

**27th Annual Report
of the
Securities and Exchange**

Fiscal Year Ended June 30, 1961

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SECURITIES AND EXCHANGE COMMISSION

Headquarters Office
425 Second Street NW.
Washington 25, D.C.

COMMISSIONERS

January 10, 1962

WILLIAM L. CARY, Chairman
BYRON D. WOODSIDE
J. ALLEN FREAR, JR.
MANUEL F. COHEN
JACK M. WHITNEY II

ORVAL L. DuBOIS, Secretary

LETTER OF TRANSMITTAL

SECURITIES AND EXCHANGE COMMISSION,
Washington 25, D.C.

SIR : On behalf of the Securities and Exchange Commission, I have the honor to transmit to you the Twenty-Seventh Annual Report of the Commission covering the fiscal year July 1, 1960, to June 30, 1961, in accordance with the provisions of Section 23 (b) of the Securities Exchange Act of 1934, approved June 6, 1934; Section 23 of the Public Utility Holding Company Act of 1935, approved August 26, 1935; Section 46 (a) of the Investment Company Act of 1940, approved August 22, 1940; Section 216 of the

Investment Advisers Act of 1940, approved August 22, 1940; Section 3 of the act of June 29, 1949, amending the Bretton Woods Agreement Act; and Section 11 (b) of the Inter-American Development Bank Act.

Respectfully,

WILLIAM L. CARY,
Chairman.

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

Earl F. Hastings
1908-1961

We wish to express here our profound regret at the death of Earl F. Hastings on September 8, 1961, shortly after his retirement for reasons of health while serving his second term as a member of the Securities and Exchange Commission.

As Director of Securities for the Arizona Corporation Commission in the years 1949 to 1956, and thereafter as a member of this Commission, he served his State and Nation well as an able and just administrator, bringing to the public service a broad experience in mining and industrial engineering. His fairness in the administration of the law, his staunch advocacy of the cause of investor protection, and his dedication to the objectives for which the Commission was established have left an indelible impression upon those members who served with him and upon the staff.

We shall miss his wise and forthright counsel, and his warm and courteous personality. To the members of his family we extend our deepest sympathy,

William L. Cary
Byron D. Woodside
J. Allen Frear, Jr.
Manuel F. Cohen
Jack M. Whitney II

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COMMISSIONERS AND STAFF OFFICERS
(As of January 4, 1962)

Commissioners

WILLIAM L. CARY of New York, Chairman -- Term Expires June 5, 1966

BYRON D. WOODSIDE of Virginia -- Term Expires June 5, 1962

J. ALLEN FREAK, Jr., of Delaware -- Term Expires June 5, 1965

MANUEL F. COHEN of Maryland -- Term Expires June 5, 1963

JACK M. WHITNEY II of Illinois -- Term Expires June 5, 1964

Secretary: ORVAL L. DuBOIS

Staff Officers

EDMUND H. WORTHY, Acting Director, Division of Corporation Finance. CHARLES E. SHREVE, Acting Associate Director.

ALLAN F. CONWILL, Director, Division of Corporate Regulation.
SOLOMON FREEDMAN, Associate Director.

PHILIP A. LOOMIS, Jr., Director, Division of Trading and Exchanges.
IRVING M. POLLACK, Associate Director.

MILTON H. COHEN, Director, Special Study of Securities Markets.
RALPH S. SAUL, Associate Director.
RICHARD H. PAUL, Chief Counsel.

PETER A. DAMMANN, General Counsel.
DAVID FERBER, Associate General Counsel.
WALTER P. NORTH, Associate General Counsel.

ANDREW BARR, Chief Accountant.

LEONARD HELFENSTEIN, Director, Office of Opinion Writing.

W. VICTOR RODIN, Associate Director.

WILLIAM E. BECKER, Management Analysis Officer.

FRANK J. DONATY, Comptroller.

ERNEST L. DESSECKER, Acting Records and Service Officer.

HARRY POLLACK, Director of Personnel.

REGIONAL AND BRANCH OFFICES

Regional Administrators

Region 1. New York, New Jersey. -- Llewellyn P. Young; William D. Moran, Associate Regional Administrator, 225 Broadway, New York 7, N.Y.

Region 2. Massachusetts, Connecticut, Rhode Island, Vermont, New Hampshire, Maine. -- Philip E. Kendrick, Federal Building, Post Office Square, Boston Q, Mass.

Region 3. Tennessee, North Carolina, South Carolina, Georgia, Alabama, Mississippi, Florida, and that part of Louisiana lying east of the Atchafalaya River. -- William Green, Suite 138, 1371 Peachtree Street, NE., Atlanta 9, Ga.

Region 4. Illinois, Indiana, Iowa, Kansas City (Kans.), Kentucky, Michigan, Minnesota, Missouri, Ohio, Wisconsin. -- Thomas B. Hart, Bankers Building (Room 630), 105 West Adams Street, Chicago 3, Ill.

Region 5. Oklahoma, Arkansas, Texas, that part of Louisiana lying west of the Atchafalaya River, and Kansas (except Kansas City). -- Oran H. Allred, United States Courthouse (Room 301), 10th and Lamar Streets, Fort Worth 2, Tex.

Region 6. Wyoming, Colorado, New Mexico, Nebraska, North Dakota, South Dakota, Utah. -- Milton J. Blake, 802 Midland Savings Building, 444 17th Street, Denver 2, Colo.

Region 7. California, Nevada, Arizona, Hawaii. -- Arthur B. Pennekamp, Pacific Building, 821 Market Street, San Francisco 3, Calif.

Region 8. Washington, Oregon, Idaho, Montana, Alaska. -- James E. Newton, Hoge Building (9th floor), 705 Second Avenue, Seattle 4, Wash.

Region 9. Pennsylvania, Maryland, Virginia, West Virginia, Delaware, District of Columbia. -- William J. Crow, Courts Building, 310 6th Street, N.W., Washington 25, D.C.

Branch Offices

Cleveland 13, Ohio. Standard Building (Room 1628), 1370 Ontario Street.

Detroit 26, Mich. Federal Building (Room 1074).

Houston 2, Tex. 717 Bettles Building, 201 Main Street.

Los Angeles 28, Calif. Guaranty Building (Room 309), 6331 Hollywood Boulevard.

Miami 32, Fla. Plaza Building (Room 440), 245 South East First Street.

St. Louis, Mo. Arcade Building (Room 1025), 812 Olive Street.

St. Paul 1, Minn. Main Post Office and Customhouse (Room 1027), 180 East Kellogg Boulevard.

Salt Lake City, Utah. Newhouse Building (Room 1119), 10 Exchange Place.

COMMISSIONERS

William L. Cary, Chairman

Chairman Cary was born in Columbus, Ohio, on November 27, 1910. He received an A.B. degree in 1931 and an LL.B. degree in 1934 from Yale University and an M.B.A. degree from the Harvard Graduate School of Business Administration in 1938. He is a member of Phi Beta Kappa and Phi Delta Phi. Following admission to the Ohio bar in 1934, he was associated with a Cleveland law firm for 2 years. Upon completion of 2 years of graduate study at the Harvard Graduate School of Business in May 1938, he joined the legal staff of the Securities and Exchange Commission where he served for nearly 2 years in the General Counsel's Office and the Reorganization Division. He served as a Special Assistant to the Attorney General in the Tax Division of the Department of Justice from March 1940 until January 1942, and as Counsel, Office of Coordinator of Inter-American Affairs, in Rio de Janeiro until January 1943. After World War II service with the U.S. Marine Corps Reserve and the Office of Strategic Services in Rumania and Yugoslavia, he became a lecturer in finance and law at the Harvard Graduate School of Business Administration (1946-47). From 1947 to 1955, he served as professor of law at Northwestern University School of Law, except for service as Deputy

Department Counselor for Procurement, Department of the Army, during the Korean War, and at Columbia University School of Law from 1955 to March 1961. He is coauthor of several books in the corporate field, and until his appointment served as special counsel to a New York law firm. He took office as a member of the Securities and Exchange Commission on March 27, 1961, for the term expiring June 5, 1961. His appointment also covered the succeeding 5-year term ending June 5, 1966. He was designated Chairman of the Commission.

Byron D. Woodside

Commissioner Woodside was born in Oxford, Pa., in 1908, and is a resident of Haymarket, Va. He holds degrees of B.S. in economics from the University of Pennsylvania, A.M. from George Washington University, and LL.B. from Temple University. He is a member of the bar of the District of Columbia. In 1929 he joined the staff of the Federal Trade Commission, and in 1933, following the enactment of the Federal Securities Act, was assigned to the Securities Division of that Commission which was charged with the administration of the Securities Act of 1933. He transferred to the Securities and Exchange Commission when the Securities Exchange Act of 1934 was enacted. In 1940 he became Assistant Director and in 1952 Director of the Division (now Division of Corporation Finance) responsible for administering the registration and reporting provisions of the Securities Act, Securities Exchange Act, the Trust Indenture Act of 1939, and, in part, the Investment Company Act of 1940. For 14 months commencing in May 1948, he was on loan to the Department of the Army and assigned to duty in Japan as a member of a five-man board which reviewed reorganization plans of Japanese companies under the Occupation's decartelization program; and beginning in December 1950 he served 17 months with the Rational Securities Resources Board and later with the Defense Production Administration as Assistant Deputy Administrator for Resources Expansion. He took office as a member of the Securities and Exchange Commission on July 15, 1960, for the term of office expiring June 5, 1962.

J. Allen Frear, Jr.

Commissioner Frear was born on a farm near Rising Sun, Del., on March 7, 1903, where he attended a rural school, graduated from the Caesar Rodney High School, and obtained a B.S. degree from the University of Delaware in 1924. He also holds an honorary degree from Bethany College. An agriculturist by vocation, he has been active in civic and political affairs. For the 12-year period from January 3, 1949, he served two 6-year terms as a Senator from the State of Delaware in the Senate of the United States. He was a member of the Committee on Banking and Currency, which has jurisdiction over legislative and other matters affecting the Commission, and the Committee on Finance. From 1940 to 1948 he was a member of the Board of Directors, Farm Credit Administration, Second Farm Credit District, except for a period of service with the U.S. Army from 1943 to 1946 in World War II. He also served on the Delaware Old Age Assistance Commission and on the board of trustees for Delaware State College. At

present he is a director of two banks in Delaware, and a member of the board of trustees of the University of Delaware. He holds membership in the Rotary Club, Sigma Nu Fraternity, and the American Legion and the Veterans of Foreign Wars. On March 15, 1961, he took the oath of office as a member of the Commission for the term expiring June 5, 1965.

Manuel F. Cohen

Commissioner Cohen was born in Brooklyn, N.Y., on October 9, 1912. He holds a B.S. degree in social science from Brooklyn College of the City of New York. He received an LL.B. degree, cum laude, in 1936 from Brooklyn Law School of St. Lawrence University and was elected to the Philonomic Council. He is a member of the New York bar. In 1933-1934 he served as research associate in the Twentieth Century Fund studies of the securities markets. He joined the Commission's staff as an attorney in 1942 after several years in private practice, serving first in the Investment Company Division and later in the Division of Corporation Finance, of which he was made Chief Counsel in 1953. He was named Adviser to the Commission in 1959 and in 1960 became Director of the Division of Corporation Finance. He was awarded a Rockefeller Public Service Award by the trustees of Princeton University in 1956 and for a period of 1 year studied the capital markets and the processes of capital formation and of government and other controls in the principal financial centers of Western Europe. In 1961 he was appointed a member of the Council of the Administrative Conference of the United States and received a Career Service Award of the National Civil Service League. Since 1958 he has been lecturer in Securities Law and Regulation at the Law School of George Washington University and is the author of a number of articles on securities regulation published in domestic and foreign professional journals. He took office as a member of the Commission on October 11, 1961, for the term expiring June 5, 1963.

Jack M. Whitney II

Commissioner Whitney was born in Huntington Beach, Calif., on May 16, 1922. He attended Millsaps College in Jackson, Miss., for 2 years, and Northwestern University School of Commerce, from which he received a B.S. degree in 1943. From 1943 to 1946 he was on active duty in the U.S. Naval Reserve, achieving the rank of Lieutenant (junior grade) in the Supply Corps. He was graduated from Northwestern University School of Law in 1949 with the degree of J.D. In law school he was an editor of the law review, and he is a member of Beta Gamma Sigma and Order of the Coif. Following graduation he became associated with the Chicago law firm of Bell, Boyd, Marshall & Lloyd, of which he was a member at the time of his appointment to the Commission. His practice was primarily in the field of corporate finance. He took office as a member of the Commission on November 9, 1961, for the term ending June 5, 1964.

PART I

CURRENT PROBLEMS BEFORE THE COMMISSION

The High Level of Activity and Changing Conditions in the Securities Markets

The activity in the security markets of the Nation continued to increase and reached a new peak in fiscal year 1961, This is shown graphically in the chart on page 2, which portrays the successive significant increases that have occurred in recent years in the flotation of new issues of securities for sale to the public. A similar increase has occurred in the volume of trading on the national securities exchanges. In the fiscal year 1961 such trading reached a new peak of 1. billion shares with a dollar volume of \$57 billion.

These figures reflect a marked growth of public participation in the securities markets. A study made by the New York Stock Exchange shows that during the period 1952-59 the number of shareholders doubled, and that in the last 3 years of that period the number increased by nearly 1 1/3 million a year. Correspondingly there has been a large increase in the number of broker-dealers, in the number of their salesmen and in the number of branch offices which they have opened. At the end of the 1961 fiscal year there were 5,500 brokers and dealers registered with the Commission as compared with 3,930 in 1950. The number of customer's men registered with the New York Stock Exchange increased from 10,608 in 1950 to 27,896 in 1961 and the number of customer's men registered with the National Association of Securities Dealers, Inc., increased from 28,794 to 93,351 in the same period. The number of branch offices maintained by member firms of the New York Stock Exchange increased from 1,661 in 1950 to 3,166 at the end of 1960. Some member firms have trebled their retail outlets.

Thus, concomitantly with the influx of a large number of new and presumably inexperienced investors into the market, there has been an influx of new and inexperienced salesmen. At the same time, the increase in the number of branch offices has tended to result in less effective supervision of the salesmen. The problem of supervision is aggravated by the employment of part-time salesmen and salesmen who operate from their private residences. These factors have made more difficult the task of the Commission and the exchange and securities association disciplinary bodies in attempting to insure that prospective investors receive adequate information and proper advice as to the suitability of particular securities to meet their personal investment needs.

Investment companies have assumed an increasing importance. The number of investment companies registered with the Commission has increased from 366 in 1950 to 663 at the close of the 1961 fiscal year and in the same period the estimated market value of their assets increased from \$4. billion to \$29 billion. In the 1961 fiscal year such companies registered \$4. billion of new securities for sale to the public, as compared with the total of \$19 billion of new securities issues registered for sale by all corporations. In the sale of investment company securities to a larger number of persons, door-to-door salesmen have been utilized and plans are provided whereby such securities may be purchased by a series of periodic payments.

Another phenomenon which has manifested itself is the strong public appeal of new issues of securities and many new issues have moved up sharply in price above the initially established offering price almost from the moment first marketed. In an effort to detect any manipulative or other fraudulent practices contributing to such price increases, the Commission has conducted more market quizzes this year than in any prior year in its history. Detection of such practices is made difficult by the lack of any systematic reporting of prices and volume of transactions in the over-the-counter market such as is available concerning transactions on security exchanges.

Study of Trading and Marketing Practices in the Exchange and Over-the-Counter Markets

In view of the tremendous growth and many new developments in the securities markets, the Commission has welcomed the authorization and special appropriation granted by H.J. Res. 438, enacted shortly after the close of the fiscal year, directing a study of trading and marketing practices on the national securities exchanges and in the over-the-counter market to determine whether exchange and securities association rules, including rules for the expulsion, suspension, or disciplining of members, are adequate for the protection of investors in the light of present conditions, whether the administration of these rules is sufficient and whether additional rules or legislation are required. This study will result in the obtaining and evaluation of much valuable overall information as to distribution and trading practices both on and off the exchanges. The Commission is directed to report the result of its study on or before January 3, 1963, and will promptly submit to the Congress any recommendations for legislation in particular areas which may be shown to be required in the course of the study.

Study of the Implications of the Growth of Investment Companies

As reported in previous reports, the Commission entered into a contract with the Wharton School of Finance and Commerce of the University of Pennsylvania for the preparation of a study of the problems created by the growth in size of investment companies. As discussed in part IX below, a report has now been received covering such subjects as organization and control of open-end investment companies, growth of investment companies, portfolio company control, investment policy, performance, and impact of investment companies on the stock market. A further report dealing with the relationships between open-end investment companies and their investment advisers and principal underwriters is expected to be received by the end of the calendar year 1961. It is anticipated that the information developed in this report will assist in providing a basis for determination by the Commission of the action which should be taken concerning the problems in these fields and whether specific legislative recommendations should be made by the Commission to the Congress.

The portion of the report yet to be received is of particular interest in view of the stockholders suits, some 50 in number, which have been instituted in the courts during the past 2 years against 18 registered investment companies and in which it is alleged, inter alia, that the management or advisory fees paid by the investment companies are grossly excessive.

The Commission has participated in several of these suits as (mucus curiae in support of plaintiffs' position that the act affords a private Federal right of action for violation of various provisions of the act but has not taken any direct action with respect to merits of the matters involved in the litigation.

Variable Annuity Contracts

The Commission has under study the many problems arising under the Investment Company Act of 1940 in connection with the issuance and sale of variable annuity contracts. On September 26, 1961, after the close of the fiscal year, the President vetoed H.R. 7482, which would have amended the Life Insurance Act of the District of Columbia to permit District life insurance companies to establish certain voting and management procedures with respect to variable annuity contracts. The passage of the bill had been opposed by the Commission. In his veto message the President pointed out that the purchaser of a variable annuity depends largely upon the efficiency and skill of the management in selecting and managing the underlying portfolio securities for the return upon his investment. He stated that the bill failed to give adequate recognition to the basic principle, recognized in the Investment Company Act, that the investor have a voice in the control of his company. He pointed out further that the bill did not resolve the problems under the act and indicated his confidence that the Commission would in the near future be in a position to offer a suggested program for solution of the problem of reconciling with the provisions of the Investment Company Act the operations of life insurance companies which desire to sell variable annuities.

Enforcement Activity

The high level of public interest and participation in the securities markets has offered a fertile field for unscrupulous operators and promoters. To counter fraudulent and other illegal practices in the sale and purchase of securities, the Commission is pursuing a vigorous enforcement program. During the fiscal year, 546 antifraud and other regulatory investigations were instituted. Injunction actions were brought in 92 cases, a greater number than in any previous year. In criminal prosecutions 126 convictions were obtained in 45 cases, the largest number of convictions in any fiscal year since the earliest days of the Commission. Inspections were made of 1,627 broker-dealer firms, and the registrations of 55 firms were revoked. Examinations or investigations were initiated in 16 cases to determine whether stop order proceedings should be brought with respect to registration statements filed with respect to new security offerings, and 14 investigations were instituted to determine whether other information filed with the Commission was

accurate and adequate. Orders suspending the exemption from registration provided for small security issues. were issued in 54 instances. Inspections were conducted of 56 registered investment companies. The most significant of these actions are described in the parts of this report which follow.

Operations from foreign bases continue to plague our enforcement efforts. Despite excellent cooperation from Canadian authorities, it is most difficult to combat fraudulent activities carried on from vantage points outside our jurisdiction.

Registration of New Security Offerings

One of the primary duties of the Commission is the examination of registration statements filed under the Securities Act of 1933 with respect to new security issues proposed to be offered to the public. The unprecedented number of registration statements filed in recent years has taxed the capacity of the Commission's staff to the utmost. The number of such statements filed increased again in the fiscal year 1961 to a new high of 1,830, representing a 12 percent increase over last year. This number may be compared with the total number of registration statements filed in fiscal 1950 of 496.

The problem for the Commission arises not only from the volume of statements, but more particularly from their character. Of the 1,830 statements filed in fiscal 1961, 52 percent, amounting to a record number of 958, were filed by companies that had not previously registered a securities offering. This compares with 28 percent as recently as 1958. The letter of comment technique whereby inadequacies in the registration statement are called to the issuer's attention by our staff and appropriate amendments filed is described in part IV of this report. Needless to say this processing technique is more time consuming where the issuer has had no previous experience in complying with the registration requirements.

The increases in the numbers and change in character of registration statements filed in recent years has far outstripped increases in examining personnel and the median time required to process registration statements has crept upwards year by year, reaching 55 days from initial filing to effective date in fiscal 1961. For fiscal 1962, under a further increased budget, it has been possible to allocate a personnel increase to the Division of Corporation Finance which it is hoped will result in a decrease in the time required in the examination process.

Management Survey

During the fiscal year the management consulting firm of Booz, Allen & Hamilton conducted a survey of the Commission under contract with the Bureau of the Budget with the consent of the Commission. The general purpose of the survey was to appraise the Commission's organization and operations and to recommend improvements where appropriate. The survey began on July 18, 1960, and the fact-finding aspects were

completed by October 31, 1960. Printed copies of the survey were made available by the Bureau of the Budget on January 16, 1961, for distribution to appropriate committees of the Congress, interested members of the public, the members and staff of the Commission, and the press.

The report contains the following principal conclusions: (1) the Commission is effectively carrying out the mission assigned to it by the Congress, but additional manpower is required in order to prevent deterioration of regulatory standards; (2) there is an urgent need for a minimum 11 percent increase in manpower above the allocation for fiscal 1961 to meet the increased workload; and (3) certain procedural and organizational changes should be made.

The report encompasses a total of 101 recommendations, 13 outlining the need for additional manpower to permit the Commission to process its workload, 74 relating to procedural changes, 11 pertaining to organizational changes, and 3 pertaining to training of new personnel.

As of August 31, 1961, 82 recommendations had been implemented or otherwise acted upon, and the remaining 19 were under study.

It may be noted that the appropriation for fiscal 1962 provides for an average employment approximately 14 percent above that in 1961.

PART II **LEGISLATIVE ACTIVITIES**

Statutory Amendments in the 86th Congress

At the beginning of the fiscal year, amendments to the Investment Advisers Act of 1940 and the Trust Indenture Act of 1939 were enacted by the 86th Congress and signed by the President, becoming Public Laws 86-750 and 86-760, respectively.

Public Law 86-750 amends the Investment Advisers Act of 1940 by expanding the bases for disqualification of a registrant because of prior misconduct, authorizing the Commission by rule to require the keeping of books and records and the filing of reports, permitting periodic examination of a registrant's books and records, empowering the Commission by rule to define and prescribe means reasonably designed to prevent fraudulent practices, extending criminal liability for a willful violation of a rule or order of the Commission, making it clear that aiders and abettors may be responsible in injunctive and administrative proceedings, and modifying the definition of the term "control" in the statute and the conditions under which an investment adviser may call himself an "investment counsel."

Public Law 86-760 amends section 304 (c) of the Trust Indenture Act of 1939. Under that section the Commission was required to grant an exemption from one or more of the provisions of the act if, at the time the application for exemption was filed, securities were outstanding under the indenture involved which were outstanding within 6 months of the enactment of the act, that is by February 4, 1940, and if compliance would require consent of the holders of outstanding securities, or would impose an undue burden of the issuer, having due regard for the public interest and the interests of investors. As amended, section 304 (c) now requires the Commission to grant the exemption in the same situation if there are securities outstanding under the indenture which were outstanding either on February 4, 1940, or such securities were outstanding on January 1, 1959.

The Commission had originally made a number of proposals to the 86th Congress for amendment of the Federal securities law. The proposals were intended to strengthen the safeguards and protections afforded the public by tightening jurisdictional provisions, correcting certain inadequacies revealed through administrative experience and facilitating criminal prosecutions and other enforcement activities. Hearings on the bills were held and modifications of the proposals were passed by the Senate and reported out by the Committee on Interstate and Foreign Commerce of the House of Representatives. With the exceptions noted above, however, they were not enacted into law. The Commission's proposals and the action taken by Congress concerning them are discussed in the 25th annual report, pages 9-11 and the 26th annual report, pages 9-10.

An amendment enacted to section 4 (a) of the Securities Exchange Act of 1934 provides that a member of the Commission, after the expiration of his term, shall continue in office until his successor is appointed and qualified, except that he may not continue beyond the expiration of the next session of Congress subsequent to the expiration of his term in office. [Footnote: Public Law 86-619. A correcting amendment relating to the salary of the Chairman was subsequently embodied in H.R. 10366 and enacted into law. Public Law 86-771.]

Congressional Action and Hearings in the 87th Congress

1. H.J. Res. 438. -- On June 27, 1961, Chairman Cary and other members of the Commission appeared before the Subcommittee on Commerce and Finance of the Committee on Interstate and Foreign Commerce, House of Representatives, to testify on H. J. Res. 438. The resolution, which was introduced by Representative Peter Mack, provided for the amendment of the Securities Exchange Act of 1934 to authorize and direct the Commission to make a study and investigation of the adequacy, for the protection of investors, of the rules of national securities exchanges and national securities associations, including rules for the expulsion, suspension, or disciplining of members for conduct inconsistent with just and equitable principles of trade. The resolution also directed the Commission to report to the Congress on or before January 3, 1963, the results of its study and investigation, together with its recommendations,

including recommendations for such legislation as the Commission deems advisable. An appropriation of \$750,000 with which to carry out the study and investigation was authorized and \$412,000 was appropriated for this purpose for the 1962 fiscal year.

Chairman Cary testified that the Commission supported the resolution and was of the opinion that a thorough study of the over-the-counter market and of the exchanges is desirable. He pointed out that the Commission's present budget is not enough to support such a study and investigation and that the Commission is virtually forced to concentrate all of its funds and manpower upon immediate problems.

Chairman Cary discussed, as tentative areas of inquiry under the study and investigation, the over-the-counter market generally, the lack of information concerning over-the-counter securities, the rules of the exchanges, the growth of public participation and trading volume, the changes in methods of distribution and marketing, and certain problems in connection with the employment of credit in the securities markets and distribution of securities through the facilities of the exchanges.

A modification suggested by Chairman Cary was incorporated in the resolution and after the end of the fiscal year it was passed by the House of Representatives and the Senate and was signed by the President.

2. Reorganization Plan No. 1 and S. 2135. -- Chairman Cary and other members of the Commission appeared before various committees of the Senate and House of Representatives in connection with hearings on Reorganization Plan No. 1, which concerned the Commission's authority to delegate, by rule or order, any of its functions. Testimony was given on May 18, 1961, before a subcommittee, of the Committee on Government Operations, House of Representatives, on June 2, 1961, before a subcommittee of the Senate Committee on Banking and Currency and on June 6, 1961, before the Committee on Government Operations of the Senate.

In substance, Chairman Cary testified that he believed that the plan would serve to relieve the Commission from dealing with many matters of lesser importance and thus conserve its time for the consideration of major matters of policy and planning, that under the plan the rights of any party appearing before the Commission would continue to be preserved, that the Commission would retain the right to review any delegated action and that the plan would expand and clarify the Commission's already existing powers of delegation.

Reorganization Plan No. 1 was disapproved by the Senate, and on June 22, 1961, Senator Harrison A. Williams, Jr. (for himself and for Senator Jacob K. Javits), introduced S. 2135, which also dealt with the Commission's authority to delegate its functions, but which differed in certain respects from Reorganization Plan No. 1. Although no hearings were held on S. 2135, the Commission submitted comments on the bill in which it suggested amendments which it believed would improve the bill, and indicated that it favored the adoption of S. 2135 subject to the suggested amendments. On August 24,

1961, the Committee on Banking and Currency, U.S. Senate, favorably reported S. 2135 with amendments as suggested by the Commission, and on September 1, 1961, the Senate passed the bill as reported.

3. H.R. 14. -- On June 8, 1961 Chairman Cary and members of the Commission appeared before the Committee on Interstate and Foreign Commerce, House of Representatives, to testify on H.R. 14, a bill to promote the efficient, fair, and independent operation of Federal regulatory agencies. The Chairman testified that the Commission is in accord with the purposes of the bill, but that certain provisions of the bill might create problems in connection with the operation of the Commission.

Legislative Proposals in the 87th Congress

The following bills relating to the Federal securities laws were introduced in the 87th Congress during the fiscal year 1961.

S. 756, introduced by Senator Homer E. Capehart, would amend section 31 of the Securities Exchange Act of 1934, which now provides an annual fee for registration of exchanges of one five-hundredth of 1 percent of the aggregate dollar amount of stock exchange transactions, equal to 2 cents per \$1,000. Under the bill, this registration fee would be increased to a rate of 5 cents per \$1,000 and there would be a similar registration fee of 5 cents per \$1,000 on transactions effected otherwise than on a national securities exchange.

S. 1117, introduced by Senator Maurine B. Neuberger, would amend section 36 of the Investment Company Act of 1940 to provide an investigatory power in the board of directors of a registered investment company, or the investment adviser or principal underwriter for such a company, with respect to among other things, securities transactions and loans by an officer, director, employee, or agent of the registered investment company or investment adviser.

S. 1842, introduced by Senator John A. Carroll (for himself and Senator Philip A. Hart), would, among other things, amend section 4 (a) of the Securities Exchange Act of 1934 to provide for a term of 10 years for members of the Commission.

H.R. 1118, introduced by Representative J. Arthur Younger, would, among other things, amend the Securities Exchange Act of 1934 to provide for the assessment and collection of increased fees to cover the cost of operation of this Commission.

H.R. 1211, introduced by Representative Abraham Multer, would amend section 16 (a) of the Securities Exchange Act of 1934 to provide that officers and directors of any issuer of registered securities report periodically the extent to which, and the purposes for which, their holdings of such securities are pledged.

H.R. 1218, also introduced by Representative Multer, would remove the exemption provided by section 3 (a) (11) of the Securities Act of 1933 for a security offering confined to the residents of the state within which the issuer is both incorporated and doing business.

H.R. 2799, introduced by Representative Francis E. Walter, would amend the Investment Company Act of 1940. The bill is substantially similar to S. 1117, which is discussed above.

H.R. 6591, introduced by Representative Abraham Multer, would amend the Securities Act of 1933 and the Investment Company Act of 1940 with respect to the status of variable annuity policies and companies which offer such policies to the public.

H.R. 6863, which was also introduced by Representative Multer, would amend the Investment Advisers Act of 1940 to require disclosure by investment advisers of transactions for their own account in any investments of the type with respect to which they render advisory services.

A substantial amount of time was devoted to matters pertaining to other legislative proposals referred to the Commission for comment and to congressional inquiries. During the fiscal year a total of 41 legislative proposals were analyzed. In addition, numerous congressional inquiries relating to matters other than specific legislative proposals were reviewed and answered.

PART III **REVISION OF RULES, REGULATIONS, AND FORMS**

The Commission maintains a continuing review of its rules, regulations, and forms in order to adapt them to changing conditions and changing methods and procedures in the fields of business and finance. Certain members of its staff are assigned to this task. Changes are also suggested, from time to time, by other members of the staff engaged in the examination of material filed with the Commission and by persons outside of the Commission who are subject to the Commission's requirements or who have occasion to work with those requirements in a professional capacity such as underwriters, attorneys, accountants, and other representatives. With a relatively few exceptions, provided for by the Administrative Procedure Act, proposed changes in rules, regulations, and forms are announced to the public and interested persons are invited to submit their views and comments thereon. These views and comments are carefully reviewed by the staff and by the Commission.

[Footnote: The rules and regulations of the Commission are published in the Code of Federal Regulations. The rules adopted under the various statutes administered by the Commission appear in the following parts of title 17 of that code :

Securities Act of 1933, pt. 230.
Securities Exchange Act of 1934, pt. 240.
Public Utility Holding Company Act of 1935, pt. 250.
Trust Indenture Act of 1939, pt. 260.
Investment Company Act of 1940, pt. 270.
Investment Advisers Act of 1940,, pt. 275.]

A number of changes were made during the 1961 fiscal year in the rules, regulations, and forms under the various statutes administered by the Commission. Other changes which the Commission announced in preliminary form and on which it invited public comments were pending at the end of the fiscal year. The changes made during the fiscal year and those pending at the end of the year are described below.

GENERAL

Revision of Rules and Forms Concerning the Reporting of Securities Holdings and Transactions

The Commission, during the fiscal year, adopted revised forms for reporting security holdings and transactions pursuant to section 16 (a) of the Securities Exchange Act of 1934, section 17 (a) of the Public Utility Holding Company Act of 1935 and section 30 (f) of the Investment Company Act of 1940.

Previously, the following separate forms were prescribed for statements under each of the statutes referred to: Forms 4, 5, and 6 under the Securities Exchange Act; forms U-17-1 and U-17-2 under the Public Utility Holding Company Act; and forms N-30F-1 and N-30F-2 under the Investment Company Act. All of these forms were consolidated into two forms designated forms 3 and 4 which are used, respectively, for the filing of initial statements of beneficial ownership of securities and statements of changes in such beneficial ownership under all three of these statutes. In connection with the adoption of the revised forms the Commission adopted certain changes in the related rules under the three statutes. The amended rule 30f-1 under the Investment Company Act provides that no statements need be filed pursuant to section 30 (f) of that act by an affiliated person of an investment adviser in his capacity as such if such person is solely an employee, other than an officer, of such investment adviser.

The draft of the proposed rule changes published for comment contained a definition of the term "person" which would have included in such term any group or syndicate the members of which are acting in concert with respect to the acquisition, disposition, holding or voting of securities of an issuer. The draft also included a proposed rule relating to the reporting of interests in securities held by corporations and business trusts. The Commission concluded that these two proposals required further study and consideration and did not include them in the revision.

Amendment of Rules Concerning Disclosure of Nonpublic Records by Employees

The Commission amended the applicable provisions of its rules of practice and related rules under the laws it administers to extend the prohibition of the rules against disclosure by Commission employees of nonpublic information in the files of the Commission.

Heretofore, these rules prohibited officers and employees of the Commission, without its specific authorization, from making available to any person other than a member, officer, or employee of the Commission, whether in response to a subpoena or otherwise, any information or document obtained during the course of any private investigation conducted by the Commission. The amendment extends this prohibition to information in "any other nonpublic records of the Commission," whether obtained in an investigation or otherwise.

A similar amendment was made in rule 122 under the Securities Act of 1933, rule 0-4 under the Securities Exchange Act of 1934, rule 104 (c) under the Public Utility Holding Company Act of 1935, and rule 0-6 under the Trust Indenture Act of 1939.

THE SECURITIES ACT OF 1933

Amendment of Rule 151

Rule 151 under the Securities Act of 1933, which defines the term "public offering," was amended to exclude under certain conditions the offering of the stock of small business investment companies to small business concerns pursuant to the requirements of the Small Business Investment Act of 1958.

Under the former section 304 (d) of the Small Business Investment Act, whenever a small business investment company provided capital to a small business concern, the small business investment company was required to offer, and the small business concern was required to purchase, a certain amount of stock of the small business investment company. Under the provisions of section 304 (c) of the Act, as amended by Public Law 86-502, a small business concern has the right but is not required to acquire such stock when capital is provided. The purpose of the amendment to rule 151 was to conform the provisions of the rule to the amended provisions of the Act.

Proposed Rule 155

The Commission during the previous fiscal year published notice that it had under consideration a proposed new rule which would be designated rule 155. The purpose of this proposed rule was to make clear that a public offering of an immediately convertible security by persons who purchased such security from an issuer in a "private placement," or a public offering of the underlying security received by such persons upon conversion

of the convertible security, may be subject to the registration provisions of the Securities Act. Reference to this matter was made in the Commission's annual report.

The matter was still under consideration at the close of the 1961 fiscal year.

Adoption of Rules 234 and 235; Rescission of Regulation A-R (Rules 230-233)

The Commission adopted rule 234 which provides a revised exemption from registration under the Securities Act of 1933 for certain notes secured by a first lien on real estate. The new rule supersedes regulation A-R (rules 230-233) which has been rescinded.

The new rule makes clear what has been the Commission's longstanding interpretation, that the exemption is available only for notes directly secured by a first lien on real estate, and hence is unavailable for collateral trust notes or participations in an underlying note, even though such underlying note is secured by a first lien on real estate, or for investment contracts involved in the offering of first lien notes. The new rule also provides that the amount of first lien indebtedness for which an exemption is available shall not exceed 75 percent of the appraised value of the property securing the notes. This is a liberalization of the previous requirement that all indebtedness against the property, whether secured by senior or junior liens, shall not exceed 75 percent of the appraised value of the property.

The Commission also adopted rule 235 which provides an exemption from registration under the act for securities of certain cooperative housing corporations. Stock or other securities representing membership in a cooperative housing corporation are exempt where the securities are issued only in connection with the sale or lease of dwelling units in the housing project and are transferable by the purchaser only in connection with the transfer of such dwelling units.

Amendments to Rule 472

Rule 472, which relates to the filing of amendments to registration statements filed under the Securities Act, was amended in certain respects during the fiscal year to facilitate the examination of such statements.

One amendment requires that where an amendment to a registration statement relates to financial statements not included in the prospectus, five additional copies of the amended financial statements shall be furnished.

The rule was also amended to require that every amendment to a registration statement shall be accompanied by two additional copies of the amendment marked to indicate clearly and precisely the changes effected in the registration statement by the amendment. If the amendment alters the text of the prospectus or other material previously filed as a

part of the registration statement, the changes must be indicated by underscoring or in some other appropriate manner.

The purpose of the latter amendment is to avoid the necessity for the staff, in reviewing the amendment, to reread the entire prospectus or other document where only a portion of the material has been altered. The amendment to the rule conforms with present administrative practice.

Amendments to Rules 473 and 478

Section 8 (a) of the Securities Act of 1933 provides that registration statements filed under that act shall become effective on the 20th day after filing or such earlier date as the Commission shall determine. The filing of an amendment to the statement establishes a new filing date and starts the 20-day period running anew. In order to prevent registration statements from becoming effective through the lapse of time and before they have been amended to cure deficiencies therein, it has been the practice of registrants to file technical or so-called "delaying" amendments to start the waiting period running again.

The Commission has amended rule 473 to permit the filing, either with a registration statement or at a later date, of an amendment which will operate to delay the effective date of the statement without the necessity of filing a delaying amendment at the expiration of each successive 20-day waiting period. The delaying effect of such an amendment may be terminated in either of two ways. One way is by filing a further amendment which specifically states that the registration statement shall thereafter become effective in accordance with section 8 (a) of the act. The other way is by the Commission's granting acceleration of the effective date of the registration statement.

The Commission has also adopted an amendment to rule 478 to permit any amendment filed pursuant to rule 473 to be signed by the registrant or its agent for service.

Amendment of Form S-8

Form S-8 is used for registration under the Securities Act of certain equity securities offered pursuant to unincorporated stock purchase or similar plans for the benefit of employees of the issuer of such equity securities and for registration of the interests in such plans. Issuers using this form are required to deliver a copy of the issuer's latest annual report with the prospectus to each eligible employee. The issuer is also required to include in the registration statement an undertaking to transmit to all employees participating in the plan at the time and in the manner such material is sent to such stockholders, copies of all reports, proxy statements and other communications distributed to its stockholders generally. Copies of such material must also be furnished to the Commission.

The foregoing requirements have been amended to provide that such information need not be transmitted to eligible or participating employees pursuant to the requirements of form S-8 where such employees are already stockholders of the issuer and receive copies of such material as such stockholders. The requirement of furnishing copies of such material to the Commission has also been amended to provide that they need not be furnished pursuant to the instructions in form S-8 where they are otherwise furnished pursuant to other requirements of the Commission. The amendments also place the duty of complying with these requirements upon the issuer of the securities offered pursuant to the plan; heretofore such duty was, in part, placed upon the "employer," which might be a company other than the issuer.

Proposed Form S-11 for Securities of Certain Real Estate Companies

During the fiscal year the Commission published notice that it has under consideration a proposed form for registration under the Securities Act of securities of certain real estate companies. The proposed form, which would be designated form S-11, would be used for registration of securities issued by real estate investment trusts, as defined in the recent amendments to the Internal Revenue Code, and by real estate syndicates, partnerships, joint ventures, and other incorporated and unincorporated issuers whose business is primarily that of acquiring and holding real estate or interests in real estate for the purpose of investment.

A number of comments have been received in regard to the proposed new form and the form was being further considered in the light of such comments at the end of the fiscal year.

Amendment of Form S-12

Form S-12 is used for registration under the Securities Act of certain American depositary receipts against outstanding foreign securities. This form requires the inclusion in the registration statement of an undertaking to furnish to the Commission copies of annual and other periodic reports, proxy statements, and other communications distributed to the security holders by the issuer of the underlying securities. The form of this undertaking has been amended to call only for the furnishing of such information in cases where it is not otherwise transmitted to the Commission.

THE SECURITIES EXCHANGE ACT OF 1934

Amendment of Rule 14a-6

Rule 14a-6 which relates to the filing of proxy statements, forms of proxy, and other soliciting material was amended to provide that where amended proxy material is filed with the Commission two copies of such material (or in the case of investment

companies, three copies) shall be marked to show the differences between it and the material as previously filed.

The purpose of the amendment is to expedite the processing of material by making it unnecessary in reviewing proxy material to reread in detail material which is substantially the same as material previously filed.

The amendment represents further action on the part of the Commission to expedite in every practicable way the examination of material filed with it in order to reduce the backlog of unprocessed material.

Proposed Rule 15d-21

Where interests of participation in employee stock purchase, savings, or similar plans have been registered under the Securities Act of 1933 and the securities offered plus those outstanding amount to \$2 million or more reports for such plans are required to be filed pursuant to section 15 (d) of the Securities Exchange Act of 1934. In the absence of any exemption, these reports are required even though the issuer of the securities offered pursuant to the plan files reports with the Commission pursuant to section 13 or 15 (d) of that act. Under a proposed rule 15d-21, on which public comments have been invited, such plans would be exempt from the operation of section 15 (d) of the act if the issuer files annual reports on form 10-K and furnishes the information, financial statements and other documents required by that form with respect to the plan.

Proposed Rule 19a2-1

During the 1960 fiscal year the Commission invited public comments on a proposed rule 19a2-1 under the act which would provide that the failure or refusal of an issuer or its officers, directors, employees, or controlling persons to cooperate with the Commission in proceedings under section 19 (a) (2) or investigations under section 21 of the act with respect to compliance with section 12 or 13 of the act shall be deemed a failure to comply with the provisions of the act or the rules and regulations thereunder for the purpose of section 19 (a) (2). The proposed rule would provide a basis for the issuance of an order under section 19 (a) (2) denying, suspending, or withdrawing the registration of a security in such cases. This matter was pending at the end of the fiscal year.

Amendment of Form 8-K

The Commission has invited public comments on certain proposed amendments to form 8-K. These proposed amendments are designed to bring to the attention of investors promptly information regarding material changes affecting the company or its affairs where it appears that the changes are of such importance that they should be reported promptly and not deferred to the end of the fiscal year. The amendments relate to matters such as the pledging of securities of the issuer or its affiliates, changes in the board of

directors otherwise than by stockholder action, the acquisition or disposition of significant amounts of assets, and transactions with insiders. This matter was pending at the end of the fiscal year.

Amendments to Form 10-K

Form 10-K is used for annual reports pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934. An amendment to this form, adopted during the fiscal year, requires registrants which are not subject to the Commission's proxy rules to furnish to the Commission for its information copies of their proxy soliciting material in the same manner as they are required to furnish copies of their annual reports to stockholders. Another amendment requires registrants which do not furnish annual reports or proxy material to their stockholders to include a statement to that effect in their annual report on form 10-K.

In connection with the proposed rule 15d-21, described above, the Commission also invited public comments on certain proposed amendments to form 10-K which would require disclosure with respect to employee stock purchase, savings, or similar plans. The required information would be furnished by the sponsoring company and the plan itself would be exempted by the proposed rule from the duty of filing reports with the Commission.

THE INVESTMENT COMPANY ACT OF 1940

Amendment of Rule 3c-1

The Commission during the fiscal year amended rule 3c-1 under the Investment Company Act of 1940 which defines the term "public offerings" to exclude under certain conditions the offering of the stock of small business investment companies to small business concerns pursuant to the requirements of the Small Business Investment Act of 1958.

The purpose of the amendment to rule 3c-1 was to conform the provisions of the rule to the amended provisions of the Small Business Investment Act of 1958.

Proposal to Adopt Exemptive Rules Applicable to Licensed Small Business Investment Companies

After the close of the fiscal year 1961 the Commission was giving consideration to the promulgation of certain rules applicable to small business investment companies licensed by the Small Business Administration under the Small Business Investment Company Act of 1958. The Commission has previously adopted rules 3c-1, 3c-2, and 14a-1 (Investment Company Act Release Nos. 2828, 2909, and 3011, respectively), excluding certain activities of small business investment companies or the ownership of their

securities from various provisions of section 3 (c) (1) of the act and permitting the use by a small business investment company of regulation E filings under the Securities Act of 1933 in raising its initial capital as required by section 14 (a) of the act. The rules now under consideration would be applicable only to licensed small business investment companies and would exempt them from various provisions of sections 17 (a), 17 (d), and 18 (c) of the Investment Company Act.

Adoption of Form N-5R

Shortly after the beginning of the fiscal year, the Commission adopted form N-5R for annual reports which small business investment companies are required to file with the Commission pursuant to section 13 or 15 (d) of the Securities Exchange Act of 1934, or pursuant to section 30 (a) of the Investment Company Act of 1940. The adoption of this form was referred to in the 26th annual report.

INVESTMENT ADVISERS ACT OF 1940

Amendment of Form ADV and Rule 204-1 and Adoption of Form ADV-SUP

In September 1960 the Investment Advisers Act was amended in many important respects. Among other things, it now provides new grounds for denying, suspending, or revoking the registration of an investment adviser. Before the amendments were adopted the provisions of section 203 (d) of the act provided, in substance, that the Commission could deny, suspend, or revoke the registration of an investment adviser if it found that such action was in the public interest and that the investment adviser, or any partner, officer, director, or controlling person: (1) within 10 years of the order, was convicted of a felony or misdemeanor involving the purchase or sale of a security or arising out of activities as an investment adviser, underwriter, broker, or dealer, or as an affiliated person or employee of an investment company, bank, or insurance company; or (2) was subject to an injunction based upon similar conduct or activity; or (3) had willfully made any untrue statement or misleading omission of a material fact in any application or report filed with the Commission.

As amended, the act now provides additional bases for denial, suspension, or revocation of registration: (1) conviction of a felony or misdemeanor involving mail fraud; fraud by wire, telephone, radio, or television; or embezzlement, fraudulent conversion, or misappropriation of funds or securities; (2) willful violation of any provision of the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Advisers Act of 1940, or any rule or regulation under any of such acts; or (3) aiding or abetting any other person's violation of any of such acts, rules, or regulations. The amendments also provide that any of the above disqualifications on the part of a controlled person, as well as a partner, officer, director, or controlling person, may be a basis for denial, suspension, or revocation.

Effective May 1, 1961, the Commission amended form ADV, the form of application for registration and to amend such an application, to require the furnishing of information to disclose whether any of the persons mentioned above is subject to any disqualification under the act, as amended; to obtain certain additional information; to clarify the instructions; to simplify its use; and to simplify its processing by the Commission. Rule 204-1 under the act was also amended to require every investment adviser whose registration is effective on May 1, 1961, and every investment adviser who has an application for registration pending on that date, to file a new form ADV-SUP as a supplement to his application not later than June 30, 1961. Form ADV-SUP requires the same information as form ADV as amended.

Adoption of Rule 204-2

Section 204-2 of the act, as amended, provides that every investment adviser (other than one specifically exempted from registration pursuant to section 203 (b)) shall make, keep, and preserve such accounts, correspondence, memoranda, papers, books, and other records, and make such reports, as the Commission by rules and regulations may prescribe as necessary or appropriate in the public interest or for protection of investors. Under this section such books and other records are subject to inspection by Commission representatives.

On May 25, 1961, the Commission adopted rule 204-2, effective July 1, 1961, to require investment advisers subject to registration to maintain specified books and records relating to their business. In addition to the usual journals and ledgers, the rule requires the maintenance of records with respect to memoranda of orders given and instructions received for the purchase, sale receipt or delivery of securities, and originals or copies of certain communications received or sent by the investment adviser. Additional requirements are applicable to investment advisers who have custody or possession of any funds or securities of any client, and to investment advisers who render any supervisory or management service to any client. The rule specifies the period during which such books and records must be preserved and also provides that an investment adviser, before ceasing to conduct business, must arrange for and be responsible for the preservation of his books and records for the remainder of the period specified in the rule, and must notify the Commission of the place where such books and records will be maintained during such period.

Proposed Rule 206 (4)-1

Section 206 of the Investment Advisers Act of 1940, as amended, contains a new subsection (4) which prohibits an investment adviser from engaging in any act, practice, or course of business which is fraudulent, deceptive, or manipulative, and gives the Commission the power by rules and regulations to define and prescribe means reasonably designed to prevent such acts, practices, and courses of business.

On April 4, 1961, the Commission announced its proposal to adopt rule 206 (4)-1 to define certain advertisements by investment advisers to be fraudulent, deceptive, or manipulative within the meaning of section 206 (4) of the act. The proposed rule is intended to implement the statutory mandate by foreclosing the use of advertisements, which have a tendency to mislead or deceive clients or prospective clients.

The proposed rule would prohibit advertisements which contain testimonials or which call attention to specific past recommendations made by the investment advisers which would have been profitable. Such advertisements are generally misleading because by their very nature they emphasize the comments and activities favorable to the adviser and ignore those which are unfavorable. Other provisions of the rule would specify the circumstances under which advertisements offering graphs, charts, formulas, etc, could be used, and would prohibit advertisements which represent that any report, analysis, or other service can be obtained free or without charge unless it is entirely free and subject to no conditions or obligations. The rule would also include a general prohibition against the use of advertisements containing untrue or misleading statements.

The Commission has received many comments and suggestions on this proposal and these are being studied to determine what changes should be made before any further action is taken on the proposal.

PART IV **ADMINISTRATION OF THE SECURITIES ACT OF 1933**

The Securities Act of 1933 is primarily a disclosure statute designed to provide investors with material facts concerning securities publicly offered for sale by use of the mails or instrumentalities of interstate commerce, and to prevent misrepresentation, deceit, or other fraudulent practices in the sale of securities. The issuer of such securities is required to file with the Commission a registration statement which includes a prospectus containing significant information about the issuer and the offering. The registration statement is available for public inspection as soon as it is filed. After the statement is filed, the securities may be offered by means of a prospectus supplying the information required by the act. Sales may not be made, however, until the registration statement has become "effective." A copy of the prospectus must be furnished to each purchaser at or before the sale or delivery of the security. The registrant and the underwriter are responsible for the contents of the registration statement. The Commission has no authority to control the nature or quality of a security to be offered for public sale or to pass upon its merits or the terms of its distribution. Its action in permitting a registration statement to become effective does not constitute approval of the securities, and any representation to a prospective purchaser of securities to the contrary is made unlawful by section 23 of the act.

DESCRIPTION OF THE REGISTRATION PROCESS

Registration Statement and Prospectus

Registration of securities under the act is effected by filing with the Commission a registration statement on the applicable form containing the prescribed disclosure. When a registration statement relates, generally speaking, to a security issued by a corporation or other private issuer, it must contain the information, and be accompanied by the documents, specified in schedule A of the act; when it relates to a security issued by a foreign government, the material specified in schedule B must be supplied. Both schedules specify in considerable detail the disclosure which should be made available to an investor in order that he may make an informed decision whether to buy the security. In addition, the act provides flexibility in its administration by empowering 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 in the registration statement, as the Commission deems appropriate in the public interest or for the protection of investors.

In general the registration statement of an issuer other than a foreign government must describe such matters as the names of persons who participate in the direction, management, or control of the issuer's business; their security holdings and remuneration and the options or bonus and profit-sharing privileges allotted to them; the character and size of the business enterprise, its capital structure, past history and earnings, and its financial statements, certified by independent accountants; underwriters' commissions; payments to promoters made within 2 years or intended to be made; acquisitions of property not in the ordinary course of business, and the interest of directors, officers and principal stockholders therein; pending or threatened legal proceedings; and the purpose to which the proceeds of the offering are to be applied. The prospectus constitutes a part of the registration statement and presents the more important of the required disclosures.

Examination Procedure

The staff of the Division of Corporation Finance examines registration statements for compliance with the standards of accurate and fair disclosure established by the act and usually notifies the registrant by an informal letter of comment of any material respects in which the statement appears to fail to conform to those requirements. The registrant is thus ordinarily afforded an opportunity to file a curative amendment. In addition, the Commission has power, after notice and opportunity for hearing, to issue an order suspending the effectiveness of a registration statement. In certain cases, such as where a registration statement is so deficient as to indicate a willful or negligent failure to make adequate disclosure, no letter of comment is sent and the Commission either institutes an investigation to determine whether stop-order proceedings should be instituted or immediately institutes stop-order proceedings. Information about the use of this "stop order" power during 1961 appears below under "Stop Order Proceedings."

Time Required to Complete Registration

Because prompt examination of a registration statement is important to industry, the Commission endeavors to complete its analysis 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. However, the filing of any amendment thereto establishes a new filing date for the purpose of the 20-day period. This waiting period is designed to provide investors with an opportunity to become familiar with the proposed offering. Information disclosed in the registration statement is disseminated during the waiting period by means of the preliminary form of prospectus. The Commission is empowered to accelerate the effective date so as to shorten the 20-day waiting period where the facts justify such action. In exercising this power, the Commission is required to take into account the adequacy of the information respecting the issuer theretofore available to the public, the facility with which investors can understand the nature of and the rights conferred by the securities to be registered, and their relationship to the capital structure of the issuer, and the public interest and the protection of investors. The note to rule 460 under the act indicates, for the information of interested persons, some of the more common situations in which the Commission feels that the statute generally requires it to deny acceleration of the effective date of a registration statement.

The number of calendar days which elapsed from the date of the original filing to the effective date of registration for the median (average) registration statement with respect to the 1,389 registration statements that became effective during the 1961 fiscal year was 55 compared with 43 days for 1,275 registration statements in fiscal year 1960 and 28 days for 925 registration statements in fiscal year 1959. The increase in the elapsed time has been due primarily to the cumulative effect of the unprecedented volume of registration statements filed, particularly those filed by issuers that had never before filed under the Act, and the lack of sufficient number of examining personnel to process such a volume. The number of registration statements filed during fiscal year 1961 was 1,830, as compared with 1,628 and 1,226 in fiscal years 1960 and 1959, respectively.

The following table shows by months during the 1961 fiscal year the number of calendar days for the median registration statement during each of the three principal stages of the registration process, the total elapsed time and the number of registration statements effective:

[table omitted]

VOLUME OF SECURITIES REGISTERED

During the fiscal year 1961, 1,507 statements in the amount of \$19. billion became fully effective under the Securities Act of 1933, a record both in number and dollar amount. The number of statements increased 8 percent over the preceding year while dollar

amount increased 33 percent or \$4. billion. Not only was there a continuation of the large volume of small issues but also an increase in the registrations covering large issues. The chart on page 2, part I, shows the number and dollar amount of fully effective registrations from 1935 to 1961.

These figures cover all registrations which became fully effective including new issues sold for cash by the issuer, secondary distributions and securities registered for other than cash sale, such as exchange transactions, issues reserved for conversion and issues reserved for options. Of the dollar amount of securities registered in 1961, 74 percent was for the account of issuers for cash sale, 18.7 percent for account of issuers for other than cash sale and 7.3 percent was for the account of others, as shown below.

[table omitted]

Securities to be sold for cash sale for account of issuer amounted to \$14.1 billion, an increase of \$3.2 billion over the previous year. This reflects increases of \$1.9 billion in debt securities and \$1.3 billion in common stock. Debt securities made up \$6.1 billion of the 1961 volume, preferred stock \$250 million, and common stock \$7.7 billion. More than half of the common stock was registered by investment companies.

Two industries, communications and manufacturing, showed marked increases over fiscal year 1960 in the dollar amounts registered for cash sale. Communication companies registered \$2.4 billion of securities in fiscal 1961 compared with \$1 billion in fiscal 1960 while manufacturing companies registered \$2.3 billion in fiscal 1961 against \$900 million in fiscal 1960. Electric and gas companies registered \$2.4 billion of securities in fiscal 1961 and investment companies \$4.5 billion, almost the same as in the previous year. Registration of securities by other financial companies (including employee stock pension plans) and real estate companies increased from \$1.4 billion in fiscal 1960 to \$1.7 billion in fiscal 1961. A classification by major industry is shown below for securities registered for cash sale for account of issuer in each of the last 3 fiscal years.

[table omitted]

Of the net proceeds of the corporate securities registered for cash sale for account of issuers in fiscal 1961, 58 percent was designated for new money purposes, including plant, equipment, and working-capital, 5 percent for retirement of securities, 35 percent for purchase of securities (principally by investment companies), and 2 percent for all other purposes.

REGISTRATION STATEMENTS FILED

During the 1961 fiscal year, 1,830 registration statements were filed for offerings of securities aggregating \$20.6 billion, as compared with 1,628 registration statements filed during the 1960 fiscal year for offerings amounting to \$15.8 billion. This represents an increase of 12 percent in the number, of statements filed and 31 percent in the dollar amount involved.

Of the 1,830 registration statements filed in the 1961 fiscal year, 958, or 52 percent, were filed by companies that had not previously filed registration statements under the Securities Act of 1933. Comparable figures for the 1960 and 1959 fiscal years were 774, or 47 percent, and 472, or 39 percent, respectively.

A cumulative total of 19,388 registration statements has been filed under the act by 9,129 different issuers covering proposed offerings of securities aggregating over \$203 billion from the effective date of the Securities Act of 1933 to June 30, 1961.

Particulars regarding the disposition of all registration statements filed under the Act to June 30, 1961, are summarized in the following table:

[table omitted]

STOP ORDER PROCEEDINGS

Section 8 (d) provides that, if it appears to the Commission at any time that a registration statement contains 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 Commission may institute proceedings looking to the issuance of a stop order suspending the effectiveness of the registration statement. Where such an order is issued, the offering cannot lawfully be made, or continued if it has already begun, until the registration statement has been amended to cure the deficiencies and the Commission has lifted the stop order.

The following table indicates the number of proceedings under section 8 (d) of the act pending at the beginning of the 1961 fiscal year, the number initiated during the year, the number terminated and the number pending at the end of the year.

[table omitted]

The six proceedings in which stop orders were issued during the fiscal year are described below.

Consolidated Development Corp. -- The registration statement filed by this corporation involved a proposed offering of 448,000 shares of its 20 cent par value common stock, of which 100,000 shares were to be offered at \$1 a share to the underwriter to which registrant owed \$100,000 and 198,000 shares were to be offered to holders of registrant's

convertible debentures at 75 cents a share. In the course of the proceeding the registrant stipulated to certain facts and consented to the entry of a stop order. The Commission found the registration statement to be materially deficient in numerous respects. Some of the more important deficiencies are described below.

The registrant is a Delaware corporation organized in 1956 under the name of Consolidated Cuban Petroleum Corp. to engage in exploration, development, and production of oil and gas in Cuba. It adopted its present name in 1959 after its petroleum ventures had sustained severe financial losses. It was then decided to engage in the acquisition and development of real estate in the State of Florida, and registrant entered into an agreement to acquire certain land for \$150,000 in cash, 800,000 shares of its stock, and subject to a \$2 million mortgage.

The Commission found the registration statement to be materially deficient in failing to set forth clearly that registrant had been financially unsuccessful in its petroleum operations and was in serious financial condition; that, as a result of recent Cuban governmental acts and its lack of success in the oil business, the registrant had suspended its oil exploration activities in Cuba and was faced with the possibility of having to write off all of its Cuban properties and equipment, leaving it with practically none of the assets shown on the balance sheet filed with the registration statement.

The information in the registration statement regarding registrant's proposed real estate operations was also materially inadequate and misleading in many respects. Among other things, the registration statement failed to disclose the funds necessary for drainage of the Florida land proposed to be acquired, the competitive real estate developments in the area, that no funds were available for acquiring or developing Florida real estate, and registrant had no specific plans for raising such funds.

The registration statement failed to disclose that if the proceeds from the offering did not exceed \$100,000 the entire amount thereof might go to the underwriter in payment of advances to the registrant, so that the financing might be solely for the benefit of the underwriter and failed to set forth material facts regarding the issuance and distribution of registrant's outstanding securities, particularly 2 million shares of its common stock.

Hazel Bishop, Inc. -- The registrant, a New York corporation organized in 1949 and engaged in the cosmetics business, filed a registration statement in June 1960 relating to 1,157,200 shares of common stock all of which were then outstanding. It was stated that these shares, which represented approximately 61 percent of registrant's outstanding common stock, were held by 70 named persons referred to as the selling stockholders. An amendment to the registration statement was filed in October 1960, which, among other things, increased the number of shares to be offered to 1,274,823 and the number of selling stockholders to 112. The Commission instituted proceedings to determine whether a stop order should issue, and registrant entered into a stipulation of facts admitting that a large part of the stock to be offered had initially been sold in violation of the registration

requirements of the Securities Act and that the registration statement was deficient, but urged the Commission to take into consideration amendments filed after the institution of the proceedings and to permit the statement as thus amended to become effective, preferably without issuance of a stop order. However, the Commission rejected this request because of "the widespread distribution of unregistered shares" and "the serious deficiencies found" and issued a stop order.

Among other things, the Commission found that the summary of earnings, which showed a profit of \$102,258 for the fiscal year ended October 31, 1959, was deceptive and misleading in several respects, particularly in that, under proper accounting practice, it should have shown a loss of \$707,996 for that period.

The registration statement, while stating that television had been registrant's principal advertising medium and that registrant had expended about \$30 million for network television advertising during the past 10 years, failed to disclose adequately that there had been a decided downward trend in advertising expenditures and that planned advertising expenses were at a further reduced level.

The registration statement contained the statement that during the period from January 1, 1959, through October 10, 1960, the price of registrant's common stock on the American Stock Exchange ranged from a high of \$10 per share to a low of \$3.. The Commission found that the reference to the high of \$10 per share was misleading without disclosure that this price was reached on only one day in June 1960 following (1) the publication of a statement by a newspaper columnist that registrant was about to introduce a new product which would increase Its sales and earnings; (2) registrant's release of unaudited results of Its operations for the 6-month period ended April 30, 1960, showing a profit of \$202,776 as compared with a loss of \$551,173 for the same period of the preceding year, and (3) registrant's announcements to the cosmetics trade that It would sponsor a number of well-known radio and television personalities.

The registration statement stated that in registrant's opinion sales of 562,500 shares of Its stock in 1959 and 1960 constituted private offerings exempt from registration under section 4 (1) of the Securities Act. The Commission found, however, that a widespread public distribution was effected with respect to such shares, that the sales were accordingly made in violation of section 5 of the act. and that the representation to the contrary in the registration statement was therefore false. The registration statement was also found deficient in failing to disclose that sales of 293,000 shares by Raymond Spector, registrant's board chairman until March 1960, also constituted a public offering in violation of section 5, and that by virtue of the violations of that section, registrant became contingently liable to the purchasers of the shares.

The Commission stated that the prospectus conveyed the impression that at least some of the shares would be offered through brokers on the American Stock Exchange and that it would be prejudicial to the protection of investors and the public interest if the massive

distribution here proposed by a large group including registrant's controlling persons should be initiated through the facilities of the exchange unless prior thereto the facts of the case were given a wider distribution than, was likely to result from mere delivery of copies of the prospectus to the exchange, pursuant to Securities Act requirements regarding delivery of prospectuses. Accordingly, the Commission stated that prior to the final effective date of the registration statement, the public interest required the transmittal by registrant of the Commission's opinion together with an adequate prospectus to all selling stockholders and the members of the exchange community.

The Commission further pointed out that in view of the representation that the offering would be "at the market," the large number of selling stockholders, the apparent lack of procedures for coordinating their activities or guarding against unlawful practices, the fact that the shares to be offered amounted to approximately 60 percent of the outstanding stock, almost twice the number of shares previously available for trading in the open market, and other factors, there were grave potentialities for violations of the securities laws by registrant and the selling stockholders. The Commission called specific attention to rule 10b-6 under the Exchange Act, prohibiting bids or purchases by any person participating in a distribution; rule 10b-7 which prohibits stabilizing in connection with an offering "at the market"; rule 10b-2, which prohibits persons participating in a distribution from paying or offering to pay any person for soliciting another to purchase any such security on the exchange; and restrictions, under section 5 (b) (1) of the Securities Act, on written communications which constitute an offer of securities. The Commission also pointed out that since an offering "at the market" implied a free and open market, any activity designed to stabilize, stimulate, or condition the market would render such implication false and misleading.

Following issuance of the stop order, registrant filed a material amendment to conform with the order and to furnish up-to-date information, and the registration statement as amended was declared effective on June 26, 1961.

J. Fred Markwell and Alexander Markwell, voting trustees for shareholders of West Star Mining Co. -- A registration statement covering voting trust certificates representing 2,500,000 shares of West Star Mining Co. common nonassessable capital stock was filed in 1957 and became effective. West Star is an Idaho corporation organized in 1939 to engage in the exploration and development of mineral deposits.

After appropriate notice a hearing was held at which the voting trustees did not appear. However, they later submitted an answer and petition in which they admitted that the registration statement was deficient in certain respects and stated that no securities subject to the registration statement had been sold and that they intended to file an amendment. No such amendment was filed.

The prospectus failed to disclose required pertinent financial information regarding the company's operations and material information regarding the exploration of the

company's properties, the nature and dates of the work done, the results of such work, and the physical condition of the workings. Certain excerpts taken from old engineering reports bearing various dates from 1923 to 1952 concerning the geology and mining prospects of the company's property were contained in the prospectus. The Commission found that the information contained in the excerpts was materially misleading without disclosure reflecting the results of subsequent exploration and development on the properties, information which was not available to the engineers preparing the reports. The prospectus also contained statements indicating that the company's mine was favorably located with reference to commercial ore bodies found on two adjoining mines. It was found that these statements were materially misleading in view of the failure to set forth information with respect to distances between the location of the ore mined at one of the adjoining mines and the boundary of the company's property. Moreover, the prospectus omitted information as to the nature of the results obtained from exploration and development work as it continued toward the company's mine from the adjoining oil producing area.

National Lithium Corp. -- Registrant, a Delaware corporation, was organized in November 1956 for the principal purpose of acquiring and developing certain mining claims containing lithium deposits in the Yellow-knife area of the Northwest Territories of Canada. The registration statement filed in February 1957 related to a public offering of 3,120,000 shares of common stock at \$1.25 per share.

A geological report regarding registrant's lithium claims, which was filed as an exhibit to the registration statement and portions of which were quoted or summarized in the prospectus, was found misleading in that the word "ore" was not used in accordance with its generally accepted meaning, and the geologist who prepared the report failed to follow accepted engineering procedures in arriving at his reserve estimates. The Commission further found that the report and the prospectus insofar as it quoted from the report contained a number of other materially misleading statements.

The prospectus also contained misleading statements concerning the market for registrant's product, the prospects for profitable operation, the use of the proceeds from the proposed offering, the possible need for additional funds, and the absence of any reasonable prospects of obtaining such additional funds. In addition, the introductory section of the prospectus did not adequately disclose the speculative features of the enterprise so that they would be plainly evident to the ordinary investor.

The impression conveyed by the figures set forth in the prospectus as acquisition and development costs of the three Canadian corporations from whom registrant obtained its mining claims was that those costs consisted entirely of cash expended when, in fact, some of the claims were acquired for stock and no payment had been made for certain other claims.

The registration statement was found to be deficient for failure to name as promoters certain persons who were instrumental in obtaining the mining claims in question for the Canadian corporations and in organizing two of these corporations, and the prospectus was also deficient in failing to identify the two individuals principally responsible for determining the total consideration to be paid for the claims acquired by the registrant.

The Commission also found that the prospectus presented an inaccurate picture regarding the beneficial ownership of registrant's stock issued to the Canadian corporations as consideration for the mining claims. In addition, the Commission found that registrant's claim that the issuance and sale of a total of 6,880,000 shares to such corporations and to persons designated by the underwriter were exempt under section 4 (1) of the act as transactions by an issuer not involving any public offering was false and that disclosure should have been made in the financial statements of the contingent liability under section 12 (1) of the act resulting from the sale of the unregistered securities.

Oil, Gas & Minerals, Inc., and American Investors Syndicate, Inc. -- These were consolidated proceedings relating to registration statements filed by Oil, Gas & Minerals, Inc. ("OGM") and American Investors Syndicate, Inc. ("American"), both Louisiana corporations. The facts were stipulated and the registrants consented to the issuance of stop orders.

OGM's principal assets consisted of a one twenty-fourth working interest in a Louisiana oil field and a plot of land located in New Orleans, La, American was organized to build and operate an apartment hotel, and its chief asset was approximately \$32,000 in cash. OGM leased the New Orleans property to American as the site for the planned apartment hotel. James A. and Joseph D. Lindsay were directors, officers and shareholders of both companies and together owned the Lindsay Securities Corp., the underwriter for both proposed issues. American proposed to issue 600,000 shares of 10 cent par value common stock and 200,000 shares of \$9 stated value convertible preferred stock for a total offering price of \$2,400,000, to be offered in units of 3 shares of common stock and 1 share of preferred stock at a price of \$12 per unit. The registration statement of OGM covered 260,000 shares of 35 cent par common stock at an offering price of \$2 per share or a total of \$520,000.

The description of properties of both corporations was found to be deficient in various respects. For example, there was a failure to disclose that the St. Charles Avenue property which American described as an excellent site for an apartment hotel located in an exclusive and highly restricted neighborhood, was in a neighborhood whose residential quality is deteriorating. The prospectus also failed to disclose that American was formed by OGM's promoters, that the \$2 million estimated cost of construction and 1 year estimated construction period were not based on any detailed plans or construction arrangements and that American's management had had no experience in the construction or operation of an apartment hotel. OGM's prospectus failed to describe the proposed apartment hotel and to disclose that American lacked the resources to construct it.

There was a failure to disclose the fact that the underwriter was organized by the promoters of the two registrants for the purpose of distributing the shares of OGM and American, and the cover page of both prospectuses failed to state that the underwriting arrangements were on a "best efforts" basis and that there was, therefore, no assurance that all or any of the proceeds mentioned would be received.

The financial statements contained in the registration statements were certified by an accounting firm which participated in the keeping of the corporate books and, therefore, was not independent. The financial statements of OGM also did not comply with regulation S-X under the act in that they did not present information in the manner required nor include specified schedules with respect to, among other things, intangible assets, capital, profit and loss, depreciation and amortization.

American's prospectus failed to include a clear summarization of the speculative features of its business, including the facts that the Company was relying upon the receipts from the issue to provide the funds for the construction of the proposed apartment hotel; that the company would need net earnings after taxes of \$108,000 to meet the annual 6-percent cumulative requirements of the 200,000 shares of preferred stock proposed to be issued and that the company presently had no assets or operations which could provide such earnings; that although the offering price of the common stock was \$1 per share, the book value of the company's common stock was 20 cents per share, stock was sold to the organizers at 10 cents per share and shares were recently offered to the public at 50 cents per share; and that OGM, the lessor of the site on which the apartment building was to be constructed, was depending on the receipts from its proposed offering to retire a \$125,000 mortgage on the leased property.

The prospectus of OGM failed to include a clear summarization of the speculative features of OGM's business and securities, and failed to disclose, among other things, that the company had operated at a loss since its inception, that it had an operating deficit of \$24,297 and that past dividends represented a return of capital; that the proposed offering price for the OGM stock of \$2 per share was arbitrarily determined, that the company's stock had a book value of 67 cents per share and that shares of the company's common stock had recently been offered to the public at \$1 per share; that before the shares could be resold by the purchasers to anyone else they had to be offered to the company and other shareholders at their book value, which would amount to \$1.30 per share if all of the offered shares were sold at \$2 per share, and that such restriction could result in substantial loss to an investor desiring to sell his shares; and that the company had a contingent liability of \$166,800 to purchasers of 68,000 shares which were sold without having been registered under the act and to purchasers of 101,800 shares which were sold by means of an inaccurate and inadequate offering circular under regulation A.

Skiatron Electronics and Television Corp. -- This registration statement covered a proposed secondary distribution of 172,242 shares of registrant's 10 cent par value

common stock, of which 75,000 shares had been issued to Matthew M. Fox, registrant's licensee; 50,000 shares were covered by warrants owned by Fox; 30,000 shares were owned by Arthur Levey, registrant's president, and 17,242 shares had been issued to employees, directors or persons who had performed services for the company. In the course of the hearing, certain facts were stipulated and the registrant consented to the issuance of a stop order.

The registrant, a New York corporation, was organized in 1948 by Levey, to engage in research and development in the field of electronics. In 1950 registrant began efforts to develop a subscription or pay television system. Lacking the resources for the development and operation of such a system, registrant entered into agreement with Fox whereby Fox or his assignee, Skiatron of America Inc., a corporation controlled by him, became the exclusive licensee of the registrant's system. Fox assumed responsibility for the commercial development and exploitation of the system including the necessary development and industrial engineering, the determination of the acceptability and feasibility of the system, and arrangements for programming.

The prospectus stated that the registrant's licensee was planning for the immediate use of its subscription television system by means of wire or close-circuit operations and that if existing negotiations with owners of outstanding entertainment and with municipalities and public utilities whose facilities might be required for such operation progressed favorably, the licensee anticipated that it would commence commercial operations during the early part of 1960. The Commission found that there was no basis for this representation. Contracts for the manufacture of equipment and other arrangements remained to be secured. The prospectus was materially misleading in failing adequately to disclose the financial and other difficulties to be met before the registrant's system could be placed in operation. Among other things, the registration statement failed to show the large amounts of capital needed to establish the proposed subscription television system and defray programming costs and to point out that neither the registrant nor its licensee possessed the resources required and neither had access to sources able and willing to supply the amounts necessary. Registrant's principal asset was the right to receive royalties under the licensing agreement with Fox. Fox and his company were deeply in debt; debts of at least \$1 million had been reduced to judgments and Fox had further debts of approximately \$3 million, a substantial portion of which was in default.

The prospectus stated that the registrant owned a number of United States and foreign patents and patent applications and that its patent coverage included the Skiatron "Subscriber-Vision" television systems. This representation was materially misleading since the outstanding patents of the registrant were not essential to the operation of either its over-the-air or wire system.

The prospectus was materially misleading in view of the failure to disclose that Fox pledged 70,000 of the 75,000 shares purchased by him and that many of such shares had been sold to the public before the registration statement was filed. Fox had previously

disposed of 195,000 warrants which he had received from registrant in 1954 in connection with the licensee agreements. By December 1958 all 195,000 warrants had been exercised and all of the shares sold to the public. In addition, Fox disposed of 206,000 shares of registrant's stock which were loaned to him by Levey for the specific purpose of collateralizing loans negotiated by Fox. The Commission found that at least a part of the shares referred to above were sold in violation of section 5 of the act. Such sales created a contingent liability under section 12 (1) of the act which should have been disclosed in the registration statement.

The registration statement was materially deficient in purporting to cover shares which had already been sold to the public. Besides the shares issued to Fox, which had been sold, a substantial portion of the shares issued to officers, directors and creditors, had also been sold by them prior to the filing of the registration statement. None of these shares should have been included in view of the provisions of section 6 (a) of the act limiting the effectiveness of a registration statement to securities "proposed to be offered."

Levey, the promoter and organizer of the registrant, also disposed of large blocks of stock to the public without registering such stock under the act. Although he claimed exemptions from registration under section 4 (1) of the act and rule 154, the Commission found that neither of these exemptions was available. The registration statement should have disclosed that Levey had been distributing shares of the company without registration as required by the act and the contingent liability under section 12 (1) of the act resulting therefrom.

EXAMINATIONS AND INVESTIGATIONS

The Commission is authorized by section 8 (e) of the act to make an examination in order to determine whether a stop order proceeding should be instituted under section 8 (d). For this purpose the Commission is empowered to subpoena witnesses and require the production of pertinent documents. The Commission is also authorized by section 20 (a) of the act to make an investigation to determine whether any provision of the act or of any rule or regulation prescribed thereunder has been or is about to be violated. Investigations are instituted under this section as an expeditious means of determining whether a registration statement is false or misleading or omits to state any material fact. The following table indicates the number of such examinations and investigations with which the Commission was concerned during the fiscal year.

[table omitted]

EXEMPTION FROM REGISTRATION OF SMALL ISSUES

Under section 3 (b) of the Securities Act, the Commission is empowered 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 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.

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.

Regulation A: General exemption for United States 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 the 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 company which is operating or proposes to operate as a small business investment company under the Small Business Investment Act. Acting pursuant to this authority, the Commission has adopted a regulation E which exempts upon certain terms and conditions limited amounts of securities issued by any small business investment company which is registered under the Investment Company Act of 1940. This regulation is substantially similar to the one provided by regulation A adopted under section 3 (b) of the act.

Exemption from registration under section 3 (b) or 3 (c) of the act does not carry any exemption from the civil liabilities for false and misleading statements imposed upon any person by section 12 (2) or from the criminal liabilities for fraud imposed upon any person by section 17 of the act.

Exempt Offerings Under Regulation A

The Commission's regulation A implements section 3 (b) of the Securities Act of 1933 and permits a company to obtain needed capital not in excess of \$300,000 (including underwriting commissions) in any one year from a public offering of its securities without registration, if the company complies with the regulation. Upon complying with the regulation a company is exempt from the registration provisions of the act. A

regulation A filing consists of a notification supplying basic information about the company, certain exhibits, and an offering circular which is required to be used in offering the securities. However, in the case of a company with an earnings history which is making an offering not in excess of \$50,000 an offering circular need not be used. A notification is filed with the regional office of the Commission in the region in which the company has its principal place of business.

During the 1961 fiscal year, 1,057 notifications were filed under regulation A, covering proposed offerings of \$239,920,549, compared with 1,049 notifications covering proposed offerings of \$224,913,982 in the 1960 fiscal year. Included in the 1961 total were 28 notifications covering stock offerings of \$5,956,350 with respect to companies engaged in the exploratory oil and gas business and 28 notifications covering offerings of \$5,555,084 by mining companies.

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

Most of the offerings which were underwritten were made by commercial underwriters, who participated in 511 offerings in 1961, 398 offerings in 1960, and 251 offerings in 1959. The remaining cases where commissions were paid were handled by officers, directors, or other persons not regularly engaged in the securities business.

Suspension of Exemption

Regulation A provides for the suspension of an exemption thereunder 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 in accordance 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 1961 fiscal year, temporary suspension orders under regulation A were issued in 54 cases. These cases together with 29 cases pending at the beginning of the fiscal year resulted in a total of 83 cases for disposition. Of these 83 cases, 55 became permanent: 35 by lapse of time, 15 by withdrawal of the request for hearing, and 5 after hearing, leaving 28 cases pending at the end of the fiscal year.

Several of the above cases are summarized below to illustrate the type of misrepresentations and other noncompliance with the regulation which led to the issuance of suspension orders.

American Television and Radio Co. -- The issuer's offering circular was materially misleading in stating that the company believed it was recognized as one of the world's leaders in the manufacture of vibrators, which transform direct electrical current to alternating current, and that its market position in this field was equal to that of its competitors, and in failing to disclose the drastic inroads in the vibrator market made by transistor auto radios, and that the market for vibrators has substantially declined in recent years. The offering circular was also misleading in describing the vibrator as essentially a transistor device when in fact there is no similarity between vibrators and transistors. A method employed by the company of merchandising from factory directly to TV technician to consumer, described in the offering circular as "unique," was in fact not unique and had been unsuccessful.

A statement in the offering circular that approximately \$120,000 of the net proceeds of the \$300,000 offering would be used to reduce the company's short-term indebtedness and that the balance would be added to working capital was found to be misleading in failing to disclose the more specific uses which the company intended to make of the proceeds, including increase of vibrator production facilities and inventory, hiring trained personnel, and entering the stereophonic high fidelity field. The offering circular was also found deficient in failing to disclose clearly the dilution of the equity of public security holders resulting from offering the securities at a price considerably in excess of book value.

The Commission further found that the company had used certain types of publicity not permitted by regulation A and not filed with the Commission, had failed to use the offering circular in the offer and sale of its securities, and had not set forth in the notification the names of all of the States in which the securities were to be offered or the name of the underwriter.

Committee Oil Co. -- According to the Commission's order in this case, the issuer's offering circular failed to disclose the source of funds with which the company intended to pay interest and principal on the debentures and the alternative use of proceeds should the company fail to acquire oil and gas properties as proposed and failed to describe adequately the risks involved in the oil and gas business and the extent to which the properties of the company were to be explored and developed. The order also challenged the company's forecast of profits based on conjecture, the statement that the company would pay all direct sales costs and certain other expenses when in fact no funds were available therefor, and the use of oil and gas reserve figures based upon secondary methods although such methods had not as yet proved successful on the properties involved.

Custer Channel Wing Corp. -- The Commission's order alleged that the offering circular in this case contained misrepresentations in regard to the development, manufacture and marketing of aircraft embodying a "new" wing design. Although the design had been proposed and under development since 1940, the company failed to

disclose the history of such development in reasonable detail, to indicate that during the 15-year period the proposed aircraft has been under development by Custer, its predecessors and subsidiaries, sums aggregating several hundred thousand dollars were raised through the sale of securities, or to disclose how such sums were expended and the reasons why a salable aircraft has not been fully developed. There was a similar failure to disclose Ouster's previous unsuccessful efforts to market the aircraft and the fact that the aircraft was demonstrated to the military and that no interest was shown or orders taken. The patents pertaining to the wing were not described nor was it disclosed that applications filed in 1953 and 1954 with the predecessor of the Federal Aviation Agency were not completed and have since been abandoned. No estimate of the amount required to secure FAA certification of the aircraft proposed to be manufactured was furnished. Misrepresentation was also alleged with respect to statements that the break-even point would be reached at approximately the 15th aircraft produced, that the company had "firm" orders for 20 aircraft, and that \$208,850 would be enough to commence actual manufacture of aircraft to fill outstanding orders. There was a failure to disclose that the market price of the class B stock was substantially lower than the public offering price. Financial statements prepared in accordance with generally accepted accounting principles were not included as required.

Hermon Hanson Oil Syndicate, Inc. -- The Commission's order stated that the offering circular did not contain accurate or adequate disclosure with respect to the geological aspects of the issuer's properties; the fact that no oil or gas in commercial quantities had been found within 150 miles thereof, that many dry holes have been drilled between the syndicate's properties and the nearest commercially producing area; the speculative features of the offering, including the fact that the \$1 per share offering price was essentially an arbitrary price having no direct relation to underlying asset values, and that public investors would be asked to furnish the total funds required to drill a wildcat well for only a 7-percent interest in the company.

Exempt Offerings Under Regulation B

During the fiscal year ended June 30, 1961, 261 offering sheets 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 1960 fiscal year, 328 offering sheets were filed and during the 1959 fiscal year, 160 were filed. The following table indicates the nature and number of Commission orders issued in connection with such filings during the fiscal years 1959-61. The balance of the offering sheets filed became effective without order.

[table omitted]

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

law 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 the fiscal years 1959-61.

[table omitted]

Exempt Offerings Under Regulation E

Regulation E provides a conditional exemption from registration under the Securities Act of 1933 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 new 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 in excess of \$50,000, the filing and use of an offering circular containing certain specified information.

Regulation E provides for the suspension of exemption in particular cases if the Commission finds that any of the terms and conditions of the regulation have not been met or complied with.

Two notifications were filed under regulation E during the 1961 fiscal year for offerings of securities aggregating \$184,350. Of these two notifications, one became effective for a proposed offering of \$168,750. The other notification was pending at the end of the fiscal year.

Exempt Offerings Under Regulation F

Regulation F provides an exemption from registration under the Securities Act 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 from the assessment are proposed to be used. If the issuer should employ any other sales literature in connection with the assessment, copies of such literature must be filed with the Commission.

During the 1961 fiscal year, 41 notifications were filed under regulation F, covering assessments of \$1,007,864. Regulation F notifications were filed in three of the nine regional offices of the Commission; i.e., the Denver, San Francisco, and Seattle regional

offices. Underwriters were not employed in any of the regulation F assessments and in no case did the assessment exceed \$61,000.

Regulation F provides for the suspension of an exemption thereunder, as in regulation A, 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.

Two regulation F filings were temporarily suspended in fiscal 1961 for alleged false and misleading statements in the sales material used. Requests for hearings were made with respect to both of these suspensions but both issuers subsequently consented to the issuance of permanent suspension orders.

LITIGATION UNDER THE SECURITIES ACT OF 1933

The Commission is authorized by the Securities Act to seek injunctions in cases where continued or threatened violations of the act are indicated, including violations of the registration and antifraud provisions of the act. During the fiscal year, 28 such injunctions were obtained and 9 cases were pending at the end of the year. Certain of these cases are described herein. Other actions in which violations of the Securities Act are present and which also involve violations of other statutes are described under the other statutes.

In *S.E.C. v. Federal Shopping Way, Inc., et al.*, the S.E.C. filed a complaint against Federal Shopping Way, Inc., and 18 other defendants seeking an injunction against continued violations of the anti-fraud provisions of the Securities Act of 1933 in the offer and sale of securities of defendant Federal Shopping, issued in connection with the financing of a shopping center enterprise located at Federal Way, Wash. It was alleged that defendants formed approximately 30 affiliated or cooperating corporations, including Federal Shopping, and sought to create the appearance that various transactions including property sales and rental agreements, between Federal Shopping and others of these corporations, were arm's-length transactions when in fact the various corporations were at all times under the domination and control of defendant John E. Cessna and other defendants and were formed and operated for the purpose of diverting moneys from Federal Shopping, concealing such diversion from that company's present and potential security holders, and deceiving such security holders as to the original acquisition costs of property acquired by Federal Shopping and the true income and profits being realized by Federal Shopping from the rental and operation of such property.

The complaint further alleged that defendants were obtaining money by means of untrue and misleading statements concerning the asserted success of Federal Shopping and its shopping center enterprise, its net earnings, dividends, and bond interest paid and to be paid and the source of such payments, the amount of rental income and its source, its financial condition, and other matters.

In *S.E.C. v. L-Wood Company, Inc.*, the defendants had been selling investment contracts and participations in profit-sharing agreements without registration and had made material misrepresentations concerning increases in the company's assets and the safety of an investment with the company. The defendants consented to entry of a final judgment enjoining further violations of the act.

The Commission secured a permanent injunction by default against all but one of the four defendants in *S.E.C. v. American Equities Corporation* prohibiting them from violating the registration and anti-fraud provisions of the Securities Act of 1933 in the offer and sale of shares of that corporation. For the purpose of inducing the purchase of these securities by investors the defendants provided various broker-dealers with false financial statements of the company and caused various broker-dealers to enter quotations in the over-the-counter market, thus creating the appearance of an active market. The case against Martin Benjamin, the remaining defendant, was still pending at the close of the fiscal year.

In *S.E.C. v. Insured Mortgage and Title Corporation, et al.*, the Commission instituted an action against one of the so-called "8 percenters" which had been selling interests in Florida mortgages to investors throughout the United States. Under Insured's "Corrigan Plan," investors were to receive 8 percent interest to be derived from payments made by mortgagors on first mortgage deeds and notes on Florida real estate which were purchased by Insured or its subsidiaries. The company issued its notes to investors, collateralized by the assignment of the mortgages. Insured was to have the authority and responsibility for processing the mortgages, selecting the particular mortgage to be assigned to an investor, collecting payments from mortgagors, remitting monthly payments of principal and interest to investors, replacing the defaulted mortgages with others, or, in the alternative, redeeming corporate notes collateralized by defaulted mortgages, and handling all administrative details pertaining to the mortgages.

The Commission charged that the defendants were selling various types of securities, including evidences of indebtedness and investment contracts, in violation of the registration provisions of the Securities Act. In addition, it was charged that false representations were being made to investors and that Insured was insolvent. The parties stipulated to the entry of a preliminary injunction which restricted the company's operations to the State of Florida pending a trial on the merits. Shortly thereafter, the president of Insured disappeared and the court appointed a receiver to liquidate the corporation's assets.

In *S.E.C. v. Glass Marine Industries, Inc.* the Commission charged the company with violations of sections 17 (a) (1), 17 (a) (3), and 24 of the Securities Act of 1933 and section 10 (b) of the Securities Exchange Act of 1934 and rule 10b-5 thereunder. The complaint charged that the company had made material misrepresentations and had omitted material facts in a registration statement which became effective on July 6, 1960,

covering a public offering which netted the company approximately \$458,000. The Commission alleged, among other things, that whereas the registration statement had stated that the proceeds of the offering would be used to promote and expand the company's sales, in fact such proceeds had been used to make loans to other companies. In addition, the complaint alleged that the company had failed to disclose its plans for a possible merger, and the fact that its production had been materially reduced by the time the registration statement became effective. A preliminary injunction has been obtained freezing the assets of the company and the matter is pending.

In *S.E.C. v. American Sales Training Research Assn., Inc.*, the Commission charged the company and certain of its officers, directors and employees with violating the registration provisions of the act. The complaint alleged that the defendants were engaged in selling education programs designed to educate a person while he sleeps, and had sold "inactive distributorships" to certain investors for a stipulated sum in return for which the investor was to receive a percentage of the profits realized by the defendants sale of its programs. The Commission contended that the defendants' "inactive distributorships" were investment contracts. A permanent injunction was entered by consent.

In *S.E.C. v. Beverly Hills Security Investments, et al.*, the defendants consented to the entry of permanent decrees enjoining them from further violations of the registration and antifraud provisions of the securities acts in the sale of securities issued in connection with a so-called 10-percent investment program. The program was based on the sale to the public of discounted trust deeds, mortgages, and contracts related to real estate situated in California, Arizona, and New Mexico,

The plan in this case was similar to that in *Los Angeles Trust Deed & Mortgage Exchange*, the earlier history of which is discussed in previous annual reports. Since those reports, the Court of Appeals for the Ninth Circuit affirmed the decree of the District Court which had enjoined the corporate defendants and certain of their managing officers from violating the registration and antifraud provisions of the Securities Act and the Securities Exchange Act in the sale of securities issued under an investment plan, based on the sale to investors of individual discounted trust deeds and mortgages. This decision constitutes a significant judicial interpretation of the term "investment contract." It also holds that, despite the absence of specific statutory authority, the Commission may obtain the appointment of an equity receiver for an offender against the Federal securities acts.

The merchandising of individual trust deeds and mortgages under high-yield investment plans, without registration with the Commission, and often through grossly untruthful and deceitful public solicitations, had constituted a serious and growing regulatory problem. *Los Angeles Trust Deed & Mortgage Exchange* alone had attracted some \$40 million from the investing public. It is now being liquidated in bankruptcy, and its promoters are under indictment. The Commission's litigation opened up and exposed the highly speculative nature of the investment programs offered by "10 percenters" who lured

many thousands of small investors to commit their savings and earnings on the representation that the investment was sound, stable, and comparatively riskless. Although California was the center for these operations, the same basic scheme has been employed elsewhere throughout the United States.

The collapse of the "10 percenters" created a major financial scandal in California, and led to a sweeping investigation by a special committee of the State assembly, and the enactment of certain remedial legislation. The serious nature of the problem created by the "10 percenters" and the ruinous consequences to many thousands of investors are mirrored in the fact that six such enterprises are now in bankruptcy, one is in State court receivership, two are in the course of reorganization under chapter X of the Bankruptcy Act, and two are subject to arrangement proceedings under chapter XI of the Bankruptcy Act. The criminal indictments returned with respect to "10 percenters" are discussed at below.

Participation as Amicus Curiae

Honigman v. Green Giant Company and *Sawyer v. Pioneer Mills Co., Ltd.*, are two cases involving the construction of the Commission's so-called "no-sale" rule. In the *Green Giant* case, the company solicited the consent of its stockholders to a plan of reorganization which would result in one class of shareholders giving up part of their equity in return for greater voting rights, while the other class would give up some voting rights in exchange for a larger equity. In a stockholders' derivative action, it was alleged that acceptance of this reorganization plan was induced by misleading statements and omissions in the literature sent to stockholders by the management. Management denied the misleading nature of the statements made and further asserted that no action for fraud could be maintained under the Federal securities laws because rule 133 provides that a reorganization is not a "sale." The Commission is participating in this case as amicus curiae, and has filed a brief which points out that although the transaction in question may not have been a sale within the registration provisions of the Securities Act, rule 133 has no application to the anti-fraud provisions of the Federal securities laws. The Commission took no position on the merits of the case.

In the *Sawyer* case, the Commission, as amicus curiae, took the same view as in *Honigman*, with respect to allegedly false and misleading solicitations of stockholder approval for a proposed merger. In addition, the Commission urged that a Federal court has jurisdiction to rescind a consummated corporate transaction effected by means of violations of the anti-fraud provisions of the Federal securities laws. Decisions in these cases have not yet been rendered.

In *Moses and New v. Michael* (consolidated) the sellers of unregistered undivided working interests in oil and gas leases appealed from summary judgments entered against them under section 12 (1) of the Securities Act. Among other things, the sellers argued that they did not violate the Federal securities laws because only photo-static copies of

the oil and gas assignments, rather than the assignments themselves, were sent through the mails. The Commission filed a brief amicus curiae, urging rejection of this contention. On July 20, 1961, the Court of Appeals sustained the Commission's contention, affirmed the judgment of the District Court, and stated that "the mailing of photostatic copies of the lease agreements * * * constituted a violation of the Act * * *."

PART V

ADMINISTRATION OF THE SECURITIES EXCHANGE ACT OF 1934

The Securities Exchange Act of 1934 provides for the registration and regulation of securities exchanges, and the registration of securities listed on such exchanges and it establishes, for issuers of securities so registered, financial and other reporting requirements, regulation of proxy solicitations and requirements with respect to trading by directors, officers and principal security holders. The act also provides for the registration and regulation of brokers and dealers doing business in the over-the-counter market, contains provisions designed to prevent fraudulent, deceptive and manipulative acts and practices on the exchanges and in the over-the-counter markets and authorizes the Federal Reserve Board to regulate the use of credit in securities transactions. The purpose of these statutory requirements is to ensure the maintenance of fair and honest markets in securities.

REGULATION OF EXCHANGES AND EXCHANGE TRADING

Registration and Exemption of Exchanges

As of June 30, 1961, 14 stock exchanges were registered under the Exchange Act as national securities exchanges:

- 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 Stock Exchange
- Pittsburgh Stock Exchange
- Salt Lake Stock Exchange
- San Francisco Mining Exchange
- Spokane Stock Exchange

There have been no sales of securities on the Chicago Board of Trade since 1953. The National Stock Exchange was granted registration as a national securities exchange on August 16, 1960, but had not commenced to operate as of June 30, 1961.

Four exchanges were exempted from registration by the Commission pursuant to section 5 of the act:

Colorado Springs Stock Exchange
Honolulu Stock Exchange
Richmond Stock Exchange
Wheeling Stock Exchange

Disciplinary Action

Each national securities exchange reports to the Commission disciplinary actions taken against its members and member firms for violations of the Securities Exchange Act of 1934 or of exchange rules. During the year 7 exchanges reported 51 cases of such disciplinary actions, including imposition of fines aggregating \$30,137 in 25 cases; the suspension of 9 individuals and the expulsion of another individual from membership; the revocation of 5 specialists' registrations and the censure of a number of individuals and firms.

It is unlawful for a member of a national securities exchange or a broker or dealer to effect any transaction in a security on such exchange unless the security is registered on that exchange under the Securities Exchange Act or is exempt from such registration. 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.

Section 12 of the Exchange Act provides that an issuer may 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. An application requires the furnishing of information in regard to the issuer's business, capital structure, the terms of its securities, the persons who manage or control its affairs, the remuneration paid to its officers and directors, the allotment of options, bonuses and profit-sharing plans, and financial statements certified by independent accountants.

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

Section 13 requires issuers having securities registered on an exchange to file periodic reports keeping current the information furnished in the application for registration. These periodic reports include annual reports, semiannual reports, and current reports. The principal annual report form is form 10-K which is designed to keep up-to-date the information furnished in form 10. Semiannual reports required to be furnished on form 9-K are devoted chiefly to furnishing midyear financial data. Current reports on form 8-K are required to be filed for each month in which any of certain specified events have 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 capital securities or in the amount thereof outstanding.

Statistics Relating to Registration of Securities on Exchanges

As of June 30, 1961, a total of 2,341 issuers had 3,931 issues of securities listed and registered on national securities exchanges, of which 2,748 were classified as stocks and 1,183 as bonds. Of these totals, 1,332 issuers had 1,544 stock issues and 1,124 bond issues listed and registered on the New York Stock Exchange. Thus, 57 percent of the issuers, 56 percent of the stock issues and 95 percent of the bond issues were on the New York Stock Exchange.

During the 1961 fiscal year, 130 issuers listed and registered securities on a national securities exchange for the first time, while the registration of all securities of 96 issuers was terminated. The total number of applications for registration of classes of securities on exchanges filed during the 1961 fiscal year was 271.

The following table shows the number of annual, semiannual, and current reports filed during the fiscal year by issuers having securities listed and registered on national securities exchanges. The table also shows the number of such reports filed under section 15 (d) of the Securities Exchange Act of 1934 by issuers obligated to file reports by reason of having publicly offered securities effectively registered under the Securities Act of 1933. The securities of such issuers are traded generally in the over-the-counter markets. As of June 30, 1961, there were 2,135 such issuers, including 350 that were also registered as investment companies under the Investment Company Act of 1940.

[table omitted]

MARKET VALUE OF SECURITIES TRADED ON EXCHANGES

The market value on December 31, 1960, of all stocks and bonds admitted to trading on one or more stock exchanges in the United States was approximately \$444,738,418,000.

[table omitted]

The New York Stock Exchange and American Stock Exchange figures were reported by those exchanges. There was no duplication of issues between them. The figures for all other exchanges were for the net number of issues appearing only on such exchanges, excluding the many issues on them which were also traded on one or the other of the New York exchanges. The number and market value of issues as shown excluded those suspended from trading and a few others for which quotations were not available. The number and market value as of December 31, 1960, of preferred and common stocks separately was as follows:

[table omitted]

The New York Stock Exchange has reported aggregate market values of all stocks thereon monthly since December 31, 1924, when the figure was \$27. billion. The aggregate market value rose to \$89. billion in September 1929, and declined to \$15. billion in July 1932. The number of stocks on this exchange has increased from 1,253 issues of 831 companies on July 1, 1932, to 1,528 issues of 1,143 companies on December 31, 1960. Their aggregate market value at the close of 1960 was nearly 20 times the total at the low point in July 1932. The American Stock Exchange has reported December 31 totals annually since 1936. Aggregates for stocks exclusively on the remaining exchanges have been compiled as of December 31 annually by the Commission since 1948.

[table omitted]

Fiscal Year Share Values and Volumes

The aggregate market values of all stocks on the exchanges as of June 30 annually, and the volumes of shares traded on the exchanges in years to June 30, have been as follows:

[table omitted]

The June 30 values were as reported by the New York Stock Exchange and as estimated for all other exchanges. Volumes include shares, warrants, and rights. Comprehensive statistics of volumes on exchanges are included among the appendix tables in this annual report.

The market value of all stocks on the stock exchanges rose from \$335. billion on December 31, 1960, to nearly \$400 billion in May 1961, subsiding to about \$381 billion by June 30, 1961. The rise of \$45.7 billion for the 6 months included approximately \$2

billion on account of new listings. The 6 months' trading volume of 1,264,314,000 shares, warrants, and rights, with a dollar volume of \$35,712,309,000, brought the fiscal year showings above to a new high total.

Foreign Stock on Exchanges

The market value on December 31, 1960, of all shares and certificates representing foreign stocks on the stock exchanges was reported at about \$11.1 billion, of which \$10.1 billion represented Canadian and \$1 billion represented other foreign stocks. The market values of the entire Canadian stock issues were included in these aggregates. Most of the other foreign stocks were represented by American Depositary Receipts or American shares, only the outstanding amounts of which were used in determining market values.

[table omitted]

The number of foreign stocks on the exchanges has declined slightly in recent years, owing principally to a reduction on the American Stock Exchange from 152 in 1956 to 145 in 1960. Trading in foreign stocks was 42. percent of the reported share volume on this exchange in 1956 and 17.9 percent in 1960.

Trading in foreign stocks on the New York Stock Exchange was 3.4 percent of the reported share volume thereon in 1956 and 2.7 percent in 1960.

Comparative Exchange Statistics

Stocks on the New York Stock Exchange and on the American Stock Exchange continued to increase in number, and stocks exclusively on the regional exchanges continued to decline in number, during the past fiscal year.

[table omitted]

The ratio of share volume on the regional exchanges to the total volume on the exchanges has continued to decline, as indicated below and in the table on page 71 of our 26th annual report (1960). Dollar volumes on the New York Stock Exchange and the regional exchanges declined proportionately during the first 6 months of 1961 in view of the unusually high showing made by the American Stock Exchange.

[table omitted]

Comparative Over-the-Counter Statistics

So far as can be ascertained from the standard securities manuals and from reports to the Commission, there are about 4,000 stocks with 300 holders or more, of about 3,500 domestic companies, quoted only in the over-the-counter market. The aggregate market

value of these stocks on December 31, 1960, was about \$69 billion, or about 20 percent of the \$335.3 billion on the stock exchanges, continuing the ratio existing over recent years as mentioned in previous annual reports. Registered investment companies are excluded from this compilation, and are referred to elsewhere in this annual report.

The \$69 billion market value included \$176. billion for bank stocks, \$12.4 billion for insurance stocks, and \$39 billion for industrial, utility, and other miscellaneous stocks.

The largest number of stockholders reported for an over-the-counter stock was "over 200,000" for the Bank of America NT & SA. Over 25,000 stockholders each were reported for 20 stocks of companies including 7 banks, 8 utilities, 2 insurance, and 3 others. The following table groups issues according to number of reported stockholders.

[table omitted]

The most usual number of stockholders for an actively quoted over-the-counter stock appears to be in a range from 1,000 to 3,000.

In addition to the stocks mentioned above, there is a large and rapidly growing number of actively quoted stocks of companies so small as not to require continuous reporting to the Commission, and whose coverage by the standard securities manuals is generally limited to brief announcements of the circumstances of the offerings. At the close of 1959, there were at least 500 actively quoted stocks of companies not reporting to this Commission nor presented in substantial detail by the standard securities manuals. The number has since increased substantially. While the aggregate dollar value of these stocks will add comparatively little to the figures in billions of dollars shown in our \$69 billion compilation, the stocks have been of intense interest to many thousands of stockholders. Fragmentary figures indicate that even a small new offering may come to have at least 500 stockholders, running, in numerous instances, into 1,000 or 2,000, and sometimes more.

A comprehensive view of the number of securities quoted over the counter and at any one time is afforded by data supplied by the National Quotation Bureau, which is the principal purveyor of over-the-counter quotations in the United States. The following table shows the number of stocks quoted in recent years and the corresponding number of dealer listings in the aggregate.

[table omitted]

The dealer listings average about four per issue, but tend to cluster in stocks of greatest current interest. About 3,500 of the stocks show substantial concentrations of dealer listings, including both bids and offers. Many of the remainder are quoted only on the bid side, generally indicating attempts either to create and expand markets for closely held

stocks or to reduce and extinguish residues from offers in exchange following upon mergers, sales of assets, etc.

Much of the increase in number of stocks and dealer listings shown in the table above is accounted for by hundreds of new offerings so small in size that the financial affairs of the companies involved are shown neither in the standard securities manuals nor in continuing reports to this Commission.

The following table separates the components of the \$69 billion market value of domestic over-the-counter stocks mentioned above into categories according to whether the issuers are or are not reporting to this Commission.

[table omitted]

Reporting Under Section 15 (d)

Issuers reporting pursuant to section 15 (d) of the Securities Exchange Act continue to increase in number, as shown in appendix table 19 of our 25th annual report. Commencing with 80 as of June 30, 1937, they reached 1,014 in number 16 years later, in 1953. They then more than doubled to 2,135 in the 6 years to June 30, 1961. The 2,017 such reporting issuers as of December 31, 1960, included 1,353 having \$31.3 billion aggregate market value of outstanding stocks. The remaining 664 issuers included partnerships, voting trusts duplicative of listed shares, stock purchase and employees' savings plans, companies with only bonds in public hands, registered investment companies, and numerous issuers for whose shares no quotation was available, including a considerable number registering in 1960 but not offering their shares until 1961.

[table omitted]

DELISTING OF SECURITIES FROM EXCHANGES

Applications may be made to the Commission by exchanges to strike any securities or by issuers to withdraw their securities from listing and registration on exchanges pursuant to rule 12d2-1 (b) under section 12 (d) of the Securities Exchange Act.

During the fiscal year ended June 30, 1961, the Commission granted applications by exchanges and issuers to remove 51 stock issues and 13 bond issues from listing and registration pursuant to rule 12d2-1 (b). There were 53 stock removals, since 2 stocks delisted by the New York Stock Exchange were also delisted by the Midwest Stock Exchange. The number of issuers involved was 50. The removals were as follows:

[table omitted]

In accordance with the practice developed in recent years, nearly all of the delisting applications were filed by exchanges, only two of the applications having been filed by issuers. Many of the applications were filed by the New York Stock Exchange pursuant to its program of delisting securities which no longer meet its standards for continued listing.

During the fiscal year, the Detroit, Pittsburgh, and Pacific Coast stock exchanges adopted rules providing that an issuer intending to delist may be required to obtain a vote of its stockholders before filing an application with the Commission. This brings the number of exchanges protected by their own delisting rules to 10, being all except one of the principal registered exchanges.

Delisting Proceedings Under Section 19 (a)

Section 19 (a) (2) authorizes the Commission to suspend for a period not exceeding 12 months, or to withdraw, the registration of a security on a national securities exchange if, in its opinion, such action is necessary or appropriate for the protection of investors and, after notice and opportunity for hearing, the Commission finds that the issuer of the security has failed to comply with any provision of the act or the rules and regulations thereunder. The following table indicates the number of such proceedings with which the Commission was concerned during the 1961 fiscal year.

[table omitted]

Section 19 (a) (4) authorizes the Commission summarily to suspend trading in any registered security on a national securities exchange for a period not exceeding 10 days if, in its opinion, such action is necessary or appropriate for the protection of investors and the public interest so requires. The Commission has used this power infrequently in the past. However, during the 1961 fiscal year the Commission found it necessary and appropriate in four instances to use its authority summarily to suspend trading in securities registered on a national securities exchange. Three of these suspensions remained in effect at the end of the fiscal year.

The only case in which an order was issued under section 19 (a) (2) during the fiscal year withdrawing securities from registration on a national securities exchange is described below.

Cornucopia Gold Mines. -- Registrant, a corporation organized in the State of Washington in 1930, registered its common stock on the American Stock Exchange in 1939. It ceased mining operations in 1941 and remained inactive until May 1957. At that time, control of the company passed to a group of individuals, including Earl Belle.

The Commission instituted proceedings under section 19 (a) (2) of the act to determine whether it was necessary or appropriate for the protection of investors to suspend or

withdraw the common stock from registration on the exchange for failure to comply with section 13 of the Securities Exchange Act of 1934, and the rules thereunder governing the filing of reports with the Commission and for filing with the Commission proxy material which was false and misleading and failed to comply with the requirements of the Commission's proxy rules,

The Commission found the registrant's 1957 annual report to be false and misleading in a number of respects. The financial statements which purported to be certified by independent certified public accountants were, in fact, prepared and certified by an individual accountant who had made no audit of, nor had he even seen, the registrant's books and records. The statements he certified were copied, with some figure and wording changes, from statements prepared by another accountant. The financial statements furnished were false and misleading in a number of respects including, among other things, inclusion as cash at December 31, 1957, of the proceeds of a loan of \$125,000 made on January 20, 1958, the failure to reveal certain contingent liabilities, and to set forth the basis for determining the amounts at which buildings and equipment were listed as assets.

The annual report was also deficient in failing to indicate important changes in the business of the registrant and in stating that certain individuals had been directors of the registrant when, in fact, they had never consented to act as such and were not aware that they had been "elected" to that office.

The Commission also found that the registrant had failed to file current reports pursuant to section 13 of the act to report the acquisition of certain subsidiaries, to describe certain legal proceedings with respect to one of its subsidiaries and to reflect a change in control of the registrant from the group referred to above to Earl Belle.

The Commission further found that the preliminary proxy material filed by the registrant with respect to a proposed meeting of stockholders in July 1958 contained false and misleading statements and omitted necessary information. For example, it gave the misleading impression that the registrant's program for the acquisition of subsidiaries was completed and that only stockholder ratification was being sought whereas, in fact, stockholder approval of certain capital changes was essential in order to enable the registrant to be in a position to meet its commitments to issue large blocks of stock necessary to complete the acquisitions. The proxy material was also false and misleading in failing to disclose adequately and accurately certain transactions by the registrant and its affiliates. Information with respect to remuneration paid by the registrant was also found to be materially misleading.

On the basis of these and numerous other deficiencies the Commission issued an order withdrawing the registrant's common stock from registration on the American Stock Exchange, which had suspended trading in the stock prior to the commencement of the Commission proceedings.

UNLISTED TRADING PRIVILEGES ON EXCHANGES

Stocks with only unlisted trading privileges on the exchanges continued to decline in number, falling from 232 on June 30, 1960, to 212 on June 30, 1961. For comparison, it may be recalled that such stocks numbered about 1,800 on the American Stock Exchange alone, at their peak in 1931.

The aggregate market value of these stocks on December 31, 1960, was \$13 billion, or less than 4 percent of the \$335.3 billion total of all stocks on the exchanges. Nearly 98 percent of the \$13 billion was on the American Stock Exchange.

[table omitted]

About \$5 billion of the \$13 billion aggregate was of 55 stocks of companies reporting as fully as though they were listed, by reason of registrations under the Securities Act, or the Public Utility Holding Company Act, or the Investment Company Act, or because the companies in some cases had other securities listed on registered exchanges.

About \$4 billion of the \$13 billion aggregate was of 63 Canadian and other foreign stocks and American Depositary Receipts for foreign shares, of companies not reporting to the Commission.

About \$4 billion of the \$13 billion aggregate was of 97 stocks of domestic companies not reporting to the Commission. More than half of this \$4 billion was held by Standard Oil Co. (New Jersey) in shares of Creole Petroleum Corp.

The \$13 billion unlisted aggregate presents a sharp reduction from a peak of \$22. billion on December 31, 1956. About two-thirds of the \$9. billion reduction was occasioned by removal from the American Stock Exchange to listing on the New York Stock Exchange of Great Atlantic & Pacific Tea Co., Inc., and Singer Manufacturing Co. stocks and by absorption of Humble Oil & Refining Co., International Petroleum Co., Ltd., and United States Foil Co. into companies whose stocks are listed on the New York Stock Exchange. At the close of the fiscal year, listings on the New York Stock Exchange of Duke Power Co. and Electric Bond & Share Co. stocks, involving a further \$0.7 billion loss to the American Stock Exchange unlisted section, were in process.

The reported volume of trading on the exchanges in stocks with only unlisted trading privileges thereon, for the calendar year 1960, was about 30,900,000 shares or about 2.2 percent of the total share volume on all the exchanges. About 82.6 percent of this volume was on the American Stock Exchange, 16.4 percent was on the Pacific Coast Stock Exchange, and four other regional exchanges contributed the remaining 1 percent. The share volume in stocks with only unlisted trading privileges was about 8.5 percent of the

total share volume on the American Stock Exchange and about 11.7 percent of that on the Pacific Coast Stock Exchange in the calendar year 1960.

Unlisted trading privileges on some exchanges in stocks listed on other exchanges remained at 1,538, there being 55 additions and 55 removals during the year. The reported volume of unlisted trading on the exchanges in these stocks, for the calendar year 1960, was close to 45 million shares. About one-fifth of this volume was on the American Stock Exchange in stocks listed on regional exchanges, and about four-fifths was on regional exchanges in stocks listed on the New York or American Stock Exchange. The number of unlisted trading privileges is greater than the number of stocks involved, since leading New York listings are traded unlisted on as many as seven regional exchanges. While the 45 million shares amounted to only about 3.2 percent of the total share volume on all the exchanges, it constituted substantial portions of the share volumes on the leading regional exchanges, reaching about 77 percent on Boston, 72 percent on Philadelphia-Baltimore, 64 percent on Cincinnati, 55 percent on Pittsburgh, 47 percent on Detroit, 32 percent on Midwest, and 21 percent on Pacific Coast Stock Exchange.

Applications for Unlisted Trading Privileges

Applications by exchanges for unlisted trading privileges in stocks listed on other exchanges, made pursuant to rule 12f-1 under section 12 (f) of the Securities Exchange Act, were granted by the Commission during the fiscal year ended June 30, 1961, as follows:

[table omitted]

During the fiscal year, the Commission granted an application by the American Stock Exchange pursuant to rule 12f-2 of section 12 (f) of the Securities Exchange Act for continuance of unlisted trading, on the ground of substantial equivalence, in the Lackawanna Railroad Co. First Mortgage Bonds, Series A and B, after their assumption by the Erie-Lackawanna Railroad Co. upon merger in October 1960.

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.

In an effort to keep as much as possible of this business on their floors, special offering plans were adopted by leading exchanges commencing in 1942, and the somewhat more flexible exchange distribution plans commencing in 1953. The plans, declared effective by this Commission, include an exemption from the antimanipulative rule 10b-2, as set

forth in paragraph (d) thereof, with respect to payment of compensation in connection with the distribution of securities.

The largest number of special offerings was 87 in 1944, with \$32,454,000 aggregate value. The number has declined through the years, there being only three in 1960, aggregating \$5,439,000.

Similarly, the largest number of exchange distributions was 57 in 1954, with \$24,664,000 aggregate value, compared with 20 in 1960, aggregating \$11,108,000.

Secondary distributions, as reported, averaged 89 in number and about \$139,000,000 in amount during the 12 years 1942-53 inclusive, rising to 115 in number and about \$433,200,000 in amount as the average over the 7 years 1954-60 inclusive.

During the 6 months ending June 30, 1961, there were no special offerings, 18 exchange distributions aggregating \$38,743,000, and 58 secondary distributions aggregating \$559,921,000. This last amount was larger than the \$424,688,000 secondary distributions during the entire year 1960, and was also larger than the \$455,764,000 in the first half and the \$366,572,000 in the second half of 1959.

[table omitted]

STUDY OF PUT AND CALL OPTIONS

During the fiscal year, the Division of Trading and Exchanges completed a study of put and call options and reported the results to the Commission. The study was undertaken at the direction of the Commission in May 1959 to enable the Commission to carry out its statutory responsibilities under the Securities Exchange Act of 1934, sections 9 (b) and (c) of which empower the Commission to impose rules and regulations on dealings in puts and calls if it deems necessary.

The study was one of several reviews of option trading made from time to time but was more comprehensive in scope than previous studies. It was based chiefly on replies to questionnaires, covering options outstanding or sold during June 1959, by put and call brokers and dealers and by New York Stock Exchange member firms which endorse or guarantee puts and calls.

A report of the study, which has been published under the title "Report on Put and Call Options," provides for the first time detailed statistical information on the size and nature of the put and call market. It includes data on the proportion of options which were exercised and on the net return to option holders.

MANIPULATION AND STABILIZATION

Manipulation

The Exchange Act describes and prohibits certain forms of manipulative activity in any security registered on a national securities exchange. The prohibited activities include wash sales and matched orders effected for the purpose of creating a false or misleading appearance of trading activity in, or with respect to the market for, any such security; a series of transactions in which the price of such security is raised or depressed, or in which actual or apparent active trading is created for the purpose of inducing purchases or sales of such security by others; circulation by a broker, dealer, seller, or buyer, or by a person who receives consideration from a broker, dealer, seller, or buyer, of information concerning market operations conducted for a rise or a decline in the price of such security; and the making of any false and misleading statement of material information by a broker, dealer, seller, or buyer regarding such security for the purpose of inducing purchases or sales. The act also empowers the Commission to adopt rules and regulations to define and prohibit the use of these and other forms of manipulative activity in any security registered on an exchange or traded over the counter.

The Commission's market surveillance staff in its Division of Trading and Exchanges in Washington and in its New York regional office and other field offices observes the tickertape quotations of securities listed on the New York Stock Exchange and on the American Stock Exchange, the sales and quotation sheets of the various regional exchanges, and the bid and asked prices published by the National Daily Quotation Service for about 6,000 unlisted securities 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.

When unusual or unexplained market activity in a security is observed, all known information regarding the security is examined and a decision made as to the necessity for an investigation. Most investigations are not made public so that no unfair reflection will be cast on any persons or securities and the trading markets will not be upset. These investigations, which are conducted by the Commission's regional offices, take two forms. A preliminary investigation or "quiz" is designed to rapidly discover evidence of unlawful activity. If no violations are found, the preliminary investigation is closed. If it appears that more intensive investigation is necessary, a formal order of investigation, which carries with it the right to issue subpoenas and to take testimony under oath, is issued by the Commission. If violations by a broker-dealer are discovered, the Commission may institute administrative proceedings to determine whether or not to revoke his registration or to suspend or expel him from membership in the National Association of Securities Dealers, Inc., or from a national securities exchange. The Commission may also seek an injunction against any person violating the act and it may refer information obtained in its investigation to the Department of Justice recommending that persons violating the act be criminally prosecuted. In some cases, where State action

seems likely to bring quick results in preventing fraud or where Federal jurisdiction may be doubtful, the information obtained may be referred to State agencies for State injunction or criminal prosecution.

The following table shows the number of quizzes and formal investigations pending at the beginning of fiscal 1961, the number initiated in fiscal 1961, the number closed or completed during the same period, and the number pending at the end of the fiscal year:

[table omitted]

When securities are to be offered to the public, their markets are watched very closely to make sure that the price is not unlawfully

raised prior to or during the distribution. Registered offerings numbering 1,507, having a value of over \$19 billion, and 1,057 offerings exempt under section 3 (b) of the Securities Act, having a value of about \$239 million, were so observed during the fiscal year. Other offerings numbering 223, such as secondary distributions and distributions of securities under special plans filed by the exchanges, having a total value of \$485 million, were also kept under surveillance.

Stabilization

Stabilization involves open-market purchases of securities to prevent or retard a decline in the market price in order to facilitate a distribution. It is permitted by the Exchange Act subject to the restrictions provided by the Commission's rules 10b-6, 7, and 8. These rules are designed to confine stabilizing activity to that necessary for the above purpose, to require proper disclosure and to prevent unlawful manipulation.

During 1961 stabilizing was effected in connection with stock offerings totalling 45,024,882 shares having an aggregate public offering price of \$1,271,512,178 and bond offerings having a total offering price of \$255,587,250. In these offerings, stabilizing transactions resulted in the purchase of 1,052,186 shares of stock at a cost of \$25,015,006 and bonds at a cost of \$2,389,262. In connection with the stabilizing transactions, 7,743 stabilizing reports showing purchases and sales of securities effected by persons conducting the distribution were received and examined during the fiscal year.

INSIDERS' SECURITY HOLDINGS AND TRANSACTIONS

Section 16 of the act is designed to prevent the unfair use of information by directors, officers and principal stockholders by giving publicity to their security holdings and transactions and by removing the profit incentive in short-term trading by them in securities of their company. Such persons by virtue of their position may have knowledge of the company's condition and prospects which is unavailable to the general public and

may be able to use such information to their personal advantage in transactions in the company's securities. Provisions similar to those contained in section 16 of the act are also contained in section 17 of the Public Utility Holding Company Act of 1935 and section 30 of the Investment Company Act of 1940.

Ownership Reports

Section 16 (a) of the Securities Exchange Act requires every person who is a direct or indirect beneficial owner of more than 10 percent of any class of equity securities (other than exempted securities) which is registered on a national securities exchange, or who is a director or officer of the issuer of such securities, to file reports with the Commission and the exchange disclosing his ownership of the issuer's equity securities. This information must be kept current by filing subsequent reports for any month in which a change in his ownership occurs. Similar reports are required by section 17 (a) of the Public Utility Holding Company Act of officers and directors of public utility holding companies and by section 30 (f) of the Investment Company Act of officers, directors, principal security holders, members of advisory boards and investment advisers or affiliated persons of investment advisers of registered closed-end investment companies.

All ownership reports are available for public inspection as soon as they are filed at the Commission's office in Washington and reports filed pursuant to section 16 (a) of the Securities Exchange Act may also be inspected at the exchanges where copies of such reports are filed. In addition, for the purpose of making the reported information available to interested persons who may not be able to inspect the reports in person, the Commission summarizes and publishes such information in a monthly "Official Summary of Security Transactions and Holdings", which is distributed by the Government Printing Office on a subscription basis. Such subscriptions to this publication exceeded 16,000 as of June 30, 1961.

During the fiscal year, 40,869 ownership reports were filed, as compared with 38,821 reports filed during the 1960 fiscal year. The following table shows the number of reports filed under each of the three acts under which such reports are required.

[table omitted]

Recovery of Short-Swing Trading Profits by Issuer

In order to prevent insiders from making unfair use of information which may have been obtained by reason of their relationship with a company, section 16 (b) of the Securities Exchange Act, section 17 (b) of the Public Utility 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 from certain purchases and sales or sales and purchases, of securities of the company within any period of less than 6 months. The Commission has certain exemptive powers with respect to transactions not comprehended

within the purpose of these provisions, but is not charged with the enforcement of the civil remedies created thereby.

REGULATION OF PROXIES

Scope of Proxy Regulation

Under sections 14 (a) of the Securities Exchange Act, 12 (e) of the Public Utility Holding Company Act of 1935, and 20 (a) of the Investment Company Act of 1940, the Commission has adopted regulation 14 requiring the disclosure in a proxy statement of pertinent information in connection with the solicitation of proxies, consents, and authorizations in respect of securities of companies subject to those statutes. The regulation includes provisions that when the management is soliciting proxies, any security holder desiring to communicate with other security holders for a proper purpose 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 reasonable prescribed limitations, require the management to include in its proxy material any appropriate proposal which such security holder desires 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.

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 groups responsible for its preparation is notified informally and given an opportunity to avoid such defects in the preparation of the proxy material in the definitive form in which it is furnished to stockholders.

Statistics Relating to Proxy Statements

During the 1961 fiscal year, 2, 197 proxy statements in definitive form were filed under the Commission's regulation 14 for the solicitation of proxies of security holders; 2,169 of these were filed by management and 28 by nonmanagement groups or individual stockholders. These 2, 197 solicitations related to 1,974 companies, some 200 of which had more than 1 solicitation during the year, generally for a special meeting not involving the election of directors.

There were 1,966 solicitations of proxies for the election of directors, 217 for special meetings not involving the election of directors, and 14 for assents and authorizations for action not involving a meeting of security holders or the election of directors.

In addition to the election of directors, the decisions of security holders were sought through the solicitation in the 1961 fiscal year of their proxies, consents and authorizations with respect to the following types of matters:

[table omitted]

Stockholders' Proposals

During the 1961 fiscal year, 48 stockholders submitted a total of 198 proposals which were included in the 127 proxy statements of 127 companies under rule 14a-8 of regulation 14.

Typical of such stockholder proposals submitted to a vote of security holders were resolutions relating to 'amendments to charters or bylaws to provide for cumulative voting for the election of directors, limitations on granting stock options and their exercise by key employees and management groups, sending a post-meeting report to all stockholders, changing the place of the annual meeting of stockholders, and the approval by stockholders of management's selection of independent auditors.

The managements of 27 companies omitted from their proxy statements under the Commission's rule 14a-8 a total of 55 additional proposals submitted by 31 individual stockholders. The principal reasons for such omissions and the numbers 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:

- (a) 20 proposals were not a proper subject matter under State law;
- (b) 9 proposals concerned a personal grievance against the company;
- (c) 8 proposals related to the ordinary conduct of the company's business;
- (d) 6 proposals were not timely submitted;
- (e) 2 proposals and reasons therefor were deemed misleading or impugned character;
- (f) 1 proposal involved the election of directors; and
- (g) 9 proposals were withdrawn by the stockholders.

Ratio of Soliciting to Nonsoliciting Companies

Of the 2,341 issuers that had securities listed and registered on national securities exchanges as of June 30, 1961, 2,097 had voting securities so listed and registered. Of

these 2,097 issuers, 30 listed and registered voting securities for the first time after their annual stockholders' meeting in fiscal 1961; thus, of the remaining 2,067 issuers with voting securities, 1,680, or 81 percent, solicited proxies under the Commission's proxy rules during the 1961 fiscal year for the election of directors.

Proxy Contests

During the 1961 fiscal year, 32 companies were involved in proxy contests for the election of directors. A total of 463 persons, both management and nonmanagement, 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 12 cases involved contests for representation on the board.

Management retained control in 9 of the 20 contests for control of the board of directors, 3 were settled by negotiation, nonmanagement persons won 2, and 6 were pending as of June 30, 1961. Of the 12 cases where representation on the board of directors was involved, management retained all places on the board in 10 cases and there were 2 cases pending as of June 30, 1961.

INVESTIGATIONS

Section 21 (a) of the 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. In addition to the investigations undertaken in enforcing the anti-fraud, broker-dealer registration, and other regulatory provisions of the act, which are discussed in part XI of this report under "Complaints and Investigations", the following investigations were undertaken in enforcing 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:

[table omitted]

REGULATION OF BROKER-DEALERS AND OVER-THE-COUNTER MARKETS

Registration

Section 15 (a) of the Securities Exchange Act of 1934 requires the registration of all brokers and dealers who use the mails or instrumentalities of interstate commerce to

effect transactions in, or to induce the purchase or sale of, securities in the over-the-counter markets. The act affords exemption from registration for those brokers and dealers whose business is exclusively intrastate or exclusively in exempted securities, commercial paper, bankers' acceptances, or commercial bills.

The following table sets forth statistics with respect to broker and dealer registrations and applications for fiscal 1961.

[table omitted]

Administrative Proceedings

Section 15 (b) of the Securities Exchange Act provides that the Commission shall, after appropriate notice and opportunity for hearing, deny or revoke registration if it finds such a sanction in the public interest and that the applicant or registrant or any partner, officer, director, or other person directly or indirectly controlling or controlled by such applicant or registrant is subject to one or more of the disqualifications set forth in the act. These disqualifications, in general,

(1) willful false or misleading statements in an application or document supplemental thereto;

(2) conviction within 10 years of a felony or misdemeanor involving the purchase or sale of securities or any conduct arising out of business as a broker-dealer;

(3) injunction by a court of competent jurisdiction against engaging in any practices in connection with the purchase or sale of securities; and

(4) willful violation of the Securities Act of 1933 or the Securities Exchange Act of 1934 or any of the Commission's rules or regulations thereunder.

The Commission is empowered by section 15A of the Securities Exchange Act to suspend or expel a broker-dealer from membership in the National Association of Securities Dealers, Inc., the only securities association registered with the Commission, upon a finding of violation of the Federal securities laws or regulations thereunder. Section 19 (a) (3) of the act grants similar powers with respect to membership in national securities exchanges.

The Commission may not deny or revoke registration without finding a disqualification of the types set forth in the act. Therefore, bad reputation or character, or lack of experience in the securities business, or even conviction of a felony unrelated to transactions in securities cannot in itself be a basis for ordering denial or revocation of registration as a broker-dealer.

Under section 15A (b) (4) of the Securities Exchange Act, in the absence of the Commission's approval or direction, no broker or dealer may be admitted to or continued in membership in the National Association of Securities Dealers, Inc., if the broker or dealer or any partner, officer, director, or controlling or controlled person of such broker or dealer was a cause of any order of denial or revocation of registration- or suspension or expulsion from membership which is in effect. An individual named as such a cause often is subject to one or more statutory disqualifications under section 15 (b) and his employment by any other broker-dealer thus could also become a basis for broker-dealer revocation proceedings against the new employer.

The following statistics deal with administrative proceedings instituted during fiscal 1961 to deny and revoke registration and to suspend and expel from membership in an exchange or the National Association of Securities Dealers, Inc.

[table omitted]

Revocation and Denial Proceedings

Action taken this past year in administrative proceedings under section 15 (b) of the Securities Exchange Act included the following cases in which the Commission revoked broker-dealer registrations:

Re, Re & Sagarese. -- The Commission found that Gerald A. Re and Gerald F. Re, members of the American Stock Exchange, had willfully violated section 5 of the Securities Act of 1933 in the unlawful distribution on that exchange of the stocks of nine companies in which they acted as specialists on the exchange. It also found that the Res willfully violated the antifraud and antimanipulative provisions of the Securities Exchange Act of 1934, its short-selling provisions and its restrictions applicable to specialists as well as its bookkeeping requirements. Accordingly, the Commission, in advance of the issuance of formal findings and opinion, ordered the immediate expulsion of the two Res from membership on the American Stock Exchange and revoked the broker-dealer registration of Re, Re & Sagarese.

Barnett & Co., Inc. -- This registrant was found to have employed well-known "boiler room" techniques in connection with the offer and sale of stock of Steuben Electronics Corporation, Inc., including the use of numerous salesmen to sell a large block of such stock exclusively by long-distance telephone calls through the means of inaccurate, highly exaggerated, and misleading representations concerning the issuer's financial condition, its income and capital, and the prospective market price of its stock, without any reasonable basis therefor and without any efforts having been made to obtain information concerning such matters. The Commission found Stanley Barnett, Maurice Lieber, and Murray Libman to be causes of the order of revocation.

Midland Securities, Inc. -- The Commission found that registrant, Ben Degaetano, president, a director and principal shareholder of registrant, and registrant's salesmen, in the sale of securities of Inland Resources Corp., made false and misleading statements that, among other things, Inland had just brought in a "gusher" and had many producing wells, the stock was to be listed on a national securities exchange, only a limited amount of stock was available, registrant's price for the stock was lower than the prevailing market price, registrant could give a special price for the stock because it had obtained a block from an estate, the price of the stock would increase sharply in a short time, and that Inland had or was about to receive government contracts. The Commission found Degaetano and Joseph P. Emanuel, Samuel Golden, Herbert Geist, Marvin Berkrot, and Irving R. Winkler, salesmen, each a cause of the order of revocation.

Cullen-Stanford Corp. -- The Commission determined that the registrant and its president, Stanford R. Gabaeff, whom it found to be a cause of the revocation order, had sold unregistered shares of Union Gulf Petroleum Corp. and had made false and misleading representations in the sale of shares of Union and of Pacific Central Co.

Among other things, it was represented that the Union stock had been approved by the Commission, that it would have a rapid growth and rise within a short period from its current price of \$4 1/8 per share to \$7 or \$8, that dividends would be paid on the stock, and that a New York syndicate was buying up the stock and such activity would cause the price to increase markedly; and that the Pacific stock would double or triple in price within 60 or 90 days, that such stock would be listed on an exchange, that dividend payments would be increased; that Pacific would announce startling new discoveries, that Pacific and Shell Oil Co. expected to merge and had entered into a contract whereby Shell agreed to take Pacific's entire output of oil, and that registrant was the fifth largest brokerage firm on Wall Street.

N. Pinsker & Co., Inc. -- Registrant sold shares of unregistered Class B stock of Tyrex Drug & Chemical Corp. in violation of section 5 of the Securities Act, participating in a distribution being made for the issuer and purchasing Tyrex stock with a view to distribution from an individual who was under common control with the issuer. In addition, registrant, employing the technique of using numerous salesmen and wholesale and persistent telephone solicitation, violated the anti-fraud provisions of the securities acts by making false and misleading representations that Tyrex had developed a drug which would cure ulcers, and concerning the future market price of Tyrex stock and the merger or affiliation of Tyrex with another company.

Earl J. Knudson & Co. -- The Commission found that registrant Earl J. Knudson, Jr., vice president, illegally offered and sold unregistered shares of International Petroleum Holding Corp. In August 1959, at the request of one Max Gilford, Knudson acquired substantially all the stock of a predecessor of International, which was a corporate shell, for \$5,000 and delivered such shares to Gilford. Following a 100-for-1 split of its shares, a total of 2, 190,000 shares, all but 100 of the shares outstanding after the split, were

transferred to Knudson. Thereafter a wide distribution of the shares was effected in several States through various individuals and broker-dealers without prior registration with the Commission. The Commission found that Knudson participated in significant steps essential to the distribution and aided and abetted in it, and that, in the light of the extensive distribution, no private offering exemption under section 4 (1) as claimed by Knudson was available.

Lawrence Rappee, doing business as Lawrence Rappee & Co. -- At the same time that registrant was conducting an intensive campaign to effect retail distribution of the common stock of Star Chemical Laboratories, Inc., it purchased shares and entered quotations for the stock in the daily sheets of the National Daily Quotation Service at progressively increasing prices which averaged 20 percent and were as much as 30 percent higher than the closely contemporaneous cost prices of the shares purchased. Registrant also arranged with a broker-dealer in another city to also submit quotations for Star Chemical stock and periodically furnished this broker-dealer with the prices to quote, which in general were the same as and followed registrant's quotations. No other broker-dealer quoted Star Chemical stock during the period.

The Commission concluded that registrant created the market for Star Chemical stock and through the quotations of the other broker-dealer created the illusion that an independent market existed to facilitate registrant's sales of the block of stock he acquired. These activities of registrant were not revealed to his customers. In addition, registrant used sales brochures which contained false and misleading statements regarding the assets and facilities of Star Chemical and represented that several other companies were its wholly-owned subsidiaries, whereas the company had only nominal assets and had no interest in or control over any of the alleged subsidiaries.

Security Enterprises, Inc. -- Registrant, Truman K. Pennell, president and owner of substantially all of the registrant's shares, and Carl L. Linn, a former employee of registrant, sold shares of American Trust Life Insurance Co. and American Trust Underwriters without disclosing to customers as required by rule 15c1-5 of the Exchange Act that Pennell was president and a large stockholder of Life and Underwriters and occupied a position of control in those companies, or the fact that registrant and Linn were also under the common control of Pennell. The Life and Underwriters shares were sold to customers at excessive prices not reasonably related to current market prices, some sales by registrant being at prices representing markups of as much as 283 percent over its contemporaneous costs on purchases from other customers, and sales by Linn representing markups as much as 102 percent over his contemporaneous costs on securities he purchased from Pennell and as much as 185 percent over his contemporaneous costs on purchases from other customers. Customers were not informed of the markups or that shares they purchased had been acquired from Pennell. During the period in which these transactions were being effected registrant and Linn also failed to give or send to customers written confirmations disclosing the information required by

rule 15c1-4 of the Exchange Act, including information as to the capacities in which they were acting.

Manthos, Moss & Co., Inc. -- This case involved transactions by registrant with customers at prices not reasonably related to prevailing market prices. The Commission held that the best evidence of current market prices is a dealer's own contemporaneous costs, in the absence of countervailing evidence. Certain securities purchased from other customers were sold on the same day at markups ranging from 12.8 percent to 60 percent of such cost and from \$62.50 to \$5,000. In other transactions where registrant sold to customers securities purchased from other broker-dealers on 1 or 2 days prior to the date of sale, registrant's markups over such cost ranged from 9.7 percent to 300 percent. Registrant also purchased securities from customers which he resold to other broker-dealers at prices ranging from 12.5 percent to 100 percent greater than the prices registrant had paid its customers, registrant's profit on an individual transaction ranging as high as \$2,062.

The use of customers' funds for the registrant's own purposes, a form of misconduct accompanied in most cases by doing business while insolvent and in violation of the net capital requirements, by failure to file financial reports, sending false confirmations, and keeping false records, was found and resulted in revocation in Wiles & Co., Thompson & Sloan, Inc., First Idaho Corp., and in First Securities Co. In the last named case, Frank L. Wasserman, a partner, commingled securities carried for the accounts of customers with registrant's own securities subject to a lien for loans made to it, and sold for his own account stock belonging to a customer without the latter's knowledge or authorization, signing the customer's name on the stock certificate to effect its transfer.

An injunction against violation of the securities registration provisions, conviction for mail fraud in the sale of securities and the failure to amend registrant's broker-dealer application to disclose such conviction were the grounds for revocation in Mortgage Clubs of America, Inc.

Suspension Proceedings

Section 15 (b) authorizes the Commission to suspend effectiveness of a broker-dealer's registration pending final determination as to whether registration should be revoked. To suspend, the Commission must make a finding, after notice and opportunity for a hearing, that suspension is necessary or appropriate in the public interest or for the protection of investors. During the past fiscal year the Commission suspended the registrations of five broker-dealers after hearings at which the evidence adduced revealed that serious misconduct was currently being engaged in by the respondents. To prevent further harm to investors the Commission determined that it was in the public interest to suspend those registrations pending determination of the question of revocation. The entry of an order of suspension is not determinative of the ultimate questions of whether willful violations have been committed and an order of revocation should be issued.

Other Sanctions

The Commission is empowered to suspend for a period not exceeding 12 months or to expel any member of a national securities exchange for violations of the Securities Exchange Act and to take such action with respect to a member of a registered securities association for such violations or for willful violations of the Securities Act.

In G. J. Mitchell, Jr. Co., the Commission suspended the registrant from membership in the National Association of Securities Dealers, Inc., for 15 days for using sales literature which constituted a prospectus not conforming to the requirements of section 10 of the Securities Act and using a selling brochure which omitted to refer to operating losses by the issuer of the securities being recommended.

In Bruns, Nordeman & Co., the registrant was suspended from membership in the National Association of Securities Dealers, Inc., and two of its partners, Harold S. Coleman and Lawrence H. Lubin were suspended from membership in the New York Stock Exchange and American Stock Exchange -- Coleman for a period of 90 days and Lubin for 60 days. The Commission found that Bruns, Nordeman, in advance of a public offering through it as underwriter of additional shares of Gob Shops, Inc., "at the market" price at the time of the offering, entered increasing bids for Gob stock in the daily quotation sheets and engaged in trading activities in such stock which "were designed to stimulate buyer interest and thereby create market activity which would induce the purchase of Gob Shops stock by others at rising prices." Additional stimulus was provided the market by the declaration by Gob, following the proposal by Coleman and Lubin who were directors, that a cash dividend be paid despite an operating loss, which was charged to capital surplus because of the insufficiency of earned surplus. Misleading optimistic sales literature and misrepresentations were also used as part of the manipulative scheme to raise the price of the Gob stock. The bidding for and purchasing of Gob stock during the distribution of the shares pursuant to the underwriting was also found to violate rule 10b-6.

The Commission found certain mitigating circumstances, including the previous good records of the registrant, Coleman and Lubin, that registrant would be disqualified from acting as an underwriter for an offering of securities under regulation A for a period of 5 years, and that pursuant to rescission offers made to customers who had purchased Gob stock from it, registrant had repurchased many shares paid had paid losses sustained by customers of over \$10,000. The Commission concluded that, under the circumstances, the public interest did not require the revocation of registrant's registration,

Net Capital Rule

Rule 15c3-1 adopted under section 15 (c) (3) of the Securities Exchange Act, commonly known as the net capital rule, provides safeguards for funds and securities of customers

dealing with broker-dealers. This rule imposes a 20-to-1 limit on "aggregate indebtedness" which may be incurred by a broker-dealer in relation to its "net capital" as those terms are defined by the rules.

Prompt action is taken whenever it appears from examination of reports filed by a registered broker-dealer, or through inspection of his books and records, that the permitted ratio is exceeded. Unless the broker-dealer promptly takes necessary steps to correct such capital deficiency, injunctive action may be taken and proceedings may be instituted to determine whether the broker-dealer registration should be revoked. During the fiscal year, violations of the net capital rule were charged in injunctive actions filed against 31 broker-dealers and in revocation proceedings instituted against 26 broker-dealers.

Broker-dealers participating in "firm commitment" underwritings must have sufficient net capital to permit participation in the underwriting for the amount agreed upon without impairing the allowable capital-debt ratio prescribed by the rule. In order to protect issuers and customers of broker-dealers participating in such underwritings, the staff carefully analyzes the latest information concerning the capital position of such broker-dealers in order to determine if assumption of the new obligations involved in the underwriting is possible without violating the net capital rule. Acceleration of the effective date of registration statements filed under the Securities Act will be denied where it appears that underwriting commitments may engender violations of the net capital rule by any participating underwriter. Participants who appeared to be inadequately capitalized to take down their commitments were informed of the potential violation and the effect it would have on the pending registration statement. Such broker-dealers either obtained sufficient additional capital so that full compliance with the rule could be had, reduced their commitments in the underwriting to such an extent as to participate in the underwriting without violating the rule, withdrew as underwriters, or participated in the underwriting on a "best efforts" basis only.

Financial Statements

Rule 17a-5 promulgated under section 17 (a) of the Securities Exchange Act requires registered broker-dealers to file annual reports of financial condition with the Commission. Every report so filed must be certified by a certified public accountant or a public accountant who is in fact independent with certain specified limited exemptions applicable to situations where certification does not appear necessary for customer protection. The rule provides specific conditions under which members of national securities exchanges are exempt from the necessity of certification. An exemption from the certification requirement is also available to a broker-dealer who, since his previous report, has limited his securities business to soliciting subscriptions as an agent for issuers, has transmitted funds and securities promptly, and has not otherwise held funds or securities for or owed monies or securities to customers. An exemption is also afforded a broker-dealer who, from the date of his last report, has confined his business to buying

and selling evidences of indebtedness secured by liens on real estate and has carried no margin accounts, credit balances or securities for any customers.

With respect to the times within which financial statements must be filed, rule 17a-5 provides that upon the initial registration of a broker-dealer the registrant's first financial report must be as of a date during the period between the expiration of the first and fifth months following the effective date of the registration. In all cases, reports must be filed within 45 days after the date as of which the report speaks.

The reports of financial condition furnish a means whereby the Commission and the public may evaluate the financial position and responsibility of registered brokers and dealers. The reports are analyzed by the staff of the Commission to determine whether the registrant is in compliance with the net capital rule. Revocation proceedings may be instituted against registrants who fail to make the necessary filings. However, it is the policy of the Commission first to advise the registrant of his obligations under rule 17a-5 and give him an opportunity to file the report.

During the fiscal year 5,060 reports of financial condition were filed. This compares to the 1960 total of 4,569.

Broker-Dealer Inspections

Section 17 (a) of the Securities Exchange Act of 1934 provides for regular and periodic inspections of registered broker-dealers. The inspection device, which the Commission has continually emphasized, is a most useful instrument in protecting investors and preventing and detecting violations of the Federal securities laws,

Among other things, the inspections involve: (1) a determination of the broker-dealer's financial condition; (2) a complete review of his pricing practices; (3) an evaluation of the safeguards employed in his handling of customers' funds and securities; and (4) a determination of whether adequate and accurate disclosures relating to transactions are made to customers.

The inspectors also determine whether brokers and dealers keep books and records in compliance with the Federal securities laws and conform to the margin and other requirements of regulation T as prescribed by the Federal Reserve Board. In addition, they examine individual trading accounts to determine whether excessive trading or switching has occurred. Frequently inspectors find evidence of the sale of unregistered securities or the use of fraudulent practices, including the use of improper sales literature or sale techniques. The inspection program has also assisted the Commission in its administration of many of its rules.

The number of inspections completed during the fiscal year totaled 1,627, an increase of 128 inspections or almost 9 percent over the previous year. With the steady increase in

the number of registered broker-dealers and benefits derived from the inspection program, the Commission intends to continue its policy of increasing the number of inspections in the future.

In determining whether to institute action against a broker-dealer found to be in violation of the statutes or rules as a result of an inspection, consideration is given to the type of violations and to the effect such violations may have upon members of the public. It is not the Commission's policy to take formal action against broker-dealers for every infraction uncovered. For example, inspections frequently reveal various inadvertent violations which are discovered before becoming serious and before customers' funds or securities are endangered. Where no harm has come to the public in such situations, the matter is usually brought to the attention of the registrant and suggestions are made to correct any improper practices. If a violation appears to be willful and the public interest or the protection of investors is best served by formal action, the Commission promptly institutes appropriate proceedings.

The following table shows the various types of violations disclosed as a result of the inspection program during the fiscal year:

[table omitted]

In addition to the Commission's inspection program, the National Association of Securities Dealers, Inc., and the principal stock exchanges also conduct inspections of their members and some of the States also have inspection programs. Each inspecting agency conducts inspections in accordance with its own procedures and with particular reference to its own regulations and jurisdiction. Consequently, inspections by other agencies are not an adequate substitute for Commission inspections since the inspector will not be primarily concerned with the detection and prevention of violations of the Federal securities laws and the Commission's regulations thereunder. However, the inspection programs of these other agencies do afford added protection to the public. The Commission and certain other inspecting agencies maintain a program of coordinating inspection activities for the purpose of avoiding unnecessary duplication of inspections and to obtain the widest possible coverage of brokers and dealers. The program does not prevent the Commission from inspecting any person recently inspected by another agency, and such an inspection by the Commission is made whenever reason therefor exists.

Agencies now participating in this coordination program include the American Stock Exchange, the Boston Stock Exchange, the Midwest Stock Exchange, the National Association of Securities Dealers, Inc., the New York Stock Exchange, the Pacific Coast Stock Exchange, the Philadelphia-Baltimore Stock Exchange, and the Pittsburgh Stock Exchange.

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

Section 15A of the Securities Exchange Act of 1934 (Maloney Act) provides for the registration with the Commission of national securities associations and establishes standards for such associations. The rules of such associations must be designed to promote just and equitable principles of trade, to prevent fraudulent and manipulative acts and practices and to meet other statutory requirements. Such associations are essentially disciplinary in purpose and serve as a medium for the cooperative self-regulation of over-the-counter brokers and dealers. They operate under the general supervision of this Commission 'which is authorized to review, disciplinary actions and decisions which affect the membership of members, or of applicants for membership, and to consider all changes in the rules of associations. The National Association of Securities Dealers, Inc. (NASD), is the only association registered under the act.

In adopting legislation permitting the formation and registration of such associations, Congress provided an incentive to membership by permitting such associations to adopt rules which preclude a member from dealing with a nonmember, except on the same terms and conditions as the member affords the investing public. The NASD has adopted such rules. Accordingly, membership is necessary to the profitable participation in underwritings and over-the-counter trading since members may properly grant price concessions, discounts, and similar allowances only to other members. Loss or denial of membership due to expulsion or suspension or other ineligibility due to a statutory disqualification, or to failure to meet standards of qualification established in NASD rules, thus imposes a severe economic sanction.

Membership in the NASD reached an all time high of 4,611 at June 30, 1961. During the year membership increased by 239, as a result of 685 admissions to, and 446 terminations of, membership. At the same time, there were registered with the NASD as registered representatives 94,040 individuals, including generally all partners, officers, traders, salesmen, and other persons employed by or affiliated with member firms in capacities which involved their doing business directly with the public. The number of registered representatives increased by 3,860 during the year as a result of 20,818 initial registrations, 11,813 re-registrations, and 28,771 terminations of registrations. At February 28, 1961, there were 94,176 registered representatives, an all time high figure.

NASD Disciplinary Actions

The Commission receives from the NASD summaries of decisions in all disciplinary actions against members. Each such complaint must be based on allegations that a member has violated specified provisions of the NASD rules of fair practice, although registered representatives of members, and persons controlling or controlled by members, may also be cited for having been the cause of a violation.

The sanctions available where violations are found include expulsion or suspension from membership, revocation or suspension of registration as a registered representative, fine, and censure. An individual may also be found to be the cause of a violation and of the penalty imposed on another party for such violation. Such a cause finding can have far-reaching effects, particularly in the case of expulsion, or suspension from membership or suspension or revocation-of registration as a registered representative. A person found to be a cause of suspension or expulsion from membership cannot be employed by any NASD member while such suspension is in effect, except with the approval of the Commission. Where an individual should have been, but was not, registered as a representative, a finding that the unregistered person was a cause of an effective expulsion, suspension, or revocation acts as a disqualification from membership, or from controlling or being controlled by a member, just as if such a penalty had been imposed directly on the person found a cause. In many cases more than a single penalty may be imposed so that expulsion, suspension, or revocation may be accompanied by a fine or censure, and, in cases where a fine is imposed, censure is customarily added.

All decisions by district business conduct committees of the NASD are reviewable by the NASD board of governors on its own motion, or on the timely application of an aggrieved party. On review the board may affirm, modify, or reverse such decisions or remand them for further consideration. At times two or more complaints against a single member are consolidated and disposed of in one decision and at other times one complaint may involve more than one member firm. During the year the association reported to the Commission its final disposition of 304 formal complaint actions. These 304 final decisions reflected action against 273 different firms. In 67 cases, the complaints were dismissed against the named respondents on findings that the allegations had not been sustained. Formal findings of violations were made in the remaining 237 cases and some sanction imposed. Of this total, 178 cases were directed solely against members while 59 cases were against members and their representatives. A total of 149 representatives had been charged with violations in the original complaints. Such charges were dismissed as to 20 such individuals and disciplinary action was taken against 129.

The maximum penalty of expulsion from membership was applied in 31 decisions (including 1 firm expelled in each of 2 decisions), and 17 members were suspended from membership for periods ranging from 10 days to 3 years (including 1 firm suspended in each of 2 decisions for consecutive periods of 12 and 6 months). Fines ranging from \$10 to \$2,500 were imposed on members in 138 cases (including 3 in which members were expelled and 1 in which the member was suspended). In 55 other cases the only penalty was censure.

The sanctions imposed on registered representatives had a similar wide range. The registrations of 45 registered representatives were revoked and 10 suspended for periods ranging from 60 days to 2 years; 35 were fined amounts ranging from \$50 to \$1,000; and 13 were censured. Twenty-six were found to be causes of 14 expulsions, 1 suspension, and 11 fines imposed on the employing firms.

In addition to the various penalties described above, some of the costs of the proceedings were usually assessed against the members and the registered representatives found to have acted improperly. During the fiscal year the association collected \$83,256. in fines and costs. This amount does not reflect the fines and costs assessed since there is little or no incentive for an expelled member or a revoked registered representative to pay them.

Commission Review of NASD Disciplinary Action

Section 15A (g) of the 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 the effectiveness of any penalty imposed by the NASD is automatically stayed pending determination in any matter which comes before the Commission for review. Section 15A (h) of the act defines the scope of the Commission's review in proceedings to review disciplinary action of the NASD. If the Commission finds that the disciplined person engaged in such acts or practices, or has omitted such acts as found by the NASD, and that such acts, practices, or omissions to act are in violation of such rules of the association as have been designated in the determination, and that such conduct was inconsistent with just and equitable principles of trade, the Commission must dismiss such proceedings unless it finds that the penalties imposed are excessive or oppressive, having due regard to the public interest, in which case the Commission must, by order, cancel or reduce the penalties. At the beginning of the fiscal year eight such review cases were pending before the Commission. During the year 13 additional such petitions were, filed, 1 was withdrawn prior to a determination, and decisions were issued on 5 cases, certain of which are discussed below, leaving 15 petitions pending at the year end.

The Commission sustained certain findings by the NASD that Boren & Co., and its president and sole stockholder, Irving N. Boren, had violated certain association rules but found the penalties imposed excessive. In 24 retail sales to customers of shares of Colorado Gas Co. stock, the prices charged by Boren ranged from 33. to 66. percent over the firm's contemporaneous cost. In 23 retail sales of Texas Toy Co. stock, the markup ranged from 11.9 to 19 percent over the prices paid by the firm on the day of the sales, and in 4 sales of other securities the markups ranged from 10.8 to 25 percent. The Commission affirmed the NASD's findings that the markups in these transactions were excessive and inconsistent with just and equitable principles of trade. However, in other retail sales of Texas Toy Co. stock, and in certain transactions for customers, the Commission was unable to sustain NASD findings that the prices and commissions charged customers had been unfair. The Commission also set aside the NASD finding of violation in failing to register certain representatives as a required finding of willfulness had not been made by the NASD.

The sanctions imposed by the NASD, expulsion of Boren & Co. from membership and revocation of the registration of Irving H. Boren as a registered representative, and the

assessment of \$8,318 in costs, were reduced by the Commission to 90-day suspensions of the firm's membership and of Boren's registration and \$1,000 in costs. The Commission pointed out that although substantial sanctions were warranted, the sanctions imposed were excessive in view of its modifications of the findings of the association. The Commission further held that a part of the costs of NASD actions is to be borne by the association from its regular budget including items such as employees' salaries which are not directly attributable to particular proceedings; that costs should not be so high as to discourage an adequate defense; and that in determining the amount of the reduction consideration must be given to the facts that certain findings of violations had been set aside and that there had been no showing of deliberate obstruction and delay. Under all the circumstances, costs were reduced to \$1,000.

The Commission also dismissed an application for review by Midland Securities, Inc., and its president and sole stockholder, Ben Degaetano, of a decision which expelled the firm from membership, found Degaetano a cause of such expulsion and revoked his registration as a registered representative and assessed costs of \$2,292. against him. The Commission's opinion affirmed findings by the NASD that the firm had sold securities at unfair prices. The Commission rejected the firm's contention that since the securities involved were low in price, the markups were justified under the NASD's so-called "5-percent markup policy," which indicates that a "somewhat higher" markup than 5 percent may sometimes be appropriate in the case of securities selling below \$10 per share. The Commission declared that markups of 10.4 to 67 percent cannot be considered as only "somewhat higher" than 5 percent. Midland's contention that its markups were justified by its claimed costs of doing business, including 10 percent sales commissions on gross sales and allegedly "unusual" services to customers, was also rejected, the Commission pointing out that merely to recoup the 10 percent sales commission on the gross sales price would require a markup of more than 10 percent, and that the alleged services did not appear to be unusual. However, the Commission reduced the assessment of costs to \$750 on grounds similar to those cited in the Boren case.

In considering an application for review filed by Maryland Securities Co., Inc., and its president, Morton Sandier, the Commission reduced a fine of \$750 imposed on the firm to \$500. The Commission sustained the NASD findings that in 17 sales of shares of stock markups ranging from 13.3 to 34.2 percent over the firm's same-day costs of such shares were excessive and violated the NASD's Rules of Fair Practice. The Commission determined that in 28 other transactions for which there were no same-day purchases by the firm the NASD had incorrectly calculated a markup of 27 percent based upon the prices paid by the firm some weeks prior thereto. Under the circumstances the Commission found that the representative "asked" prices shown in the daily sheets published by the National Daily Quotation Bureau were a more representative basis for the computation of markups, but that even when computed on this basis the firm's markups in 20 transactions of 11. percent were excessive and unfair. The Commission reduced the costs assessed by the association from \$247.38 to \$75.

Commission Review of NASD Action on Membership

Section 15A (b) 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 controlling or controlled person, is under any of the several disabilities specified in the statute or the bylaws. By these provisions Commission approval is a condition to admission to or continuance in association membership of any broker-dealer who, among other things, controls or is controlled by a person whose registration as a broker-dealer has been revoked or who has been and is suspended or expelled from association membership or from a national securities exchange, or whose registration as a registered representative has been revoked by the NASD or who was found to have been a cause of such an effective order.

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. Where, after consideration, the association is favorably inclined, it ordinarily files with the Commission an application on behalf of the petitioner. A broker-dealer, however, may file an application directly with the Commission either with or without association sponsorship. The Commission reviews the record and documents filed in support of the application and, where appropriate, obtains additional relevant and pertinent evidence. At the beginning of the fiscal year, three such petitions were pending before the Commission. During the year nine petitions were filed; one was withdrawn; decisions were issued in eight cases; and three petitions were pending at the year end.

The Commission found it appropriate in the public interest to approve seven petitions for continuance in, and one petition for admission to, NASD membership notwithstanding employment of a disqualified person. In four such instances the petitions concerned disqualified persons who had earlier received Commission approval to be employed by specified NASD member firms. The circumstances of the initial approval having changed, reapproval was necessary.

LITIGATION UNDER THE SECURITIES EXCHANGE ACT OF 1934

For the protection of the public, the Commission is authorized to institute actions for injunctions when violations of the Securities Exchange Act are present or threatened. A large proportion of such actions involves unlawful activities by broker-dealers. During the past year such illegal activities consisted primarily of violations of the anti-fraud sections and of the provisions concerning financial responsibility and the maintenance of net capital and bookkeeping requirements. Frequently the firms involved have violated

two or more of the protective provisions of the act. Generally, also, violations of the anti-fraud provisions involve violations of the Securities Act of 1933. In several of the cases, it developed that the broker-dealer was insolvent, and on motion of the Commission, receivers were appointed by the court. Injunctions were obtained in 40 cases during the fiscal year and at the year end 12 cases were pending.

Section 25 of the act grants to any person aggrieved by an order issued by the, Commission under the act the right to obtain review of the order by a U.S. court of appeals.

Illustrative examples of the variety of injunctions and appellate actions are discussed below together with actions in which the Commission participated as amicus curiae.

In *S.E.C. v. DuPont Homsey & Co. and Anton E. Homsey* the Commission obtained a permanent injunction against a registered broker-dealer and one of its general partners, Anton E. Homsey, who was a member of the New York Stock Exchange, prohibiting further violations of the antifraud and other provisions of the act and the Commission's net capital rule. The case arose out of the misappropriation by Homsey of approximately \$690,000 in customers' securities deposited with the firm. Upon motion of the Commission a receiver was appointed for all assets of the firm. The customers of the firm whose securities had been misappropriated were compensated from separate funds contributed by the New York Stock Exchange.

In *S.E.C. v. Fruit of the Loom, Inc., et al.* the Commission alleged that the defendants had violated section 10 (b) of the Securities Exchange Act and rule 10b-5 thereunder in connection with a written offer to Loom's stockholders by Bates Manufacturing Co. to purchase the preferred and common stock of Loom at \$50 and \$20 per share, respectively; the offer was transmitted by Loom's management with its endorsement. At the same time, another company, Philadelphia & Reading Corp., was publicly offering to purchase the preferred and common stock of Loom at higher prices -- \$51.50 and \$23 per share, respectively. To compete with this higher offer, Bates, with the cooperation of two members of Loom's management, entered into a secret agreement with Carl M. Loeb, Rhoades & Co., a broker-dealer, to acquire stock of Loom at prices equaling the P. & R. offer and, with special written approval, at even higher prices and to repurchase all the shares obtained by Loeb, Rhoades.

The Commission charged that Loom, through its management and specifically through two members thereof, violated rule 10b-5 by failing to disclose the higher P. & R. offer to its stockholders while the Bates offer at the lower prices which it had endorsed and transmitted was still continuing. Not only did the management of Loom not disclose the higher prices being offered by P. & R., but it aggravated this violation by advising its stockholders that the Bates offer, which it was transmitting, was better than that of another company, and by its failure to inquire as to the nature of P. & R.'s offer although P. & R. had previously informed Loom's management that an earlier offer would be

increased. Two members of Loom's management took advantage of the secret purchasing program of Loeb, Rhoades on behalf of Bates and sold their stock to that firm after having advised Loom's stockholders that members of management intended to tender their shares pursuant to the terms and conditions of the Bates offer.

The Commission charged that Bates violated rule 10b-5 by making a public offer to purchase stock of Loom at one price and then pursuing a secret program through Loeb, Rhoades and under the auspices of Loom's management to pay higher and varying prices. Bates also misrepresented that a certain large block of shares of Loom would not be tendered pursuant to its offer because of a "conflict of interest" when in fact, shortly after the Bates offer was transmitted to Loom's stockholders, this block was sold to Bates at higher prices.

Loeb, Rhoades necessarily violated rule 10b-5, the Commission charged, in its capacity as the knowing instrument through which many of the violations of Bates and of certain members of Loom's management were committed. The defendants consented to a permanent injunction and offers of rescission were made by Bates and by Loeb, Rhoades.

In *S.E.C. v. Cecil Rhoades, et al.* permanent injunctions by consent were entered against Cecil Rhoades and Marshall Field, enjoining them from further violations of the anti-fraud and antimanipulative provisions of the act. Cecil Rhoades had sold short about 600 shares of IBM stock and 1,400 shares of Polaroid Corp. stock, both securities listed on the New York Stock Exchange, and, in order to cover such short position at favorable prices, the defendants employed a device, scheme, and artifice to defraud by concealing their own identities and arranging to have sell orders for 4,000 shares of Polaroid stock and 500 shares of IBM stock placed with various brokers in fictitious names. As a result, a false and misleading appearance of active trading in these stocks was created, and their market prices declined, enabling defendants to cover Rhoades' short position.

In *S.E.C. v. Stanley I. Younger* the Commission brought suit to prohibit Younger from perpetrating a fraudulent scheme by placing orders with various New York broker-dealers to sell securities which he did not own and by instructing the broker-dealers to buy on the over-the-counter market, on the basis of the credit established through the sales of such securities, the common stock of National Photocopy, Inc., a nonexistent corporation. In order to create a market in National Photocopy, Inc., Younger deposited with a Salt Lake City broker-dealer a large block of stock of this fictitious corporation and had the broker-dealer place asked quotations in the National Daily Quotation Service. A permanent injunction was entered by consent.

In *S.E.C. v. Arlee Associates, Inc., et al.* the Commission obtained a permanent injunction prohibiting the defendants from violating the anti-fraud provisions of the securities acts by selling without the consent of the owners securities pledged with the defendant First Discount Corp. as collateral for loans, and prohibiting them from effecting securities transactions for the accounts of others without being registered with

the Commission as broker-dealers. The Commission's complaint also alleged that the defendants placed purchase orders with broker-dealers when they did not intend to deposit funds or securities to cover such purchases, and the injunction prohibited any further such conduct. As a result of their unlawful conduct, the defendants had defrauded various broker-dealers of over \$1,400,000, and the whereabouts of securities collateralizing loans in excess of \$4,500,000 is unknown. A receiver has been appointed to administer the assets of the defendants Arlee Associates, Inc., and First Discount Corp.

In *S.E.C. v. William G. Karal*, Karal was permanently enjoined from employing any device, scheme, or artifice to defraud brokers and dealers in securities. He was charged with defrauding brokers and dealers by placing orders to purchase large blocks of listed securities with members of the New York Stock Exchange, and then failing to pay for them, causing the firms to cancel the transactions and sell the securities so purchased. If the sellout resulted in a profit, Karal would then tender payment for the securities purchased and demand payment for the proceeds of the sale, including the profit. If, however, the sellout resulted in a loss, Karal ignored demands for payment, and refused to make good the loss.

In *Peoples Securities Company v. S.E.C.*, the Court of Appeals for the Fifth Circuit affirmed the Commission's denial of Peoples' motion to cancel or withdraw its application for registration as a broker-dealer under section 15 (b) of the Securities Exchange Act, its denial of Peoples' application, and its finding that certain controlling persons were causes of the denial. The court rejected Peoples' contention based on the early case of *Jones v. S.E.C.* that it had an absolute right to withdraw its application any time before the effective date of registration. It also held that section 15 (b) did not require that the Commission cancel the application simply because Peoples had been dissolved as a corporation.

In *Blaise d'Antoni & Associates v. S.E.C.*, the Court of Appeals sustained an order of the Commission revoking the registration of a broker-dealer for violation of the net capital rule, naming its president and sole stockholder a cause of the revocation, and denying the latter's application for broker-dealer registration and his request to withdraw such application. The Court noted the importance of the net capital rule as "one of the most important weapons in the Commission's arsenal to protect investors." It rejected the controlling person's contention that he had an absolute right to withdraw his application for registration. Commission orders revoking broker-dealer registrations were also affirmed in *Associated Securities Corporation and Norman B. Jenson v. S.E.C.* and *N. Sims Organ & Co. v. S.E.C.*

An important decision involving applications for stays of Commission orders involved two such applications heard together by the Court of Appeals for the Tenth Circuit in *Associated Securities Corp. v. S.E.C.* and *Greenberg v. S.E.C.*, Petitioners sought to stay orders of the Commission revoking Associated's broker-dealer registration and affirming the N A SB's revocation of Greenberg's registration as a registered representative. The

Court noted that in passing on a request to stay an order of the Commission pending a petition for review, it had to balance the possible injury to the petitioners against the probable harm to the public interest. The Court held that while the exclusion of these petitioners from the securities business may be a serious personal injury, such injury was far outweighed by the consideration of possible harm to the investing public. To grant a stay, the Court felt, would be to substitute its judgment of the public interest considerations for that of the Commission, which had the primary responsibility for making such a determination, and whose determination as to those considerations should not be upset except for cogent reasons.

In *Samuel B. Franklin and Co. v. S.E.C.* the Court of Appeals upheld an order of the Commission dismissing a proceeding to review disciplinary action taken, by the National Association of Securities Dealers. The Court held that the evidence amply supported the findings of the Commission that the petitioner had sold and purchased securities at prices which were not fair under all the relevant circumstances and which were not reasonably related to the market price, in violation of the rules of the NASD. Noting that there is no hard-and-fast "5-percent rule," the Court nevertheless held that the NASD's 5-percent policy on markups and markdowns is applicable to low price and penny stocks, and that the Commission did not affirm the fine imposed by the NASD merely because the markups and mark-downs of petitioner exceeded 5 percent, but because they were clearly excessive. The Court also adopted the Commission's view that the timely filing of a petition for agency reconsideration tolls the 60-day period within which to seek review of an order of the Commission in a court of appeals and that a petition to review such an order which is filed within 60 days from the termination of the application for reconsideration by the agency is timely. A petition for a writ of certiorari is pending.

Participation as Amicus Curiae

The Supreme Court has granted certiorari in *Blau v. Lehman* in which the Commission is participating as amicus curiae. This case involves the question whether, under section 16 (b) of the Securities Exchange Act, a corporation whose securities are registered on a national securities exchange may recover the entire "short swing" profits realized by an investment banking partnership from trading in such securities where a member of the partnership is also a director of the corporation. The Court of Appeals had held 54 that a waiver by the partner-director of his share of profits realized in such transactions did not relieve him from liability under section 16 (b), but that such liability was limited to his proportionate share in the firm's profits, and it dismissed the complaint against the other partners. A motion by the Commission for leave to participate as amicus curiae and file a petition for rehearing in the Court of Appeals was denied. In addition to supporting plaintiff's petition for certiorari, the Commission filed a brief on the merits, urging that the partnership be held liable for the entire "short swing" profits realized by the firm.

Bellanca Corporation v. Sidney L. Albert, et al. involved a suit for damages, based on the antifraud and reporting provisions of the act, against a former controlling shareholder and

director of the plaintiff corporation and other former directors. The complaint charged that Albert fraudulently induced the corporation to issue and sell its stock and prevented the corporation from filing required reports with the Commission. The other directors were charged with aiding and abetting violations of the act by authorizing, ratifying and acquiescing in Albert's actions. The Commission in a memorandum filed as amicus curiae urged that the complaint stated causes of action against the defendants and was timely filed within the applicable statute of limitations.

In *Matheson v. Armbrust*, the Court of Appeals upheld a private right of action by a defrauded purchaser of securities based upon violation of section 10 (b) or the Securities Exchange Act and rule 10b-5 thereunder. The Court concluded that Congress did not intend to draw a distinction under section 10 (b) between defrauded sellers and buyers of securities. Accordingly, it rejected the contention that specific remedies available to the defrauded purchaser under the Securities Act were exclusive and barred an action based upon violation of rule 10b-5.

The Court also held that an interstate telephone call made to induce the negotiations which led to the fraudulent sale was sufficient to create Federal jurisdiction over the transaction, that actions under rule 10b-5 are additional to State and any other Federal actions and a plaintiff may bring suit in a Federal court even though he may also have an adequate remedy in the State courts; and that rule 10b-5 encompasses "face-to-face" securities transactions not i

PART VI **ADMINISTRATION OF THE PUBLIC UTILITY HOLDING COMPANY ACT** **OF 1935**

In administering 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 subsidiaries of registered holding companies. Although the matters under the act dealt with by the Commission and its staff embrace a variety of intricate and complex questions of law and fact generally involving more than one area of regulation, briefly there are three principal regulatory areas. The first covers those provisions of the act, contained principally in section 11 (b) (1), which require the physical integration of public utility companies and functionally related properties of holding company systems and those provisions, contained principally in section 11 (b) (2), which require the simplification of intercorporate relationships and financial structures of holding company systems. The second covers the financing operations of registered holding companies and their subsidiaries, the acquisition and disposition of securities and properties, and certain accounting practices, servicing arrangements and intercompany transactions. The third includes the exemptive provisions of the act, the provisions covering the status under the

act of persons and companies, and those regulating the right of a person affiliated with a public utility company to acquire securities resulting in a second such affiliation. Matters embraced within this area of regulation frequently come before the Commission and its staff. Many such matters do not result in formal proceedings and others are reflected in such proceedings only in an indirect manner when they are related to issues principally under one of the other areas of regulation.

The Branch of Public Utility Regulation of the Commission's Division of Corporate Regulation performs the principal functions under the act. It observes and examines problems which arise in connection with transactions which are or may be subject to regulation under the act and discusses such problems with interested persons and companies and advises them as to the applicable sections of the act, the rules thereunder and Commission policy with respect thereto. Questions are raised with and problems are presented to the staff daily. These include questions raised by security holders and problems presented by companies contemplating transactions requiring the filing of an application or declaration, particularly financing operations and the acquisition and disposition of securities and properties. This day-to-day activity includes profiling discussions and conferences, in person and by telephone, with company representatives and with other persons where the matter under consideration affects their interest. Members of the staff of this Division actively participate in hearings and often aid the Commission in the preparation of its decision on a particular matter. The staff continually reexamines the status of exempt companies, examines the annual reports filed with the Commission and those sent to stockholders and, of course, the staff must keep abreast of new technical developments in the electric and gas industry, including the use of atomic energy as a source of power.

COMPOSITION OF REGISTERED HOLDING SYSTEMS AND PROGRESS WITH RESPECT TO SECTION II AND OTHER SIGNIFICANT PROBLEMS

At the beginning of the fiscal year there were 26 registered holding company systems subject to regulation under the act. These included five small registered holding company systems which were formerly exempt pursuant to rule 9 of the general rules and regulations under the act. On August 11, 1960, pursuant to section 5 (d) of the act, the Commission declared one of these five companies not to be a holding company and thereupon its registration ceased to be in effect.

During the fiscal year a milestone was reached in the administration of the act. Proceedings relating to three of the largest holding company systems subject to the act and which, in the past, had taken up a substantial amount of time and effort by the Commission and its staff, progressed to completion resulting for all practical purposes in the elimination of these three registered holding company systems from regulation under the act. [foot

Rule 9 permitted a holding company to claim exemption from the act for itself and its subsidiaries if the holding company system was of relatively small size, measured by the aggregate amount of its utility assets or of the annual revenues derived from public utility operations. The rule was rescinded effective Feb. 29, 1960.] The three systems are those of Cities Service Co., Electric Bond & Share Co., and Standard Gas & Electric Co.

Details with respect to Cities Service Co. are set forth on pages 134 and 135 of the Commission's 26th Annual Report. On Dec. 23, 1960, the Commission issued an order pursuant to section 5 (d) of the act declaring that Cities Service no longer was a holding company, and its registration under the act ceased to be in effect. The order continued in effect the reservation of jurisdiction over fees and expenses incurred in various proceedings. In 1941, when Cities Service registered as a holding company it was the top company in a holding company system which consisted of 125 companies with extensive utility and nonutility interests and consolidated assets of over \$1 billion.

As indicated on pages 136-137 of the Commission's 26th Annual Report, at the beginning of this fiscal year Electric Bond & Share Co. did not own as much as 5 percent of the outstanding securities of any domestic public utility company and had pending before the Commission an application, filed pursuant to section 3 (a) (5) of the act, for an exemption as a holding company from the provisions of the act. On December 6, 1960, the Commission granted the exemption subject to certain conditions. These conditions are designed to eliminate any possible affiliate relationship between Bond & Share and a former public utility subsidiary and to prevent or modify practices which might tend toward or lead to an absence of arm's-length dealings in connection with services performed by Bond & Share, through a wholly owned service company, for certain other domestic public utility companies which had formerly been subsidiary companies of Bond & Share. In its order the Commission reserved jurisdiction to revoke Bond & Share's exemption if the conditions are not adhered to or to impose additional conditions if necessary. The Commission also reserved jurisdiction in respect of the fees and expenses incurred by certain participants and after the close of the fiscal year the Commission released jurisdiction over certain of such fees and expenses of some of the participants and reserved jurisdiction as to others. A long and difficult job was thereupon brought to a conclusion. In 1938, when Bond & Share registered as a holding company it was the largest holding company system in the country. As at December 31, 1938, the consolidated assets of Bond & Share and its subsidiary companies amounted to more than \$3. billion. The system included 5 subsidiary holding companies and 131 domestic subsidiaries. At the time the exemption order was issued Bond & Share had no subsidiary company which was either a registered holding company or a public utility company, and Bond & Share had converted itself into an investment company, registered as such on February 6, 1961.

Details with respect to Standard Gas & Electric Co. are set forth on page 140 of the Commission's 26th Annual Report, On January 19, 1961, the Commission approved step V of Standard Gas' plan which, briefly stated, proposed a liquidation and dissolution

program for Standard Gas and its subsidiary registered holding company, Philadelphia Co., through distributions to Standard Gas' stockholders of portfolio securities and cash. On April 22, 1961, the plan was approved and ordered enforced by the U.S. District Court for the District of Delaware. Although there remains for Commission consideration the fees and expenses in connection with this proceeding and the transactions governing the final distribution of Standard Gas' remaining assets, virtual completion of the long and difficult job in this system was achieved during the fiscal year. In 1938, when Standard Gas registered as a holding company it controlled a far-flung utility and nonutility system operating in over 20 States and in the Republic of Mexico. As at December 31, 1939, the system consisted of over 100 companies and its consolidated assets amounted to more than \$1 billion. At the present time, Standard Gas controls no public utility company and it has only common stock outstanding in the hands of the public. Philadelphia Co. has been dissolved.

The remaining 18 active registered systems include 20 registered holding companies since, as shown in the tabulation below, the holding company systems of Allegheny Power System, Inc., and Central & South West Corp. have 2 registered holding companies each. Of these 20 companies, 13 function solely as holding companies and 1 function as operating as well as holding companies. In these 18 active registered systems, there are 91 electric and/or gas utility subsidiaries, 40 nonutility subsidiaries, and 12 inactive companies, totaling 163 system companies.

The following tabulation shows the number of holding companies, electric and/or gas utility companies and nonutility companies in each of the 18 active registered systems as at June 30, 1961, and their aggregate assets, less valuation reserves, as at December 31, 1960:

[table omitted]

During the fiscal year, certain changes occurred in the total number of companies in 6 of the 18 active registered systems, resulting in a net reduction of 9 companies to a total of 163 as compared with a total of 172 companies as at the end of the previous fiscal year. American Electric Power Co., Inc., disposed of a nonutility subsidiary, reducing the total companies in its system from 24 to 23, Central & South West Corp. disposed of its interest in Compania Electrica de Matamoras, S.A., a Mexican public utility subsidiary, reducing the number of system companies from eight to seven. The Columbia Gas System, Inc., increased the system companies from 20 to 21 as a result of the creation of a new subsidiary, Columbia Gas of Maryland, Inc., which acquired all of the gas distribution utility assets of an associate located in the State of Maryland. Middle South Utilities, Inc., disposed of its interest in Louisiana Gas Service Co., a public utility, reducing the total system companies from 11 to 10. Iroquois Gas Corp., a public utility subsidiary of National Fuel Gas Co., acquired the assets of an associate, Penn-York Natural Gas Corp., a nonutility subsidiary which later dissolved, resulting in a reduction of total system companies from nine to eight. Six of the electric subsidiaries of New

England Electric System were merged into a seventh electric subsidiary, resulting in a reduction of total system companies from 25 to 19.

On the basis of total assets, less valuation reserves, of the entire privately owned electric and gas utility and natural gas pipeline companies in the United States, a comparison of such data with similar data for the 18 holding company systems registered under the act indicates that one-fifth of the total privately owned electric and gas utility industry is subject to the Commission's jurisdiction under the act. Since no other regulatory agency supervises the financial practices of as great a segment of the industry, persons interested in financial problems look to this Commission for leadership and guidance with respect to such matters. The Commission took the initiative in requiring competitive bidding regarding securities sold for cash, enunciating standards regarding appropriate capitalization ratios, specifying the protective provisions required to be included in first mortgage bonds and preferred stock, and requiring full refundability of senior securities at all times and at reasonable redemption prices.

The largest number of companies subject to the act as components of registered holding company systems at any one time was 1,620 in 1938. Altogether 2,413 companies have been subject to the act as registered holding companies or subsidiaries thereof at one time or another during the period from June 15, 1938, to June 30, 1961. Included in this total were 224 holding companies (holding companies and operating-holding companies), 1,037 electric and/or gas utility companies, and 1,152 nonutility enterprises. From June 15, 1938, to June 30, 1961, 2,226 of these companies have been released from the regulatory jurisdiction of the act or have ceased to exist as separate corporate entities. Of the remaining 187 companies, 163 are members of the 18 active systems listed in the table above and 24 are members of the 5 additional small systems referred to above.

Of the above-mentioned 2,226 companies, 926 with assets aggregating approximately \$13 billion at their respective dates of divestment have been divested by their respective parents and are no longer subject to the act as components of registered systems. The balance of 1,300 companies includes 791 which were released from the regulatory jurisdiction of the act as a result of dissolutions, mergers and consolidations and 509 companies ceased to be subject to the act as components of registered systems as a result of exemptions granted under sections 2 and 3 of the act or the grant of orders pursuant to section 5 (d) of the act finding such companies had ceased to be holding companies.

While, as the above indicates, the Commission has succeeded for the most part in accomplishing the aims and purposes of the Congress reflected in section 11 there still remain a number of problems to be resolved under that section. Some of them are the subject matter of proceedings now before the Commission and are discussed under the developments in individual registered systems.

Unresolved issues under section II (b)(1) concern the retainability of nonutility pipeline companies by Consolidated Natural Gas Co.; the retainability by Delaware Power &

Light Co. of both its gas and electric facilities; the retainability of gas and transportation properties of one of the public utility subsidiary companies in the Middle South Utilities, Inc., system; the retainability by the National Fuel Gas Co. system of oil and gas transmission businesses; and the retainability by Utah Power & Light Co. of its subsidiary, the Western Colorado Power Co. Under section 11 (b) (2), unresolved issues relate to the existence of publicly held minority interests in subsidiary companies of Allegheny Power System, Inc., the Columbia Gas System, Inc., Eastern Utilities Associates, New England Electric System, and Union Electric Co.

DEVELOPMENTS IN INDIVIDUAL REGISTERED SYSTEMS

There is discussed below each of the active registered holding company systems and other systems in which there occurred during the fiscal year 1961 significant developments other than financing transactions discussed under another heading.

Allegheny Power System, Inc. (Formerly The West Penn Electric Co.)

This system had consolidated assets, less valuation reserves, of approximately \$587,600,000 at December 31, 1960, and for the year ended that date, the system's consolidated operating revenues amounted to about \$158,579,000,

During the fiscal year this holding company changed its name from the West Penn Electric Co, to Allegheny Power System, Inc. The change in name was approved by a vote of the stockholders at a special meeting held in November 1960. While the change of name as such was not subject to approval by the Commission under the Holding Company Act, a declaration was filed pursuant to section 12 (e) of the act regarding the solicitation of proxies to amend its charter to effect the change and was permitted such declaration to become effective.

Allegheny Power owns 12.5 percent of the voting securities of Ohio Valley Electric Corp., which, with its wholly-owned subsidiary, Indiana-Kentucky Electric Corp., furnishes electric power to an installation of the Atomic Energy Commission near Portsmouth, Ohio. There was still pending before the Commission at the close of the fiscal year the issue of whether the acquisition of such stock by Allegheny Power and other sponsoring companies (among which are American Electric Power Co., Inc., and Ohio Edison Co., registered holding companies) meets the standards of section 10 of the act. This issue and the organization and financing of Ohio Valley Electric Corp. and Indiana-Kentucky Electric Corp. are discussed on pages 126-129 of the Commission's 23d Annual Report.

American Electric Power Co., Inc.

As at December 31, 1960, the American Electric System had consolidated assets, less valuation reserves, of some \$1,507,189,000, and for the year ended that date, consolidated operating revenues totaled about \$338,078,000.

The Commission approved a declaration filed by American Electric permitting it to issue sufficient shares of its common stock to pay a 2i,-percent stock dividend. The Commission also approved a plan filed by American Electric pursuant to section 11 (e) of the act proposing the sale to a nonaffiliate of certain quarrying properties owned and operated by a nonutility subsidiary. In 1945 the Commission had determined that, under the standards of section 11 (b) (1), the operation by the system of these properties constituted a business incidental to the operations of the system's integrated electric utility system on the ground that blasting and quarrying operations by a nonaffiliate might have seriously endangered the foundations of a nearby hydroelectric dam which was part of the system's integrated system. Since 1945 more efficient, accurate, and safer quarrying methods have been developed so that it is now possible to obtain assurance that the quarrying operations by a nonaffiliate owner would not jeopardize the dam. In the light of the foregoing the Commission approved the section 11 (e) plan on the ground that the conditions upon which the 1945 order was predicated do not now exist and it could no longer be said the quarrying operations were incidental to the operations of the integrated system.

On April 17, 1961, the Commission approved a proposal by Wheeling Electric Co. to sell to Ohio Power Co. all of Wheeling Electric's utility facilities located in the State of Ohio. These companies are both subsidiaries of American Electric.

In addition to the above matters there was an important development relating to capitalization ratios and accounting for deferred taxes which arose from the filing by Kentucky Power Co., a subsidiary of American Electric, of a proposal to issue and sell \$40,000,000 face amount of long-term notes to banks. This is discussed as a separate matter at pages 121-123.

American Electric Power owns 37. percent of the stock of Ohio Valley Electric Corp. The status of this matter is discussed under Allegheny Power System, Inc., above.

American Natural Gas Co.

As at December 31, 1960, the American Natural system had consolidated assets, less valuation reserves, of approximately \$872,585,000, and, for the year then ended, its consolidated operating revenues amounted to about \$240,250,000.

On November 13, 1959, the Commission issued its findings and opinion regarding the plan of American Natural filed pursuant to section 11 (e) of the act providing for the elimination of American Natural's then outstanding shares of \$25 par value nonredeemable preferred stock by the payment of \$32.50 per share to the holders thereof.

The order approving the plan was not entered until, as required by the Commission, it was modified to provide that the amount of cash payment, exclusive of dividends, in excess of the par value of the preferred stock would be charged by American Natural to its earned surplus and that American Natural would pay only such fees, expenses, and other remuneration in connection with the proceeding as the Commission might determine, award, or allow. During the fiscal year, claims for such fees and expenses were filed, and, after the submission of additional information and the filing of briefs, the Commission approved the amounts requested.

Also during the fiscal year, the Commission permitted an amendment of American Natural's charter to increase its authorized shares of common stock and to split such stock on the basis of 2 1/2 shares for 1.

Central & South West Corp.

As at December 31, 1960, the Central & South West system had consolidated assets, less valuation reserves, of approximately \$724,436,000, and, for the year then ended, its consolidated operating revenues totaled about \$173,152,000.

In June 1961, Southwestern Electric Power Co., a subsidiary company of Central, registered as a holding company as to the Arkklahoma Corp., an electric transmission company. Central, Southwestern, and Arkklahoma had previously filed a joint application requesting that Central and Southwestern each be declared not to be a holding company as to Arkklahoma, and that Arkklahoma be declared not to be a subsidiary company to Southwestern. Southwestern owns 32 percent of the capital stock of Arkklahoma; and Arkansas Power & Light Co. and Oklahoma Gas & Electric Co., neither of which is affiliated with Southwestern or with each other, each owns 34 percent of Arkklahoma's capital stock. A hearing was ordered on the joint application, but before the hearing took place, Southwestern registered as a holding company and the Commission, upon request, permitted the joint application to be withdrawn.

Cities Service Co.

The details of the status of Cities and its subsidiaries up to September 2, 1960, are set forth at pages 134-135 of the 26th annual report.

The section 11 (d) plan there referred to was consummated December 2, 1960; and Cities, by order issued December 23, 1960, under section 5 (d) was found to have ceased to be a holding company and its registration as a holding company ceased to be in effect. The order of the Commission approving the section 11 (d) plan reserved jurisdiction in respect of the allowance and allocation of fees and expenses in connection with the consolidated proceeding. At the end of the fiscal year a proceeding was pending with respect to such fees and expenses.

The Columbia Gas System, Inc.

This registered holding company and its subsidiary companies had consolidated assets, less valuation reserves, of \$1,256,365,000 at December 31, 1960, and consolidated operating revenues for the year then ended of \$517,050,000.

Columbia continued its corporate realignment program, initiated in 1955, to segregate retail and wholesale operations and carry on the retail business by a single company in each State with one additional company to transport gas in interstate commerce and render wholesale service to affiliated and nonaffiliated companies. Effective January 1, 1961, Columbia Gas of Maryland, Inc., acquired the retail gas distribution facilities, in Maryland, of Cumberland & Allegheny Gas Co., another subsidiary company of Columbia, which was engaged in retail service in West Virginia and Maryland. The latter company will sell gas at wholesale to the Maryland company and continue retail service in West Virginia. To date the program has been completed with respect to the retail operations in the States of Kentucky, New York, and Maryland.

After lengthy court proceedings discussed on pages 155-156 of the Commission's 26th annual report, a plan of reorganization of American Fuel & Power Co. and its two principal subsidiary companies, Inland Gas Corp. and Kentucky Fuel Gas Corp., was consummated. A new company, the Inland Gas Corp., Inc., acquired the properties and businesses of the above corporations and the common stock of the new company was placed in escrow for delivery to Columbia if it should, upon application under the act, obtain approval to acquire the stock.

At the close of the fiscal year there was pending before the Commission an integration proceeding regarding the retainability of the properties of six subsidiary companies of Columbia having net property equal to approximately 12.5 percent of the aggregate net property of the Columbia system. Many difficulties have interfered with any substantial progress toward resolution of the proceedings. During the fiscal year the Commission's staff reexamined the problems involved and conferences with company representatives took place. The basic problems were further complicated by the question of whether the facts and circumstances had changed since the hearing was closed. As a result of conferences between the staff of the Division of Corporate Regulation and Columbia officials an agreement was reached as to the appropriate procedure to be followed to bring the record up to date so as to permit the matter to go forward.

Consolidated Natural Gas Co.

This registered holding company and its subsidiary companies had consolidated assets, less valuation reserves, of approximately \$782,111,000 at December 31, 1960, and for the year then ended, the system's consolidated revenues amounted to about \$363,372,000.

Pursuant to an order of the Commission dated December 29, 1960,²² Consolidated Natural Gas Co. issued 23,000 shares of its capital stock, par value \$10 per share, to the Union Heat & Light Co. of Grove City, Pa., a nonaffiliate. The stock, valued at \$45 per share, or an aggregate of \$1,035,000, was issued in connection with the acquisition by the Peoples Natural Gas Co., a subsidiary of Consolidated, of all of the assets of Union. Peoples assumed all of Union's liabilities and issued to Consolidated 10,350 shares of Peoples' capital stock, par value \$100 per share, or an aggregate par value of \$1,035,000.

The properties acquired became part of Peoples Natural Gas Co. which now serves the 7,000 former customers of Union. Union proposes to distribute the shares of Consolidated to its two stockholders and then dissolve.

Delaware Power & Light Co.

As at December 31, 1960, this system had consolidated assets, less valuation reserves, of about \$204,382,000, and, for the year then ended, its consolidated operating revenues amounted to approximately \$54,940,000.

Delaware continues to participate in the Enrico Fermi atomic power project which in connection with Power Reactor Development Co. is discussed on pages 129-130 of the 23d annual report. In addition, Delaware is a member of High Temperature Reactor Development Associates, Inc., which is developing and constructing a reactor project that will embody an electric generating station using steam produced by an advanced type atomic reactor.

Eastern Utilities Associates

This registered holding company and its subsidiaries had consolidated assets, less valuation reserves, of approximately \$111,972,000 at December 31, 1960, and, for the year then ended, its consolidated operating revenues amounted to about \$38,042,000.

During the fiscal year, a significant step was made with respect to compliance by Eastern Utilities Associates with the April 4, 1950, order directing the company to divest itself of its direct or indirect interest in the gas utility properties of its subsidiary, Blackstone Valley Gas & Electric Co. Step 1 of the section 11 (e) plan discussed at pages 135-136 of the Commission's 26th Annual Report was approved on August 10, 1960. Step 1 provided for the transfer of Blackstone's gas properties and related facilities to Valley Gas Co. -- a new company organized for that purpose in 1956 -- in exchange for the common stock, first mortgage bonds and a long-term unsecured promissory note of Valley, and for the contemporaneous negotiated sale of such bonds and notes. On October 21, 1960, this phase of the plan was approved and ordered enforced by the U.S. District Court for the District of Rhode Island; and, on appeal by a public common stockholder of Blackstone, the District Court's order was affirmed by the U.S. Court of Appeals for the First Circuit. Subsequent to the close of the fiscal year, the Commission

issued its memorandum opinion and order approving the terms and conditions relating to the sale of Valley's bonds and notes. At the close of the fiscal year, no steps had been taken with respect to step 2 of the plan which contemplates the sale of the common stock of Valley to the public common stockholders of Blackstone and the shareholders of Eastern Utilities.

EUA, through its subsidiary, Montaup Electric Co., has an investment of \$900,000, representing a 4. percent equity interest, in Yankee Atomic Electric Co., discussed infra at pages 114-115.

General Public Utilities Corp.

As at December 31, 1960, this system, excluding Manila Electric Co., a foreign public utility subsidiary, had consolidated assets, less valuation reserves, of approximately \$930,749,000, and, for the year then ended, its consolidated operating revenues totaled about \$204,813,000.

Construction work began in February 1960 on a small (5,000 kw.) pressurized water-type nuclear reactor at the Saxton generating station of Pennsylvania Electric Co., a system subsidiary. The facility is expected to be completed by the end of 1961, after which it will be operated as a research and development project over a 5-year period. At the end of the fiscal year the Atomic Energy Commission had scheduled a public hearing to consider issuance of a provisional operating license for the Saxton unit.

Granite City Generating Co. (Voting Trustees)

As at March 31, 1961, the end of its fiscal year, this system had total assets, less valuation reserves, of about \$292,000 and Granite City Generating Co., an electric utility company, had total operating revenues of about \$125,000 for the 12 months ended that date. The Voting Trustees, by virtue of their voting control of all of the voting securities of the electric utility company, are a holding company and registered as such in 1937. The electric utility company owned a power plant which was leased to Union Electric Co. and the entire annual rentals for the leased plant, less expenses and taxes, were devoted to the retirement of the outstanding first mortgage bonds of the electric utility company. During the fiscal year the Voting Trustees and the electric utility company sold all of that company's assets to a nonaffiliated steel company and, to the extent necessary, the proceeds from the sale were used to retire all of the electric utility company's first mortgage bonds then outstanding. During the coming fiscal year, it is expected that the Voting Trustees will file a plan under section 11 (e) of the act to distribute the cash balance, after the payment of fees of the Voting Trustees and all liquidating and other expenses, to the holders of the voting trust certificates of the electric utility company.

Middle South Utilities, Inc.

This registered holding company had consolidated assets, less valuation reserves, of about \$793,945,000 at December 31, 1960, and, for the year then ended, its consolidated revenues amounted to approximately \$214,574,000.

As discussed at page 138 of the 26th annual report, Middle South proposed to adopt a restricted stock option plan and issue thereunder restricted common stock options to key officers and employees of the company and its subsidiary companies. During the fiscal year, the Commission approved the proposal subject to certain conditions. As filed, the plan provided that during a period of 5 years from the date of approval of the plan by the stockholders of Middle South, non-transferable options were to be granted, as determined by a special option committee, to key executive employees of the system for the purchase of up to 120,000 of the authorized and unissued shares of common stock of Middle South. No options were to be issued to any one employee which would permit him to acquire more than 10,000 shares of stock, no option could be exercised in whole or in part during the first 12 months after its grant but each option could be exercised as to one-fourth of the shares optioned thereunder for each 12-month period subsequent to the date of grant, and no option could be exercised after 7 years from the date of grant. The exercise price per share of the common stock covered by each option was to be not less than 95 percent of the market value of such stock at the time of the grant of the option, subject to modifications and adjustments under certain conditions; and the exercise price could subsequently be reduced to 95 percent of the market value of the stock on the day of reduction if the average market value thereof for the 12 consecutive calendar months preceding the month in which the reduction occurred was less than 80 percent of the fair market value of the stock on the date of the grant of the original option.

In approving the proposal, the Commission required the plan be amended so that (a) the aggregate exercise price of common stock optioned to any one optionee may not exceed 150 percent of the regular annual cash compensation then being paid to him, (b) the exercise price may not be less than 100 percent of the market price of the stock on the date of the grant of the option, and (c) not more than 25 percent of the shares reserved under the plan may be optioned to employees who, at the time of adoption of the plan, are officers in the Middle South system. Middle South accepted the conditions and, in addition, eliminated the provision permitting the reduction in the exercise price if the market price of the stock declined.

During the fiscal year Middle South filed a plan pursuant to section 11 (e) of the act providing for the exchange of shares of its common stock for the 3.18-percent publicly held shares of common stock of New Orleans Public Service, Inc., a public utility subsidiary company of Middle South, on the basis of 2% shares of common stock of Middle South for each share of common stock of New Orleans. The Commission consolidated the plan proceeding with a proceeding instituted by the Commission to determine what action, if any, should be taken by Middle South and New Orleans pursuant to section 11 (b) (2) of the act to insure that the corporate structure of New Orleans does not unfairly or inequitably distribute voting power among its security

holders. A notice of filing was issued 32 and a hearing held, and, at the end of the fiscal year, the matter was under advisement.

Following the announcement by the Government on July 11, 1955 (p. 85 of the 21st annual report) that the power contract between the Atomic Energy Commission and Mississippi Valley Generating Co., a subsidiary of Middle South, would be canceled, the Government advised Mississippi Valley that no payments would be made under the contract. Subsequently, on November 4, 1955, Mississippi Valley sued the Government in the Court of Claims and recovered a judgment on behalf of itself and certain use plaintiffs. Upon appeal by the Government, the U.S. Supreme Court reversed the judgment on the ground that the conflict of interest on the part of one of the Government's participants in the negotiations leading up to the power arrangements vitiated the contract. Mississippi Valley's assets aggregate about \$524,000 and its liabilities, including expenses incurred in connection with the litigation in the Court of Claims and Supreme Court, approximate \$1,824,000, leaving an excess of liabilities over assets of about \$1,300,000. Middle South, in a proceeding pending at the close of the fiscal year, proposed to make available about \$1,027,000 to pay the claims against Mississippi Valley, which is to be dissolved.

National Fuel Gas Co.

As at December 31, 1960, the National Fuel system had consolidated assets, less valuation reserves, of approximately \$215,011,000, and the system had consolidated operating revenues of \$113,118,000 for the year 1960.

In July 1960, a plan was filed by National Fuel pursuant to section 11 (e) of the act for the elimination of the 5.95-percent minority interest in the common stock of one of its gas utility subsidiary companies, Pennsylvania Gas Co. The plan provides for the exchange of shares of the common stock of National for the publicly held shares of common stock of Penn Gas. The Commission consolidated the plan proceeding with a proceeding instituted by the Commission to determine what action, if any, should be taken by National and Penn Gas, pursuant to section 11 (b) (2) of the act, to ensure that the corporate structure of Penn Gas does not unfairly or inequitably distribute voting power among its security holders. Hearings were held and briefs were filed and, at the end of the fiscal year, the matter was pending before the Commission for determination.

During the fiscal year, a gas utility subsidiary, Penn-York Natural Gas Corp., sold its physical assets to an affiliated company and thereafter dissolved.

New England Electric System

As at December 31, 1960, this registered holding company and its subsidiaries had consolidated assets, less valuation reserves, of \$624,697,000; and, for the year ended on that date, the system's consolidated operating revenues amounted to \$179,939,000.

In its findings and opinion and order issued February 20, 1958, the Commission held that the electric properties of New England Electric System (NEES) and its subsidiaries constituted an integrated electric utility system retainable under common control under the integration standards of section II (b)(1) of the act. The order of February 20, 1958, reserved for later determination the question of whether any or all of the gas properties owned and operated by the NEES system are retainable under the integration standards of the act. The hearing has been concluded with respect to the retain-ability of the system's gas properties and, at the close of fiscal year, requested findings and briefs were in preparation by the participants.

On January 9, 1961, the Commission approved a proposal by NEES and six of its electric utility subsidiary companies to merge into a seventh electric utility subsidiary. Under the proposal, Worcester County Electric Co. (the name of which was subsequently changed to Massachusetts Electric Co.) acquired all the assets of Attleboro Electric Co., Northampton Electric Lighting Co., Northern Berkshire Electric Co., Quincy Electric Co., Southern Berkshire Power & Electric Co., and Weymouth Light & Power Co. The merged company constitutes the largest retail electric utility subsidiary of the NEES system. As at December 31, 1960, its assets, after deducting valuation reserves amounted to \$116,730,000 and its revenues in 1960 amounted to \$63,051,000, both figures giving pro forma, effect to the merger.

During the fiscal year a hearing was held to determine whether (a) the Commission should approve a plan filed under section 11 (e) of the act by NEES providing for the issuance by NEES of additional shares of its common stock in exchange for the 2.82-percent publicly held shares of the common stock of its electric subsidiary, Lynn Electric Co., and (5) whether an order should be entered under section 11 (b) (2) of the act directing the elimination of the publicly held interest in Lynn. Subsequent to the close of the fiscal year the Commission issued its findings and opinion and order approving the plan and, in addition, directing the elimination of the minority interest.

On December 30, 1959, the Commission issued an order under section 13 of the act conditionally approving a proposal by NEES and its subsidiary service company, New England Power Service Co., providing for the transfer to the Service Co.'s, payroll of the salaries of all officers and employees of NEES who are also officers and employees of the Service Co. The order of December 30, 1959, provided that the authority granted thereunder would expire on June 30, 1961, unless the Commission continued the authorization. Subsequent to the close of the fiscal year, the Commission issued an order, subject to certain conditions, authorizing the indefinite continuance of the arrangement.

NEES, through a subsidiary company, owns 30 percent of the common stock of Yankee Atomic Electric Co., which, as set forth at page 128 of the Commission's 25th annual report, was authorized to construct and operate a nuclear power generating station. During the fiscal year, the plant, located at Rowe, Mass., was completed and commenced

the generation of electric power. The completion was ahead of schedule and the construction costs were less than the estimated amounts. Following operation at gradually increasing power levels, the Atomic Energy Commission, on June 23, 1961, amended the experimental license of Yankee Atomic to permit operation at approximately 136,000 kw., the full rated capacity of the plant.

Ohio Edison Co.

This company is a registered holding company and an operating electric utility company. Ohio Edison and its electric utility subsidiary, Pennsylvania Power Co., had consolidated assets, less valuation reserves, of approximately \$660,132,000 at December 31, 1960, and system consolidated operating revenues for the year then ended amounted to about \$159,947,000.

Ohio Edison has a 16. percent interest in the common stock of Ohio Valley Electric Corp. The status of such holding is discussed under Allegheny Power System, Inc., above.

During the fiscal year, the Commission approved 4Y a proposal of Ohio Edison concerning adoption of a restricted stock option plan which is substantially similar to the one proposed by Middle South and discussed above.

The Southern Co.

As at December 31, 1960, this system had consolidated assets, less valuation reserves, of approximately \$1,400,312,000, and, for the year then ended, it had consolidated operating revenues of about \$319,-162,000.

On August 1, 1947, the Commission entered an order, pursuant to section 11 (b) (1) of the act, requiring, among other things, the divestment from the Southern system of the bus properties and business operated in Rome, Ga., by Georgia Power Co. No plan having been proposed to the Commission by the system to effectuate compliance with this order, the Division of Corporate Regulation during the 1961 fiscal year filed a plan, under section 11 (d) of the act, proposing a public sale of the transportation properties and business through a court-appointed trustee, and the Commission ordered that a hearing be held thereon. The order also stated that the Commission would consider, among other things, whether the proposed plan should be modified or whether another type of plan should be required. Upon request of Georgia Power, postponement of the hearing was granted to give it an opportunity to submit an alternative solution. Subsequently, Georgia Power and the city of Rome, Ga., entered into negotiations and, after the close of the fiscal year, the city adopted a resolution, accepted by Georgia Power, which provided among other things for the transfer of the transportation properties and business to the city. After the close of the fiscal year, the Commission found that this solution satisfied the applicable standards of the act and permitted the transfer to the city to be carried out.

Union Electric Co.

Union Electric is a registered holding company and a public-utility company. As at December 31, 1960, the consolidated assets, less valuation reserves, of Union Electric and its subsidiaries amounted to approximately \$642,830,000, and system consolidated operating revenues for the calendar year 1960 totaled about \$159,189,000.

As indicated at pages 141-142 of the Commission's 26th annual report, Union Electric has filed with the Commission an application for exemption as a holding company from the provisions of the Holding Company Act pursuant to section 3 (a) (2) thereof, and briefs were filed by Union Electric, by J. Raymond Dyer, a stockholder of the company, and by the staff of the Division of Corporate Regulation. Oral argument was held and the matter was pending at the close of the fiscal year.

The three cases arising out of the objections of Dyer to the solicitation of proxies by the company's management which were pending before the courts at the close of the last fiscal year have been decided. The Commission's order, permitting Union Electric's proxy material to become effective and thus authorizing the solicitation with respect to the 1957 annual stockholders meeting, was affirmed by the Court of Appeals for the Eighth Circuit, as was the Commission's order with respect to the 1959 proxy material. That court also affirmed the Commission's order denying Dyer's request that the Commission process Union Electric's proxy material for its 1960 annual meeting pursuant to the provision of the Holding Company Act rather than under the Securities Exchange Act. In addition, the same court dismissed as frivolous a petition filed by Dyer for review of the Commission's action denying his request that the Commission process Union Electric's proxy material for the 1961 annual meeting pursuant to the Holding Company Act and to review the Commission's alleged authorization of Union Electric's proxy solicitation. The same court also affirmed the district court's finding that Dyer's mailing of a postcard violated the Commission's order prohibiting anyone from soliciting proxies until a declaration had been filed and the Commission had permitted it to become effective. However, the Court vacated the injunctive decree as being too broad, since it prohibited Dyer from soliciting proxies in connection with any future annual meeting of Union Electric's stockholders and not merely the 1957 meeting to which the Commission's order related. The same court also affirmed the Commission's order permitting a declaration filed by Union Electric under section 7 of the act to become effective, thereby authorizing Union Electric to offer common stock to stockholders and to offer the unsubscribed shares to its employees.

FINANCING OF ACTIVE REGISTERED PUBLIC UTILITY HOLDING COMPANIES AND THEIR SUBSIDIARIES

During the fiscal year, registered holding companies and their subsidiaries issued and sold to the public and to financial institutions, pursuant to authorizations granted by the Commission under sections 6 and 7 of the act, 28 issues of their stock and long-term debt securities aggregating \$555 million. Of this amount, \$15 million was used for the purpose of refunding outstanding debt securities carrying higher rates of interest. The balance of \$540 million represented securities sold for the purpose of raising new capital. Of the 18 active registered holding company systems, 13 of them sold long-term debt or stocks to the public and to financial institutions in varying amounts and of various types.

The following table presents the financing by those 13 registered holding companies and their subsidiaries classified by amounts and types of securities.

[table omitted]

The table does not include securities issued and sold by subsidiaries to their respective parent holding companies, issuance of short-term notes to banks, portfolio sales by any of the system companies, nor securities issued for stock or assets of nonaffiliated companies. These issuances and sales also required authorization by the Commission except in the case of the issuance of notes having a maturity of less than 9 months where the aggregate amount did not exceed 5 percent of the total capitalization of the company. The issuance of such latter securities is exempted by the provisions of section 6 (b) of the act.

Competitive Bidding

All of the 28 issues of securities sold for cash in fiscal 1961, as shown in the preceding table, were offered at competitive bidding pursuant to the requirements of rule 50 promulgated under the act. Three other issues of securities, not included in the table, were sold during the fiscal year 1961 pursuant to orders of the Commission granting exception from the competitive bidding requirements of the rule, because of the unusual circumstances which were present in each case.

One issue not sold at competitive bidding consisted of 710,000 shares of common stock of Louisiana Gas Service Co., a subsidiary of Louisiana Power & Light Co., which in turn is a subsidiary of Middle South Utilities, Inc. As described at pages 137-138 of the 26th annual report, Louisiana Gas was organized for the purpose of acquiring and operating the gas properties formerly owned by Louisiana Power and on August 11, 1960, the Commission approved the sale by Louisiana Power through a nonunderwritten subscription offering of its holdings of 670,000 shares of common stock of Louisiana Gas to the stockholders of Middle South. The plan, as amended, also provided for the sale in like manner by Louisiana Gas of up to 40,000 additional shares of its stock to the shareholders of Middle South. In its order the Commission granted an exception from the competitive bidding requirements of rule 50 with respect to the proposed sale of both blocks of Louisiana Gas stock, totaling 710,000 shares. All of the 670,000 shares held by

Louisiana Power were sold during the fiscal year, but no part of the 40,000 shares to be offered by Louisiana Gas was sold.

In its order of October 6, 1960, which permitted Electric Bond & Share Co. to acquire 73,115 shares of its outstanding common stock by purchase in the open market and to offer such shares to the stockholders of Walter Kidde Constructors, Inc., in exchange for the stock of the latter company, the Commission excepted the proposed offer from the competitive bidding requirements of rule 50.

In its order of December 29, 1960, the Commission granted Consolidated Natural Gas Co. an exception from the competitive bidding requirements of rule 50 with respect to the proposal of that company to issue and sell to Union Heat & Light Co., a nonaffiliate, 23,000 shares of Consolidated's capital stock in connection with the proposed acquisition by Peoples Natural Gas Co., a subsidiary of Consolidated, of all of the assets of Union.

During the period from May 7, 1941, the effective date of rule 50, to June 30, 1961, a total of 823 issues of securities with aggregate sales value of \$12,023 million were sold at competitive bidding under the rule. These totals compare with 229 issues of securities with an aggregate sales value of \$2,365 million which have been sold pursuant to orders of the Commission granting exception from the competitive bidding requirements of the rule under paragraph (a) (5) thereof. Of the total amount of securities sold pursuant to orders of exceptions granted under this paragraph, 126 issues with sales value of \$1,888 million were sold by the issuer and the balance of 103 issues with a dollar value of \$477 million were portfolio sales. Of the 126 issues sold by issuers, 70 were in amounts of from \$1 million to \$5 million and 2 bond issues were in excess of \$100 million each.

ISSUANCE OF LONG-TERM DEBENTURES BY SUBSIDIARY PUBLIC UTILITY COMPANIES

During the fiscal year, applications were filed under the act by two nonaffiliated public utility subsidiary companies of registered holding companies, seeking, in each case, authority to issue and sell unsecured long-term debentures. The applications were filed by Pennsylvania Electric Co. ("Penelec"), a public utility subsidiary company of General Public Utilities Corp. ("GPU"), for an issue of \$12 million principal amount of 25-year debentures, and by Indiana & Michigan Electric Co. ("Indiana & Michigan"), a public utility subsidiary company of American Electric Power Co., Inc., for an issue of \$20 million principal amount of 25-year debentures. After thorough consideration, the Commission approved both transactions on May 25, 1961.

In passing upon the Penelec proposal, the Commission noted in its findings and opinion 66 that it departed from the pattern of financing theretofore followed by Penelec and the GPU holding-company system of having outstanding in the hands of the public, except for short-term notes issued to commercial banks, only two layers of securities of

subsidiary public utility companies, i.e., first mortgage bonds and cumulative preferred stock. The debenture issue, by reason of its approval by the Pennsylvania Public Utility Commission, the State commission of the State in which Penelec is organized and doing business, was exempt, under the provisions of section 6 (b) of the act, from the financing standards prescribed by section 7 of the act, subject to the imposition of such terms and conditions as the Commission might deem appropriate in the public interest or the interest of investors or consumers. The Commission observed that it was required to give weight to the decision of the State regulatory agency and that it may impose conditions only to the extent that the security issue offends the basic standards and policies of the act and thereby creates the likelihood of those abuses which led to passage of the act; and that, in effect, a greater degree of latitude is permitted in applying the standards and policies of the act to a security approved by a State commission than to an issue subject to all provisions of section 7; but that, where there is a material variance from those standards and policies, it is the responsibility of the Commission, despite State approval, to impose appropriate terms and conditions. The Commission noted that the issuance of the proposed debentures would create an additional layer of long-term securities of Penelec in the hands of the public, thus having a tendency to create a complexity in the corporate structure of Penelec, and of the GPU holding-company system.

The Commission considered Penelec's contentions that (a) after issuance of the debentures, its common stock equity "cushion" would still be adequate to preserve its stability to issue additional senior securities even when economic conditions are unfavorable to the issuance of additional common stock; and (6) it had considered the advisability of issuing additional preferred stock but had rejected this as an uneconomical method of raising capital under present tax rates.

Penelec represented to the Commission that, unless conditions not now contemplated change radically, it will abandon any future issuances of preferred stock; and GPU and its subsidiary companies expect to give early consideration to the feasibility of retiring the system's outstanding preferred stock. In view of these representations, and in light of the pro forma capitalization ratios and earnings coverage of both Penelec and the GPU system, the Commission deemed it unnecessary to consider what terms and conditions might appropriately be imposed if it had concluded that the proposed creation of an additional layer of permanent securities was a material variance from the policies and standards of the act. In addition, the Commission noted that the indenture under which the proposed debentures were to be issued and which had been the subject of extended conferences between the company and the Commission's staff, contained various protective provisions, including annual cash sinking fund payments designed to retire 48 percent of the issue before maturity thereof; limitations on the payment of common stock dividends; a limitation on short-term indebtedness; and certain conditions, in terms of capitalization ratios and interest coverage, in respect of additional issuance of long-term debt.

CAPITALIZATION RATIOS AND ACCOUNTING FOR DEFERRED TAXES

An important development during the past fiscal year related to capitalization ratios and accounting for deferred taxes arising from the taking of liberalized depreciation and accelerated amortization for tax purposes (pursuant to sees. 167 and 168 of the Internal Revenue Code) while taking straight-line depreciation for financial accounting purposes. The questions involved arose in connection with an application filed pursuant to section 6 (b) of the act by Kentucky Power Co., a public utility subsidiary company of American Electric Power Co., Inc., a registered holding company, proposing the issuance of \$40 million long-term notes to banks.

The balance sheet of Kentucky filed as an exhibit to the application contained an amount of \$831,825 designated "Earned Surplus Restricted for Future Federal Income Taxes" and the consolidated balance sheet of American and its subsidiaries contained an amount of \$94,698,293 which was similarly designated. The Commission's Division of Corporate Regulation contended that this treatment was not consistent with the Commission's statement of policy regarding balance sheet treatment of credit equivalent to reduction in income taxes. Under the statement of policy, such accumulated tax reduction, if material in amount, may not be designated as "earned surplus" (or its equivalent) or in any manner as a part of equity capital (even though accompanied by words of limitation such as "restricted" or "appropriated").

After several weeks of hearings counsel for Kentucky and American, and counsel for the Commission's Division of Corporate Regulation, entered into discussions looking to the possible settlement of the issues which had been raised. An agreement was reached which was submitted to and approved by the Commission.

Under the settlement proposal, as approved, supplemental financial statements were filed by both companies which the Commission found not in contravention of its statement of policy. In the new financial statements, the accumulated reductions are carried under a designation reading: "Accumulated Amount Invested in the Business Equivalent to Reduction in Federal Income Taxes Resulting From Accelerated Amortization and Liberalized Depreciation, Which Is Recorded as Earned Surplus Restricted for Future Federal Income Taxes in Accounts Maintained Pursuant to State Regulatory Requirements."

As part of the settlement, the Commission also approved certain ratio tests concerning the future capital structure of the various companies in the American holding-company system. The opinion in the matter stated that in future financings by companies in the system, the Commission will give due weight to the existence of the accumulated tax reduction and its size in determining appropriate capitalization ratios; and, so long as the consolidated balance sheet of American and its subsidiary companies, or the corporate balance sheet of any of its subsidiary companies, includes a substantial amount of accumulated tax reduction, the Commission will not take any adverse action in respect of

capitalization ratios where, upon completion of the financing: (a) common stock equity is not less than 30 percent of total capitalization, including surplus; (b) mortgage debt is not in excess of 60 percent of total capitalization, including surplus; and (c) total long-term debt is not in excess of 65 percent of total capitalization, including surplus. For purposes of these tests, any accumulated tax reduction resulting from charges against income as an operating revenue reduction in respect of accelerated amortization or liberalized depreciation for Federal income tax purposes will not be included as a part of either common stock equity or total capitalization, including surplus.

PROTECTIVE PROVISIONS OF FIRST MORTGAGE BONDS AND PREFERRED STOCKS OF PUBLIC UTILITY COMPANIES

The Commission, in passing upon issuances of first mortgage bonds and preferred stocks of public-utility companies subject to the act, examines the applicable mortgage indentures and charter provisions to insure that there is substantial conformity with the standards set forth in the statements of policy adopted by the Commission in 1956. These statements of policy represent a codification of the principles and policies which the Commission had theretofore been administering on a case-by-case basis, and which the Commission had found necessary and desirable for the protection of investors in first mortgage bonds and preferred stocks of public utility companies. Except where, in particular circumstances, deviations from the statements of policy are clearly warranted, the Commission has uniformly required conformity with the statements.

During the fiscal year, applications or declarations were filed by public utility companies under the act with respect to 14 first mortgage bond issues involving an aggregate principal amount of \$265,500,000, and four preferred stock issues with a total par value of \$29,500,000.

Among other things, the statement of policy with respect to first mortgage bonds requires that, under certain circumstances, the distribution of earned surplus to common stockholders be restricted. In respect of 4 of the 14 bond issues filed by public utility companies under the act during the fiscal year, this requirement of the statement of policy was adequately provided for in the existing indentures. In the other 10 bond issues, additional restrictions were required, and were provided for either on the initiative of the issuer or as a result of informal discussions between the Commission's staff and representatives of the issuer.

In recognition of the fact that the mortgaged utility property constitutes the bulk of the bondholders' security, the statement of policy for bonds also requires the periodic renewal and replacement of the depreciable mortgaged utility property. In substance, this requirement obligates the issuer to construct property additions (or, alternatively, to deposit cash or outstanding bonds with the trustee) in an amount which, over the estimated useful life of the mortgaged depreciable property, will provide for the

replacement in kind or in cash of the book cost of the mortgaged property. The statement of policy requires that the mortgage indenture express the periodic renewal and replacement provision as a percent of the book cost of depreciable property, but alternatively permits- existing indenture provisions expressed on some other basis -- as, for example, a percent of operating revenues -- to remain unchanged if the issuer can satisfactorily demonstrate to the Commission that the existing provision affords substantially the same protection as that based on a percent-of-property basis.

The indentures of 11 of the 14 bond issues sold during the fiscal year expressed the renewal and replacement provision as a percent of depreciable property deemed adequate by the Commission. The indentures pertaining to the other three bond issues expressed the requirement as a percent of revenues which the Commission found afforded protection to the bondholders at least equal to that which would be afforded under an appropriate percent-of-property basis.

In the case of the four issues of preferred stock with an aggregate par value of \$29,500,000, in respect of which applications or declarations were filed during the fiscal year, three issues had charter provisions which substantially conformed with the statement of policy for preferred stock. In the case of the fourth issue, certain charter provisions (or omissions) were found to be inconsistent with the statement of policy in respect of (a) the issuance of additional preferred stock or other capital stock ranking prior thereto, (b) amendment of the charter in a manner adverse to the preferred stockholders, (c) redemption or reacquisition of outstanding preferred stock during periods when dividends thereon are in arrears, (d) mergers or consolidations and (e) the issuance or assumption of unsecured indebtedness. The Commission, therefore, in approving the proposed issue of preferred stock, conditioned its order so as to extend to the holders of the preferred stock the protective features prescribed by the statement of policy.

During the fiscal year, the Commission has continued to require adherence to the provision contained in both the bond and the preferred stock statements of policy that the securities be freely refundable at the option of the issuer upon reasonable notice and payment of a reasonable redemption premium, if any. Continuing studies made by the Commission's staff for fiscal year 1961 with respect to electric and gas utility bond issues sold at competitive bidding, whether or not subject to the act, indicate that the presence or absence of a restriction on free refundability has not affected the number of bids received by an issuer at competitive bidding or the ability of the winning bidder to market the bonds. This finding coincides with that described in the 26th annual report, at pages 149-150, containing a summary of the results of an examination of all electric and gas utility bond issues (including debentures) sold at competitive bidding between May 14, 1957, and June 30, 1960, by companies subject to the act as well as those not so subject. This study has been extended to include fiscal year 1961.

During the period from May 14, 1957, to June 30, 1961, a total of 310 electric and gas utility bond issues, aggregating \$6,563. million principal amount, was offered at competitive bidding. The refundable issues numbered 240 and accounted for a total of \$4,434. million, while the nonrefundable issues -- all except one being nonrefundable for a period of 5 years, and that one being nonrefundable for a period of 7 years -- numbered 70 and totaled \$2,129 million principal amount. The number of refundable issues thus represented 77.4 percent of the total number of issues, while, in terms of principal amount, the refundable issues accounted for 67.6 percent.

The weighted average number of bids received on the refundable issues for the period was 4.57, while on the nonrefundable issues it was 4.23. The median number of bids was five on the refundable and four on the nonrefundable issues. With respect to the success of the marketing of the bond issues, an issue was considered to have been successfully marketed if at least 95 percent of the issue was sold at the syndicate price up to the date of termination of the syndicate. On this basis, 73.8 percent of the refundable issues were successful, while 70 percent of the nonrefundable ones were successful. In terms of principal amount, 70.8 percent of the refundable issues were successful, while 66.6 percent of the nonrefundable ones were successful. Extension of the comparison to include the aggregate principal amounts all issues which were sold at the applicable syndicate prices up to the termination of the respective syndicates, regardless of whether a particular issue met the definition of a successful marketing, indicates that 87.6 percent of the combined principal amount of all the refundable issues were so sold, as compared with 83.3 percent for the nonrefundable issues. These statistics developed in respect of the two groups of bond issues support the Commission's policy of requiring free refundability of utility bond issues subject to the act. In connection with this policy of the Commission, it may be noted that, during the fiscal year, National Fuel Gas Co., a registered holding company, sold at competitive bidding \$27 million principal amount of 4 1/2-percent sinking fund debentures due 1986 and used a portion of the proceeds from the sale to redeem, at 106.01 percent of principal amount, \$15 million principal amount of its outstanding 5 1/2-percent sinking fund debentures which were issued in 1957 with maturity in 1982. Such redemption will effectuate a savings in capital costs over the remainder of the original life of the redeemed issue. If these 5 1/2-percent debentures due 1982 had been nonrefundable for a 5-year period the company would have been unable to effectuate the redemption.

In the 25th annual report, at page 141, and in the 26th annual report, at pages 150-51, reference was made to a comprehensive study of redemption provisions of corporate bonds being conducted at the Wharton School of Finance and Commerce of the University of Pennsylvania. The final results of this study were not available as of the close of the fiscal year 1961.

EXCHANGE OF SECURITIES PURSUANT TO SECTION 11 REORGANIZATIONS

In connection with the numerous plans of reorganization of holding company systems which have been approved by the Commission over the years pursuant to the provisions of section 11 of the act, the holders of securities of reorganized companies are required to surrender their "old" securities in order to receive the securities of the reorganized companies. While securities amounting to hundreds of millions of dollars have been exchanged by the holders thereof for cash and new securities, some security holders have failed to surrender their "old" securities. The Commission has made continuing efforts to insure that all reasonable steps are taken to locate and to give notice to the security holders entitled to effect an exchange. Establishing contact is often difficult due to the death of registered holders, the lack of recent addresses, and the like, and is frequently complicated by the fact that many of the securities had been considered by their owners to be virtually worthless. In many instances, the further exchange of securities has been barred by the lapsing of the period fixed for exchange in the plan of reorganization or in the order of the appropriate Federal district court enforcing the plan. However, there are many cases in which the "bar date" on exchanges has not passed or in which no time limit has been fixed.

The staff of the Division of Corporate Regulation checks upon efforts made by the various companies to contact and locate holders of unexchanged securities and, in order to explain the situation and clear up misunderstandings, frequently communicates with such security holders by letter and, occasionally, by telephone. In most instances, the companies are urged to employ the services of a professional tracing agency to locate missing shareholders or their heirs. Where an extension of the period for exchanging shares appears necessary, either the company involved or the Commission will petition the appropriate court for additional time.

During the past fiscal year renewed and more intensive efforts were made by the Commission to locate "lost security holders." A further review was made of all reorganization plans under section 11 to determine instances where there was no "bar date" or the time for exchange of securities had not yet expired, and more than 100 questionnaires were sent by the Commission's Division of Corporate Regulation to companies, banks, and exchange agents inquiring as to the status of any unexchanged securities and what efforts had been made or were contemplated to locate the rightful owners of the securities. As a result, renewed efforts were made by the exchange agents, with the aid of professional tracing agencies in some instances. While there can be no exact measurement of the benefits of this inquiry, thousands of dollars worth of securities have found their way to their beneficial owners, who, often are in financial need.

PART VII
PARTICIPATION OF THE COMMISSION IN CORPORATE
REORGANIZATIONS UNDER CHAPTER X OF THE BANKRUPTCY ACT

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 in that the Commission does not initiate chapter X proceedings or hold its own hearings. It has no authority to determine any of the issues in these proceedings. However, at the request of the judge or on the Commission's own motion, if approved by the judge, the Commission may participate in such proceedings in order to provide independent, expert assistance to the court, the participants, and investors on matters arising in such proceedings and, where the Commission considers such action appropriate, it may file advisory reports on reorganization plans. Thus, the facilities of the Commission's technical staff and its disinterested recommendations are placed at the service of the judge and the parties, affording them the views of impartial experts in a highly complex area of corporate law and finance. The Commission pays special attention to the interests of public security holders, who may not otherwise be effectively represented.

Where the scheduled indebtedness of a debtor corporation exceeds \$3 million, the judge under section 172 of chapter X must, before approving any plan of reorganization, submit it to the Commission for its examination and report. If the indebtedness does not exceed \$3 million, the judge may, if he deems advisable, submit the plan to the Commission before deciding whether to approve it. Where the Commission files a report, copies of it, or a summary thereof, 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 or require the adoption of a plan of reorganization and is not obligated to file a formal advisory report on a plan.

The Commission's advisory reports on plans of reorganization are usually widely distributed and serve an important function. However, they represent only one aspect of the Commission's activities in cases in which it participates. The Commission, as a party to a chapter X proceeding, is actively interested in the solution of every major issue arising therein, and the adequate performance of its duties requires that it undertake in most cases intensive legal and financial studies. Even in cases where the plans are not submitted to the Commission and no report is filed, the Commission must consider various reorganization proposals of interested parties while plans are being formulated, and be prepared to comment fully upon all plans that are the subject of hearings for approval or confirmation. In the exercise of its functions under chapter X, the Commission has endeavored to assist the courts in achieving equitable, financially sound, expeditious, and economical readjustments of the affairs of corporations in financial distress. To aid in attaining these objectives the Commission has lawyers, accountants, and financial analysts in its New York, Chicago, and San Francisco regional offices who keep in close touch with all chapter X hearings and issues. Supervision and review of the regional offices' chapter X work is the responsibility of the Division of Corporate Regulation of the Commission, which also handles the actual trial work in cases arising in the Atlanta and Washington, D.C., regional areas.

SUMMARY OF ACTIVITIES

The Commission actively participated in 56 reorganization proceedings involving 85 companies (56 principal debtor corporations and 29 subsidiaries of those debtors) during the past fiscal year. The stated assets of these 85 companies totaled approximately \$599,477,000 and their indebtedness totaled approximately \$559,735,215. The proceedings were scattered among district courts in 23 States and the District of Columbia as follows: 10 proceedings in New York; 5 each in Illinois and Kentucky; 4 in Texas; 3 each in Oklahoma and Maryland; 2 each in Iowa, Pennsylvania, California, Colorado, Michigan, North Carolina, Nevada, and Utah; and 1 each in Washington, Virginia, New Jersey, North Dakota, Kansas, Georgia, Louisiana, Wyoming, Florida, and the District of Columbia.

During the year, the Commission entered its appearance in 11 new proceedings under chapter X involving companies with aggregate stated assets of approximately \$32,383,000 and aggregate indebtedness of approximately \$27,615,215. They involved the rehabilitation of corporations engaged in the operation of such varied businesses as a deluxe resort motel, an automobile parts fabricator, an aluminum product fabricator, TV tube rehabilitation, amusement park, oil and gas exploration, mutual investment fund, apartment and transient hotel, an insured 10-percent second mortgage broker, meat packing, manufacture of cosmetics, a machine shop, and real estate development.

Proceedings involving eight principal debtor corporations were closed during the year. At the end of the year, the Commission was actively participating in 48 reorganization proceedings involving 75 companies.

THE COMMISSION AS A PARTY TO PROCEEDINGS

The Commission has not considered it necessary or appropriate that it participate in every chapter X case. Apart from consideration of the excessive administrative burden of participating in every one of the 111 cases initiated during the fiscal year, many of the cases involve only trade or bank creditors and few stockholders. The Commission has sought to participate principally in those proceedings in which a substantial public-investor interest is involved. This is not the only criterion, however, and in some cases involving only limited public-investor interest, the Commission has participated because an unfair plan had been or was about to be proposed, the public security holders were not adequately represented, the reorganization proceedings were being conducted in violation of important provisions of the act, the facts indicated that the Commission could perform a useful service, or the judge requested the Commission to participate. [Footnote: In In the Matter of Southern Enterprise Corporation (S.D. Texas, Houston Div., No. 2548), the judge stated his reasons for requesting the Commission to participate as follows :

"* * * (1) the complexity of the corporate structure of Southern Enterprise Corp. and its several subsidiaries and the complexity of this reorganization proceeding, (2) the necessity for protection of the public-investor interest of more than 885 stockholders, holding more than 211,300 shares at a cost of more than \$833,900 of the common capital stock of the debtor, (3) the necessity for the interests of creditors holding asserted claims against the debtor in excess of \$295,700, (4) and the desire of this court and of the trustee in this proceeding for the expert assistance in technical matters offered by the Securities and Exchange Commission."]

MATTERS RELATED TO THE PROCEEDINGS

When a party in chapter X proceedings, the Commission has urged upon the court the procedural safeguards to which all parties are entitled. The Commission also has attempted in its interpretations of the statutory requirements to encourage uniformity in the construction of chapter X and the procedures thereunder.

In its efforts to protect the public security holder the Commission, in the case of Magic Mountain, Inc., filed objections to the referee's report which had recommended that the debtor's voluntary petition for reorganization be dismissed. The debtor owned an amusement park which was only partially completed. The Commission in its objections pointed out to the court that there were 12,000 holders of the common stock of the debtor and stated that "nothing is more demonstrative of the need for reorganization" than the possibility that these stockholders might be wiped out by the many pending foreclosure actions. The Commission urged that a disinterested trustee be appointed to determine whether the corporation could be reorganized, and to investigate the conduct of the debtor's former management. The district court judge entered an order in accordance with the Commission's views.

In Kirchofer and Arnold, Inc. and in connection therewith, in Morehead City Shipbuilding, Inc., a subsidiary, although it was clear that the debtors would have to be liquidated because hopelessly insolvent, the Commission recommended that the debtors not be adjudicated bankrupts since this would involve a precipitous liquidation with great loss to the security holders. Rather, the Commission recommended that the chapter X court retain its jurisdiction and conduct an orderly liquidation pursuant to a plan in an attempt to obtain a better price for the debtors' assets.

Similarly, in Dixie Aluminum Corporation, after the trustee's report that no plan of reorganization could be effected without substantial additional operating capital, and that no one could be found who was interested in making such an investment, the court adjudicated the debtor a bankrupt. However, after advice by Commission counsel that liquidation pursuant to a plan under chapter X would be more appropriate for the

protection of the public security holders, the district judge vacated his order and retained jurisdiction under chapter X.

In the H. H. Mundy Corporation case the Commission objected to the retention of the trustee's attorney on the grounds that he was not "disinterested" as defined in section 158 of the Bankruptcy Act since he was an attorney for a director of the debtor and assisted the debtor's counsel in the preparation of the chapter X petition. Following the staff's objection, the trustee's attorney resigned.

In the Food Town, Inc. case the Commission objected to a proposed order for general employment of an accounting firm to assist the trustee in his section 167 investigation since this firm had audited the debtor's books at the time a purported fraud was committed. The court approved the employment of the firm, but limited its employment to matters unrelated to its adverse interest in order to meet the objections of the Commission.

In the Muntz TV, Inc. case, following consummation of the plan, one of the debtor's trustees was designated as the chief executive officer of the reorganized company at a salary of \$10,000 a year. It has been the Commission's consistent policy to oppose the employment of a trustee or his counsel by the reorganized debtor. This policy is based on the theory that the effectiveness of the trustee's position, so far as the public security holders are concerned, depends on his disinterested attitude. The Commission recommended to the court that the trustee, who was still occupying that position, should not be permitted to serve also in an important salaried position with the reorganized company. The court, however, did not follow the Commission's recommendation. Instead it allowed the trustee a substantial fee for his services in addition to the salary being paid him as chief executive officer.

In the TMT Trailer Ferry, Inc. case the Commission objected to the claims of Merrill-Stevens Drydock and Repair Co., one of the largest TMT creditors, on various grounds. The court allowed the Commission time to investigate and file specifications in support of its objections. This matter is still pending.

In the Swan-Finch Oil Corporation proceeding 1X the court of appeals upheld the Commission's viewpoint, set forth in the Commission's 26th annual report, that a petition for the reorganization of a subsidiary under chapter X could be filed in the court in which the chapter X reorganization of the parent was pending notwithstanding the pendency of a chapter XI proceeding for the subsidiary in another district.

PROBLEMS IN CONNECTION WITH THE ADMINISTRATION OF ESTATES

In Pickman Trust Deed Corporation, the debtor operated a second trust deed business in the San Francisco area under a program wherein notes secured by trust deeds were

purchased by Pickman to be placed into customers' accounts on the basis of a 10 percent annual return. Pickman, which obtained \$5 million from investors, is 1 of 12 companies which have operated in this manner in California and are currently in financial difficulties, representing total investments of over \$70 million.

After the Commission successfully caused the debtor to amend its chapter XI petition to conform to the provisions of chapter X, a question arose as to the nature of the legal rights of investors who had been allocated notes. The trustee adopted a position that all notes were to be pooled for the benefit of all investors. The Commission, however, advocated that each investor should be allowed to trace his specific note and reclaim it on an individual basis, on the ground that otherwise contractual rights would be disregarded. The trustee, after 6 days of litigating the matter before the district court, proposed a compromise whereby claimants to approximately \$2,300,000 of notes which were recorded in their names could elect to reclaim their notes or remain in a pool. The Commission argued that the compromise proposal was premature since a section 167 report had not been prepared by the trustee, in the absence of which customers would not have the necessary information as to the status of the debtor to make an intelligent choice whether to withdraw their notes or remain in a pool. The court, however, approved the compromise and classified investors as "secured creditors" rather than "owners," but with the right to withdraw their underlying securities if their deeds were recorded.

In DePaul Educational Aid Society the debtor was organized in 1927 as a nonprofit corporation to build and operate a building which would house DePaul University while at the same time insulating the university from any liability. The debtor issued 6-percent mortgage bonds to the public. When the debtor went into a chapter X reorganization in 1959 the Commission made an extensive investigation of its financial condition. The investigation showed that the debtor was extremely undercapitalized. Difficulties ensued from the debtor's inception but the university kept the debtor alive with financial aid during its first few years. However, when business conditions worsened in the 1930's, the university withdrew its aid and the debtor became insolvent. After the debtor passed through a section 77B reorganization proceeding, the university secretly purchased about one-third of all the debtor's outstanding bonds at large discounts while continuing to occupy the bulk of the debtor's rentable space at a rental which barely covered minimum operating costs. It was the Commission's contention, as well as that of the trustee, that, DePaul University's claims should be subordinated to those of the public bondholders. This matter is still pending.

In the case of Hudson and Manhattan Railroad Company the Commission took the position that the court should not approve the action of the directors of the reorganized company in appointing the trustee as the chief executive of the company and his counsel as general counsel. The appointment of these persons to remunerative positions was inconsistent with the policy of chapter X to maintain the independence and disinterestedness of a trustee and of his counsel until the termination of the proceeding. The Commission pointed out that just as a chapter X trustee may retain special counsel

for certain limited purposes during a proceeding, where such counsel need not be disinterested, it would not be inappropriate for the reorganized company to employ either the trustee or his counsel for special purposes. In this case, the possible sale of the company's assets to a public authority would represent such a special purpose. The court approved the directors' action because of the unique situation arising out of the apparent imminence of sale negotiations.

TRUSTEE'S INVESTIGATIONS

A complete accounting for the stewardship of corporate affairs by the old management is a requisite under the Bankruptcy Act and 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 company's affairs, diverted its funds to their own use or benefit, or been guilty of other misconduct. The staff of the Commission participates in the trustee's investigation so that it may be fully informed as to all details of the financial history and business practice of the debtor. The Commission views its duty under chapter X as requiring it to call the attention of the trustee or the court, if necessary, to any matters which should be acted upon.

In TMT Trailer Ferry, Inc., after the district court confirmed a plan of reorganization which the Commission felt was inequitable because, among other things, it returned control of the debtor to those responsible for its downfall, the Commission prevailed upon the trustee to complete his section 167 report. Thereafter a hearing was held which resulted in the district court vacating its previous order and ordering the trustee to submit a new plan. An appeal was taken by those who benefited under the original plan. Following the close of the fiscal year, the Court of Appeals for the Fifth Circuit affirmed the district court order and denied a petition for rehearing.

In Equitable Plan Company, the trustee, holding a substantial amount of shares of Doeskin Products, Inc., instituted a derivative action in the Federal court on behalf of Doeskin to set aside the fraudulent issue of 1 million shares of Doeskin stock and to recover assets misappropriated by officers and directors in the control of Lowell M. Birrell. Doeskin moved to stay the action because of a prior stockholder's suit pending in the State court. The Commission appeared, *amicus curiae*, and urged that the chapter X trustee was in a different-position from any other stockholder in that it was his duty to protect a substantial asset of Equitable Plan and that he should not be prevented from undertaking any action which he deemed necessary to that end. The district court, in a decision based in part upon the Commission's position, denied the motion for a stay. The Court of Appeals for the Second Circuit affirmed.

In Automatic Washer Co., Inc. the trustee obtained a judgment for more than \$500,000 for fraud in the alleged sale of rubber machinery to the debtor. While an appeal from this

judgment was pending, the defendant offered to compromise the judgment for \$105,000 cash. The Commission, along with a creditors' committee, objected to the settlement on the ground, among others, that the trustee had not made a real effort to determine whether the judgment could be satisfied. The district court approved the settlement offer, and an appeal was taken by the creditors' committee and a stockholders' committee in which the Commission participated. The Court of Appeals for the Eighth Circuit reversed the district court's action and remanded the case, stating that there had not been a sufficient investigation to enable the district court to exercise an informed judgment. Shortly after the close of the fiscal year, the same compromise, reduced to writing and with a provision added that the judgment debtor should not be interrogated as to his assets, was resubmitted to the district court. After a full hearing, the trustee was directed to reject the offer.

The trustee also obtained a judgment of over \$1 million against Banker's Life and Casualty Co. as a result of an investigation in which he was assisted by the Commission.

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 proceedings are brought under that chapter which should have been brought under chapter X, section 328 of the Bankruptcy Act authorizes the Commission to make application to the court to dismiss the chapter XI proceeding unless the petition that initiated the proceeding is amended to comply with the protective requirements of chapter X.

In Life and Industrial Companies, Inc., a parent and three affiliated companies which controlled manufacturing plants producing concrete and plating, filed chapter XI petitions on July 8, 1960. The debtors' public investors included 225 holders of 6-percent subordinated debenture bonds, 51 holders of preferred stock, and 1,324 holders of common stock, or a total of 1,600. An arrangement was proposed on July 28, 1960, whereby the debtors would merge into a new corporation. Stock of such corporation would be issued to the unsecured creditors and stockholders. On October 7, 1960, the Commission, feeling that the proceedings under chapter XI were not sufficient to protect the public security holders and that chapter XI was being misused, filed a motion under section 328 of the Bankruptcy Act to intervene and to dismiss the proceeding. In its motion the Commission pointed out that what in effect was taking place was a complete reorganization which was not authorized under chapter XI. The Commission noted that reorganization of companies with complex capital structures should be conducted under chapter X, where appropriate substantive and procedural safeguards are supplied. The District Court for the Eastern District of Arkansas denied the Commission's motion but immediately adjudicated the debtors bankrupt.

In Herold Radio and Electronics Corporation the debtor had been engaged in the business of manufacturing and distributing radios, phonographs and other electronic equipment since 1950. The debtor had outstanding \$1,472,000 principal amount of 6-percent convertible subordinated debentures, 4,816 shares of \$5 par value cumulative convertible preferred stock and 582, 199 shares of \$0. par value common stock. Except for 38 percent of the common stock which was held by persons associated with management, these securities were all held by members of the investing public. There were approximately 400 holders of debentures, 52 holders of preferred stock, and 1,600 holders of the common stock which was listed on the American Stock Exchange.

On August 15, 1960, the debtor filed a petition in the District Court for the Southern District of New York under section 322 of chapter XI alleging inability to meet its debts as they matured and an intention to propose an arrangement. The Commission moved to intervene and to dismiss the debtor's petition unless it was amended to comply with the requirements of chapter X.

The district court granted the Commission's motion and dismissed the debtor's chapter XI petition as improperly filed on the grounds that chapter XI is not available to a debtor when there are publicly held securities and the corporation has need of a thoroughgoing reorganization and recasting of its capital structure. Subsequent to the dismissal of the chapter XI proceeding, the debtor consented that it be adjudicated a bankrupt.

In Trustors' Corporation, the debtor filed a chapter XI petition on April 3, 1961. The debtor dealt in second trust deed notes which it sold to investors who were assured an annual return of 10 percent on their investment. The company's operation was similar to that in the Pickman Trust Deed case, supra. At the time the petition was filed, there were outstanding \$8,900,000 face amount of notes held for 1,800 customers. Trustors' is itself an obligor on \$1,500,000 of these trust deed notes. The debtor has outstanding 42,834 shares of 6 percent cumulative preferred stock held by 492 stockholders. The common stock is held by two of its officers.

The Commission moved for dismissal of the petition on June 20, 1961, stating that a proposal filed by the debtor in connection with its plan of arrangement might modify its secured debts. Since only chapter X can affect the rights of secured creditors the need for transferring the proceedings was evident. Subsequent to the close of the fiscal year, the debtor abandoned the, objectionable proposal and, accordingly, the Commission withdrew its objections to the chapter XI proceeding.

ACTIVITIES WITH REGARD TO ALLOWANCES

Every reorganization case ultimately presents the difficult problem of determining the allowance of compensation to be paid out of the debtor's estate 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 from the estate for the services it renders, has sought to assist the courts in protecting debtors' estates from excessive charges and at the same time in equitably allocating compensation on the basis of the claimants' contributions to the administration of estates and the formulation of plans.

The role of the Commission with regard to fees was questioned in the Liberty Baking Corporation case. Applications for allowances from nine applicants requested a total of \$341,693.53. The Commission's recommendations totaled \$173,184.13. The court offered the applicants an opportunity, if they desired, to cross-examine persons responsible for the Commission's recommendations. The Commission expressly declined a written request by several applicants to subject the Commission or any of its members to cross-examination explaining that the recommendations stated to the court by counsel were the Commission's and that such inquiry would be analogous to examining a judge concerning the bases of his decision. The Commission further stated that the careful consideration accorded its views by some courts derives from the Commission's unique position as a disinterested party to the proceeding and its broad range of experience in cases of this nature. The court thereafter awarded fees in the amount of \$229,090.

As reported in the Commission's 25th annual report, the Commission took the position that the attorney first appointed for the trustees in the F. L. Jacobs Company case was not "disinterested" and he resigned while a decision was pending on the application for his removal. He subsequently sought an allowance for services rendered prior to his resignation. The Commission opposed any award to him since, as an experienced bankruptcy lawyer, he was well aware of the significance of his acts. The court, however, granted him compensation equal to 25 percent of the amount requested.

In the Stardust, Inc., case applications for allowances totaling \$637,100 were requested. The Commission recommended total overall allowances of \$326,925. At the end of the fiscal year the court had not acted on the applications.

In El-Tronics, Inc. applications for allowances were filed totaling \$462,500. The Commission recommended allowances totaling \$180,000; no allowances were recommended for one of the counsel for a trade creditors' committee and for its secretary. Counsel had traded in the stock of the debtor during the proceeding and was disqualified from an allowance under section 249 and withdrew his application. The secretary of the creditors' committee, it appeared, had participated with third persons in the purchase of claims against the debtor from creditors of the class represented by the committee. The claims, after being voted in favor of the trustees' plan, were converted into stock pursuant to the plan and thereafter sold at a substantial profit. The Commission obtained an order from the court authorizing an investigation of the activities of the secretary and others involved in these transactions. The secretary moved to vacate the order of investigation and for leave to withdraw his allowance application. The Commission took the position that the order constituted an appropriate exercise of the power of the court to look into the

activities of a fiduciary during the proceeding and that permission should not be granted to the secretary to withdraw his application pending the outcome of the investigation. At the close of the fiscal year, the decision on this matter and on the allowances had not been rendered.

In Inland Gas Corporation the Commission, at the request of the district judge, submitted a report of its recommendations on applications for compensation, exclusive of expenses, totaling \$1,422,072. The Commission recommended fees totaling \$1,070,383. At the hearing the judge stated that he gave great weight to the Commission' report and that he relied heavily upon it. In his order granting allowances, the judge adopted the Commission's recommendations on all but three of the 27 applications. One of the applicants has been granted leave to appeal and the matter is still pending.

PART VIII

ADMINISTRATION OF THE TRUST INDENTURE ACT OF 1939

The Trust Indenture Act of 1939 requires that bonds, notes, debentures and similar securities publicly offered for sale, except as specifically exempted by the act, be issued under an indenture which meets the requirements of the act and has been duly qualified with the Commission. These indentures must provide means' by which the rights of holders of securities issued under such indentures may be protected and enforced by including provisions which relate to designated standards of eligibility and qualification of the corporate trustee to provide reasonable financial responsibility and to minimize conflicting interests. The act outlaws exculpatory provisions formerly used to eliminate all liability of the indenture trustee and imposes on the trustee, after default, the duty to use the same degree of care and skill "in the exercise of the rights and powers invested in it by the indenture" as a prudent man would use in the conduct of his own affairs.

The provisions of the Trust Indenture 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, and necessary information as to the trustee and the indenture must be contained in the registration statement. In the case of securities issued in exchange for other securities of the same issuer and securities issued under a plan approved by a court or other proper authority which, although exempted from the registration requirements of the Securities Act, are not exempted from the requirements of the Trust Indenture Act, the obligor must file an application for the qualification of the indenture, including a statement of the required information concerning the eligibility and qualification of the trustee.

[table omitted]

LITIGATION UNDER THE TRUST INDENTURE ACT

The Commission filed a brief as amicus curiae during the course of a reorganization, pursuant to section 122 (a) of the Real Property law of the State of New York, of the Hotel St. George Corp. which had offered securities pursuant to an indenture qualified under the provisions of the Trust Indenture Act of 1939. The Commission took the position that in accordance with section 312 (b) of the Trust Indenture Act, the court should vacate its order directing the indenture trustee not to send to all bondholders of the corporation proposed communications which had been submitted to the trustee by a protective committee comprised of certain of the bondholders. The Commission suggested that if the trustee should be of the opinion that a mailing of any such material would be contrary to the best interests of the bondholders or would be in violation of applicable law, the trustee should be directed to file a written statement to that effect with the Commission, in accordance with the procedure specified in section 312 (b) of the act. The matter was settled without a ruling by the court on the Commission's motion to participate as amicus curiae.

PART IX

ADMINISTRATION OF THE INVESTMENT COMPANY ACT OF 1940

Companies primarily engaged in the business of investing, reinvesting, holding, and trading in securities are subject to registration and regulation under the Investment Company Act of 1940. This act, among other things, prohibits such companies from changing the nature of their business or their investment policies without the approval of their stockholders, requires disclosure of their finances and investment policies, regulates the means of custody of the companies' assets, requires management contracts to be submitted to security holders for their approval, prohibits underwriters, investment bankers, and brokers from constituting more than a minority of the directors of such companies, and prohibits transactions between such companies and their officers, directors, and affiliates except with the approval of the Commission. The act also regulates the issuance of senior securities and requires face-amount certificate companies to maintain reserves adequate to meet maturity payments upon their certificates.

The securities of investment companies which are offered to the public are also required to be registered under the Securities Act of 1933 and the companies must file periodic reports. Such companies are also subject to the Commission's proxy rules and closed-end companies are subject to "insider" trading rules. The Division of Corporation Finance and the Division of Corporate Regulation both assist the Commission in the administration of the statute, the former being concerned with the disclosure provisions and the latter with regulatory provisions.

COMPANIES REGISTERED UNDER THE ACT

As of June 30, 1961, there were 663 investment companies registered under the act, including 44 small business investment companies, and the estimated aggregate market value of their assets on that date was approximately \$29 billion. These figures represent an overall increase of 93 registered companies and an increase of roughly \$5.5 billion in the market value of assets over the corresponding totals at June 30, 1960. The total registered companies by classification are as follows:

[table omitted]

During the fiscal year ending June 30, 1961, 118 new companies registered under the act while the registrations of 25 companies were terminated, including one of the new registered companies which was deregistered and one which withdrew its registration.

[table omitted]

In the 1961 fiscal year 29 small business investment companies registered under the Investment Company Act, representing 25 percent of the total registrations under the act during the fiscal year. In addition, pursuant to an arrangement with the Small Business Administration, the staff of the Commission examines a copy of each Proposal to Operate as a Small Business Investment Company, filed with the SBA, to determine the status of the Proposed Operator under the Investment Company Act and the other statutes administered by the Commission. Both the proposed operator and the SBA are notified as to the staff's conclusion in each case. A total of 356 such proposals were reviewed by the staff of the Commission during the fiscal year.

GROWTH OF INVESTMENT COMPANY ASSETS

The following table illustrates the striking growth of investment company assets during the past 21 years, particularly in the most recent years.

[table omitted]

INSPECTION PROGRAM

The Commission initiated in 1957 a program for the periodic inspection of investment companies pursuant to the statutory authority conferred under section 31 (b) of the Investment Company Act. Prior to the fiscal year 1961, 57 companies had been inspected pursuant to this program. An additional 56 companies were inspected in fiscal year 1961. As in prior years, a number of inspections were undertaken by staff teams consisting of attorneys or analysts from the Division of Corporate Regulation and securities

investigators from the appropriate field office. However, several of the regional offices now have personnel experienced in the inspection of investment companies and approximately 23 inspections were conducted exclusively with regional office personnel. This is consonant with the Commission's program, which contemplates placing the principal responsibility for making inspections in the regional offices as personnel in such offices become sufficiently experienced in the regulatory provisions applicable to investment companies.

The inspections made indicated, in a number of instances, failure to comply with various regulatory provisions of the Investment Company Act or with the other statutes administered by the Commission. The 26th annual report discusses, at page 170, the irregularities discovered in inspections made in previous years. Inspections in the 1961 fiscal year disclosed a number of instances in which fund prospectuses did not accurately or adequately describe the actual practice of the funds, and as a result, the prospectuses were revised. This involved such matters as the policy on control of portfolio companies, interrelationships of several investment companies with common management, and methods used in pricing shares for sale and redemption. This year's inspection program also disclosed several instances of failure to keep accurate and up-to-date minutes of meetings of boards of directors, failure to obtain the requisite shareholders' vote needed to approve an advisory contract, infrequent attendance at meetings of certain directors, instances of portfolio securities being held which were not in accordance with stated investment policies, expenses paid by funds which should have been paid by the investment advisor, possible affiliations in violation of the act and insufficiency of accounting records. Instances were noted where an increase in the amount of fidelity bond was indicated. In one case where sales of portfolio securities to affiliated persons were made under circumstances which raised questions as to possible violations of the prohibitions of the act, the transactions were reversed or the fund was compensated for the difference between the sales price and current market price on the date of the sale. Normally where deficiencies are noted, unless other action is indicated, they are brought to the attention of the investment companies involved so that corrective steps may be taken.

STUDY OF SIZE OF INVESTMENT COMPANIES

On behalf of the Commission, the Securities Research Unit of the Wharton School of Finance and Commerce of the University of Pennsylvania has been conducting a fact-finding survey in connection with a study of the problems created by the growth in size of investment companies. This inquiry has been undertaken pursuant to section 14 (b) of the Investment Company Act. Information has been obtained through questionnaires sent to registered investment companies.

The first questionnaire was distributed in fiscal 1959 to all registered open-end investment companies and the information furnished in response thereto is the basis for a

report covering the following subjects: Origin and Scope of the Study and Summary of Principal Findings; The Organization and Control of Open-end Investment Companies; Growth of Funds of the Investment Company Industry, 1952-1958; Open-end Investment Companies and Portfolio Company Control; Investment Policy; Investment Company Performance; and Impact of Investment Funds on the Stock Market.

A second questionnaire, distributed in December 1960, will form the basis of an additional report dealing with the relationships between open-end companies and their investment advisers and principal underwriters.

It is expected that the complete report will be available to the Commission prior to the end of the calendar year 1961. With information gained therefrom, the Commission will be in a position to determine what further action by it is required and whether specific remedial legislative recommendations should be made by the Commission to the Congress.

CURRENT INFORMATION

The Commission's rules promulgated under the act require that the basic information contained in notifications of registration and in registration statements of investment companies be kept up to date, through periodic and other reports, except in cases of certain inactive unit trusts and face-amount companies. The following current reports and documents were filed during the 1961 fiscal year:

[table omitted]

The foregoing statistics do not reflect the numerous filings of revised prospectuses by open-end mutual funds and unit investment trusts making a continuous offering of their securities. These prospectuses, which must be checked for compliance with the act, are required to show material changes which have occurred in the operations of the companies since the effective date of the prospectuses on file. In this respect the registration of the securities of such companies is essentially different from the registration of the usual corporate securities.

APPLICATIONS AND PROCEEDINGS

The Investment Company Act prohibits certain types of transactions in the absence of an exemptive order by the Commission issued upon a determination that specified statutory standards have been met. Accordingly, one of the principal activities of the Commission in its regulation of investment companies is the consideration of applications for such exemptive orders. Under Section 6 (c) 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 that 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), 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 certain provisions of sections 2, 3, and 8 the Commission may determine the status of persons and companies under the act.

There were 216 applications under various sections of the Investment Company Act before the Commission during the fiscal year 1961. The various sections of the act with which these applications were concerned and their disposition during the fiscal year are shown in the following table:

[table omitted]

Usually the applications for exemptions under the act are processed without holding formal hearings; however, hearings are held when the impact of the proposal upon investor or the public interest are substantial or matters of fact or of law are in dispute.

In the past fiscal year, the following matters upon which hearings had been held were determined:

As reported in more detail in the 26th annual report, page 178, The Equity Corp. consented to a judgment enjoining it from violation of the ant-pyramiding provisions of the act arising out of its continued holdings of the common stock of Equity General Corp. and Development Corp. of America, both investment companies. Pursuant to the method of compliance specified in such injunction, Equity General was merged into Equity Corp.; the preferred stock of Development Corp., which was publicly owned, was redeemed at its contract price; and Development Corp. was merged into Equity Corp. The Commission exempted the Equity Corp.-Development Corp. merger from section 17 (a) of the act. In connection with the merger, the common stockholders of Development Corp., other than Equity, were paid in cash \$7.91 as the value of each share they held, unless they exercised their right to demand an appraisal under Delaware law.

The Commission also granted an exemption from section 17 (a) of the act to Madison Fund, Inc., and International Mining Corp. for the sale of the assets of Canton Co. of Baltimore, 79 percent of whose outstanding stock was owned by Madison, to Northside Warehouse Corp., a subsidiary of International. The ownership by Madison of an 8.3 percent interest in International created an affiliation which, under the act, resulted in a bar to the transaction unless exempted. It was proposed that Northside would be merged with Canton and the surviving corporation would acquire the Canton stock for \$25 per share payable in cash and notes of International, which price and other terms of the transactions the Commission considered to be fair and reasonable and not to involve any

overreaching. In exempting the transactions, the Commission found that the record did not support the objections of a stockholder of International and a stockholder of both Madison and International, both of whom contended that the transactions were unfair.

The Commission also granted an application pursuant to section 17 (b) of the act filed by Century Investors, Inc., and Webster Investors, Inc., investment companies, and American Manufacturing Co., Inc., an affiliate of Century and Webster, for an exemption with respect to transactions incident to a merger of Century and Webster into American. Under the proposal, each publicly held share of common stock of Century and each publicly held share of common stock of Webster were to be exchanged for 1.27 shares and 1.25 shares of common stock of American, respectively. The Commission found the exchange ratios reasonable and fair, that there was no overreaching involved, and that the terms of the proposed merger were consistent with the general purposes of the act. At American's request the Commission deferred action on the application of American for an order declaring that it would not be an investment company upon consummation of the merger, conditioning such action on compliance by American with its commitment that it would not engage in any transactions which would be prohibited to a registered investment company pending the Commission's determination of the company's status.

An exemption was granted to Atlas Corp. and its controlled company, Mertronics Corp., with respect to an offering of Summers Gyroscope Co. shares to their shareholders. The purpose of the offering was to effect a divestiture by Atlas and Mertronics of all their interests in Summers in order to dispose of proceedings before the Civil Aeronautics Board arising out of interlocking relationships existing between Atlas, which controls an air carrier, and Summers, which is deemed to be engaged in a phase of aeronautics. The offering was proposed to be made at 75 cents per share through primary and secondary subscription rights. In order to assure complete divestiture of their entire interest in Summers, Atlas and Mertronics entered into agreements with a former officer and director of Atlas whereby he undertook to purchase, at 75 cents per share, all shares of Summers stock owned by them, subject to their prior right to offer such shares to their shareholders. The Commission noted that it did not appear necessary to decide the question of control of Atlas by the former officer since the consideration to the former officer in return for his obligation to purchase all unsubscribed Summers shares was reasonable and fair and no overreaching was involved. Accordingly, it was appropriate to exempt the transactions from section 17 (a) of the act even if such affiliation existed.

Proceedings were instituted to determine whether an exemptive order previously granted to the Securities Corporation General should be revoked. The order exempted the sale by Securities of 51. percent of the outstanding stock of Anemostat Corp. of America to Dynamics Corp. of America which held about 33 percent of such stock. The proceedings were instituted when the Commission was informed that the purported directors of Securities at the time the sale was negotiated and the exemption application filed had not been elected in accordance with the provision of the act which requires directors of registered companies to be elected by the stockholders at annual or special stockholder

meetings. The Commission determined not to revoke the exemptive order, rejecting a contention by a stockholder that because of noncompliance the exemptive order was automatically void and finding that the failure to comply with the requirements of the act relating to election of directors was inadvertent; that the persons who caused the change in the board of directors owned a majority of the outstanding stock and could have elected, and at the next regular stockholder meeting did elect, their representatives as directors in compliance with the act and that there was no evidence of fraud or overreaching in the transaction and the terms of the transaction were reasonable and fair.

The Commission issued an exemption order under the act permitting Vornado, Inc., to purchase 160,000 shares of its common stock from Investors Diversified Services, Inc., in exchange for \$2,340,000 principal amount of Vornado's 3.10-percent junior subordinated notes, due May 1, 1976, and a warrant expiring April 27, 1967, to purchase 42,000 shares of Vornado common stock at \$16 per share. The terms of the contract of sale of the 160,000 shares of Vornado stock were found to be fair and reasonable and not rendered unfair or unreasonable by subsequent market price increases in Vornado's stock.

The Commission granted an application of the Great American Life Underwriter, Inc., for an exemption from the Investment Company Act of 1940, retroactive to January 1, 1941, the effective date of the act. The company had discontinued the issuance and sale of face-amount certificates prior to the effective date of the act but continued to receive payments on and to service outstanding securities and accordingly was within the definition of an investment company. In view of the discontinuance of the sale of such securities and the Commission's conclusion that the company was primarily engaged in the insurance business through controlled subsidiaries, the Commission concluded that the company should be granted an exemption from the Investment Company Act on the ground that it is not the type of company intended to be regulated thereunder. Among the other considerations leading to this conclusion were the facts that the company has a very substantial part of its investments in, and derives a very substantial part of its income from, its holdings of stock in its insurance subsidiary and that the company's officers and directors have been active in the management and operation of the insurance subsidiary. In determining that the exemption might be made retroactive, the Commission pointed out that the company would have been entitled to the exemption at any time, that it failed earlier to file an application for exemption because of good faith through mistaken belief that it was not subject to the act, that it clearly is not now an investment company and was at all times primarily engaged in the insurance business, and its outstanding face-amount certificates were at all times protected by reserves on deposit with a State agency and have been reduced to the point where they are insignificant in comparison to applicant's assets.

An Arizona corporation called International Bank applied to the Commission for an order declaring it not to be an investment company under the Investment Company Act, and the Commission ordered hearings thereon. The company also seeks a temporary exemption from the registration requirements of the act pending final determination of its status

under the act. It asserts that it is not engaged in business as an investment company but is engaged, through wholly owned subsidiaries and through working control of Financial General Corp. and Iowa Interests Corp., in the small loan business; international trade financing; registration of ships, servicing of corporations, and commercial banking in Liberia; life, fire, and casualty insurance; banking; real estate development; manufacture of plywood and textiles, and other activities.

A hearing was held in the case of Mid-America Mutual Fund, Inc. on an application to allow it to sell its shares to certain insurance policy holders at less than the public offering price. A decision is pending.

The following significant decisions were issued by the Commission in matters in which no formal hearing was held:

The Commission granted an application of Israel Development Corp. for an exemption from section 18 (c) of the act with respect to its issuance and sale of \$3 million of debentures due 1976 while it has outstanding \$1,625,000 of bank loans secured by the pledge of various securities. The Commission's decision construed section 18 (c) as intended to make clear that a company might have outstanding both publicly distributed and privately arranged debt securities only if there were no differences in the preferences as to assets and interest of any outstanding indebtedness. The exemption order is subject to the condition that the bank loans be eliminated not later than August 22, 1962, and that thereafter, while the proposed debentures are outstanding, the company does not issue or sell any senior security representing indebtedness containing a preference or priority over such debentures in the distribution of its assets or in respect of the payment of interest.

The Commission also issued a decision granting an application of Reinsurance Investment Corp. for exemption from all provisions of the act for a period of 1 year. As of September 30, 1960, the company had total assets valued at \$5,596,722 and consisting of 1,152,000 shares of Loyal American Life Insurance Co., Inc., valued at \$3,312,000 and 189,495 shares of American Income Life Insurance Co. valued at \$1,184,950 with the balance of its assets consisting mainly of government securities and cash. According to the decision, the company has majority voting control, although not majority ownership of American; Loyal American until recently was a majority-owned subsidiary and the company intends to acquire sufficient additional shares of Loyal American within 1 year to make it a majority-owned subsidiary; and, in such event, the company may no longer fall within the definition of an investment company or may qualify for exemption.

The Commission issued a decision and order exempting the merger of Delaware Realty & Investment Co. into Christiana Securities Co. from the provisions of section 17 (a) of the act. Delaware owned 32.7 percent of the outstanding common (voting) stock of Christiana. The value of the total net assets of Christiana as of September 30, 1960, was approximately \$2,418 million of which 98.6 percent was represented by its holdings of common stock of E. I. du Pont de Nemours & Co. On the same date, the value of the total

net assets of Delaware Realty was approximately \$1,052 million, of which 74.5 percent was represented by its holdings of Christiana common stock and 22.6 percent by its holdings of Du Pont common stock. Under the agreement of merger, the common stock of Delaware was converted into common stock of Christiana.

Variable Annuity Contracts

As described in detail in the 26th annual report, the Commission, on February 25, 1960, issued decisions granting certain exemptions under the 1940 act to Variable Annuity Life Insurance Co. and Equity Annuity Life Insurance Co., engaged in the business of offering variable annuity contracts. Subsequent to an enabling amendment to the District of Columbia Life Insurance Code, the assets of each of these companies applicable to variable annuity contracts have been segregated into a separate fund which is available only for satisfaction of the claims of variable annuity contract holders. As a result, during the fiscal year, the Commission granted additional exemptions from prohibitions of the 1940 act with respect to loans and advances to agents, managers and sales employees 14 and to permit in certain circumstances borrowings from nonaffiliates in addition to bank borrowings.

The Prudential Insurance Co. of America has filed an application for exemption from the 1940 act or, in the alternative, for exemption from certain provisions thereof, in connection with its proposed plan for the sale of variable annuity contracts. Hearings on this application were commenced on June 12, 1961, and were still in progress at the close of the fiscal year. The application seeks a determination that Prudential will be the issuer of such contracts and is not required to register as an investment company. Under New Jersey law, pursuant to which Prudential was organized, the proceeds from the sale of variable annuity contracts must be placed in a fund segregated from the company's other assets. Prudential proposes to invest such proceeds primarily in equity securities and if the Commission determines that this segregated fund, rather than Prudential, is the issuer of the contracts and an investment company, Prudential requests an order exempting the fund from certain provisions of the act. The provisions of the act from which exemption is sought for the fund deal mainly with the voting rights of holders of investment company securities, the manner in which directors are selected and the terms under which a redeemable security may be issued and sold. New Jersey law provides that holders of variable annuity contracts are entitled only to vote for directors, charter amendments, and mergers whereas the act provides for shareholder approval of other matters, including changes in investment policies which would govern the fund. Similarly the act prohibits any person from serving as a director of an investment company unless elected by the security holders and Prudential seeks to continue its present arrangement whereby 7 of its 23-member board of directors are appointed rather than elected. Additional exemptions are sought concerning the redemption features of the contracts and the sales load to be deducted from payments.

LITIGATION UNDER THE INVESTMENT COMPANY ACT OF 1940

The Commission filed a complaint against Townsend Corporation of America, et al., charging that Townsend Corp. of America (TCA) and Townsend Management Co. (TMC) had been under the control and domination of Morris M. Townsend, Clinton Davidson, and Raymond E. Hartz; that these individuals had knowingly operated the two companies and their subsidiaries for their personal benefit and in derogation of the interests of TCA and TMC shareholders; that both companies had engaged in business as investment companies since 1957 without being registered, in violation of the registration requirements of the Investment Company Act; that from that time until January 1960, when they registered at the insistence of the staff of the Commission, they had engaged in numerous transactions which were in violation of the act; that upon registration in January 1960 the companies acknowledged that they had acquired investments which they could not lawfully continue to hold, and represented to the Commission that within 1 year they would either divest themselves of such investments or would cease to be investment companies; and that they had failed to perform either undertaking and had made no diligent attempt to do so but, on the contrary, had engaged in further illegal transactions.

The complaint further alleged, among other things, that the named individuals caused TCA and TMC to acquire securities which they would have been prohibited from acquiring had they been registered; to obtain loans in excess of the debt limit prescribed by the act; to enter into situations involving cross-ownership of securities prohibited by the act; and to issue non-voting common stock prohibited by the act; and caused TCA to make loans to TMC and the latter's subsidiary which would have been prohibited had the companies been registered as required by the act.

The complaint also alleged that in September 1960, TCA mailed to its stockholders a report which was false and misleading in the following material respects: It reflected fictitious and inflated assets; it failed to disclose the adverse operating results of TCA and its subsidiaries for the 6 months ended June 30, 1960, and the facts that TCA's chief source of income had been dividends paid by its subsidiary, Resort Airlines, Inc., which had held a contract with the U.S. Air Force, that at June 30, 1960, such contract was not renewed, and that Resort Airlines had a net loss for the first 6 months of 1960; and it stated that TCA's profit for 1959 was about \$700,000 when in fact the profit reported was a capital gain of a subsidiary which was insolvent, with the result that such profit was not available for distribution to TCA stockholders.

The complaint also alleged that the individual defendants caused TCA and TMC to borrow from Resort Airlines from time to time sums aggregating over \$1,200,000, which loans were repaid in newly issued shares of common stock of TCA and TMC to the detriment of the stockholders of Resort Airlines. In addition, the complaint alleged, among other things, borrowings at excessive rates of interest, failure to call stockholders'

meetings and to mail reports to stockholders, the granting of options to the individual defendants in violation of the act, and waste of assets.

Injunctions were entered by consent against the two corporations and the three individuals. The court took possession of TCA and TMC for the purpose of enforcing compliance with the act and appointed an interim board of directors to carry out the terms of its decree.

In connection with the above it may be noted that a voluntary petition for reorganization under chapter X of the Bankruptcy Act was filed on May 10, 1961, by Townsend Growth Fund, Inc., a registered open-end investment company, of which TMC and a subsidiary thereof were the investment advisers and of which another subsidiary of TMC was the principal underwriter. Davidson was chairman and Townsend and Hartz were members of the board of directors of the Growth Fund. This represents the first chapter X reorganization of a registered investment company since World War II. A trustee, appointed by the U.S. District Court for the Southern District of New York, is now in control of the company's assets. The company was unable to meet its obligations as they matured, including requests for redemptions, since a large part of its portfolio consisted of securities not readily marketable. There were 302,900 shares of stock outstanding on May 5, 1961, held in approximately 1,900 stockholders accounts.

The case of Hennesey v. S.E.C. was an appeal from an order of the Commission granting the application of the Great American Life Underwriters, Inc. (Underwriters), for a retroactive exemption under section 6 (c) of the Investment Company Act from the provisions of the act from and after January 1, 1941, the effective date of the act.

Hennesey, a stockholder of Underwriters, whose participation in the proceedings was limited to an appearance on the first day of the hearings, filed an application with the Commission for reargument and rehearing. The Commission denied the application on the grounds that it was not timely filed and raised no issues not previously presented to or considered by the Commission. Following the denial of the application for rehearing Hennesey filed a petition for review in the Court of Appeals.

Underwriters was granted leave to intervene and subsequently moved to dismiss the appeal on the ground that Hennesey had no standing to appeal because she had not participated in the hearings and had not raised any issues before the Commission. The Commission opposed the motion to dismiss, taking the position that the petitioner could raise on appeal any issue that had been raised before the Commission by a participant in the hearing whose interests were not adverse to those of the petitioner. The Court of Appeals subsequently denied the motion to dismiss.

Following the end of the fiscal year, the Court of Appeals affirmed the Commission's order, holding (1) that the record contained substantial evidence to support the Commission's findings of fact; (2) that in view of the exceptional circumstances of the

case the Commission was justified in entering a retroactive order, and that the Commission should not be deprived of the flexibility that the retroactive procedure permits; and (3) that in view of the Commission's determination that Underwriters was not the type of company intended to be covered by the act, it was not necessary for the Commission to scrutinize Underwriters' transactions. A petition for rehearing was denied.

In *Civil & Military Investors Mutual Fund, Inc. v. S.E.C.*, a mutual fund appealed from a Commission order declaring that the name of the Fund was deceptive and misleading within the meaning of section 35 (d) of the Investment Company Act of 1940. The Commission found an implication inherent in the name "that registrant is particularly suited to meet the investment needs of [government] personnel", and concluded that such implication was deceptive and misleading. The Court of Appeals affirmed the Commission order and stated that the determination made by the Commission was not unreasonable and was supported by substantial evidence. In addition, the Court held that the Commission's finding of a "harmful tendency [to deceive] inherent in the name itself" was sufficient to support the Commission's action and that there was no need to find "an actual intent to deceive."

The case of *Nadler v. S.E.C.* is an appeal from an order of the Commission refusing to revoke a previous Commission order, issued pursuant to sections 17 (b) and 23 (c) of the Investment Company Act, which exempted from the provisions of section 17 (a) of the act certain transactions between affiliates, and permitted one of the parties, an investment company, to receive as part of the consideration certain of its own preferred shares.

A stockholder of the companies involved urged before the Commission that the directors of the investment company were not elected in accordance with the requirements of section 16 (a) of the act, and that accordingly all of their subsequent acts, including the application to the Commission for an exemption, as well as the Commission's order granting the exemption, were void. As described above at p. 149, the Commission held that the acts of the directors were voidable only and that under all the circumstances the prior order should not be revoked. The case was pending at the close of the fiscal year.

Participation as Amicus Curiae

Three important cases in which the Commission is appearing as amicus curiae involve private rights of action under the Investment Company Act. In *Brouk v. Managed Funds*, Managed Funds filed a complaint in the U.S. District Court for the Eastern District of Missouri, seeking an accounting, injunctive relief, and money damages from its former directors, its investment advisers, its brokers and others, for alleged violations of the Investment Company Act of 1940. It was alleged (1) that the investment advisers received fees for which 110 services were performed; (2) that the person to whom the investment advisory function was delegated channelled the Fund's brokerage business to a brokerage partnership of which he was a member; (3) that the Fund did not follow the investment policy announced in its prospectuses in that it engaged in excessive portfolio

transactions; (4) that false statements were contained in the Fund's registration statements; (5) that the investment advisers and brokers occupied a fiduciary relationship to Managed Funds which was breached through mismanagement and waste of the Fund's assets; and (6) that the director-defendants had knowledge both of the fiduciary relationship and of the mismanagement and waste, but failed to take any action to prevent it. The District Court denied defendants' motion to dismiss, but the Court of Appeals reversed on the ground that the Investment Company Act provides for no civil remedies. The Court denied plaintiff's motion for rehearing as well as the Commission's motion requesting leave to appear as amicus on the rehearing. The Supreme Court has granted certiorari.

In its brief supporting the petition for certiorari the Commission contended that the decision of the Court of Appeals is in conflict with numerous courts of appeals decisions under other Federal securities laws and with several holdings of the district courts that the Investment Company Act gives rise to an implied private right of action, and that a proper construction of the legislative history and the statutory language provides for a private right of action.

The Commission participated as amicus curiae in *Brown v. Bullock*, an action instituted by shareholders of Dividend Shares, Inc., a registered investment company. The complaint alleged that the defendants, who are directors of the fund and also of the fund's investment adviser and underwriter, engaged in a course of conduct constituting "gross misconduct" and "gross abuse of trust" under the standards imposed by section 36 of the Investment Company Act, and in an unlawful and willful conversion in violation of section 37 of the act. The complaint also alleged that certain proxy material caused to be distributed by defendants on behalf of the fund was to their knowledge false and misleading in violation, of section 20 (a) of the act and the Commission's rules thereunder and that the fund's directors failed to perform their duties under section 15 in connection with the annual renewals of the fund's investment advisory contract. The action was brought by plaintiffs both as a derivative action on behalf of the fund and as a representative action on their own behalf and that of other stockholders of the fund similarly situated.

Defendants moved to dismiss the complaint on the ground that it failed to state a Federal claim, arguing, inter alia, that neither section 36 nor section 20 (a) nor the, rules thereunder give rise to a private right of action. The Commission, as amicus curiae, took the position that a private right of action under the act may flow from violations of the duties imposed by the act, and specifically from violations of the proxy requirements under the act and from "gross misconduct" or "gross abuse of trust."

After extensive briefs had been filed by the parties and by the Commission, the district court denied defendants' motion to dismiss and in a carefully considered and detailed opinion held that defendants' position was unsound and that the complaint stated claims under the Federal statute upon which relief could be granted.

An appeal was taken from the district court's denial of the motion to dismiss and the Commission filed a brief and presented oral argument as amicus curiae on the appeal. On September 5, 1961, the court of appeals en banc affirmed the decision of the district court holding that a private right of action would flow from violation of the duties contained in the act, specifically holding that violation of section 37 (larceny and embezzlement) and the duties imposed by section 15 (relating to renewal of the advisory contracts) would give rise to such private rights of action. The court did not pass on the section 20 (a) or 36 issues since it held the section 15 and 37 violations were sufficient to sustain the complaint.

The actions of *Chabot v. Empire Trust Co.* and *Schwartz v. National Securities Series* were brought by shareholders of a mutual fund, organized as a common law trust, against the trustee and others for restoration to the fund of fees paid to the trustee. The trustee moved to stay the proceedings until the plaintiffs had delivered a bond to indemnify it against the costs and expenses of defending the action. The District Court for the Southern District of New York held applicable the provision of the trust agreement to the effect that no shareholder of the fund should have the right to an accounting except upon furnishing indemnity to the trustee against costs and expenses, with such indemnity to be payable unless it should be established that the trustee had been guilty of fraud, misfeasance, or gross negligence. The district court therefore stayed the action pending the posting of security.

On appeal from that decision, the court of appeals expressed doubt whether the complaint in fact asserted a claim within the jurisdiction of a Federal court but noted that this point was soon to be decided by it in *Brown v. Bullock* (described above). It upheld, however, the right of appeal from the order of the district court. Subsequent to the close of the fiscal year, the Commission filed a brief as amicus curiae expressing the view that the provision of the trust agreement requiring the posting of security before the shareholders can commence their action is void under section 17 (h) of the act which prohibits an investment company from operating under any instrument which contains "any provision which protects or purports to protect any director . . ." Such a provision would also violate section 47 (a), the Commission contended, in that the security requirement constitutes a waiver of compliance with provisions of the act.

PART X **ADMINISTRATION OF THE INVESTMENT ADVISERS ACT OF 1940**

The Investment Advisers Act of 1940 requires the registration of persons who are engaged for compensation in the business of advising others with respect to securities. There are, however, certain limited exemptions from the requirement of registration. One who advises only investment or insurance companies need not register. An exemption is

also afforded the adviser who in the last 12 months had fewer than 15 clients and does not hold himself out generally to the public as an investment adviser. Furthermore, the registration requirement does not apply to one whose investment advice is given only to persons resident in the State in which he maintains his principal place of business as long as the advice does not concern securities listed on a national securities exchange or admitted to unlisted trading privileges on such an exchange.

Prior to amendments to the Investment Advisers Act, effective September 13, 1960, it was unlawful for registered investment advisers to engage in practices which constitute fraud or deceit upon clients or prospective clients. Section 206 of the act, as amended, now prohibits any investment adviser from engaging in fraudulent, deceptive, or manipulative acts or practices and gives the Commission authority, by rules and regulations, to define and to prescribe means reasonably designed to prevent such acts and practices.

Prior to said amendments the Commission was not empowered to inspect the books and records of an investment adviser. Section 204 of the act, as amended, now requires every investment adviser, if not exempt from registration, to make, keep and preserve such books and records as may be prescribed by the Commission and empowers the Commission to inspect such books and records.

The act as amended has added additional grounds under section 203 (d) of the act for denying, suspending or revoking the registration of an investment adviser. These include conviction of a felony or misdemeanor involving mail fraud; fraud by wire, telephone, radio or television; or embezzlement, fraudulent conversion or misappropriation of funds or securities; also willful violation of any provision of the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Advisers Act of 1940, or any rule or regulation under any of such acts, as well as aiding or abetting any other person's violation of such acts, rules or regulations.

These and other amendments to the acts and rules promulgated or proposed thereto are more fully discussed in part II of this report.

Investment advisers who violate any of the provisions of the act are subject to appropriate administrative, civil or criminal remedies.

Investment advisers who also effect transactions as brokers and dealers, must disclose any interest they may have in transactions effected for clients if acting as an investment adviser with regard to such transactions. The act prohibits any investment adviser not exempt from registration from basing his compensation upon a share of the capital gains or appreciation of his client's funds. The act also makes it unlawful for any such investment adviser to enter into, extend or renew any investment advisory contract or to perform such contract if the contract provides for compensation to the investment adviser on the basis of a share of capital gains or capital appreciation of the funds or any portion

of the funds of the client or fails to provide that no assignment of such contract shall be made by the investment adviser without the consent of the other party to the contract.

At the close of the fiscal year, 1,855 investment advisers were registered with the Commission. The following tabulation contains statistics with respect to registrations and applications for registration during fiscal year 1960.

[table omitted]

During the past fiscal year, the Commission has instituted proceedings against three registered investment advisers.

Cambridge Research and Investment Corp.; Arthur J. Bryant. -- Proceedings against these two registrants were consolidated. Cambridge was permanently enjoined by the U.S. District Court for the District of Massachusetts, in an action instituted by the Commission, from violating section 206 of the act by soliciting subscriptions to its service and accepting subscription fees by means of misstatements or omissions of material facts concerning its ability to publish and furnish the service for the entire period of the subscriptions, and without disclosing that it had not published and furnished such copies to a number of subscribers since November 1959, and that it had applied subscription fees to its own use at a time when it was unable to publish and furnish such service. Bryant, who was president of Cambridge, was also permanently enjoined from aiding and abetting such violations. In addition to the injunction, the Commission found that Cambridge, aided and abetted by Bryant, violated section 207 of the Investment Advisers Act in that it willfully failed to amend information in its application for registration to disclose that Bryant ceased to be sole owner of more than 25 percent of the voting securities of Cambridge and that Cambridge had moved its principal place of business from the address shown on its registration application. In view of the injunction and the violations, the Commission found it in the public interest to revoke the registrations of registrants as investment advisers.

Frank Payson Todd, doing business as The New England Counsellor. -- Registrant, publisher of an investment letter called "The New England Counsellor", recommended that subscribers purchase common stock of Canadian Javelin, Ltd., a Canadian corporation engaged in operating a foundry and developing mining properties. The company retained Todd to make an evaluation of its financial program and paid him \$500 for this service. Shortly thereafter, he purchased 17,000 shares of Javelin stock for \$70,500 and gave two unsecured demand notes in payment. After such purchase registrant mentioned Canadian Javelin in his newsletter about every other week and sent telegrams to his subscribers advising purchase of Canadian Javelin stock. He was reimbursed for part of his telegraph expenses by the secretary to the president of Canadian Javelin. The stock was unregistered.

In an action brought by the Commission, a permanent injunction was issued by the U.S. District Court for the District of Massachusetts against registrant. The injunction decree recited that it appeared to the court that registrant was engaged and about to engage in acts violating the registration and antifraud provisions of the Securities Act of 1933 and section 206 of the Investment Advisers Act, and enjoined him from using the mails or interstate facilities to (1) sell or deliver stock of Canadian Javelin or any other securities contrary to the registration provisions of the Securities Act; (2) publicize any security in return for a consideration from any issuer, underwriter or dealer, without disclosing such consideration and the amount thereof; or (3) in connection with the offer or sale of Canadian Javelin stock or any other securities, employ any fraudulent device or course of conduct or untrue or misleading statement concerning, among other things, recommendations to purchase such securities, profits from such purchases, the price at which such securities should be sold or traded, and the compensation received for recommending such securities. The decree also permanently enjoined the registrant, while registered with the Commission as an investment adviser, from engaging in fraudulent activities or representations, and recommending the purchase of securities, or accepting fees from clients for such recommendations without disclosing that he was receiving compensation from persons interested in selling such securities. Registrant consented to the entry of the decree without admitting any of the allegations in the complaint.

In the revocation proceeding, which followed the injunction, registrant argued that, since the injunction was entered by consent and no factual issues were litigated, the decree could have no binding effect on the administrative proceeding and that the injunction alone, in the absence of proof that it had been violated, was not sufficient to warrant a finding that revocation or suspension of registration is in the public interest. The Commission rejected this argument holding that an injunction against an investment adviser within the ambit of section 203 (d) of the Investment Advisers Act is sufficient to support a finding that revocation of registrant is in the public interest, that in determining the question of public interest it was appropriate to look to the nature of the acts enjoined and the basis on which the injunction was entered, and that the fact that the injunction was entered by consent did not alter the basic consideration. The Commission observed that it was not determinative that the injunction had not been violated, since to hold otherwise would be to treat the existence of an injunction as precluding action by the Commission with respect to the registration although the statute expressly makes it a ground for revocation. The Commission stated "An investment adviser is a fiduciary and, as such, owes a duty of fair and impartial advice to his clients. It is clear that Todd's conduct grossly violated this standard, and we conclude that under all the circumstances it is in the public interest to revoke his registration as an investment adviser."

LITIGATION UNDER THE INVESTMENT ADVISERS ACT OF 1940

In S.E.C. v. Robert Carter Allen et al. Allen conducted an investment advisory service under the name of Insurance Stock Advisory Service, Inc. The complaint alleged that the defendants solicited and received payments from insurance companies for recommending securities issued by such companies in the defendant's semimonthly bulletins which were then distributed to subscribers as containing unbiased and independent recommendations. Permanent injunctions were entered by consent.

In S.E.C. v. Capital Gains Research Bureau, Inc. the Commission charged the company, an investment service, and its president, Harry P. Schwarzman, with violations of sections 206 (1) and (2) of the Investment Advisers Act. The complaint alleged that the company assumed a position opposed to that of its customers by purchasing certain securities, then recommending to its customers that they purchase such securities without disclosing its position or its intention to sell, and thereafter selling its securities in the higher market resulting from its customers' purchases. Conversely, the complaint charged, the company sold securities short, then advised its clients that such securities were overvalued, and within a few days, as a result of a falling market, was able to buy the securities at a profit. The Commission's request for a preliminary injunction was denied and the matter has been appealed to the Court of Appeals.

PART XI **OTHER ACTIVITIES OF THE COMMISSION**

COURT PROCEEDINGS

Civil Proceedings

At the beginning of the fiscal year 1961 there were pending in the courts 84 injunctive and related enforcement proceedings instituted by the Commission to prevent fraudulent and other illegal practices in the sale or purchase of securities. During the year 92 additional proceedings were instituted and 81 cases were disposed of, leaving 95 such proceedings pending at the end of the year. In addition the Commission participated in a number of corporate reorganization cases under chapter X of the Bankruptcy Act, in 12 proceedings in the district courts under section 11 (e) of the Public Utility Holding Company Act; and in 9 miscellaneous actions. The Commission also participated in 55 civil appeals in the U.S. Courts of Appeals. Of these 27 came before the courts on petition for review of an administration order, 7 arose out of corporate reorganizations in which the Commission had taken an active part, 8 were appeals in actions brought by or against the Commission, 3 were appeals from orders entered pursuant to section 11 (e) of the Public Utility Holding Company Act, and 10 were appeals in cases in which the Commission appeared as amicus curiae. The Commission also participated in 7 appeals or petitions for certiorari before the U.S. Supreme Court resulting from these or similar actions.

Complete lists of all cases in which the Commission appeared before a Federal or State court, either as a party or as amicus curiae, during the fiscal year, and the status of such cases at the close of the year, are contained in the appendix tables.

Certain significant aspects of the Commission's litigation during the year are discussed in the sections of this report relating to the statutes under which the litigation arose.

Criminal Proceedings

The statutes administered by the Commission provide for the transmission of evidence of violations to the Attorney General, who may institute criminal proceedings. The regional offices and, at times, the main office of the Commission prepare detailed reports in cases where the facts appear to warrant criminal prosecution. After careful review by the General Counsel's office, these reports are considered by the Commission and, if it believes criminal prosecution is appropriate, the reference for criminal prosecution is forwarded to the Attorney General. Commission employees familiar with the case generally assist the U.S. Attorneys in the presentation to the grand jury, the conduct of the trial, and the preparation of briefs on appeal. The Commission also submits parole reports prepared by its investigators relating to convicted offenders.

During the past fiscal year 42 cases were referred to the Department of Justice for prosecution. As a result of these and prior referrals, 44 indictments were returned against 205 defendants during the fiscal year. There also were 126 convictions in 45 cases, the largest number of convictions obtained in any fiscal year since the earliest days of the Commission's history. Convictions were affirmed in four cases, reversed in two cases, and appeals were still pending in seven other criminal cases at the close of the period. Of five criminal contempt cases handled during the year, three defendants were convicted in two cases, another case was dismissed and two cases are still pending.

From 1934, when the Commission was established, until June 30, 1961, 2,982 defendants have been indicted in the U.S. District Courts in 689 cases developed by the Commission, and 1,507 convictions have been obtained. The record of convictions obtained and upheld in completed cases is over 86 percent for the 27-year life of the Commission.

The fraud cases again, as in prior years, covered a wide variety of fraudulent practices. They included high-pressure long-distance telephone "boiler room" frauds, frauds by investment advisers, frauds in the sale of securities by new as well as established businesses, and fraudulent security sales relating-to the promotion of insurance companies, oil, gas, and mining ventures, alleged inventions, and other spurious investment schemes. In addition, there were prosecutions for the filing of false proxy statements, as well as other false documents filed with the Commission, and the first criminal prosecution for violation of the Investment Company Act of 1940. Because of the large volume of cases it is impossible to report in detail all of the criminal matters, but

some of the more important and endless variety of fraudulent devices and techniques are described in the specific cases discussed below. [Footnote: Charges of violations of the mail fraud statute are frequently included in the indictments which charge violations of the antifraud provisions of the securities law. The Commission is assisted in its efforts in these cases by the personnel of the Post Office Department.]

The first criminal prosecution under the Investment Company Act resulted in a conviction in *United States v. Francis Peter Crosby*, where the defendant pleaded guilty to violations of that act, as well as the Securities Exchange Act. Crosby had acquired control of Jefferson Research Foundation, Inc., and, through that corporation, control of Jefferson Custodian Fund, Inc., an investment company. Crosby then liquidated a portion of the portfolio of the fund for some \$241,000 to raise cash and attempted to sell the fund worthless securities for \$396,000. When the custodian of the fund refused to execute the orders to purchase the worthless securities, Crosby attempted to secure another custodian.

The first conviction for violation of the anti-touting provisions of section 17 (b) of the Securities Act was obtained in *United States v. Todd*, where F. Pay son Todd, doing business as the New England Counsellor, entered a plea of nolo contendere to charges that he had recommended purchases at the market to his customers of the stock of Canadian Javelin without disclosing that he had received compensation from the issuer and underwriters and that his recommendations for purchase to his clients were for the purpose of facilitating a distribution of the stock by creating a demand for it and to raise its market price.

The first convictions for violations of the proxy provisions of the Securities Exchange Act were had in *United States v. Fortune Pope and Anthony Pope*. The defendants were each sentenced on pleas of guilty and nolo contendere to fines of \$25,000 and additionally given a 1-year suspended prison sentence and placed on probation for that period. The defendants were convicted of soliciting proxies of stockholders of the Colonial Sand & Stone Co., Inc., by means of false and misleading proxy statements and filing such false and misleading proxy statements with the Commission and with the American Stock Exchange.

Another conviction involving the use of false and misleading proxy soliciting material was obtained in *United States v. Maurice Olen*, where the defendant was convicted on his nolo contendere plea and fined \$2,500. In *United States v. Alexander L. Guterma* involving the stock of United Dye & Chemical Corp., Guterma pleaded guilty to charges that he conspired to file a false and misleading proxy statement with respect to that company, to obstruct the making and filing of reports required to be filed by the company with the New York Stock Exchange and the Commission, and to defraud purchasers in the sale of unregistered securities of that corporation. This case is still pending as to other codefendants.

Guterma also pleaded guilty to the indictment in *United States v. Samuel S. Garfield et al.*, which charges a conspiracy to distribute to the public shares of the common stock of United Dye & Chemical Corp. through the mails without complying with the registration provisions of the Securities Act. This case is pending as to other defendants. Guterma again pleaded guilty in *United States v. Samuel S. Garfield et al.* to an indictment charging conspiracy to violate the registration and antifraud provisions of the Securities Act in the distribution of stock of Shawano Development Corp. by use of false and misleading literature and by means of an intensive local and long-distance telephone sales campaign. This indictment also is pending as to other defendants.

Guterma and Paul Hughes pleaded guilty in *United States v. Paul Hughes et al.*, where the defendants are charged with fraud in the sale of stock of the Western Financial Corp., Diversified Financial Corp. of America, and Consolidated American Industries, Inc., and where it is alleged an extensive telephone and mail campaign was carried on to effect the sale of the stock at arbitrary prices from \$2.25 to \$2.50 per share. Other defendants are awaiting trial.

Convictions were affirmed in *United States v. Guterma*, 281 F. 2d 742 (C.A. 2, 1960), cert. denied, 364 U.S. 871, for conspiracy to violate and for violation of the reporting requirements of the Securities Exchange Act. This landmark case was the first criminal prosecution of corporate insiders for their failure to file ownership reports and for their obstruction of the filing of the annual report required to be filed by companies having securities listed on a national securities exchange.

A conviction for violations of the Securities Act and the mail fraud statute was affirmed in *J. Phil Burns et al. v. United States*, 286 F. 2d 152 (C.A. 10, 1961). The defendants were found guilty of selling over \$51 million of securities of the Selected Investments Trust Fund of which \$12 million were redeemed. Dividends had been paid out of capital while the defendants represented to investors that dividends were paid from profits; false financial statements were distributed; defendants redeemed certificate bonds at their face amount which substantially exceeded their actual value; and defendants converted and used for their own personal profit money and properties of the trust fund without reimbursing the trust fund. In addition, the defendants, with a total investment of \$13,800 in the Selected Investments Corp., dominated and controlled the multimillion dollar trust fund which in turn controlled approximately 37 subsidiary companies. The defendants, J. Phil Burns and Hugh A. Carroll, were sentenced to 5 years, William A. Rigg received a suspended sentence of 5 years and was placed on probation, and Julia Moore Carroll was placed on probation for 5 years. The defendant corporation, Selected Investments Corp. and United Securities Agency, were each fined \$1,500.

The stock of Atlas Gypsum Corp., Ltd., was sold through the securities brokerage firm of J. C. Graye Co., in one of a series of boiler room promotions controlled by Stanley I. Younger and his associates in *United States v. Stanley I. Younger et al.* (D. Conn.). The defendants acquired a large block of Atlas Gypsum stock at approximately 20 cents per

share and subsequently sold these shares to investors in some 30 States by means of arbitrary markups at prices as high as \$3. per share. As the trial was to start in October, six defendants entered pleas of guilty or nolo contendere; after the Government called its first witness, the remaining defendants on trial withdrew not-guilty pleas and entered pleas of nolo contendere. Stanley Ira Younger received an 8-year sentence, James C. Graye received a 3-year sentence and varying sentences were imposed on the remaining defendants, including Carmine Lombardozzi who received a suspended sentence of 3 years and 5 years' probation with a fine of \$2,500, Arthur Tortorello who received a 3-year sentence to be suspended after service of 3 months, and Louis Michael de Fillippo who was similarly sentenced.

In connection with the investigation of the Atlas Gypsum Corp., Ltd. matter, Jack Yetman pleaded guilty to committing perjury while testifying before investigating officers of the Securities and Exchange Commission and is awaiting sentence.

Younger was again a defendant in another boiler room promotion, United States v. Phillip Newman Associates, Inc., et al. (D.N.H.) where he received a 3-year sentence, to be served concurrently with other sentences imposed upon him, for violations of the antifraud provisions of the Securities Act in the sale of securities of Monarch Asbestos Co., Ltd., through the brokerage firm of Phillip Newman Associates, Inc.

Younger also was convicted, together with Richard T. Cardall, of violating the antifraud provisions of the Securities Exchange Act and the Mail Fraud Statute in the case of United States v. Stanley I. Younger, et al. (S.D.N.Y.). Here the defendants placed orders with brokers for stock of National Photocopy, Inc., a nonexistent corporation, and then sold Photocopy stock using an alias through other brokers. In this manner they caused the brokers to purchase the Photocopy stock, but never accepted or paid the broker for the stock. For his part in the manipulations of National Photocopy, Inc., stock Younger received a sentence of 3 1/2 years. A somewhat similar scheme was utilized by the defendant in United States v. William C. Karal (D. Mass.).

Seven codefendants of Lowell M. Birrell, a fugitive presently residing in Brazil, were convicted in United States v. Samuel J. Smiley (S.D.N.Y.) of violating the antifraud provisions of the Securities Exchange Act in defrauding Doeskin Products, Inc., by causing Doeskin to issue over 1 million shares of its stock by falsely pretending that \$2,140,000 had been received by Doeskin. Some of the defendants also induced Doeskin to pay a commission of \$53,500 on this fictitious sale. They then sold 70,000 shares back to the corporation and obtained \$100,000 more. A number of other codefendants in addition to Birrell are presently fugitives in this case.

A number of broker-dealers were convicted and a number of others are awaiting trial on charges arising from conduct of a securities business. Thus in United States v. Flomsey (D. Mass.) a 2-year sentence and a \$5,000 fine was imposed on Anton E. Homsey on his plea of guilty. Defendant, who was a partner in the Boston securities firm of DuPont,

Homsey & Co., hypothecated investors' securities in violation of the provisions of the Securities Exchange Act. Single investors were defrauded in amounts of \$385,000, \$85,000, and \$25.; a Florida couple gave Homsey \$102,000 of securities, having been promised 5 percent interest plus the dividends on the securities. They did not receive the dividend payments, the interest, or the return of the securities. Joseph F. Whalen, Jr., a salesman for the same firm of DuPont, Homsey & Co., also hypothecated securities for his own use, forged checks received from the proceeds of the sale and then appropriated the same to his own use and benefit. Whalen was sentenced to 1 year's imprisonment on his guilty plea.

Fraud and registration violations are included among the pending charges in *United States v. Greenberg, et al.* (S.D.N.Y.). Jacob A. Greenberg and Morris Mac Schwebel are charged with selling stock of Soil Builders International Corp. to Associates Union Trust, a Lichtenstein trust, with offices in Geneva, Switzerland, which stock was then immediately resold to investors in the United States without registration. Misrepresentations as to the profitable operation of the business, its proposed listing on the American and New York Stock Exchanges, and other similar matters also are alleged in the indictment. These defendants also are charged in another indictment with conspiring to violate and violating the registration provisions of the Securities Act in the sale of common stock of Basic Atomics, Inc.

A number of convictions were obtained for fraud involving the sale of insurance company stock. Thus in *United States v. Charles F. Newell and Chauncey A. Allen* (D. Colo.) the defendants were convicted of falsely representing in the sale of stock of the Unity Insurance Co. of Omaha that the investor's money would be placed in escrow until an insurance business franchise was issued by the State of Nebraska; that the company had the money to qualify and would get the license, and the company was so profitable that they would refund the issuer's money at any time with 5-percent interest. The defendants did not disclose that the officers of Unity Insurance Co. did not invest their own money in the company but received stock options from the company and that the greater portion of the investor's purchase price went to a company officer.

There were also several prosecutions for alleged fraud in the sale of notes and mortgages and related securities. An indictment was returned in *United States v. David Farrell, et al.* (S.D. Cal.), where some 9,000 investors invested in excess of \$40 million in an alleged "Secured 10% Earnings Program", for violations of the Securities Act and the Mail Fraud Statute in the sale of securities of the Trust Deed & Mortgage Exchange, Los Angeles Trust Deed & Mortgage Exchange, Trust Deed & Mortgage Markets, and Colorado Trust Deed & Mortgage Markets. The indictment alleged that the defendants engaged in a scheme and artifice to defraud investors throughout the United States and in foreign countries by falsely representing that the Secured 10% Earnings Program assured investors "full, firm 10% earnings" with a degree of liquidity comparable to insured bank deposits or insured savings and loan certificates, that the "Exchange" maintained by TD & ME and LATD & ME was similar to a stock exchange, and that LATD & ME and TD

& MM were "safe, solid, solvent and adequately financed institutions" -- the "oldest and largest in America" offering "Secured 10% Earnings." The indictment alleges that in fact LATD & ME and TD & MM were insolvent and that funds entrusted to them by investors were constantly endangered and in jeopardy.

The defendant in *United States v. Wendell Ralph Lutes* (S.D. Ind.) was convicted on charges of defrauding investors by the sale of common stock of the Brown Mortgage Co., Inc. The defendant had organized this company for the avowed purpose of making mortgage loans in Brown County, Ind., and represented to purchasers that the company would earn 12 percent a year on mortgage loans and that the company could pay a 10-percent stock dividend. The company actually did not own mortgages and did not do business of this kind; the defendant caused a 10-percent stock dividend to be paid solely for the purpose of aiding in the sale of the stock. The defendant Lutes drew from the company funds of over \$80,000 by writing company checks to fictitious persons, forging the endorsements, and then endorsing the checks for deposit in his bank account; by taking securities belonging to the mortgage company, registering them in his name and then selling the mortgages; by organizing a stock brokerage firm in Saint Petersburg, Fla., with funds of the mortgage company; and by inducing a purchaser to take control of the Brown County Mortgage Co. and redeem Lutes' shareholdings for an amount far in excess of its value.

An alleged revolutionary uranium processing machine, the "Benson Uranium Upgrader," was one of the schemes involved in *United States v. John Milton Addison, et al.* (N.D. Tex.). The defendants obtained money from the public in 35 States, including Hawaii, in the sum of about \$2 million. After trial the judge imposed a 15-year sentence and \$36,000 fine on one defendant and sentences of from 7 to 2 years on five others. The fraudulent promotion of a steam generating machine, as well as a protective paint, a nonslip nut, roll-a-way furniture, and a water retaining fertilizer, were involved in *United States v. Clark L. Fry* (W.D. Wis.).

Oil and mining promotions continued to provide a fertile field for fraudulent promoters. The defendant in *United States v. Thomas E. Robertson* (S.D.N.Y.) was sentenced to 3 months' imprisonment on the first count and a sentence 1 year was suspended on all other counts after conviction on an indictment charging violations of the antifraud provisions and the registration requirements of the Securities Act in the offer and sale of stock of the American-Canadian Oil & Drilling Corp. Robertson had acquired 500,000 shares of stock of American-Canadian in exchange for certain oil and gas leases which was sold to investors without registration and without disclosing that Thomas E. Robertson, Inc., was the principal and owner of the shares. Robertson and his company made misrepresentations as to dividend payments, the value of the stock, approval of the Securities and Exchange Commission, listing of the stock on a national securities exchange, value of the properties, and cost of acquisition of the properties.

In another oil promotion, *United States v. Mervin J. Fischman, et al.* (D. Mass.), pleas of not guilty were changed to guilty by two defendants who employed a scheme to defraud investors in a long-distance telephone campaign to sell shares of the Lexa Oil Corp. to residents of Massachusetts and other States. In the telephone campaign false representations were made that Lexa Oil Corp. had struck a well that was producing 250 barrels a day; that proceeds from the sale of shares that were being offered by Anglo-American were to be used by Lexa as working capital; that Anglo-American was offering the shares of Lexa at a lower price than that being charged in the open market; that an investment in Lexa would certainly result in a high profit; and that the shares of Lexa were going to be listed on a stock exchange. Fischman received a suspended sentence of 5 years and 5 years' probation and Palermo received a 2-year probationary sentence.

A purported Canadian mining venture resulted in a 3-year sentence for the defendant in *United States v. George Alexander Kerr* (D. Wash.) upon his plea of guilty to violating the Mail Fraud Statute. Kerr sold shares of Eagle Plains Development, Ltd., a Canadian corporation, misrepresenting that there was a limited amount of stock available for purchase; that a million dollars had been invested by a syndicate in the corporation; and that the company owned producing mining property and that the stock on the New York Stock Exchange "Eagle P" was, in fact, the stock of Eagle Plains Development. By this scheme the defendant and his associates obtained more than \$375,000 from some 1,000 investors in the United States by long-distance telephone calls and a mail campaign from Vancouver, British Columbia, and Whitehorse, Yukon Territory. Other participants in the scheme were apprehended by Canadian authorities.

COMPLAINTS AND INVESTIGATIONS

Each of the acts administered by the Commission specifically authorizes investigations to determine whether violations of law have occurred.

The nine regional offices of the Commission, with the assistance of their branch offices, are primarily responsible for the conduct of investigations. In addition, the Office of Special Investigations of the Division of Trading and Exchanges of the Commission's Washington Office conducts investigations dealing with matters of particular interest or urgency, either independently or assisting the regional offices. The Division of Trading and Exchanges exercises general supervision over and coordination of the investigative activities of the regional offices. Its staff examines and analyzes the investigative findings and recommendations of the regional offices and recommends appropriate action to the Commission.

There are several sources of information which eventually lead to investigation. One of the primary sources of information is complaints submitted by members of the general public concerning the activities of persons involved in the offer and sale of securities. The Division of Trading and Exchanges and the regional offices give careful

consideration to such information and, if it appears that violations of the Federal securities laws may have occurred, an investigation is commenced. Other sources of information which are of great assistance to the Commission in carrying out its enforcement responsibilities are the national securities exchanges, brokerage firms, State and Canadian securities authorities, better business bureaus, the National Association of Securities Dealers, Inc., and various law enforcement agencies.

It is the Commission's policy to conduct its investigations on a confidential basis. Such a policy is necessary for effective law enforcement and in the interest of fairness to persons against whom unfounded or unconfirmed charges may be presented. Another advantage of confidential investigations is that suspected violators may not be warned and afforded an opportunity to frustrate or obstruct the investigation. The Commission investigates many complaints where no violation is ultimately found to exist. To conduct such investigations publicly would ordinarily result in hardship or embarrassment to many innocent persons and might affect the market for the securities in question, resulting in injury to investors with no countervailing public benefits. Moreover, members of the public have a tendency to be reluctant to furnish information concerning suspected violations if they think their personal affairs would be publicized. Accordingly, the Commission does not generally divulge the existence of or findings of any investigation unless they are made a matter of public record through proceedings before the Commission or in the courts.

When a preliminary investigation indicates a serious violation or appears to require more extensive investigation, which may include examination of books and records or interviews with numerous persons, a case is docketed and a full investigation is conducted. Under certain circumstances it becomes necessary for the Commission to issue a formal order of investigation which designates members of its staff as officers to issue subpoenas and take testimony under oath. This step is taken when the principals and others involved in the investigation are uncooperative or it is otherwise necessary to use the subpoena power in order to determine the exact nature of the activities involved. During the past year, 131 formal orders were issued in connection with investigations handled through the Division of Trading and Exchanges. In addition, there were 24 formal orders issued at the recommendation of the Division of Corporation Finance. That Division conducts certain investigations necessary to assist in processing filings made with that Division under the Securities Act of 1933 and the Securities Exchange Act of 1934.

When an investigation has been completed and enforcement action appears appropriate, the Commission may proceed in one of several ways. The evidence may be referred to the Department of Justice with a recommendation for criminal prosecution. Should this occur, members of the Commission's staff, who were instrumental in developing the case, usually assist the Department of Justice and the U.S. attorney in presenting the case to the grand jury. If an indictment is returned, members of its staff usually aid in the trial of the case.

The Commission may, when appropriate, authorize institution of civil action for injunctive relief to restrain further violations. In such event, the complaint is filed in the Commission's name with the appropriate U.S. district court and the case is presented by a member of the Commission's staff. The Commission may also institute administrative proceedings when the investigation indicates that such action is appropriate, for example, that a registration statement or report filed with it is false or misleading or omits required information, or that a broker-dealer or investment adviser registered with this Commission is violating the Federal securities laws.

The following table reflects in summarized form the investigative activities handled by the Division of Trading and Exchanges of the Commission during fiscal 1961:

[table omitted]

ENFORCEMENT PROBLEMS WITH RESPECT TO CANADIAN SECURITIES

While the unlawful offering and sale of securities by Canadian issuers and broker-dealers continues to be a serious problem, considerable progress has been made within the past fiscal year, resulting in great improvement in this field.

The success which has been achieved is due to continued and aggressive efforts and the increasing awareness of the seriousness of the problem on the part of Canadian provincial authorities and responsible members of the Canadian securities industry, resulting in an active interest in cooperative enforcement. We are currently receiving excellent cooperation from most Provinces and some segments of the Canadian securities industry.

A principal factor in our enforcement program during the past year has involved the issuance of postal fraud orders which greatly reduced illegal offerings from Toronto. During the past fiscal year, upon evidence furnished by the Commission, 58 postal fraud orders have been issued. Numerous "extensions" to such orders have also been issued to cover changes of address by persons who sought by such changes to avoid the consequences of original orders directed to them.

On March 28, 1961, the Toronto Stock Exchange and the Ontario Broker-Dealers Association took steps to require their members to refrain, from offering securities illegally in the United States. Conferences were held between representatives of the Commission and representatives of the securities industry in Toronto to discuss the situation and to work out a plan whereby broker-dealers in Ontario could operate in compliance with the laws of the United States. As a result of these actions several broker-dealers from Toronto have become registered with this Commission under the Securities Exchange Act of 1934, and have agreed that they will not offer or sell securities in the United States in violation of the registration requirements of the Securities Act of 1933.

The chairman of the Ontario Securities Commission has expressed his approval of these arrangements.

Our enforcement difficulties with respect to jurisdictional problems, including the denial of extradition by Canadian courts in a test case under the Supplementary Extradition Convention, have been presented in detail in previous annual reports.

Details concerning actions involving Canadian securities are described elsewhere in the section relating to litigation under the Securities Act of 1933 and in the section relating to criminal proceedings.

The Commission continues to maintain its Canadian restricted list. This is a list of Canadian companies whose securities the Commission has reason to believe currently are being, or recently have been, distributed in the United States in violation of the registration requirements of the Securities Act of 1933. Failure to comply with the registration requirements deprives investors of material information and facilitates false claims as to the worth of securities. Thus investors are denied the essential protections provided by the Securities Act.

The list and supplements thereto are issued to and published by the press and copies are mailed to all registered broker-dealers and are available to the public. The list serves as a warning to the public and alerts broker-dealers to the fact that transactions in the securities of the companies named therein may be unlawful. Most United States broker-dealers refuse to execute transactions in such securities.

During the fiscal year 1961, 26 supplements to the list were issued in which 47 names were added and 4 deleted upon compliance with established procedures. The number of names on the list as of June 30, 1961, was 253.

The current list, as of September 30, 1961, follows:

CANADIAN RESTRICTED LIST

Adonis Mines, Ltd.
Alaska-Canadian Mining & Exploration Co., Ltd.
Aldor Exploration and Development Co., Ltd.
A. L. Johnson Grubstake
Alouette Mines, Ltd.
Amador Highland Valley Coppers, Ltd.
Ambassador Mining Developments, Ltd.
Americanadian Mining & Exploration Co., Ltd.
Amican Petroleum & Natural Gas Corp., Ltd.
Anthony Gas and Oil Explorations, Ltd.
Apollo Mineral Developers Inc.

Associated Livestock Growers of Ontario
Atlantis Industrial Development Co., Ltd.
Atlas Gypsum Corp., Ltd.
Ava Gold Mining Co., Ltd.
Baranouri Minerals, Ltd.
Barite Gold Mines, Ltd.
Basic Lead and Zinc Mines, Ltd.
Bengal Development Corp., Ltd.
Black Crow Mines, Ltd.
Blue Springs Explorations
Bonwitha Mining Co., Ltd.
Burbank Minerals, Ltd.
Cable Mines and Oils, Ltd.
Caesar Minerals, Ltd.
Cairngorm Mines, Ltd.
Cameron Copper Mines, Ltd.
Canada Radium Corp., Ltd.
Canadian Alumina Corp., Ltd.
Canford Explorations, Ltd.
Canol Metal Mines, Ltd.
Cartier Quebec Explorations, Ltd.
Casgoran Mines, Ltd.
Central & Eastern Canada Mines (1958), Ltd.
Centurion Mines, Ltd.
Cessland Gas and Oil Corp., Ltd.
Colville Lake Explorers Ltd.
Consolidated Easter Island Mines Ltd.
Consolidated Mines & Oils Corp., Ltd.
Copper Prince Mines, Ltd.
Courageous Gold Mines, Ltd.
Cove Uranium Mines, Ltd.
Cree Mining Corp., Ltd.
Crusade Petroleum Corp., Ltd.
Davian Exploration, Ltd.
Dayjon Explorers, Ltd.
Dempster Explorations, Ltd.
Derogan Asbestos Corp., Ltd.
Devonshire Mining Co., Ltd.
Devonshire Mining Syndicate
Diadem Mines, Ltd.
Dolmac Mines, Ltd.
Dolsan Mines, Ltd.
Dominion Fluoridators, Ltd.
Dominion Granite & Marble, Ltd.

DuMaurier Mines, Ltd.
Dumont Nickel Corp.
Dupont Mining Co., Ltd.
Eagle Plains Developments, Ltd.
Eagle Plains Explorations, Ltd.
East Trinity Mining Corp.
Eastern-Northern Explorations, Ltd.
Elk Lake Mines, Ltd.
Embassy Mines, Ltd.
Explorers Alliance, Ltd.
Export Nickel Corp. of Canada, Ltd.
Fairmont Prospecting Syndicate
Federal Chibougarnau Mines, Ltd.
File Lake Explorations, Ltd.
Fleetwood Mining and Exploration, Ltd.
Flint Rock Mines, Ltd.
Font Petroleums, Ltd.
Foreign Exploration Corp., Ltd.
Fort Hope Grubstake, The Franksin Mines, Ltd.
Gasjet Corp., Ltd.
Genex Mines, Ltd.
Georay Prospecting Syndicate
Golden Algoma Mines, Ltd.
Golden Hope Mines, Ltd.
Goldmaque Mines, Ltd.
Granwick Mines, Ltd.
Guardian Explorations, Ltd.
Haitian Copper Mining Corp., Ltd.
Hallmark Explorations, Ltd.
Halstead Prospecting Syndicate
Hoover Mining and Exploration, Ltd.
Ibsen Cobalt-Silver Mines, Ltd.
Inlet Mining Corp.. Ltd.
International Ceramic Mining, Ltd.
Irando Oil and Exploration, Ltd.
Jack Haynes Syndicate
Jacmar Explorations, Ltd.
Jaylac Mines, Ltd.
Jilbie Mining Co., Ltd.
Jomac Mines, Ltd.
Kateri Mining Co., Ltd.
Kelkirk Mines, Ltd.
Kelly-Desmond Mining Corp., Ltd.
Kennament Development Corp., Ltd.

Key West Exploration Co., Ltd.
Kimberly Copper Mines, Ltd.
Kipwater Mines, Ltd.
Kordol Explorations, Ltd.
Korich Mining Co., Ltd.
Kukatash Mining Corp.
Kuskokwim Grubstake
Ladysmith Explorations, Ltd.
Lake Kingston Mines, Ltd.
Lake Otter Uranium Mines, Ltd.
Lama Explorations and Mining Co., Ltd.
Lambton Copper Mines, Ltd.
Larutan Petroleum Corp., Ltd.
Lavandin Mining Co.
Lavant Mines, Ltd.
Leader Mining Corp., Ltd.
Lee Gordon Mines, Ltd.
Lindsay Explorations, Ltd.
Lucky Creek Mining Co., Ltd.
Lynwatin Nickel Copper, Ltd.
Mack Lake Mining Corp., Ltd.
Magni Mining Corp., Ltd.
Mallen Red Lake Gold Mines, Ltd.
Maple Leaf Investing Corp., Ltd.
March Minerals, Ltd.
Marian Lake Mines, Ltd.
Marpic Explorations, Ltd.
Marpoint Gas & Oil Corp., Ltd.
Mattagami Explorers Corp.
Megantic Mining Corp.
Mexicana Explorations, Ltd.
Mexuscan Development Corp.
Midas Mining Co., Ltd.
Mid-Nation Developments, Ltd.
Mile 18 Mines, Ltd.
Milldale Minerals, Ltd.
Milmar-Island Mines, Ltd.
Mina-Nova Mines, Ltd.
Minden Land Enterprises, Ltd.
Mineral Exploration Corp., Ltd.
Missile Metals and Mining Corp., Ltd.
Monarch Asbestos Co., Ltd.
Monarch Gold Mines, Ltd.
Montor Gold Mines, Ltd.

Monpre Mining Co., Ltd.
Montclair Mining Corp., Ltd.
Mylake Mines, Ltd.
National Telepix (Canada), Ltd.
Nationwide Minerals, Ltd.
Native Minerals, Ltd.
Natto Mining Co., Ltd.
Neeland Flin Flon Mining and Explorations, Ltd.
New Campbell Island Mines, Ltd.
New Faulkenham Mines, Ltd.
New Hamil Silver-Lead Mines, Ltd.
New Mallen Red Lake Mines, Ltd.
New Metalore Mining Co., Ltd.
New Spring Coulee Oil and Minerals, Ltd.
New Surpass Petrochemicals, Ltd.
Norbank Explorations, Ltd.
Norcopper and Metals Corp.
Normalloy Explorations, Ltd.
Norsco Mines, Ltd.
Norseman Nickel Corp., Ltd.
North American Asbestos Co., Ltd.
North Gaspé Mines, Ltd.
North Lake Mines, Ltd.
Northport Mineral Explorers, Ltd.
North Tech Explorations, Ltd.
Nortoba Mines, Ltd.
Nu-Gord Mines, Ltd.
Nu-Reality Oils, Ltd.
Nu-World Uranium Mines, Ltd.
Olympus Mines, Ltd.
Outlook Explorations, Ltd.
Palliser Petroleums, Ltd.
Pantan Mines, Ltd.
Paramount Petroleum & Minerals Corp., Ltd.
Peace River Petroleums, Ltd.
Pick Mines, Ltd.
Plexterre Mining Corp., Ltd.
Prestige Lake Mines, Ltd.
Primary Gold Mines, Ltd.
Prudential Petroleums, Ltd.
Purdex Minerals, Ltd.
Quebec Graphite Corp.
Queensland Explorations, Ltd.
Quinalta Petroleum, Ltd.

Rambler Exploration Co., Ltd.
Red River Mining & Exploration, Ltd.
Regal Mining & Development, Ltd.
Resolute Oil and Gas Co., Ltd.
Revere Mining Corp., Ltd.
Riobec Mines, Ltd.
Roberval Mining Corp.
Rockroft Explorations, Ltd.
Rothsay Mines, Ltd.
Roxton Mining & Development Co., Ltd.
St. Anthony Mines, Ltd.
St. Lawrence Industrial Dev. Corp.
St. Stephen Nickel Mines, Ltd.
Saskalon Uranium and Oils, Ltd.
Sastex Oil and Gas, Ltd.
Savoy Copper Mines, Ltd.
Seaboard Industries, Ltd.
Senvil Mines, Ltd.
Sheba Mines, Ltd.
Sheraton Uranium Mines, Ltd.
Shoreland Mines, Ltd.
Sico Mining Corp., Ltd.
Siconor Mines, Ltd.
Sinclair Prospecting Syndicate
South Seas Mining, Ltd.
Space Age Mines, Ltd.
Stackpool Mining Co., Ltd.
Strathcona Mines, Ltd.
Sturgeon Basin Mines, Ltd.
Success Mines, Ltd.
Sudbay Beryllium Mines, Ltd.
Sudbay Exploration and Mining, Ltd.
Swift Copper Mines, Ltd.
Tabor Lake Gold Mines, Ltd.
Taiga Mines, Ltd.
Tamicon Iron Mines, Ltd.
Taurcanis Mines, Ltd.
Temanda Mines, Ltd.
Territory Mining Co., Ltd.
Trans Nation Minerals, Ltd.
Trans-Oceanic Hotels Corp.
Trenton Petroleum & Minerals Corp., Ltd.
Tri-Cor Mining Co., Ltd.
Triform Explorations, Ltd.

Trio Mining Explorations, Ltd.
Trojan Consolidated Mines, Ltd.
Tumac Mining & Development Ltd.
Turbenn Minerals, Ltd.
Turzone Explorations, Ltd.
Tyndall Explorations, Ltd.
Upper Ungava Mining Corp., Ltd.
Val Jon Exploration, Ltd.
Valray Explorations, Ltd.
Vanguard Explorations, Ltd.
Venus Chibougamau Mines, Ltd.
Ver-Million Gold Placer Mining, Ltd.
Vico Explorations, Ltd.
Vimy Explorations, Ltd. Co., Viscount Oil and Gas, Ltd.
Wakefield Uranium Mines, Ltd.
Webbwood Exploration Co., Ltd.
Western Allenbee Oil and Gas Co., Ltd.
Westwind Explorations, Ltd.
Windy Hill Mining Corp.
Wingdam & Lightning Creek Mining Co., Ltd.
Yukon Prospectors' Syndicate

SECTION OF SECURITIES VIOLATIONS

A section of securities violations is maintained by the Commission as a part of its enforcement program to provide a further means of detecting and preventing fraud in securities transactions. The section maintains files providing a clearinghouse for other enforcement agencies for information concerning persons who have been charged with violations of various Federal and State securities statutes. Considerable information is also available concerning violators resident in the Provinces of Canada. The specialized information in these files is kept current through the cooperation of the U.S. Post Office Department, the Federal Bureau of Investigation, parole and probation officials, State securities authorities, Federal and State prosecuting attorneys, police officers, better business bureaus, chambers of commerce and other agencies. At the end of the fiscal year these records contained information concerning 76,399 persons against whom Federal or State action had been taken in connection with securities violations. In keeping these records current, there were added during the fiscal year items of information concerning 13,281 persons, including 4,651 persons not previously identified in these records.

The section issues and distributes quarterly a securities violations bulletin containing information received during the period concerning violators and showing new charges and developments in pending cases. The bulletin includes a "wanted" section listing the names and references to bulletins containing descriptive information as to persons wanted

on securities violations charges. The bulletin is distributed to a limited number of officials of cooperating law enforcement and other agencies in the United States and Canada.

Extensive use is made of the information available in these records by regulatory and law enforcing officials. Numerous requests are received each year for special reports on individuals in addition to the information supplied by regular distribution of the quarterly bulletin. All available information is supplied in response to inquiries from law enforcement agencies. During the fiscal year the Commission received and disposed of 3,216 "securities violations" letters or reports and dispatched 812 communications to cooperating agencies.

APPLICATION FOR NONDISCLOSURE OF CERTAIN INFORMATION

The Commission is authorized under the various acts administered by it to grant requests for nondisclosure of certain types of information which would otherwise be disclosed to the public in applications, reports or other documents filed pursuant to these statutes. Thus, under paragraph (30) of schedule A of the Securities Act of 1933, disclosure of any portion of a material contract is not required if the Commission determines that such disclosure would impair the value of the contract and is not necessary for the protection of investors. Under section 24 (a) of the Securities Exchange Act of 1934, trade secrets or processes need not be disclosed in any material filed with the Commission. Under section 24 (b) of that act written objection to public disclosure of information contained in any material filed with the Commission may be made to the Commission which is then authorized to make public disclosure of such information only if in its judgment such disclosure is in the public interest. Similar provisions are contained in section 22 of the Public Utility Holding Company Act of 1935 and in section 45 of the Investment Company Act of 1940. These statutory provisions have been implemented by rules specifying the procedure to be followed by applicants seeking a determination that public disclosure is not necessary in a particular case.

[table omitted]

ACTIVITIES OF THE COMMISSION IN ACCOUNTING AND AUDITING

The several acts administered by the Commission recognize the importance of dependable informative financial statements which disclose the financial status and earnings history of a corporation or other commercial entity. These statements, whether filed in compliance with the requirements under those statutes or included in other material available to stockholders or prospective investors, are indispensable to investors as a basis for investment decisions. The Congress, cognizant of the fact that such statements lend themselves readily to misleading inferences or even deception, whether or not intended, included express provisions with respect to disclosure requirements.

Thus, for example, the Securities Act requires the inclusion in the prospectus of balance sheets and profit and loss statements "in such form as the Commission shall prescribe" and authorizes the Commission to prescribe the "items or details to be shown in the balance sheet and earnings statement, and the methods to be followed in the preparation of accounts * * *." Similar authority is contained in the Securities Exchange Act, and even more comprehensive power is embodied in the Investment Company Act and the Public Utility Holding Company Act.

Pursuant to the broad rule-making power thus conferred with respect to the preparation and presentation of financial statements, the Commission has prescribed uniform systems of accounts for companies subject to the Holding Company Act; has adopted rules under the Securities Exchange Act governing accounting and auditing of securities brokers and dealers; and has promulgated rules contained in a single, comprehensive regulation, identified as regulation S-X, which govern the form and content of financial statements filed in compliance with the several acts. This regulation is implemented by the Commission's Accounting Series Releases, of which 89 have so far been issued. These releases were inaugurated in 1937 and were designed as a program for making public, from time to time, opinions on accounting principles for the purpose of contributing to the development of uniform standards and practice in major accounting questions. 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 such rules, the Commission's principal means of protecting investors from inadequate financial reporting, fraudulent practices and overreaching by management under the various acts is by requiring the report of an independent public accountant which is based on auditing standards and prepared in accordance with accounting principles and practices which are recognized as sound and which have attained general acceptance.

The Securities Act provides that the financial statements required to be made available to the public through filing with the Commission shall be certified by "an independent public or certified accountant." The other three statutes permit the Commission to require that such statements be accompanied by a certificate of an independent public accountant, and the Commission's rules require, with minor exceptions, that they be so certified. The value of certification by qualified accountants has been conceded for many years, but the requirement as to independence, long recognized and adhered to by some individual accountants, was for the first time authoritatively and explicitly introduced into law in 1933. The Commission's rules are designed to accept accountants qualified to practice in their own State as qualified to practice before the Commission unless they have entered into disqualifying relationships with a particular client, such as becoming a promoter, underwriter, voting trustee, director, officer, employee, or stockholder; or, in rare cases, have demonstrated incompetence, subservience to the management, or have engaged in unethical and improper professional conduct. The Commission has worked along these lines to encourage and foster an independent state of mind of the accountant with respect

to his dealings with his client so that he may better be able to perform the service to the public contemplated by the Congress in the various acts.

The Commission is vigilant in its efforts to assure itself that the audits which it requires are performed by independent accountants; that the information contained in the financial reports represents full and fair disclosure and that appropriate auditing and accounting practices and standards have been followed in their preparation. In addition it recognizes that changes and new developments in financial and economic conditions affect the operations and financial status of the several thousand commercial and industrial companies required to file statements with the Commission and that accounting and auditing procedures cannot remain static and continue to serve well a dynamic economy. The Commission's accounting staff, therefore, studies the changes and new developments for the purpose of establishing and maintaining appropriate accounting and auditing policies, procedures and practices for the protection of investors. The primary responsibility for this program rests with the Chief Accountant of the Commission, who has general supervision with respect to accounting and auditing policies and their application.

Progress in these activities requires continuing contact and consultation between the staff and accountants both individually and through such representative groups as, among others, the American Accounting Association, the American Institute of Certified Public Accountants, the American Petroleum Institute, the Controllers Institute of America, the National Association of Railroad and Utilities Commissioners, and the National Federation of Financial Analysts Societies, as well as other Government agencies. Recognizing the importance of cooperation in the formulation of accounting principles and practices, adequate disclosure and auditing procedures which will best serve the interests of investors, the American Institute of Certified Public Accountants, the Controllers Institute of America, and the National Federation of Financial Analysts Societies appoint committees which maintain liaison with the Commission's staff. The Commission on its part has authorized its Chief Accountant to continue to serve as a member of an advisory committee to the accounting principles board of the American Institute of Certified Public Accountants.

The many daily decisions of the Commission require the almost constant attention of some of the Chief Accountant's staff. These include questions raised by each of the operating divisions of the Commission, the regional offices and the Commission. As a result of this day-to-day activity of the Commission and the need to keep abreast of current accounting problems, the Chief Accountant's staff spends much time in the examination and reexamination of sound and generally accepted accounting and auditing principles and practices. From time to time members of the staff are called upon to assist in field investigations, to participate in hearings and to review opinions insofar as they pertain to accounting matters.

Profiling and other conferences, in person or by telephone, with officials of corporations, practicing accountants and others occupy a considerable amount of the available time of the staff. This procedure, which has proven to be one of the most important functions of the Office of the Chief Accountant and of the Chief Accountant of the Division of Corporation Finance and his staff, saves registrants and their representatives both time and expense.

Many specific accounting and auditing problems arise as a result of the examination of financial statements required to be filed with the Commission. Where examination reveals that the rules and regulations of the Commission have not been complied with or that applicable generally accepted accounting principles have not been adhered to, the Examining Division usually notifies the registrant by an informal letter of comment. These letters of comment and the correspondence or conferences that follow continue to be a most convenient and satisfactory method of effecting corrections and improvements in financial statements, both to registrants and to the Commission's staff. Where particularly difficult or novel questions arise which cannot be settled by the accounting staff of the divisions and by the Chief Accountant, they are referred to the Commission for consideration and decision. By these administrative procedures the Commission deals with many accounting questions.

These procedures are particularly applicable to the problems which arise in connection with initial filings made by new corporate entities and by corporations whose securities had been closely held or traded over the counter. Currently there are many such filings being made by companies whose business is closely associated with rapidly growing technological and scientific developments and with our expanding population, as in real estate and recreational activities.

Some of the problems frequently causing difficulty arise because audits made in prior years did not measure up to generally accepted standards, particularly in that they often omitted accepted-audit procedures with respect to inventories and receivables. These procedures require observation of inventories and confirmation of receivables where either of these assets represents a significant proportion of the current assets or of the total assets of a concern. Failure to apply them where they are practicable and reasonable generally precludes expression of an opinion on the fairness of the financial statements taken as a whole because the income, earned surplus, and the current position may be materially affected. If the auditor finds himself faced with such a situation, he must satisfy himself as to inventories for prior years by appropriate methods. In some instances this is very difficult and may preclude certification because the client may not have taken an inventory at any prior yearend or because inventory records for such years are incomplete or because such records may have been destroyed.

Other difficulties often arise in connection with the initial filings of such companies because accountants and other advisers serving them have not had any prior dealing with the Commission. In some cases these persons have not familiarized themselves with the

rules and regulations of the Commission -- particularly the instructions as to financial statements required by the forms, the rules relating to independence of the certifying accountant, and those relating to the form and content of financial statements set forth in regulation S-X.

During the fiscal year the Chief Accountant and his staff cooperated with other divisions of the Commission in the preparation of proposals to amend articles 7 and 12 of regulation S-X governing the form and content of financial statements and schedules filed by insurance companies other than life and title insurance companies; to amend form 10-K and regulation S-X setting forth the disclosures and financial statements required by employee stock purchase, savings or similar plans; and for a new form for the registration of securities of certain real estate companies. The revision of articles 7 and 12 of regulation S-X was adopted July 26, 1961. This revision reflects changes in requirements of the annual statement filed with State regulatory authorities and developments in insurance reporting since these articles were originally adopted.

As a result of the reluctance on the part of independent public accountants to express an opinion in respect of the financial statements included in the annual statement and the accounting principles and practices reflected therein as required by rule 2-02 (c) of regulation S-X without taking exception to certain insurance accounting practices, there has grown up the practice of reconciling the statutory capital share equity and net income or loss with capital share equity and net income or loss as determined in accordance with generally accepted accounting principles and practices. Special note 2 of rule 7-05 gives recognition to this practice where such differences are deemed to be material, the principal differences being in the accounting for nonadmitted assets and commissions and expenses incurred in writing insurance.

With respect to commission and expenses written off it has been the practice to add back such expenses only to the extent of increase in equity in unearned premiums, less Federal income tax effect, which can be supported by reliable loss and expense ratios. Comparable conservative practices are followed in making the other adjustments.

The Chief Accountant's office also cooperated with other divisions of the Commission in the preparation of a rule under the Investment Advisers Act of 1940 which requires investment advisers subject to registration with the Commission to maintain specified books and records relating to their business. This rule as adopted by the Commission became effective July 1, 1961.

Early in 1959 the Commission issued its findings, opinion, and order pursuant to rule II (e) of the Commission's Rules of Practice denying to Theodore Bollt, formerly a partner in Bollt & Shapiro, a firm of certified public accountants, now dissolved, who was found to have engaged in unethical and improper professional conduct, the privilege of practicing before the Commission until he obtained the approval of the Commission.

Late in 1960 Bollt filed a petition for reinstatement of his privilege of practicing before the Commission.

In his petition Bollt represented, among other things, that his professional and business reputation had not been impugned prior to the Commission's proceedings; that on the basis of the Commission's findings against him he was suspended from membership in the American Institute of Certified Public Accountants for a period of 6 months, which period of suspension has expired; that although he was no longer engaged in the practice of public accounting, and had no intention of actively practicing as an accountant before the Commission, the issuance and continuance of the Commission's suspension order of January 28, 1959, and the widespread publicity received by it had severely adversely affected his business and professional standing; and that the further continuance of such order was not necessary or appropriate in the public interest.

The Commission considered the representations set forth in the petition and, being satisfied that under all the circumstances it would not be inconsistent with the public interest, early in 1961 it terminated its order denying Bollt the privilege of practicing before the Commission.

During the fiscal year the Commission issued its findings, opinion, and order in a proceeding instituted under rule 2 (e) of its rules of practice against Myron Swartz, a certified public accountant. The Commission found that the respondent had made it possible for false and misleading financial statements and certificates to be circulated on his stationery over his signature and, thereafter, without disclosing the falsity of such statements, continued to perform accounting services, including the preparation of incorrect and misleading statements for filing with the Commission. The Commission found also that in a subsequent Commission investigation respondent testified falsely with respect to certain of the matters referred to above. The Commission concluded that, in view of the gravity of the misconduct in the case before it and in view of the high standard of honesty and professional conduct the Commission must demand of accountants and others practicing before it if it is to fulfill its responsibility to protect the public interest, Swartz should be denied the privilege of practicing before the Commission in the future.

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

Section 15 of the Bretton Woods Agreements Act, as amended, exempts from registration under both the Securities Act of 1933 and the Securities Exchange Act of 1934 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 shall determine 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 the above 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 Council 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.

During the fiscal year ending June 30, 1961, the Bank made 27 loans totaling the equivalent of \$610 million, compared with a total of \$659 million last year. The loans were made in Argentina, British Guiana, Burma, Ceylon, Chile, Colombia (2 loans), Costa Rica, El Salvador, India (2 loans), Israel, Japan (4 loans), Mexico (2 loans), Norway, Pakistan (2 loans), Panama, Peru, Sudan, Thailand, Uganda, and Yugoslavia. This brought the gross total of loan commitments at June 30 to \$5,790.5 million. By June 30, as a result of cancellations, repayments and sales of loans, the portions of loans signed still retained by the bank had been reduced to \$4,217.2 million.

During the year the Bank sold or agreed to sell \$202 million principal amount of loans, all without its guarantee. On June 30 the total sales of loans amounted to \$1,013 million, of which \$69 million was with the Bank's guarantee.

The outstanding funded debt of the Bank amounted to \$2,228 million on June 30, 1961, reflecting a net increase of \$155.4 million over the past year. In this period there was a gross increase in borrowings of \$837.6 million consisting of three public bond issues, two in Swiss francs equivalent to \$37. million and one in Netherlands guilders equivalent to \$13.2 million; the private placement of bonds and notes equivalent to \$736 million, partly to raise new funds and partly as refunding operations (\$508 million in U.S. dollars, \$220. million in deutsche marks and \$7.1 million in Swiss francs); the delivery of \$14.6 million of dollar bonds and \$23.4 million in deutsche mark notes of issues sold previously subject to delayed delivery arrangements and \$12.1 million equivalent which was added to the funded debt as a result of the revaluation of outstanding Netherlands guilder, Canadian dollar, and deutsche mark bonds and notes. An amount of \$182.5 million of the U.S. dollar and deutsche mark borrowings in the fiscal year had not been drawn down at June 30, 1961. The funded debt was decreased by \$499.7 million as a result of the maturing of \$15 million of bonds and notes; sinking fund and purchase fund transactions amounting to \$18.1 million; and the refunding of privately placed issues equivalent to \$466 million.

Pursuant to the increase in the authorized capital of the Bank from \$10 billion to \$21 billion on September 15, 1959, 62 members have doubled their subscriptions and 29 members have subscribed to \$1,396.5 million in addition to their 100 percent increases. During the fiscal year, Cuba and the Dominican Republic withdrew from membership and Portugal and Nigeria became members of the Bank with capital subscriptions of \$80 million and \$66.4 million, respectively, making total membership 68. The subscribed capital of the Bank amounted to \$20.093 billion on June 30, 1961.

INTER-AMERICAN DEVELOPMENT BANK

The Inter-American Development Bank Act, which authorizes the United States to participate in the new Inter-American Development Bank, provides an exemption for certain securities which may be issued by the Bank similar to the exemption provided for securities of the International Bank for Reconstruction and Development. Acting pursuant to this authority, the Commission, during the fiscal year, 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 Bank is also required to file a report with the Commission prior to the sale of any of its primary obligations to the public in the United States. Up to June 30, 1961, no such sales had been made.

The first meeting of the Board of Governors of the Bank took place in February 1960, and the Bank officially commenced operations on October 1, 1960. As of June 30, 1961, the Bank had approved loans from its ordinary capital totaling \$4,700,000 to borrowers located in Brazil. As of that date additional applications for loans from ordinary capital were pending in the amount of \$36,189,974 from applicants located in Brazil, Chile, Colombia, El Salvador, Guatemala, Honduras, Nicaragua, Peru, and Venezuela. In addition, loans from the Bank's Fund for Special Operations had been made in Bolivia in the total amount of \$10 million. Additional loans from the fund for special operations were pending in the amount of \$19,150,000 with respect to borrowers in Brazil, Haiti, Honduras, and Paraguay.

STATISTICS AND SPECIAL STUDIES

During the past fiscal year the Branch of Economic Research continued its regular work in connection with the statistical activities of the Commission and the overall Government statistical program under the direction of the Office of Statistical Standards, Bureau of the Budget. In addition, the Branch of Exchange Regulation continued its compilation of data on the stock market.

The statistical series described below are published in the Commission's Statistical Bulletin and in addition, except for data on registered issues and on the stock market, current figures and analyses of the data are published in quarterly press releases.

Issues Registered Under the Securities Act of 1933

Monthly and quarterly statistics are compiled on the number and volume of registered securities, classified by industry of issuer, type of security, and use of proceeds.

Summary statistics for the years 1935-61 are given in appendix table 1 and detailed statistics for the fiscal year 1961 appear in appendix table 2.

New Securities Offerings

This is a monthly and quarterly series 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 railroad securities. The offerings series includes only securities actually offered for cash sale, and only issues offered for account of issuers. Annual statistics on new offerings for recent years as well as monthly figures from January 1960 through June 1961 are given in appendix tables 3, 4, and 5.

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

Individuals' Saving

The Commission compiles quarterly estimates of the volume and composition of individuals' saving in the United States. The series represents net increases in individuals' financial assets less net increases in debt. The study shows the aggregate amount of saving and the form in which the saving occurred, such as investment in securities, expansion of bank deposits, increase in insurance and pension reserves, etc. A reconciliation of the Commission's estimates with the personal saving estimates of the Department of Commerce, derived in connection with its national income series, is published annually by the Department of Commerce as well as in the Securities and Exchange Commission Statistical Bulletin.

Corporate Pension Funds

An annual survey is made of pension plans of all United States corporations where funds are administered by corporations themselves, or through trustees. The survey shows 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.

Financial Position of Corporations

The series on working capital position of all U.S. corporations, excluding banks, insurance 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 Commission, 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. Shortly after the close of each quarter, data are released on actual 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.

Stock Market Data

The Branch of Exchange Regulation 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 exchanges for accounts of members and nonmembers, odd-lot stock transactions on the New York exchanges, special offerings, and secondary distributions. It also computes indexes of stock market prices each week based upon the closing market prices of common stocks listed on the New York Stock Exchange. This stock price index and data on round-lot and odd-lot trading on the two New York exchanges are released weekly. The other statistical data mentioned above, as well as these weekly series, are published regularly in the Commission's Statistical Bulletin.

During the fiscal year, the Commission revised its stock price index to conform with the recommendation of the Office of Statistical Standards that all Government indexes be compiled on a uniform and recent base period where feasible. There were two major changes in the stock price index: (1) The base period was changed to the years 1957-59 from the former base year of 1939; and (2) the coverage was expanded to include 32 industry classifications and 300 stocks, in place of 29 groups covering 265 issues. Weekly indexes were computed on the new base back to January 1939. The Commission published a pamphlet containing the revised indexes, a description of the method of computation, and a list of stocks included in the indexes.

OPINIONS OF THE COMMISSION

The Commission issues opinions in contested and other cases arising under the statutes administered by it and under the Commission's rules of practice, where the nature of the

matter to be decided, whether substantive or procedural, is of sufficient importance to warrant a formal expression of views. These opinions include detailed findings of fact and conclusions of law based on evidentiary records taken before a hearing examiner who serves independently of the operating-divisions, or, in an occasional case, before a single Commissioner or the entire Commission. In some cases, formal hearings are waived by the parties and the findings and conclusions are based on stipulated facts or admissions.

The Commission, as well as individual Commissioners to whom particular cases may be assigned for the preparation of an opinion, is assisted in the preparation of findings and opinions by its Office of Opinion Writing, a staff office completely independent of the operating divisions of the Commission and directly responsible to the Commission itself. The independence of the staff members reflects the principle, embodied in the Administrative Procedure Act, of a separation between staff members performing investigatory or prosecutory functions and those performing quasi-judicial functions. In some cases, with the consent of all parties, the interested operating division assists in the drafting of opinions.

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

During the fiscal year 1961, the Commission issued 167 opinions and other rulings of an adjudicatory nature.

DISSEMINATION OF INFORMATION

The objective of the laws administered by the Commission of providing public disclosure of pertinent financial and other information concerning securities offered for public sale and those traded on exchanges so that they may be realistically evaluated by the investing public, is furthered by various activities of the Commission which facilitate the dissemination of such information. This is accomplished in part, of course, through the requirements of the law and Commission rules for the distribution of the prospectus or offering circular on new offerings and the filing of annual and other periodic reports. All registration statements and reports are available for public inspection. Much of the data also is reprinted and receives general circulation through published securities manuals, investment advisory services and statistical services, which are reference material for securities analysts and investment advisers.

To facilitate public dissemination of the financial and other proposals filed with and actions taken by it, the Commission issues a daily News Digest containing a resume of these filings and actions. The Digest is distributed daily to the press; and it also is

distributed on a daily, subscription basis through the Government Printing Office (1,195 copies) and on a weekly basis by the Commission to a mailing list comprising the names of over 11,000 individuals and firms. Included in the Digests issued during the year were summary reports on the 1,674 registration statements filed during the year (not including amendments pursuant to section 24 (e) of the Investment Company Act) which proposed the public offering of \$16. billion of securities. Also included were resumes of the 1,302 notices, orders, decisions, rules, and other announcements issued by the Commission. Much of the information is published in the daily press and in financial and other periodicals. The texts of the Commission's pronouncements are available to the press and given more limited distribution to registrants, practicing lawyers, and others.

Members of the Commission and its staff frequently deliver addresses before professional, business, and other groups, and participate in "briefing" and other conferences in order to explain the Commission's functions and activities, explain important rules and policies, and otherwise contribute to a better understanding by individuals and firms subject to its jurisdiction as well as the investing public of the role of the Commission.

Information Available for Public Inspection

The many thousands of registration statements, applications, declarations, and annual and other periodic reports filed each year are available for public inspection at the Commission's principal office in Washington, D.C. In addition, copies of recent reports filed by companies having securities listed on exchanges other than the New York Stock Exchange and the American Stock Exchange, and copies of current reports of many nonlisted companies which have registered securities for public offering under the Securities Act, may be examined in the Commission's New York regional office; and recent reports filed by companies whose securities are listed on the New York and American Stock Exchanges may be examined in the Commission's Chicago regional office. Moreover, there are available for examination in all regional offices copies of prospectuses relating to recent public offerings of securities registered under the Securities Act; and all regional offices have copies of broker-dealer and investment adviser registration applications, broker-dealer annual financial reports and regulation A letters of notification filed in their respective regions. Reports of companies whose securities are listed on the various exchanges may be seen <at their respective offices.

Photocopies of reports or portions thereof and other material in the public files of the Commission may be obtained upon request directed to the Commission's public reference room in Washington. The charge per page for photocopies varies from 15 cents to 50 cents depending upon the size of the page being copied. A minimum charge of \$1 is made for less than seven pages (legal size). The charge for each certification of any such document by the Commission is \$2. Each year many thousands of requests for photocopies of and information from the public files of the Commission are received by the public reference room in Washington, D.C. During the year 5,848 persons examined

material on file in the Washington office, and several thousand others examined files in the New York and Chicago regional offices. About 210,251 photocopy pages were sold pursuant to 3,444 individual orders,

PUBLICATIONS

Publications currently being issued include:

Weekly:

Index of Weekly Closing Prices.

Monthly:

Statistical Bulletin.

Official Summary of Security Transactions and Holdings of Officers, Directors, and Principal Stockholders.

Quarterly:

Financial Report, U.S. Manufacturing Corporations (jointly with the Federal Trade Commission).

Plant and Equipment Expenditures of U.S. Corporations (jointly with the Department of Commerce).

New Securities Offered for Cash.

Volume and Composition of Individual's Saving.

Working Capital of U.S. Corporations.

Annually:

Annual Report of the Commission.

Securities Traded on Exchanges under the Securities Exchange Act of 1934.

Companies Registered under the Investment Company Act of 1940.

Corporate Pension Funds.

Directory of Companies Filing Annual Reports.

Other publications:

Decisions and Reports of the Commission.

The Work of the Securities and Exchange Commission.

ORGANIZATION

The Commission's staff consists of attorneys, security analysts, accountants, engineers, investigators, and administrative and clerical personnel.

The following organizational changes have been made since June 30, 1960, in accordance with the Commission's policy of continuing review of its organization and functional alignments:

In August 1960, the Commission established an additional Branch of Investigations and an additional Branch of Enforcement in the New York regional office. This action was designed to permit improved utilization of available personnel for the mounting workload of cases requiring investigative and enforcement action and for the regulation A, corporate reorganization and interpretative functions of the New York regional office.

In November 1960, the position of Adviser to the Commission was abolished and the functions were transferred to other staff officials.

In June 1961, the positions of Executive Director and Associate Executive Director were abolished and certain functions thereof were delegated to other members of the staff.

In August 1961, the Commission established three additional Branches of Corporate Analysis and Examination in the Division of Corporation Finance to handle the increased volume of filings on proposed new financing under the Securities Act of 1933.

In October 1961, the Commission established a special study of securities markets to conduct the study and investigation of the adequacy of the rules of the national securities exchanges and national securities associations provided for by Public Law 87-196, dated September 5, 1961.

Also in October 1961, the Commission established two new branches, the Branch of Special Investigations, Trial and Enforcement, and the Branch of Criminal References, in the Division of Trading and Exchanges. This action was designed to consolidate in one division the Commission's investigation and enforcement activities in the headquarters

office and to contribute to more effective coordination of such activities in the several regional offices.

PERSONNEL, BUDGET, AND FINANCE

In fiscal 1961, the Commission continued its efforts to recruit outstanding college and law school students with the specialized academic training required for its fields of work. Recruitment brochures covering specific positions were prepared and articles in the recruiting literature published by the Civil Service Commission updated. Close contacts with placement officers and finance and law professors of various colleges and law schools enabled the Commission to hire a number of high-caliber recent finance and law graduates to fill positions at the entrance levels.

Early in the fiscal year, an attorney honors program was adopted, aimed directly at those law school graduates whose academic achievements, special training and career objectives indicated an unusual suitability for the work involved in carrying out the objectives of the Federal securities laws. On June 19, 1961, hiring procedures for filling attorney positions were further revised to provide for giving an examination to those candidates who, on initial review and evaluation of their applications, are considered to be well qualified for employment on the Commission's staff.

The Federal service entrance examination conducted by the U.S. Civil Service Commission continues to be an excellent source of supply for the filling of competitive positions at the GS-5 and GS-7 levels, particularly in the financial analyst category. Appointments also are made from the lists of eligibles established under this examination to investigator (trainee) and other professional job categories at the entrance levels.

Training activities in fiscal 1961 were conducted in accordance with the Commission's basic policies of (1) training employees to do their work more efficiently and effectively, (2) stimulating and encouraging employee self-development and self-training to the fullest extent and (3) affording equal opportunities for development. Supervisory officials were enrolled in a special training course for middle and top management officials. Professional training, though largely on the job, was supplemented by special critique and instructional sessions to meet identifiable needs. For example, in the Denver regional office, new attorneys and investigators attended sessions conducted by the regional administrator and senior officials on special aspects of gathering evidence and developing securities fraud cases. In Washington, a briefing conference on securities laws and regulations, which was sponsored by the Federal Bar Association and in which members of the Commission and top officials participated, served an additional purpose of training junior and intermediate staff members, who were selected to attend at no cost to the Commission those sessions particularly pertinent to their work.

The average grade level of positions in the Commission in fiscal 1961 was GS-8. compared with GS-8. for 1960. Approximately 200 positions were studied and grades substantiated or adjusted. Proper grade allocations for its top-level positions continue to be of utmost importance to the Commission for the effective execution of its programs. In the interest of attracting and retaining highly qualified persons for these positions, continuous efforts are being made to obtain favorable consideration of recommendations, heretofore submitted to the Civil Service Commission, to place these positions in grades GS-16, GS-17 and GS-18 as spaces become available.

A total of 955 employees were eligible to enroll in the Federal employees health benefits program which went into effect on July 10, 1960. Of this number 845, or 89 percent, elected to enroll in health plans offered under the program. Sixty percent selected the service (Blue Cross) plan, 32 percent the indemnity (Aetna Life Insurance Co.) plan and 8 percent local comprehensive medical plans. Ninety-three percent of the employees enrolling in plans chose the high option.

In its sixth annual service and merit awards ceremony held in October 1960, the Commission for the first time gave formal recognition to those members of the staff whose term of service included time completed in other Federal agencies. The length-of-service emblem pin used by various Federal agencies was adopted. In addition, new 15-year and 25-year SEC service pins now make it possible to reward length of service with the Commission at 5-year intervals commencing with the completion of 10 years. Pins covering total Federal service were awarded to 3 employees for 40 years, 7 employees for 35 years and 16 employees for 30 years, Fifty-five employees received pins for 25 years of SEC service, Cash awards totaling \$6,800 and certificates of merit were presented to 54 employees and 13 employees received a total of \$395 for suggestions adopted during the fiscal year.

During the fiscal year, the outstanding achievements of members of the Commission's staff received further public recognition in the form of awards made by other organizations. On March 21, 1960, Manuel F. Cohen, Director, Division of Corporation Finance, was 1 of 10 employees throughout the Federal service to receive a Career Service Award presented by the National Civil Service League annually, Mr. Cohen was selected on the basis of a "record of Federal service exemplifying outstanding qualities of technical competence and efficiency, and personal and intellectual integrity of the highest order." On May 20, 1961, the Federal Government Accountants Association presented its first National Award for Distinguished Leadership to Andrew Barr, Chief Accountant of the Commission. Mr. Barr received his award "for distinguished leadership in formulating and administering financial requirements placed upon the business community under the laws administered by the Securities and Exchange Commission."

In February 1961, Magdalen B. Murphy, attorney-adviser, and Helen K. Steiner, analytical statistician, both on the staff of the Division of Trading and Exchanges, were

presented citations in recognition of their contributions to the public service and to the prestige of women employees in the Federal Government.

The trustees of the William A. Jump Memorial Foundation in May 1961 presented Andrew N. Grass, Jr., a chief enforcement attorney in the New York regional office, a certificate and citation in recognition of his exemplary accomplishments and special contributions to the efficiency and prestige of the public service.

The Commission is justifiably proud of the devoted, conscientious, and competent service rendered by its staff. Public recognition is an essential factor in building and maintaining the prestige of public careers and awards of this nature serve to improve the quality of public administration and the morale and public service motivations of Federal employees.

The following comparative table shows the personnel strength of the Commission as of June 30, 1960 and 1961:

[table omitted]

The Commission is required by law to collect fees for registration of securities issued, qualification of trust indentures, registration of exchanges, and sale of copies of documents filed with the Commission.

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 1959, 1960, and 1961:

[table omitted]