

SECURITIES AND EXCHANGE COMMISSION

Report by
The Executive Director and the General Counsel
on
Cooperation by Commission Employees with State Governments
In connection with State Securities Legislation

JUN 12 1959

In April of this year Congresswoman Pfof asked the Chairman to inquire into a complaint by one of her constituents that employees of this Commission were "lobbying" for State securities legislation in a Western State subsequently identified as the State of Montana. We have been advised further that certain other members of the Congress have received complaints that Commission employees have been lobbying for State securities legislation in various State legislatures in the West.

We have communicated with Messrs. Pennekamp and Newton and searched the Commission's files for instances where members of the Commission's staff have cooperated with State officials on legislative matters. The following analysis and report is submitted for your information.

THE COMMISSION'S POLICY OF COOPERATION WITH THE STATES

The principal of Federal-State cooperation in the area of securities regulation antedates the passage of the Securities Act of 1933 and the establishment of the Securities and Exchange Commission in 1934.

For example, in its report of January 31, 1924 the Committee on Interstate and Foreign Commerce, U.S. House of Representatives, stated in part that:

"... Practically all of the States have effective laws to prevent the sale of fraudulent and worthless securities within their own boundaries. But the United States mails and the other agencies of interstate commerce, over which the Federal Government is by the Constitution given exclusive control, are being used by dishonest promoters to violate, evade, and to a large extent nullify these laws which the States have enacted for the protection of their citizens. And as a result the people are being defrauded of hundreds of millions of dollars annually.

"The securities officials of the different States are now appealing to Congress for Federal legislation to help suppress this national evil.

“And since the Federal agencies -- the mails and other agencies of interstate commerce -- are being used to violate, evade and practically nullify the State securities laws, the Federal Government ought to cooperate with the several States to the extent of preventing the use of its agencies for promoting the sale of fraudulent securities in the different States contrary to the laws of such States.”¹

The Securities and Exchange Commission always has followed the policy of cooperating with the States and State agencies in areas of mutual concern. References to this policy, for example, are made in the Commission’s Second and Seventh Annual Reports to the Congress for the fiscal years ended June 30, 1936 and June 30, 1941, respectively. In addressing the 1940 annual convention of the National Association of Railroad and Utilities Commissioners, a former Member of the Commission stated the policy this way: “I want to impress upon you that our entire utility program is so designed that we may -- as we do -- work in close cooperation with the State commissions. Under the provisions of the Holding Company Act, State commissions have an express right to intervene in any SEC proceeding affecting them. The Holding Company Act, as much I think as any other Federal act, contemplated Federal-State cooperation. For example, in Section 18(b) of the Act there is provided an over-all authorization for SEC-State commission cooperation. There it is said that the SEC upon the request of a State commission may ‘investigate, or obtain any information regarding the business, financial condition, or practices of any registered holding company or subsidiary company thereof or facts, conditions, practices or matters affecting the relations between any such company and any other company and companies in the same holding company system’. We at the SEC are happy indeed to use our facilities to aid State commissions in carrying out their important duties in connection with the regulation of public utilities operating within their respective States. We hope that more and more the State commissions will call upon us for aid wherever, because of inadequate facilities and limited powers over extra-State matters, they find themselves handicapped. We, in turn, have similarly profited immeasurably from our close relations with the State commissions.”

In testifying before a Subcommittee of the House Committee on Interstate and Foreign Commerce on January 11, 1952, on the administration of the Public Utility Holding Company Act of 1935, a former Member of the Commission expressed the policy as follows:

“The Commission is acutely aware of the manner in which its work complements that of the State commissions and has endeavored to cooperate to the fullest degree with them in the protection of consumers as well as investors. Several sections of the Act are designed to prevent overlapping of SEC regulation with that of local bodies, and where there is concurrent jurisdiction the Commission endeavors to coordinate its work with that of the State bodies. The Commission has also undertaken, pursuant to section 18, several investigations of financial or business practices of registered companies and their subsidiaries at the request of State commissions.”

¹ Report No. 132, 68th Congress, 1st Session

The policy has been implemented in many other ways. For example, in September, 1953, the Commission issued a policy memorandum authorizing its Regional Administrators to turn over to State authorities certain cases being investigated by the Commission in which the facts developed indicated an offense more readily provable as a violation of State law than as a violation of any statute administered by the Commission. In October, 1957, this policy was restated in order further to facilitate cooperation with State agencies as well as with other Federal and Canadian enforcement agencies.

Since its early days the Commission has maintained a cooperative relationship with the National Association of Securities Administrators, presently known as the North American Securities Administrators. This is an association consisting of members from the North American countries who are administrators or other officials vested by law with the authority to administer the regulation or supervision of the commerce of securities. The purpose of the Association is to support and enforce, through cooperation, securities regulation for the prevention or suppression of fraud in the commerce of securities and further to promote the public and investor interest in the sale of securities. No Member of the Securities and Exchange Commission is a member of the Association. The Commission, however, cooperates with the Association and its members in areas of mutual concern for investor protection. Beginning in 1935 and consistently over the years the Commission has authorized its members or staff representatives to attend and frequently to address on subjects of mutual concern the meetings and conventions of this Association; and for several years the Association has maintained a SEC Liaison Committee.

ASSISTANCE RENDERED TO STATE AGENCIES ON LEGISLATIVE MATTERS

As a consequence of the cooperation between the Commission and the States in enforcement activities under the Federal and State securities laws, the views and broad experience of the Commission's staff have been sought with reference to development of amendments to, or revisions of, State securities laws. In response to such requests members of the Commission's staff have consulted with and otherwise assisted State officials. The following examples are illustrative of this type of cooperation with certain Midwestern as well as Western States.

Arizona

In September, 1949, the Director of the Securities Division of the State of Arizona informed the Commission that he considered the Arizona Blue Sky Law inadequate and requested the Commission's assistance in drafting an entirely new statute. A draft bill was submitted to the Commission for comment and suggestions, and subsequently a member of the Commission staff assisted the Director in a comprehensive revision of the bill. At the further request of the Director, the provisions of the bill and the manner in which it was correlated to the Federal securities laws were explained to representatives of the securities industry and other interested groups. Also numerous conferences were held with the Attorney-General and the

Chairman of the Committee on Banking and Insurance but no appearances were made at any legislative hearings.

The bill was presented to the Arizona legislature during the session which began in January, 1951, and was enacted into law with only one dissenting vote in one chamber and none in the other.

California

The Commissioner of Corporations of the State of California requested comments on the probable effectiveness of the new rules appearing in Article 38 of Title X of the California Administrative Code as to investment contracts involving the sale of notes secured by liens on real estate. Comments and suggestions, based on the Commission's experience in such matters, were submitted to the Commissioner in February, 1959.

Montana

In March, 1956, the Governor of Montana and the State Auditor and Securities Commissioner requested the Commission's assistance in connection with amendments to the Montana Securities Act. By specific request, a member of the Commission's staff assisted the State Auditor and Investment Commissioner in drafting the proposed amendments. Also by request, he appeared before the Judiciary Committees of the Montana House and Senate for the purpose of furnishing facts as to certain illustrative cases which had been prosecuted for violations of the anti-fraud provisions of the Federal Securities Act of 1933. The bill was not passed by the Montana legislature.

In December, 1958, at the further request of the State Auditor and Securities Commissioner, discussions were had with representatives of his office regarding the proposed securities law. Discussions also were had with the two North American Securities Administrators from Montana, as well as with the Governor of Montana and his Executive Assistant.

In January, 1959, again at the request of the Governor, the member of the Commission's staff appeared before the Judiciary Committees of the Montana House and Senate for the purpose of presenting factual data. The proposed securities law passed the Montana House of Representatives but failed to pass the Senate.

Washington

The Commission's assistance to the Securities Department of the State of Washington commenced as early as 1942. In answer to a request of the State Securities Commissioner, a number of amendments to the Washington securities act were suggested. Similar assistance was rendered during the next several legislative sessions. No appearances before State legislative committees were involved.

In April, 1958, the Director of the Department of Licenses of the State of Washington requested a member of the Commission's staff to serve as a consultant member of an advisory committee to assist the Department on legislation pertaining to the Blue Sky Law. The Committee held numerous meetings, including several at which representatives of the State Securities Department were present. No appearances before legislative committees were involved.

The new Washington securities law has been enacted, and became effective June 11, 1959.

Idaho

In 1953 the President and Secretary of the Idaho Mining Association appointed a committee to cooperate with appropriate State officials in making a study of the Idaho Blue Sky Law for the purpose of suggesting to the Idaho legislature "appropriate amendments to better protect Idaho investors from promotional schemes of an unscrupulous nature". At the request of the Idaho Mining Association, a member of the Commission's staff consulted with the Idaho Commissioner of Finance with respect to proposed revisions of the statute. The revisions were not adopted by the Idaho legislature.

Alaska

In 1958 the Executive Director of the Alaska Legislative Council invited the Commission to participate in a meeting of the Council. The invitation was accepted, and in October, 1958, two members of the Commission's staff met with the Council for the purpose of furnishing information regarding the need for a Blue Sky Law based on the Commission's experience with enforcement matters in Alaska. (Following this meeting they proceeded to Anchorage in connection with several Commission cases.) No appearances before Committees of the Alaska legislature were involved. The Alaska legislature adopted the securities act in April, 1959.

In April, 1959, the Insurance Commissioner of Alaska, charged with the administration of the new securities act pending the establishment of a Department of Commerce, requested the Commission's assistance in drafting certain rules and regulations under the new law. The Commission will, of course, cooperate in this regard.

Iowa

In January, 1959, the Chairman of the Insurance Committee of the Iowa House of Representatives submitted to the Commission for comment a proposed bill to amend the Iowa securities act. The Commission's comments and suggestions were forwarded in March, 1959.

Oklahoma

In February, 1958, at the request of the Chairman of the Senate Subcommittee considering the revision of the Oklahoma securities act, members of the Commission's staff conferred with the members of the Subcommittee on the subject of enforcement of the Federal

securities laws. The conference, which was held in the Commission's Fort Worth Regional Office, also covered many mutual problems encountered by the State and Federal governments in the area of securities regulation.

Illinois

In April, 1953, the Secretary of State of Illinois submitted a proposed draft of a new securities law for comment by the Commission. The bill was reviewed and comments were submitted as requested. The bill subsequently was enacted into law.

In December, 1954, the Securities Commissioner of Illinois requested the Commission's comments with respect to proposed amendments of the Illinois Securities Law of 1953. Comments and suggestions were forwarded to the Securities Commissioner in January, 1955.

In July, 1955, the Securities Commissioner of Illinois requested the Commission to comment on a proposed rule relating to investment advisers. The Commission's comments and suggestions were forwarded in August, 1955.

DISCUSSION AND CONCLUSION

Any meeting of or discussion by representatives of State governments and Commission personnel may, to a casual or perhaps uninformed observer, appear to be for the purpose of lobbying for State securities legislation. It is important, therefore, to distinguish "lobbying"² from cooperative activities that always have played such a vital role in Federal and State law enforcement.

The assistance which has been rendered by members of the Commission's staff to the States in connection with pending proposals for adoption of or amendment to their securities laws (and rules promulgated thereunder) has been pursuant to requests by executive and legislative officials of the various States. The Commission always has considered that the cooperation of the Federal and State agencies in protecting investors against fraudulent securities sales is vitally important from the standpoint of the public interest and has encouraged its staff in the regional offices and in the Headquarters Office to respond to requests for assistance in areas

² Lobbying is defined to be "any personal solicitation of a member of a legislative body during a session thereof, by private interview, or letter or message, or other means and appliances not addressed solely to the judgment, to favor or oppose, or to vote for or against, any bill, resolution, report, or claim pending, or to be introduced by either branch thereof, by any person who misrepresents the nature of his interest in the matter to such member, or who is employed for a consideration by a person or corporation interested in the passage or defeat of such bill, resolution, report, or claim, for the purpose of procuring the passage or defeat thereof. But this does not include such services as drafting petitions, bills, or resolutions, attending to the taking of testimony, collecting facts, preparing arguments and memorials, and submitting them orally or in writing to a committee or member of the legislature, and other services of like character, intended to reach the reason of legislators." (Black's Law Dictionary, Fourth Edition)

of mutual concern. Federal-State cooperation in this and other areas is basic to our form of government.

In terms of the definition and in terms of actual events, we conclude that no member of the Commission's staff has engaged in lobbying activities.

/s/ A.K. Scheidenhelm

A.K. Scheidenhelm
Executive Director

Thomas G. Meeker
General Counsel

JUN 12 1959

Honorable Gracie Pfost
House of Representatives
Room 139, Old House Office Building
Washington 25, D.C.

Dear Mrs. Pfost:

This is in further reply to your letters of April 18 and April 25, 1959, in which you requested that I look into the allegation by a constituent of yours that employees of the Commission have been "lobbying" for legislation in the Montana State Legislature.

We have reviewed the matter carefully, and I am satisfied that no employee of the Commission has engaged in the type of activity suggested to you by your constituent.

You are aware, of course, that the statutes we administer specifically provide for dual jurisdiction in the field of securities legislation and enforcement. Other provisions of the statutes as well as reports of Congressional committees clearly indicate the need of close cooperation between federal and state authorities. We are proud of our activities in this area and frequently, in reports to the Congress, in testimony before Congressional committees, and in speeches to public bodies, we have emphasized the importance of this policy.

As a consequence of the cooperation between the Commission and the states in enforcement activities under the federal and state securities laws, the views and broad experience of the Commission's staff have been sought with reference to development of amendments to, or revisions of, state securities laws. In response to such requests members of the Commission's staff have consulted with and otherwise assisted state officials. This was precisely the situation in Montana.

In March 1956 the Governor of Montana, together with the State Auditor and Securities Commissioner, requested and received the Commission's assistance in drafting proposed amendments to the Montana Securities Act. Also, by request, a member of the Commission's staff appeared before the Judiciary Committee of the Montana House and Senate to relate illustrative cases which had been prosecuted for violations of the anti-fraud provisions of the Federal Securities Act.

In December 1958, at the request of the Montana authorities, further discussions were held between our representatives and the Governor and other state officials.

In January 1959, again at the request of the Governor, a member of our staff appeared before the Judiciary Committees for the purpose of presenting certain factual data.

Although your information may choose to characterize these activities as "lobbying", I am sure you will readily perceive that they are merely examples of the cooperation we are happy to extend to state officials when we are asked to do so in the public interest.

Sincerely yours,

Edward N. Gadsby
Chairman

Congress of the United States
House of Representatives
Washington, D.C.
April 25, 1959

Hon. Edward N. Gadsby, Chairman
Securities and Exchange Commission
Washington 25, D.C.

Dear Mr. Gadsby:

This will acknowledge your April 24 letter in reply to my request for an investigation into lobbying activities by SEC employees in Western state legislatures.

My information mentions specifically the activities of the regional director of your Seattle office in the Montana State Legislature. I hope this will prove helpful to you in your inquiry.

Sincerely,

GRACIE PFOST
Member of Congress

APR 24 1959

Honorable Gracie Pfost
House of Representatives
Room 139, Old House Office Building
Washington 25, D.C.

Dear Mrs. Pfost:

Thank you for your letter of April 18 in which you request that I look into the allegation by a constituent of yours that certain employees of this Commission have been lobbying for state legislation affecting our agency in various state legislatures in the West.

While I am aware that certain of our personnel have upon request of various state agencies and with the approval of the Commission consulted with such agencies in connection with pending proposals for adoption of or amendment to state securities laws, I do not know of any situation where any employee of this agency has been "lobbying" for any particular legislation. It would help me in responding to your inquiry if you could indicate more specifically the state or states in which your constituent claims such lobbying has been carried on by any of our employees. While I am awaiting such additional information, we will inquire into this matter generally with our Regional Administrators in the West.

Please be assured of the Commission's desire to respond fully and fairly to your inquiry.

Sincerely yours,

Edward N. Gadsby
Chairman

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Congress of the United States
House of Representatives
Washington, D.C.
April 18, 1959

Hon. Edward N. Gadsby, Chairman
Securities and Exchange Commission
425 Second Street N.W.
Washington, D.C.

Dear Mr. Gadsby:

I have been informed by a constituent that employees of the Securities and Exchange Commission are lobbying for state legislation affecting your agency in various state legislatures in the West.

I am sure you will agree that such practices are unethical and certainly not within the duties of the personnel of the SEC.

I would appreciate it if you would look into the matter and inform me of your findings as soon as possible.

Sincerely,

GRACIE PFOST
Member of Congress

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Source Material

Newton's letter of May 4, 1959 to Thomas G. Meeker

Pennekamp's letters of April 29 and May 6, 1959

Kenamer's personnel file

File 140-6-133

Study of SEC – Hearings before a Subcommittee of the House Committee on Interstate and Foreign Commerce, 82nd Congress, 2nd Session (Part 1)

Arizona, State of (File 148-2)

North American Securities Administrators (File 132-3)

North American Securities Administrators (File 132-3)

Former Chairman Armstrong's file (Correspondence "H")

State Securities Legislation (File 124-12)

Illinois, State of (File 148-2, Parts 1 and 2)

Second and Seventh Annual Reports to the Congress