corp.*,[49] on cross appeals from an order granting a preliminary injunction as to some defendants and denying such an injunction as to others, the Court of Appeals for the Second Circuit rendered significant rulings concerning the broad applicability of the registration and antifraud provisions of the securities laws. It held that a public distribution of unregistered securities occurred through the joint action of persons in Utah, who bought up a minority of the shares of a shell corporation, and other persons, in Canada, to whom the shares were sold and who in turn sold the shares back into the United States. The district court had found that the scheme had been devised by one Edward White, who had acquired the majority block of shares but had not, at the time of the action, offered his shares for sale. The court of appeals held that "where such joint action is proved the beneficent purposes of the securities acts for the protection of investors and in the public interest can be accomplished only by treating such new distributions as jointly conceived and jointly consummated," [50] and it found those who had aided and abetted sales by others to be guilty of violations. The court affirmed so much of the district court's determination [51] as had preliminarily enjoined North American, White, and another principal participant from further violations of the registration requirements of Sections 5(a) and (c) of the Securities Act of 1933 and vacated and remanded for further consideration the district court's refusal to enter preliminary injunctions against four peripheral participants in the distribution.[52]

Although the company's president did not have a central role in the distribution, the court held that he had "aided and abetted the furtherance of the unlawful scheme by the major participants" since he had helped in the preparation of a "Progress Report" that had been employed as a selling device.[53] Concerning two additional participants, the court of appeals held, contrary to the district court, that "no financial stake or motivation is required to support a charge of Section 5 violation." [54] And, noting that the conduct of participants in an unlawful distribution may be "classified as joint

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[49] 424 F.2d 63 (1970).

[50] 424 F.2d at 71.

[51] 280 F. Supp. 106 (S.D.N.Y., 1968).

[52] The shares of North American had first been offered to the public prior to the effective date of the Securities Act, but the court found the "grandfather" exemption of Section 3(a)(1) unavailable to the defendants because there had been a "new offering" of North American shares.

[53] 424 F.2d at 81.

[54] *Ibid.*

participation or aiding and abetting. . . .",[55] the court explicitly recognized that they may be found to violate Section 5 even absent a finding that they are underwriters.

With reference to the "Progress Report," which was found materially false and misleading, the court reiterated its holding in *S.E.C. v. Texas Gulf Sulphur Co.*,[56] that false, misleading, or incomplete assertions made "in a manner reasonably calculated to influence the investing public" violate Rule 10b-5 under the Securities Exchange Act regardless of the motive involved in making the material public.[57] It held that actions of the principal participants were "precisely the opposite of [the] diligence and good faith dissemination" of information by corporate management that might have prevented violation of the antifraud provisions. The court held that "the Corporation could not abdicate responsibility for . . . transmission [of the Progress Report] to persons not shareholders by claiming that it . . . intended the report for the eyes of shareholders only." [58]

The district court's refusal to enjoin the company's president from antifraud violations was vacated on the basis that his participation in the preparation of the Progress Report alone

> "is enough to establish the . . . [antifraud] charge . . . if the District Court finds that he did not exercise 'due diligence' in ascertaining the accuracy of the information contained in the Progress Report, irrespective of whether he engaged in the sale of any North American shares, intended to effect a distribution of the shares, or had any financial interest as a result of the sale of the shares." [59]

Other defendants who "were not managerial insiders of North American," were, the court found, "not casual tippers either", and the district court's reliance on their motivation and lack of financial interest was held to be error.[60] With respect to a broker defendant, the court held that the " 'special relationship' between a broker and the public creates an implied warranty that the broker has an adequate and reasonable basis in fact for his opinion, and . . . the SEC has the power to enforce that warranty against a broker by an injunctive action. . . ." [61]

After the close of the fiscal year, the district court, upon remand, applied the principles enunciated by the court of appeals and en-

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[55] 424 F.2d at 82.

[56] 401 F.2d 833 (C.A. 2, 1968), *certiorari denied*, 394 U.S. 976 (1969). See 34th Annual Report at pp. 6-8.

[57] 424 F.2d at 78.

[58] 424 F.2d at 79.

[59] 424 F.2d at 83.

[60] 424 F.2d at 83-86.

[61] 424 F.2d at 84.

tered preliminary injunctions against the four defendants as to whom the Commission had taken its appeal.[62]

In *S.E.C.* v. *Texas Gulf Sulphur Co.*,[63] upon remand pursuant to the previously reported decision of the Court of Appeals for the Second Circuit,[64] the United States District Court for the Southern District of New York determined that a press release issued by Texas Gulf on April 12, 1964, would have been misleading to a reasonable investor using due care and, since the framers of the release had not exercised due diligence in its issuance, that Texas Gulf violated Section 10(b) of the Securities Exchange Act and Rule 10b–5 thereunder. Injunctive relief was granted against two individual defendants who had purchased Texas Gulf stock after issuance of the April 12, 1964, release and before a correcting release was issued on April 16, 1964. The court declined to grant the Commission's request for an injunction against the company, however, determining that it could not conclude, on the record before it, that there was a reasonable likelihood of future violations. For comparable reasons the court also denied injunctive relief against most of the individual defendants who had been found to have violated Section 10(b) and Rule 10b–5 by having purchased Texas Gulf stock on the basis of material undisclosed information.

The court also held, in accordance with the views of the Commission, that a district court has authority to deprive defendants of profits realized through the misuse of inside information and found it appropriate to do so in this case. Accordingly, those defendants who had not sold their stock back to Texas Gulf were ordered to pay the difference between their cost and the mean price of the stock on the New York Stock Exchange on the day after the issuance of the correcting press release.[65] The one defendant who was charged had failed to return illegally acquired stock options to Texas Gulf, the court ordered that the options be rescinded and canceled.
with giving tips as well as with purchasing stock was held liable not only for his own profits but also for the profits of his tippees; he was not, however, charged with the profits of those to whom his tippees had made recommendations. With respect to a defendant who

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[62] S.D.N.Y., No. 67 Civ. 3724, August 14, 1970. The injunction against one defendant was based on its consent.

[63] 312 F. Supp. 77 (1970).

[64] 401 F.2d 833 (1968), *certiorari denied*, 394 U.S. 976 (1969). See 35th Annual Report, p. 109 and 34th Annual Report, pp. 6–8.

[65] The money is to be held by Texas Gulf in escrow until the court orders its disposition; in the absence of such an order, the money is to become the property of Texas Gulf.

Texas Gulf and the individual defendants are appealing the district court's decision.[66]

In *S.E.C.* v. *MacElvain*,[67] the Court of Appeals for the Fifth Circuit held that the offer of fractional undivided interests in mining claims to offshore lands, when coupled with an implied promise to litigate the validity of the title to the land being sold for the benefit of all purchasers, constituted an "investment contract" and therefore a "security," within the meaning of the Securities Act. In affirming the entry of an injunction against violations of the registration requirements of that Act, the court stated that "a defendant's assertion of the correctness of his behavior is a ground for restraint," and a "court's power to grant injunctive relief survives discontinuance of the illegal conduct and can even be utilized without a showing of past wrongs." [68]

In *S.E.C.* v. *Bowler*,[69] the Commission had adduced evidence which showed that the individual defendants had been guilty not only of numerous violations of the registration and antifraud provisions of the Securities Act but also of mismanagement, self-dealing, and gross abuses of trust with respect to six corporate defendants. The Court of Appeals for the Fourth Circuit reversed an order of the district court,[70] which had granted a permanent injunction against violations of the Securities Act but denied the Commission's motion for the appointment of a receiver and had, instead, approved a plan for reorganization of the corporate defendants proposed by the individual defendants which would have allowed them to retain an active management role.

The court of appeals found that the district court's injunction was insufficient to protect the public interest, stating that "the limited injunction against improper security dealings would provide no brake against mismanagement, other than security dealings in violation of the Securities Act. . . ." [71] It held that, in the absence of a proceeding under Chapter X of the Bankruptcy Act, the appointment of "a receiver is . . . appropriate where necessary to protect the public interest and where it is obvious, as here, that those who have inflicted serious detriment in the past must be ousted." [72]

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[66] By a subsequent order, the court granted the Commission's motion for a default judgment against one defendant who had failed to respond to the Commission's complaint. No appeal is being taken from this order.

[67] 417 F.2d 1134 (1969), *certiorari denied*, 397 U.S. 972 (1970)

[68] 417 F.2d at 1137.

[69] 427 F.2d 190 (C.A. 4, 1970).

[70] The opinion of the district court is not reported.

[71] 427 F.2d at 197.

[72] 427 F.2d at 198.

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.

In *Chris-Craft Industries, Inc.* v. *Bangor Punta Corporation*,[73] the Court of Appeals for the Second Circuit, sitting *en banc*, agreed with the positions taken by the Commission, *amicus curiae*, (1) that a press release issued by Bangor Punta Corporation announcing a forthcoming exchange offer for the shares of Piper Aircraft Corporation, which release placed a dollar value on the package of securities Bangor Punta was to offer, constituted a "gun-jumping" offer for sale of securities in violation of Section 5(c) of the Securities Act; and (2) that cash purchases of Piper stock made by Bangor Punta during the exchange offer violated Section 10(b) of the Securities Exchange Act and Rule 10b–6 thereunder.

The Commission had expressed the view that, in the context of an impending exchange offer, a press release that fully sets forth all the facts permitted to be disclosed by Rule 135 under the Securities Act (Notice of Certain Proposed Offerings) complies with the full disclosure requirements of Section 10(b) and Rule 10b–5 under the Securities Exchange Act, even though other material facts pertaining to the transactions are not contained in the release. The court of appeals did not reach this issue. It found that it was not a material fact, as defined in *S.E.C.* v. *Texas Gulf Sulphur Company*,[74] that a provision in an agreement with members of the Piper family, which, among other things, committed Bangor Punta to make the exchange offer, stated that each share of Piper would be exchangeable for a package of Bangor securities "having a value, in the written opinion of the First Boston Corporation, of $80 or more."[75]

[73] 426 F.2d 569 (1970).

[74] 401 F.2d 833 (C.A. 2, 1968), *certiorari denied*, 394 U.S. 976 (1969).

[75] Judge Anderson concurred with the majority opinion, but disagreed with the majority's determination that the dollar valuation was not "material." In his opinion, which is very closely akin to the argument made in the Commission's brief, Judge Anderson states:

> "The Court's holding, in which I concur, is simply that the possible application of disclosure principles discussed by . . . [the Texas Gulf Sulphur] case is here 'outweighed by the danger that substantial numbers of investors were misled by the figure's publication' in a manner violating Rule 135."

In a dissenting opinion, Chief Judge Lumbard stated that, in his view, that information was material and was required to be announced under the rationale of *Texas Gulf*.

Judge Moore concurred in that part of the opinion affirming the trial court's denial of a preliminary injunction (an issue not argued by the Commission),

The court also held that cash purchases of the stock of a target company by a person whose exchange offer is outstanding with respect to that stock have a manipulative effect upon the market and that the prevention of this kind of manipulation comes within the spirit and letter of Rule 10b-6. That rule, among other things, prohibits the issuer of a security from purchasing the security or "any right to purchase any such security" while a distribution of such security is in progress. Here, as a result of Bangor Punta's exchange offer, the Piper shares carried the right to acquire Bangor Punta securities.

In *Rekant v. Desser*,[76] the Court of Appeals for the Fifth Circuit, in accord with views expressed by the Commission, *amicus curiae*, held that a stockholder may bring a derivative action under Rule 10b-5 based on his corporation's transfer of its own securities to insiders for inadequate consideration even though there was no allegation that any of the directors of the corporation were deceived as to the nature of the transfer. Because the complaint did not allege that misrepresentations or omissions had influenced the investment judgment of either the plaintiff or other shareholders, however, the court held, as the Commission urged, that no claim for individual or class relief had been stated. For that reason also, the court did not reach the merits of the Commission's further suggestion that Rule 10b-5 would be violated if misrepresentations and omissions influence investment judgment but do not induce an actual purchase or sale of a security. The court also found it unnecessary to determine whether there is a private right of action under Section 15(d) of the Securities Exchange Act, since in this case any cause of action under that provision and under Rule 10b-5 overlapped.

Criminal Proceedings

The statutes administered by the Commission provide that the Commission may transmit evidence of violations of any provisions of these statutes to the Attorney General, who in turn may institute criminal proceedings. Where an investigation by the Commission's staff indicates that criminal prosecution is warranted, a detailed report is prepared. After careful review by the Office of Criminal Reference and Special Proceedings and the General Counsel's Office, the report and the General Counsel's recommendations are considered by the Commission. If the Commission believes criminal proceedings are warranted, the case is referred to the Attorney General,

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stated that the determination of the other issues should have been deferred until after a trial on the merits, but went on to indicate his disagreement with the majority on the "gun-jumping" and Rule 10b-6 issues.

[76] 425 F.2d 872 (1970).

who in turn refers the case to the appropriate U.S. Attorney. Commission employees familiar with the case generally assist the U.S. Attorney in the presentation of the facts to the grand jury, the preparation of legal memoranda for use in the trial, the conduct of the trial, and the preparation of briefs on appeal.

During the past fiscal year, 35 cases were referred to the Department of Justice for prosecution. As a result of these and prior referrals, 36 indictments were returned against 102 defendants during the year. Fifty-five convictions were obtained in 28 cases. Convictions were affirmed in 9 cases, and appeals in 12 other cases were pending at the close of the year.

Among the cases in which indictments were obtained during the fiscal year, the following are particularly noteworthy: Harry A. Lowther, Jr. and three others were indicted [77] for alleged violations of the antifraud provisions of the Securities Act of 1933 and conspiracy to violate those and other provisions of the Securities Act and the Securities Exchange Act in connection with the offer and sale of common stock of Elkton Company, a corporate shell which Lowther allegedly revived by causing it to acquire assets of questionable value. The indictment charges that the price of Elkton stock was subsequently manipulated by means of fraudulent misrepresentations and that a distribution of unregistered shares of the stock followed.

Simon J. Messitte and others were indicted [78] for alleged violations of the anti-manipulative provisions of the Securities Exchange Act and the antifraud provisions of the Securities Act and conspiracy to violate these provisions. This case involved alleged cash payoffs to broker-dealers in order to raise the price of Alloys Unlimited, Inc. stock on the American Stock Exchange.

Lewis L. Colasurdo and 10 others connected with Crescent Corporation and Pakco Companies, Inc. were indicted [79] for alleged conspiracy to violate the disclosure provisions of the Securities Exchange Act. In addition, Colasurdo and certain other defendants were variously charged with mail fraud, wire fraud, false filings with the Commission, submission of false statements to the United States Government, and obstruction of justice. The indictment alleged that Colasurdo obtained control of Crescent by using the assets of both Crescent and Pakco. Through his control position, Colasurdo, aided and abetted by the other defendants, was allegedly able to engage in and conceal the unauthorized use of the assets of both companies.

[77] D. Colo.

[78] S.D.N.Y.

[79] S.D.N.Y.

Pedro Manuel Martinez and several others were indicted[80] for violations of the antifraud provisions of the Securities Act, mail fraud, and conspiracy. The indictment alleges that Martinez and others purchased a majority of the shares of Alaska Western Life Insurance Company from another defendant by using the assets of that company to finance their purchase. It further alleges that after gaining control of the company, certain of the defendants converted large amounts of the company's assets to their personal use.

An indictment was returned against J. R. Cissna and others[81] charging violations of the antifraud provisions of the Securities Act, mail fraud, and conspiracy. Cissna allegedly schemed with others to sell investment contracts consisting of 1/8000 fractional undivided interests in a proposed recreational development called Recre-Plex. It was represented that funds from these sales would be used to build the recreational complex when allegedly they were used mainly to meet the expenses of Federal Shopping Way, Inc., a company of which Cissna was chairman of the board and chief executive officer.

An indictment superseding a previous indictment has been returned against John B. Walling and others[82] charging violations of the mail fraud statute, the antifraud provisions of the Securities Act, the stolen property act, and the conspiracy statute. The defendants allegedly induced 22 churches to issue bonds by representing that the bonds would either be purchased outright or held in escrow by World Oil and Gas Corporation of Delaware or its affiliated insurance companies and, in turn, funds would be advanced to the churches as needed for construction of church facilities. The indictment charges that World Oil, purportedly a multimillion dollar corporation owning Tennessee real estate valued at $26 million, had little if any assets.

Convictions were obtained in the following cases, among others: Ernest A. Bartlett, Jr. was found guilty[83] on each of 26 counts of an indictment charging violations of the antifraud and registration provisions of the Securities Act, mail fraud, wire fraud, and conspiracy to commit these crimes. The indictment charged that Bartlett and others induced investors to purchase securities of Arkansas Loan & Thrift Corporation by making false statements concerning the safety of the investment, the financial condition and earnings of the company, and the sources of dividends. It was also charged that

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[80] D. Alaska

[81] W.D. Wash.

[82] N.D. Tex.

[83] W.D. Ark.

the defendants falsely claimed that debt securities issued by Arkansas Loan & Thrift were insured by Savings Guaranty Corporation, when in fact that corporation was affiliated with Arkansas Loan & Thrift and had no assets of its own, and that they diverted assets of Arkansas Loan & Thrift to their own use and benefit.

As reported in last year's annual report,[84] Frank D. Mills and Jerome Deutsch were indicted for violations of provisions of the Investment Company Act of 1940.[85] During the fiscal year Mills pleaded guilty to violating Section 17(d) of that Act, relating to joint ventures between investment companies and their affiliates, and Deutsch was convicted of aiding and abetting violations of Section 17(e) of the Act, the "kickback" provision. Deutsch was found to have made an unlawful payment to Mills, at a time when the latter was vice president and portfolio manager of an investment company, in the form of a bargain price on the purchase of a security from a company of which Deutsch was an officer.

In a case involving a widespread distribution of unregistered shares of Petron Corporation by the use of nominees and the use of selected brokerage houses which employed "boiler-room" tactics and received kickbacks for selling the securities, Forrest and Donald Parrott were found guilty[86] on charges of conspiracy to sell unregistered securities, sale of unregistered securities, fraud in the sale of securities, mail fraud and fraud by wire. Their convictions were subsequently affirmed by the United States Court of Appeals for the Second Circuit.[87]

In a prosecution arising out of transactions in the securities of Eastern Mass. Street Railway Company,[88] Vincent Carrano pleaded guilty to an indictment charging violations of the antifraud provisions of the Securities Exchange Act and mail fraud, and Gordon M. Copp and Allan L. D'Honau were convicted after trial of violations of the antifraud and anti-manipulative provisions of the Securities Exchange Act, mail fraud, and conspiracy. The indictment charged that the defendants placed orders with various broker-dealers for the purchase of securities but paid for the securities only if the market price of the securities rose and refused payment when the market price of those securities dropped.

Harold N. Leitman, former president and chairman of the board of VTR, Inc., was found guilty[89] under an indictment charging him

[84] Page 116.
[85] S.D.N.Y.
[86] S.D.N.Y.
[87] 425 F.2d 972 (1970), *cert. denied* (October 12, 1970).
[88] C.D. Cal.
[89] S.D.N.Y.

with filing false financial information for VTR with the Commission and the American Stock Exchange. In a related matter, Alvin Leitman and Milton Rubin each pleaded guilty [90] to two counts of an information charging that they aided and abetted violations of the rules and regulations governing filings with the Commission, which would have required that schedules be filed with the Commission showing the indebtedness of certain insiders to VTR.

The Commission has continued its efforts to assure that injunctions obtained by it are adhered to. During the past fiscal year, 10 persons and companies were convicted of criminal contempt for violating injunctions, and, in one case, also for violation of a court order directing compliance with a Commission subpoena. Substantial prison terms and fines were imposed on the defendants. A number of other contempt cases were pending at the close of the year.

Organized Crime Program.—The Commission has always given priority to the investigation of cases where there is an indication that organized crime may be involved. Pursuant to Executive Order 11534,[91] the Chairman of the Commission was designated to be a member of the National Council on Organized Crime. In that capacity, the Chairman will join with other government officials in seeking to formulate a national strategy for the elimination of organized crime.

The Commission maintains a close liaison with the Organized Crime and Racketeering Section of the Department of Justice and submits quarterly reports relating to organized crime investigations. During the 1969 fiscal year, the Commission had placed four enforcement staff members on the New York Strike Force against organized crime. Current plans call for the placing of additional enforcement personnel on certain other Strike Forces. During the 1970 fiscal year, the Commission established an organized crime section in its headquarters office to focus on the involvement of organized crime in the securities markets. This unit acts as a "back-up" unit to the various Strike Forces and as an enforcement unit investigating certain securities violations in which persons with organized crime associations are believed to be involved.

Proposed Swiss Treaty.—Since approximately January 1969, a representative of the Commission has participated with the State Department and other agencies of the United States Government in discussions looking toward a possible Treaty of Mutual Assistance in Criminal Matters between the United States and Switzerland. It is believed that such a Treaty would be of assistance to the Commis-

[90] S.D.N.Y.

[91] 35 F.R. 8865, June 9, 1970.

sion in dealing with problems presented by the use of Swiss financial institutions in connection with securities transactions taking place in the United States.

The Commission's representative has participated in a series of informal discussions between U.S. and Swiss officials in Washington, D.C. and in Bern, Switzerland. These meetings have resulted in an informal agreement by the working group on an English text of a draft treaty. Work on this matter is continuing.

DISCIPLINARY ACTION BY SELF-REGULATORY ORGANIZATIONS

Exchanges

Although the Exchange Act does not provide for Commission review of disciplinary action by exchanges, each national securities exchange reports to the Commission actions 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 of regulation under that Act.

During the fiscal year, eight exchanges reported 129 separate actions, including impositions of fines in 78 cases ranging from $100 to $150,000, with total fines aggregating $735,900; the suspension from membership of 20 individuals; and the censure of 21 member firms. These exchanges also reported the imposition of various sanctions against 86 registered representatives and other employees of member firms.

NASD

The Commission receives from the NASD copies of its decisions in all disciplinary actions against members and registered representatives. In general, such actions are based on allegations that the respondents violated specified provisions of the NASD's Rules of Fair Practice. Where violations are found, the NASD may impose one or more sanctions upon a member, including expulsion, suspension, fine, or censure. If the violator is an individual, his registration as a representative may be suspended or revoked, he may be suspended or barred from being associated with any member, and he may be fined and/or censured. Under Section 15A(b)(4) of the Exchange Act and the NASD's by-laws, no broker-dealer may be admitted to or continued in NASD membership without Commission approval if he has been suspended or expelled from membership in the NASD or a national securities exchange; he is barred or suspended from association with a broker or dealer or with members of the NASD or an exchange; his registration as a broker-dealer has been denied, suspended, or revoked; he has been found to be a cause of certain sanctions imposed upon a broker-dealer by the Commission, the NASD,

or an exchange; or he has associated with him any person subject to one of the above disqualifications.

During the past fiscal year the NASD reported to the Commission its final disposition of disciplinary complaints against 179 member firms and 117 individuals associated with them. With respect to 10 members and 18 associated persons, complaints were dismissed because the alleged violations had not been established. In the remaining cases, violations were found and penalties were imposed on 169 members and 99 registered representatives or other individuals. The maximum penalty of expulsion from membership was imposed against 12 members, and 16 members were suspended from membership for periods ranging from 2 days to 2 years. In many of these cases, substantial fines were also imposed. In another 137 cases, members were fined amounts ranging from $100 to $40,000. In 4 cases, the only sanction imposed was censure, although censure was usually a secondary penalty where a more severe penalty was also imposed.

Various penalties were also imposed on associated individuals found in violation of NASD rules. The registrations of 27 registered representatives were revoked, and 30 representatives had their registrations suspended for periods ranging from 5 days to 2 years. Fines in various amounts were also imposed against many revoked or suspended representatives. In addition, 39 other representatives were censured and/or fined amounts ranging from $100 to $10,000. Three individuals were barred from association with any NASD member.

Commission Review of NASD Disciplinary Action.—Section 15A(g) of the Exchange Act provides that disciplinary actions by the NASD are subject to review by the Commission on its own motion or on the timely application of any aggrieved person. This Section also provides that upon application for or institution of review 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. Section 15A(h) of the Act defines the scope of the Commission's review. If the Commission finds that the disciplined party committed the acts found by the NASD and thereby violated the rules specified in the determination and that such conduct was inconsistent with just and equitable principles of trade, the Commission must sustain the NASD's action unless it finds that the penalties imposed are excessive or oppressive, in which case it must cancel or reduce them.

At the start of the fiscal year, three NASD disciplinary decisions were pending before the Commission on review. During the year seven additional cases were brought up for review. Two cases were

disposed of by the Commission. In one case the Commission sustained in full the disciplinary action taken by the NASD, and in the other it modified the penalties.[92] Eight cases were pending at the end of the year.

Commission Review of NASD Action on Membership.—As previously noted, Section 15A(b)(4) of the Act and the bylaws of the NASD provide that, except where the Commission finds it appropriate in the public interest to approve or direct to the contrary, no broker or dealer may be admitted to or continued in membership if he, or any person associated with him, is under any of the several disabilities specified in the statute or the NASD by-laws. A Commission order approving or directing admission to or continuance in Association membership, notwithstanding a disqualification under Section 15A(b)(4) of the Act or under an effective Association rule adopted under that Section or Section 15A(b)(3), is generally entered only after the matter has been submitted initially to the Association by the member or applicant for membership. The Association in its discretion may then file an application with the Commission on behalf of the petitioner. If the Association refuses to sponsor such an application, the broker or dealer may apply directly to the Commission for an order directing the Association to admit or continue him in membership. At the beginning of the fiscal year, one application for approval of admission to or continuance in membership was pending. During the year, 8 additional applications were filed, and 4 were approved, leaving 5 applications pending at the year's end.

COOPERATION WITH OTHER ENFORCEMENT AGENCIES

In recent years the Commission has given increased emphasis to the coordination of its enforcement activities with those of the various state and local authorities, the self-regulatory agencies, and foreign securities agencies. This program encompasses the referral to state and local authorities for investigation and prosecution or other action of those violations where the amounts of money or the number of investors involved do not appear to be substantial enough to warrant development of the case at the Federal level. The Commission frequently provides manpower assistance to these authorities in the development of such cases. In addition, the Commission's regional offices have taken steps to improve the coordination of inspections and other activities with state securities administrators and with the NASD in those areas where their respective jurisdictions

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[92] Securities Exchange Act Release Nos. 8769 (December 5, 1969) and 8816 (February 13, 1970).

overlap. Staff members of the Commission and of certain state authorities have conducted joint inspections which have made the entire inspection program more effective.

During the fiscal year, the Commission continued its program of cooperative regional enforcement conferences at each of its regional offices. These conferences, during which Commission personnel meet with personnel from state securities agencies, post office inspectors, Federal, state, and local prosecutors and local representatives of self-regulatory agencies such as the NASD, are designed to promote the exchange of information concerning regional enforcement problems, the development of methods of increasing cooperation and communication, and the elimination of needless effort and waste of manpower and other resources in the regulation of the securities markets. Although the Commission served as the primary agency in establishing those cooperative enforcement conferences, they have progressed to the point where state securities agencies frequently serve as hosts of the programs.

For the past 4 years, the Commission has held one or two-week nationwide enforcement training sessions at its headquarters office in Washington, D.C. to which it has invited staff members of state and foreign securities agencies. The 1970 session was attended by representatives of various Federal, state, and Canadian agencies, as well as by staff members from each of the Commission's offices throughout the country.

Section of Securities Violations

The Commission's Section of Securities Violations provides one of the means for cooperation on a continuing basis with other agencies having enforcement responsibilities. This Section acts as a clearing house for information regarding enforcement actions in securities matters taken by state and Canadian authorities, by other governmental and self-regulatory agencies, and by the Commission. In addition to handling requests for specific information, the Section publishes a periodic Bulletin which is sent to contributing agencies and to other enforcement and regulatory organizations. The Bulletin contains current information which is a matter of public record regarding the institution and disposition of remedial and enforcement proceedings.

Among other things, the data in the SV files (which are maintained in a computer) constitute a valuable tool for screening applicants for registration as securities or commodities brokers or dealers as well as applicants for loans from such agencies as the Small Business Administration and the Economic Development Administration of the Department of Commerce.

During the fiscal year, the Section received 4,210 letters either providing or requesting information and sent out 2,631 communications to cooperating agencies. State and Canadian securities administrators reported 118 criminal actions, 27 injunctive actions, 168 actions in the nature of cease and desist orders, and 173 other administrative orders, such as denials, suspensions, and revocations of issuers, broker-dealers, and salesmen. As of the end of the fiscal year, the number of names in the SV files totalled 78,465, representing a net increase of 209 during the year.

ENFORCEMENT PROBLEMS WITH RESPECT TO FOREIGN SECURITIES

The past fiscal year was marked by extensive efforts by various promoters and others to distribute foreign securities in the United States without complying with the registration and disclosure provisions of the Securities Act and generally in violation of antifraud provisions of the securities laws. In some instances companies which were represented as having issued the securities were in fact non-existent. Known securities law violators, as well as individuals associated with organized crime, appeared to be connected with some of the more flagrantly fraudulent offerings of foreign securities.

To alert brokers and dealers, financial institutions, investors, and others to possible unlawful distributions of foreign securities, the Commission maintains and publicizes a Foreign Restricted List. That list is comprised of the names of foreign companies whose securities the Commission has reason to believe recently have been, or currently are being, offered for public sale and distribution in the United States in violation of the registration requirements of the Securities Act. The number of companies on the list increased from 39 at June 30, 1969, to 46 at the end of the 1970 fiscal year. Most brokers and dealers refuse to effect transactions in securities issued by companies on the list; however, this does not necessarily prevent promoters from illegally offering such securities directly to investors in the United States, either in person or by mail.

One of the names placed on the Foreign Restricted List during fiscal year 1970 was San Salvador Savings and Loan Co., Ltd., a purported Bahamian company.[93] The Commission had reason to believe that $1,600,000 in 11 percent bearer bonds, issued under that name, had been offered for sale in the United States. The Government of the Bahamas reported that a corporation by this name had changed its name to Regency Properties, Ltd. in 1965, indicating that securities printed in 1969 using the San Salvador name may be

[93] Securities Act Release No. 5043 (January 30, 1970).

counterfeit. The Bahamian government further reported that there was no record of the required government authorization to issue and sell bonds abroad. Moreover, the certificates purporting to represent the bonds had no coupons attached.

In a case involving the distribution of securities of Paulpic Gold Mines, Ltd., a Canadian corporation, it appeared that two residents of the United States, after purchasing 450,000 shares of stock of Paulpic in Canada at prices ranging from 18 to 43 cents per share, induced 76 investors in California and Ohio to purchase 70,000 unregistered shares from the Canadian broker for the two individuals at prices of $3.00 and $3.50 per share although no intervening event had occurred in the affairs of the company to warrant such increase in the price of the shares. The Ontario Securities Commission alerted the staff of this Commission to these activities, and the company was placed on the Foreign Restricted List.[94]

The Bank of Sark and First Liberty Fund, Ltd. were also placed on the Foreign Restricted List[95] during the fiscal year. Securities purporting to be bank drafts and certificates of deposit of the "Bank of Sark" and shares of First Liberty Fund, Ltd. had been offered in the United States by the same promoters. The available evidence indicates that the purported bank is merely a corporate shell and has consistently refused to pay bank drafts sent to it for collection or to honor the certificates of deposit. The assets of First Liberty, a Bahamian corporation, were represented to be in the custody of the "Bank of Sark."

On June 30, 1970, the following companies were on the Foreign Restricted List:

[94] Securities Act Release No. 5044 (February 6, 1970). The Ontario Commission conducted extensive public hearings and published a lengthy opinion exposing the fraudulent character of this promotion.

[95] Securities Act Release No. 5065 (May 28, 1970).

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BAHAMIAN

American International Mining
Compressed Air Corporation Limited
Durman, Ltd., formerly known as Bankers International Investment Corporation
First Liberty Fund, Ltd.
San Salvador Savings and Loan Co., Ltd.
United Mining and Milling Corporation

BRITISH HONDURAN

Caribbean Empire Company, Ltd.

CANADIAN

Allegheny Mining and Exploration Company, Ltd.
Amalgamated Rare Earth Mines, Ltd.
American Mobile Telephone and Tape Co., Ltd.
Antoine Silver Mines, Ltd.
Briar Court Mines, Ltd.
Claw Lake Molybdenum Mines, Ltd.
Ethel Copper Mines, Ltd.
Golden Age Mines, Ltd.
Ironco Mining and Smelting Company, Ltd.
Jupiter Explorations, Ltd.
Kenilworth Mines, Ltd.
Klondike Yukon Mining Co.
Kokanee Moly Mines, Ltd.
Lynbar Mining Corp., Ltd.
Norart Minerals, Limited
Northland Minerals, Ltd.
Obsco Corporation, Ltd.
Pacific Northwest Developments, Ltd.
Paulpic Gold Mines, Ltd.
Pyrotex Mining and Exploration Company, Ltd.
Radio Hill Mines Company, Ltd.
Richwood Industries, Ltd.
Trihope Resources, Ltd.
Wee Gee Uranium Mines, Ltd.
Yukon Wolverine Mining Company

EUROPEAN

Central and Southern Industries Corp.

PANAMANIAN

British Overseas Mutual Fund Corporation
Cerro Azul Coffee Plantation
Continental and Southern Industries, S. A.
Crossroads Corporation, S. A.
Darien Exploration Company, S. A.
DeVeers Consolidated Mining Corporation, S. A.
Euroforeign Banking Corporation, Ltd.
Global Explorations, Inc.
Panamerican Bank and Trust Company
Security Capital Fiscal and Guaranty Corporation, S. A.
Victoria Oriente, Inc.

UNITED KINGDOM

Bank of Sark, of the Isle of Guernsey

WEST INDIAN

California and Caracas

DISQUALIFICATION FROM PRACTICE BEFORE COMMISSION

In *Paul M. Kaufman*,[96] the Commission, pursuant to Rule 2(e) of its Rules of Practice, temporarily denied the privilege of appearing or practicing before it to a member of the New York bar, pending disposition of his appeal from criminal convictions of conspiracy to violate and violations of the antifraud provisions of Section 17(a) of the Securities Act of 1933. The Commission rejected Kaufman's contention that his convictions could not be considered evidence of lack of "character or integrity" within the meaning of Rule 2(e) because, pending disposition of his appeal, they were not final. The Commission stated that "[i]f the public is to be protected and the public's confidence in the legal profession and in this Commission maintained, an attorney convicted of a serious crime such as securities fraud should not be permitted to hold himself out as entitled to represent others in securities matters before us merely because an appeal is pending." The Commission's order further provided that Kaufman's disqualification would become final if and when any of his convictions were affirmed and no longer subject to direct review.[97]

The *Kaufman* case indicated the need for an expeditious disqualification procedure in situations such as that involved in that case and in comparable situations. Accordingly, in September 1970, the Commission amended Rule 2(e) of its Rules of Practice to provide for the automatic suspension from appearance or practice before it of (1) any attorney who has been suspended or disbarred by a court of the United States or in any State, Territory, District, Commonwealth, or Possession; (2) any accountant, engineer, or other expert who has had his license to practice revoked or suspended by any State, Territory, District, Commonwealth, or Possession; or (3) any person who has been convicted of a felony or of any misdemeanor involving moral turpitude.[98] The suspension will take effect regardless of whether an appeal from the underlying suspension, revocation, disbarment, or conviction is pending or could be taken, provided, however, that if all grounds for the underlying action are removed, the suspension from practice before the Commission will be lifted upon appropriate application. The revised rule also provides that the Commission may suspend from practice any person who, after notice and opportunity for hearing, is found to have will-

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[96] Securities Exchange Act Release No. 8925 (July 2, 1970).

[97] On July 22, 1970, the United States Court of Appeals for the Second Circuit affirmed the judgment of conviction on all counts. *United States v. Kaufman, et al.*, 429 F.2d 240, *certiorari denied*, 39 U.S.L.W. 3226 (November 24, 1970).

[98] Securities Act Release No. 5088 (September 24, 1970).

fully violated, or willfully aided and abetted violations of, the Federal securities laws.

The Commission has also invited comments[99] on a proposal further to amend Rule 2(e) to provide that any person who has been permanently enjoined from violating the federal securities laws, or who has been found by the Commission or any court to have willfully violated, or willfully aided and abetted violations of, the federal securities laws, may be ordered by the Commission to show cause why he should not be censured or disqualified from appearing or practicing before it.

[99] *Ibid.*

PART V

REGULATION OF INVESTMENT COMPANIES

In broad terms, an investment company is any arrangement by which a group of persons invests funds in an entity that is itself engaged in investing in securities. Investment companies are important vehicles for public participation in the securities markets. They enable small as well as large investors to participate in a professionally managed and diversified portfolio of securities.

The Investment Company Act of 1940 sets forth the Commission's responsibilities in protecting investors in such companies.[1] It provides a comprehensive framework of regulation which, among other things, prohibits changes in the nature of an investment company's business or in its investment policies without shareholder approval, contains prohibitions against theft or conversion of assets or gross abuse of trust, and provides specific controls to eliminate or mitigate inequitable capital structures. The Act also requires that an investment company disclose its financial condition and investment policies; requires that management contracts be submitted to shareholders for approval; prohibits underwriters, investment bankers, or brokers from constituting more than a minority of an investment company's board of directors; regulates the custody of investment company assets; and provides specific controls designed to protect against unfair transactions between investment companies and their affiliates.

In addition to complying with the requirements of the Investment Company Act, an investment company must comply with the Securities Act of 1933 when offering its securities, and it is subject to certain provisions of the Securities Exchange Act of 1934, including those relating to proxy and tender offer solicitations and insider trading and reporting.

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[1] For a discussion of legislation amending the Investment Company Act, which was enacted after the close of the fiscal year, see Part I of this report.

COMPANIES REGISTERED UNDER THE ACT

As of June 30, 1970, there were 1,328 investment companies registered under the Act, whose assets had an aggregate market value of approximately $56.1 billion. Compared with corresponding totals at June 30, 1969, these figures represent an over-all decrease of approximately $16.4 billion, or about 23 percent, in the market value of assets although there was an increase of 161, or almost 14 percent, in the number of registered companies.

The following table shows the numbers and categories of registered companies and the approximate market value of the assets in each category as of June 30, 1970.

Companies Registered Under the Investment Company Act of 1940 as of June 30, 1970

	Number of registered companies			Approximate market value of assets of active companies (millions)
	Active	Inactive [a]	Total	
Management open-end ("Mutual Funds")	804	42	846	$12,542
Funds having no load or load not exceeding 3 percent of net asset value	202			3,547
Variable annuity-separate accounts	49			224
Capital leverage companies	1			32
All other load funds	522			38,739
Management closed-end	195	52	247	6,141
Small business investment companies	47			302
Capital leverage companies	8			280
All other closed-end companies	140			5,559
Unit investment trusts	194	31	225	6,642
Variable annuity-separate accounts	21			7
All other unit investment trusts	173			6,635
Face-amount certificate companies	7	3	10	1,012
Total	[b] 1,200	128	1,328	56,337

[a] "Inactive" refers to registered companies which as of June 30, 1970, 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 orders under Section 8(f) terminating their registration.

[b] Total excludes 24 active separate accounts of life insurance companies (asset value of $710,150,233) with respect to which exemption from registration under Rule 6c-1 under the Investment Company Act is claimed.

The approximately $6.6 billion of assets of the registered unit investment trusts includes approximately $6.1 billion of assets of unit investment trusts which invest in securities of other registered investment companies, substantially all of them mutual funds.

A total of 187 companies registered under the Investment Company Act during the fiscal year, a greater number than registered in any other year since the adoption of the Act except fiscal 1969 when 222 registered. The following table shows the various categories of

companies registered during the fiscal year and those which terminated their registrations.

New Registrations, and Terminations of Registration, During the Fiscal Year Ended June 30, 1970

	Registered during the fiscal year	Registration terminated during the fiscal year
Management open-end ("Mutual Funds")		
Funds having no load or load not exceeding 3 percent of net asset value	42	2
Variable annuity-separate accounts	9	1
All other load funds	82	9
Sub-total	133	12
Management closed-end		
Small business investment companies	1	2
All other closed-end funds	26	9
Sub-total	27	11
Unit investment trusts		
Variable annuity-separate accounts	11	0
All other unit investment trusts	14	3
Sub-total	25	3
Face-amount certificate companies	2	0
Total	187	26

As the table shows, 20, or approximately 11 percent, of the newly registered companies were variable annuity separate accounts of insurance companies.[2] Including these companies, there were 70 active variable annuity separate accounts registered at June 30, 1970, consisting of 21 unit investment trusts and 49 management open-end investment companies. A significant part of the Commission's regulatory effort with respect to variable annuities has involved the application of the requirements of the Investment Company Act to the patterns and procedures which have grown up in the insurance industry.

INVESTMENT COMPANY ASSETS

The following table sets forth the number of investment companies registered under the Investment Company Act and their estimated aggregate assets, in round amounts, at the end of each fiscal year, 1941 through 1970.

[2] The applicability of the requirements of the Investment Company Act to variable annuity contracts was discussed in prior annual reports. Typically, a variable annuity contract provides payments for life commencing on a selected date with the amounts of the payments varying with the investment performance of equity securities which are set apart by the insurance company in a separate account which is registered with the Commission as an investment company. The separate accounts now registered are either open-end management companies or unit investment trusts.

Fiscal year ended June 30	Number of companies				Estimated aggregate market value of assets at end of year (in millions)[a]
	Registered at beginning of year	Registered during year	Registration terminated during year	Registered at end of year	
1941	0	450	14	436	$2,500
1942	436	17	46	407	2,400
1943	407	14	31	390	2,300
1944	390	8	27	371	2,200
1945	371	14	19	366	3,250
1946	366	13	18	361	3,750
1947	361	12	21	352	3,600
1948	352	18	11	359	3,825
1949	359	12	13	358	3,700
1950	358	26	18	366	4,700
1951	366	12	10	368	5,600
1952	368	13	14	367	6,800
1953	367	17	15	369	7,000
1954	369	20	5	384	8,700
1955	384	37	34	387	12,000
1956	387	46	34	399	14,000
1957	399	49	16	432	15,000
1958	432	42	21	453	17,000
1959	453	70	11	512	20,000
1960	512	67	9	570	23,500
1961	570	118	25	663	29,000
1962	663	97	33	727	27,300
1963	727	48	48	727	36,000
1964	727	52	48	731	41,600
1965	731	50	54	727	44,600
1966	727	78	30	775	49,800
1967	775	108	41	842	58,197
1968	842	167	42	967	69,732
1969	967	222	22	1,167	72,465
1970[b]	1,167	187	26	1,328	56,337

[a] The aggregate assets reflect the sale of new securities as well as capital appreciation.
[b] Does not include the 25 separate accounts of life insurance companies (asset value of $710,150,233) with respect to which exemption from registration under Rule 6e-1 under the Investment Company Act is claimed. (One such separate account filing was withdrawn.)

INVESTMENT COMPANY FILINGS, OTHER THAN APPLICATIONS

As previously noted, investment companies offering their shares for sale to the public must register them under the Securities Act of 1933. Registration statements filed by such companies are reviewed for compliance with that Act as well as with the Investment Company Act. Proxy soliciting material filed by investment companies is reviewed for compliance with the Commission's proxy rules. The number of registration statements and proxy soliciting materials filed or processed during the fiscal year was as follows:

Type of material	Pending June 30, 1969	Filed	Processed	Pending June 30, 1970
Registration statements and post-effective amendments under the Securities Act of 1933	248	1,301	1,241	308
Registration statements under the Investment Company Act of 1940	160	[a]180	173	167
Proxy soliciting material	173	701	759	115

[a] Although 187 companies registered during the fiscal year by filing notification of registration on Form N-8A, only 180 of these companies filed full registration statements on Form N-8B-1.

Investment companies also filed 713 annual reports, 2,787 quarterly reports, 1,853 periodic reports to shareholders containing financial statements and 1,927 copies of sales literature.

NEW DEVELOPMENTS IN THE INVESTMENT COMPANY FIELD

Investment Companies Sponsored by Foreign Interests

Fund Managed by an Affiliate of the French Government.—During the year an investment company managed by an affiliate of the French Government, SoGen International Fund, Inc., filed a registration statement and commenced operations. The Fund's investment adviser and principal underwriter is SoGen International Corporation, all of whose outstanding stock is owned by Sociètè Genérale, one of France's largest banks and its affiliate, Sociètè Genérale Alsacienne de Banque, Strasbourg, France. Sociètè Genérale is owned by the French Government.[3]

The Fund's prospectus states that the adviser conducts its operation independent of Sociètè Genérale and neither Sociètè Genérale nor the French Government supervises the Fund's management or investment practices or policies.

Shares of the Fund are offered for sale both in the United States and abroad. Foreign investors are able to purchase Fund shares directly or may purchase Bearer Depository Receipts representing registered shares of the Fund which will be issued by a Luxembourg subsidiary of the adviser.

The Fund's investment policy allows it to invest in companies organized and operating in the United States or elsewhere in the free world. While the Interest Equalization Tax is in effect, most or substantially all of the Fund's investments will be in companies organized in the United States. Foreign investments will also be limited by any mandatory guidelines that the Federal Reserve Board may adopt pursuant to Executive Order. To the extent that the Fund invests in a foreign issuer its investment policies allow it to engage in forward currency transactions in an attempt to protect the Fund from devaluation of that country's currency. This policy may be used only defensively and the Fund may not sell forward currency of a particular country to an extent greater than the then current value of its investment in issuers incorporated or operating in that country.

Investment Company Selling Exclusively to Non-resident Aliens.—A British-organized fund, the Cheapside Dollar Fund Limited, registered under the Investment Company Act during the year and proposed to offer its shares only outside of the United States, and principally to residents of the United Kingdom, through the Fund's London office.[4] Registration under the Investment Company Act results in certain advantages under British tax law and flow-through

[3] Smith Barney Corporation acts as sub-investment adviser to the Fund.

[4] Its registration statement under the Securities Act of 1933 became effective July 21, 1970.

treatment under Subchapter M of the Internal Revenue Code of 1954.

Commission Policy on Restricted Securities

During the fiscal year, the Commission issued an official policy statement on the acquisition and holding of restricted securities by investment companies.[5] These securities, sometimes called "letter stock," are securities acquired in private placements or which for some other reason require registration under the Securities Act of 1933 before they may be resold to the public. The Commission's release discussed the problems of valuation of such securities, problems of disclosure regarding such valuation, and problems of portfolio management where restricted securities are included in the portfolio. The release also expressed the Commission's view that a 10 percent limitation (in terms of net assets) on holdings of restricted securities or other assets not readily marketable should be maintained by an open-end investment company so as to avoid liquidity problems. A later release [6] made clear that the disclosure requirements for unregistered securities pertained not only to registration statements, but also to reports filed with the Commission or distributed to shareholders, and to sales literature and proxy statements.

Foreign Sales Guidelines

On June 23, 1970, the Commission published guidelines on the applicability of the Federal securities laws to the offer and sale outside the United States of shares of registered open-end investment companies.[7] As discussed in the last annual report,[8] the Commission had proposed the guidelines in February 1969, in response to the rapid expansion of many registered domestic investment companies into overseas markets and the concern that some foreign governments exhibited about the activities of such companies in their countries. The purpose of the guidelines is not only to publicize the Commission's views on the applicability of the statutes which it administers to sales of registered open-end investment company shares outside the United States to foreign investors, but also to set forth what are believed to be appropriate standards for the marketing of United States investment company securities abroad.

The guidelines will insure that substantially the same disclosure required by the Federal securities laws for American investors will

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[5] Investment Company Act Release No. 5847 (October 21, 1969). See also 35th Annual Report, pp. 130–131.

[6] Investment Company Act Release No. 6026 (April 13, 1970).

[7] Securities Act Release No. 5068, Securities Exchange Act Release No. 8907, and Investment Company Act Release No. 6082.

[8] 35th Annual Report, p. 132.

generally be available to foreign investors purchasing shares of American registered investment companies. Such disclosure at the point of sale helps protect the United States securities market as a whole by insuring that foreign investors will not seek redemptions because of later realization that they had been inadequately informed about their investment. Loss of confidence in the integrity of American registered investment companies could trigger widespread redemptions resulting in losses to foreign and domestic investors and damage to the United States securities market.

The guidelines call for Securities Act registration of open-end investment company shares sold abroad and for the use in connection with foreign sales of a prospectus substantially similar to the one used domestically. The prospectus used in any foreign country should be printed in a language readily understood by that segment of the foreign public being solicited, and dealer agreements with foreign broker-dealers should provide for prospectus delivery to all purchasers. Copies of the prospectus used abroad along with the English version of the prospectus upon which the foreign language prospectus is based are to be filed with the Commission.

In the area of advertising, the U.S. distributor is expected to seek compliance by foreign dealers with the standards of the Commission's Statement of Policy,[9] by means of dealer agreements. Some deviation from the standards for tombstone advertisements set forth in Rule 134 under the Securities Act would be permitted as demanded by local custom, but, to the extent possible, all advertisements should be within the bounds of the Statement of Policy.

The guidelines also state that the regulatory requirements of the Investment Company Act are generally applicable to the sale of shares of open-end companies to foreign nationals abroad. For example, the guidelines indicate that applications for exemptions under the Investment Company Act must be filed and granted to permit sales of shares in foreign countries at prices other than the public offering price in effect in this country. In accordance with this guideline provision, several funds have been exempted from Section 22(d) for foreign sales of their shares at prices which include sales loads different from those charged for domestic sales.[10]

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[9] Investment Company Act Release No. 2621, Securities Act Release No. 3856 (October 31, 1957).

[10] *Pilgrim Fund*, Investment Company Act Release Nos. 5968 (February 5, 1970) and 5992 (February 27, 1970) ; *Oppenheimer Systematic Capital & Accumulation Programs*, Investment Company Act Release Nos. 6055 (May 14, 1970) and 6070 (June 5, 1970) ; *Lexington Research Fund, Inc.* and *Piedmont Capital Corporation*, Investment Company Act Release No. 6148 (July 31, 1970).

Amendment of Rule 22d–1

On June 5, 1970, the Commission published notice [11] of a proposal to amend Rule 22d–1 under the Act.[12] Paragraph (h) of the Rule presently allows sales of open-end investment company shares at a reduced load or no sales load at all to directors, officers and partners of the investment company, its investment adviser or principal underwriter, and bona fide full-time employees or sales representatives of any of the foregoing who have acted as such for at least 90 days, and to any trust, pension, profit-sharing or other benefit plan for such persons. The provision was designed to permit such sales for the purpose of promoting employee incentive and good will and was adopted at a time when most investment advisers and principal underwriters for registered investment companies had relatively few employees.

Because of the way Paragraph (h) is written, however, there are certain anomalies in its applicability. For example, it permits employees of a life insurance company which acts as investment adviser or principal underwriter for an investment company to benefit from the reduced or eliminated sales load, while employees of an insurance company which performs the same services through subsidiaries or affiliates are not eligible for such benefits.

Further, in recent years an increasing number of investment advisers and principal underwriters of investment companies have become part of large complexes of companies, and as a result, a number of applications have been filed for exemption from the provisions of Section 22(d) of the Act to permit sales at reduced or no load to employees of subsidiary or affiliated companies, many of whom had no connection with the investment company business.[13]

As a consequence, the Commission proposed to restrict the category of favored persons by limiting sales of open-end investment company shares at a reduced or eliminated sales load to officers, directors or partners of the investment company, its investment adviser or principal underwriter, employees or sales representatives of the foregoing who spend more than half of their working time rendering investment advisory services to the investment company or

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[11] Investment Company Act Release No. 6069.

[12] Section 22(d) prohibits a registered investment company, its principal underwriter, or a dealer in its redeemable securities from selling such securities to "any person" except at a current public offering price described in the prospectus.

[13] The first of the applications, that of Transamerica Capital Fund, Inc., was discussed in the 35th Annual Report, p. 136.

selling its shares, and any trust, pension, profit-sharing or other benefit plan for the benefit of such persons.[14]

Amendment of Rule 17d-1

In April 1970, the Commission published a proposal to amend Rule 17d-1 under the Investment Company Act so as to clarify the applicability of the Rule to stock option and stock purchase plans of companies controlled by registered investment companies and to exempt from the requirement of filing an application under the Rule transactions in connection with such plans where no affiliated person of any investment company, investment adviser or principal underwriter participates therein. The amendment was adopted substantially as proposed following the close of the fiscal year.[15]

Section 17(d) of the 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 rules 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.

As amended, the Rule enables operating companies controlled by registered investment companies to adopt stock option or stock purchase plans for their officers, directors, or employees who are not affiliated persons of any investment company which is an affiliated person of the controlled company, or of the investment adviser or

[14] In almost all instances where the Commission granted exemptive orders from Section 22(d), the orders contained an express condition that if an amendment to Rule 22d-1 more restrictive than the terms of the orders were adopted, the orders would automatically terminate and the amended rule apply. The release announcing the proposed amendment to the Rule indicated that where orders have been granted without this condition the Commission would institute appropriate proceedings for revocation or modification of such orders so that all companies would be equally subject to the amended Rule.

[15] Investment Company Act Release No. 6154 (August 10, 1970). The notice of the proposal was issued April 30, 1970. Investment Company Act Release No. 6038.

principal underwriter of such an investment company, without seeking the approval of the Commission. The exemptive status of profit-sharing plans of controlled companies was continued. As to all plans, however, the availability of the exemption is predicated on the conditions that participants in the plan (1) must not be affiliated with the investment company, its adviser, or principal underwriter, and (2) must not have been affiliated with any of them during the life of the plan and for 6 months prior to institution of the profit-sharing plan or the purchase of stock pursuant to a stock purchase plan or the granting of options pursuant to a stock option plan.

This amendment was not intended to modify the prohibition contained in the Act against the issuance of stock options or the adoption of stock purchase plans either directly or indirectly by registered investment companies.

Rules Relating to Variable Annuities and Separate Accounts

Because of their special nature, variable annuity separate accounts require exemptions from a number of provisions of the Investment Company Act. As a result of experience gained in processing a number of applications for exemptions, the Commission concluded that it would be appropriate to provide, through the promulgation of rules under the Investment Company Act, certain limited exemptions which had previously been granted by individual exemptive orders. Accordingly, several rules were adopted on July 10, 1969.[16] On April 30, 1970, the Commission published for comment four proposed rules which would provide certain additional exemptions.[17] These rules would eliminate the need for preparing, filing, and processing routine applications and provide a further specification of the manner in which relevant regulatory provisions will be applied in connection with the organization and operation of separate accounts.

APPLICATIONS FOR COMMISSION ACTION

Under Section 6(c) of the Act, the Commission, by rules and regulations, upon its own motion or by order upon application, may exempt any person, security, or transaction from any provision of the Act if and to the extent such exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the Act. Other Sections, such as 6(d), 9(b), 10(f), 17(b), 17(d), and 23(c), contain specific provisions and standards pursuant to which the Commission may grant exemptions from particular sections of the Act or may approve certain types of transactions. Also, under

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[16] See 35th Annual Report, p. 143.

[17] Investment Company Act Release No. 6039.

certain provisions of Sections 2, 3, and 8, the Commission may determine the status of persons and companies under the Act. One of the principal activities of the Commission in its regulation of investment companies is the consideration of applications for orders under these sections.

During the fiscal year, 280 applications were filed under these and other sections of the Act, and final action was taken on 217 applications. As of the end of the year, 307 applications were pending. The following table presents a breakdown, by sections involved, of the number of applications filed and disposed of during the year and the number pending at the beginning and close of the year.

Applications Filed With Or Acted Upon By Commission Under The Investment Company Act During The Fiscal Year Ended June 30, 1970

Sections	Subject	Pending July 1, 1969	Filed	Closed	Pending June 30, 1970
3, 6	Status and exemption	64	56	36	84
5	Subclassification of investment companies	1	0	0	1
7	Registration of investment companies	2	0	0	2
8(f)	Termination of registration	46	43	28	61
9, 10, 16	Regulation of affiliation of directors, officers, employees, investment advisers, underwriters and others.	7	12	4	15
11, 25	Regulation of securities exchange offers and reorganization matters.	2	5	4	3
12, 14(a), 15	Regulation of functions and activities of investment companies.	20	14	19	15
17	Regulation of transactions with affiliated persons	40	48	41	47
18, 22, 23	Requirements as to capital structure, loans, distributions and redemptions and related matters.	56	93	78	71
20	Proxies, voting trusts, circular ownership	1	0	1	0
27	Periodic payment plans	1	3	1	3
28	Regulation of face amount certificate companies	1	2	0	3
30	Other periodic reports	3	4	5	2
Total		244	280	217	307

The Equity Corporation, a closed-end non-diversified investment company, applied pursuant to Section 8(f) of the Investment Company Act for an order declaring that it had ceased to be an investment company and terminating its registration.

In denying the application, the Commission found that the Equity management, in violation of Section 13(a)(4) of the Act, had changed the nature of Equity's business so as to cease to be an investment company prior to obtaining a shareholders' vote of approval.[18] The Commission's opinion stated, however, that if Equity's management still desired that it not be an investment company, it should present to the shareholders for their vote the question of whether or not they wished Equity to be an investment company in accordance with "a concrete plan prepared in good faith sufficient to

[18] Investment Company Act Release No. 6000 (March 5, 1970).

constitute a real alternative of a viable investment company business."

Equity filed a petition for rehearing which, among other things, requested clarification of the stockholder-vote procedure and also presented a plan which it considered might satisfy the Commission's requirements. Following objections to the plan by the staff and a group of objecting stockholders who participated in the proceedings, Equity submitted an alternative plan developed as a result of discussions with the staff. The objecting stockholders also opposed this plan. The Commission denied the petition for rehearing but ruled that the alternative plan satisfied the conditions set forth in its principal decision, authorized Equity to submit it to a vote of its shareholders, and stated that, if the plan were disapproved by the shareholders, it would enter a deregistration order upon appropriate application.[19]

An application under Section 8(f) was also filed by *Intermark Investing Company, Inc.*, which is registered as a closed-end investment company.[20] In September 1968, Intermark had obtained shareholders' approval of its proposal to surrender its license as a small business investment company and pursue a program designed to change the nature of its business to that of an operating company. Thereafter it acquired all of the outstanding stock or assets of approximately twenty operating companies. In 10 of the acquisitions, Intermark issued "earnouts"—that is, in addition to the issuance of shares in exchange for the outstanding shares of companies acquired, Intermark agreed to issue additional shares conditioned upon the earnings of the acquired companies over the succeeding three years.

Following a hearing the hearing examiner concluded that the application should be denied. He found that the earnouts were "senior securities," within the meaning of the Act, and had been issued in violation of Section 18(c) of the Act and were therefore voidable. The examiner also found that Intermark's proxy statement for the September 1968 meeting was false and misleading in various respects, thus vitiating the vote of shareholders required under Section 13(a)(4) of the Act.

The Commission granted petitions for review of the examiner's initial decision filed by Intermark and the Commission's staff.

Alleghany Corporation filed an application during the year for an order pursuant to Section 8(f) declaring that it had ceased to be an investment company as defined in the Act.[21] In January 1970, the

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[19] Investment Company Act Release No. 6194 (September 23, 1970).

[20] Investment Company Act Release No. 5904 (November 24, 1969).

[21] See Investment Company Act Release No. 6117 (July 16, 1970).

Interstate Commerce Commission authorized Alleghany to acquire the operating rights and property of Jones Motor Co., Inc. and its subsidiary, Erie Trucking Company, both motor carriers. Alleghany asserted that by virtue of its acquisition of Jones it was subject to regulation under the Interstate Commerce Act as a motor carrier and had thereby ceased to be an investment company by virtue of the provisions of Section 3(c)(9) of the Act which excludes from the definition of an investment company any company subject to regulation under the Interstate Commerce Act.

After the close of the fiscal year, the Commission granted the requested order.[22]

Midnite Mines, Inc. filed an application pursuant to Section 3(b)(2) of the Act which authorizes the Commission to exempt from the Act any company which is primarily engaged in a business or businesses other than that of investing, reinvesting, owning, holding, or trading in securities, either directly or through majority-owned subsidiaries or controlled companies conducting similar types of businesses. Midnite's principal asset is a 49 percent interest in Dawn Mining Company which is engaged in operating the "Midnite Mine," a uranium mine. The other 51 percent of Dawn is owned by Newmont Mining Corporation. Midnite and Newmont jointly operate Dawn pursuant to a contract between them. The Commission granted the exemption, finding that since the terms of this contract provided that Dawn be operated jointly by Midnite and Newmont, Dawn was a controlled company of Midnite, even though Midnite held a minority interest.[23]

National Rural Utilities Cooperative Finance Corporation obtained from the Commission an order pursuant to Section 6(c), granting a temporary exemption from all provisions of the Investment Company Act.[24] National Rural, a non-profit cooperative association owned and operated by rural electric systems, intends to engage primarily in making loans to its members to finance their rural electric services and facilities, thereby supplementing the Rural Electrification Administration ("REA") loan program. To finance this lending program, National Rural proposes to raise capital by the sale of membership and capital term certificates to its member electric systems, and by private placement and underwritten public offerings of its debentures. The loans to members will be secured by mortgage liens on the property of borrowing members. Although the

[22] Investment Company Act Release No. 6168 (August 21, 1970).

[23] Investment Company Act Release No. 6123 (July 20, 1970).

[24] Investment Company Act Release No. 6109 (July 7, 1970).

liens will attach to certain personal property, the primary underlying security will be the real estate and fixtures of the cooperative borrowers.

A great majority of National Rural's loans will be made jointly with the REA, which will control the timing and amount of such loans. Once National Rural's loan program is fully implemented, it will be primarily engaged in purchasing or acquiring mortgages and other liens on and interests in real estate, and thus be excluded from the definition of investment company in the Act by reason of Section 3(c)(6)(C). During the initial period of operations, however, National Rural may not be able to rely on the Section 3(c)(6)(C) exclusion. The Commission's order granted an exemption from the Act for this initial period, not to exceed 3 years.

Talley Industries, Inc. filed an application, pursuant to Section 17(b) of the Investment Company Act, for an exemption from Section 17(a) to permit the merger into Talley of General Time Corporation. Section 17(a), generally speaking, prohibits an affiliate of an investment company from purchasing or selling securities or other property from or to the investment company. Section 17(b) requires the Commission to exempt a proposed transaction from the provisions of Section 17(a) if evidence establishes that the terms of the transaction are reasonable and fair, and that the proposed transaction is consistent with the policy of each registered investment company concerned and with the general purposes of the Act.

Under the merger plan, the common stockholders of General Time were to receive one share of a new Talley cumulative preferred, carrying annual dividends of $1 and convertible into $9/10$ of a share of Talley common, for each share of General Time, which had been paying regular dividends. Alternatively they could elect to receive one share of non-dividend paying Talley common for each such share. Holders of General Time preferred were to receive four shares of the new Talley preferred for each of their shares, or could elect to receive four shares of Talley common for each such share.

American Investors Fund, Inc., a registered investment company, owned about 6 percent of Talley's voting stock, making Talley an affiliated person of the Fund under the Act. At the same time, the Fund was a shareholder of General Time. The Commission rejected the contention that since the Fund did not control and was not controlled by the companies being merged, there was no "purchase" or "sale" involving the Fund within the meaning of Section 17(a). The Commission held Talley's proposed acquisition of General Time shares from the Fund a "purchase" and the exchange by Talley of

its own shares for the General Time shares held by the Fund a "sale" within the meaning of Section 17(a).

Regarding the substantive terms of the merger, the Commission concluded that it could not find the proposal fair to General Time shareholders unless they were given a longer-term choice between continuing to hold a dividend-paying security with a preferred status or accepting a common stock position in Talley, and that fairness required that this be accomplished by making the new Talley preferred convertible into a full share of Talley common, and by eliminating any issuance of Talley common to General Time shareholders. The Commission further held that the issuance of four shares of new Talley preferred, each convertible into a full share of Talley common, for each share of General Time preferred, would satisfy fairness standards. The Commission stated that if Talley filed an appropriate amendment to its merger plan within 30 days incorporating the changes suggested by the Commission, an order would be entered granting Talley's application.[25] Talley filed an appropriate amendment, and its application was granted.[26]

Ivy Fund, Inc. and its investment adviser, Studley, Shupert & Co., Inc. of Boston, filed an application pursuant to Section 17(b) of the Investment Company Act for an order exempting from the provisions of Section 17(a) the grant by the Fund to the adviser of a license to use the word "Ivy" in a new name for the adviser and in the names of other investment companies for which the adviser performs or in the future may perform advisory services.[27]

The terms of the proposed license, for which the adviser agreed to pay $2,000, provide that the license is terminable at the option of the Fund if the adviser ceases to be its investment adviser and that the right of any other fund to use the name "Ivy" pursuant to the license is terminable at the option of the Fund in the event the adviser ceases to be an investment adviser to either the Fund or such other investment company. Following hearings, the hearing examiner overruled the objection of the Commission's staff that the consideration for the license had not been proven reasonable and fair and concluded that the application met the statutory terms and should be granted.[28] The Commission thereafter granted the staff's petition for review.

The America Group Companies Fund, *State Mutual Life Assurance Company of America* and other members of *The America*

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[25] Investment Company Act Release No. 5953 (January 9, 1970).

[26] Investment Company Act Release No. 5977 (February 10, 1970).

[27] Investment Company Act Release No. 5971 (February 6, 1970).

[28] Administrative Proceeding File No. 3-2175 (August 24, 1970).

Group applied for an exemption from the provisions of Section 17(d) of the Act, which prohibits joint transactions between an investment company and its affiliates, and Rule 17d–1 thereunder, so as to enable the Fund and members of The America Group to invest in securities of the same issuer.

The Fund was formed to provide a means for the collective investment of funds committed to equity investment by several related insurance companies constituting The America Group. Only institutional members of The America Group may become shareholders of the Fund. Since State Mutual will control the Fund, it is an affiliated person of the Fund. Other members of The America Group, upon acquisition of 5 percent or more of the voting stock of the Fund, would also become affiliated persons of the Fund.

The Commission granted the exemption requested,[29] with the condition, to which State Mutual consented, that the investment of State Mutual in the Fund will at all times amount to at least 50 percent of the value of the net assets of the Fund.

First Multifund of America, Inc. and *First Multifund Advisory Corp.* filed an application for a declaratory order of the Commission, pursuant to Section 554(e) of the Administrative Procedure Act ("APA"), that it is lawful, in accordance with Article III, Section 26 of the Rules of Fair Practice of the NASD, for members of the NASD who are underwriters of the shares of mutual funds, to grant concessions to members of the NASD who act as brokers for purchasers of such shares not excluding brokers who are affiliated persons of such purchasers. The Fund is an open-end investment company which invests solely in the shares of other open-end investment companies. Its co-applicant, the Fund's adviser, had, prior to the application, placed orders for the Fund for the purchase of shares of other open-end investment companies, and had retained the dealers' concessions received from the underwriters of those shares. The adviser proposed to continue this practice in the future, and the application was filed in an effort to secure a Commission determination that the practice was lawful.

Section 554(e) of the APA states that "The agency, with like effect as in the case of other orders, and in its sound discretion may issue a declaratory order to terminate a controversy or remove uncertainty." The staff moved to dismiss the application because (1) the questioned practices had preceded the filing of the application by almost 2 years and (2) denial of the order would not terminate the controversy because applicants could then file for exemptions from the Act.

[29] Investment Company Act Release No. 5788 (August 19, 1969).

The Commission denied the motion to dismiss under the then state of the proceedings and ordered a hearing on the application to consider, in addition to the issues raised by applicants, certain issues raised by the staff as to the propriety under the Act of applicants' practices.[30] Included in the specified issues were whether the Commission has the power to issue the declaratory order requested and, if so, whether it should do so, and whether the adviser's practices were prohibited by Sections 17(a)(1), 17(e)(1) and/or 22(d) of the Act, unless exempted. Hearings were held, and at the close of the fiscal year, the matter was pending.

In *N.A.S.D.* v. *S.E.C.*, the Commission's order granting First National City Bank of New York exemptions from certain provisions of the Investment Company Act with respect to a Commingled Investment Account which the Bank established and registered under the Act was affirmed by the Court of Appeals for the District of Columbia Circuit.[31] In the same opinion, the court reversed the judgment of the district court in *Investment Company Institute* v. *Camp*, which had invalidated Regulations of the Comptroller of the Currency relied on by the Bank in establishing its Commingled Account. Petitions for certiorari filed by the NASD and the I.C.I. have been granted by the Supreme Court. The brief filed by the Solicitor General in the NASD case states that he has been advised by the Commission that only two of the present members of the Commission participated in the Commission decision (one supporting the decision and one dissenting) and that the three subsequently-appointed members were not prepared to take any position, and that accordingly the Commission expressed no position on the merits. The Solicitor General, as an *amicus curiae*, urged affirmance.

CONTROL OF IMPROPER PRACTICES

Inspection and Investigation Program

During the fiscal year, the Commission's staff conducted 69 inspections pursuant to Section 31(b) of the Investment Company Act. Many of these inspections disclosed violations of that Act and of other statutes administered by the Commission. Among the violations were inadequate arrangements for safekeeping of the investment company's portfolio securities, inadequate disclosures concerning the activities of the company, failure to maintain adequate fidelity bond coverage for persons dealing with investment company assets and self-dealing transactions which included arrangements by

[30] Investment Company Act Release No. 6044 (May 5, 1970).

[31] 420 F.2d 83 (1969).

affiliates of investment companies to recapture fund brokerage for their own benefit.

As in past years there have been a number of serious accounting and bookkeeping problems. Some companies have priced shares inaccurately because their books did not enable them to compute net asset value correctly. As a result of various operational problems, several companies voluntarily suspended sales of shares pending the resolution of these problems.

In light of the increasing number of registered investment companies, the Commission determined to expand the inspection program carried on by its staff. Separate units for inspecting and investigating investment companies are being established in the Boston, Chicago and San Francisco regional offices. New York had previously established such a unit. The other regional offices are being required to allocate a greater portion of their manpower and resources to this program.

Largely as an outgrowth of information obtained during inspections, 12 private investigations were commenced during the fiscal year to develop facts concerning what appeared to be serious violations. As a result of the Commission's inspection and investigation program, approximately $1.3 million was returned to investors either directly or indirectly during the year. This brings to about $8.1 million the sums returned to investors since the inception of the inspection program in 1963.

Civil and Administrative Proceedings

During the fiscal year, the Commission instituted a number of civil and administrative proceedings involving investment companies and continued prosecution of other investment company proceedings.

Failure to Register as an Investment Company.—The Commission brought an injunctive action in February 1970 in the United States District Court for the Southern District of New York against *First National City Bank* ("Citibank"), *Merrill Lynch, Pierce, Fenner and Smith, Inc.* and *Special Investment Advisory Service* ("SIAS").[32] The complaint alleged that the defendants had violated Section 7(b) of the Investment Company Act by operating an unregistered investment company and Sections 5(a) and (c) of the Securities Act by offering and selling unregistered securities issued by SIAS. It was alleged, among other things, that Citibank and Merrill Lynch had organized SIAS as an unincorporated fund which had been primarily engaged since at least October 1, 1964, in the business of investing, reinvesting, owning, holding, or trading in securities; that SIAS had a value of approximately $35 million and over 1,000

[32] See Litigation Release No. 4534 (February 6, 1970).

security holders; and that, while investments in SIAS were solicited on the representation that each investor's investment would receive personalized or individual attention, moneys received were in fact invested in a virtually identical manner in one of two groups of securities.

While the defendants denied that they had engaged in any illegal or improper conduct, they entered into a Stipulation and Undertaking with the Commission, pursuant to which the court entered an order disposing of the action but retained jurisdiction to ensure fulfillment of the terms of the Stipulation and Undertaking.[33] These require that defendants cease the offer, sale, or redemption of securities issued by SIAS and the purchase or sale of securities for the account of SIAS and refrain in the future from engaging in activities similar to those described in the complaint except in compliance with the registration requirements of the Securities Act and the Investment Company Act. Merrill Lynch also agreed to terminate its relationships with other banks and persons which offered services similar to SIAS.

Prospectuses; Sales Literature.—In January 1970, the Commission filed a complaint in the United States District Court for the Southern District of New York seeking an injunction against *American General Insurance Company* and certain affiliated companies, Channing Financial Corporation, Channing Company, Incorporated, and The Variable Annuity Life Insurance Company (VALIC).[34] The complaint alleged that commencing on September 3, 1969, and on each succeeding Wednesday through October 29, 1969, the defendants caused advertisements to be placed in the Wall Street Journal offering for sale shares issued by the Channing group of investment companies and variable annuity contracts issued by VALIC separate accounts; that these advertisements failed to comply with the prospectus requirements of Section 5(b)(1) of the Securities Act; and that the defendants failed to file copies of the advertisements with the Commission as required by Section 24(b) of the Investment Company Act. The case was subsequently transferred to the United State District Court for the Southern District of Texas.[35]

Norman F. Dacey & Associates, Inc., a registered broker-dealer, and its president, *Norman F. Dacey*, were censured for securities violations in connection with their offering of shares of Dacey Trust Fund, a registered investment company.[36] The sanction was imposed

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[33] *Ibid.*

[34] See Litigation Release No. 4522 (January 15, 1970).

[35] S.D. Tex., Civ. Action No. 70-H-291.

[36] See Securities Exchange Act Release No. 8878 (May 4, 1970).

in a hearing examiner's initial decision which became the final decision of the Commission when no appeal was filed. According to the decision, after the Fund had filed a Securities Act registration statement, respondents prepared and used a form letter to answer inquiries concerning the prospective offering. It was found that these letters constituted the first step of an effort to sell Fund shares and, as such, were "prospectuses." They did not, however, contain the information required to be included in a prospectus and were not accompanied or preceded by a prospectus meeting such requirements. Their use therefore violated Section 5(b) of the Securities Act. Moreover, the letters contained "materially misleading" statements in that among other things they implied an assurance that an investor's capital would increase but did not point out the market risks inherently involved in an investment in Fund shares.

Portfolio Transactions and Restricted Securities.—During the fiscal year, the Commission instituted administrative proceedings involving *Winfield Growth Fund, Inc.*, a registered open-end investment company, certain broker-dealer and investment adviser firms and individuals affiliated with the Fund, and others.[37] The orders for proceedings alleged, among other things, that respondents engaged in acts and practices designed to channel fund brokerage to or for the benefit of affiliated persons of the Fund and that certain respondents caused the Fund to purchase and value restricted securities improperly. The orders alleged that these activities violated various provisions of the Federal securities laws, including the self-dealing, pricing and redemption provisions of the Investment Company Act and antifraud provisions of the Securities Act and Securities Exchange Act. The Fund, without admitting or denying the facts alleged, consented to findings that its registration statement was deficient in that, among other things, it failed to disclose the above practices, and to the entry of a stop order. Thereafter it amended its registration statement which, as amended, was declared effective.[38] Following the close of the fiscal year, offers of settlement submitted by the remaining respondents and providing for various sanctions were accepted by the Commission.[39] The Commission's definitive findings and opinion are to be issued at a later date.

Proceedings also involving alleged misuse of fund brokerage were instituted against *Provident Management Corporation*, investment

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[37] See Securities Act Release No. 5028 and Securities Exchange Act Release No. 8764 (December 2, 1969).

[38] See Securities Act Release No. 5031 (December 15, 1969).

[39] Securities Exchange Release Nos. 8945 (July 28, 1970) and 8980 (September 17, 1970).

adviser to and principal underwriter for Provident Fund for Income, Inc.; Porteous & Company, Inc., a broker-dealer under common control with Management; and certain other broker-dealers and individuals. The allegations in the order for proceedings related principally to the receipt of compensation by Porteous & Co. in the form of clearance commissions directed to Porteous & Co. by certain broker-dealers who were selected by the respondents affiliated with the Fund to execute portfolio transactions for the Fund; the receipt of tender fees by Porteous & Co. in connection with the tender of Fund portfolio securities for which Porteous & Co. performed no services; and the failure to disclose the receipt of such monies by Porteous & Co. in the Fund's prospectus, proxy material and other materials filed with the Commission.

Offers of settlement were submitted by the respondents, including the unaffiliated broker-dealers who allegedly participated in the improper arrangements with respect to portfolio brokerage, and were accepted by the Commission.[40] The offers provided for the imposition of various sanctions and the findings of certain alleged violations, which were, however, not admitted. Detailed findings and an opinion were issued by the Commission following the close of the fiscal year.[41]

In June 1970, the Commission filed a complaint in the United States District Court for the Southern District of New York for a preliminary and final injunction against *Arnold Bernhard & Co., Inc.*, a registered investment adviser, and certain affiliated firms and individuals.[42] Bernhard & Co. publishes investment advisory publications under the name "Value Line" and acts as investment adviser for several investment companies bearing that name.

The complaint alleges, among other things, violations by the defendants of the antifraud provisions of the securities acts arising out of the failure to disclose Bernhard & Co.'s activities as a finder of mergers, acquisitions, and financing in that firm's publications and in investment company prospectuses; of Sections 17(e)(1) and 15(a)(1) of the Investment Company Act by virtue of the acceptance of compensation for placement of investment company portfolio transactions; and of Sections 20(a) and 34(b) of the Investment

[40] Securities Exchange Act Release Nos. 8790 (December 31, 1969), 8822 (February 19, 1970) and 8846 (March 27, 1970). An order suspending the effectiveness of the Fund's registration statement because of nondisclosure regarding the matters described above had been issued during the prior fiscal year and had been vacated following the filing of a corrective amendment. See 35th Annual Report, p. 138.

[41] Securities Exchange Act Release No. 9028 (December 1, 1970).

[42] See Litigation Release No. 4647 (June 25, 1970).

Company Act and Rule 20a-1 thereunder in that proxy materials and an annual report of one of the investment companies filed with the Commission contained untrue statements and omitted material information regarding the above matters.

During the fiscal year, the Commission filed a brief objecting to a proposed settlement in *Kurach* v. *Weissman*, private litigation involving Dreyfus Fund, Inc.[43] In essence, the settlement provided that the Fund's advisory fee would be offset by certain net profits derived from brokerage activities of a subsidiary of the Fund's investment adviser and it guaranteed a minimum benefit to the Fund from this arrangement. "Net profits" was defined to include commissions received by the subsidiary in "reciprocal" transactions.

The Commission argued that the settlement was illusory because it did not provide Fund shareholders with any benefits they were not in any event entitled to receive. The Commission contended that an investment adviser to a fund is under an obligation, in executing portfolio transactions, not to ignore available means to enable the fund to achieve the most favorable result under the circumstances. The Commission also urged that Section 17(e)(1) of the Investment Company Act precluded the subsidiary from receiving and retaining reciprocal commissions where it did not perform an actual brokerage function. After the Commission filed its brief, the parties to the action amended the proposed settlement so that the subsidiary's net proceeds from reciprocal business would be credited to the Fund without deductions except for expenses directly related to such receipts and would not be applied in reduction of the minimum recovery guaranteed to the Fund by its adviser under the settlement.

In March 1970, the court, noting that the amendment to the proposed settlement obviated some of the Commission's objections, approved the settlement. The court reasoned that in view of the "brokerage" exception of Section 17(e) and the absence of other relevant authority, it wold not be justified in holding that the subsidiary was obligated to turn over *all* of its brokerage profits to the Fund.[44]

Gross Abuse of Trust.—In January 1970, the United States District Court for the District of Nevada entered a decree which among other things permanantly enjoined *Peter A. Straface* from further acts constituting a gross abuse of trust with respect to Kent Growth Fund, which the complaint alleged is under his control, and from converting to his own use, or the use of another, any assets of the

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[43] S.D.N.Y., 67 Civ. 93.

[44] CCH Fed. Sec. L. Rep. ¶92,607.

Fund.[45] The decree also enjoined Straface, the Fund, Bonanza Investment Management Company (the Fund's investment adviser), and National Capital Corporation, which are also allegedly controlled by Straface, from making false statements and omitting material information concerning the operations, financial condition, personnel and facilities of and capital contributions to the three companies and failing to comply with the record-keeping, reporting and minimum capital requirements of the Investment Company Act. The defendants consented to the decree.

Back Office Problems.—Two proceedings involved failure by mutual funds, and investment advisers and managers of mutual funds, to maintain on a current basis the books, accounts and other records of the mutual funds as required by Section 31(a) of the Investment Company Act and Rule 31a-1 thereunder.

In January 1970, the Commission filed a complaint in the U.S. District Court for the Central District of California seeking to enjoin *Enterprise Fund, Inc.* ("Enterprise"), an open-end diversified management investment company, and Shareholders Management Company ("Management"), Enterprise's investment adviser and principal underwriter, from further violations of certain "bookkeeping" requirements under Section 31(a) and Rule 31a-1.[46] The complaint alleged that Enterprise, aided and abetted by Management, had failed to maintain and keep current required books and records and requested the court to enjoin the offer or sale of Enterprise shares until that situation had been remedied.

On February 27, 1970, the court entered a final judgment of permanent injunction against Enterprise and an order approving a stipulation and undertaking with respect to Management, which prohibit the offer or sale of Enterprise shares until further court order and direct Enterprise to make and keep current its accounts, books and other records in compliance with Section 31(a) and Rule 31a-1 thereunder. The order also requires Management to make current and accurate those accounts, books and records of Enterprise kept by it and to use its best efforts to insure compliance by Enterprise with Section 31(a) and Rule 31a-1. Enterprise and Management consented to the entry of the permanent injunction and order without admitting the violations charged in the complaint.

Pursuant to the stipulation and undertaking, Management, at its own expense, must retain an independent certified public accounting firm to review the accounts, books and other records of Enterprise and to comment on any material inadequacies found to exist in

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[45] See Litigation Release No. 4526 (January 20, 1970).

[46] C.D. Cal., Civ. Action No. 70-220-EC (1970).

the accounting system or the internal accounting controls and procedures. The report of the accounting firm is a condition precedent to an application by Enterprise to the court for permission to resume sales of its securities. In addition the accounting firm is to examine Enterprise's capital accounts including control, subsidiary and individual shareholder accounts, and to render a report as to whether these accounts are in compliance with Section 31(a).

The stipulation and undertaking also provides that, prior to application for resumption of sales, Management is to conduct or have conducted, at its own expense, an analysis of the costs and expenses incurred or paid by Enterprise and Management in connection with the maintenance of Enterprise's accounts, books and other records, report thereon to Enterprise and the Commission, and pay Enterprise for such costs and expenses incurred by Enterprise as shall be agreed upon between Enterprise and Management and approved by the court. At fiscal year end, the accountant's report and the cost and expense analysis had not been completed.

In August 1969, the Commission instituted administrative proceedings under the Securities Exchange Act of 1934 against *Value Line Securities, Inc.*, a registered broker-dealer which acts as principal distributor for three registered investment companies, the firm's president and the controlling shareholder of the firm's parent which acts as manager of and investment adviser to the three companies.

The order for proceedings alleged that the respondents offered and sold shares of the three investment companies by means of misleading prospectuses which failed to disclose a lack of personnel and facilities necessary to service shareholders' accounts properly. It further alleged, among other things, that respondents violated Section 31 of the Investment Company Act by not properly maintaining the books and records of Value Line Special Situations Fund, Inc. during the period April to December 1968, and that they filed misleading affidavits with the Commission.[47]

Improper Accounting Methods.—The Commission instituted proceedings under Section 8(d) of the Securities Act of 1933 to determine whether a stop order should be issued against a registration statement filed by *Monmouth Capital Corporation*, a small business investment company registered under the Investment Company Act. The proceedings were instituted on the basis of allegations by the staff that Monmouth had made a series of stock distributions without adequate undistributed earned surplus to capitalize such distributions as required by proper accounting principles. The staff also alleged that Monmouth's failure to follow generally accepted

[47] See Securities Exchange Act Release No. 8670 (August 21, 1969).

accounting principles in the preparation of its financial statements rendered the financial statements misleading.

Monmouth submitted an offer of settlement in which it consented to Commission findings that generally accepted accounting principles were not followed with respect to the various stock distributions since it did not have the requisite earned surplus. It further consented to a finding that its registration statement omitted to state material facts required to be stated therein or necessary to make the statements therein not misleading, in that the accountants' opinion with respect to the financial statements contained therein did not note that such statements were not prepared in accordance with generally accepted accounting principles. The offer of settlement was conditioned upon the Commission dismissing the proceeding without the entry of a stop order. Monmouth agreed to amend its registration statement so as to correct the deficiencies within 90 days after acceptance of the offer by the Commission. The Commission determined that acceptance of Monmouth's offer would satisfactorily resolve the proceedings. Commission findings and an opinion dealing with the improper practices and the misleading aspects of the financial statements were to be issued after the amendment had been filed.

PART VI

REGULATION OF 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 in the retail distribution of gas. The Commission's jurisdiction also extends to natural gas pipeline companies and other nonutility companies which are subsidiary companies of registered holding companies. There are three principal areas of regulation under the Act. The first includes those provisions of the Act which require 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. The second covers 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. The third area of regulation includes the exemptive provisions of the Act, 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 a second such company through the acquisition of securities.[1]

COMPOSITION OF REGISTERED HOLDING-COMPANY SYSTEMS

At the close of the 1970 fiscal year, there were 23 holding companies registered under the Act. Of these, 20 are included in the 17 "active" registered holding-company systems, 3 of the 20 being subholding utility operating companies in these systems.[2] The remaining 3 registered holding companies, which are relatively small, are not considered part of "active" systems.[3] In the 17 active systems, there

[1] Pending legislation to transfer to the Federal Power Commission the Commission's functions under the Holding Company Act is discussed at pages 20–21, *supra*.

[2] The three subholding companies are The Potomac Edison Company and Monongahela Power Company, public-utility subsidiary companies of Allegheny Power System, Inc., and Southwestern Electric Power Company, a public-utility subsidiary company of Central and South West Corporation.

[3] These holding companies are British American Utilities Corporation; Kinzua Oil & Gas Corporation and its subholding company, Northwestern Pennsylvania Gas Corporation; and Standard Gas & Electric Company, which is in the process of dissolution.

are 94 electric and/or gas utility subsidiaries, 48 nonutility subsidiaries, and 16 inactive companies, or a total, including the parent holding companies and the subholding companies, of 178 system companies. The following table shows the number of active holding companies and the number of subsidiaries (classified as utility, nonutility, and inactive) in each of the active systems as of June 30, 1970, and the aggregate assets of these systems, less valuation reserves, as of December 31, 1969.

Classification of Companies as of June 30, 1970

Registered holding-company systems Name	Solely registered holding companies	Registered holding operating companies	Electric and/or gas utility subsidiaries	Nonutility subsidiaries	Inactive companies	Total companies	Aggregate System Assets, Less Valuation Reserves, at December 31, 1969[a] (thousands)
1 Allegheny Power System, Inc.	1	2	8	5	1	17	$1,090,501
2. American Electric Power Company, Inc	1	0	14	10	2	27	2,786,608
3. American Natural Gas Company	1	0	3	5	0	9	1,555,596
4 Central and South West Corporation	1	1	4	2	1	9	1,107,553
5. Columbia Gas System, Inc., The	1	0	11	9	0	21	1,893,964
6 Consolidated Natural Gas Company	1	0	5	2	0	8	1,218,305
7. Delmarva Power & Light Company	0	1	2	0	0	3	365,778
8. Eastern Utilities Associates	1	0	4	0	2	7	143,025
9. General Public Utilities Corp.	1	0	6	3	0	10	1,890,862
10. Middle South Utilities	1	0	6	1	3	11	1,575,942
11. National Fuel Gas Company	1	0	4	2	0	7	339,523
12. New England Electric System	1	0	16	1	0	18	1,018,172
13. Northeast Utilities	1	0	11	7	6	25	1,285,601
14. Ohio Edison Company	0	1	3	0	0	4	946,936
15. Philadelphia Electric Power Company	0	1	1	0	1	3	58,370
16. Southern Company, The	1	0	5	2	0	8	2,737,552
17. Utah Power & Light Company	0	1	1	0	0	2	408,971
Subtotals	13	7	104	49	16	189	20,423,259
Adjustments (a) to eliminate duplication in company count and (b) to add the net assets of nine jointly-owned companies not included above.[b]	0	0	−10	−1	0	−11	515,570
Total companies and assets in active systems	13	7	94	48	16	178	20,938,829

[a] Represents the consolidated assets, less valuation reserves, of each system as reported to the Commission on Form U5S for the year 1969.

[b] These nine companies are Beechbottom Power Company, Inc. and Windsor Power House Coal Company, which are indirect subsidiaries of American Electric Power Company, Inc. and Allegheny Power System, Inc.; Ohio Valley Electric Corporation and its subsidiary, Indiana-Kentucky Electric Corporation, which are owned 37.8 percent by American Electric Power Company, Inc., 16.5 percent by Ohio Edison Company, 12.5 percent by Allegheny Power System, Inc., and 33.2 percent by other companies; The Arklahoma Corporation, which is owned 32 percent by the Central and South West Corporation system, 34 percent by the Middle South Utilities, Inc. system, and 34 percent by an electric utility company not associated with a registered system; Yankee Atomic Electric Power Company, Connecticut Yankee Atomic Power Company, Vermont Yankee Nuclear Power Corporation, and Maine Yankee Atomic Power Company, which are statutory utility subsidiaries of Northeast Utilities and New England Electric System.

SECTION 11 MATTERS IN REGISTERED HOLDING-COMPANY SYSTEMS

Washington Gas Light Company, which was granted, pursuant to Section 3(a)(2), an exemption from the Act except Sections 11(b) (2), 11(d), and 11(e), has filed a plan under Section 11(e)[4] proposing the elimination of the 0.7 percent publicly-held minority interest in the common stock of its gas utility subsidiary company, Shenandoah Gas Company.[5] A hearing on the plan was held after the close of the fiscal year, and the case is pending for decision by the Commission.

As reported previously,[6] the Commission approved, as fair and equitable under Section 11(e) of the Act, a plan of liquidation and dissolution of *Standard Gas and Electric Company*, a registered holding company. The plan was approved and enforced by the United States District Court for the District of Delaware, which overruled objections by the State of New York that under its abandoned property law it was entitled to receive funds due unlocated New York stockholders. In a decision rendered on September 25, 1970, the Court of Appeals affirmed.[7]

PROCEEDINGS WITH RESPECT TO ACQUISITIONS, SALES, AND OTHER MATTERS

In *American Electric Power Company, Inc.*, discussed previously,[8] hearings were reopened at the instance of the company on its application to acquire, pursuant to an invitation for tenders, shares of common stock of Columbus and Southern Ohio Electric Company, a nonassociate electric utility company, in exchange for AEP stock, on the basis of 1.3 shares of AEP common stock for each share of Columbus common stock. The Commission's Division of Corporate Regulation opposes approval of the application, contending that the proposed acquisition would have serious anti-competitive effects and tend towards a concentration of control of a kind and to an extent detrimental to the public interest, in contravention of Section 10(b)(1) of the Act. The United States Department of Justice has also announced its opposition to approval of the proposed acquisition.

In *New England Electric System*, reported previously,[9] the hearing continued during the fiscal year on the proposal for an affiliation, through the creation of a new holding company, by New England Elec-

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[4] Holding Company Act Release No. 16706 (May 1, 1970).

[5] Holding Company Act Release No. 16784 (July 15, 1970).

[6] See 35th Annual Report, pp. 147–148.

[7] *Standard Gas and Electric Company*, C.A. 3, No. 18,334.

[8] See 35th Annual Report, p. 148; 34th Annual Report, p. 138.

[9] See 35th Annual Report, p. 149; 34th Annual Report, p. 138.

tric System and Eastern Utilities Associates, both registered holding companies, and Boston Edison Company, a nonaffiliated electric utility company.

In *Michigan Consolidated Gas Company*,[10] the Commission denied an application by Michigan Consolidated, a retail natural gas company and a subsidiary company of American Natural Gas Company, a registered holding company, for permission to provide financing to a subsidiary company which, pursuant to the National Housing Act, proposed to construct in its service area two housing projects for low and moderate income families. In a majority decision, in which the Chairman and Commissioners Herlong and Needham joined and which overruled an earlier Commission decision permitting an initial housing project,[11] the Commission held that the acquisition would not meet the standards of Sections 10(c)(1) and 11(b)(1) and ordered Michigan Consolidated to divest its interest in the two housing projects forthwith. Section 10(c) (1) bars approval of an acquisition detrimental to Section 11, and Section 11(b)(1) provides, among other things, that the Commission may permit retention of nonutility businesses which are "reasonably incidental, or economically necessary or appropriate to the operations" of an integrated public-utility system. The majority, noting that the proposed housing ventures were related to the operations of the public-utility system "only in that [they] may be held to rehabilitate and preserve areas serviced by Michigan Consolidated and thereby promote its general gas utility business," concluded that such a "customer relationship" is not "the type of operating or functional relationship which Congress contemplated when it established the standards of the 'other business' clauses." Nor, found the majority, was the undertaking "in the ordinary course of business" so as to warrant an exemption under Section 9(c) (3).[12]

In a separate opinion, Commissioner Owens concurred in part and dissented in part. He agreed with the majority that the application could not be granted under the standards of Section 11(b)(1), but he would have granted the application pursuant to Section 9(c)(3) on the ground that the acquisition by Michigan Consolidated of the securities of its housing subsidiary was to be "in the ordinary course of business" of Michigan Consolidated and was not detrimental to the public interest or the interest of investors or consumers. Commissioner Smith, in

[10] Holding Company Act Release No. 16763 (June 22, 1970).

[11] Holding Company Act Release No. 16331 (March 31, 1969). See 35th Annual Report, pp. 149–51.

[12] On August 20, 1970, Michigan Consolidated filed a petition for review of the Commission's order. *Michigan Consolidated Gas Company* v. *S.E.C.*, C.A.D.C., No. 24564.

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a dissenting opinion, urged adherence to the Commission's prior decision. In the alternative, he considered that an exemption under Section 9(c)(3) was warranted.[13]

Subsequently, Michigan Consolidated and the subsidiary filed a motion for an interim order authorizing them to complete the construction and financing of the two projects, as a step in implementing the divestiture order. This motion was denied (Commissioner Smith dissenting).[14] Thereafter the subsidiary filed a further motion seeking authority to issue and sell a mortgage note for about $2,166,000 on one of the projects, the proceeds to be used to operate that project and pay contractors' bills for the other project during the period required to implement the divestiture order. The Commission (Commissioner Smith dissenting) denied this motion as well.[15]

On August 20, 1970, a bill to amend the Holding Company Act to enable holding company systems to participate in governmentally assisted low and moderate income housing programs was introduced in the Senate.[16] The amendment, which would add paragraph (4) to Section 9(c) of the Act, would empower the Commission, by rule, regulation, or order, to exempt from the acquisition provisions of Section 10 of the Act (1) the securities of a subsidiary company engaged in the business of providing low and moderate income housing within its service area and pursuant to housing programs authorized by the National Housing Act, as amended, or a substitute thereof, or (2) the securities of a company organized for such housing programs within its service area which receives assistance from a company created or organized pursuant to Title IX of the Housing and Urban Development Act of 1968. In a letter of August 31, 1970, to the Chairman of the Senate Committee on Banking and Currency, to which the amendment was referred, Chairman Budge stated that the Commission would have no objection to enactment of the bill.

In *Hawaiian Electric Company, Inc.*,[17] the Commission approved an application by Hawaiian Electric, an exempt holding company,

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[13] The Commission (Commissioner Owens concurring in part and dissenting in part, and Commissioner Smith dissenting) subsequently denied applications for the financing of housing projects by Mississippi Power and Light Company, a subsidiary company of Middle South Utilities, Inc., a registered holding company, Holding Company Act Release No. 16814 (August 20, 1970), and by Ohio Power Company, a subsidiary company of American Electric Power Company, Inc., a registered holding company, Holding Company Act Release No. 16825 (September 9, 1970).

[14] Holding Company Act Release No. 16819 (August 26, 1970).

[15] Holding Company Act Release No 16842 (September 22, 1970).

[16] S. 4272, 91st Cong., 2d Sess.

[17] Holding Company Act Release No. 16592 (January 26, 1970).

to acquire all of the outstanding shares of common stock of Hilo Electric Company. Although the electric utility companies operate exclusively on different islands of the State of Hawaii and Section 2(a)(29)(A) requires that an integrated electric-utility system be either physically interconnected or capable of physical interconnection, the Commission decided that "in assessing the practicalities of economic and physical integration in this case, [it should] give particular weight to the unique geography of the State of Hawaii in light of the legislative history." [18]

Illinois Power Company [19] involved an application by Illinois Power, an exempt holding company, for approval of an acquisition, pursuant to an invitation of tenders, of the common stock of Central Illinois Public Service Company, also an exempt holding company. Both companies are engaged in the electric and gas utility business within the State of Illinois. The Commission approved the proposed acquisition and continuation of the existing exemption of Illinois Power under Section 3(a)(1) of the Act but on condition that the gas properties of both companies be divested. In imposing this condition the Commission stressed the Supreme Court's emphasis, in *S.E.C.* v. *New England Electric System*,[20] on the policy of the Act favoring competition between electric and gas companies. The Commission denied the request by certain preferred stockholders of Central Illinois to require, as a condition of the acquisition, that the several series of outstanding preferred stock of Central Illinois be eliminated through redemption, exchange for Illinois Power stock, or otherwise. Illinois Power subsequently announced that it did not intend to make the tender offer because it could not accept the condition imposed by the Commission. Prior to this announcement the preferred stockholders of Central Illinois petitioned for review of the order insofar as it denied the condition they sought.[21]

In *Vermont Yankee Nuclear Power Corporation* and *Maine Yankee Atomic Power Company*,[22] the Commission approved amended applications [23] by the sponsors of Vermont Yankee and Maine Yankee, holding that the amended proposals afforded an opportunity to non-sponsor utilities to obtain low cost power at its source and certain auxiliary services such as transmission and back-up reserves, and

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[18] At the time of the passage of the Act (1935), Hawaii was a territory rather than a State, and, as such, the Act was then not applicable to it.

[19] Holding Company Act Release No. 16574 (January 2, 1970).

[20] 390 U.S. 207 (1968).

[21] *Hutchinson, et al.* v. *S.E.C.*, C.A. 7, No. 18494.

[22] Holding Company Act Release No. 16794 (July 31, 1970).

[23] See 35th Annual Report, pp. 151–153; 34th Annual Report, p. 136; 33rd Annual Report, pp. 123–124.

that the terms of such proposals resolved the issues previously raised under Section 10(b)(1). Orders of the Commission approving the original applications [24] had been reversed by the Court of Appeals [25] because of certain antitrust issues under Section 10(b)(1) of the Act, and the cases had been remanded to the Commission.[26]

In *Ohio Power Company*,[27] the Commission approved the acquisition by Ohio Power, a subsidiary company of American Electric Power Company, Inc., of the municipal electric utility system owned and operated by the City of Martins Ferry, Ohio, for a cash consideration of $4,825,000. The Commission determined among other things that under the circumstances, including the deteriorated condition of the Martins Ferry facilities, the proposed acquisition did not have anticompetitive effects requiring disapproval under Section 10(b)(1).

As previously reported, *Middle South Utilities, Inc.*, a registered holding company, has filed an application relating to a proposed offer to acquire, through an invitation for tenders, the outstanding shares of common stock of Arkansas-Missouri Power Company, a nonassociate electric and gas utility company, in exchange for Middle South common stock.[28] A hearing has been held, and the matter is now pending for determination by the Commission.

The Columbia Gas System, Inc., a registered holding company, filed an application relating to a proposal under which, in effect, each share of National Gas & Oil Corporation, a nonassociate gas utility company, will be exchanged for 0.6 shares of Columbia common stock. A hearing has been ordered to determine whether the proposed acquisition meets the standards of Section 10 of the Act.[29]

FINANCING OF ACTIVE REGISTERED PUBLIC-UTILITY HOLDING COMPANIES AND THEIR SUBSIDIARIES

During fiscal 1970, 15 active registered holding-company systems issued and sold for cash a total of 59 issues of long-term debt and capital stock, aggregating $1,684 million,[30] pursuant to authoriza-

[24] Holding Company Act Release Nos. 15958 (February 6, 1968) and 16006 (March 15, 1968).

[25] *Municipal Electric Association of Massachusetts v. SEC*, 413 F. 2d 1052 (C.A.D.C., 1969).

[26] Petitions to review intermediate orders entered by the Commission after remand (Holding Company Act Release Nos. 16467–16470, September 5, 1969) have been dismissed pursuant to stipulation. *Municipal Electric Association* v. *SEC*, C.A.D.C., Nos. 23568 and 23569.

[27] Holding Company Act Release No. 16753 (June 8, 1970).

[28] Holding Company Act Release No. 16416 (June 25, 1969).

[29] Holding Company Act Release No. 16715 (May 6, 1970).

[30] Debt securities are computed at their principal amount, preferred stock at the offering price, and common stock at the offering or subscription price.

tions granted by the Commission under Sections 6 and 7 of the Act.[31] All of these issues were sold for the purpose of raising new capital. The following table presents the amounts and types of securities issued and sold by these holding-company systems.[32]

Securities Issued and Sold for Cash to the Public and Financial Institutions by Active Registered Holding Companies and Their Subsidiaries—Fiscal Year 1970

(In millions)

Holding-company systems	Bonds	Debentures	Preferred stock	Common stock
Allegheny Power System, Inc.				
Monongahela Power Company	$15.0		$5.1	
Potomac Edison Co.	20.0		5.1	
West Penn Power Co.	25.0		5.1	
American Electric Power Company, Inc.				$76.8
Appalachian Power Company	[a] 130.0			
Indiana & Michigan Electric Co.	[b] 65.0			
Ohio Power Company	80.0			
American Natural Gas Company				39.9
Central Indiana Gas Co., Inc.	8.0			
Michigan Consolidated Gas Co.	30.0			
Michigan Wisconsin Pipe Line Co.	40.0			
Wisconsin Gas Company	16.0			
Central and South West Corporation				37.7
Central Power and Light Company	25.0			
Southwestern Electric Power Company	35.0			
Columbia Gas System, Inc., The		[b] $90.0		
Consolidated Natural Gas Company		[b] 60.0		
Delmarva Power & Light Company	30.0		10.1	12.0
General Public Utilities Corporation		50.0		[b] 53.4
Jersey Central Power & Light Co.	[b] 22.0			
Metropolitan Edison Co.	25.0			
Pennsylvania Electric Co.	25.0			
Middle South Utilities, Inc.				65.1
Arkansas Power & Light Co.	25.0			
Louisiana Power & Light Co.	25.0			
Mississippi Power & Light Co.	20.0			
National Fuel Gas Company		20.0		
New England Electric System				
Narragansett Electric Co., The	7.5			
New England Power Company	15.0		10.1	
Northeast Utilities				
Connecticut Light and Power Company, The	40.0		15.3	
Hartford Electric Light Company, The	20.0		10.2	
Western Massachusetts Electric Company	30.0		15.2	
Ohio Edison Company	[b] 85.0			
Pennsylvania Power Co.	15.0			
Southern Company, The				
Alabama Power Company	35.0			
Georgia Power Company	[b] 125.0		[b] 25.4	
Utah Power & Light Company	30.0			14.5
Total	1,063.5	220.0	101.6	299.4

[a] Three issues.
[b] Two issues.

[31] The active systems which did not sell stock or long-term debt securities to the public were: Eastern Utilities Associates and Philadelphia Electric Power Company.

[32] 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 Section 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.

Recent Financing Developments

The financing highlight of fiscal 1970 was the record volume of external financing by registered holding companies and their subsidiaries. The $1,684 million of new securities issued and sold for cash by these companies, as shown in the preceding table, represents the greatest volume of external financing by companies subject to the Act for any year since passage of the Act, except for fiscal 1946 when approximately $2,158 million of securities were issued and sold. Among other things, the $299.4 million of common stock issued and sold to the public and existing shareholders in fiscal 1970 represented the greatest amount of common equity financing since fiscal 1946.[33] This unprecedented volume of financing was accompanied by record-high interest and preferred dividend rates, and the combination of these factors induced a number of departures from conventional financing methods during fiscal 1970.

For many years, the first mortgage bonds issued and sold by electric utility companies subject to the Act have uniformly carried 30-year maturities. Commencing in the last month of fiscal 1969, variations began to appear. On June 18, 1969, Indiana & Michigan Electric Company, an electric utility subsidiary of American Electric Power Company, Inc., a registered holding company, issued and sold, pursuant to competitive bidding, $60 million principal amount of first mortgage bonds having a 5-year maturity and a cost of money to the company of 7.95 percent.[34] In November 1969, Ohio Power Company, another electric utility subsidiary of American Electric Power Company, Inc., issued and sold, pursuant to competi-

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[33] This very large increase in volume of new capital financing by companies subject to the Act occurred although during the 24-year period (1946–1970) the number of electric and gas utility companies subject to the Act underwent major contraction due to the integration and simplification requirements of Section 11(b) of the Act. As of June 30, 1946, there were 49 registered holding-company systems which included 103 holding companies, 367 electric and/or gas utility subsidiary companies, and 428 nonutility and inactive companies, making a total of 898 companies subject to the Act. See 12th Annual Report, p. 48. As of June 30, 1970, there were only 17 active registered holding-company systems, and they comprised 20 registered holding companies, 94 electric and/or gas utility subsidiary companies, and 64 nonutility and inactive companies, making a total of 178 companies. See page 159, *supra*, for the tabulation of companies as of June 30, 1970.

[34] The Commission had authorized the company to issue the bonds with a maturity having a range of from 5 to 30 years, the maturity date to be determined not less than 72 hours prior to the opening of bids. *Indiana & Michigan Electric Company*, Holding Company Act Release No. 16391 (June 6, 1969). The company determined that the 5-year period would be most advantageous to it. *Indiana & Michigan Electric Company*, Holding Company Act Release No. 16406 (June 18, 1969).

tive bidding, $80 million principal amount of 25-year first mortgage bonds, with a cost of money to the company of 8.92 percent.[35]

On March 25, 1970, Indiana & Michigan Electric Company was authorized to issue and sell $50 million principal amount of first mortgage bonds due 2000 and $15 million principal amount of first mortgage bonds due 1975. Separate bids for each series of bonds were invited, and both issues were sold on April 7, 1970.[36] The issuer's interest costs were approximately 8.315 percent on the 5-year series and 8.872 percent on the 30-year series. On April 24, 1970, Appalachian Power Company, another subsidiary company of American Electric Power Company, Inc., was authorized to issue and sell at competitive bidding $70 million principal amount of first mortgage bonds with a maturity of 25 years.[37] When this issue was not sold, the company was authorized by supplemental order to issue and sell the bonds in one or two series, the principal amount and maturity (not less than 5 years nor more than 30 years) of each such series to be determined by the issuer not less than 72 hours prior to the opening of bids.[38] On June 15, 1970, the company issued and sold $20 million principal amount of bonds with a 25-year maturity and $50 million of bonds with a 5-year maturity. The company's interest costs were approximately 9.192 percent on the 5-year series and 10.114 percent on the 25-year series.

Similarly, on March 20, 1970, The Narragansett Electric Company, an electric utility subsidiary of New England Electric System, a registered holding company, was authorized to issue and sell at competitive bidding $7,500,000 principal amount of first mortgage bonds with a maturity of not less than 5 years nor more than 30 years. The company chose a 5-year maturity and sold the bonds on April 1, 1970, at an interest cost to the company of 8.367 percent.[39]

Under Sections 6, 7, and 11(b)(2) of the Act, in holding-company systems where senior-security financing is customarily done at the operating subsidiary level, parent holding companies are generally

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[35] The company had proposed to issue and sell its bonds with a maturity of from 25 to 30 years. *Ohio Power Company*, Holding Company Act Release No. 16511 (November 4, 1969). The company, 72 hours prior to the opening of bids, chose the 25-year maturity, and the Commission authorized the issue and sale of the bonds on this basis. *Ohio Power Company*, Holding Company Act Release No. 16531 (November 26, 1969).

[36] *Indiana & Michigan Electric Company*, Holding Company Act Release No. 16662.

[37] *Appalachian Power Company*, Holding Company Act Release No. 16696.

[38] *Appalachian Power Company*, Holding Company Act Release No. 16734 (May 25, 1970).

[39] *The Narragansett Electric Company*, Holding Company Act Release No. 16649.

not permitted to issue long-term debt securities, except under extraordinary circumstances. However, during the fiscal year, General Public Utilities Corporation, a registered holding company whose subsidiaries normally are financed in this manner, was authorized to issue and sell at competitive bidding $50 million principal amount of 5-year debentures, and to issue and sell, from time to time but not later than December 31, 1972, commercial paper notes having an aggregate principal amount outstanding at any time not in excess of $100 million. The company was authorized to borrow from commercial banks, not later than December 31, 1972, in an aggregate principal amount outstanding at any time not in excess of $85 million, for the purpose of meeting such maturities of the commercial paper notes as might not be refunded by the issuance of additional commercial paper notes. In addition, the company was authorized to borrow an additional $50 million from banks not later than December 31, 1972. The net proceeds of the debentures, commercial paper, and bank borrowings were to be used by General Public Utilities Corporation to make additional investments in its public-utility subsidiary companies to finance their construction.[40]

The sharp rise of interest rates in recent years has made it increasingly difficult for registered holding-company systems to maintain earnings coverage of interest requirements on their long-term debt securities at sufficient levels to satisfy indenture requirements and avoid impairment of the ratings of their debt securities by the investment advisory services. One consequence of this development has been increasing resort to preferred stock financing. In fiscal 1970, as shown in the table above, registered holding-company systems issued and sold 10 issues of preferred stock with an aggregate value of $101.6 million, which, except for one year, was the largest volume of this type of financing since 1947.

Competitive Bidding

Rule 50 under the Act requires that all proposed issuances or sales of any securities of, or owned by, any company in a registered holding-company system be sold at competitive bidding unless an exception from such requirement is available under the terms of paragraphs (a)(1) to (a)(5), inclusive, of the rule. Of the 59 issues of new securities shown in the preceding table, 56 issues, aggregating $1,554 million, were offered for competitive bidding pursuant to the requirement of Rule 50. The remaining three issues were common stocks totaling $130 million, which were sold at prices and terms determined by the issuers or set by negotiation with investment bank-

[40] *General Public Utilities Corporation*, Holding Company Act Release Nos. 16540 (November 28, 1969) and 16550 (December 8, 1969).

ers pursuant to orders of the Commission granting exceptions from the competitive bidding requirement.

One of these issues was a negotiated underwritten public offering of 2,540,097 shares of additional common stock by American Electric Power Company, Inc., a registered holding company, with aggregate value of $76.8 million, which was offered on August 18, 1969 at the closing market price on the New York Stock Exchange of $30.25 per share. Underwriters' compensation of $0.90 per share was equivalent to 2.975 percent of the public offering price.[41] The two other issues which were not sold pursuant to competitive bidding were nonunderwritten rights offerings of common stock to its shareholders by General Public Utilities Corporation, a registered holding company. The first of these two issues was an offering of 1,340,000 shares, in September-October 1969, at a subscription price of $21.50 per share, which represented a discount of 10.4 percent from the market price of $24.00 per share. Participating dealers were employed to solicit subscriptions by shareholders through exercise of their rights and to sell any stock not so subscribed. A total of 1,322,500 shares were sold through exercise of rights and sales by participating dealers, who received average compensation on all shares sold of $0.20 per share, or 0.93 percent of the subscription price. The remaining 17,500 shares were withdrawn.[42]

The second rights offering by General Public Utilities Corporation, in the amount of 1,405,000 shares, was initially authorized by the Commission as an underwritten rights offering with the subscription price to be determined by the issuer and underwriters' compensation to be determined by competitive bidding pursuant to the terms of Rule 50.[43] On May 14, 1970, the Commission authorized the company to make the proposed rights offering without standby underwriting and to employ participating dealers to solicit subscriptions by the company's shareholders and sell the unsubscribed shares.[44] The offering was made in May–June 1970, at a subscription price of $17.50 per share, which represented a discount of 14.1 percent from the market price of $20.375 per share. Shareholders were accorded oversubscription privileges, and all shares were subscribed by them. Participating dealers received average compensa-

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[41] *American Electric Power Company, Inc.*, Holding Company Act Release Nos. 16426 (July 9, 1969) and 16452 (August 18, 1969).

[42] *General Public Utilities Corporation*, Holding Company Act Release No. 16473 (September 10, 1969).

[43] *General Public Utilities Corporation*, Holding Company Act Release No. 16699 (April 27, 1970).

[44] *General Public Utilities Corporation*, Holding Company Act Release No. 16725.

tion on all shares offered of $0.046 per share, or 0.26 percent of the subscription price.

In both rights offerings by General Public Utilities Corporation, the sales of stock to stockholders through exercise of rights were automatically excepted from the competitive bidding requirement of Rule 50 by the terms of paragraph (a)(1) thereof, and the sales of unsubscribed shares through participating dealers were excepted from competitive bidding by the Commission pursuant to the provisions of paragraph (a)(5) of the rule.

Two other issues shown in the preceding table received only one bid each when offered for competitive bidding, and the Commission granted exceptions from the competitive bidding requirement so as to permit immediate acceptance of such bids. One of these was an offering of $50 million principal amount of 10-1/4 percent debentures due 1974 of General Public Utilities Corporation,[45] and the other was an offering of 50,000 shares of $9.40 cumulative preferred stock of The Potomac Edison Company, an electric utility subsidiary company of Allegheny Power System, Inc., a registered holding company.[46]

In fiscal 1969 the Commission approved a plan of reorganization under Section 11(e) of the Act, pursuant to which Pennzoil Company, then a registered holding company, and its gas utility subsidiary company, United Gas Corporation, were consolidated to form Pennzoil United, Inc., subject to a condition that Pennzoil United dispose of its interest in all of its gas utility properties.[47] Subsequently, the gas properties were transferred to United Gas, Inc., a new subsidiary company of Pennzoil United, which was authorized to invite bids for stand-by compensation on a proposed underwritten rights offering of United Gas common stock to the stockholders of Pennzoil United.[48] Following the failure to receive any bids for the United Gas stock, the proposed rights offering was excepted from the competitive bidding requirement of Rule 50 under the terms of paragraph (a)(5) thereof, and Pennzoil United attempted to negotiate an underwritten rights offering.[49] This attempt also was unsuc-

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[45] *General Public Utilities Corporation*, Holding Company Act Release Nos. 16540 (November 28, 1969) and 16550 (December 8, 1969).

[46] *The Potomac Edison Company*, Holding Company Act Release Nos. 16688 (April 21, 1970) and 16711 (April 30, 1970).

[47] See 34th Annual Report, p. 134; 33rd Annual Report, p. 121; and 32nd Annual Report, pp. 77–79.

[48] *Pennzoil United, Inc.*, Holding Company Act Release No. 16481 (September 23, 1969).

[49] *Pennzoil United, Inc.*, Holding Company Act Release No. 16717 (May 7, 1970).

cessful, and the Commission authorized Pennzoil United to make a nonunderwritten rights offering with subscriptions to be solicited by participating dealers.[50] In June 1970, Pennzoil United reported that 477,693 shares of the 4,056,714 shares of United Gas common stock had been subscribed by Pennzoil United stockholders and by the officers, employees, and directors of United Gas.[51] After the close of the fiscal year, the Commission was advised that 508,390 additional shares had been sold.

Vermont Yankee Nuclear Power Corporation applied for an exception from competitive bidding in respect of the proposed issuance and sale of $40 million principal amount of its first mortgage bonds, and the Commission ordered a hearing, but subsequently the application was withdrawn.[52] After the close of the fiscal year the Commission authorized Vermont Yankee Nuclear Power Corporation to issue and sell, pursuant to competitive bidding, $80 million principal amount of first mortgage bonds due 1998. Proceeds will be used to repay short-term borrowings from banks and from sponsors.[53]

On September 17, 1970, the Commission announced that no exceptions from the requirements of competitive bidding will be granted informally so as to permit negotiations with investment bankers for the purpose of either choosing a particular group of bankers to be the underwriters or to establish the terms and conditions under which the securities are to be sold. All such matters will be considered only by way of a formal application in accordance with the requirements of subparagraph (a) (5) of Rule 50.[54]

During the period from May 7, 1941, the effective date of Rule 50, to June 30, 1970, a total of 1,109 issues with an aggregate value of $18,462 million has been sold at competitive bidding under the rule. These totals compare with 245 issues of securities with aggregate value of $2,821 million which have been sold pursuant to orders granting exceptions under paragraph (a)(5) of the rule. Of the total amount of securities sold pursuant to such orders, 139 issues with a total value of $2,332 million were sold by the issuers, and the balance of 106 issues aggregating $489 million were portfolio sales. Of the 139 issues sold by the issuers, 73 were in amounts of from $1

[50] *Pennzoil United, Inc.*, Holding Company Act Release No. 16747 (June 2, 1970).

[51] *United Gas, Inc.*, Second Supplement to Prospectus dated June 2, 1970, File No. 2-33474-1.

[52] *Vermont Yankee Nuclear Power Corporation*, Holding Company Act Release Nos. 16521 (November 13, 1969) and 16665 (March 30, 1970).

[53] *Vermont Yankee Nuclear Power Corporation*, Holding Company Act Release No. 16866 (October 13, 1970).

[54] Holding Company Act Release No. 16832.

to $5 million each, 3 debt issues were in excess of $100 million each,[55] 2 stock issues totaling $36 million were issued in fiscal 1966 to holders of convertible debentures and employee stock options, and the remaining 61 issues were in amounts ranging from $5 million to $100 million.

Policy as to Refundability of Preferred Stock

During the fiscal year certain registered holding-company systems and other interested persons requested a modification of those provisions of the Commission's Statement of Policy Regarding Preferred Stock Subject to the Public Utility Holding Company Act of 1935 which required that preferred stocks issued and sold pursuant to the terms of Sections 6(b) and 7 of the Act be redeemable at the option of the issuer "at any time upon reasonable notice and with reasonable redemption premiums, if any." [56] On April 20, 1970, the Commission published an invitation for comments.[57] On June 22, 1970, the Commission adopted certain modifications of its Statement of Policy which permit the issuers of preferred stocks subject to the Act to include in the charters, by-laws, or related instruments defining the rights, preferences, and privileges of new issues of preferred stock, a provision prohibiting for a period of not more than 5 years the refunding of such stock by the issuance of debt securities at lower interest costs or other preferred stocks at lower dividend costs.[58] Theretofore, the general redemption prices of preferred stocks had been considered reasonable, within the meaning of the Statement of Policy, whenever such redemption prices did not exceed the sum of the initial public offering price plus (1) 100 percent of the annual dividend rate during the first 5 years, (2) 75 percent of the dividend rate in the second 5 years, (3) 50 percent of the dividend rate in the third 5 years, and (4) 25 percent of the dividend rate for the remainder of the life of the stock. In conformity with this formula, when the 5-year period of non-refundability authorized by the Commission expires, the general redemption price at which the preferred stock may then be called will be the same as it would have been if there had been no restriction on refundability.

The Commission's announcement stated that the modification of the redemption policy would not apply to the redemption of preferred stock upon voluntary liquidation or to redemptions in

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[55] *Ohio Valley Electric Corporation*, a $360 million bond issue; *United Gas Corporation*, a $116 million bond issue; and *Pennzoil Company*, a $135 million note issue maturing in 18 months sold to underwriters.

[56] Holding Company Act Release No. 13106 (February 16, 1956).

[57] Holding Company Act Release No. 16685.

[58] Holding Company Act Release No. 16758.

connection with mergers, sales of properties, or for other corporate purposes, and that, upon the occurrence of any of such events, the redemption price of the preferred stock was to be the same as if no restriction on refundability had been authorized. The Commission also emphasized that it would continuously review the effects of its redemption policies, including specifically the foregoing modification, and based upon experience with the modification make such adjustments in these policies as may from time to time be deemed appropriate, including a rescission of the modification, extension of the authorized five-year non-refunding period, or any other change experience would warrant.

PART VII

PARTICIPATION IN 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 in order to provide independent, expert assistance to the courts, the participants, and investors in a highly complex area of corporate law and finance. It pays special attention to the interests of public security holders who may not otherwise be represented effectively.

Where the scheduled indebtedness 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 a summary 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 is 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.

For purposes of carrying out its functions under Chapter X, the Commission has divided the country into five geographic areas. The

New York, Chicago, San Francisco and Seattle regional offices of the Commission each have responsibility for one of these areas. Each of these offices has lawyers, accountants and financial analysts who are engaged actively in Chapter X cases in which the Commission has filed its appearance. 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 fifth area.

SUMMARY OF ACTIVITIES

In the fiscal year 1970, the Commission continued to maintain a high level of activity under Chapter X. It entered its appearance in 19 new proceedings involving companies with aggregate stated assets of approximately $227 million and aggregate indebtedness of approximately $156 million. The corporations involved in these proceedings were engaged in a variety of businesses, including, among others, the manufacture of printing presses, textile machinery, and various steel products; the operation of a motor hotel, a ski resort, and fast food restaurants; real estate development; computer services; oil and gas drilling; and the sale of cemetery lots.

Including the new proceedings, the Commission was a party in a total of 107 reorganization proceedings during the year. The stated assets of the companies involved in these proceedings totaled approximately $1.05 billion and their indebtedness totaled approximately $860 million. The proceedings were scattered among district courts in 35 states and the District of Columbia as follows: 12 in New York; 10 in California; 9 in Arizona; 5 each in Florida, New Jersey, and Texas; 4 each in North Carolina, Louisiana, Pennsylvania, Indiana, Illinois, and Washington; 3 each in Oklahoma, South Dakota, and Hawaii; 2 each in West Virginia, Ohio, Kansas, Michigan, Arkansas, Nevada, and Utah; 1 each in Maryland, the District of Columbia, Tennessee, Alabama, Massachusetts, Connecticut, Colorado, Iowa, Kentucky, North Dakota, Wisconsin, Minnesota, Montana, and Idaho.

During the year, 12 proceedings were closed. As of the end of the fiscal year the Commission was a party in 95 reorganization proceedings.

JURISDICTIONAL, PROCEDURAL, AND ADMINISTRATIVE MATTERS

In Chapter X proceedings in which it participates, the Commission seeks to have the courts apply the procedural and substantive safeguards to which all parties are entitled. The Commission also attempts to secure judicial uniformity in the construction of Chapter X and the procedures thereunder.

In *American National Trust* and *Republic National Trust*,[1] the Court of Appeals for the Seventh Circuit, as urged by the Commission, affirmed[2] an order of the district court dismissing a motion by a certificate holder of the debtor trusts to vacate and set aside the orders approving reorganization petitions which had been filed by other certificate holders. The motion questioned the status of the petitioning certificate holders as creditors of the debtors and the good faith of the debtors' consent to the reorganization petitions. The court of appeals stated that any objections to the standing of the petitioning certificate holders as creditors of the trusts should have been raised at the hearing at which the petitions were finally approved by the court and trustees appointed, and it held that the orders approving the petitions had become final within the meaning of Section 149 of Chapter X which provides that an order approving a Chapter X petition which has become final is "a conclusive determination of the jurisdiction of the court."

Subsequent to the end of the fiscal year, the Supreme Court denied a petition for a writ of certiorari filed by the movant. In its brief in opposition to that petition, the Commission contended that the orders approving the petitions had become final, within the meaning of Section 149, when the times for filing contravening answers by the debtors or others pursuant to Sections 143 and 137 and the time within which to appeal from those orders had expired; that Section 149 precluded a subsequent vacation of the orders in the reorganization court or through collateral attack in a state court; and that, in view of the debtors' consent to the involuntary petitions, there was no need to satisfy the additional requirement of an involuntary petition as to the creditor status of the petitioners.

In *Imperial '400' National, Inc.*,[3] the Court of Appeals for the Third Circuit affirmed[4] an order of the reorganization court enjoining further prosecution in another court of an ordinary bankruptcy proceeding on behalf of a partnership which had a 25 percent interest in and operated a motel in which Imperial had a 75 percent partnership interest.[5] This motel is one of 97 motels each of which is owned by a separate partnership in which Imperial has more than a 50 percent general partnership interest and the remaining partnership interest is owned by local co-owners who operate the motel.

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[1] S.D. Ind., No. IP 68-B-447 and No. IP 68-B-609.

[2] *In the Matter of American National Trust*, 420 F.2d 1117 (C.A. 7, 1970), *cert. denied sub nom. Shanklin* v. *American National Trust and Republic National Trust*, 400 U.S. 823 (1970).

[3] D. N.J., No. B-656-65.

[4] *In the Matter of Imperial '400' National, Inc.*, 429 F.2d 671 (1970).

[5] See 35th Annual Report, pp. 161-162.

Agreeing with the Commission, the court of appeals emphasized that broad jurisdiction is vested in the reorganization court in order to achieve complete reorganization of a debtor in the Chapter X proceeding and that the term "property" as used in Section 111 of Chapter X, which gives the reorganization court " . . . exclusive jurisdiction of the debtor and its property, wherever located", should be broadly construed. The court also rejected the use of a "separate entity" concept of a partnership where strict adherence to it could defeat the broad purposes of reorganization. In that connection, the court restated in the following words the rationale of its landmark opinion in *In re Pittsburgh Railways Co.*:[6] "In order to effectuate the purpose of Chapter X proceedings . . . traditional concepts of property, title and separate entities may have to give way."

In another case concerning the motel involved in the appeal discussed above,[7] the court of appeals affirmed an order which had enjoined the lessor of the property on which the motel is situated from terminating the lease and obtaining possession of the premises, which had been constructed with Imperial's funds. In reaching its conclusion, the court construed the lease liberally in order to avoid a forfeiture.

In *Federal Shopping Way, Inc.*,[8] as previously reported,[9] the Commission participated in the debtor's appeal to the Court of Appeals for the Ninth Circuit from the order of the district court approving the petition for reorganization. The principal question was whether the appointment of a receiver *pendente lite* constituted the act of bankruptcy necessary to allow an involuntary petition for reorganization pursuant to Section 131(5) of Chapter X of the Bankruptcy Act. A related appeal from the district court's order by the Washington State Insurance Commissioner has been dismissed; only the debtor's appeal remains. In addition, an indictment was returned charging five of the debtor's promoters and officers with violations of the antifraud provisions of the Securities Act of 1933 and the Federal mail fraud and conspiracy statutes.[10] The above matters were pending at the close of the fiscal year.

In *Manufacturers' Credit Corporation*,[11] as previously reported,[12] the debtors, consisting of the parent and 25 affiliated and subsidiary

[6] *155 F. 2d* 477, 485, *cert. denied sub nom. Philadelphia Co.* v. *Guggenheim*, 329 U.S. 731 (1946).

[7] *In the Matter of Imperial '400' National, Inc.*, 429 F.2d 680 (C.A. 3, 1970).

[8] W.D. Washington, Northern Div., No. 61609.

[9] 35th Annual Report, p. 161.

[10] See Litigation Release No. 4644 (June 19, 1970).

[11] D. N.J., No. B-1084-67.

[12] 34th Annual Report, p. 160.

companies, were engaged primarily in the business of operating bus lines in New Jersey and vicinity. In affirming the order of the district court which had granted the Commission's Section 328 motion,[13] the Court of Appeals for the Third Circuit [14] agreed with the Commission that the proposed plan of arrangement under Chapter XI (which would have turned the companies over to the creditors, including the public noteholders) was not sufficient to protect the public investors and that the full safeguards of a Chapter X proceeding were required. Thereafter, amended petitions under Chapter X were filed for nineteen of the twenty-six corporations. However, when the trustee sought to extend the Chapter X proceeding to include the remaining seven corporations, answers were filed by two groups of creditors.

One group of creditors opposed the trustee's attempt to extend the Chapter X proceedings to four corporations which were indirectly wholly-owned by the parent. Pursuant to a settlement, supported by the Commission, Chapter X petitions for three of the four corporations were dismissed with the stipulation that if the financial conditions of those companies deteriorated, the trustee could then file Chapter X petitions for them. The financial conditions of all three companies did deteriorate and the trustee filed Chapter X petitions which were approved without opposition.

The second group of creditors opposed the extension of the Chapter X proceeding to three additional subsidiaries of the parent, claiming, among other things, that the group had a secured interest in all of the stock of those companies. The referee found that no valid pledge existed and that the Chapter X proceeding should be extended to cover the three companies. The Commission took the position that, on the basis of *In re Pittsburgh Railways*,[15] extension was both appropriate and necessary for the purpose of effectuating a unitary administration of the companies. The district court confirmed the referee's report and extended the Chapter X proceedings to include the three companies. An appeal to the Court of Appeals for the Third Circuit was dismissed pursuant to stipulation. All 26 companies of the Manufacturers' Group are now under Chapter X.

In *American National Trust* and *Republic National Trust*,[16] the Commission supported and the district court approved a petition of

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[13] *In the Matter of Manufacturers' Credit Corp., et al.*, 278 F. Supp. 384 (D. N.J., 1968).

[14] *In the Matter of Manufacturers' Credit Corp., et al.* v. *S.E.C.*, 395 F. 2d 833 (1968).

[15] 155 F. 2d 477 (C.A. 3, 1946).

[16] S.D. Ind., No. IP 68-B-447 and No. IP 68-B-609.

the trustee to reject, as executory, a contract which provided for the construction and sale to the debtors of a shopping center plaza and to order the return by the seller to the debtors of cash and real property found by the court to have been transferred by the debtors as security for the performance of the contract. The Court of Appeals for the Seventh Circuit [17] affirmed the rejection of the contract but reversed that portion of the order directing the return of the cash and real property on the basis that such order exceeded the summary jurisdiction of the court because the property was in the actual possession of the seller under a substantial adverse claim. The Commission had taken the position that the reorganization court had properly exercised its inherent equity power to restore the parties to their positions before the contract and thereby to avoid a windfall for the seller at the expense of the debtors' creditors and public investors.

In *Landmark Inns of Durham, Inc.*,[18] the debtor had leased certain lands in 1964 for a term of 52 years. Pursuant to the lease, the debtor built and operated a motel on the property. In 1969, the landlords, alleging various breaches of the lease agreement, including failure to make timely rental and mortgage payments, petitioned the Chapter X court to declare a forfeiture of the lease. The Commission, citing *In re Fleetwood Motel Corp.*,[19] argued that it would be inequitable to permit the landlords to secure possession of the debtor's principal asset as the result of a forfeiture, thereby defeating any possibility of a reorganization of the debtor in which the public had a substantial investment. After the close of the fiscal year, the referee denied the landlords' petition.

In *R. Hoe & Co., Inc.*,[20] involving a major manufacturer of printing presses, the trustee sought authorization to sell the debtor's principal asset, its press division, outside of a plan of reorganization. The Commission took the position that Section 116(3) of Chapter X did not authorize such sale and that a sale would be tantamount to a plan of reorganization stripped of the numerous statutory safeguards inherent in Chapter X. The district court, however, held that the sale was desirable and authorized it pursuant to Sections 115 and 116(3) of Chapter X.

In *TMT Trailer Ferry, Inc.*,[21] as previously reported,[22] the Su-

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[17] *In the Matter of American National Trust*, 426 F.2d 1059 (1970).

[18] M.D. N.C., No. B-198-69.

[19] 335 F. 2d 857 (C.A. 3, 1964).

[20] S.D. N. Y., No. 69-B-461.

[21] S.D. Fla., No. 3659-M-Bk.

[22] 35th Annual Report, p. 160.

preme Court reversed[23] the decision of the Court of Appeals[24] which had affirmed an order of the district court confirming a plan of reorganization, which provided, among other things, for compromises of major claims without hearings on the merits of objections to the claims or on the merits of the compromises. After an extensive evidentiary hearing before a special master on the smaller of the two disputed claims which the Supreme Court had remanded for further investigation, the trustee proposed a compromise of the claim. This compromise was opposed by the Protective Committee for Independent Stockholders. The Commission, although it had reservations as to the merits of certain aspects of the trustee's proposed compromise, determined that the compromise as a whole was not unreasonable in light of the extensive evidentiary record developed before the special master, and therefore did not oppose it. At the close of the fiscal year, the matter was still pending.

In *Spanish Language Television of Arizona, Inc.*,[25] a proceeding in which the Commission was not participating, the Commission called the court's attention to the fact that since the trustee whom the court had appointed had been an employee of the debtor within 1 year prior to the commencement of the reorganization proceeding, he was not disinterested within the meaning of Section 158 of the Bankruptcy Act. Shortly thereafter the trustee resigned and a successor trustee was appointed. In *York International Building, Inc.*,[26] also a non-participating case, the Commission secured the withdrawal of a claim of a corporation in which the trustee owned a substantial amount of stock in order to enable the trustee to meet the standard of disinterestedness established by Section 158.

TRUSTEE'S INVESTIGATION

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.

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[23] *Protective Committee etc.* v. *Anderson*, 390 U.S. 414 (1968).

[24] *Protective Committee etc.* v. *Anderson*, 364 F. 2d 936 (C.A. 5, 1966). See previous annual reports: 35th Annual Report, p. 160; 34th Annual Report, p. 153; 33rd Annual Report, p. 135; 32nd Annual Report, pp. 92-93; 31st Annual Report. p. 100; 30th Annual Report, p. 105: and 29th Annual Report, pp. 91-92.

[25] D. Ariz., No. B-69-1182-Phx.

[26] D. Hawaii, No. Bk-68-393.

In *Commonwealth Financial Corp.*,[27] as previously reported,[28] the former president of the debtor had moved for a protective order staying any attempts by the trustee to take his deposition in the course of the trustee's Section 167 investigation, on the ground that the Commission had no right to participate in that investigation. He alleged that the Commission was conducting a separate and independent investigation of the affairs of the debtor, including his activities, and that any information obtained by the Commission might be later used against him in a related criminal proceeding. The district court had denied the motion and the Court of Appeals for the Third Circuit had affirmed.[29] The depositions of the former president and the former secretary and counsel of the debtor were taken, but both witnesses asserted their privileges against self-incrimination.

REPORTS ON PLANS OF REORGANIZATION

Generally, the Commission files a formal advisory report only in a case which involves a substantial public investor interest and presents significant problems. When no such formal report is filed the Commission may state its view briefly by letter, or authorize its counsel to make an oral or written presentation to amplify the Commission's views.

During the fiscal year the Commission published one formal advisory report.[30] Its views on nine other plans were transmitted to the court either orally or by written memoranda.[31]

The Commission's only formal advisory report of the year[32] dealt with the trustee's plan for the reorganization of *Jade Oil & Gas Co.*,[33] a small, independent oil company. Although the company had a history of losses and was insolvent on a book basis, the plan gave the debtor's old common stockholders a 44 percent interest in the reorganized enterprise. The trustee's approach was based on the

[27] E.D. Pa., No. 30108.

[28] See 34th Annual Report, p. 152, and 35th Annual Report, p. 162.

[29] *In the Matter of Commonwealth Financial Corp.*, 408 F. 2d 640, *certiorari denied sub nom. Thal* v. *Commonwealth Financial Corp.*, 395 U.S. 961 (1969).

[30] *In re Jade Oil & Gas Co.*, C.D. Cal., Nos. 17312–F, Corporate Reorganization Release No. 289 (September 15, 1969).

[31] *In re Canandaigua Enterprises Corp.*, W.D. N.Y., No. Bk–63–1954; *In re Clute Corp.*, D. Colo., No. 32895; *In re Commonwealth Financial Corp.*, E.D. Pa., No. 30108; *In re First Holding Corp.*, S.D. Ind., No. IP–69–B–2936; *In re Little Missouri Minerals Association, Inc.*, D. N.D., No. W67–103; *In re Lusk Corp.*, D. Ariz., No. B–5696–Tuc.; *In re Norman Finance & Thrift Corp.*, W.D. Okla., No. 68–1007; *In re Tower Credit Corp.*, M.D. Fla., No. 66–171–Bk–T; and *In re Vinco Corp.*, E.D. Mich., No. 63–192.

[32] Corporate Reorganization Release No. 289 (September 15, 1969).

[33] C. D. Cal., Nos. 17312–F and 17313–F.

premise that small, independent exploratory oil companies are valued on the basis of projected cash flow rather than on the basis of probable "earnings" computed in accordance with generally accepted accounting principles. The Commission agreed that prospective cash flow was a key factor in the case, but pointed out that the cash flow concept must be used with caution, particularly in the case of a small oil company because (1) oil and gas are wasting assets; and (2) by making no provision for depletion, cash flow analysis makes no allowance for the need to generate funds to finance the exploration and development without which the enterprise is doomed to eventual extinction. The Commission also noted that the trustee had capitalized anticipated cash flow at a very high rate, which was said to have been based on the multiples at which the stocks of other small, speculative oil companies sold, and it observed that "market data that merely reflect composite assessments of the odds for or against lucky strikes and sensational finds—assessments shaped in large measure by extravagant intangibles—are much too shaky a foundation for judicial findings as to value and fairness." The Commission found that the stockholders' interest in the company was marginal at best. Accordingly, it concluded that the trustee's plan was unduly generous to the old stockholders at the expense of the public investors who held the debtor's debentures and of other unsecured creditors.

The Commission also found the proposed capital structure unsound. It noted that since the company was an oil company of the wildcat type, its stock would be extremely speculative in any event. That characteristic was to be accentuated by the plan, which called for the issuance of large quantities of preferred stock. The preferred would pre-empt such asset values and earning power as the company had, leaving the common an essentially spurious security. Moreover, the number of common shares to be issued was extremely large. This was bound to make the common stock even more volatile than it would otherwise be. The Commission recommended a simple all-common capital structure with a much smaller number of outstanding common shares than that envisaged by the plan.

One of the plan's key features was a proposal for raising the funds needed in order to consummate it through the sale of a new cumulative preferred. Since the company would be unable to pay cash dividends on this preferred, it was planned to pay dividends in common stock. The Commission observed that under this proposal the new investors' interest in the enterprise would be progressively enlarged at the expense of its old creditors. In addition, purchasers of the preferred were to receive a large number of warrants entitling them to purchase common stock. The Commission considered

these warrants inconsistent with the standards of Chapter X because they added still another speculative complication to an already dubious capital structure and gave the purchasers of the new preferred an opportunity for gain unaccompanied by any risk of loss and because their effect would be to give the new investors a disproportionate share of any future increments in the value of the business. The Commission was mindful of the high risks that the new investors would assume and of the need for appropriate compensatory incentives. It suggested, however, that such incentives be supplied by giving the new preferred a larger share of the total equity than the plan would have given rather than by way of warrants and massive stock dividends.

Although the district court did not agree with all of the Commission's criticisms and sustained an allocation of the equity interest in the reorganized company that the Commission believed unfair to creditors, it did impose severe limitations on the benefits to be given the purchasers of the new preferred.[34] The court refused to approve the plan unless amended so as to condition both the exercisability of the warrants and the declaration of the proposed common stock dividends on the new preferred on the attainment of a prescribed level of earnings. That level had not been reached at any time in the company's history, and there was no reasonable prospect of its being reached in the foreseeable future. Hence the warrants and the dividend rights of the new preferred were stripped of all practical effect.

The plan was amended to conform to the court's holding, voted on favorably by creditors and stockholders, and thereafter confirmed. Consummation was deferred, however, until the new preferred issue had been sold to the public. After the close of the fiscal year, a Securities Act registration statement with respect to that issue became effective.[35] A public offering followed.

In *Tower Credit Corporation*,[36] the Commission dealt with a plan for the reorganization of an insolvent consumer finance company.[37]

[34] The matter came before the court on the Commission's exceptions to a special master's report rejecting in toto its attack on the plan and recommending approval.

[35] File No. 2-36843.

[36] M. D. Fla., No. 66-171-Bk-T.

[37] For discussion of pre-plan phases of this proceeding, see 33rd Annual Report, p. 130, and 34th Annual Report, pp. 146-147. See also *S.E.C.* v. *Krentzman*, 379 F. 2d 35 (C.A. 5, 1968) where at an earlier stage of the case the court of appeals granted the Commission's petition for a writ of mandamus requiring the district judge to permit the Commission to cross-examine witnesses and to offer evidence. The court of appeals noted that limitations on the extent to which the Commission could participate in Chapter X proceedings would hamper it severely in carrying out its tasks as adviser to the court and protector of the public interest.

The plan called for continuing the company's consumer finance business. But that was incidental. Its main feature was a proposal for putting the debtor into the real estate business. The group of promoters who put the plan forward owned a large tract of heavily mortgaged, unimproved land. Under the plan they were to transfer that land to the reorganized company in exchange for a controlling block of its common stock.[38] Funds for an ambitious program of land development and for the rehabilitation of the company's badly debilitated loan business were to come from a projected post-reorganization public offering of a million shares of the reorganized company's common stock, at $10 a share. Although their plan turned on this hoped-for financing, the prospective reorganizers had been unable to obtain any underwriters. They stated that they hoped to interest some securities houses in the financing after the reorganization had been consummated.

The Commission found the plan unfeasible. Pointing out that there was no assurance that the massive flotation of new securities on which it turned would meet with a favorable reception in the market place, the Commission's memorandum observed that "without such successful offering the plan is merely a union of an ailing and anemic debtor and a barren real estate speculation." Accordingly, the Commission urged that the plan be amended so as to defer consummation and to reserve the court's jurisdiction over the debtor until the proceeds of the contemplated public offering had been received.

The proponents then amended their plan on several occasions. After lengthy hearings, a simple plan was finally developed as a result of negotiations among the Commission's staff, the trustee, and the proponents. The land acquisition and the projected public offering that had figured so prominently in the original plan were dropped. Instead, the reorganizers undertook to contribute cash to the reorganized enterprise. The Commission found this plan consistent with the statutory standards and recommended its approval. After the close of the fiscal year, an order of approval was entered. Creditors and stockholders then voted in favor of the plan, which was subsequently confirmed.

At the Commission's insistence, the plan included certain special investor protection features. The history of the proceeding showed that the plan proponents, who were to hold a controlling block of the reorganized company's stock and would also be its

[38] Extensive cross-examination of the proponents of the plan by Commission counsel showed that the cost of the land to the proponents had been materially overstated and that one of the two mortgages by which the property was encumbered had recently been created by the proponents in their own favor.

directors and officers, had a strong self interest in selling unimproved land to the reorganized company. It was also apparent that the proponents were likely to attempt to cause the reorganized company to confer large stock options on them. The Commission maintained that fairness required that decisions on these extremely important subjects be made after reorganization by a majority of the disinterested shareholders. After the court had indicated its agreement with the Commission's views, a provision was added to the plan requiring that for a period of 5 years after the plan's consummation purchases of unproductive real estate (other than those in the normal course of the reorganized company's business), the grant of stock options to officers and directors, and amendments to the certificate of incorporation be approved by a majority of the stock—exclusive of the stock owned of record or beneficially by the proponents of the plan.

In *First Holding Corp.*,[39] the plan provided that creditors whose claims were secured by mortgages were to receive real estate contracts receivable at face value in satisfaction of their claims. Non-public, unsecured creditors were to be issued 6 percent installment notes, while the public holders of the debtor's "collateral trust notes" and "convertible secured bonds" would receive the entire equity interest in the reorganized company. The Commission pointed out that the proposed plan was unfair in that it gave non-public creditors an unjustified preference over the public investors who held the debtor's "collateral trust notes" and "secured bonds". The Commission stressed that the holders of these "secured" bonds and notes might well be secured creditors and, if not, that they were at least unsecured creditors who should be treated equally with the other general creditors. The court, however, approved the plan.

In *Canandaigua Enterprises Corporation*,[40] as previously reported,[41] the district court considered a new plan of reorganization after vacating its order confirming a prior plan. The new plan, among other things, provided for stockholder participation, and payment to unsecured creditors of 50 percent in cash, with the remainder, including accrued debenture interest, to be paid in preferred stock of the reorganized company. The Commission opposed the new plan on the grounds that it was neither fair, equitable, nor feasible. The Commission found the plan unfair because, among other things, it provided for stockholder participation in the reorganization of an insolvent company. The Commission also stated that

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[39] S.D. Ind., No. IP-69-B-2936.

[40] W.D. N.Y., No. Bk-63-1954.

[41] See 35th Annual Report, p. 167, n. 41.

the plan was not feasible because there was no showing that the reorganized company would be able to raise approximately $5.4 million, the amount payable on redemption of the preferred stock 5 years after consummation, and because the plan established a reorganized company with an unsound capital structure in relation to its asset value and foreseeable earnings. The court approved the new plan and, over the objections of the Commission, confirmed it.

The indenture trustee for debenture holders appealed to the Court of Appeals for the Second Circuit from the orders of the district court vacating confirmation of the prior plan of reorganization and approving the new plan.[42] Subsequently, the new plan was accepted by 89 percent of the principal amount of debenture holders voting, and the indenture trustee moved to dismiss its appeal. While the Commission felt that the indenture trustee had a right to withdraw its appeal, it urged the court of appeals to preserve the opportunity for any debenture holder who might so desire to continue this appeal since the time for appeal from either order had expired and debenture holders might have relied on the trustee's appeal to protect their interests.[43]

In line with the Commission's recommendation, the court of appeals instructed the indenture trustee to notify all debenture holders at its expense of the fact that it was seeking to dismiss the appeal. The notice, which was to be approved by the district court, was to include an explanation of the reasons why the trustee took the appeal initially and why it now believed that the appeal should be dismissed and to state that any debenture holder who desired to continue the appeal could within 15 days substitute himself for the indenture trustee as appellant.

In *The Lusk Corporation*,[44] the trustee proposed a plan calling for liquidation of the debtor's assets and distribution of the proceeds to

[42] CA. 2, Nos. 34239 and 33330.

[43] The Commission argued that: (1) the motion to dismiss the appeal presented a situation not unlike that contemplated by Rule 23(e) of the Federal Rules of Civil Procedure, which provides that a class action may not be dismissed without approval of the court and specifies that notice of a proposed dismissal shall be given to all members of the class; (2) the representative aspect of persons taking an appeal in a Chapter X proceeding was noted in *Young* v. *Higbee Co.*, 324 U.S. 204 (1945), where the Supreme Court stated that two preferred stockholders who had appealed from an order confirming a Chapter X reorganization plan were representatives of the class of stockholders, even though the appellants there expressly disclaimed any intention to represent the class; and (3) in the case at bar, *a fortiori*, the indenture trustee as fiduciary for the class of debenture holders should not be permitted to withdraw its appeal without adequate protection for the entire class.

[44] D. Ariz., No. B-5696-Tuc.

its creditors, including public investors holding the debtor's subordinated debentures. Since those proceeds were insufficient to cover the creditors' claims, shareholders could not participate. Although the debtor's stock was worthless, the plan provided for the sale of such stock by the trustee to the debtor's former chief executive. The Commission pointed out that the purpose of this sale was obscure and that the proposal appeared to call for judicial approval of a scheme for perpetuating a mere corporate shell. Accordingly, the Commission urged that the plan be amended so as to defer the sale of the debtor's stock until evidence had been taken and a full record made with respect to the purpose and probable consequences of the proposed sale. The plan was amended in accordance with the Commission's suggestion. At the close of the fiscal year, the matter had not as yet been brought on for hearing.

In *Clute Corp.*,[45] the court, as recommended by the Commission, approved a plan which provided, among other things, for a compromise treating defrauded stockholders as creditors, but limiting each such stockholder's claim to half of the market price at the time of purchase.

In *Continental Vending Machine Corp.*,[46] the plan called for the liquidation of an insolvent enterprise and for participation by the public investors who held the debtor's subordinated debentures in the proceeds of the liquidation. Their right to participate stemmed from a controversy between them and the indenture trustee, who was also a senior creditor. The debenture holders and the debtor's trustee had contended that the indenture trustee, a commercial bank, had breached its fiduciary duties to the debenture holders by (1) making loans to the debtor which had the effect of artificially prolonging its existence and causing its financial position to deteriorate further to the debenture holders' detriment;[47] and (2) failing to take appropriate action to prevent the debtor's chief executive from diverting its funds to ventures of his own. The plan reflected a settlement by which the indenture trustee agreed to waive its senior position for the debenture holders' benefit, enabling the debenture holders to recover approximately 18 percent of their claims. After the Commission advised that the settlement was fair and that it considered the distribution to junior creditors thereunder consistent with the absolute priority rule, the plan was approved and confirmed.

In *Norman Finance & Thrift Corp.*,[48] the plan provided for the

[45] D. Colo., No. 32895.

[46] E.D. N.Y., No. 63-B-663.

[47] The debenture holders claimed that the debtor had agreed with the indenture trustee to refrain from drawing on the fund created by the loan.

[48] W.D. Okla., No. 68-1007.

reorganized company to issue stock which would be purchased by Triton Corp., the debtor's controlling stockholder. As consideration for the stock, Triton Corp. would contribute the cash necessary for the consummation of the plan and the payment of all administration costs through the final decree. Under the plan, the secured creditors were to receive the full value of their security upon its sale or other disposition. Holders of thrift certificates, investment accounts, debentures and all other unsecured creditors whose claims amounted to $100 or less were to receive a 40 percent cash payment. Those unsecured creditors and public investors whose claims were larger could choose between 40 percent in cash to be paid within 15 months after confirmation, or Triton Corp.'s own 4 percent non-cumulative, convertible preferred stock equal to the face amount of their claims. The debtor's preferred and common stock were to be cancelled, since the court found the debtor to be insolvent. The Commission advised the court that the plan failed to meet the statutory standards and purpose of Chapter X because (1) the plan was unfair and also violated Section 216(12)(a) by reason of its failure to provide for the election of directors by preferred stockholders in the event of a default in the payment of dividends to the preferred stock; (2) the turning over of the debtor's causes of action to the reorganized company violated Section 216(13); and (3) the absence of a provision for periodic reports to security holders violated Section 216(12)(b). The plan was amended to meet the Commission's objections, and then approved and confirmed by the court.

In *Little Missouri Minerals Association, Inc.*,[49] the trustee and the debtor each proposed a plan of reorganization. The court agreed with the Commission that the plan proposed by the trustee was fair, equitable and feasible while the debtor's plan was not. The trustee's plan called for the liquidation of the debtor, which had acquired mineral interests from individual landowners by fraud, and for the return of those interests to the defrauded landowners in exchange for the Class A stock originally issued to them. The debtor's plan provided for the company's restoration to its pre-reorganization status, with the mineral rights and corporate control continuing to reside with the former management. The Commission opposed the debtor's plan because it was manifestly unfair in keeping both the mineral rights acquired by fraud and corporate control in the hands of the former management. The Commission also pointed out that there was no prospect of obtaining the favorable vote required for confirmation.

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[49] D. N.D., No. W-67-103.

In *Rancho Montana de Oro, Inc.*,[50] a plan was proposed whereby all of the assets of the debtor were to be sold to an unrelated corporation in exchange for a large block of the purchaser's stock. This stock was then to be sold by the trustee to an investment banker for the purpose of public distribution, with the proceeds to be distributed to the debtor's creditors and sole stockholder. Since the plan proposed the sale of securities to the public without registration under Section 5 of the Securities Act of 1933, the Commission intervened in the Chapter X proceeding solely for the purpose of enforcing the Federal securities laws. While the Commission agreed with the contention of the trustee and the debtor that Section 3(a)(10) of the Securities Act would exempt the transaction between the purchaser-issuer and the trustee from the registration requirements of that Act, it contended that the exemption did not extend to any public offering by the trustee of the securities to be received. After a hearing on the plan the district judge, in a minute order, rejected the Commission's objections and approved the plan. The Commission filed a notice of appeal from the minute order.[51] The formal order subsequently entered upon the district judge's minute order held only that the Section 3(a)(10) exemption applied to the proposed transaction between the issuer and the trustee. The district judge expressly refused to find that the exemption would apply if the trustee sold the purchaser-issuer's stock to the public. The trustee then agreed to amend the plan so as to provide for the distribution of such stock directly to the administrative claimants and to the debtor's creditors in satisfaction of their claims with the balance to be distributed to the debtor's sole stockholder.

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 services 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 223 applications for compensation totaling about $5.4 million were reviewed.

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[50] C.D. Cal., No. 69708-TC.

[51] The Commission, having intervened solely for the purpose of enforcing the federal securities laws, took the position that the limitation of Section 208 (11 U.S.C. §608) respecting appeals by the Commission in Chapter X proceedings was inapplicable. See *S.E.C.* v. *Bloomberg*, 299 F. 2d 315 (C.A. 1, 1962).

In a decision involving *Imperial '400' National, Inc.*, the Court of Appeals for the Third Circuit considered an award of interim fee allowances by the district court to the reorganization trustee and his attorney. These allowances—$90,000 to the trustee and $125,000 to his attorney—were the third interim allowances during the reorganization proceeding and were based not only on their work during the third period but also on a reconsideration of services performed during the entire reorganization. The court of appeals reversed the order, holding that the district court had erred in considering the work done by the fee applicants during the entire reorganization proceedings, in the absence of a showing "that the previous interim awards did not adequately relieve any burden arising out of their service during the first two periods".[52] The court of appeals found the fees awarded to have been excessive when viewed in light of services performed during the third period. Because the record did not indicate what allowances of compensation would be necessary in order that the administration of the debtor's estate would be carried out as of the termination of the third period, the court held that the fee applicants had not sustained their burden of proof and remanded the case to the district court for definite findings and conclusions unless the creditors agreed to the allowances recommended by the Commission for the third period—$27,500 to the trustee and $45,000 to his attorney. In this connection, the court observed that the recommendations of the Commission on this matter "should be given great weight . . . [b]ecause of its experience in such matters, its impartiality, and its sole familiarity with the relevant facts of this case".

In *TMT Trailer Ferry, Inc.*,[53] as previously reported,[54] attorneys for the Protective Committee for Independent Stockholders applied for an interim allowance of $100,000 for services rendered and more than $20,000 reimbursement of expenses. Because the committee had rendered services for over 10 years and because the major services related to successful opposition to confirmed plans of reorganization, the Commission supported the application in principle but recommended an interim allowance of $60,000 for services rendered and $10,000 reimbursement of expenses. The attorney for the successor trustee, who had previously obtained an *ex parte* order from the district court vacating the court's previous determination that committee counsel were entitled to an interim award, opposed counsel's renewed application. He alleged that counsel had represented con-

[52] *In the Matter of Imperial '400' National, Inc.*, 432 F.2d 232 (1970).
[53] S.D. Fla., No. 3659-M-Bk.
[54] 35th Annual Report, p. 168.

flicting interests in attempting to obtain creditor status for those stockholders who were allegedly defrauded in the purchase of their stock and that the committee had exceeded the authority given it by stockholders in opposing reorganization plans which provided for no participation by stockholders in the reorganized company. The district court allowed committee counsel interim compensation of only $10,000 and $5,000 reimbursement of expenses.

Trustee's counsel had also proposed that the depositions of the individual members of the committee and committee counsel be taken and that this be done in Florida. The committee and its counsel applied to the district court for a protective order from the depositions and for instructions as to future participation in the reorganization proceeding. Since the committee members lived in New York and California, committee counsel lived in the District of Columbia and Florida, the facts which the trustee's counsel sought in his proposed depositions were, in the view of the Commission, either already a matter of record, irrelevant, or based on erroneous legal assumptions, and the activities of trustee's counsel tended to discourage active participation in the reorganization proceeding by representatives of public investors, the Commission supported the committee's motion for a protective order and instructions. The district court denied the motion.

The committee and its counsel obtained leave from the Court of Appeals for the Fifth Circuit to file an appeal seeking revision of the compensation award to the amounts originally requested. The Commission urged the court to increase the award to the amounts it had recommended to the district court. In addition, the committee and its counsel, with the Commission's support, appealed separately the district court's denial of its motion for a protective order and instructions. At the close of the fiscal year both appeals were still pending.

In Canandaigua Enterprises Corporation,[55] the trustee, who had been granted a first interim allowance of $100,000 in the prior year, applied for a second interim allowance of $200,000 for services rendered by himself and his law firm [56] since the beginning of the proceeding. The Commission urged that the application be viewed as separate requests for interim allowances by the trustee and his law firm, since the services rendered were by separate persons and distinguishable. The Commission also contended that the application

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[55] W.D. N.Y., No. Bk-63-1954.

[56] No attorney for the trustee was appointed during these proceedings. In the interest of economy the court advised the trustee to act as his own attorney, and, if necessary, to utilize the services of members of his firm.

should be viewed as a request for an interim allowance for the 9½ month period since entry of the order granting the first interim allowance, because an adjustment of the first award, absent unusual circumstances not present in this case, would militate against orderly administration of the estate. Accordingly, the Commission recommended awards of $7,500 and $10,000 to the trustee and his law firm, respectively. The court, however, granted a single award of $100,000 to the trustee as an additional allowance on account of services rendered since the inception of the proceeding in December 1964.

In *Manufacturers' Credit Corporation*,[57] as previously reported,[58] the court granted the Commission's motion under Section 328, and subsequently approved Chapter X petitions for the parent corporation and 18 subsidiaries. The Chapter XI receiver and his two attorneys sought interim allowances totaling $150,000 from the Chapter X and XI estates for services rendered while the debtors were in Chapter XI. The referee recommended interim awards of $40,000 to the receiver and $35,000 to each of his attorneys, allocating 70 percent to the Chapter X companies and 30 percent to the Chapter XI companies on the basis of the relative income of the debtors involved rather than of services rendered. The Commission opposed the award of interim allowances, urging that in Chapter X, in order to assure the prompt and efficient rendition of services, interim allowances are appropriate for officers of the court who continue to render substantial services to the estate, but not to the Chapter XI receiver and his attorneys whose services had, for the most part, ceased. The Commission also pointed to the stringent cash position of the estate. The district court confirmed the referree's report and granted the interim allowances, but provided for installment payments over a period of 6 months.

In *Roberts Company*,[59] the trustee and his two attorneys made application for interim compensation at the rate of $4,000 per month each for the trustee and his senior attorney, and $2,000 per month for the trustee's junior attorney. After an evidentiary hearing the Commission filed a memorandum recommending that the maximum interim compensation of the trustee and his senior attorney be set at $3,000 per month. The Commission further recommended that the trustee's junior attorney, who was not involved in the major functions to be performed in the proceedings, be considered as functioning as the debtor's house counsel, and be compensated as such. It recommended that he be retained at a salary of $2,000 per month,

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[57] D. N.J., No. B-1084-67.

[58] See 34th Annual Report, p. 160. See also 35th Annual Report, pp. 168-169.

[59] M.D. N.C., No. B-37-70.

but that this be considered as payment in full. The referee agreed with the Commission's position regarding the application of the trustee and his senior attorney, but the district court awarded all applicants the full sums requested as interim compensation.

In *Swan-Finch Oil Corp.*,[60] the trustee, who had been granted $490,000 as a final allowance 4 years earlier, applied for a second final allowance of $250,000 for services rendered since the previous award, and counsel for the trustee, who had received no prior award, applied for a final allowance of $162,500. The Commission recommended a $60,000 allowance to the trustee in view of the substantial final allowance already awarded, the statement by the court four years earlier that the trustee was expected to render some further services for which he was to make no further claim, and the lack of time records, balanced against the inherent complexity of the estate and the trustee's contribution. The Commission recommended $90,000 for counsel to the trustee in view of the facts that amounts recovered for the estate while counsel served the trustee were not attributable solely to his efforts, the services rendered in some measure merely duplicated the trustee's work, and counsel could not be expected to be remunerated at the rates customarily charged private clients in commercial matters. The court awarded $65,000 to the trustee and $100,000 to counsel for the trustee.

In *Webb & Knapp, Inc.*,[61] counsel for the trustee and the trustee, each of whom had been granted three interim allowances totaling $335,000 and $60,000, respectively, applied for a fourth interim allowance of $200,000 and $25,000, respectively, for services rendered during a 22-month period. The Commission recommended deferral of counsel's application with the alternative recommendation that if the court were to make some award, it should not exceed $75,000. The recommendation for deferral was based on the substantial amount requested; the uncertainty as to what would be ultimately available for final allowances, in view of a $35,000,000 Internal Revenue Service claim; the fact that most of the estate's assets had already been liquidated, making reorganization impossible; and the substantial prior awards. The Commission recommended that no further interim award be made to the trustee in view of the above factors and particularly since the trustee had not rendered such substantial services as to warrant an interim award in order to alleviate economic hardship. After the close of the fiscal year, the court held that a decision on the applications should be deferred so as to permit

[60] S.D. N.Y., No. 93046.

[61] S.D. N.Y., No. 65-B-365.

clarification of the status of the tax claims, on which the future course of the proceedings in large part depended.

INTERVENTION IN CHAPTER XI PROCEEDINGS

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.

In *Federal Coal Company*,[62] the debtor had at the time of its organization made a public offering of units consisting of long-term debentures and common stock. Massive interest arrearages accumulated over the years because of the debtor's inability to pay the interest due the debenture holders.[63] When the debentures matured, this accrued but unpaid interest was far in excess of the principal. The debtor then sought to effect a Chapter XI arrangement with the debenture holders, who were its only creditors. Under the proposed arrangement persons whose debentures were in principal amounts of less than $1,000 were to receive a modest cash settlement in full satisfaction of their claims.[64] The claims of those who held debentures in the principal amount of $1,000 or more were to be scaled down to 40 percent of principal. These larger holders were to receive new long-term debentures in that reduced amount. Contending that the arrangement would effect a drastic revision of the rights of almost 2,000 public investor creditors and that the debtor's history raised questions calling for an investigation by a disinterested Chapter X trustee, the Commission moved for dismissal pursuant to Section 328. That motion was opposed by the debtor which argued that Chapter XI was appropriate because its stock was held by the same people who held its debentures. The district court rejected the debtor's contentions and granted the Commission's motion.[65] In its opinion the court pointed out that although all the debentures had originally been held by the stockholders in amounts directly proportional to their stock holdings and although there was still a large degree of

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[62] S.D. W. Va., No. 69-270.

[63] Interest was due only if earned. But the debenture holders were entitled to accrued interest at maturity.

[64] The proposed payment was 30 percent of principal, which was only about 12 percent of the total of principal plus accrued interest.

[65] The opinion is unreported.

overlapping between the debenture holders and the stockholders, the two groups were no longer identical. The court also stated that even had there been such identity, that factor would not be controlling because "the safeguards of Chapter X afford greater protection to creditors and stockholders alike by providing greater judicial control over the entire proceedings, together with impartial and expert administrative assistance in corporate reorganizations through the active participation of the S.E.C., as well as the appointment of a disinterested trustee." From this determination the debtor appealed after the close of the fiscal year.

In *Security Savesco, Inc.*,[66] creditors made a Section 328 motion. When the court asked for the Commission's views with respect to that motion, the Commission appeared and participated in the development of an evidentiary record. After reviewing that record, the Commission advised the court that it was unable to support the motion. The movants thereafter consented to the denial of their motion.

The debtor dealt in single-family dwellings. It purchased such properties, assumed the mortgages to which they were subject, and then resold them to people who intended to occupy them. The buyers agreed to make stipulated monthly payments to the debtor over protracted periods. A buyer was entitled to a deed only after he had made all his payments. If a buyer was unable or unwilling to continue with his payments, the debtor would repossess the house. But the debtor had no claim against such a defaulting buyer for the payments that were to be made over the remaining portion of the contract period.[67]

The debtor had virtually no equity capital. The small amount of stock that had been issued was held by management. The debtor had financed itself by selling approximately $12 million of demand and short-term debt securities to some 4,500 investors. Operations had been unprofitable, with the resulting deficits being covered by the sale of new debt securities. When continued deficit financing became impossible, the debtor was constrained to seek relief under Chapter XI. Shortly before the filing of the petition, the old control group had sold its stock to an experienced entrepreneur, who had not previously been affiliated with the company. Concluding that the debtor's business was uneconomic and incapable of rehabilitation, new management proposed a Chapter XI arrangement predicated on the gradual liquidation of the debtor's inventory of repossessed homes

[66] W.D. Wash., No. 66820.

[67] Two of the Chapter X cases in which the Commission is participating involve debtors engaged in real estate enterprises of this type, *Arlington Discount Co.*, S.D. Ohio, No. 48421; *First Holding Corp.*, S.D. Ind., No. IP-69-B-2936.

and real estate receivables, and reinvestment of the proceeds in types of commercial financing with which the company's new chief executive had considerable previous experience.

Under the proposed Chapter XI arrangement the public creditors were to receive a 55 percent cash distribution over a 7-year period and half of the equity interest in the reorganized company; the old stock was to be extinguished; and the new chief executive would receive the other half of the new stock in return for a contribution of new assets and his undertaking to manage the company without compensation until the public investors had received all of the cash distributions to which they were entitled under the arrangement.[68]

The creditors who moved for dismissal of the Chapter XI proceeding contended that since the proposed arrangement entailed a drastic revision of the rights of public creditors, Chapter XI was unavailable. The debtor replied that Chapter XI was appropriate because a complete change in management had already been effected and because this Chapter XI proceeding, in view of the peculiar circumstances involved, was assertedly more akin in substance to a Chapter X proceeding than to the normal Chapter XI proceeding. The Commission noted its emphatic disagreement with the suggestion that the proceeding was really tantamount to one under Chapter X.

In concluding that it was unable to support the creditors' motion, the Commission stressed the uneconomic character of the debtor's business, observing that "in the face of the debtor's history and the character of its business, to speak of a 'reorganization' as that word is generally understood in a Chapter X context is to engage in hyperbole." Relief under Chapter X being barred and liquidation being a pressing economic necessity, the real question in the case was whether the business was to be liquidated gradually in Chapter XI or rapidly in ordinary bankruptcy. On that issue the Commission took no position. Nor did it choose to express an opinion as to whether Chapter XI permits the confirmation of an arrangement under which an existing business is to be liquidated and the proceeds used to launch a new and quite uncertain venture.

The Commission suggested that if the court did confirm the arrangement, certain amendments would be appropriate to assure the public investors of representation on the board of directors and to minimize the likelihood of uninformed, speculative trading in the

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[68] No dividends or other distributions are to be paid or accrued on the new chief executive's shares until the creditors receive all of the cash to which the plan entitles them.

new common stock, the value of which would remain conjectural for many years.[69]

Efforts are sometimes made to misuse Chapter XI so as to deprive investors of the benefits of the Securities Act and the Securities Exchange Act. When such cases come to the attention of the Commission's staff, it normally attempts to resolve the problem by informal negotiations with the debtor's counsel. When such negotiations prove fruitless or there appears to be a deliberate effort to evade the statutes administered by the Commission, the Commission intervenes in the Chapter XI proceeding to assist in the development of an adequate record, direct the court's attention to the applicable provisions of the Federal securities laws, express its views as to their bearing on the particular case, and thus discharge its statutory investor protection responsibilities.

In *United States Research Corporation*,[70] the debtor used deceptive materials in order to induce its creditors to consent to the proposed arrangement. The funds needed to consummate the arrangement were to come from an unregistered offering of additional stock to present stockholders. That offering was already in progress and was being made with the aid of the same misleading material that had been disseminated to creditors. After the Commission had intervened and developed the facts, the court adjudicated the debtor a bankrupt.

In *Realsite, Inc.*,[71] the proposed arrangement called for the issuance of some 1.5 million shares of the debtor's stock to a small group of persons who were to contribute certain properties to the debtor and to take control of it after consummation.[72] The plan of arrangement stated that the shares in question were to be issued "pursuant to Section 393 of the Bankruptcy Act", which exempts certain trans-

[69] The latter result was to be achieved by a sharp reduction in the number of shares to be issued. Under the plan, as originally proposed, one share would have been issued for each $10 in claims. The Commission recommended that one share be issued for each $100 in claims.

[70] N.D. Ga., No. 67509.

[71] S.D. Fla., No. 63-244-Bk-CF.

[72] This was originally a Chapter X proceeding. After six years of administration under that chapter, a plan was proposed which the Commission considered and which the court found unfeasible. See 35th Annual Report, p. 166. The court then found that no plan of reorganization was feasible and adjudicated the debtor a bankrupt. The proceeding thus became one in ordinary bankruptcy. The debtor thereupon availed itself of the right to file a Chapter XI petition given it by Section 321 of that chapter, which provides that "A debtor may file a petition under this chapter in a pending bankruptcy proceeding. . . ."

actions in securities issued to creditors in Chapter XI proceedings from the registration requirements of the Securities Act. The Commission intervened to point out that this claim to an exemption from registration was invalid. In urging the court to strike the offending reference to Section 393 from the plan of arrangement, the Commission pointed to the text of that section, exempting from registration under the Securities Act "any transaction in any security issued pursuant to an arrangement in exchange for claims against the debtor or partly in exchange and partly for cash and/or property . . .", and noted its historic position that the section applies only to transactions with persons who were creditors at the time the petition was filed. The Commission's memorandum said:

> "The prospective recipients of these shares have no 'claims against the debtor'. They are people who are eager to sell the debtor something in exchange for its stock. Section 393 promotes arrangements between embarrassed debtors and their creditors by facilitating the issuance of new securities by the former to the latter. It was not meant to enable promoters to manufacture 'free' stock for themselves by putting assets into a dormant corporation that happens to have wound up in Chapter XI."

The debtor subsequently amended its arrangement so as to delete the incorrect claim to a Securities Act exemption. The amended arrangement was confirmed and consummated after the Commission's staff had made it clear to all concerned that the shares to be issued in exchange for property had to be taken for investment and not with a view to distribution pursuant to the exemption from registration for "transactions by an issuer not involving any public offering" provided for by Section 4(2) of the Securities Act, and that any public offering of those shares would be unlawful unless such offering were registered under the Securities Act or some exemption from registration was available.

Sports Arenas, Inc.,[73] was another case in which an effort was made to claim a Section 393 exemption for securities to be issued in exchange for property to be contributed to the debtor rather than for "claims against the debtor" of which Section 393 speaks. The Commission intervened and succeeded in obtaining a commitment from the prospective recipients to take the securities for investment. The plan of arrangement that was eventually confirmed provided that the shares to be issued in exchange for property would bear an appropriate restrictive legend.

In *Atlantic General Fiberglass Products, Inc.*,[74] and in *White Electromagnetics, Inc.*,[75] the Commission at the request of the court

[73] C.D. Cal., No. 38368–HP.

[74] S.D. Ala., No. 29,541.

[75] D. Md., No. 14012.

attended the first meetings of creditors called for by Section 334 of Chapter XI to assist in the development of adequate records on the feasibility of the proposed arrangements and on their compatibility with the best interests of creditors. Both debtors proved unable to proceed with their plans, and each was adjudicated a bankrupt.

PART VIII

SUPPORTING ACTIVITIES

PUBLIC INFORMATION SERVICES

Dissemination of Information

As the discussion in prior sections of this Report indicates, most large corporations in which there is a substantial public investor interest have filed registration statements or registration applications under the Securities Act or the Securities Exchange Act with the Commission and are required to file annual and other periodic reports. Widespread public dissemination of the financial and other data included in these documents is essential if public investors generally are to benefit by the disclosure requirements of the securities laws. This is accomplished in part by distribution of the prospectus or offering circular in connection with new offerings. Much of the data reflected therein and in the annual and other periodic reports is also reprinted and receives general circulation through the medium of securities manuals and other financial publications, thus becoming available to broker-dealer and investment adviser firms, trust departments and other financial institutions and, through them, to public investors generally. The documents mentioned above are also available for public inspection both at the offices of the Commission and at the exchanges on which particular securities may be listed.

Various activities of the Commission also facilitate public dissemination of information filed as well as other information. Among these is the issuance of a daily "News Digest" which contains (1) a resume of each proposal for the public offering of securities for which a Securities Act registration statement is filed; (2) a list of issuers of securities traded over-the-counter which have filed registration statements under the Securities Exchange Act; (3) a list of companies which have filed periodic reports disclosing significant corporate developments; (4) a summary of all notices of filings of applications and declarations, and of all orders, decisions, rules and rule proposals issued by the Commission; (5) announcements of the Commission's participation in corporate reorganization proceedings under Chapter X of the Bankruptcy Act and of the filing of advisory reports of the Commission on the fairness and feasibility of reorganization plans; (6) a brief report regarding actions of courts in

litigation resulting from the Commission's law enforcement program; and (7) a brief reference to each statistical report issued by the Commission. During the year, the News Digest included summary reports on the 4,038 Securities Act registration statements filed with the Commission (not including investment company offering proposals filed as amendments to previously filed statements), 1,099 notices of filings, orders, decisions, rules and rule proposals issued by the Commission, 297 developments in litigation under its enforcement program, 9 releases on corporate reorganization proceedings, and 81 statistical releases.

The News Digest is made immediately available to the press, and it is also reprinted and distributed by the Government Printing Office, on a subscription basis, to some 4,440 investors, securities firms, practicing lawyers and others. In addition, the Commission maintains mailing lists for the distribution of the full text of its orders, decisions, rules and rule proposals.

These informational activities are supplemented by public discussions from time to time of legal, accounting and other problems arising in the administration of the Federal securities laws. During the year, members of the Commission and various staff officers made speeches before a number of professional, business and other groups interested in the Federal securities laws and their administration and participated in panel discussions of like nature. Participation in these discussions not only serves to keep attorneys, accountants, corporate executives and others abreast of developments in the administration of those laws, but it also is of considerable value to the Commission in learning about the problems experienced by those who seek to comply with those laws. In order to facilitate such compliance the Commission also issues, from time to time, general interpretive releases and policy statements explaining the operation of particular provisions of the Federal securities laws and outlining policies and practices of the Commission.

Publications.—In addition to the daily News Digest, and releases concerning Commission action under the Acts administered by it and litigation involving securities violations, the Commission issues a number of other publications, including the following:

Weekly:

- Weekly trading data on New York Exchanges: Round-lot and odd-lot transactions effected on the New York and American Stock Exchanges (information is also included in the Statistical Bulletin).

Monthly:

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

Quarterly:

- Financial Report, U.S. Manufacturing Corporations (jointly with the Federal Trade Commission).[a] (Statistical Series Release summarizing this report is available from the Publications Supply Unit.)
- Plant and Equipment Expenditures of U.S. Corporations (jointly with the Department of Commerce).
- New Securities Offerings.
- Working Capital of U.S. Corporations.
- Stock Transactions of Financial Institutions.

Annually:

- Annual Report of the Commission.[a]
- Securities Traded on Exchanges under the Securities Exchange Act of 1934.
- List of Companies Registered under the Investment Company Act of 1940.
- Classification, Assets and Location of Registered Investment Companies under the Investment Company Act of 1940.[b]
- Private Noninsured Pension Funds (assets available quarterly in the Statistical Bulletin).
- 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] (Out of print, available only for reference purposes in SEC Washington, D. C. and Regional Offices.)
- Securities and Exchange Commission—The Work of the Securities and Exchange Commission.
- Commission Report on Public Policy Implications of Investment Company Growth.[a]
- Cost of Flotation of Registered Equity Issues, 1963–1965.[a]
- Report of SEC Special Study of Securities Markets.[a] (Out of print, available only for reference purposes in SEC Washington, D. C. and Regional Offices.)

[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.

Availability of Information for Public Inspection

The many thousands of registration statements, applications, declarations, and annual and periodic reports filed with the Commission each year are available for public inspection and copying at the Commission's public reference room in its principal offices in Washington, D.C. Also available at that location are other documents contained in Commission files and indexes of Commission decisions.

The categories of materials which are available for public inspection and copying are specified in the Commission's rule concerning records and information, 17 CFR 200.80, as revised to implement the provisions of the Public Information Amendment to Section 3 of the Administrative Procedure Act which became effective July 4, 1967. The rule also establishes a procedure to be followed in requesting

records or copies thereof, provides a method of administrative appeal from the denial of access to any record, and provides for the imposition of fees when more than one-half man-hour of work is performed by members of the Commission's staff to locate and make available records requested.

The Commission has special public reference facilities in the New York and Chicago 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 pursuant to the Securities Exchange Act by 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 indexes of Commission decisions. Additional material is available in the New York, Chicago and San Francisco regional offices.

Members of the public may make arrangements through the public reference room at the Commission's principal offices 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 12 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 microfilm and microfiche 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, 9-K, 8-K, N-1Q and N-1R under the Securities Exchange Act of 1934 or the Investment Company Act of 1940; 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 whose securities are listed on the New York Stock Exchange, the American Stock Exchange, or regional stock exchanges, or traded over-the-counter, and standard industry classifications (S.I.C.). Arrangements also may be made to subscribe to reports of companies of one's own selection. The subscription services system may be extended to further groups of filings in the future if demand warrants. The company also will supply, at reasonable prices, copies in microfiche or micro-

film form of other public records of the Commission desired by a member of the public. Microfiche readers and reader-printers have been installed in public reference areas in the Commission's headquarters office and New York Regional Office, and sets of the microfiche are available for inspection there.

Visitors to the public reference rooms of the Commission's Washington, D.C., New York and Chicago offices also may make immediate reproductions of material in those offices on coin-operated copying machines at a cost of 25 cents per 8½" x 14" 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 service and copies may be obtained from the Public Reference Section of the Commission.

Each year, many thousands of requests for copies of and information from the public files of the Commission are received by the Public Reference Section in Washington, D.C. During the 1970 fiscal year, 12,496 persons examined material on file in Washington and several thousand others examined files in the New York, Chicago, and other regional offices. More than 31,424 searches were made for information requested by individuals and approximately 13,320 letters were written with respect to information requested.

Rule Concerning Publication of Interpretative and "No-Action" Letters

In September 1968, the Commission had published a request for comments as to whether staff interpretative and "no-action" letters should be made available to the public.[1] Interpretative letters are informal opinions regarding the application of the law to contemplated factual situations. In a "no-action" letter, an authorized staff official states with respect to a specified proposed transaction that the staff will not recommend to the Commission that it take enforcement action if the transaction is consummated in the manner described in the incoming letter.

The Commission received numerous comments in response to the release, the overwhelming majority favoring public disclosure of the matters treated in interpretative and "no-action" letters in one form or another. It was suggested, however, that a means be found to give confidential treatment to sensitive matters.

Shortly after the end of the fiscal year, the Commission published for comment a proposed rule (17 CFR 200.81) concerning the publication of interpretative and "no-action" letters, and subsequently it adopted the rule in modified form.[2]

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[1] Securities Act Release No. 4924 (September 20, 1968).

[2] Securities Act Release No. 5073 (July 14, 1970); Securities Act Release No. 5098 (October 29, 1970).

Section 200.81 provides that no-action and interpretative letters submitted on or after December 1, 1970 and the responses thereto will be available for public inspection or copying 30 days after the staff has given or sent the response to the person requesting it. In particular cases where it appears that a further delay in publication would be appropriate, the letter and response thereto will be given confidential treatment for a reasonable period not exceeding an additional 90 days upon application therefor. The burden will be on the person requesting the no-action position or interpretation to establish the need for confidential treatment and it will not be granted unless such need is clearly shown. Only in exceptional situations, such as mergers or acquisition programs, will the full 90-day period be allowed.

It is contemplated that from time to time, where the subject matter of a no-action or interpretative letter is of particular interest or importance, such letter and response thereto will be published in summarized form in the Commission's daily News Digest. This will call attention to the position taken in the staff's response and interested persons can, if they so desire, inspect the full text of the letter and response thereto in the public file. In addition, copies of the letter and response may be purchased at prescribed rates by writing to the Public Reference Room, Securities and Exchange Commission, Washington, D.C. 20549.

A note to paragraph (b) of the rule requires that all requests for interpretative advice or a no-action position shall indicate in a separate caption at the beginning of the request each section of the Act or rule involved. If more than one section or rule is involved, a separate copy of the request must be submitted for each such section or rule and an additional copy for the use of the staff of the Commission. The note was added in response to comments on the proposed rule which indicated concern that the requests and responses thereto should be available in a form which will facilitate reference to those relating to a particular section or rule.

The Commission pointed out that no-action and interpretative responses by the staff are subject to reconsideration and should not be regarded as precedents binding on the Commission.

ELECTRONIC DATA PROCESSING

During the 1970 fiscal year the Commission continued the implementation and improvement of existing and planned uses of EDP which were described in previous annual reports. In addition, opera-

tional support was provided to the Institutional Investor Study for the creation, editing and maintenance of its data files.

Extension of Application of Automation Techniques

In a further expansion of the use of automation for analysis of data related to the financial structure of business and the economics and practices of the securities industry, several new systems were developed and are currently in varying stages of implementation.

One of these is a system for compiling and analyzing plant and equipment expenditure data reported quarterly by approximately 1700 selected firms. This system, which became operational in the last quarter of the fiscal year, is one of the most important of the recurring statistical programs conducted within the Office of Policy Research. It is used extensively within the Government by agencies involved in business and economic analysis and is crucial to Government decisions relating to monetary and fiscal policies.

Another system, which can be categorized as a general purpose file management system, was developed primarily for use by the Institutional Investor Study for the creation and maintenance of the many data files to be used in its analysis of questionnaire data submitted by firms covered in the study. As a result of its successful use in that project, this program package is being applied by the permanent staff of the Commission to several of its new EDP projects.

A coordinated effort was also begun to study the feasibility of utilizing the CUSIP numbering system in Commission reporting and record-keeping activities. This numbering system provides a standard method for the identification of specific issuers and issues within the securities industry. Another system, for which preliminary work began in fiscal year 1970, is to be used for the compilation of periodic workload statistics and to generate various reports and analyses reflecting complaint processing operations.

As time and other resources permit, the use of EDP will be extended to other areas of Commission activities.

Assistance to State and Federal Agencies

The Commission continued, during this past year, to provide certain information from its computer files to State authorities, self-regulatory institutions and other Federal agencies as described in previous annual reports.[3]

Sharing of EDP Facilities

During the past year the Commission continued its sharing arrangement with the Naval Ship Engineering Center, Department of

[3] See 34th Annual Report, p. 168; 35th Annual Report, p. 179.

the Navy. Under this arrangement the Commission provided approximately 2400 hours of computer time at a significant savings to the Government as compared with the prevailing rates of outside sources. Due to changes in Department of the Navy programs, this arrangement was terminated on June 30, 1970.

In an effort to continue the important Government-wide sharing program, the Commission entered into an arrangement to provide a maximum of 150 hours of computer time to the General Accounting Office in fiscal year 1971, and it is currently negotiating similar arrangements with several other Federal agencies.

EDP Training

During the year the Commission continued its training programs geared to the specific needs of its computer specialists and operators. The program is designed to enable the Commission's EDP staff to utilize more advanced hardware and programs in the development and implementation of new and revised computer systems.

PERSONNEL AND FINANCIAL MANAGEMENT

Personnel Program

Highlights of the Commission's personnel management program in fiscal 1970 included (1) adoption of a personnel management evaluation system, (2) continued emphasis on employee training, (3) the granting of the first SEC "Equal Employment Opportunity Award," and (4) the transfer of its occupational health function to the Public Health Service.

The President requested that there be established in each agency a system to review periodically the effectiveness of personnel management within the organization. Pursuant to this directive, the Commission adopted such a system on June 15, 1970. A Personnel Management Evaluation Committee, chaired by the Executive Assistant to the Chairman, was given responsibility for implementing the system by means of surveys or studies which are designed to measure how effectively the Commission's personnel programs operate in its various divisions and offices. Reports containing findings and recommendations of the Committee will be submitted to the Chairman.

Each of the three principal operating divisions of the Commission in Washington, D.C., namely, the Division of Trading and Markets, the Division of Corporation Finance, and the Division of Corporate Regulation, regularly conducts its own training program. Such a program typically consists of a schedule of lectures and discussions by senior employees on the Commission's staff experienced in the particular subjects to be covered. The Division of Trading and Mar-

kets conducted a week-long enforcement seminar in May 1970. The Division of Corporate Regulation conducted a training program after hours during the spring of 1970, primarily for its newer employees, dealing with the Investment Company Act of 1940. The Division of Corporation Finance held weekly sessions for its new employees on the examination of registration statements and other filings under the reporting and disclosure provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934.

The Commission's first Equal Employment Opportunity Award was presented to its Washington, D.C., Regional Administrator, Alexander J. Brown, Jr., "for outstanding service as SEC coordinator of a symposium on the Federal securities laws, sponsored by the Howard University School of Law, in cooperation with the Securities and Exchange Commission, during February through May 1970, for interested students attending Washington Metropolitan Area law schools." The program involved an 11-week series of evening lectures providing a broad overview of SEC functions and responsibilities in which members of the Commission's staff served as the "faculty." A group of 250 law students enrolled for the sessions, and 120 received certificates for regular attendance.

The program has considerable potential for law school curriculum development as evidenced by observations of the Curriculum Committee of Howard Law School contained in an evaluation report, as follows:

> "The need for developing expertise in the ever growing fields of law makes it difficult to perform the essential task of developing basic cognitive legal skills of the law student. If the law school responds to the need for developing various expertise by additions or changes in the curriculum, it runs the risk of de-emphasizing the development of the basic lawyer skills. The solution might very well be in the development of non-credit and extra curricular symposia such as this one. In this respect the SEC may have made a very profound contribution to legal education."

Pursuant to the Commission's request, the Public Health Service (PHS) conducted a survey of the Commission's occupational health program. The report submitted by PHS stated, in part, that the health services offered by the Commission to employees in its Headquarters Office in Washington were "considerably below the minimum standard" of the Division of Federal Employee Health as well as of recommendations of the Council on Occupational Health, American Medical Association. On the basis of the PHS survey report and recommendations, the Commission, in January 1970, authorized the transfer of its Health Unit to the jurisdiction of the Public Health Service. The transfer of function was effected on

schedule in April 1970 and Headquarters Office employees are now accorded the same level of occupational health services enjoyed by the Commission's regional and branch office employees.

As part of the Commission's Fifteenth Annual Service and Merit Awards Ceremony held in October 1969, Distinguished Service Awards were presented to the following officials of the Commission:

Solomon Freedman, Director, Division of Corporate Regulation—"In recognition of a distinguished career spanning 27 years with the Securities and Exchange Commission as a staff attorney and administrator and for his outstanding contributions to the effective administration and enforcement of the Federal securities laws."

Leonard Helfenstein, Director, Office of Opinions and Review—"In recognition of 26 years of distinguished Federal service and for his many significant contributions to the development of administrative law embodied in the official Findings, Orders, and Opinions of the Securities and Exchange Commission."

Walter P. North, Associate General Counsel—"In recognition of a distinguished legal career with the Securities and Exchange Commission and for his many significant contributions as an outstanding appellate advocate to the development of case law in the area of Federal securities regulation."

Supervisory Excellence Awards were presented to Mary E. T. Beach, Branch Chief, Division of Corporation Finance, for obtaining from her staff high productivity, quality performance and sustained high morale; and to Stanley Sporkin, Associate Director (Enforcement), Division of Trading and Markets, for developing an accomplished enforcement staff. Eight employees were given 35-year pins for SEC service and twelve received pins for 30-year SEC service; within-grade salary increases in recognition of high quality performance were granted to 75 employees; and cash awards totalling $34,987 were presented to 110 employees for superior performance, special service, or adopted suggestions.

Personnel Strength; Financial Management

The following comparative table shows the personnel strength of the Commission as of June 30, 1969 and 1970.

	June 30, 1969	June 30, 1970
Commissioners	4	5
Staff:		
Headquarters Office	911	1,007
Regional Offices	481	442
Total Staff	1,392	1,449
Grand Total	1,396	1,454

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The table on page 211 shows the status of the Commission's budget estimates for the fiscal years 1966 to 1971, from the initial submission to the Bureau of the Budget to final enactment of the annual appropriation.

The Commission is required by law to collect fees for or from (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 who are not members of a registered national securities association (the National Association of Securities Dealers (NASD) is the only such organization); and (5) certification of documents filed with the Commission.[4]

The following table shows the Commission's appropriation, total fees collected, percentage of fees collected to total appropriation, and the net cost to the taxpayers of Commission operations for the fiscal years 1968, 1969 and 1970.

Year	Appropriation	Fees collected	Percentage of fees collected to total appropriation (percent)	Net cost of Commission operations
1968	$17,730,000	$14,622,567	82	$3,107,433
1969	18,624,000	21,996,362	118	(3,372,362)
1970	21,904,977	15,525,693	71	6,379,284

[4] Fees collected are derived principally from categories (1), (3) and (4) above. Rates for these are (1) 1/50 of 1 percent of the maximum aggregate price of securities proposed to be offered, or 20¢ per $1,000, with a minimum fee of $100; (3) 1/500 of 1 percent of the aggregate dollar amount of the sales of securities transacted on exchanges; (4) for fiscal 1968: a basic registration fee of $100 for non-NASD broker-dealers plus $5 for each associated person, with a maximum payment of $15,000; $30 for each office and $25 for each associated person for whom a nonmember broker or dealer has not previously filed a personnel form; and an initial assessment fee of $150; for fiscal 1969 and 1970: the maximum payment was raised to $20,000 for all fees payable.

SECURITIES AND EXCHANGE COMMISSION

Action Taken on Budget Estimates and Appropriation From Fiscal 1966 Through Fiscal 1971

Action	Fiscal 1966		Fiscal 1967		Fiscal 1968		Fiscal 1969		Fiscal 1970		Fiscal 1971	
	Positions	Money	Positions	Money	Positions	Money	Positions	Money	Positions	Money	Positions	Money
Estimate submitted to the Bureau of the Budget	1,564	$17,782,000	1,450	$17,582,000	1,437	$17,625,000	1,444	$18,177,800	1,467	$20,788,000	1,532	$22,379,000
Action by the Bureau of the Budget	−31	−382,000		−32,000	−21	−180,000	−16	−74,800	−35	−372,000	−80	−463,000
Amount allowed by the Bureau of the Budget	1,533	17,400,000	1,450	17,550,000	1,416	17,445,000	1,428	18,103,000	1,432	20,416,000	[4] 1,452	21,916,000
Action by the House of Representatives	−71	−958,000	−25	−300,000	−11	−95,000	−25	−173,000	−42	−666,000	−42	−200,000
Subtotal	1,462	16,442,000	1,425	17,250,000	1,405	17,350,000	1,403	17,930,000	1,390	19,750,000	1,410	21,716,000
Action by the Senate					+11	+95,000		+100,000	+42	+666,000		
Subtotal	1,462	16,442,000	1,425	17,250,000	1,416	17,445,000	1,403	18,030,000	1,432	20,416,000	1,410	21,716,000
Action by Conferees					−11	−95,000						
Annual Appropriation	1,462	16,442,000	1,425	17,250,000	1,405	17,350,000	1,403	18,030,000	1,432	20,416,000	1,410	21,716,000
Supplemental appropriation for statutory pay increase				300,000		380,000		594,000		1,488,977		
Total appropriation	1,462	[1] 16,442,000	1,425	17,550,000	1,405	17,730,000	[2] 1,338	[2] 18,624,000	1,432	21,904,977		

[1] Includes $1,000,000 for relocation of offices in Washington, D.C. to commercial space.
[2] Progressive reduction of 100 positions (employment level on June 30, 1966) and subsequent reinstatement of 35 positions by the Bureau of the Budget representing a net savings of $299,000 required under the Revenue and Expenditure Control Act of 1968. Savings to be applied to estimated pay increase cost of $893,000 effective July 14, 1968.
[3] Includes $300,000 for the Study of Institutional Investors.
[4] The reduction of 42 positions represents the Congressional reduction of $200,000 and the absorption of the additional cost to continue the Institutional Investor Study to December 31, 1970.

PART IX

APPENDIX

STATISTICAL TABLES

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TABLE 1.—*A 36-Year Record of Registrations Effective Under the Securities Act of 1933—Fiscal Years 1935–1970*

[Amounts in millions of dollars]

Fiscal year ended June 30	Number of statements [1]	All registrations	Cash sale for account of issuers			
			Total	Bonds, debentures, and notes	Preferred stock	Common stock
1935 [2]	284	$913	$686	$490	$28	$168
1936	689	4,835	3,936	3,153	252	531
1937	840	4,851	3,635	2,426	406	802
1938	412	2,101	1,349	666	209	474
1939	344	2,579	2,020	1,593	109	318
1940	306	1,787	1,433	1,112	110	210
1941	313	2,611	2,081	1,721	164	196
1942	193	2,003	1,465	1,041	162	263
1943	123	659	486	316	32	137
1944	221	1,760	1,347	732	343	272
1945	340	3,225	2,715	1,851	407	456
1946	661	7,073	5,424	3,102	991	1,331
1947	493	6,732	4,874	2,937	787	1,150
1948	435	6,405	5,032	2,817	537	1,678
1949	429	5,333	4,204	2,795	326	1,083
1950	487	5,307	4,381	2,127	468	1,786
1951	487	6,459	5,169	2,838	427	1,904
1952	635	9,500	7,529	3,346	851	3,332
1953	593	7,507	6,326	3,093	424	2,808
1954	631	9,174	7,381	4,240	531	2,610
1955	779	10,960	8,277	3,951	462	3,864
1956	906	13,096	9,206	4,123	539	4,544
1957	876	14,624	12,019	5,689	472	5,858
1958	813	16,490	13,281	6,857	427	5,998
1959	1,070	15,657	12,095	5,265	443	6,387
1960	1,426	14,367	11,738	4,224	253	7,260
1961	1,550	19,070	16,260	6,162	248	9,850
1962	1,844	19,547	16,286	4,512	253	11,521
1963	1,157	14,790	11,869	4,372	270	7,227
1964	1,121	16,860	14,784	4,554	224	10,006
1965	1,266	19,437	14,656	3,710	307	10,638
1966	1,523	30,109	25,723	7,061	444	18,218
1967	1,649	34,218	27,950	12,309	558	15,083
1968	[3] 2,417	[3] 54,076	37,269	14,036	1,140	22,092
1969	[4] 3,645	[4] 86,810	52,039	11,674	751	39,614
1970	[5] 3,389	[5] 59,137	48,198	18,436	823	28,939

[1] Statements registering American Depositary Receipts against outstanding foreign securities as provided by Form S-12 are included.
[2] For 10 months ended June 30, 1935.
[3] Includes three statements registering lease obligations relating to industrial revenue bonds of $140 million.
[4] Includes eight statements registering lease obligations relating to industrial revenue bonds of $354 million.
[5] Includes four statements registering lease obligations relating to industrial revenue bonds of $21 million.

TABLE 2.—*Registrations Effective Under the Securities Act of 1933, Fiscal Year Ended June 30, 1970*

[Amounts rounded to thousands of dollars and may not add to totals]

PART 1.—Distribution by months

Year and month	All registrations			Proposed for sale for account of issuers [1]			
				Total [2]		Corporate [3]	
	Number of statements	Number of issues [1]	Amount	Number of issues [1]	Amount	Number of issues [1]	Amount
1969							
July	302	343	$5,065,434	275	$3,974,325	159	$1,856,020
August	253	284	3,904,731	232	2,855,850	118	1,111,363
September	297	331	4,597,565	275	3,558,100	186	2,012,076
October	359	408	4,408,161	328	3,314,230	215	1,610,859
November	280	317	4,667,425	255	3,812,920	160	1,977,439
December	333	359	4,427,305	317	3,336,955	192	1,965,657
1970							
January	247	270	4,100,342	228	3,333,161	147	1,910,886
February	207	237	4,622,024	208	4,144,980	118	1,860,895
March	247	294	4,524,633	251	3,760,579	173	2,607,239
April	358	407	9,555,043	358	8,543,158	181	4,209,572
May	241	277	4,412,676	227	3,885,815	82	1,969,752
June	261	282	4,830,913	232	3,677,827	119	2,884,009
Total, fiscal year 1970 [4]	3,385	3,809	59,116,252	3,186	48,197,900	1,850	25,975,768

PART 2.—Purpose of registration and type of security

Purpose of registration	Total	Type of security		
		Bonds, debentures, and notes [5]	Preferred stock	Common stock [6]
All registrations (estimated value)	$59,116,252	$18,843,214	$1,450,416	$38,822,623
For account of issuer for cash sale	48,197,900	18,436,454	822,641	28,938,804
Immediate offering [3]	26,470,377	18,320,015	768,046	7,382,317
Corporate	25,975,768	17,825,405	768,046	7,382,317
Offered to:				
General public	22,864,200	16,064,523	768,046	6,031,632
Security holders	2,980,607	1,707,582	0	1,273,025
Other special groups	130,960	53,300	0	77,660
Foreign governments	494,610	494,610	0	0
Extended cash sale and other issues [2]	21,727,523	116,439	54,596	21,556,488
For account of issuer for other than cash sale	7,355,294	232,256	334,167	6,788,871
For account of other than issuer	3,563,058	174,503	293,608	3,094,948
Cash sale	1,287,220	27,301	0	1,259,920
Other	2,275,838	147,203	293,608	1,835,028

[1] Warrants are excluded from the count of the number of issues although included in dollar amount.
[2] Includes issues to be offered for sale continuously over an extended period of time, such as investment company issues and securities reserved for exercise of warrants or options.
[3] Covers only issues proposed for sale immediately following effective registration.
[4] The 3,385 effective registration statements covered in this table differ from the 3,329 "net" effective statements shown in the text table "Number and disposition of registration statements filed" as follows:

Included in effectives but excluded from net effectives:
- Three registrations effective in fiscal 1969 prior to receiving competitive bids. The amendments disclosing the accepted terms were received in fiscal 1970.
- Sixty-four registrations effective in fiscal 1970 which were later withdrawn.

Excluded from effectives but included in net effectives:
- Five registrations effective prior to receiving competitive bids. The amendments disclosing the accepted terms were not received in fiscal 1970.
- Four registrations of lease obligations relating to industrial revenue bonds.
- Two registrations effective subject to competitive bids in fiscal 1969, amendments not received and withdrawn.

[5] Includes face amount certificates.
[6] Includes certificates of participation, warrants and voting trust certificates.

TABLE 3.—*Brokers and Dealers Registered Under the Securities Exchange Act of 1934*[1]*—Effective Registrations as of June 30, 1970, Classified by Type of Organization and by Location of Principal Office*

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	36	8	2	26	152	8	5	139
Alaska	4	3	0	1	7	3	0	4
Arizona	31	4	2	25	107	4	4	99
Arkansas	25	7	2	16	103	7	4	92
California	599	165	52	382	2,864	165	441	2,258
Colorado	81	19	4	58	452	19	33	400
Connecticut	56	12	9	35	294	12	81	201
Delaware	18	4	2	12	141	4	4	133
District of Columbia	63	10	11	42	421	10	70	341
Florida	134	23	6	105	497	23	17	457
Georgia	52	8	5	39	288	8	34	246
Hawaii	35	6	2	27	131	6	5	120
Idaho	10	4	0	6	25	4	0	21
Illinois	192	27	35	130	1,304	27	247	1,030
Indiana	61	18	1	42	277	18	2	257
Iowa	53	9	3	41	289	9	11	269
Kansas	37	5	3	29	214	5	11	198
Kentucky	14	2	3	9	70	2	27	41
Louisiana	33	12	9	12	156	12	107	37
Maine	20	5	2	13	61	5	9	47
Maryland	44	11	7	26	260	11	101	148
Massachusetts	216	67	25	124	1,112	67	138	907
Michigan	81	17	9	55	433	17	97	317
Minnesota	76	5	5	66	458	5	10	443
Mississippi	24	6	6	12	82	6	18	58
Missouri	93	15	11	67	752	15	138	599
Montana	12	5	0	7	31	5	0	26
Nebraska	23	3	0	20	156	3	0	153
Nevada	9	2	0	7	23	2	0	21
New Hampshire	13	7	0	6	33	7	0	26
New Jersey	246	80	27	139	711	80	69	562
New Mexico	6	2	0	4	25	2	0	23
New York (excluding New York City)	431	165	33	233	1,060	165	110	785
North Carolina	37	9	4	24	213	9	19	185
North Dakota	12	4	0	8	41	4	0	37
Ohio	127	15	26	86	805	15	266	524
Oklahoma	34	13	2	19	96	13	4	79
Oregon	43	6	4	33	189	6	8	175
Pennsylvania	259	43	49	167	1,402	43	310	1,049
Rhode Island	29	8	5	16	82	8	24	50
South Carolina	17	3	1	13	86	3	2	81
South Dakota	2	1	0	1	5	1	0	4
Tennessee	48	9	2	37	210	9	24	177
Texas	200	53	5	142	1,114	53	20	1,041
Utah	54	7	4	43	183	7	13	163
Vermont	7	4	1	2	23	4	4	15
Virginia	64	19	12	33	288	19	60	209
Washington	94	24	2	68	407	24	4	379
West Virginia	11	3	1	7	35	3	5	27
Wisconsin	50	6	1	43	349	6	39	304
Wyoming	11	2	2	7	32	2	4	26
Total (excluding New York City)	3,927	965	397	2,565	18,549	965	2,599	14,985
New York City	1,260	139	392	729	11,196	139	4,312	6,745
Total	5,187	1,104	789	3,294	29,745	1,104	6,911	21,730

[1] Does not include 37 registrants whose principal offices are located in foreign countries or other territorial 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 location of persons. Information taken from latest reports filed prior to June 30, 1970.
[4] Includes all forms of organizations other than sole proprietorships and partnerships.

TABLE 4.—*Number of Security Issues and Issuers on Exchanges*

PART 1.—UNDUPLICATED COUNT AS OF JUNE 30, 1970 OF THE NUMBER OF STOCK AND BOND ISSUES ADMITTED TO TRADING ON EXCHANGES, AND THE NUMBER OF ISSUERS INVOLVED

Status under the Act [1]	Stocks	Bonds	Total stocks and bonds	Issuers involved
Registered pursuant to Sections 12(b), (c) and (d)	3,459	1,786	5,245	2,980
Temporarily exempted from registration by Commission rule	15	5	20	10
Admitted to unlisted trading privileges on registered exchanges pursuant to Section 12(f)	56	8	64	47
Listed on exempted exchanges under exemption orders of the Commission	41	4	45	28
Admitted to unlisted trading privileges on exempted exchanges under exemption orders of the Commission	8	0	8	8
Total	3,579	1,803	5,382	3,073

[1] **Registered:** A security may be registered on a national securities exchange by the issuer filing an application with the exchange and with the Commission containing certain types of specified information.

Temporarily exempted: These are securities such as short term warrants or securities resulting from mergers, consolidation, etc., which the Commission has by published rules exempted from registration under specified conditions and for stated periods.

Admitted to unlisted trading privileges: This refers to securities which have been admitted to trading on the initiative of exchanges without listing. Since July 1964, the effective date of the 1964 amendments to Section 12(f) of the Exchange Act, additional securities may be granted unlisted trading privileges on exchanges only if they are listed and registered on another exchange.

Listed on exempted exchanges: Certain exchanges have been exempted from registration under Section 6 of the Act because of the limited volume of transactions. The Commission's exemption orders specify in each case that securities which were listed on the exchange at the date of the order may continue to be listed thereon, and that no additional securities may be listed except upon compliance with Sections 12(b), (c) and (d).

Unlisted on exempt exchanges: The Commission's exemption orders specify that securities which were admitted to unlisted trading privileges at the date of the order may continue such privileges, and that no additional securities may be admitted to unlisted trading privileges except upon compliance with Section 12(f).

PART 2.—NUMBER OF STOCK AND BOND ISSUES ON EACH EXCHANGE AS OF JUNE 30 1970, CLASSIFIED BY TRADING STATUS, AND NUMBER OF ISSUERS INVOLVED

Exchanges	Issuers	Stocks						Bonds				
		R	X	U	XL	XU	Total	R	X	U	XL	Total
American	1,186	1,116	7	71			1,194	167	3	10		180
Boston	603	61	5	516			582	12				12
Chicago Bd. of Trade	4	2		2			4					
Cincinnati	177	30	1	155			186	8	1			9
Detroit	286	82	3	193			278					
Honolulu*	38				41	10	51				5	5
Midwest	541	354	4	222			580	13				13
National	129	135					135	6				6
New York	1,592	1,811	8				1,819	1,515	5			1,520
Pacific Coast	713	600	7	211			818	31	2			33
Phila.-Balt.-Wash	788	213	7	674			894	50		2		52
Richmond*	14	2			23		25				1	1
Salt Lake	58	55		3			58					
Spokane	33	29		6			35					

Symbols. R—registered; X—temporarily exempted; U—admitted to unlisted trading privileges; XL—listed on an exempted exchange; XU—admitted to unlisted trading privileges on an exempted exchange.

Note—Issues exempted under Section 3(a)(12) of the Act, such as obligations of the U.S. Government, the states, and cities, are not included in this table.

*Exempted exchanges.

TABLE 5.—*Value of Stocks on Exchanges*

[Billions of dollars]

December 31	New York Stock Exchange	American Stock Exchange	Exclusively on other Exchanges	Total [1]
1936	$59.9	$14.8	----	$74.7
1937	38.9	10.2	----	49.1
1938	47.5	10.8	----	58.3
1939	46.5	10.1	----	56.6
1940	41.9	8.6	----	50.5
1941	35.8	7.4	----	43.2
1942	38.8	7.8	----	46.6
1943	47.6	9.9	----	57.5
1944	55.5	11.2	----	66.7
1945	73.8	14.4	----	88.2
1946	68.6	13.2	----	81.8
1947	68.3	12.1	----	80.4
1948	67.0	11.9	$3.0	81.9
1949	76.3	12.2	3.1	91.6
1950	93.8	13.9	3.3	111.0
1951	109.5	16.5	3.2	129.2
1952	120.5	16.9	3.1	140.5
1953	117.3	15.3	2.8	135.4
1954	169.1	22.1	3.6	194.8
1955	207.7	27.1	4.0	238.8
1956	219.2	31.0	3.8	254.0
1957	195.6	25.5	3.1	224.2
1958	276.7	31.7	4.3	312.7
1959	307.7	26.4	4.2	338.4
1960	307.0	24.2	4.1	335.3
1961	387.8	33.0	5.3	426.2
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

[1] Total values 1936–47 inclusive are for the New York Stock Exchange and the American Stock Exchange only.

TABLE 6.—*Dollar Volume and Share Volume of Sales Effected on Securities Exchanges in the Calendar Year 1969 and the 6-Month Period Ended June 30, 1970*

[Amounts in thousands]

PART 1.—12 MONTHS ENDED DEC. 31, 1969

Exchanges	Total dollar volume	Bonds		Stocks		Rights and warrants	
		Dollar volume	Principal amount	Dollar volume	Share volume	Dollar volume	Number of units
Registered exchanges	180,877,384	4,501,268	5,123,542	175,297,359	4,963,428	1,078,757	170,804
American	31,965,792	928,896	950,316	30,074,031	1,341,025	962,865	76,739
Boston	1,191,626	0	0	1,191,291	26,366	335	40
Chicago Board of Trade	0	0	0	0	0	0	0
Cincinnati	19,130	74	97	19,055	333	0	0
Detroit	216,583	0	0	216,581	6,439	2	5
Midwest	5,988,494	232	476	5,987,586	146,303	677	442
National	179,739	0	0	179,739	25,483	0	0
New York	133,172,975	3,550,327	4,123,327	129,603,420	3,173,565	19,228	69,768
Pacific Coast	5,535,347	21,564	40,052	5,421,655	156,870	92,128	21,688
Philadelphia-Baltimore-Washington	2,532,184	175	274	2,528,487	60,906	3,522	2,121
Pittsburgh	46,613	0	0	46,613	1,358	0	0
Salt Lake	17,865	0	0	17,865	12,276	0	0
Spokane	11,036	0	0	11,036	12,506	0	0
Exempted exchanges	13,644	0	0	13,644	763	0	0
Honolulu	11,679	0	0	11,679	715	0	0
Richmond	1,965	0	0	1,965	47	0	0

PART 2.—6 MONTHS ENDED JUNE 30, 1970

Exchanges	Total dollar volume	Bonds		Stocks		Rights and warrants	
		Dollar volume	Principal amount	Dollar volume	Share volume	Dollar volume	Number of units
Registered exchanges	70,632,437	2,216,279	2,929,710	68,171,185	2,220,578	244,973	189,849
American	9,066,082	214,938	364,098	8,685,854	478,265	165,291	22,807
Boston	517,576	0	0	517,259	13,485	317	308
Chicago Board of Trade	0	0	0	0	0	0	0
Cincinnati	4,778	4	7	4,757	109	17	53
Detroit	80,407	0	0	80,379	2,746	28	149
Midwest	2,651,265	594	687	2,646,957	70,591	3,714	2,284
National	31,568	0	0	31,568	7,015	0	0
New York	54,654,910	1,977,466	2,515,202	52,614,986	1,529,889	62,458	154,842
Pacific Coast	2,322,307	22,254	48,618	2,278,780	74,824	21,274	7,941
Philadelphia-Baltimore-Washington	1,306,609	1,024	1,099	1,303,710	36,185	1,875	1,465
Salt Lake	4,071	0	0	4,071	3,351	0	0
Spokane	2,862	0	0	2,862	4,118	0	0
Exempted exchanges	5,713	0	0	5,713	439	0	0
Honolulu	5,455	0	0	5,455	433	0	0
Richmond	258	0	0	258	6	0	0

Note: Data on the value and volume of securities sales on the registered exchanges are reported in connection with fees paid under Section 31 of the Securities Exchange Act of 1934. Included are all securities sales, odd-lot as well as round-lot transactions, effected on exchanges except sales of bonds of the U.S. Government which are not subject to the fee. Comparable data are also supplied by the exempted exchanges. Reports of most exchanges for a given month cover transactions cleared during the calendar month. Clearances generally occur on the 5th business day after that on which the trade was effected.

TABLE 7.—*Comparative Share Sales and Dollar Volumes on Exchanges*

Year	Share sales	NYS %	AMS %	MSE %	PCS %	PBS %	BSE %	DSE %	PIT %	CIN %	Other %
1935	681, 970, 500	73. 13	12. 42	1. 91	2. 69	0. 76	0. 96	0. 85	0. 34	0. 03	6. 91
1940	377, 896, 572	75. 44	13. 20	2. 11	2. 78	1. 02	1. 19	. 82	. 31	. 08	2. 06
1945	769, 018, 138	65. 87	21. 31	1. 77	2. 98	. 66	. 66	. 79	. 40	. 05	5. 51
1950	893, 320, 458	76. 32	13. 54	2. 16	3. 11	. 79	. 65	. 55	. 18	. 09	2. 61
1955	1, 321, 400, 711	68. 85	19. 19	2. 09	3. 08	. 75	. 48	. 39	. 10	. 05	5. 02
1956	1, 182, 487, 085	66. 31	21. 01	2. 32	3. 25	. 72	. 47	. 49	. 11	. 05	5. 27
1957	1, 293, 021, 856	70. 70	18. 14	2. 33	2. 73	. 98	. 40	. 39	. 13	. 06	4. 14
1958	1, 400, 578, 512	71. 31	19. 14	2. 13	2. 99	. 73	. 45	. 35	. 11	. 05	2. 74
1959	1, 699, 696, 619	65. 59	24. 50	2. 00	2. 81	. 90	. 37	. 31	. 07	. 04	3. 41
1960	1, 441, 047, 564	68. 48	22. 27	2. 20	3. 11	. 89	. 39	. 34	. 06	. 05	2. 21
1961	2, 142, 523, 490	64. 99	25. 58	2. 22	3. 42	. 79	. 31	. 31	. 05	. 04	2. 29
1962	1, 711, 945, 297	71. 32	20. 12	2. 34	2. 95	. 87	. 31	. 36	. 05	. 05	1. 63
1963	1, 880, 798, 423	72. 94	18. 84	2. 33	2. 83	. 84	. 29	. 47	. 04	. 04	1. 38
1964	2, 126, 373, 821	72. 54	19. 35	2. 43	2. 64	. 93	. 29	. 54	. 05	. 04	1. 19
1965	2, 671, 011, 839	69. 91	22. 53	2. 63	2. 34	. 82	. 27	. 53	. 04	. 05	. 88
1966	3, 312, 383, 465	69. 37	22. 85	2. 57	2. 68	. 86	. 40	. 46	. 04	. 05	. 72
1967	4, 646, 524, 907	64. 41	28. 42	2. 36	2. 46	. 88	. 43	. 33	. 02	. 03	. 66
1968	5, 408, 737, 347	61. 98	29. 74	2. 63	2. 65	. 90	. 78	. 32	. 02	. 01	. 97
1969	5, 134, 994, 769	63. 16	27. 61	2. 86	3. 48	1. 23	. 51	. 12	. 03	. 01	. 99
Six months to June 30, 1970	2, 410, 865, 991	69. 88	20. 78	3. 02	3. 43	1. 66	. 58	. 12	*	. 01	. 62
	Dollar volume (in thousands)										
1935	$15, 396, 139	86. 64	7. 83	1. 32	1. 39	. 68	1. 34	. 40	. 20	. 04	. 16
1940	8, 419, 772	85. 17	7. 68	2. 07	1. 52	. 92	1. 91	. 36	. 19	. 09	. 09
1945	16, 284, 552	82. 75	10. 81	2. 00	1. 78	. 82	1. 16	. 35	. 14	. 06	. 13
1950	21, 808, 284	85. 91	6. 85	2. 35	2. 19	. 92	1. 12	. 39	. 11	. 11	. 05
1955	38, 039, 107	86. 31	6. 98	2. 44	1. 90	. 90	. 78	. 39	. 13	. 09	. 08
1956	35, 143, 115	84. 95	7. 77	2. 75	2. 08	. 96	. 80	. 42	. 12	. 08	. 07
1957	32, 214, 846	85. 51	7. 33	2. 69	2. 02	1. 00	. 76	. 42	. 12	. 08	. 04
1958	38, 419, 560	85. 42	7. 45	2. 71	2. 11	1. 01	. 71	. 37	. 09	. 08	. 05
1959	52, 001, 255	83. 66	9. 53	2. 67	1. 94	1. 01	. 66	. 33	. 08	. 07	. 05
1960	45, 306, 603	83. 81	9. 35	2. 73	1. 95	1. 04	. 60	. 34	. 06	. 08	. 04
1961	64, 071, 623	82. 44	10. 71	2. 75	2. 00	1. 04	. 50	. 37	. 06	. 07	. 06
1962	54, 855, 894	86. 32	6. 81	2. 76	2. 00	1. 05	. 46	. 42	. 06	. 07	. 05
1963	64, 438, 073	85. 19	7. 52	2. 73	2. 39	1. 07	. 42	. 52	. 05	. 06	. 05
1964	72, 461, 750	83. 49	8. 46	3. 16	2. 38	1. 15	. 43	. 66	. 06	. 06	. 05
1965	89, 549, 093	81. 78	9. 91	3. 45	2. 43	1. 13	. 43	. 70	. 05	. 08	. 04
1966	123, 666, 443	79. 78	11. 84	3. 14	2. 85	1. 10	. 57	. 57	. 04	. 08	. 03
1967	162, 189, 211	77. 29	14. 48	3. 08	2. 80	1. 13	. 67	. 44	. 03	. 04	. 04
1968	197, 117, 957	73. 56	18. 00	3. 12	2. 66	1. 14	1. 04	. 35	. 03	. 02	. 08
1969	176, 389, 769	73. 49	17. 60	3. 39	3. 13	1. 43	. 67	. 12	. 03	. 01	. 13
Six months to June 30, 1970	68, 421, 871	76. 99	12. 92	3. 87	3. 36	1. 91	. 76	. 12	*	. 01	. 06

Note.—Annual sales, including stocks, warrants and rights, as reported by all U.S. exchanges to the Commission. Figures for merged exchanges are included in those of the exchanges into which they were merged. Details for all years prior to 1955 appear in Table 7 in the Appendix of the 32nd Annual Report.

Symbols.—NYS, New York Stock Exchange; AMS, American Stock Exchange; MSE, Midwest Stock Exchange; PCS, Pacific Coast Stock Exchange; PBS, Philadelphia-Baltimore-Washington Stock Exchange; BSE, Boston Stock Exchange; DSE, Detroit Stock Exchange; PIT, Pittsburgh Stock Exchange; CIN, Cincinnati Stock Exchange.

* Merged with Phila.-Balt.-Wash. as of Dec. 31, 1969.

TABLE 8.—*Block Distributions of Stocks Reported by Exchanges*

[Value in thousands of dollars]

Year	Special offerings			Exchange distributions			Secondary distributions		
	Number	Shares sold	Value	Number	Shares sold	Value	Number	Shares sold	Value
1942	79	812,390	$22,694				116	2,397,454	$82,840
1943	80	1,097,338	31,054				81	4,270,580	127,462
1944	87	1,053,667	32,454				94	4,097,298	135,760
1945	79	947,231	29,878				115	9,457,358	191,961
1946	23	308,134	11,002				100	6,481,291	232,398
1947	24	314,270	9,133				73	3,961,572	124,671
1948	21	238,879	5,466				95	7,302,420	175,991
1949	32	500,211	10,956				86	3,737,249	104,062
1950	20	150,308	4,940				77	4,280,681	88,743
1951	27	323,013	10,751				88	5,193,756	146,459
1952	22	357,897	9,931				76	4,223,258	149,117
1953	17	380,680	10,486				68	6,906,017	108,229
1954	14	189,772	6,670	57	705,781	$24,664	84	5,738,359	218,490
1955	9	161,850	7,223	19	258,348	10,211	116	6,756,767	344,871
1956	8	131,755	4,557	17	156,481	4,645	146	11,696,174	520,966
1957	5	63,408	1,845	33	390,832	15,855	99	9,324,599	339,062
1958	5	88,152	3,286	38	619,876	29,454	122	9,508,505	361,886
1959	3	33,500	3,730	28	545,038	26,491	148	17,330,941	822,336
1960	3	63,663	5,439	20	441,664	11,108	92	11,439,065	424,688
1961	2	35,000	1,504	33	1,127,266	58,072	130	19,910,013	926,514
1962	2	48,200	588	41	2,345,076	65,459	59	12,143,656	658,780
1963	0	0	0	72	2,892,233	107,498	100	18,937,935	814,984
1964	0	0	0	68	2,553,237	97,711	110	19,462,343	909,821
1965	0	0	0	57	2,334,277	86,479	142	31,153,319	1,603,107
1966	0	0	0	52	3,042,599	118,349	126	29,045,038	1,523,373
1967	0	0	0	51	3,452,856	125,404	143	30,783,604	1,154,479
1968	1	3,352	63	35	2,669,938	93,528	174	36,110,489	1,571,600
1969	0	0	0	32	1,706,572	52,198	142	38,224,799	1,244,186

NOTE.—The first special offering plan was made effective Feb. 14, 1942; the plan of exchange distribution was made effective Aug. 21, 1953; secondary distributions are not made pursuant to any plan but generally exchanges require members to obtain approval of the exchange to participate in a secondary distrubition and a report on such distribution is filed with this Commission.

TABLE 9.—*Unlisted Stocks on Exchanges*

PART 1.—NUMBER OF STOCKS ON THE EXCHANGES AS OF JUNE 30, 1970 [1]

Exchanges	Unlisted only [2]	Listed and registered on another exchange	
		Admitted prior to Mar. 1, 1934 [3]	Admitted since Mar. 1, 1934 [4]
American	51	10	2
Boston	0	85	471
Chicago Board of Trade	0	2	0
Cincinnati	0	0	157
Detroit	0	10	202
Honolulu	8	0	0
Midwest	0	0	232
Pacific Coast	0	40	174
Phila-Balt-Wash [5]	0	145	556
Salt Lake	1	0	1
Spokane	2	1	3
Total [6]	62	293	1,798

PART 2.—UNLISTED SHARE VOLUME ON THE EXCHANGES—CALENDAR YEAR 1969

Exchanges	Unlisted only [2]	Listed and registered on another exchange	
		Admitted prior to Mar. 1, 1934 [3]	Admitted since Mar. 1, 1934 [4]
American	47,958,150	6,886,890	348,990
Boston	0	4,553,887	15,964,250
Chicago Board of Trade	0	0	0
Cincinnati	0	0	186,260
Detroit	0	203,934	2,693,411
Honolulu	64,680	0	0
Midwest	0	0	49,092,646
Pacific Coast	0	773,000	44,343,304
Phila-Balt-Wash	0	12,058,828	30,130,692
Pittsburgh	0	249,179	563,322
Salt Lake	0	0	0
Spokane	773,485	3,789	12,351
Total [6]	48,796,315	24,729,507	143,338,226

[1] Refer to text under heading "Unlisted Trading Privileges on Exchanges," in Part III of this Report. Volumes are as reported by the stock exchanges or other reporting agencies and are exclusive of those in short-term rights.
[2] Includes issues admitted under Clause 1 of Section 12(f) as in effect prior to the 1964 amendments to the Exchange Act and two stocks on the American Stock Exchange admitted under former Section 12(f), Clause 3.
[3] These issues were admitted under former Section 12(f), Clause 1.
[4] These figures include issues admitted under former Section 12(f), Clauses 2 and 3 (except the two stocks on the American Stock Exchange referred to in footnote 2), and under new Section 12(f)(1)(B).
[5] Includes securities admitted to unlisted trading privileges on the Pittsburgh Stock Exchange, which merged with the Philadelphia-Baltimore-Washington Stock Exchange, effective December 30, 1969.
[6] Duplication of issues among exchanges brings the total figures to more than the actual number of issues involved.

TABLE 10.—*Summary of Cases Instituted in the Courts by the Commission Under the Securities Act of 1933, the Securities Exchange Act of 1934, the Public Utility Holding Company Act of 1935, the Investment Company Act of 1940, and the Investment Advisers Act of 1940*

Types of cases	Total cases instituted up to end of 1970 fiscal year	Total cases closed up to end of 1970 fiscal year	Cases pending at end of 1970 fiscal year	Cases pending at end of 1969 fiscal year	Cases instituted during 1970 fiscal year	Total cases pending during 1970 fiscal year	Cases closed during 1970 fiscal year
Actions to enjoin violations of the above acts	1,853	1,755	98	75	111	186	88
Actions to enforce subpoenas under the Securities Act and the Securities Exchange Act	145	142	3	2	6	8	5
Actions to carry out voluntary plans to comply with section 11(b) of the Holding Company Act	155	155	0	1	1	2	2
Miscellaneous actions	58	58	0	0	0	0	0
Total	2,211	2,110	101	78	118	196	95

TABLE 11.—*A 37-Year Summary of All Injunction Cases Instituted by the Commission 1934 to June 30, 1970, by Calendar Year*

Calendar year	Number of cases instituted by the Commission and the number of defendants involved		Number of cases in which injunctions were granted and the number of defendants enjoined [1]	
	Cases	Defendants	Cases	Defendants
1934	7	24	2	4
1935	36	242	17	56
1936	42	116	36	108
1937	96	240	91	211
1938	70	152	73	153
1939	57	154	61	165
1940	40	100	42	99
1941	40	112	36	90
1942	21	73	20	54
1943	19	81	18	72
1944	18	80	14	35
1945	21	74	21	57
1946	21	45	15	34
1947	20	40	20	47
1948	19	44	15	26
1949	25	59	24	55
1950	27	73	26	71
1951	22	67	17	43
1952	27	103	18	50
1953	20	41	23	68
1954	22	59	22	62
1955	23	54	19	43
1956	53	122	42	89
1957	58	192	32	93
1958	71	408	51	158
1959	58	206	71	179
1960	99	270	84	222
1961	84	36[illegible]	85	272
1962	99	403	82	229
1963	91	358	98	363
1964	76	276	88	352
1965	72	302	68	271
1966	56	236	50	181
1967	89	380	79	291
1968	94	489	97	391
1969	99	584	102	518
1970 (to June 30)	61	242	52	258
Total	1,853	6,869	[2] 1,711	5,470

SUMMARY

	Cases	Defendants
Actions instituted	1,853	6,869
Injunctions obtained	1,683	5,470
Actions pending	36	[3] 333
Other dispositions [4]	134	1,066
Total	1,853	6,869

[1] These columns show disposition of cases by year of disposition and do not necessarily reflect the disposition of the cases shown as having been instituted in the same years.

[2] Includes 28 cases which were counted twice in this column because injunctions against different defendants in the same cases were granted in different years.

[3] Includes 60 defendants in 8 cases in which injunctions have been obtained as to 47 co-defendants.

[4] Includes (a) actions dismissed (as to 941 defendants); (b) actions discontinued, abated, abandoned, stipulated, or settled (as to 73 defendants); (c) actions in which judgment was denied (as to 48 defendants); (d) actions in which prosecution was stayed on stipulation to discontinue misconduct charged (as to 4 defendants).

TABLE 12.—*Summary of Cases Instituted Against the Commission, Cases Involving Petitions for Review of Commission Orders, Cases in Which the Commission Participated as Intervenor or Amicus Curiae, and Reorganization Cases on Appeal under Ch. X in Which the Commission Participated.*

Types of cases	Total cases instituted up to end of 1970 fiscal year	Total cases closed up to end of 1970 fiscal year	Cases pending at end of 1970 fiscal year	Cases pending at end of 1969 fiscal year	Cases instituted during 1970 fiscal year	Total cases pending during 1970 fiscal year	Cases closed during 1970 fiscal year
Actions to enjoin enforcement of Securities Act, Securities Exchange Act or Public Utility Holding Company Act with the exception of subpoenas issued by the Commission	85	83	2	1	2	3	1
Actions to enjoin enforcement of or compliance with subpoenas issued by the Commission	17	17	0	0	1	1	1
Petitions for review of Commission's orders by Courts of Appeals under the various Acts administered by the Commission	340	329	11	19	10	29	18
Miscellaneous actions against the Commission or officers of the Commission and cases in which the Commission participated as intervenor or *amicus curiae*	342	333	9	17	5	22	13
Appellate proceedings under Ch. X in which the Commission participated	235	226	9	1	9	10	1
Total	1,019	988	31	38	27	65	34

TABLE 13.—*A 37-Year Summary of Criminal Cases Developed by the Commission—1934 Through 1970 by Fiscal Year* [1]

[See table 14 for classification of defendants]

Fiscal year	Number of cases referred to Dept. of Justice in each year	Number of persons as to whom prosecution was recommended in each year	Number of such cases in which indictments have been obtained	Number of defendants indicted in such cases [2]	Number of these defendants convicted	Number of these defendants acquitted	Number of these defendants as to whom proceedings have been dismissed on motion of United States Attys.	Number of these defendants as to whom cases are pending [3]
1934	7	36	3	32	17	0	15	0
1935	29	177	14	149	84	5	60	0
1936	43	379	34	368	164	46	158	0
1937	42	128	30	144	78	32	34	0
1938	40	113	33	134	75	13	46	0
1939	52	245	47	292	199	33	60	0
1940	59	174	51	200	96	38	66	0
1941	54	150	47	145	94	15	36	0
1942	50	144	46	194	108	23	63	0
1943	31	91	28	108	62	10	36	0
1944	27	69	24	79	48	6	25	0
1945	19	47	18	61	36	10	15	0
1946	16	44	14	40	13	8	19	0
1947	20	50	13	34	9	5	20	0
1948	16	32	15	29	20	3	6	0
1949	27	44	25	57	19	13	25	0
1950	18	28	15	27	21	1	5	0
1951	29	42	24	48	37	5	6	0
1952	14	26	13	24	17	4	3	0
1953	18	32	15	33	20	7	6	0
1954	19	44	19	52	29	10	13	0
1955	8	12	8	13	7	0	6	0
1956	17	43	16	44	28	5	11	0
1957	26	132	18	80	35	5	40	0
1958	15	51	14	37	17	5	15	0
1959	45	217	39	234	117	20	97	0
1960	53	281	44	207	113	11	79	4
1961	42	240	42	276	133	22	83	38
1962	60	191	51	152	85	15	52	0
1963	48	168	39	117	72	7	32	6
1964	48	164	37	174	105	12	34	23
1965	49	167	45	160	100	7	32	21
1966	44	118	38	179	99	13	26	41
1967	44	212	29	219	78	20	106	15
1968	40	128	30	148	41	11	28	68
1969	37	139	31	105	28	0	6	71
1970	[4] 35	93	19	65	1	1	0	63
Total	1,241	4,451	[5] 1,028	4,460	2,305	441	[6] 1,364	350

[1] The figures given for each year reflect actions taken and the status of cases as of the end of the most recent fiscal year with respect to cases referred to the Department of Justice during the year specified. For example, convictions obtained in fiscal 1970 with respect to cases referred during fiscal 1969 are included under fiscal 1969. While the table shows only 1 conviction under 1970, the total number of convictions for cases referred during that year and prior years was 55, as noted in the text of this report. There were 36 indictments returned in 28 cases during fiscal year 1970.

[2] The number of defendants in a case is sometimes increased by the Department of Justice over the number against whom prosecution was recommended by the Commission. Also more than one indictment may result from a single reference.

[3] See Table 15 for breakdown of pending cases.

[4] Fifteen of these references involving 31 proposed defendants, and 14 prior references involving 43 proposed defendants, were still being processed by the Department of Justice as of the close of the fiscal year.

[5] Eight hundred and ninety-two of these cases have been completed as to one or more defendants. Convictions have been obtained in 698 or 78 percent of such cases. Only 194 or 22 percent of such cases have resulted in acquittals or dismissals as to all defendants; this includes numerous cases in which indictments were dismissed without trial because of the death of defendants or for other administrative reasons. See note 6, *infra*.

[6] Includes 90 defendants who died after indictment.

TABLE 14.—*A 37-Year Summary Classifying All Defendants in Criminal Cases Developed by the Commission—1934 to June 30, 1970*

	Number indicted	Number convicted	Number acquitted	Number as to whom cases were dismissed on motion of U.S. Attorneys	Number as to whom cases are pending
Registered broker-dealers[1] (including principals of such firms)	693	405	51	178	59
Employees of registered broker-dealers	393	185	28	120	60
Persons in general securities business but not as registered broker-dealers (includes principals and employees)	875	433	76	361	5
All others [2]	2,499	1,282	286	705	226
Total	4,460	2,305	441	1,364	350

[1] Includes persons registered at or prior to time of indictment.
[2] The persons referred to in this column, while not engaged in a general business in securities, were almost without exception prosecuted for violations of law involving securities transactions.

TABLE 15.—*Summary of Criminal Cases Developed by the Commission Which Were Pending at June 30, 1970*

Pending, referred to Department of Justice in the fiscal year	Cases	Number of defendants in such cases	Number of such defendants as to whom cases have been completed	Number of such defendants as to whom cases are still pending and reasons therefor		
				Not yet apprehended	Awaiting trial	Awaiting appeal [1]
1959	0	34	34	0	0	0
1960	1	23	19	1	3	0
1961	6	65	27	1	37	0
1962	0	0	0	0	0	0
1963	1	9	3	0	6	0
1964	1	34	11	0	23	2
1965	6	27	6	1	20	0
1966	8	46	5	0	41	11
1967	3	17	2	0	15	3
1968	13	72	4	1	67	6
1969	21	78	7	6	65	5
1970	17	64	1	0	63	0
Total	77	469	119	10	340	27

SUMMARY

Total cases pending [2]	107
Total defendants [2]	549
Total defendants as to whom cases are pending [2]	430

[1] The figures in this column represent defendants who have been convicted and whose appeals are pending. These defendants are also included in the figures in column three.
[2] As of the close of the fiscal year, indictments had not yet been returned as to 80 proposed defendants in 30 cases referred to the Department of Justice. These are reflected only in the recapitulation of totals at the bottom of the table. The figure for total cases pending includes 17 cases in a Suspense Category.

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