25th Annual Report
of the
Securities and Exchange Commission

Fiscal Year Ended June 30, 1959

SECURITIES AND EXCHANGE COMMISSION
Headquarters Office
425 Second Street NW.
Washington 25, D.C.

COMMISSIONERS

January 6, 1960

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ORVAL L. DuBois, Secretary

LETTER OF TRANSMITTAL

SECURITIES AND EXCHANGE COMMISSION,
Washington, D.C.,
January 6, 1960.

SIR : On behalf of the Securities and Exchange Commission, I have the honor to transmit to you the Twenty-Fifth Annual Report of the Commission covering the fiscal year July 1, 1958, to June 30,1959, 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; and section 3 of the act of June 29, 1949, amending the Bretton Woods Agreement Act.

Respectfully,

EDWARD N. GADSBY, Chairman

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

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A 25 YEAR SUMMARY OF THE ACTIVITIES OF THE
SECURITIES AND EXCHANGE COMMISSION

1934-1959

A little over 25 years has passed since adoption of the first Federal securities law which, like subsequent enactments, was designed to protect the interests of investors and of the public generally. On this "silver anniversary" of the organization of the Securities and Exchange Commission to administer those laws, it is fitting in this 25th Annual Report to review the causes, objectives and principal features of the statutes under which the Commission is charged with responsibilities in the interest of protecting investors and the public.

The Federal securities laws were not designed to prevent investors from losing money in the stock market; indeed, it is extremely doubtful whether any laws could do this in a free economy. These laws seek, by requiring disclosure of the facts about issues of securities offered in interstate commerce or traded on exchanges, by prohibiting fraud in such transactions, and by other means, to .secure the dissemination of accurate information to investors and to foster sound securities markets. More fundamentally, they aim to require that those who deal with the investments of the American people observe high standards of conduct.

If the present financial markets are compared with those of thirty years ago, it may reasonably be concluded that these basic objectives have been realized. This is so notwithstanding the fact that the present level of economic and financial activity, with resulting opportunities for fraud and malpractice, puts the structure of Federal securities regulation to a most severe test.

One of the basic objectives of the Federal securities laws in providing protection for investors was to bring about a restoration of investor confidence in securities and the securities markets. Such confidence had been severely shaken as a result of the stock market debacle of 1929 and its aftermath. Restoration of investor confidence was important not only to those in the securities industry whose livelihood depended upon it, but was of tremendous importance to our whole economy. In order to grow and prosper, business and industry require large amounts of capital for plant expansion, new equipment and working capital, and the availability of such capital depends in large measure upon the investing public's confidence in securities as a safe and profitable medium for the investment of its savings. The restoration and maintenance of investor confidence are thus intimately related to industrial growth and a healthy economy.

On September 1, 1929, the market value of all stocks listed on the New York Stock Exchange amounted to $89 billion. By the middle of 1932 their market value had declined to $15 billion. As of June 30, 1959, stocks listed on that Exchange had an aggregate market value of almost $300 billion.

Also significant are the data with respect to the public offerings. During the last 5 fiscal years (1955-59), there have been 4,336 registered public offerings of securities aggregating nearly $71 billion in amount -- or an average of 867 offerings amounting to $14 billion per year. For the prior 20 fiscal years (1935-54), the number of registered offerings averaged 446 and were in the average amount of $4.5 billion per year. Although figures for the years prior to 1934 are not strictly comparable, it appears that less than $400 million of new issues were offered in the depression year 1933, while about $10 billion were offered in the peak year 1929, much of which proved worthless.

It is interesting to note in this connection that, according to available data, business invested about $11 billion in new plant and equipment in 1929. Capital outlays by business averaged $4.5 billion per year during the 3 years 1934-35-36, increased to an average of $10 billion during the years 1944-45-46 and reached an average of $30 billion in the years 1954-55-56. New capital investment amounted to a record $37 billion in 1957 and $30 billion in 1958; and it is anticipated that such investments will increase to $33 billion in 1959. To complete the picture, gross national product, which amounted to $104 billion in 1929, averaged $73 billion per year for the period 1934-35-36, $212 billion for 1944-45-46, and $393 billion for 1954-55-56. The figure grew to $442 billion for each of the years 1957 and 1958, and is expected to reach an all-time high of $485 billion for 1959.

A true measurement of the benefits which have derived from Federal securities administration is of course impossible, but some indication of the advancements made in behalf of investor protection appears in a comparison of the financial community and the nature of its operations today with that which existed prior to the federal regulation of securities.

The picture of financial and corporate practices existing in the earlier era, as unfolded in congressional and other investigations, some conducted by the Commission itself, demonstrated the need for legislation action. Responsible persons in financial institutions, corporate executives and many others entrusted with the savings of investors, to whom they owed a high degree of fiduciary care and responsibility, had abused the trust thus reposed in them. With respect particularly to the sale of new securities, the House of Representatives in its report on the first legislative enactment in the securities field (Report 85, 73d Congress, First Session) stated, in part :

"During the post-war decade some 50 billions of new securities were floated in the United States. Fully half or $20,000,000,000 worth of securities floated during this period have become worthless. These cold figures spell tragedy in the lives of thousands of individuals who invested their life savings, accumulated after years of effort, in these worthless securities. The flotation of such a mass of essentially fraudulent securities was made possible because of the complete abandonment by many underwriters and dealers in securities of those standards of fair, honest and prudent dealing that should be basic to the encouragement of investment in any enterprise. Alluring promises of vast wealth were freely made with little or no attempt to bring to the investor's attention those facts essential to estimating the worth of any security. High-pressure salesmanship rather than careful counsel was the rule in this most dangerous of enterprises."

These and other abuses contributed to a collapse of values, and their revelation seriously undermined the confidence of the investing public in the capital markets and in securities as media of investment. The orgy of speculation which had existed in the stock market, coupled with the fraud, manipulation and other malpractices then prevalent, could lead only to disaster.

One of the evils was the artificial stimulation of interest in, and the manipulation of the market price of, a given security so that it might be "dumped" on unsuspecting investors at the higher price and with a handsome profit to the manipulator. "Pool" operations were numerous, the operators timing their purchases and sales in a manner which created market activity at increasingly higher prices and thereby stimulated participation by the investing public, whose purchases further accentuated the market rise. When the price reached its desired level, the pool operators "pulled the plug", dumping their securities on the market at the higher price, whereupon the market price slumped to its original level or lower. The operators also participated in "bear raids", and, assuming a short position in a particular stock, engaged in a series of transactions which drove the market price of the stock down to a level at which they could cover their short position at a profit.

These and similar operations resulted in a situation in which no one could be sure that market prices for securities bore any reasonable relation to intrinsic values or reflected the impersonal forces of supply and demand. In fact, the investigation record demonstrated that during 1929 the prices of over 100 stocks on the New York Stock Exchange were subject to manipulation by massive pool operations. One of the principal contributing factors to the success of the manipulator was the inability of investors and their advisers to obtain reliable financial and other information upon which to evaluate securities, and manipulators were further aided by the dissemination of false and misleading information, tips and rumors which flooded the market place.

There were other factors which were shown to have contributed to the fundamental weakness of the pre-SEC securities market. Principal among these was the extensive use of credit to finance speculative activities or the purchase of stock on margin. Speculators ignored the fact that the yield on stocks purchased on margin was far less than the interest on their debit balances with brokers. There was almost no limit to the amount of credit which a broker might extend to his customer. As a result, a slight decline in the market price of securities could, and did, set off a chain reaction -- the customer was sold out in a declining market at a loss because he had insufficient funds to put up additional margin; such distress sales further accentuated the market decline and caused other margin customers to be sold out; and brokers who had over-extended themselves with banks in order to finance excessive speculation by customers were hard-pressed for capital and some even became insolvent, thus further endangering the position of other customers.

The misuse of corporate information by management officials and other "insiders" was also common practice. Executive officers who owed a high degree of fiduciary responsibility to the company and its stockholders withheld vital information about the company, its operations and earnings, while accumulating a personal position in its stock, placing themselves in position to capitalize on any fluctuation in the price of the stock when the news was released to the public. Moreover, the entrenched position of management was fortified by lax standards governing the solicitation of proxies by means of which management perpetuated itself in power.

An extensive investigation of electric and gas utility holding companies conducted by the Federal Trade Commission, which has often been termed the most comprehensive study of any industry undertaken by the Federal government, had disclosed widespread abuses in the formation and operation of utility holding company systems, including(1) inadequate disclosure to investors of the information necessary to appraise the financial position and earning power of the companies whose securities they purchase; (2) issuance of securities against fictitious and unsound values; (3) overloading of operating companies with debt and fixed charges, which tended to prevent voluntary rate reductions; (4) imposition of excessive charges upon operating companies for various services such as management, construction work and the purchase of supplies and equipment; (5) the control by holding companies of the accounting practices and rate, dividend and other policies of their operating subsidiaries so as to complicate and obstruct State regulation; (6) the control of holding companies and subsidiaries through disproportionately small investment; and (7) the extension of holding company system control and domination over far-flung utility properties without regard to the integration and coordination of related properties.

Starting with operating company common stocks, representing fractional investments in the properties themselves, the holding companies issued billions of dollars of debt securities and preferred stocks and pyramided holding company upon holding company in such a way that control represented by the voting stock of the top company was based on little or no actual investment in the operating properties at the bottom level, at which level alone were generated the earnings and income to support the entire system. The imposition of leverage security upon leverage security had the result that a small percentage increase in operating company income would be phenomenally magnified at the level of the top holding company's most junior equity securities. But this factor of magnification worked in reverse when income declined. Electric and gas operating companies actually suffered less during the depression days of the early 1930s than almost any other substantial segment of our economy. Their operating revenues dropped no more than about 15 percent from the peak levels of the 1920s. That drop, however, was enough to bring down in ruins many of the fantastic corporate superstructures that had been imposed on top of the operating companies. Several of the largest holding companies were forced into bankruptcy. The investing public which had been induced to purchase their securities suffered tragic losses of untold millions of dollars.

It has been estimated that, from 1924 to 1930, utility holding companies floated some $5 billion of securities, the great bulk of which went not to build or improve utility properties but to purchase already outstanding voting securities of operating utility companies. The businesses of some of the companies acquired had no remote relationship to that of an electric or gas utility and one system even included a baseball team. The build-up, without any economic justification, of huge utility empires stretching across the nation was exemplified by one holding company which grew in gross assets from $6 million in 1923 to $1 billion in 1929, only to become insolvent and require years for its reorganization and rehabilitation -- not, however, without tremendous losses to the investing public.

From September 1929 to April 1936, 53 utility holding companies with about $1.7 billion of securities outstanding went into receivership or bankruptcy. An additional 23 holding companies with about $535 million of outstanding securities defaulted on interest and offered readjustment plans. At December 1940, registered holding companies had about $2.5 billion of preferred stock outstanding of which $1.4 billion had dividend arrearages amounting to $476 million.

The financial practices of the holding companies had also resulted in serious injury to many of their operating subsidiaries. From September 1929 to April 1936, 36 utility subsidiaries, with outstanding securities of $445 million, went into bankruptcy or receivership. An additional 16 such companies with $152 million of outstanding securities offered readjustment or extension plans after defaulting on interest. Of preferred stocks of operating subsidiaries aggregating about $1.6 billion at December 1940, some $453 million had dividend arrearages amounting to about $165 million.

Another investigation, conducted by the Commission in the mid-1930's, of companies engaging in the business of investing, reinvesting and trading in securities and which offer their own securities for public sale in order to obtain investment capital, clearly indicated the need for regulation of this important segment of our financial community. Here again, the evidence showed a callous disregard by certain management officials of their fiduciary obligations to investors and, in many instances, a course of conduct which clearly constituted fraud. Among the practices revealed by the Commission's investigation were the purchase and sale of portfolio securities by and between the company, its management officials and other affiliated interests, for the personal profit of the insiders. The sale of investment company shares through false and fraudulent representations was a common practice.

This investigation also disclosed that no machinery existed for enforcing fiduciary responsibilities of individuals and firms which were engaged in the business of advising others, for compensation, with respect to their purchases and sales of securities, and that serious abuses were possible and probable.

Another Commission investigation disclosed practices which evidenced a need for independent trustees to provide protection of the interests of security holders in the areas of corporate reorganizations of insolvent corporations and the issuance and sale of debt securities pursuant to mortgage and other indentures.

With these exposures of malpractices Congress stepped into the breach and imposed, upon those engaged in the purchase and sale of securities, standards of conduct which should long since have been universally recognized by them as basic to any proper relationship to public investors. In fact, they were based upon the fundamental concepts of fiduciary obligation which the law already imposed on those managing other people's money and securities.

The first remedial measure, the Securities Act of 1933, dealt with the capital formation process so essential to industrial growth. In urging the passage of this legislation, which he characterized as the "Truth in Securities" law, President Roosevelt stated that what was sought was "a return to a clearer understanding of the ancient truth that those who manage ... other people's money are trustees ..." The primary aim of the legislation was to provide public disclosure of all financial and other data bearing upon the worth of securities so that they might be realistically evaluated by investors. It also sought to outlaw fraud in the sale of securities under a broadened concept of fraud not limited by technical common law definitions.

Disclosure under the Securities Act is accomplished in a two-step process:(1) by filing a registration statement with the Commission containing certain required financial and other data; and (2) by making available to purchasers and to investors who receive written offers to sell through the mails, a prospectus containing all pertinent facts upon which the company's operations may be appraised and its securities evaluated. Among other things, the prospectus must contain information with respect to the character, size and profitableness of the business; the capitalization of the issuer; the purpose of the proposed offering of securities and the use to which the proceeds are to be applied; outstanding options for the purchase of securities of the issuer; remuneration of officers and directors, including bonus and profit-sharing arrangements; contractual or other arrangements with management officials or other affiliated interests; pending or threatened legal proceedings; and the underwriting and other terms of the offering. Moreover, the prospectus must include a balance sheet and three-year earnings statement, certified by an independent public accountant.

When the registration statement is filed, the securities covered thereby may be offered for public sale, either orally or by means of certain written instruments prescribed by Commission rules. But the securities may not be sold until the registration statement becomes or is made effective. The duration of this "waiting period", usually several weeks, depends upon the degree of initial compliance with the disclosure requirements. The waiting period provides an opportunity, explicitly provided for in the statute and the Commission's rules, for widespread dissemination in the financial community and among dealers and the investing public, of the salient factual disclosures, financial and otherwise, contained in the registration statement. Thus, opportunity is given the investing public to be informed of the essential facts about the company and the securities it proposes to offer for public sale before the public investor is committed to their purchase.

During this waiting period, also, the Commission conducts a thorough examination of the registration statement and prospectus to determine, as best it can, that all required facts have been disclosed, accurately and completely, and that there are no "half truths" due to the omission to state facts required to be stated in order to make not misleading the disclosures and representations made. If in its examination the Commission finds that the registration statement is inaccurate or incomplete in respect of material facts, the Commission may, after notice and opportunity for hearing, issue a "stop order" suspending the registration statement, which operates to bar distribution of the securities so long as the stop order remains in effect. The order may be lifted when and if the registration statement is amended to correct the deficiencies upon which the stop order was based. Normally, however, resort to the stop order procedure is not essential to a determination of compliance with the disclosure requirement, and the issuing company is advised of and given an opportunity to file any revision, correction or clarification of disclosures which the examination may show to be necessary to an understanding of the facts.

An analysis of an issuing company's balance sheet and earnings statement is of paramount importance in the evaluation of securities. The value of financial statements is directly dependent on the soundness of the accounting principles and practices observed in their preparation and on the adequacy and reliability of the work performed by public accountants who certify as to their fairness. Uniformity in auditing practices and consistency in accounting presentation are essential to public reliance upon and an understanding of the earnings and other data presented and to a proper comparison with the financial statements of other companies. Therefore, a major objective of the Commission has been to improve accounting and auditing standards and to assist in the establishment and maintenance of high standards of professional conduct by certifying accountants.

The accounting rules, decisions and opinions of the Commission, in conjunction with authoritative pronouncements by professional accounting societies and by other governmental agencies, have achieved a substantial clarification and improvement in the accounting and auditing principles and practices generally followed in the preparation of financial statements throughout the financial community, whether or not the particular issuing company is directly subject to the Commission's regulations. Moreover, the Commission's requirement that an accountant who certifies financial statements filed with it shall be "independent" of his client, has extended and fortified the ethical standards customarily observed by certifying accountants.

The Commission's examination relates only to the accuracy and adequacy of the disclosures. The Commission is not empowered to, and does not, appraise the merits of the securities or otherwise pass upon the soundness of the venture. In fact, the Act declares it to be unlawful to represent to investors that the Commission has approved or otherwise passed on the merits of registered securities or found the registration disclosures accurate and complete. However, it should be noted in this connection that heavy penalties attach to the filing of registration statements which are false and misleading. Moreover, investors who suffer losses in the purchase of registered securities have important recovery rights (which they may pursue in Federal or State courts) if the disclosures contained in registration statements are false and misleading. While the Commission cannot and does not vouch for the accuracy and adequacy of registration disclosures, its examination, coupled with the penalties against false filings and the recovery rights of investors, tend to contribute to the general reliability of the disclosures.

Dissemination of information contained in the registration statement is basic to the statutory objective of investor protection. This is accomplished by the large-scale distribution of the prospectus to all members of the underwriting and distributing or selling groups as well as to prospective investors. The law requires the delivery of the prospectus to any person to whom a written offer is made through the mails, and to each and every purchaser. This dissemination of information is supplemented by the extensive redistribution of the registration disclosures by the various securities manuals and other investment advisory and statistical services, which are readily available to all broker and dealer firms, trust departments and others. Thus, new securities may be evaluated by a broad cross-section of the investing public.

The registration process has been an effective instrument for the restoration of investor confidence. The fact that there has been a $15 billion average volume of public offerings of registered securities during the past four years, and that capital expenditures during that period have reached record heights, is eloquent testimony to the smooth functioning of the capital formation processes today and of the steady flow of private capital into industry.

The second enactment in the field of Federal securities regulation was the Securities Exchange Act of 1934, which sought to outlaw misrepresentation, manipulation and other abusive practices in our securities markets and to establish and maintain just and equitable principles of trade which would be conducive to open, fair and orderly markets.

The Congress recognized that the dearth of reliable financial and other information in the pre-SEC days had made it difficult, if not impossible, to evaluate adequately and realistically securities traded on exchanges, and that this paucity of information facilitated the dissemination of false information about the issuing companies and their securities and the manipulation of the prices of securities. Accordingly, the 1934 act extended the disclosure principle by requiring every company which has securities listed on an exchange to register with the Commission and to file annual and other periodic reports disclosing financial and other data which the investing public needs in evaluating the company's securities. A similar periodic reporting requirement is imposed by this law upon the larger companies whose securities have been registered for public offering under the Securities Act, whether or not they are listed on an exchange. The Commission is given authority to require that these financial statements be certified by independent public accountants. On June 30, 1959, securities of 2,236 issuing companies were listed and registered on national securities exchanges. The volume of trading on the exchanges in these securities during the year ended that date was about $50 billion, and their aggregate market value at the year end was about $350 billion. The very size of these figures is evidence of the importance to investors of reliable financial and other information with respect to the issuing companies and their securities. The data contained in the reports of these companies receives widespread dissemination through securities manuals, statistical and advisory services, the financial press and otherwise, and has an important impact upon the evaluation of their securities by the investing public.

The disclosure principle was further extended by two additional provisions of this law, applicable to "insider" trading in listed securities and to the solicitation of proxies from the holders of such securities. With respect to the former, the 1934 act requires that insiders (officers, directors, and 10% owners) report regularly to the Commission and the exchange their holdings of and transactions in all equity securities of the particular issuer with whom they are affiliated. The number of these reports of holdings and transactions of insiders now exceeds 39,000 annually. Furthermore, in order to curb the misuse of "inside" information by such persons which had been so prevalent prior to enactment of the statute, insiders are made liable to account to their companies for their profits on any purchase and sale, or sale and purchase, which occurs within a six-month period.

Moreover, management officials of listed companies must disclose in their solicitation of proxies basic financial and other information reflecting the company's financial condition and the results of its operations -- information which reflects management's stewardship. To enable investors in such companies to vote intelligently upon all corporate matters requiring stockholder approval, whether the election of directors, authorization for the issuance of 'additional securities, merger with another company or otherwise, the Commission has promulgated a set of "proxy rules" which require disclosure of the basic facts pertinent to the subject matter of the vote. In addition, the form of proxy must give the stockholder freedom of action to vote for or against different proposals, and may not bind him to vote on an all-or-none basis.

The Commission's proxy rules also entitle independent or minority stockholders to include, in management solicitations, any proper proposals which they wish to have put to a vote of the stockholders. Under the rules, independent solicitations of proxies by minority stockholders, including the solicitation of proxies for the election of their own nominees to the board, are also facilitated.

The 1934 act also provides for the registration of stock exchanges and of brokers and dealers who engage in the over-the-counter securities business. A prerequisite to stock exchange registration is a requirement that the rules of the exchange shall proscribe practices by members which may not be just and equitable to public investors, and the exchange must be empowered to suspend, expel or otherwise discipline members for violations of those rules. The Commission has a residual power to see that exchange rules are modified or supplemented to accomplish these objectives. Today, 14 national securities exchanges are registered with the Commission.

This system of self-regulation, which recognizes that exchanges are vested with a public interest and that the exchanges themselves have the primary responsibility for establishing, maintaining and enforcing just and equitable principles of trade, is an important factor in the market place today. It also has its counterpart in the over-the-counter markets, contained in a 1938 amendment to the law providing for the organization of associations of over-the-counter dealers which would "police" their membership. One such institution, the National Association of Securities Dealers, Inc. ("NASD"), has been organized and now has over 4,000 members. It has adopted and enforces a code of fair practice governing the conduct of its members and their relationships to investors.

As previously indicated, brokers and dealers must register with the Commission before they may engage in the securities business in interstate commerce. At the end of the 1959 fiscal year, 4,907 brokers and dealers were registered with the Commission. The Commission may deny or revoke the registration of a broker-dealer in cases of fraud in securities transactions, or other misconduct in the securities business, where the Commission, after notice and opportunity for hearing, finds such denial or revocation in the public interest. Likewise, the Commission may, on similar grounds, suspend or expel a member from membership in the NASD or in a stock exchange.

The Commission maintains an active surveillance of securities trading practices, both on exchanges and in the over-the-counter markets. It also has adopted numerous rules which establish standards of conduct governing the activities of brokers and dealers and prohibit acts and practices inimical to the interests of investors. Two of these are worthy of special note. One prohibits short selling on an exchange which would tend to precipitate or accentuate a price decline. Another requires that brokers and dealers maintain at all times a minimum capital position in relation to their liabilities to other persons so that the funds and securities of customers in their custody will not be jeopardized. This rule minimizes the possibility that sudden reverses will cause a firm to become insolvent and thereby endanger customers' free credit balances and securities held in custody. It may be noted in this connection that the Commission carries on a program of broker-dealer inspections to ensure compliance with its net capital rule and otherwise to see that the activities of brokers and dealers are conducted properly.

No less important to the stability and orderliness of the stock market today are the rules of the Board of Governors of the Federal Reserve System which regulate the amount of credit which brokers and banks may extend on the purchase of listed securities by investors. The margin requirement has fluctuated over the years from a low of 25 percent in 1934 to 100 percent (no margin) during the war years, in accordance with that Board's view as to proper margin in light of the over-all credit position of the Nation. By curbing excessive speculation, the rules have added a stabilizing influence in the market. The necessity for frequent and drastic "margin calls" has thus been reduced, offering further stability to the market. The Commission has the duty of enforcing compliance by brokers and dealers in securities with the rules so established.

Both the 1933 and 1934 acts authorize the Commission to take testimony under oath and to subpoena books and records for the purpose of developing the facts with respect to possible securities violations, and to seek Federal court orders of injunction against the continuance of acts and practices violative of the laws or Commission rules thereunder. They also provide for criminal prosecution (through the Department of Justice) of any individual, firm or corporation if evidence developed in the Commission's investigations establishes that they have engaged in fraud, manipulation or other misconduct in connection with the purchase and sale of securities or have otherwise willfully violated the law.

The record of investigation and enforcement actions of the Commission is a formidable one, far too long to be recited here. That record is detailed in the several annual reports which have been filed by the Commission with Congress over the years. It may be noted that many violations of the law are discovered and stopped before any substantial damage to investors has occurred. In other cases, the Commission's investigations have resulted in restitution of investors' funds in substantial amount. Of perhaps even greater importance to the investing public is the deterrent effect which the statutory sanctions and the Commission's enforcement powers have upon those who might otherwise have, and exercise, a free hand to defraud innocent investors.

The legislation designed to meet the problems posed by the abuses disclosed in the investigation of the electric and gas utility industry was embodied in the Public Utility Holding Company Act of 1935. The principal objective of this statute was to free local operating utility companies from the control and domination of absentee and uneconomic holding companies, and to permit them to be regulated more effectively by the States in which they operate. In 1930, 15 holding company systems controlled 80 percent of the privately owned electric generating capacity in this country, and similar concentration existed in the gas utility field. As previously indicated, these countrywide utility empires were put together with little regard for efficient and economic service of electricity and gas to consumers and without regard for the investors whose funds had been used to concentrate a maximum of control and' profit in the hands of a few.

The act called for a breakup of the huge utility combines and, generally speaking, sought to restrict the operations of utility holding companies to one or more systems whose operations are integrated and confined to a single State and States contiguous thereto. It also had as one of its major objectives the simplification of the corporate and capital structures of holding company systems and the redistribution of voting power among security holders on a fair and equitable basis.

In 1940, when the statutory program of integration and simplification actually got under way, 12 of the registered systems each conducted retail operations in 10 or more States, and 17 additional systems operated in 5 to 9 States. At one time or another since 1938, these systems contained a total of 2,387 companies, many engaged in miscellaneous unrelated nonutility businesses, and many being sub-holding companies serving no demonstrable economic function. Drastic surgery was called for to simplify these structures, to restore some semblance of sane and sensible corporate and capital structures and to redistribute voting power and control on a fair and equitable basis consistent with a realistic evaluation of the rights of the various and conflicting interests of security holders.

The volume and complexity of the corporate and capital structures which were required to be simplified, and the nature and scope of the geographical dispersion of the properties required to be integrated presented extremely difficult and novel problems which it was the task of the Commission to resolve. Opponents of the legislation had asserted that the law would cause dumping and forced liquidation of securities, demoralizing the market therefor, and they characterized the integration and simplification requirements as a "death sentence" for the utility industry. The Congress, on the other hand, contemplated that this program should not destroy any legitimate investment values, and the Commission was given a mandate to bring about the required integration and simplification in keeping with that objective.

The opposition of industry which marked the passage of this reform measure was continued after its enactment. Most of the larger companies refused to register with the Commission, as the law required, and it was not until the Supreme Court upheld the constitutionality of the registration requirement in 1938 that these companies bowed to the registration requirement. They continued, however, to resist the law's integration and simplification requirements.

The act contemplated that industry would be given an opportunity to propose voluntary plans which would effectuate the objectives of integration and simplification, but it also wisely empowered the Commission to take necessary action to that end if the industry failed so to do. For the most part, at least initially, the industry was unyielding, and it became necessary for the Commission to invoke its power to issue administrative orders directing compliance with the requirements of the law. Of course, such orders could only be issued after notice and opportunity for hearing and after the development of an evidentiary record. Many of the orders requiring integration and simplification were challenged in the courts, on constitutional and other grounds, but all were ultimately sustained.

After the Commission had thus established the general pattern of compliance, holding company systems came forward with voluntary plans for divestment of nonretainable properties and securities of nonretainable subsidiaries. Such plans had to comply with the statutory mandate in this respect and had to be fair and equitable to all affected security holders. Plans proposed for simplification of corporate and capital structures also had to be tested in the same manner. In ruling upon these plans, the Commission developed the so-called "investment value" doctrine under which the claims of security holders are evaluated for purposes of reorganization on a going-concern basis rather than on the liquidation basis followed in reorganizations in equity receivership and bankruptcy proceedings where the claims are treated as matured. Under the investment value doctrine, which was duly sustained by the courts, plans of reorganization were approved which accorded participation to senior claimants upon the basis of the present worth of their securities on a going-concern basis, and similarly to junior security holders on the basis of their secondary claim to future earnings, even though they would not have had a right to participate if the senior claims were evaluated upon the basis of their liquidation preferences.

Compliance with the integration and simplification requirements took various forms. They included mergers and consolidations, separation of large systems into smaller, integrated systems, divestment of nonutility properties unrelated to the utility business, sale of nonretainable utility properties to other systems with whose properties they could be integrated, sale of the securities of nonretainable subsidiaries to the public at competitive bidding or pursuant to a rights offering to stockholders of the parent company and distribution of securities pro rata among stockholders.

The fundamental economic soundness of the act and the methods prescribed for its administration have been demonstrated by the results achieved, and the directive of Congress that the program could and should be effectuated without injury to investors has been carried out. Although tremendous values were salvaged by integration and simplification, that process unavoidably entailed the realization of losses by many investors who had purchased securities on the basis of anticipated values which had been but a mirage, or had been dissipated by the holding companies themselves. All the damage could not possibly be undone -- the dollar amount of securities which had been issued was in some instances vastly in excess of the values that could be realized by the salvage and rebuilding process.

The integration and simplification program represented the most comprehensive undertaking ever assumed by the Government to rehabilitate an entire major industry. In the process, the number of companies now comprising the 18 active registered holding company systems has been reduced to 176 -- and only 3 of the systems operate in more than 4 States and none operates in more than 9. Today, the securities of the divested companies and of those registered companies which have completed their integration and simplification programs have an excellent market acceptance. The utility industry as a whole is enjoying financial health and stability, and has been able to finance expansion programs of unprecedented proportions largely out of new money raised from the public sale of securities. It is interesting to note in this connection that a study made by the Commission in 1951 of the market values of the common stocks of 12 holding companies between the dates of their registration with the Commission and September 24,1951, showed that in each instance the market value of the company's stock increased during that period and in almost all instances the rate of increase substantially exceeded the rate of increase in the Dow Jones utilities averages. Holders of utility preferred stocks have similarly benefited in that all dividend arrearages have been satisfied and the holders have been accorded securities and cash representing the fair value of their investments.

In actuality, then, the feared integration and simplification provisions of the law have been vindicated and those who condemned the act have come to praise it. That which was once denounced as a death sentence to the progress of the utility industry is now generally regarded as having been the means of its regeneration.

The 176 companies which remain subject to the Commission's continuing jurisdiction under the act must comply with its regulatory provisions governing their purchase and sale of utility securities and properties, dividend payments (in circumstances where such payment might result in a corporate abuse), intercompany loans, solicitation of proxies, and insiders' transactions. The act also forbids registered holding companies to charge for services to their subsidiaries and requires that all services performed for any company in a holding company system by a mutual or subsidiary service company be rendered at cost, fairly and equitably allocated.

With respect to the issuance and sale of securities, the act generally provides that the Commission shall not authorize their sale unless it finds that the security meets certain tests, including the requirement that the security must be reasonably adapted to the earning power of the company and its issuance necessary and appropriate to the economical and efficient operation of the issuer's business and not detrimental to the public interest or the interest of investors or consumers. The Commission has adhered to the policy of requiring sound capital structures containing adequate common stock equity. The Commission also must find that fees, commissions and other remuneration paid in connection with the sale are not unreasonable.

It is recognized that the cost of capital is an important element of expense affecting utility rates and that utility companies are under a duty to obtain their capital at the lowest cost consistent with a sound financial structure. One of the evils disclosed by the investigation was the absence of arms-length bargaining in the sale of securities and utility assets, which was in large measure an outgrowth of the "traditional banker" relationships between certain large investment banking firms and particular holding company systems. Such relationships had given these bankers a virtual monopoly over the financing of system companies and had generally resulted in exorbitant underwriting commissions.

To implement the statutory objective that underwriting fees and commissions be reasonable in amount, to eliminate investment banker control and to assure the maintenance of competitive conditions, the Commission in 1941 adopted a rule under the act which generally requires that securities of registered holding companies and their subsidiaries be sold by means of competitive bidding. Since the adoption of that rule, there has been active competition among investment bankers for the purchase of utility securities. Approximately $11 billion of utility securities of various classes have been sold by means of competitive bidding under the rule in the past 17 years. The rule allows an exception from competitive bidding under special circumstances and upon a showing that a negotiated underwriting or a direct placement would be more advantageous and that competitive conditions are otherwise maintained. Some $2.3 billion of securities have been excepted from the rule since it was adopted.

The effect of the competitive bidding rule actually extends beyond the limited number of companies subject to its requirements, for the prices obtained and the underwriting spread paid by these companies in their offering and sale of securities through competitive bidding have set the standard for all security offerings, whether or not subject to the rule. Competitive bidding is regularly required by the Interstate Commerce Commission, the Federal Power Commission, and many State regulatory commissions. This technique was in effect in some areas before 1941, but it is clear that its adoption by the SEC has been instrumental in achieving the wide acceptance which is now given to it. Moreover, it has been employed by a number of utility companies who were under no compulsion to do so. There can be little doubt that the competitive bidding rule has been responsible in a substantial degree for the noticeable decrease in the cost of flotation of securities over the past two decades.

In furtherance of the statutory objectives of economy in the raising of capital and the protection of the interests of investors, consumers and the public, the Commission has from time to time promulgated other rules and policy statements governing the financing of registered system companies. Notable among these are statements of policy governing "protective provisions" which must be included in mortgage indentures pursuant to which debt securities are issued and sold and in corporate charters governing the rights and interests of preferred stockholders. With respect to bond indentures, for example, the bonds must be redeemable at any time at reasonable redemption premiums, certain asset and earnings tests must be met if a company wishes to issue additional bonds, a sinking fund is required as well as a renewal and replacement covenant which, in effect, requires the company to expend for property additions an amount reflecting the depreciation taking place in the mortgaged properties, and certain restrictions are imposed upon the acquisition of properties subject to a prior lien and upon the amount of common stock dividends the company may pay.

With respect to preferred stock, the charter must include provisions that dividends shall be cumulative, that the preferred shall be redeemable at any time at a reasonable redemption premium, and that the preferred shareholders are entitled to elect a majority of the members of the board of directors in the event of the accumulation of a year's arrearages in the payment of dividends on the preferred. Furthermore, the payment of dividends upon the common stock must be restricted if the common stock equity falls below a certain prescribed percentage of the company's total capitalization and surplus, and a favorable vote of the holders of a certain percentage of the outstanding preferred shares is required before certain corporate actions affecting their interests may be taken.

It is apparent that the accomplishments under the Holding Company Act and particularly in connection with the vast integration and simplification program have been considerable. While the integration and simplification programs for some ten of the registered systems have not been completely effectuated, the Commission is hopeful that the remaining problems, some of a more or less serious nature, may soon be resolved and the overall program of utility integration and simplification consummated. The continued expansion of utility systems, of course, including the creation of new holding companies through the purchase of utility securities or the acquisition by existing registered systems of the assets or securities of other nonaffiliated companies, has created and will from time to time continue to create new problems of integration and simplification.

A number of holding company systems will continue to be subject to the Commission's jurisdiction under the act for an indefinite period. The many aspects of their financial and related activities will call for the continued exercise of the Commission's jurisdiction, as in the past, to assure that the public interest is protected and to guard against the recurrence of the evils which gave rise to the enactment of the law. In addition, new technological developments, such as the use of atomic energy, the pooling together of facilities by various nonaffiliated systems for the purpose of effecting economies in the generation of electric energy and other similar challenges will no doubt continue to command the Commission's attention in the years to come.

The Holding Company Act authorized the Commission to conduct a study and investigation of investment trusts. After 5 years of intensive and exhaustive inquiry into the entire industry, the Commission recommended comprehensive legislation for its regulation. Vigorous opposition to the extent of the regulation proposed in the original bill led to conferences between the Commission and industry representatives, resulting in a compromise statute which passed both Houses of Congress unanimously as the Investment Company Act of 1940. This unanimity was no doubt due in large part to the Commission's expose of the sordid history of the organization and operation of certain investment trusts and to a recognition on the part of the more responsible element in the industry that Federal regulation was not only necessary in the interest of investor protection but was also essential to the full acceptance by the public of investment companies as a feature of our financial system.

The Commission's study showed that investment companies had all too often been organized and operated in such a way as to further the selfish interests of the sponsors and insiders at the expense of the stockholders to whom they owed a high fiduciary duty. Subordination of the interests of stockholders took many forms. In some cases, the promoters, management officials and controlling persons unloaded worthless securities and dubious investments upon the investment company, or took for their own account profitable ventures offered to the company. In others, the investment company financed clients of insiders or companies in which insiders were personally interested. Insiders also engaged in practices which permitted them to obtain large profits without any risk by trading in the securities issued by the investment company, to the pecuniary detriment of its investors. They also engaged in practices which increased their distribution profits and management fees and resulted in substantial dilution of the investors' interests. Many other abuses came to light, including sales and promotional literature designed to create the false impression that investment companies were not unlike savings banks and insurance companies, except that they were not limited to legal investments. The sales load in some types of companies exceeded 30 percent of the net amount invested.

The 1940 act seeks to obtain a degree of independence in the board of directors and to prohibit self-dealing and the taking of excessive commissions or profits by affiliated persons or companies. It seeks to achieve greater participation by stockholders by requiring them to act on basic policies, to restrict the types of securities which may be issued by investment companies and to guard against inadequate and unfeasible capital structures, to require transmission of informative reports to stockholders, including financial statements certified by independent accountants when the Commission so prescribes, and to eliminate improper selling practices. Persons guilty of securities frauds are barred from serving as officers and directors, Underwriters, investment bankers and dealers may not constitute more than a minority of the board of directors.

Basic to Commission regulation under this law is the requirement that companies engaged in investing, reinvesting and trading in securities register with the Commission and file periodic financial and other reports. The registration statement must include a declaration of policy by the investment company on various aspects of its business, including its investment policy, and the company may not deviate from its stated policy without the consent of the holders of a majority of its outstanding voting securities. Transactions with affiliated persons and companies are prohibited, although the Commission, upon application by the company, may grant an exemption from such prohibition if it finds that the terms of the transaction are fair and reasonable, that no "over-reaching" on the part of any individual is involved and that the transaction is consistent with the company's established policies and with the intent and purposes of the law. A registered investment company must, subject to Commission rules, maintain its assets under a custodianship agreement with a bank or a member of a national securities exchange, or under a safekeeping arrangement with a bank. Officers and employees who have access to the assets of the company or authority to direct their disposition must be bonded.

The act also empowers the Commission, where necessary, to seek court injunctive orders to prevent transactions, acts and practices in contravention of its provisions or rules of the Commission thereunder. If the activity constitutes gross misconduct or gross abuse of trust in the management of investment companies, the Commission may apply to the court for removal of management officials responsible therefor, for the appointment of trustees or receivers where necessary to preserve the company's assets and for an order compelling the restitution of funds to stockholders.

In one case, for example, the controlling stockholder caused the investment company to liquidate capital assets to meet interest requirements and pay current expenses, including salaries and rentals to himself, and to acquire control of a race track. In an action initiated by the Commission, the court appointed a receiver and enjoined the controlling stockholder and other defendants from serving as officers and trustees of the company. Similarly, in another action brought by the Commission an officer who caused an investment company to make unsecured loans to various business corporations he controlled was enjoined from serving any investment company in any capacity in the future. Injunctions and appointments of receivers have been obtained where the sales literature falsely stated that the investment company was guaranteed against loss by the United States Government and where the officers and directors attempted to unload worthless securities upon the investment company.

An important aspect of the Commission's administration of this law has been its insistence upon the elimination of abusive practices in the offering and sale of investment company securities. Several years ago some companies were found to be employing sales literature of a misleading character, such as representations that a particular security was as safe an investment as a United States savings bond. Leading members of the industry cooperated with the Commission in a study of the sales literature and sales practices being employed. Following this study, the Commission issued a Statement of Policy setting forth various types of advertising and sales literature considered to be in violation of the law, and the industry has cooperated with the Commission in administering it.

In the administration of the act, the Commission must rule upon various applications by investment companies for exemptions from specified provisions. The exemption most frequently sought concerns transactions involving the purchase and sale of property or securities between investment companies and affiliated interests. In order to receive an exemption, the applicant must establish to the satisfaction of the Commission that the terms of the proposed transaction are fair and reasonable and do not involve overreaching. Many difficult problems of evaluation and potential conflict of interest are presented in these cases. Since 1940, more than 1,200 exemption applications have been acted upon by the Commission.

The growth of investment companies since 1940 has been phenomenal. At June 30, 1941, 436 companies with aggregate assets of $2.5 billion were registered with the Commission. The number of registered companies has varied since that date, with a low of 352 in 1947 and a present high of 512. The aggregate assets of the 512 companies at June 30, 1959, was $20 billion, or eight times the size of the 436 companies in 1941. The Congress recognized that investment companies might become so large as to raise problems concerning "concentration of control of wealth and industry" and other questions, and the act directs the Commission to conduct a study of such problems and to report the results thereof to Congress. Such a study is now in progress.

In a recent decision of the Supreme Court, it was held that "variable annuity" contracts were "investment contracts" subject to the Commission's jurisdiction under the Securities Act and the Investment Company Act. As a result, these contracts must satisfy the registration and disclosure requirements of the Securities Act, and the issuing companies must register as investment companies and comply with the other provisions of the Investment Company Act. The Commission is now endeavoring to resolve the problem of fitting this type of investment company into the pattern of regulation which the 1940 act established.

Closely related to the Commission's surveillance of over-the-counter securities dealers and of investment companies is its administration of the Investment Advisers Act of 1940. The regulatory provisions of that act, however, touch only a few aspects of a field not yet adequately covered. Although modeled on the broker-dealer registration provisions of the 1934 act, and dictated by certain abuses indicated by the Commission's investment trust study, it has few "regulatory teeth." It does not give the Commission the same control over the activities of the investment advisers (including power to impose sanctions) now applicable to brokers and dealers, and is considered to 'be largely a mere "census-taking" statute. The most serious defect in the current statute is the inability of the Commission to inspect the books and records of registered investment advisers, to prescribe what books and records shall be maintained or to require the filing of reports. In light of market conditions existing today, it would appear contrary to the public interest to allow such a condition to continue. As part of its current legislative program, the Commission has proposed amendments to the law to include adequate regulatory provisions with respect to investment advisers.

Prior to the Commission's investigation of investment trusts, it undertook a study of protective and reorganization committees. This study resulted in two additional Congressional enactments, the Trust Indenture Act of 1939 and chapter X of the National Bankruptcy Act (1938 revision).

This study concerned itself with the events which led to the insolvency of debtor companies, and in particular with the activities of protective and reorganization committees organized to protect the interests of the various classes of creditors and security holders and to participate in the reorganization of the debtor corporation. Numerous instances came to light where the indenture trustee, whose primary responsibility was to protect the interests of the holders of indenture securities, had basic conflicts of interest, including divided loyalties as between the debtor and its management officials on the one hand and the interests of public investors on the other. Such conflicts precluded any effective action by the trustee to safeguard the interests of investors prior to default or to see that their rights were asserted in a timely and proper fashion in the event of default.

The Trust Indenture Act seeks to protect the purchasers of bonds, debentures, notes and similar debt securities when sold in amounts exceeding $1 million, by prescribing certain minimum standards governing the provisions of indentures. It requires the indenture to spell put the rights of the holders of the securities and to provide reasonable standards of diligence and loyalty applicable to the indenture trustee, and to facilitate its actions to protect the investor. The emphasis of this law is upon an effective and "independent" trustee whose interests do not conflict with those of investors and upon eliminating indenture provisions which might exculpate the trustee against dereliction in carrying out duties and responsibilities prescribed by the indenture.

The provisions of this act and the Securities Act are so integrated that registration under the latter act of securities to be issued under a trust indenture is not permitted to become effective unless the indenture conforms to the standards of the Trust Indenture Act. Like registration statements, trust indentures are examined by the Commission for compliance with the law. The Commission may issue an order refusing qualification, if the indenture does not conform to the prescribed standards or if the trustee has any conflicting interests. Once an indenture is qualified, enforcement of its terms is left to the trustee and the indenture security holders.

The report of the Commission's investigation also had shown serious abuses in the functioning of protective committees and the manner in which insiders used such committees to control reorganization proceedings for their personal benefit and to the detriment of public security holders.

The basic thrust of chapter X of the Bankruptcy Act (the Chandler Act) was to eliminate the practical control of reorganization proceedings by inside groups and self-constituted committees and to require, in all cases in which the debtor's indebtedness exceeds $250,000, the appointment by the court of a disinterested trustee, whose attorney must also be independent. It is the function of the trustee to assume charge of the debtor's operations and proceed with the preparation of a plan for its reorganization. He may investigate the acts of the prior management and institute recovery actions where the facts justify such action. Although protective committees and other representatives of security holders are permitted to participate, their activities are subject to strict court review and control. Fees for services in reorganization proceedings are also subject to court approval, which serves to prevent unwarranted and excessive fees to special groups while providing fair and reasonable compensation to those whose services can be shown to have benefited the estate.

Furthermore, chapter X provides that the Commission may participate in corporate reorganization proceedings if requested or approved by the court, so as to aid the court and the independent trustee by rendering expert and independent advice and assistance on all important phases of the proceeding. It operates in an "advisory" capacity, and has the right to be heard on all matters arising in the proceeding, but no right to appeal. It usually undertakes intensive legal and financial studies related to the company, its operations, its indebtedness and other outstanding securities, possible claims against management officials or controlling persons, the prospects for the company's future operations and the possibility of a successful reorganization.

If the indebtedness of the debtor exceeds $3 million the court must, and if less than that amount it may, submit to the Commission all plans of reorganization deemed worthy of consideration. The Commission may thereupon prepare and file with the court its "advisory report" which analyzes the plan or plans in detail and recommends for or against court approval, depending upon whether the Commission considers that the plan provides fair and equitable treatment to all interests affected and is feasible. In some instances the Commission's recommendations are presented orally to the court through its counsel.

The Commission's report is in no way binding upon the court, which may either reject the plan or approve it and submit it to a vote of creditors and affected security holders. In the latter event, a copy or summary of the Commission's advisory report is transmitted to security holders along with the plan, so that they may be informed of the Commission's analysis of and views on the fairness and feasibility of the plan before casting their votes for or against the plan.

Since September 1938 the Commission has participated in chapter X proceedings for the reorganization of 457 debtor companies (371 principal debtors and 86 subsidiaries thereof) with stated assets of more than $3.5 billion and indebtedness of nearly $2.5 billion. Over 60 of these proceedings are still pending. The proceedings have involved the reorganization and rehabilitation of companies engaged in a variety of industries and businesses, including agriculture, mining, manufacturing, financial and investment, merchandising, real estate, construction and allied industries, transportation and communication, service, and utilities. In these proceedings, the Commission has issued a total of 40 advisory reports and 37 supplemental reports. In most other cases, its views and recommendations on the fairness and feasibility of the reorganization plans were presented orally by Commission counsel.

The assistance rendered by the Commission in corporate reorganization proceedings has been favorably noted almost without exception by Federal courts, although they do not always follow the Commission's recommendations. The Chief Judge of the Court of Appeals for the Second Circuit had the following to say about the Commission's advisory services 4 years ago:

"We regard the service being rendered by the Commission to the Courts in connection with the reorganization of corporations to be most valuable, if not indispensable, for the proper disposition of this vital segment of court business according to the Congressional intent. The Commission affords the necessary expert knowledge, the skill, and the uniform approach which individual judges cannot have; and to the district judges in particular, the assistance is unique in its usefulness, and not otherwise to be obtained." 21st Annual Report, p. 89.

More recently, a district court judge made the following comment on the role of the Commission following a hearing on fee allowances in which the Commission had objected to allowances in the requested amounts exceeding $4 million and where the Court approved allowances of $2,068,000, some $250,000 above that recommended by the Commission:

"Though I have been forced to differ from the recommendations of the SEC in many of the instances, I wish to pay tribute to the careful and helpful analysis that the Commission made of the claims. Indeed, I take this opportunity to express my gratitude for the active and intimate participation of the Commission and its counsel in the reorganization proceedings. If any proof were needed of the wisdom of Congress in providing for representation of the public by the Securities and Exchange Commission in reorganization proceedings, it has been furnished in this case. I would have felt helpless without the aid given unstintingly by counsel for the Commission. Each has cheerfully rendered, at the usual modest salary of a public servant, services equal in value to those of any to whom awards are made by this decision." In the Matter of Third Avenue Transit Corporation, S.D.N.Y. Nos. 85851, 86410, 86412, 86413, 86537, unreported, (1958).

Upon appeal, the allowances were further reduced to a figure only $30,000 more than the Commission initially recommended, or an ultimate saving to the debtor estate and its security holders of nearly $2.25 million.

This report began with a discussion of "investor confidence." As indicated herein, all available signs would seem to bear out the fact that investor confidence has been largely restored. In fact, it may be noted that recent estimates place the number of public investors today at 12,500,000, nearly double the 1952 total. The record volume of securities successfully offered for public sale, taken together with the recent rise in the volume of trading on the New York Stock Exchange to the highest level in the Commission's history, is adequate evidence of the restoration of investor confidence.

But the impact of the Federal securities laws and their administration has been felt no less by financial institutions, corporate executives, professional people, and other elements in the financial community than by investors. It can reasonably be said that these acts and their administration have generally fostered improved standards of business conduct among all groups in their relationship to stockholders and investors. While this no doubt has been dictated in part by enlightened self-interest, it nonetheless has contributed substantially to investor confidence.

This, as we have seen, has had its desired effect, for the capital formation processes have successfully served their purpose of being a conduit for the flow of investors' savings into industry in ever increasing volume.

While the Commission can view with pardonable pride the record of its contribution to the interests of the investing public, it cannot rest on the record of its past accomplishments. In a dynamic economy such as this nation is experiencing, new problems of investor protection are constantly arising. The very fact that securities are being offered for public sale in record volume and that exchange trading in securities has reached a high level, plus the fact that more and more people have surplus savings, some of which is being used for investment and speculation in securities, are in and of themselves adequate reasons for the Commission not to become complacent. A boiling stock market not only attracts new investors, some of whom have neither the resources nor the knowledge and skill to speculate in the stock market, but also attracts a fringe element, ever ready to take unfair advantage of the innocent and unsuspecting investor. A substantially increased record of law enforcement actions by the Commission within the past year leaves no doubt of this latter fact.

Nor would we suggest that the investing public might reasonably become complacent. It cannot be overemphasized that nothing in the securities laws or their administration can keep the market price of securities from fluctuating, down as well as up. No reasonable person would wish it otherwise. It is, therefore, incumbent upon individual investors and their advisers to exercise care and even restraint in their analysis, evaluation and purchase of securities.

It is most essential that investors exercise extreme care in their dealings with unknown brokerage firms and their salesmen, particularly those who telephone long-distance with "pie-in-the-sky" promises that the investor can double or triple his money overnight, without risk of loss, through the purchase of stock of a particular company. Common sense would dictate that such a promise is utterly fantastic and ridiculous. Unfortunately, foresight is never quite so good as hindsight, particularly when the promise of quick and easy profits is dangled before one's eyes, as many investors have learned to their sorrow.

The Commission would like to take this occasion to express its thanks and appreciation to a capable, industrious, and efficient staff, both past and present.

In the 1949 Task Force Report on "Regulatory Commissions" by the first "Hoover Commission," the Commission was characterized as "***an outstanding example of the independent commission at its best***." [Italics supplied.]

The statement, of course, applied to the Commission and its work more than 10 years ago and was surely well-deserved. However, it is no less applicable, we submit, to the excellent work of a most competent staff during the past 10 years.

The volume of Commission business in recent years, in nearly all phases of its activities, has been on the increase. An example of this is to be found in the record of Securities Act registration statements filed with and examined by the Commission. In the 26-year administration of that act, a total of 15,930 registration statements were filed which proposed offerings of securities aggregating $167 billion in amount. The past 6 years alone accounted for 5,561 of the filings and $81 billion of the total amount. That the staff has been able to carry on effectively under a tremendous increase in the volume of Commission business is a tribute to its ability and conscientious devotion to duty.

ORIGINAL COMMISSION (As of July 2, 1934)

JOSEPH P. KENNEDY, Chairman
JAMES M. LANDIS
GEORGE C. MATHEWS [deceased]
ROBERT E. HEALY [deceased]
FERDINAND PECORA

Other former members of the Commission, in order of their appointment:

J. D. Ross [deceased]

WILLIAM O. DOUGLAS [served as Chairman]

JEROME N. FRANK [deceased] [served as Chairman]

EDWARD C. EICHER [deceased] [served as Chairman]

LEON HENDERSON

SUMNER T. PIKE

GANSON PURCELL [served as Chairman]

EDMUND BURKE, Jr.

ROBERT H. O'BRIEN

ROBERT K. MCCONNAUGHEY

JAMES J. CAFFREY [served as Chairman]

RICHARD B. MCENTIRE [deceased]

EDMOND M. HANRAHAN [served as Chairman]

HARRY A. MCDONALD [served as Chairman]

PAUL R. ROWEN

DONALD C. COOK [served as Chairman]

EDWARD T. MCCORMICK

ROBERT I. MILLONZI

CLARENCE H. ADAMS

J. HOWARD ROSSBACH

RALPH H. DEMMLER [served as Chairman]

J. SINCLAIR ARMSTRONG [served as Chairman]

A. J. GOODWIN, Jr.

COMMISSIONERS AND STAFF OFFICERS
(As of October 15, 1959)

Commissioners

EDWARD N. GADSBY of Massachusetts, Chairman. [Term expires June 5, 1963]

ANDREW DOWNEY ORRICK of California [Term expires June 5, 1962]

HAROLD C. PATTERSON of Virginia [Term expires June 5, 1960]

EARL F. HASTINGS of Arizona [Term expires June 5, 1964]

JAMES C. SARGENT of New York [Term expires June 5, 1961]

Secretary: ORVAL L. DuBois

Staff Officers

ALBERT K. SCHEIDENHELM, Executive Director.
CHARLES T. KAPPLER, Associate Executive Director.

BYRON D. WOODSIDE, Director, Division of Corporation Finance.
SHARON C. RISK, Associate Director.

JOSEPH C. WOODLE, Director, Division of Corporate Regulation.
W. ALLEN JOHNSON, Associate Director.

PHILIP A. LOOMIS, Jr., Director, Division of Trading and Exchanges.
RALPH S. SAUL, Associate Director.

THOMAS G. MEEKER, General Counsel.
WALTER P. NORTH, Associate General Counsel.

ANDREW BARR, Chief Accountant

LEONARD HELFENSTEIN, Director, Office of Opinion Writing,.
W. VICTOR RODIN, Associate Director.

MANUEL F. COHEN, Adviser to the Commission. [Formerly Chief Counsel, Division of Corporation Finance.]

REGIONAL AND BRANCH OFFICES

Regional Administrators

Region 1. New York, New Jersey. -- Paul Windels, Jr.; Edward Schoen, Jr., 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 9, 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 E. Pennekamp, 821 Market Street, San Francisco 3, Calif.

Region 8. Washington, Oregon, Idaho, Montana, Alaska. -- James E. Newton, 905 Second Avenue Building (Room 304), Seattle 4, Wash.

Region 9. Pennsylvania, Maryland, Virginia, West Virginia, Delaware, District of Columbia. -- William J. Crow, Courts Building, 310 6th Street NW., 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. 424 Bettes 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 1, Mo. Arcade Building (Room 1025), 812 Olive Street.

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

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

COMMISSIONERS

Edward N. Gadsby, Chairman

Chairman Gadsby was born in North Adams, Mass., on April 11, 1900. He received an A.B. degree from Amherst College in 1923 and a J.D. degree from the New York University School of Law in 1928. From 1929 to 1937 he was associated with the law firm of Mudge, Stern, Williams & Tucker of New York City. From 1937 to 1947 he practiced law in North Adams, Mass. In 1947 he was appointed a Commissioner of the Massachusetts Department of Public Utilities and held that position until 1952, serving as Chairman from 1947 to 1949. From 1952 to 1956 he served as General Counsel of the Massachusetts Department of Public Utilities and thereafter was a member of the law firm of Sullivan & Worcester of Boston, Mass. On August 20, 1957, he took office as a member of the Securities and Exchange Commission for a term expiring June 5, 1958 and was designated Chairman of the Commission. He was reappointed effective June 5, 1958 for a term expiring June 5, 1963 and was again designated as Chairman.

Andrew Downey Orrick

Commissioner Orrick was born in San Francisco, Calif., on October 18, 1917. He received his B.A. degree from Yale College in 1940 and an LL.B. degree from the University of California (Hastings College of Law) in 1947. From 1942 to 1946 he was on active duty with the United States Army and was separated from the service as a captain in the Transportation Corps. After being admitted to practice in California in 1947 he was associated with the law firm of Orrick, Dahlquist, Herrington & Sutcliffe, in San Francisco, until February 1954, when he became Regional Administrator of the San Francisco Regional Office of the Securities and Exchange Commission. He served in that capacity until May 25, 1955, when he was sworn in as a member of the Commission for a term of office expiring June 5, 1957. On June 12, 1957, he was reappointed as a member of the Commission for a term of office expiring June 5, 1962. During the periods from

May 27, 1957 to June 6, 1957 and from June 12, 1957 to August 20, 1957 he as designated as Acting Chairman of the Commission.

Harold C. Patterson

Commissioner Patterson was born in Newport, R.I., on March 12, 1897, and attended public schools in Massachusetts and Maryland. He attended George Washington University after graduating from Randolph Macon Academy. In 1918 he enlisted in the United States Naval Reserve for service in World War I, was commissioned ensign, United States Naval Reserve, in 1918; in June 1919 commissioned ensign United States Navy; and resigned in 1923. Prior to 1954, he had for many years been a partner of Auchincloss, Parker & Redpath, members of the New York Stock Exchange, in Washington, D.C. He resigned from the firm June 1, 1954. He served as a Board Member of the National Association of Securities Dealers, Inc., and was active over the years in its securities industry policing work. On June 15, 1954, he was appointed Director of the Division of Trading and Exchanges of the Securities and Exchange Commission and served in that capacity until August 5, 1955, when he took office as a member of the Commission for a term of office expiring June 5,1960.

Earl F. Hastings

Commissioner Hastings was born in Los Angeles, Calif., on April 27, 1908, and resides in Glendale, Ariz. He attended Texas Western University and the University of Denver. He is a registered professional engineer. During the years 1932 to 1941 he served as a consulting engineer with mining and industrial firms. From 1941 to 1942 he worked with Hawaiian constructors on a military installation on Oahu, T.H. From 1942 to 1947 he served in various engineering and managerial capacities. At that time he became a general partner of the firm, Darlington, Hastings & Thorne, which served as industrial consultants and managers. In 1949 he was appointed Director of Securities, Arizona Corporation Commission, Phoenix, and he served in that capacity until March 1,1956, when he was appointed a member of the Securities and Exchange Commission for a term of office expiring June 5,1959. He was reappointed, effective June 5, 1959, as a member of the Commission for a term expiring June 5, 1964.

James C. Sargent

Commissioner Sargent was born in New Haven, Conn., on February 26, 1916, and holds degrees of B.A. and LL.B. from the University of Virginia. He was admitted to the New York Bar in 1940 and became associated with the firm of Clark & Baldwin, New York City. From January 1941 to July 1951, except for military service, he was employed as a trial attorney by Consolidated Edison Company of New York. He enlisted in the United States Army Air Force in 1942 and served in this country as an Air Intelligence school instructor and as a combat and special intelligence officer in the Southwest Pacific. He was separated to inactive duty in January 1946 with the rank of captain. In the fall of

1948, he served as an Assistant Attorney General of the State of New York in the Election Frauds Bureau in New York City. From July 1951 to August 1954 he was employed as law assistant to the Appellate Division, First Department, Supreme Court, State of New York. He was associated with the firm of Spence & Hotchkiss, New York City, from August 1954 until November 1955. In November 1955 he was appointed Administrator of the Commission's New York Regional Office. He served in that capacity until June 29,1956, when he was sworn in as a member of the Commission for a term of office expiring June 5, 1961. He is a Lecturer at Law at the University of Virginia.

PART I
CURRENT PROBLEMS BEFORE THE COMMISSION

The foreword to this report has described the nature of the laws administered by this Commission, the abuses in the securities markets which led to their enactment and some of the problems encountered in administering these laws during the past quarter century. During the 1959 fiscal year these laws were put to their severest test for during that year the nation witnessed the highest level of activity in the securities markets since the organization of the Commission in 1934. This increase in market activity created complex enforcement problems, required the adoption of new regulatory measures and techniques and imposed heavy administrative burdens upon the staff of the Commission. The effects of surging securities markets upon the activities of the Commission are described in detail later in this report. This section briefly sets forth some of the more important problems created by these conditions and the impact of these problems upon the work of the Commission.

The following salient statistics reveal the remarkable increase in activity in the securities markets and the tremendous growth of public interest and participation in those markets:

The total amount of new securities for which registration statements were filed with the Commission in fiscal 1959 totaled $16.6 billion, only $300 million less than the record amount filed in fiscal 1958.

During fiscal 1959 the Commission processed 1,119 registration statements, the largest number of registration statements ever to be processed in a single year in the history of the Commission.

The number of broker-dealers registered with the Commission rose to 4,907, an increase of almost 1,000 registrants since 1951, and the number of representatives registered with the National Association of Securities Dealers, Inc., on June 30, 1959 was 77,917, the largest number in its 20-year history.

The aggregate market value of all stocks on all stock exchanges, which never exceeded $100 billion between 1933 and 1945, reached $337.6 billion on June 30, 1959, almost three times the market value of all stocks on exchanges during the first decade of the Commission's history.

The reported volume of trading on the New York Stock Exchange increased from a daily average of 2 million shares in February 1958, to a peak of 4,100,000 shares in October and November 1958, the highest daily average for any month since June 1933.

The number of holders of shares of publicly owned corporations, according to estimates by the New York Stock Exchange, increased from 6,490,000 in 1952 to 12,500,000 in 1959, the largest number of public shareholders in the nation's history.

The number of registered investment companies increased from 367 in 1952 to 512 in 1959, and the total assets of investment companies increased from $6.8 billion in 1952 to $20 billion in 1959.

A number of factors appear to be responsible for this increase in activity and interest in the securities markets. Among these are the attractiveness of these markets for financing new corporate enterprises and the expansion of old ones, the emphasis upon capital gains in selling equity securities, the fear of inflation, the growing participation in the market of the large institutional investor and an unfortunate tendency among some persons to use the stock market as a medium for gambling. However, the principal concern of the Commission is not with the cause of this activity but with insuring that the securities markets, however active, are fair, orderly and honest, that prices in these markets express the free interplay of supply and demand and that decisions by investors to buy or sell are made in the light of full disclosure of all material facts. The discharge of these statutory responsibilities by the Commission is complicated in present securities markets by the participation of a large number of inexperienced investors and by broker-dealers and promoters unfamiliar with, or contemptuous of, the ethical and legal obligations owed to investors.

Fraud in the Sale of Securities

Active and rising markets have raised the expectations of a substantial segment of the public that it is possible for the unsophisticated investor to reap large and quick profits. In this atmosphere opportunities for fraud and manipulation multiply. Investors become less concerned with the facts about the issuer and the investment characteristics of its securities than with the allure of a possible "killing" described to them by an unknown salesman over the telephone. They become more susceptible to baseless tips and rumors, thus facilitating a variety of deceptive and manipulative practices.

This atmosphere has attracted into the business of selling securities not only the confidence man, the petty swindler and the corporate plunger, but also an outright criminal element. These persons have seized upon the technique of selling securities to unsuspecting customers through the use of boiler rooms. The term "boiler room" refers to a firm engaged in the sale of securities primarily over the long distance telephone, to persons with whom the firm has had no previous contact and by high pressure methods ordinarily accompanied by gross misrepresentation and other fraudulent devices.

Boiler rooms may operate not only from the large financial centers but also in other locations around the country. There has been a noticeable increase, for example, in migratory operators moving from state to state. In some promotions several boiler rooms may be used to sell the spurious issue in widely scattered areas around the country, each boiler room being assigned to saturate its particular region. Not infrequently the long distance telephone salesmen for the boiler room establish themselves in hotel rooms, apartments and alleged business offices.

In many cases, the security sold by a boiler room is unknown and worthless. To create the appearance of an active over-the-counter market for the security, the promoter will place with numerous brokers and dealers, orders for the purchase and sale of small amounts of the security at prices set by him, or arrange to have others do this, with the result that such brokers and dealers will publish quotations for the security at the prices specified in the orders. The salesmen for the boiler room are now able to refer in their sales "pitch" to a market price for the security which the unsuspecting investor can independently verify. When the distribution of the promoter's holdings is completed, however, the orders are withdrawn and the "market" disappears.

In his telephone sales pitch, the boiler room salesman usually promises rapid increases in the market price of the security and no risk of loss in its purchase; he may make numerous misrepresentations concerning the issuer and its future prospects; he may urge purchases notwithstanding statements on the part of the customer that he cannot afford to do so; and he may advise the customer, of whose financial situation he knows nothing, to sell valuable securities in order to purchase the spurious boiler room security being offered.

The Commission has found that resort to the civil injunction and administrative proceeding, no matter how vigorously employed, is not completely effective in halting the operation of boiler rooms. Promoters easily find another worthless issue and either establish or use an existing boiler room as a vehicle for a new fraudulent promotion. The Commission believes that only criminal prosecution will effectively stop those who show such a contemptuous disregard for the law. The Commission has, therefore, placed increased emphasis in its work upon the prosecution of such offenders. In fiscal 1959 the Commission referred to the Department of Justice 45 cases for criminal prosecution, one of the highest number of referrals in the Commission's history, and referrals are continuing at approximately the same rate in fiscal 1960.

A large portion of the Commission's staff is now engaged in investigating, developing, and assisting in the prosecution of criminal actions. Such activity requires careful and painstaking work usually over a period of many months. Investors must be identified and interviewed. Books and records of brokers, dealers and others must be examined and analyzed. The information thus obtained then has to be developed in a form permitting its introduction into evidence in legal proceedings.

Emphasis upon developing criminal cases means that the Commission with its limited resources has had to utilize staff personnel who would otherwise devote their full attention to other urgent enforcement and regulatory problems. The Commission believes, however, that its policy of pressing for criminal prosecution of violators of the Federal securities laws is the most effective deterrent to fraud in the sale of securities and must be vigorously pursued.

In addition to its enforcement program against boiler rooms, the Commission has sought through a broad publicity campaign to alert investors to the risks involved in the purchase of securities from unknown high-pressure salesmen. Posters warning investors of boiler room operators have been widely distributed, spot radio and television announcements carrying similar warnings have been prepared to be broadcast in cooperation with The Advertising Council, and brochures listing protective measures that an investor should take before making a purchase have been prepared for wide public distribution.

Manipulation in the Securities Markets

In April 1959 the Commission issued a statement warning investors to exercise extreme caution and self-restraint when considering the purchase of securities upon the basis of tips and rumors. Price fluctuations were occurring in certain securities on the exchanges and in the over-the-counter markets without apparent economic reason. Also there appeared to be a considerable amount of speculation on the part of public investors. These conditions facilitated the manipulation of securities prices and boded eventual losses to investors. Officials of the leading exchanges also joined in warning investors, and brokerage houses urged their customers to exercise caution in purchasing unknown securities.

In volatile markets where prices are susceptible to swift and wide changes on the basis of rumors, manipulation is facilitated and the task of enforcement becomes increasingly difficult. The Commission has therefore had to place greater emphasis upon the detection and prevention of manipulation and a substantial number of investigations are now in progress. Some of these investigations have resulted in indictments and it is anticipated that certain other cases now under investigation will also lead to criminal prosecution.

Exemptions From Registration and Profiling Publicity

One of the areas of evasion of the registration and prospectus requirements of the Securities Act of 1933 is the claiming of exemptions which, in fact, are not available. The attempt to use these exemptions to evade registration requirements usually occurs where the issue, or the sales procedure to be employed, would not stand the light of the full disclosure requirements of registration. In order to narrow this area of evasion, the Commission has consistently sought through its participation in litigation involving claimed exemptions, through its own decisions and through its rule-making power, to define and clarify the proper limits of certain of these exemptions. One of the significant developments in this area has been the recent amendment by the Commission of Rule 133.

Under Rule 133, which embodies an interpretation of long standing, the issue of securities in connection with certain types of corporate mergers, consolidations, reclassifications of securities and acquisitions of corporate assets is not deemed to constitute a "sale" of securities to stockholders of corporate parties to the transactions. This rule has the effect of exempting these transactions from the registration requirements, but not from the anti-fraud provisions, of the Securities Act. The rule provides no exemption for subsequent distribution of such securities. Because of the substantial number of transactions ostensibly effected in reliance upon the rule but which involved violation of the registration requirements, the Commission amended Rule 133 to restate the purpose and effect of that rule and to clarify its application and limitations. In addition, the Commission adopted a new registration form to provide an expeditious registration procedure for securities issued in a transaction within Rule 133 where such registration is required and where the issuer has solicited proxies under the Commission's proxy rule with respect to such transaction.

In three significant cases the courts have further delineated the boundaries of exemptions from the registration requirements of the Securities Act. A frequently used device for evasion has been the abuse of the intrastate exemption under section 3(a) (11) of the act. The issuer may attempt to use a resident of the state as a nominee for non-resident beneficial owners or the alleged sales to residents may be merely a step in a planned interstate distribution. In S.E.C. v. Hillsborough Investment Corporation, et al. the Court upheld the limitation on the scope of that exemption, long viewed as applicable by the Commission, that a single sale to a non-resident, directly or indirectly, destroys the intrastate exemption for the entire issue, including the securities sold only to residents.

Various devices have been used in an attempt to avoid registration on the claim that a distribution is within the "private offering" exemption under section 4(1) of the act. The Commission and the courts have consistently rejected a numerical test as a conclusive basis for determining the availability of that exemption. In Gilligan, Will & Co. et al. v. S.E.C. the Court of Appeals for the Second Circuit further held that even if a numerical test did exist, persons claiming the exemption would have the burden of establishing a reasonable and bona fide belief that the total number of individuals involved in the placement would remain within that limit. The Court also concluded that the private offering exemption was not available to a dealer who assertedly acquired securities for "investment" where the dealer speculatively purchased unregistered securities in the hope that the financially weak issuer had "turned the corner" and then unloaded the securities on an unadvised public when he later determined that their purchase was an unsound investment.

The third case dealt with the exemption under section 4(1) of the act for trading transactions -- an exemption frequently claimed by boiler rooms. In S.E.C. v. Culpepper et al., the Court of Appeals for the Second Circuit held that a broker-dealer who engages in steps necessary to consummate a public distribution is an "underwriter" within the meaning of the act even though the broker-dealer has no privity with the issuer or a control group.

Another area of evasion of the registration requirements is the use of publicity with respect to an issuer or its securities prior to the filing of a registration statement. In two cases coming before it last year, the Commission undertook to set forth the precise limitations on profiling publicity under section 5(c) of the Securities Act of 1933. In these opinions, the Commission pointed out that the statutory procedure for disseminating information about the issue prior to the time of sale is exclusive and that it "cannot be nullified by recourse to public relations techniques to set in motion or further the machinery of distribution before the statutory disclosures have been made and upon the basis of whatever information the distributor deems it expedient to supply."

Regulation of the Exchanges

During the fiscal year 1959, the Commission took a more active regulatory role with respect to exchange activities. A Commission investigation found, for example, that on the American Stock Exchange floor trading activities were accentuating market swings particularly in issues susceptible to extreme price fluctuations because of a small floating supply. At the suggestion of the Commission that Exchange adopted a rule designed to prevent floor traders from making purchases of stock at successively higher prices and to restrict the impact of their trading upon the market for active and volatile issues. The Commission also questioned the activities of certain specialists on that Exchange, particularly off-floor transactions by specialists in securities in which they were registered. At the suggestion of the Commission, that Exchange adopted a number of additional rules relating to specialists for the purpose of restricting their dealings so far as practicable to those reasonably necessary to permit them to maintain a fair and orderly market in the securities in which they are registered. The regulation of commission rates on the exchanges was the subject of the Commission's attention during fiscal 1959. In line with the suggestions of the Commission, the New York Stock Exchange in March 1959 reduced minimum commissions on small value transactions and instituted a broad study in consultation with the staff of the Commission into the costs of effecting exchange transactions.

Regulation of the Over-the-Counter Markets

The increase in new offerings traded over-the-counter and the phenomenal growth in the number of broker-dealers registered with the Commission and of representatives registered with the National Association of Securities Dealers, Inc., evidence the growing interest in over-the-counter securities. The Commission is seeking to ascertain what changes, if any, may be occurring in the distribution and trading practices of the over-the-counter market as a result of this growth.

In recent securities markets, there has been a strong underlying public demand for so-called "glamour" stocks. These securities often sell at a substantial premium on the first day of trading. Most of these issues are low-priced, have no public market prior to the offering and often involve companies in the electronics, missile and related defense fields. In some instances, promoters have changed the name of the company and its operating divisions to suggest some connection with these activities.

The Commission, after the end of the fiscal year, instituted a broad inquiry into the genesis and distribution of some of these issues to determine, among other things, whether some of these issues have been generated primarily to enrich the promoters, underwriters and others; whether artificial restraints have been imposed upon the floating supply of these issues in order to raise the market price; and whether certain practices have developed in connection with the distribution and marketing arrangements for these issues which violate provisions of the federal securities laws. [Footnote: During the course of the inquiry the Commission, on October 23, 1959, issued Securities Act Release No. 4150 calling to the attention of the financial community certain practices disclosed by the inquiry which, in view of its staff, may involve violations of federal securities laws.]

Inspection of Investment Companies

The rise in the number of new investment companies and the tremendous growth of the industry led the Commission several years ago to develop a program for the routine inspection of investment companies. Since there has been no additional staff available for this purpose and in view of the increased workload of regular administrative business, the Commission has been able to conduct inspections only on a pilot basis for the past few years. It is hoped, however, that additional personnel will be made available so that the inspection program will move forward more rapidly in the future and that a realistic cycle of inspections can be instituted and maintained.

The inspections made by the Commission to date, limited in number though they have been, have shown the urgent need for this method of assuring compliance with the Investment Company Act. In some cases failures to comply with the act or improper practices were discovered and corrective action requested and taken. In one case, the violations were serious in nature and resulted in a stop-order proceeding under the

Securities Act and the issuance of an opinion and stop-order. Apart from bringing to light improprieties or fraudulent conduct, the institution of routine inspections should prove to be particularly beneficial to the newly organized or smaller investment company in complying with the requirements of the Investment Company Act.

Other Factors in the Securities Markets

Under the statutes which it administers, the Commission has the duty to conduct inquiries into the securities markets not only for the purpose of enforcement but also to ascertain facts to aid in the adoption of rules and regulations and for making appropriate legislative recommendations. In dynamic and changing markets, the Commission must continually reassess the statutes and the rules and regulations which it administers in light of new knowledge. For example, the Commission has instituted an inquiry into the problems created by the growth in the size of investment companies for the purpose of determining whether the increased size of investment companies has created problems requiring remedial legislation. Another inquiry of somewhat less importance but of interest to the public is one into the "put" and "call" market. This little known and little explored area of the securities market is now being studied by the Commission to ascertain, among other things, who writes these options, how they are marketed and who purchases them.

PART II
LEGISLATIVE ACTIVITIES

Statutory Amendments Proposed by the Commission

Proposals to amend 87 provisions of the Federal securities laws were submitted by the Commission to the 85th Congress in July and August 1957. These proposals were introduced in both the Senate and the House of Representatives, and the bills were referred to committee, but no action was taken on the bills during the 85th Congress.

During the latter part of 1958 the Commission reexamined these recommendations for legislation and made some modifications, deleting certain proposals and adding others. The modified proposals, which would amend the Securities Act of 1933, The Securities Exchange Act of 1934, the Trust Indenture Act of 1939, the Investment Company Act of 1940 and the Investment Advisers Act of 1940, were then submitted in the 86th Congress to the Committee on Banking and Currency, United States Senate, and the Committee on Interstate and Foreign Commerce, House of Representatives. These Committees have the duty of exercising watchfulness over the execution of the securities laws under section 136 of the Legislative Reorganization Act of 1946.

The Commission's proposals were introduced in the Senate by Senator A. Willis Robertson, Chairman of the Committee on Banking and Currency, for himself and for Senator Homer E. Capehart, as S. 1178, S. 1179, S. 1180, S. 1181, and S. 1182. In the

House of Representatives, Representative Oren Harris, Chairman of the Committee on Interstate and Foreign Commerce, introduced companion bills, H.R. 5001, H.R. 2480, H.R. 5002, H.R. 2481, and H.R. 2482.

Basically the Commission's proposals, the more significant of which are briefly described below, are 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.

The proposed amendments to the Securities Act of 1933 would clarify the jurisdictional basis of the civil liability provisions of the statute; extend existing civil liabilities and provide criminal liability with respect to documents filed with the Commission pursuant to Commission rules in connection with exempt offerings; increase from $300,000 to $500,000 the size of offerings which may be exempted from registration under section 3(b) of the statute; and make it clear that a showing of past violations is a sufficient basis for injunctive relief and that aiders and abettors may be responsible in civil and administrative proceedings.

The proposed amendments to the Securities Exchange Act of 1934 would make comparable changes with respect to injunctive relief and liability of aiders and abettors. In addition, changes proposed in that statute would make it a violation of the act to embezzle monies or securities entrusted to the care of an exchange member or a registered broker or dealer; clarify and strengthen the statutory provisions relating to manipulation and to the financial responsibility of brokers and dealers; authorize the Commission by rule to regulate the borrowing, holding or lending of customers' securities by a broker or dealer; make it clear that attempts to purchase or sell securities are covered by the antifraud provisions of the statute; revise the provisions relating to broker and dealer registration with respect to(a) the basis on which action for denial or revocation may be taken, (b) the sanctions which may be imposed by the Commission, (c) the conditions under which an application for registration may be withdrawn, and (d) the postponement of the effectiveness of an application for registration; authorize the Commission to suspend or withdraw the registration of a securities exchange when the exchange has ceased to meet the requirements of its original registration; clarify the Commission's authority to suspend a security from exchange trading where there has been a failure to comply with the act and where otherwise necessary in the public interest; prohibit trading in the over-the-counter market for limited periods where the public interest and the protection of investors so requires; provide that an insolvent broker or dealer may be adjudicated a bankrupt in an injunctive proceeding instituted by the Commission; and provide for a monetary forfeiture for each day that certain reports required under the act are delinquent.

The changes proposed in the Trust Indenture act of 1939 are designed primarily to conform this statute to recommendations made under the Securities Act.

The proposed amendments to the Investment Company Act of 1940 would require an investment company to state as matters of fundamental policy, which generally could not be changed without the consent of its stockholders, the extent to which it intends to invest in particular types of securities and such other basic investment objectives as it represents it will emphasize; strengthen the provisions requiring a minimum number of independent or nonmanagement directors; limit the extent to which a face-amount investment company can include preferred and common stock in its "qualified investments"; make clear the application of the statute to an "advisory board"; and modify the exception for companies subject to regulation by the Interstate Commerce Commission and clarify the exceptions applicable to companies engaged in banking, insurance, small loan, factoring, discount or real estate businesses.

The proposed changes in the Investment Advisers Act of 1940 would expand the basis for disqualification of a registrant because of prior misconduct; authorize the Commission by rule to require the keeping of books and records and the filing of reports; permit periodic examinations of a registrant's books and records; empower the Commission by rule to define and prescribe means reasonably designed to prevent fraudulent practices; extend criminal liability for willful violation of a rule or order of the Commission; and revise the provisions relating to the postponement of effectiveness and the withdrawal of applications for registration.

Many minor amendments of these statutes are also proposed.

Hearings on the bills were held before the Subcommittee on Securities of the Banking and Currency Committee of the Senate, on June 15, 16, 17, 18, 23, 24, and 25, 1959, and before the Subcommittee on Commerce and Finance of the Committee on Interstate and Foreign Commerce of the House of Representatives on June 3, July 8 and 9 and August 4, 1959. The Commission and staff members presented testimony at the beginning of the hearings before each committee, and again after interested industry representatives and others had been heard. As a result of conferences with industry representatives, similar to those held in connection with the formulation of the legislative recommendations in the 85th Congress, and as a consequence of comments and suggestions made during the course of the hearings by members of Congress and witnesses, the Commission made certain modifications in its proposals. These modifications did not represent abandonment of the original proposals, but essentially constituted clarification and statutory specification of matters in conformity with the original intention of the Commission.

The Commission also advised the Committees that it had no objection to three amendments to the Investment Advisers Act proposed during the hearings by certain investment advisers and their representatives. One would modify the definition of the term "control" in the statute, the second would grant the Commission authority to provide exemptions from the statute, and the third would modify the conditions under which an investment adviser may call himself an "investment counsel."

Other Legislative Proposals

Various other bills to amend the securities laws were introduced, and the Commission submitted comments to the committees of Congress, These bills, except for U.K. 4025 and H.R. 5543, renewed proposals made in previous sessions of the Congress. No hearings were held on the bills, which are discussed briefly below.

1. Proposal to Increase Registration Fees. -- On January 28, 1959, Senator Homer E. Capehart for himself and for Senator Frank J. Lausche introduced S. 737, and on April 13, 1959, Representative John B. Bennett introduced an identical bill, H.R. 6294. Both bills would amend section 31 of the Securities Exchange Act of 1934, which now provides an annual fee for registration of exchanges of one five-hundredths of 1 percent of the aggregate dollar amount of stock exchange transactions, equal to 2 cents per $1,000. Under the bills this exchange registration fee would be increased to a rate of 5 cents per $1,000 and there would be a similar registration fee for brokers and dealers of 5 cents per $1,000 on transactions effected otherwise than on a national securities exchange.

2. Disclosure of Beneficial Ownership of Registered Securities in Election Contests. -- On January 9, 1958, Senator Homer E. Capehart introduced S. 132, a bill directed to identifying beneficial owners of securities in proxy contests. The bill would add to section 14 of the Securities Exchange Act of 1934 a provision making it unlawful for any person to give or to attempt to give a proxy to vote a registered security at any annual or special meeting for the election or removal of directors, with respect to which proxies are solicited by opposing nominees, unless(1) such person is the beneficial owner of the security, or(2) the name and last known address of the beneficial owner appears on the proxy. In addition, the bill would make it unlawful for any person knowingly to exercise or attempt to exercise any proxy in violation of this provision.

3. Reporting Requirement of Beneficial Owners of Registered Securities and Officers and Directors of Issuers Thereof. -- On January 28, 1959, Senator Homer E. Capehart introduced S. 736, which would amend section 16 of the Securities Exchange Act of 1934 to require every beneficial owner of more than 5 percent (instead of 10 percent as now provided) of any class of any equity security which is registered on a national securities exchange to file reports of his securities holdings and transactions with the Commission.

H.R. 1028 was introduced by Representative Abraham Multer on January 7,1959. This bill would amend section 16(a) of the Securities Exchange Act of 1934 to require officers and directors of any issuer of registered securities to report periodically the extent to which, and the purposes for which, their holdings of such securities are pledged.

4. Proposals Relating to Exempt Offerings and Civil Liabilities in Connection Therewith. -- Two bills designed to impose additional civil liabilities in connection with exempt offerings under section 3(b) of the Securities Act of 1933 were introduced in the first session of the 86th Congress. On January 7, 1959, Representative Leonard Farbstein introduced H.R. 93, a bill which would augment existing provisions for civil liabilities by providing for specific liability on the part of those responsible for untrue statements of material facts or omissions to state material facts in any statements or document filed with the Commission in connection with an exempt offering under section 3(b). This bill is identical with the proposal embodied in the Commission's legislative program, except that the Commission proposal also encompasses false filings pursuant to section 3(c) of the statute.

On February 17, 1959, Representative John R. Bennett introduced H.R. 4568, a bill which would raise the exemptive ceiling under section 3(b) from $300,000 to $500,000 and would make applicable to such exempt offerings the strict civil liabilities now pertaining solely to registered offerings.

5. Repeal of Exemption for Intrastate Offering. -- H.R. 884, introduced by Representative Abraham Multer of New York, would remove the exemption provided by section 3(a) (11) of the Securities Act for a security offering confined to the residents of the state within which the issuer is both incorporated and doing business. The Commission has not submitted its views on this proposal.

6. Reduced Sales Load for Certain Purchases of Investment Company Shares. -- As a consequence of the Commission's promulgation on December 2, 1958, of rule 22d-1 under the Investment Company Act, Representative Edward W. Hiestand introduced H.R. 4025 and H.R. 5543, both of which would amend section 22(d) of the statute to authorize quantity purchases of investment company shares by certain retirement associations at reduced sales loads. Prior to the adoption of rule 22d-1 several associations of individuals, which would not be exempted under the provisions of the rule, had received the benefit of a smaller sales load in connection with certain quantity purchases and had been advised by the Commission's staff that it would not recommend that any action be taken in respect of such purchases. Both H.R. 4025 and H.R. 5543 are designed to restore the earlier interpretation.

A substantial amount of time was directed to matters pertaining to other legislative proposals referred to the Commission for comment and to congressional inquiries. During the fiscal year 1959 a total of 76 legislative proposals were analyzed. In comparison, 58 proposals were analyzed during fiscal 1958 and 33 during fiscal 1957. In addition, numerous congressional inquiries relating to matters other than specific legislative proposals were received and answered.

Congressional Hearings

In addition to the hearings in connection with the Commission's legislative program discussed above, the Commission presented to the House Committee on Interstate and Foreign Commerce a general discussion of the Commission's activities and the particular problems currently facing the Commission.

The Commission appeared before the Subcommittee on Legislative Oversight of the House Committee on Interstate and Foreign Commerce in September and November 1958 and again in June 1959.

The Commission also appeared on May 13, 1959, before the House Select Committee on Small Business to testify concerning the Commission's role in administering the laws governing the operation of small business investment companies.

PART III
REVISION OF RULES, REGULATIONS AND FORMS

The Commission made a number of changes during the 1959 fiscal year in its rules, regulations and forms under the various statutes administered by it. Other changes which the Commission published in preliminary form for the purpose of obtaining public comments thereon 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.

[Footnote: The rules and regulations of the Commission are published in the Code of Federal Regulations, the rules adopted under the various Acts administered by the Commission appearing in the following parts of title 17 of that Code:

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

Changing conditions, methods and procedures in business and in the financial practices of business make it necessary for the Commission to maintain a continuing review of its rules, regulations and forms. 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 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 and are very helpful in connection with the Commission's consideration of proposed changes.

THE SECURITIES ACT OF 1933

Amendment of Rule 133

Shortly after the end of the fiscal year the Commission adopted certain amendments to rule 133. The modification of this rule has been under consideration for some time and has been mentioned in previous annual reports of the Commission. Rule 133 provides in general that for the purpose of determining the application of the registration and prospectus provisions of the Securities Act, no "offer" or "sale" shall be deemed to be involved so far as stockholders of a corporation are concerned where, pursuant to the provisions of a statute or the certificate of incorporation, there is submitted to a vote of such stockholders a plan involving a statutory merger, consolidation, reclassification of securities or transfer of assets of the corporation in consideration of the issuance of securities of another corporation. The general purpose of the amendments to the rule is to make it clear that under certain circumstances securities distributed by persons receiving them in connection with such transactions may be required to be registered under the act. For example, the amended rule provides that where one company is merged into another company, a stockholder in control of the merged company who receives securities of the surviving company with a view to making a distribution of such securities to the public shall be deemed to be an underwriter and registration of the securities is required before the distribution can be made. However, registration is not required with respect to securities sold in certain brokers' transactions as defined in the rule.

In connection with the amendment of rule 133, a new Form S-14 was adopted for the registration of certain securities issued in a rule 133 transaction. This form is discussed below.

Amendment of Rule 135

This rule, as originally adopted, provided that a notice or other communication sent by an issuer to its security holders to inform them of the proposed issuance of rights to subscribe to additional securities would not be deemed to offer any security issue for sale if such notice was sent in conformity with the rule. The principal requirements were that the notice be sent within 60 days prior to the record date, state that the offering will be made only by the prospectus and in addition contain only certain specified information necessary to inform the security holders of the forthcoming offering. The purpose of the rule was to enable an issuer to furnish certain factual information to its security holders in advance of making the actual offering.

The rule was amended during the fiscal year to permit the sending of similar notices where an issuer proposes to offer securities to its own security holders, or to the security holders of another issuer in exchange for securities presently held by them, and also where the issuer proposes to make an offering of securities to its employees or to the employees of an affiliate.

Proposed Rule Changes Relating to Assessable Stock

During the 1958 fiscal year the Commission invited public comments on a proposed new rule 136 and certain proposed amendments to rule 140 with respect to assessable stock and the levying of assessments thereon. The general purpose of these proposals was to make it clear that the Securities Act of 1933 applies to the levying of assessments on assessable stock to the same extent that it applies to other securities. Action on these proposals was deferred pending further study of the matter. During the 1959 fiscal year the Commission published revised proposals with respect to the rules referred to and also a proposed exemption Regulation F, which were adopted shortly after the close of the fiscal year.

The new Regulation F, which provides an exemption from registration under the act for assessments and delinquent assessment sales in amounts not exceeding $300,000 in any one year, 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. This notification could be prepared in a relatively short time by any officer of the company who is familiar with the company's affairs and there is no fee or charge for its filing. The filing may be made by mailing the notification to the appropriate regional office of the Commission.

The only information which a company is required to send to its stockholders, or otherwise publish, is a statement of the purposes for which the proceeds from the assessment are proposed to be used. This information may be included in the notice of assessment given by mail or otherwise published as required by State law. If the issuer should employ any other sales literature in connection with the assessment, copies of such literature must be filed with the Commission.

Proposed Rule 144

During the fiscal year the Commission Invited public comments on a proposed rule relating to certain transactions by the International Bank for Reconstruction and Development. The proposed rule, to be designated rule 144, would have defined the term "transactions by an issuer not involving any public offering," in section 4(1) of the act, to include certain activities of the Bank. After the close of the fiscal year, the Commission announced that it had discontinued consideration of the proposed rule since there appeared to be no present need for it.

The proposed rule would also define the term "distribution" in section 2(11) of the act as not applying to such transactions by the bank or by any dealer who is acting on an agency basis pursuant to a written contract with the bank.

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

Adoption of Rule 151

This rule defines the term "public offering" to exclude under certain conditions the offering of stock of small business investment companies to small business concerns pursuant to the requirements of the Small Business Investment Act of 1958.

Under section 304(d) of the Small Business Investment Act, whenever a small business investment company provides capital to a small business concern through the purchase of the latter's convertible debenture bonds, the small business concern is required to purchase stock of the small business investment company in an amount equal to not less than 2 percent nor more than 5 percent of the capital so provided, in accordance with regulations of the Small Business Administration. Those regulations specify certain minimum amounts of such stock which a small business concern is required to purchase depending upon the amount of capital which it obtains from a small business investment company through the issuance of convertible debenture bonds.

The new rule provides that a public offering of capital stock of a small business investment company is not deemed to be involved where the offer or sale is made in connection with the purchase of debenture bonds from a small business concern pursuant to the requirements of the Small Business Investment Act, the amount of stock involved is the minimum required by that act and the regulations thereunder in connection with the particular transaction, and the stock is acquired by the small business concern for investment and not with a view to its distribution.

Amendment of Rule 434A

This rule permits the use of summary prospectuses which omit in part or summarize information set forth in the more complete prospectus required to be used in connection with the offering and sale of securities. Summary prospectuses may be used in the form of newspaper advertisements, circulars, etc. as a screening device to locate persons interested in receiving a copy of the complete prospectus.

The rule was amended during the fiscal year to permit the use of summary prospectuses by a larger group of issuers. The rule as previously in effect permitted the use of summary prospectuses only by registrants which file reports under sections 13 and 15(d) of the Securities Exchange Act of 1934. The amended rule permits the use of summary prospectuses by certain other registrants which do not file such reports but which meet certain standards as to size, earnings, and the publication of reports.

Adoption of Regulation E

The Commission during the fiscal year adopted a new regulation, designated Regulation E, which 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 exempts issues not in excess of $300,000 from registration under the act, was adopted pursuant to the new section 3(c) which was added to the Securities Act by section 307(a) of the Small Business Investment Act.

Regulation E is similar in many respects to the general exemption for certain securities, other than those of investment companies, provided by Regulation A. It requires the filing of a notification with the Commission and, except in the case of offerings not in excess of $50,000, the filing and use of an offering circular containing certain specified information. In general, information is required in the offering circular as to the business and investment policies of the issuer, its management and its financial condition. The financial statements required must be prepared in accordance with generally accepted accounting principles and practices but need not be certified by independent public accountants. Provision is made for the suspension of an exemption in a particular case if the Commission finds that any of the terms and conditions of the regulation have not been met or complied with.

Adoption of Form N-5

During the fiscal year the Commission adopted a new form, designated Form N-5, for the registration under the Securities Act of 1933 of securities to be issued by 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, This form is also to be used for the registration statements of such companies filed pursuant to section 8(b) of the Investment Company Act of 1940.

The new form is a combination form which enables a small business investment company to register under the Investment Company Act of 1940 and at the same time to register securities for a public offering under the Securities Act of 1933 by means of a single registration statement. If a company has already registered under the Investment Company Act, the form may be used for subsequent registration under the Securities Act. If a company desires to register under the Investment Company Act prior to registering securities under the Securities Act, the form may be used for this purpose also.

Adoption of Form S-14

In connection with the adoption of amendments to rule 133, the Commission also adopted a new Form S-14. This form is designed to provide a simplified registration procedure for securities issued in a rule 133 transaction where such registration is required and where the issuer has solicited proxies under the Commission's proxy rules with respect to such transaction. The form provides that the prospectus may consist chiefly of the information set forth in the proxy statement supplemented by the necessary underwriting and distribution data and pertinent information regarding developments in the registrant's business subsequent to the rule 133 transaction.

THE SECURITIES EXCHANGE ACT OF 1934

Adoption of Rule 16b-8

The Commission during the fiscal year adopted a new rule under section 16(b) of the Securities Exchange Act of 1934. This section of the act provides that profits obtained by certain holders of the stock of a listed company from purchases and sales, or sales and purchases, of any equity securities of such company (other than exempt securities) within any 6-month period may be recovered by the company or by any security holder on its behalf.

The new rule, designated rule 16b-8, exempts from section 16(b) under certain conditions the receipt from an issuer of shares of stock having general voting power and registered on a national securities exchange upon the surrender of an equal number of shares of stock of the same issuer which do not have such voting power and are not so registered, where the transaction is effected pursuant to the provisions of the issuer's certificate of incorporation for the purpose of making an immediate sale of the shares so received.

The conditions of the rule, briefly summarized, are that the person so receiving such shares is not an officer or director of the issuer or a person who was a beneficial owner immediately prior to the transaction of more than 10 percent of a registered equity security of the issuer; that the shares surrendered and the shares received are freely transferable and entitle the holders thereof to participate equally per share in all distributions of earnings and assets; that the shares received must be registered upon issuance in the name of a person or persons other than the holder of the shares surrendered and may be required to be issued as of right only in connection with the public offering, sale, and distribution or gift of such shares; and that no shares of the class surrendered or any other shares of the class received are acquired by the person effecting the transaction within six months before or after the date of the transaction.

Amendment of Form 8-K

The Commission during the fiscal year adopted certain amendments to Form 8-K, which is the form prescribed for current reports filed pursuant to sections 13 and 15(d) of the Securities Exchange Act of 1934. The amendments relate to the item of the form which requires information in regard to matters submitted to a vote of security holders, either at a meeting of such security holders or otherwise. The purpose of the amendments was to clarify the item with respect to the circumstances under which the information specified in the item is required to be furnished.

The Commission also invited public comments on certain other proposed amendments to Form 8-K 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. Shortly after the end of the fiscal year the time for submitting comments on these proposed changes was extended to August 15, 1959.

THE INVESTMENT COMPANY ACT OF 1940

Adoption of Rule 3c-1

In connection with the adoption of rule 151 under the Securities Act, the Commission also adopted a new rule 3c-1 under the Investment Company Act of 1940 defining the term "public offering", for the purposes of section 3(c)(1) of that act, to exclude under certain conditions, the offering of stock of small business investment companies to small business concerns pursuant to the requirements of the Small Business Investment Act of 1958.20 Section 3(c)(1) of the Investment Company Act provides that any issuer whose outstanding securities (other than short term paper) are beneficially owned by not more than 100 persons and which is not making and does not presently propose to make a public offering of its securities is not an investment company within the meaning of the act. Since the requirements of the Small Business Investment Act and the rules and regulations thereunder require that a small business investment company in its role as a provider of capital continually stand ready to sell its stock to small business concerns, a continuous disposition of stock by such investment companies may possibly be interpreted to be a "public offering." The Commission, therefore, adopted rule 3c-1 to effectuate the purposes and objectives of the Small Business Investment Act without adversely affecting the public investor interest. The terms and conditions of the rule 3c-1 definition are substantially the same as those contained in rule 151.

Adoption of Rule 10f-3 -- Permitting Acquisition of Securities of Underwriting Syndicates

To alleviate the problems and administrative burdens involved in processing individual applications for relief pursuant to section 10(f) of the act, the Commission, in December 1958, adopted rule 10f-3 exempting certain limited acquisitions of securities by registered investment companies during the existence of an underwriting syndicate where such acquisitions are not made from affiliated underwriters. Notice of the proposed rule was issued in July 1958 and the comments received were unanimously in favor of the adoption of the rule, although a number of suggestions for its modification were included.

Section 10(f) of the act provides that an investment company, unless exempted by rule, regulation or order, is prohibited from purchasing a security during the existence of an underwriting syndicate, if any of the principal underwriters are affiliated persons of the investment company. Before the adoption of rule 10f-3, investment companies were required in all such cases to obtain an exemptive ruling by the Commission prior to the purchase of such securities or to purchase them conditioned on obtaining an exemptive order within such periods of time as a particular underwriter might be willing to grant even though extending beyond the date of the public offering. The new rule permits the investment company to make such purchases under certain conditions without the necessity of obtaining an order of exemption.

Through its experience in considering the many applications for relief filed pursuant to section 10(f) over the years, the Commission was in a position to determine what conditions and safeguards should be imposed in such situations to insure the protection of investors. These include limitations with respect to the consideration paid, as related both to the amount of the offering and the assets of the investment company. In addition, underwriters' commissions may not exceed stated amounts, no purchase may be made from an affiliated underwriter, and the offering must be effectively registered under the Securities Act of 1933. These conditions are designed to permit purchases where the circumstances are such as to make it likely that the purchases would be consistent with the protection of investors. Purchases that do not meet the strict conditions of the rule may, nevertheless, be exempted by order upon application where the statutory standards are satisfied.

Adoption of Rule 22d-1 -- Relating to Variations in Sales Load of Redeemable Securities

Section 22(d) prohibits a registered investment company, its principal underwriter, or a dealer from selling redeemable securities of the company to any person except at a current public offering price described in the prospectus. Rule 22d-1 was adopted by the Commission in order to settle and codify administrative interpretations of the provisions of section 22(d) and to provide by rule exemptions from its provisions which would obviate the necessity for numerous individual applications. Thus, the burden is removed from the industry of preparing applications under section 6(c), and the Commission need not process such exemptions, in cases identical to those where such relief had previously been granted. The result of the rule is to ensure uniform compliance with the provisions of section 22(d). The rule was the product of a comprehensive review of the legislative history of section 22(d) of the act, and all past administrative interpretations and exemptive orders issued under that section. One of the most important objectives of the rule was to determine the question of the availability of a quantity discount (i.e., a reduced sales charge for sales exceeding an established amount) for persons who were banded together for the purpose of making purchases as a group.

The rule permits the granting of quantity discounts and does not insist that the amount of securities must be determined as of a single point of time. In this respect the rule follows previous Commission decisions which had permitted a sales load discount to be based upon shares previously acquired and then owned plus the shares being purchased. Purchases made within a period of not more than 13 months pursuant to a "letter of intent" may also be aggregated for ascertaining the quantity entitled to a discount but the agreement under which such purchases are made must assure that the lower price is justified by the quantity actually purchased and that adjustments will be made if required. In each of these instances, the inclusion of shares of other mutual funds is permitted if the same principal underwriter is involved.

The rule, however, requires uniform prices to individual investors and prohibits quantity discounts to groups of individuals, except in the case of a family unit. A trustee or other fiduciary may obtain a quantity discount for a single trust estate of which there are more than one beneficiary, but quantity discounts may not be allowed on the aggregate of sales to a trustee or representative acting for more than one account or more than one trust. The rule specifically provides that the term "any person" shall not include a group of individuals whose funds are combined directly or indirectly for the purchase of shares, whether jointly or through a representative or agent of the group. The rule in this respect reflects a stricter interpretation than prior Commission views under which quantity discounts had been extended to trustees, custodians, or agents acting on behalf of members of an organization.

The rule permits sales at reduced prices to tax exempt organizations, following Commission decisions in the past granting such ex-emptive treatment. Sales at net asset value or with a lower load are also permitted to be made to officers, directors, and employees of the investment company, its underwriter and investment adviser, but written assurance must be given that the purchases are for investment purposes and that the securities will not be resold except through the usual redemption or repurchase procedure. Sales to employee pension or benefit plans are included within the exemption afforded by the rule.

With respect to the reinvestment of distributions the rule permits the limitation of reinvestment privileges to participants in a systematic investment or dividend reinvestment plan provided all shareholders are offered the opportunity to participate in the dividend reinvestment plan at any time. All stockholders must be notified of the availability of the dividend reinvestment privilege once each year by a statement in the annual report or other document.

The rule has been helpful in stabilizing the pricing methods of the mutual funds. The need for individual exemptive orders has been substantially eliminated, thus lightening the burdens on the companies and the Commission to that extent. The provisions of the rule are, of course, subject to review by the Commission, and specific applications for relief may still be submitted.

Adoption of Form N-5 -- Registration Form for Small Business Investment Companies

As previously indicated, the new Form N-5 is a combination form which enables a small business investment company to register under the Investment Company Act pursuant to section 8(b) and at the same time to register securities for a public offering under the Securities Act of 1933 by means of a single registration statement. If a company has already registered under the Investment Company Act the form may be used for subsequent registration under the Securities Act. If a company desires to register under the Investment Company Act prior to registering securities under the Securities Act, the form may also be used for that purpose.

PART IV
ADMINISTRATION OF THE SECURITIES ACT OF 1933

The Securities Act of 1933 is designed to provide disclosure to investors of 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. Disclosure is obtained by requiring the issuer of such securities to file with the Commission a registration statement and related prospectus containing significant information about the issuer and the offering. These documents are available for public inspection as soon as they are filed. The registration statement must become "effective," however, before the securities may be sold to the public. In addition the prospectus must be furnished to the 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 any security proposed to be publicly offered may be 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 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 set forth 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 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 registration statement of a foreign government must contain comparable information in regard to the underwriting and distribution of the securities being registered, the natural and industrial resources of the country, its revenues, obligations and expenses, a description of the securities being registered, and similar matters. 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 each registration statement for compliance with the standards of accurate and adequate disclosure 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 afforded an opportunity to file a curative amendment. In addition, the Commission has power, after notice and opportunity for hearing, to issue a "stop 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 irresponsible 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 1959 appears below under "Stop Order Proceedings."

Time Required to Complete Registration

Because prompt examination of a registration statement is important to industry, the Commission completes its analysis as promptly as possible. Congress provided for 20 days in the ordinary case between the filing date of a registration statement or of an amendment thereto and the time it may become effective. 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 believes that the statute generally requires it to deny acceleration of the effective elate of a registration statement.

The number of calendar days which elapsed from the date of filing to the effective date of the median registration statement with respect to the 925 registration statements that became effective during the fiscal year ended June 30, 1959, was 28. [Footnote: Does not include 149 registration statements of investment companies filed and effective as amendments to previously effective registration statements pursuant to section 24(e) of the Investment Company Act of 1940. The number of calendar days elapsed from the date of filing to the effective date of registration of the median (average) of these 149 registration statements was 22.] The number of such calendar days in the 1958 and 1957 fiscal years was 24 and 23, respectively.

These 28 calendar days for the median registration statement in the 1959 fiscal year were divided among the three principal stages of the registration process as follows:

(a) from the date of filing the registration statement to the date of the staff's letter of comment, 17 days;

(b) from the date of the staff's letter of comment to the date of filing the first material amendment after such letter, 6 days; and

(c) from the date of filing the first material amendment after the staff's letter of comment to the effective date of registration, 5 days. Holidays as well as Saturdays and Sundays are included in these numbers of days.

The increase in elapsed time is a reflection of the substantial increase in the number of registration statements filed, as indicated below, and of the fact that a large number of these statements related to new or unseasoned ventures which required relatively more time and effort in making an appropriate review.

VOLUME OF SECURITIES REGISTERED

Securities effectively registered under the Securities Act of 1933 during fiscal 1959 totalled $15.7 billion, 5 percent less than the record $16.5 billion registered the previous year. The number of registration statements filed was 1,226, 34% greater than in 1958. During the 25-year history of the Commission, approximately $160 billion of registrations have become effective, $71 billion in the last 5 fiscal years. The lowest annual volume of registrations was $659 million in the wartime year 1943. The chart below shows the dollar amount of effective registrations by fiscal years from 1935 to 1959.

[chart omitted]

These figures cover all securities effectively registered, 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 long-term options. Of the dollar amount of securities registered in 1959, 77.3 percent was for the account of issuers for cash sale, 17.5 percent for account of issuers for other than cash sale and 5.2 percent was for the account of others, as shown below.

[table omitted]

Securities to be sold for cash, for account of the issuer amounted to $12.1 billion in 1959, a decrease of $1.2 billion over the previous year. This reflects a 23 percent decrease, about $1.6 billion, in the volume of debt securities, partially offset by a small increase in the volume of common stock. Debt securities made up $5.3 billion of the 1959 volume, preferred stock $400 million and common stock $6.4 billion. Investment company securities showed a sharp increase in 1959 and accounted for 60 percent of the total for common stock compared with less than one-half in fiscal 1958.

The amount of securities registered by investment companies increased almost 50 percent in 1959 over the previous year while that registered by communication companies decreased 80 percent. Among the smaller groups, the trade group aggregate showed an outstanding increase. Securities classified by industry, registered for cash sale for account of issuers in each of the last 3 fiscal years are shown below:

[table omitted]

Of the net proceeds of the corporate securities registered for cash sale for the account of issuers in fiscal 1959, 53 percent was designated for new money purposes, including plant, equipment, and working capital, 1 percent for retirement of securities, 43 percent for purchase of securities, principally by investment companies and 3 percent for all other purposes.

REGISTRATION STATEMENTS FILED

During the 1959 fiscal year, 1,226 registration statements were filed for offerings of securities aggregating $16,622,890,371, an increase of 34% over the 913 registration statements filed during the 1958 fiscal year for offerings amounting to $16,913,744,964.

Of the 1,226 registration statements filed in the 1959 fiscal year, 472, or 39 percent, were filed by companies that had not previously filed any registration statement under the Securities Act of 1933. Comparable figures for the 1958 and 1957 fiscal years were 254, or 28 percent, and 305, or 32 percent, respectively.

A cumulative total of 15,930 registration statements has been filed under the act by 7,397 different issuers covering proposed offerings of securities aggregating over $167 billion from the enactment of the Securities Act of 1933 to June 30,1959.

[table omitted]

The reasons given by registrants for requesting withdrawal of the 65 registration statements that were withdrawn during the 1959 fiscal year are shown in the following table:

[table omitted]

RESULTS OBTAINED BY THE REGISTRATION PROCESS

The staff's examination of registration statements often results in significant changes being effected in order that adequate disclosure will be made to the investing public. These changes cover a wide range of subject matters. Examples of disclosures made as a result of the staff's examination are set forth below.

Disclosure of Speculative Features

A registrant organized to produce electronic equipment filed a registration statement for 175,000 shares of common stock (par value of 750 per share) to be offered at $5 a share, the underwriting commission to be $1 per share. Examination of the registration statement revealed that certain speculative features of the proposed offering had not been adequately disclosed.

The prospectus, as filed, stated that the book value of the company's shares prior to the offering was approximately 96 cents but that after the offering it would be approximately $1.86 per share. The registrant was required to include a further statement that such increase would be contributed by the public investors. The registrant was further required to disclose that the underwriters at a total cost of $75 had acquired 75,000 shares of the company's stock representing 15 percent of the total amount of such stock to be outstanding, whereas if all of the shares offered were sold, public investors would pay $875,000 for 35 percent of the stock to be outstanding.

The company was also required to point out in the prospectus that:(1) it proposes to operate in fields where large expenditures for research and development are considered normal and necessary; (2) competition is intense, there being many companies, some with substantially greater resources than the registrant, conducting research and development work in the same general areas; (3) because of research and development work being done, it is possible that one or more of the registrant's proposed products may became obsolete before production is started or at any time thereafter; and (4) only actual production can determine the cost at which any of registrant's proposed products can be produced and only marketing can determine the prices at which they can be sold and the extent of the demand for them.

Disclosure as to Use of Proceeds

A company engaged in the business of acquiring and developing oil and gas properties filed a registration statement covering $1,500,000 of 6 percent convertible debentures due 1969, to be offered initially to its stockholders by means of subscription rights. The underwriter agreed that within 6 business days after the termination of the rights offering it would purchase or find purchasers for debentures not taken down by stockholders so that the company would receive the proceeds from at least $400,000 principal amount of debentures. The underwriter also agreed to use its best efforts for 60 days after the termination of the rights offering to find purchasers for debentures not taken down by stockholders.

As originally filed, the prospectus indicated that the great bulk of the net proceeds was to be used for acquisition of new properties and development of properties then held. However, an analysis made by our staff of the financial position of the company and its future cash needs disclosed that the company was in a precarious cash position, that on the basis of the prior year's operations cash requirements during the next 18 months would be substantially in excess of the amount of cash that would be generated during that period and that therefore the purpose of the offering was not to acquire and develop properties, but to remedy the company's serious financial situation. As a result of numerous comments made by the staff, the prospectus was extensively revised and there was set forth in the forepart thereof, a one and one-half page statement regarding the proposed offering and the company's financial problems, including the following categorical statements:

1. The purpose of the offering was to alleviate the company's shortage of working capital;

2. The company had a working capital deficit of $488,635;

3. Current liabilities included $87,835 of notes payable given for past due accounts payable;

4. Past due accounts payable and past due notes payable amounted to $256,572 and $86,335 respectively;

5. The total amount of funds required to remedy the working capital deficit and retire long term debt maturing within the next 18 months was $1,195,204;

6. Since, on the basis of the previous year's financial report, the company's operations would generate only $335,000 of cash during the next 18 months, cash requirements would exceed cash generated by $860,000;

7. The minimum principal amount of debentures required to be sold to meet the company's present and anticipated cash needs was $1,050,000;

8. Past due accounts and notes payable which might not be paid if sufficient funds were not realized through sale of the debentures might be enforced through legal proceedings;

9. No priority would be accorded the debenture holders as to principal or interest vis-à-vis other general creditors in the event the company's cash needs were not met through the sale of debentures or otherwise.

While a skilled financial analyst, after study and analysis, might have been able to deduce some of the information set forth above, none of the statements recited was contained in the prospectus as originally filed. It is fair to assume that the average investor would have been materially misled by the prospectus as originally filed.

Revision of Summary of Earnings

A corporation which had both domestic and foreign subsidiaries filed a registration statement containing financial statements which failed to reflect significant losses from the operations of one of the foreign subsidiaries. After our staff determined this fact during the course of the examination procedures and discussed it with the corporation's representatives, the financial statements were appropriately amended to include provisions for the foreign subsidiary's losses.

The effect of such revision was to reduce net income for 1956, 1957, and 1958 by approximately $164,000, $88,000, and $10,000 respectively. After this revision net income per share for the 3 years was $0.06, $0.04 and $0.09 per share, or reductions of approximately 76, 70, and 10 percent, respectively.

Disclosure as to Operations

A company engaged in the development and production of certain electronic equipment filed a registration statement covering 240,000 shares of common stock at the par value of 75 cents a share. The offering price was $6 per share and the underwriting commission was $1 a share. In reviewing the registration statement it was noted that the proposed offering was to be made on an extremely high price-earnings ratio and price-book-value ratio. Accordingly the registrant was required to amend the prospectus to state that the price of the shares being offered had been arbitrarily determined by the board of directors and did not bear any relationship to assets or earnings of the company. It was further required to be pointed out that the offering price was 312 times the unaudited earnings per share for the last fiscal year and 13.2 times the net tangible book value on the basis of the company's balance sheet.

With respect to the company's operations, the company was required to state in regard to one of its lines of business that it had at all times operated substantially below production capacity and that during a recent month, for example, it operated at about 7.5 percent of such capacity, leaving 92,5 percent of its capacity idle. The company was further required to point out that it had not yet engaged regularly in the production of certain machinery for commercial use and had no assurance as to the size of the market for such machinery or the acceptability of the company's products in such market.

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 1959 fiscal year, the number initiated during the year, the number terminated and the number pending at the end of the year:

[table omitted]

Shortly after the end of the fiscal year stop orders were issued in two of the proceedings which were pending at the end of the fiscal year and a third proceeding was dismissed. The two proceedings in which stop orders were issued are included in the proceedings described below.

Comico Corporation. -- Comico Corporation is a Delaware corporation organized in 1957 for the purpose of exploiting a deposit of silica material located in Arkansas and held under a leasehold assigned to the company by its promoters. The company filed a registration statement covering a proposed public offering of 750,000 shares of common stock at $2 per share. The Commission instituted investigative hearings to determine whether a stop order should issue. Following these hearings and prior to the effective date of the registration statement the Commission instituted stop order proceedings. Prior to the institution of the stop order proceedings, the registrant filed an application for withdrawal of the registration, statement which was denied by the Commission.

The registration statement contained a lengthy and optimistic discussion of the uses and markets for the minerals in the registrant's leasehold. The Commission found this statement materially misleading, among other things, because it was not based upon any factual engineering or market survey. The Commission found that the registration statement was also misleading for failure to disclose prior unsuccessful attempts to develop the property leased by the registrant and for failure to fully and adequately disclose the proposed use of the proceeds of the offering, the compensation to underwriters and the interests of management in transactions with the registrant. Moreover, the registration statement failed to indicate clearly that the management would receive 660,000 shares of the registrant's stock for $25,000, whereas the public would be asked to pay $1,500,000 for 750,000 shares. Other deficiencies included the failure to disclose the provisions of the lease and the obligation to pay unusually high royalties, and the failure to set forth clearly in one place the speculative feature of the registrant's business and securities. The Commission issued a stop order suspending the effectiveness of the registration statement.

Diversified Oil and Mining Corporation. -- This company was organized as a spin-off from Shawano Development Corporation and engaged principally in the acquisition of interests in and the operation of oil and gas properties. It filed a registration statement covering a proposed public offering of 2,500,000 shares of $1 par 6 percent convertible, noncumulative, preferred stock, and warrants to purchase at $2 per share 500,000 shares of the company's 10 cent par common stock. The securities were to be offered in units of 25 shares of preferred stock and 5 warrants at a price of $25.50 per unit.

The statement of matters to be considered at the hearing in a stop order proceedings challenged the adequacy and accuracy of the information disclosed in the registration statement in numerous respects, including information given with respect to the proposed plan of distribution, the use of the proceeds, the description of the business and securities of the registrant, transactions with the promoters and possible liabilities for the previous sale of unregistered securities. Prior to the commencement of the hearing, the registrant submitted a stipulation in which it waived a hearing and the post-hearing procedures provided for in the Commission's rules of practice and consented to the entry of an order suspending the effectiveness of the registration statement. Thereafter, the Commission issued an order suspending the effectiveness of the registration statement.

Fort Pierce Port & Terminal Company. -- This company was organized in 1956 primarily for the purpose of acquiring harbor front property at Fort Pierce, Fla., to be developed and operated as a deep-water port facility. The company filed a registration statement covering a proposed public offering of 2,138,500 shares of its $1 par common stock at $1.25 per share.

The company's properties, consisting of 3,000 feet of harbor front and certain other properties on nearby Causeway Island and on the mainland, were acquired by promoters of the company (including Joseph C. Mackey, board chairman, and H. A. Ramsey, president) with the intention of selling them to the company. The promoters' cost was $155,000 in cash and the assumption of mortgages aggregating $608,750. The properties were transferred to the company at an appraised value of $1,838,500, the company assuming the $608,750 of mortgages and issuing $1,229,500 par value of stock to the promoters. Subsequently, the company acquired 64.4 acres of submerged lands from the State of Florida for $3,220.

Various references in the prospectus to the appraised value of the company's properties were questioned by the Commission's staff including the $430,000 appraised value of the property acquired from the State of Florida for $3,220. According to the staff there appeared to be a lack of adequate basis for the values determined by the appraisal. The properties acquired from the promoters were carried in the company's balance sheet at the appraised valuation ($1,838,250) contrary to generally accepted accounting principles, and the prospectus failed to contain proper disclosures with respect, among other things, to(1) the competitive traffic situation in relation to the port development project, including the results of a study of the facilities made in 1957 by the U.S. Army Engineers; and (2) the speculative feature of the proposed offering. The Commission instituted stop order proceedings with respect to the registration statement.

Prior to completion of the proceedings, the company filed an application for withdrawal of the registration statement, In its application the company conceded "certain inaccurate statements of material facts and certain omissions of material facts" and agreed that correction would be made in any new registration statement which might be filed by the registrant, although the company stated that it did not intend to proceed with its stock offering at that time. The Commission concluded that withdrawal would not be inconsistent with the public interest and the protection of investors and consented to the withdrawal of the registration statement.

Funeral Directors Manufacturing and Supply Company. -- This registrant was organized in Kentucky in 1954 for the purpose of manufacturing plastic grave vaults and plastic and aluminum caskets. It filed a registration statement covering a proposed offering of 199,-907 shares of the registrant's common stock at $100 per share. The registration statement represented that registrant owned no property but that, depending on the success of the offering, it intended to purchase or construct warehouses and plants and factories.

The Commission found that the registration statement contained material misstatements and omissions of material facts with respect to the state of the development work necessary to effect volume production of the registrant's products and failed to disclose the length of time it would take to effect full production. The registration statement also failed to list two officers employed by the registrant and stated that the remuneration to be paid registrant's officers had not been determined or authorized when, as a matter of fact, such remuneration had been authorized and the registrant had incurred a substantial contingent indebtedness to its officers. The registration statement also stated that there were no agreements to recompense any promoter for past or future services when, in fact, registrant was indirectly indebted to a promoter, who was the president of the registrant, for accrued rents, utilities, and services.

A post-effective amendment to the registration statement not only failed to correct the previously existing deficiencies but was itself deficient in additional material respects.

At the close of the case presented by the Commission's staff, the registrant admitted that the disclosures made in the registration statement and in the post-effective amendment were inadequate and that material events and changes which had occurred since the statement became effective were not disclosed in the post-effective amendment. The registrant consented to the issuance of a stop order by the Commission.

Industro Transistor Corporation. -- The registrant was organized in New York in December 1953 and engaged in the manufacture and sale of transistors. It filed a registration statement in 1958 covering a proposed public offering of 135,000 shares of 10-cent par value common stock and, in addition, 36,000 transferable 5-year warrants for the purchase of 1 share of common stock per warrant and the 36,000 shares of common stock subject to such warrants. Proceedings were instituted to determine whether a stop order should issue suspending the effectiveness of the registration statement. Among the deficiencies found to exist are those described below.

The prospectus failed to contain an adequate and accurate statement with respect to the volume of the registrant's production, the amount of sales to the customers listed in the prospectus, the registrant's competitive position in the industry and the nature of its sales and distribution arrangements. The financial statements included in the prospectus were not prepared in accordance with the Commission's requirements and good accounting practice. For example, sales returns were not shown as a deduction from sales but were treated as purchases of raw material. The income statement showed a net profit from operations for a 4-month period of over $17,000 whereas, if it had been properly prepared, it would have shown a substantial loss.

The prospectus failed to disclose that the compensation of the underwriter included the difference between the exercise price of the 36,000 warrants which the underwriter was to receive and the market price of the stock. The prospectus was also misleading in stating that the underwriter was to pay 1 cent for each warrant, whereas it does not appear that any arrangement was made for such payment, in addition, the prospectus failed to state the possible adverse effect upon the registrant and its security holders of the granting of warrants to the underwriter and to certain other persons, and to state adequately and accurately the purposes for which proceeds from the sale of the securities were to be used.

The Commission issued a stop order suspending the registration statement shortly after the end of the fiscal year. Subsequently, the registrant amended the registration statement to make appropriate disclosure in accordance with the Commission's decision and the Commission lifted its stop order, thus permitting the registration statement to become effective.

Managed Funds Incorporated. -- The registrant, an open-end management type investment company registered under the Investment Company Act of 1940, was organized under the laws of Delaware in 1946. The promoters were Hilton H. Slayton, Hovey E. Slayton, and Thomas W. Ruth. Hilton Slayton was president and a director, and Hovey Slayton was a vice president and a director, of the registrant. The registrant filed a registration statement under the Securities Act of 1933 in 1954 and subsequently registered additional securities by amendment as permitted by section 24(e) of the Investment Company Act. The Commission instituted proceedings under the Securities Act to determine whether a stop order should issue suspending the effectiveness of the registration statement.

The proceedings developed the fact that although Slayton Associates, Inc., all of the voting stock of which was owned by Hilton and Hovey Slayton, was under contract with the registrant to act as its investment advisor and had been paid for such services, it had entered into a contract with Stephen M. Jaquith, a registered representative of a brokerage firm, under which Jaquith was to perform the services of investment advisor for the registrant. For his services, Jaquith and his firm received substantial compensation in the form of commissions on securities transactions. A portion of these commissions were, at the direction of Hilton Slayton, credited to two other individual's, one his brother-in-law and the other a director of the registrant and the Slayton's former attorney. This contract with Jaquith was not disclosed in the registration statement nor had it been approved by the stockholders of the registrant as required by the Investment Company Act.

The record showed that the board of directors gave scant attention to the management of the registrant; made no effort to be informed concerning registrant's policies and whether such policies were being followed; made no decisions concerning purchases and sales of portfolio securities and generally permitted the registrant to be managed by the Slaytons without consultation with or approval by the board as a whole. None of this was disclosed in the registration statement. The prospectus represented that the operations of the registrant were under the supervision and direction of its board of directors and failed to point out that the Slaytons were assuming the functions of the board of directors in directing the operations of the registrant.

The prospectus represented that the principal objective of the registrant was capital growth, that such investment policy would result in normal turnover of portfolio securities and that dividends would be paid quarterly based on the receipt of income or profits on securities held. These representations were materially misleading since the registrant did not follow the stated policies but instead followed the policy of investment for the purpose of providing a flow of cash to its stockholders at a high uniform rate and engaged in a policy of excessive portfolio turnover.

The prospectus was also misleading in failing to disclose that the registrant's policy of realizing capital gains for the purpose of making quarterly distributions to shareholders was deleterious to the position of the shareholders in several respects. First, it required a high rate of portfolio turnover which resulted in the payment of large amounts of brokerage commissions and the payment of higher prices on the repurchase of identical securities immediately after their sale. Second, it further reduced the invested capital of shareholders who reinvested their distributions, since a sales load was charged on such reinvestment. Third, it did not take into consideration whether proper management would require the sale of securities in which net unrealized depreciation existed and thus avoid making distributions which were taxable to shareholders. Fourth, as noted above, the policy of distributing capital gains quarterly was not consistent with the objective of capital growth of the portfolio.

It was registrant's policy to place a portion of the orders for transactions in portfolio securities with broker-dealers who sold its shares. Reciprocal business in the volume of eight or nine million dollars was directed to approximately 36 dealers for the fiscal year ended November 30, 1958. The Commission held that the prospectus should have disclosed that brokerage transactions were directed to broker-dealers who had sold shares of the registrant. In addition, the prospectus should have disclosed that obligations for merchandise and services rendered to the registrant's underwriters and investment advisors were being satisfied by directing to the suppliers brokerage commissions on transactions in the portfolio securities of the registrant. These disclosures should have accompanied the statements in the prospectus of the amount of sales load reallowed to dealers to make these statements not misleading.

On the basis of the Commission's findings, a stop order was entered shortly after the end of the fiscal year suspending the effectiveness of the registration statement.

Mon-O-Co Oil Corporation. -- Registrant, a Montana corporation, was organized in 1940 and engaged in the acquisition of oil and gas leases and exploration for oil and gas. It filed a notification and offering circular under regulation A in March 1957 for the purpose of obtaining an exemption from registration with respect to an offering to its stockholders, pursuant to preemptive rights, of 4,000 stock units, each unit consisting of one share of class A stock and 24 shares of class B stock at $75 per unit and an offering of 14,474 stock units in exchange for certain working interests held by public investors. The Commission thereafter temporarily suspended the exemption. In July 1957, the registrant filed a registration statement covering the same offering plus an additional offering of 4,000 stock units to the stockholders. Prior to the effective date of the registration statement, the Commission instituted stop order proceedings which were consolidated with proceedings to determine whether the order suspending the regulation A exemption should be vacated or made permanent.

The Commission determined that the regulation A exemption should be permanently suspended, on the grounds, among other things, that the offering circular contained false and misleading statements of material facts and that the amount of the offering exceeded the maximum amount of $300,000 permitted for offerings under regulation A. With respect to the stop order proceedings, the Commission found that the geologist's report included in the prospectus contained an excessive estimate of recoverable reserves of oil, and that the registration statement was also materially deficient in the description of the registrant's other properties, in stating the total estimated expenses of the offering and in stating the purposes for which the proceeds were to be used. It also found that the material in the prospectus was poorly organized and that much of the information contained in it was not presented in clear and understandable fashion. Material relating to the same subject matter was scattered throughout various sections of the prospectus, with the result that the ordinary investor would have great difficulty in ascertaining the essential elements of the registrant's business and the merits of the proposed offering without referring to numerous portions of the prospectus and making independent calculations and conclusions as to the facts. The speculative features of the offering were not accurately and adequately disclosed, and there were a number of other deficiencies in the registration statement.

The Commission refused to permit the registration statement to be withdrawn and issued a stop order suspending its effectiveness.

Texas Glass Manufacturing Corporation. -- The registrant, a Texas corporation, was organized in 1952 to engage in the manufacture of window and heavy sheet crystal glass. The company's only property consisted of a plant site in Bryan, Tex., donated by that city and the deed for which was held in escrow contingent upon the execution of a contract to construct a plant. The registrant filed a registration statement in 1957 covering a proposed public offering of 2,700,000 shares of its $1 par value common stock at $2 per share, plus 300,000 shares subject to certain options at $1 per share. Amendments were subsequently filed which, among other things, changed the number of shares being registered. The Commission instituted stop order proceedings with respect to the registration statement in July 1957.

The Commission found that the registration statement contained many deficiencies, some of which were highly material and some of which, while relatively less important, were indicative of a general lack of care in the preparation of the registration statement. Thus, the registration statement contained materially misleading statements with respect to the company's stage of development, the kind of glass which it proposed to manufacture, the processes to be used in manufacturing glass, the source of raw materials and the nature of the market for the registrant's products. For example, it was stated that the company would produce its glass on machines and by methods that are unique and less time consuming, whereas it appeared that the machines and methods proposed to be used are those commonly known and employed by the glass industry.

The registration statement indicated that certain previous sales of the company's stock were exempt from registration under section 3(a) (11) of the act, whereas it appeared that no exemption was available and that there was a contingent liability on the part of the company for such sales which liability was not reflected in the company's financial statements. The prospectus also indicated that 80 percent of the proceeds from the sale of the stock would be placed in an escrow fund to be returned to investors should the company fail to raise enough funds to carry out its plans, but no further information was given with respect to the nature of any escrow agreement or the circumstances under which such fund would be returned to investors. The prospectus also set forth statements with respect to costs applicable to plant construction contracts without indicating that such contracts had not yet been executed. The registration statement also included hypothetical figures purporting to show production costs and revenues for the proposed plant and setting forth a substantial figure as the annual net profit, even though the company had not yet engaged in any business. There were also other deficiencies in the disclosures provided in the registration statement.

In view of the numerous and serious deficiencies in the registration statement the Commission issued a stop order suspending the effectiveness of the registration statement.

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. Six such examinations were initiated during the 1959 fiscal year. None were pending from the previous fiscal year. In two cases the examinations led to stop order proceedings under section 8(d). Four examinations were pending at the close of the fiscal year.

The Commission is also authorized by section 20(a) of the act to make an investigation to determine whether any provisions of the act or of any rule or regulation prescribed thereunder have been or are 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 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 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 regulations:

Regulation A: General exemption for United States and Canadian issues up to $300,000.

Regulation A-M: Special exemption for assessable shares of stock of mining companies up to $100,000.

Regulation A-R: Special exemption for first lien notes up to $100,000.

Regulation B: Exemption for fractional undivided interests in oil or gas rights up to $100,000.

Regulation B-T: Exemption for interests in oil royalty trusts or similar types of trusts or unincorporated association up to $100,000.

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

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. During the fiscal year the Commission, acting pursuant to this authority, adopted a new regulation E, which exempts upon certain terms and conditions limited amounts of securities, not in excess of $300,000, issued by any small business investment company which has received a license or a notice to proceed from the Small Business Administration. This regulation is substantially similar to the one provided by regulation A 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 by section 12(2) or from the criminal liabilities for fraud imposed by section 17 of the act.

Exempt Offerings Under Regulation A

The Commission's regulation A permits a company to obtain not exceeding $300,000 (including underwriting commissions) of needed capital in any 1 year from a public offering of its securities without registration if the company complies with the regulation. Regulation A requires the filing of a notification with the appropriate regional office of the Commission, supplying basic information about the company, certain exhibits, and except in the case of a company with an earnings history which is making an offering not in excess of $50,000, an offering circular which is required to be used in offering the securities.

During the 1959 fiscal year, 854 notifications were filed under regulation A, covering proposed offerings of $170,241,400, compared with 732 notifications covering proposed offerings of $133,889,109 in the 1958 fiscal year. Included in the 1959 total were 42 notifications covering stock offerings of $9,460,253 with respect to companies engaged in the exploratory oil and gas business and 59 notifications covering offerings of $11,314,184 by mining companies.

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

[table omitted]

Most of the offerings which were underwritten were made by commercial underwriters, who participated in 251 offerings in 1959, 185 offerings in 1958, and 252 offerings in 1957. 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 110 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 1959 fiscal year, temporary suspension orders were issued in 87 cases as compared with 88 in the 1958 fiscal year. Of the 87 orders, 2 were later vacated. Requests for hearing were made in 26 cases. In 11 of such cases the requests were later withdrawn, and as of June 30, 1959, the proceedings in the remaining 15 cases were still pending.

As indicated in the 24th annual report, 11 cases were pending as of June '30, 1958, in which a hearing was requested after a temporary suspension order had been issued. In four of such cases the issuers withdrew their hearing requests and consented to the entry of permanent suspension orders and in three cases permanent suspension orders were entered by the Commission after hearings. The remaining four cases were pending on June 30, 1959.

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

Brookridge Development Corporation. -- The temporary suspension order alleged that the terms and conditions of regulation A were not complied with in that the notification failed to disclose all sales of unregistered securities by the issuer or any principal security holder within one year prior to filing. It was asserted, moreover, that the amount of securities proposed to be offered and the amount sold during the past year in violation of section 5 of the act would exceed the regulation A $300,000 limitation. It was also alleged that the offering circular was materially misleading in failing to disclose:(1) Options to which officers of the issuer were entitled; (2) security holdings of the officers and directors; and (3) the effect of the underwriter's participation in the market on the price of the issuer's securities. In addition, the offering circular was alleged to be materially misleading in its inclusion of $176,478.86 described as "Investment in

Subsidiaries" in the December 31, 1958, consolidated balance sheet, and by the inclusion in the consolidated income statement of dividends received from subsidiaries. The Commission's order further averred that the use of the offering circular without appropriate disclosure would be in violation of section 17 of the Securities Act of 1933. The issuer requested a hearing, but this request was subsequently withdrawn and the suspension order became permanent with the lapse of time.

Empire Oil Corporation. -- The order temporarily suspending the regulation A exemption alleged that the terms and conditions of regulation A had not been complied with in that escrow arrangements for certain shares had not been made with an independent escrow agent and information was not supplied (as to the issuer's predecessors and affiliates. Moreover, it was asserted, the offering circular was materially misleading in failing to disclose information with respect to the offering of securities for additional properties, the net production of crude oil and natural gas, estimated oil reserves, and existing or threatened litigation against the issuer. Also, the offering circular was alleged to be materially misleading in its use of appraisal valuations. Violation of section 17 of the Securities Act, in addition, was asserted. No hearing was requested, and the suspension order became permanent with the lapse of time.

Florida National Development Corporation. -- The temporary suspension order alleged that the regulation A terms and conditions had not been complied with in that, among other things, the $300,000 ceiling was exceeded and the issuer failed to disclose that one Mac-Elrod was a promoter or predecessor, or both, of the issuer. The issuer's offering circular was averred to be false and misleading in its failure to disclose:(1) the exact amount paid for the issuer's properties and whether such properties were acquired by the issuer in arms-length transactions; (2) the facts surrounding certain brokerage commissions; (3) the circumstances concerning a $759,660 mortgage and note; and (4) the status of an option on 1,860 acres of land. Further, the financial statements included in the offering circular were materially misleading. The temporary suspension order also asserted violation of section 17 of the Securities Act. No hearing was requested and the temporary suspension order became permanent with the lapse of time.

Gob Shops of America. -- The Commission temporarily suspended the regulation A exemption because it had reason to believe that the issuer's notification failed to comply with the terms and conditions of regulation A and that the offering circular contained false and misleading statements concerning the market and the market price of the stock and the underwriter's activities in the maintenance, domination and control of the market and market price of the stock. A hearing was held at the issuer's request. The issuer moved to dismiss the proceedings on the ground that its withdrawal had become effective and in the alternative requested that withdrawal be permitted, asserting that its failings involved "inadvertent and empty infractions of technical rules or mistaken acts." The Commission held that there was no right under the circumstances to withdrawal of a notification and denied the motion to dismiss. The Commission concluded that the omission to state that the price of the stock was artificially inflated and that the market was not free and open was a serious deficiency. Accordingly, the issuer's request for withdrawal was denied and a permanent suspension order was entered by the Commission.

Inspiration Lead Company, Inc. -- The temporary suspension order alleged numerous deficiencies in the issuer's offering circular concerning, among other things, the issuer's past operations, ore reserves, mining costs, and assets. A hearing was held pursuant to the issuer's request. At the hearing the issuer conceded that the offering circular was inadequate and incomplete in a number of respects, but asserted that the deficiencies were the result of inadvertence and mistake and asked that it be permitted to withdraw its filing for the purpose of revision and correction. The Commission, however, found the deficiencies and omissions to be serious and extensive. It stated, "We have previously indicated that an opportunity to amend a deficient filing cannot be permitted to impair the required standards of careful and honest filings or to encourage a practice of irresponsible or deliberate submission of inadequate material to be followed by correction of deficiencies found by our staff in its examination." The Commission concluded that there was not such a showing of good faith or other mitigating circumstances in connection with the deficiencies as to justify a further opportunity to present an adequate filing in lieu of a permanent suspension. The issuer's request for withdrawal was denied and an order was issued permanently suspending the exemption.

Macinar, Inc. -- The order of temporary suspension in this case alleged that the notification failed to disclose that Automatic Table Co. was an affiliate of the issuer; that it failed to disclose securities sold by Paul Gaston, an affiliate; and that the $300,000 regulation A ceiling would have been exceeded by the offering. It was also averred that the offering circular contained untrue statements of material facts and failed to disclose required information concerning a note payable in the sum of $17,400 held by the wife of the issuer's principal security holder. Moreover, there was a failure to set forth the issuer's assumption of an affiliate's $12,854.82 note and to disclose ail material transactions of officers, directors, and controlling persons with the issuer, its predecessors, and affiliates. The issuer filed a request for hearing and a motion to vacate the temporary suspension order. Both the request for hearing and the motion to vacate were subsequently withdrawn and the temporary suspension order became permanent.

Sports Arenas (Delaware) Inc. -- The temporary suspension order asserted that the issuer failed to disclose all promoters, controlling persons and affiliates and their backgrounds; that the aggregate public offering price of the securities and the aggregate gross proceeds actually received from the sale of securities to the public exceeded the $300,000 regulation A limitation; that an offering circular was not used in the offering of shares to the public; that certain sales material was used which was not filed with the Commission; and that the issuer failed to file a complete and accurate report of sales as required by regulation A. The issuer's offering circular, in addition, was alleged to be materially misleading in its failure to disclose the method of offering, whereby the issuer's securities would be sold to the public at a price higher than the $1.25 stated offering price, and to disclose the profits of those participating in the distribution. Violation of section 17 of the Securities Act was also alleged. No hearing was requested and the suspension order became permanent.

Exempt Offerings Under Regulation B

During the fiscal year ended June 30, 1959, 160 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 1958 fiscal year, 109 offering sheets were filed and during the 1957 fiscal year, 133 were filed. The following table indicates the nature and number of Commission orders issued in connection with such filings during the fiscal years 1957-59. The balance of the offering sheets filed became effective without order.

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 such fiscal years.

[table omitted]

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. Many such actions were brought by the Commission during the past year. Generally these involved violations of both the registration and anti-fraud provisions of the act.

Litigation Involving Violations of the Registration and Anti-Fraud Provisions

Among the more important of such litigation was a complex of four cases involving the sale of common stock of General Oil and Industries, Inc. in violation of the registration and anti-fraud provisions. The company was originally organized in 1931 under the name of Pacific Gold Placers, Inc. All of its stock was issued prior to July 27, 1933, the effective date of the Securities Act, In 1958 the company was purchased by one Sidney B. Josephson, who changed its name, and increased the capitalization by 2 million shares. Thereafter, the complaints alleged, Josephson, a defendant in all of the cases, caused many of these unregistered shares to be sold in interstate commerce to the public by means of various misrepresentations. The Commission brought suits against A. G. Bellin Securities Corp., Stratford Securities Co., Inc., Phoenix Securities Corp., Stanley Brown, registered broker-dealers, and numerous individual defendants, along with Josephson, to enjoin the sale of these securities. Orders of preliminary injunction have been entered in the first two cases for violation of the registration provisions, and the cases set for hearings.

Two cases involved the sale of Canadian Javelin Limited

stock in violation of both the antifraud and registration provisions of the act. In the first case, the Commission brought suit against Canadian Javelin, European Fiduciary Corp., and various officers and employees of these corporations. The complaint charged the defendants with selling the securities by telephone and through the mails in the United States without filing a registration statement. It further charged that the securities were being sold by concealing the identity of the sellers, the consideration being paid to the brokers and dealers for recommending the securities, and also by misrepresenting their value. The corporations and three of the defendants consented to entry of final judgment enjoining further sales. In the second case, a U.S. investment adviser and an associate were charged with similar violations in the sale of Canadian Javelin. A permanent injunction was entered against them by consent.

In another case involving the sale of Canadian securities in this country, the Commission charged Philip Newman Associates, a registered broker-dealer, with selling securities of the Monarch Asbestos Co., Ltd., through the mails and by telephone to persons in the United States without filing a registration statement. The Newman firm and its officers were also charged with misrepresenting the securities with respect to the value of the stock and the business expectations of the company. A permanent injunction was entered against the Newman firm and its officers and employees by consent, and a preliminary injunction was granted as to Monarch Asbestos and others by default.

In S.E.C. v. Los Angeles Trust Deed and Mortgage Exchange et al., 264 F. 2d 190 (C.A. 9, 1959), the district court granted the Commission's motion for a preliminary injunction and the appointment of a receiver in an action brought by the Commission based on violations of the registration and fraud provisions of the Securities Act and the Securities Exchange Act in connection with the sale of trust deeds on individual parcels of property. See the 24th Annual Report at pages 51-52 for a discussion of the district court action. The judgment was reversed by the Court of Appeals for the Ninth Circuit, which did not reach the issue of whether the trust deeds constituted securities. It felt that this question, as well as others, including the matter of the appointment of a receiver, should await trial on the merits, particularly since the Court believed that certain procedural errors had occurred on the hearing. Accordingly, the Court remanded the case for trial, and trial was pending at the end of the fiscal year.

As in past years, many cases involved fraud in the sale of securities of mining companies. In S.E.C. v. Gotham Securities the Commission's complaint charged the defendants with fraud in the sale of Saskalon Uranium and Oil, Ltd. common stock. The purchasers were told that they would "reap rich rewards," that the shares would be listed on a national exchange, and that the company was about to pay a dividend. A permanent injunction was entered against the defendants by consent.

Permanent injunctions were also entered against the Lincoln Securities Corp. and its officers and salesmen, for fraud in the sale of shares of Shoreland Mines, Ltd., a Canadian mining company. Judgment was entered upon consent of defendants. In S.E.C. v. Del Marva Oil and Gas, et at. a final judgment was entered by consent against five oil and gas companies and their controlling stockholders. The judgment permanently enjoined defendants from making misleading statements of the value of mining properties, the ownership of leases, the probability of discovery of oil, etc. In S.E.C. v. Scott Taylor and Co., Inc. a temporary restraining order has been issued to restrain the sale of shares of Atomic Mining Corp., a Canadian corporation, pending a hearing of the case. A temporary restraining order has also been issued in S.E.C. v. Webster Securities Corp. to restrain sales of stock of Goldfield Mines Co. of Nevada. In S.E.C. v. Gravity Science Foundation, et al., the complaint charged defendant with selling investment contracts and undivided interests in oil and gas leases without registering under the Securities Act. Various misrepresentations concerning the operations of the company were also alleged to have been made. The Commission moved against the sale and offering of investment contracts without registration in S.E.C. v. The Donna-June Co. In this case the investment contracts were represented by limited partnership interests plus a profit-sharing agreement. In both cases, a permanent injunction was ordered with consent of defendants.

Two important cases involved failure of defendants to meet the prospectus requirements of the 1933 act. In S.E.C. v. North American Finance Co. the complaint charged defendant with offering for sale 500,000 shares of common stock by transmitting through the mails a prospectus which did not meet the statutory requirements. The Commission alleged, among other things, that numerous misrepresentations were made as to the value of the shares, that the Commission had approved the price at which the securities were being sold, and that the stock was insured. The case is particularly significant in that it is the first to hold that a prospectus does not meet the requirements of section 10(a) of the Securities Act if the financial statements therein represent that an accountant is independent when in fact he is not. A permanent injunction was entered upon consent of defendants. A permanent injunction was entered against Universal Drilling Co., Inc. and its president, Louis J. Roussel restraining defendants from transmitting any prospectus relating to the sale of common stock in Universal until the prospectus met the requirements of the Securities Act. Counsel for these defendants informed the court of their intention to make an offer of rescission to customers who purchased the stock from the defendants J. H. Lederer Co., Inc. and Jean K. Veditz Co., Inc., registered broker-dealers. The court continued the restraining order previously entered against the latter, to prevent dissipation of funds until determination of the Commission's application for appointment of a receiver. A permanent injunction was also entered by consent in S.E.C. v. Universal Service Corp. for violation, inter alia, of the prospectus provisions.

A permanent injunction by consent was entered against the Vari-Pac Corporation for numerous fraudulent representations in violation of the 1933 act. In a companion case, the Commission later succeeded in obtaining a permanent injunction against the defendant I. B. Morion & Co., Inc. for violation of the antifraud provisions of the 1933 act and the registration provisions pertaining to broker-dealers in the Securities Exchange Act of 1934. Two other dealers in Vari-Pac stock were also enjoined from making further offers or sales.

In S.E.C. v. O.T.C. Enterprises, Inc. the defendants were offering shares in a company purportedly developing a spaceship to fly through the universe utilizing "free energy." A public inaugural flight of the prototype at Oklahoma City, scheduled for April 19, 1959, failed to materialize. Otis T. Carr, president of the company, publicly announced that a space craft designed by him would be constructed in which a flight to the moon would be made on December 7, 1959, returning to earth on December 15, 1959. In addition to selling shares to hundreds of investors, the promoters obtained additional income by selling plans for the spaceship and toy models at prices ranging from $5 to $10 a piece, and by organizing groups to study unidentified flying objects. They also attempted to promote a Space City, to be located near Washington, D.C., and to maintain direct contact with communities on other planets and stars. At least half a million dollars was obtained from hundreds of investors. Final judgment was obtained by the Commission permanently enjoining defendants from further sales or offers of sales.

Among other cases in which fraudulent misrepresentations were enjoined were: S.E.C. v. General Associates, Inc., S.E.C. v. The Angelique Co., S.E.C. v. J. P. Lord, Inc., S.E.C. v. Walker-Stevens, Inc., S.E.C. v. Consolidated Enterprises, Inc., S.E.C. v. Kimball Securities, Inc. and S.E.C. v. International Corp., et al.

In S.E.C. v. Arvida Corporation the Commission's complaint charged two broker-dealers with violation of section 5(c) of the Securities Act prohibiting public offerings of securities before the filing of a registration statement. In enjoining any further violation, the court held that the issuance of a press release giving a number of facts concerning the development of Arvida Corporation and the proposed stock offering, and the convening of a press conference at which additional facts were given, including the proposed price, constituted an offer to sell within the meaning of the act and was in violation of the act because a registration statement covering the securities offered had not been filed with the Commission. Judgment was entered upon consent of defendants. In related broker-dealer proceedings the Commission also concluded that defendants had violated the registration provisions of the 1933 act willfully, but held that no sanction was required in the public interest under the particular circumstances of the case. Securities Exchange Act Release No. 5870 (February 9, 1959). After the institution of these proceedings a registration statement was filed and became effective.

In a case still pending, the Commission has brought suit to enjoin John Addison, Niles White, White, Green & Addison Associates, Inc., Trans-world Mining Corporation, Murchison Ventures, Inc., and numerous individual officers and employees, from further violating the registration provisions of the Securities Act of 1933, and to enjoin the defendants, their banks and depositories from dissipating or disbursing the assets or funds of these defendants, and particularly the sum of $146,625 found in a suitcase left by Addison in a public carrier terminal. The Commission's complaint charges that since 1955 the defendants have been selling securities, namely, notes, evidences of indebtedness, participation in profit-sharing agreements, investment contracts, and fractional undivided interests in oil, gas, and other mineral rights, by use of the mails and in interstate commerce, without having first registered with the Commission. In a supporting affidavit filed with the complaint, it was alleged that Addison and his associates obtained loans from approximately 400 individuals in 23 States, the total of such loans amounting to nearly $1 million. A preliminary in junction has been entered and the sum of $146,625 ordered impounded in the registry of the Court pending a hearing on the merits of the case.

Permanent injunctions restraining sales in violation of the registration provisions were decreed by consent in the following cases: S.E.C. v. Pettyjohn, et al., S.E.C. v. Justus, et al., S.E.C. v. Hillsborough Investment Corp., S.E.C. v. Robbins, S.E.C. v. Bonanza Oil Corp., et al., S.E.C. v. Hinsdale Raceway, Inc., S.E.C. v. Vanco, Inc., et al., and S.E.C. v. Mono-Kearsage Consol. Permanent injunctions were also entered in S.E.C. v. Southwest Securities Inc., et al., and S.E.C. v. Ben Franklin Oil and Gas Corp., et al., both discussed in the 24th Annual Report.

In the Hillsborough case, supra, the court granted a preliminary injunction against defendants Hillsborough Investment Corporation and Roger Mara, its manager. The defendant corporation, incorporated in New Hampshire, advertised in the newspapers, offering to sell its stock to New Hampshire residents. A few advertisements contained no such limitation. About a dozen sales were made to nonresidents, in some cases after being held in the name of a resident for 30 days. Defendants resisted the motion for a temporary injunction on the ground that a small number of interstate sales, where no future interstate sales were contemplated, should not take the issue out of the intrastate exemption contained in section 3(a)(11) of the 1933 act. The court held that even a single sale to a nonresident, whether directly or through the device of selling to a resident intermediary, destroyed the exemption as to the whole issue, and required registration in order to make future sales to residents.

The Mono-Kearsage Consolidated Mining Company case, supra, was an action by the Commission to enjoin sales of that company's stock without registration by broker-dealers and others who had received the stock from transferees of the company who were in control of the company. The defendants contended that they did not know of the control relationship. The Court, in granting an injunction, held that defendants were underwriters within the meaning of the Securities Act of 1933, that the term "underwriter" includes anyone who purchases from a person directly or indirectly controlling an issuer, or in common control with the issuer, with a view to public distribution of the securities of the issuer, that the defendants were to be held to have knowledge of those facts which they could obtain upon reasonable inquiry. The Court said further:

"Probably the facts directly known by them were sufficient to acquaint them with the true situation. If not, they were sufficient to impose upon them the duty of making further inquiry. Under the circumstances, they were not entitled to rely solely on the self-serving statements of Pennington and the other Canadians denying those facts which would have indicated that they were representing controlling persons, or were under common control with an issuer. With all these red flags warning the dealer to go slowly, he cannot with impunity ignore them and rush blindly on to reap a quick profit. He cannot close his eyes to obvious signals which if reasonably heeded would convince him of, or lead him to, the facts and thereafter succeed on the claim that no express notice of those facts was served upon him. 167 F. Supp. 248, 259 (D. Utah, 1958)."

Litigation Relating to Stop Order Proceedings

In Columbia General Investment Co. v. S.E.C. the Court of Appeals for the Fifth Circuit affirmed a Commission stop order pursuant to section 8(d) of the Securities Act suspending the effectiveness of Columbia's registration statement and denying Columbia's application for withdrawal prior to the effective date of the registration statement. Relying on Jones v. S.E.C., 298 U.S. 1 (1936), Columbia contended that the request for withdrawal divested the Commission of jurisdiction to issue the stop order. In upholding the Commission's order, the Court distinguished the Jones case on the fact that in the instant case 1,800 members of the public held 63,000 shares of the same class of securities covered by the registration statement. The Court noted that these stockholders and members of the investing public who might trade in these securities are proper subject of the official concern of the Commission. Moreover, the Court stated that since Jones a significant change in the law had taken place and it could no longer be said, as it was in Jones, that withdrawal was the concern of the registrant alone. Under the 1954 amendments to the act a registrant may now make offers to sell after filing but before registration. The Court ruled that, if a registrant has an unfettered right to withdraw under these conditions, then the machinery of the Commission could easily be employed as an instrument of fraud. The Court rejected Columbia's contentions that the filing of a substantive amendment terminates, for the purposes of stop order proceedings, the legal significance of the original registration statement.

Participation as Amicus Curiae

In Woodward v. Wright, 266 F. 2d 108 (C.A. 10, 1959), the Commission filed a brief amicus curiae in an appeal from a judgment for the defendant-sellers of an undivided interest in oil and gas rights. The action was based on the civil liability provisions of section 12 of the Securities Act, and while the lower court found that the sellers' prospectus contained a material false statement, it barred recovery since the purchasers had failed to show their reliance on the misrepresentation. After concluding that the contract of sale conveyed fractional undivided interests in oil and gas and hence securities, the Court of Appeals reversed and remanded the case to the district court on the ground that the evidence brought the appellants within the liability provisions of section 12(2). The court rejected the district court's ruling and agreed with the Commission's position that Congress did not impose upon a plaintiff the burden of proving reliance as a condition of recovery under section 12(2). The court refused to permit recovery under section 12(1) holding on the particular facts that a public offering had not been made.

In Creswell-Keith, Inc. v. Willingham, 264 F. 2d 76 (C.A. 8, 1959), the Commission also filed a brief as amicus curiae. This was a private suit wherein the plaintiff involved section 12(2) of the act to rescind a commitment for securities claiming fraudulent misrepresentations were made. The defendants filed motions for dismissal for want of jurisdiction stating that neither the misrepresentations nor the delivery of the securities was made by use of the mails or interstate commerce. The trial court upheld this contention; however this holding was overruled on appeal where the court held, as urged by the Commission, that the section 12(2) "remedy is available if the mails or interstate commerce is used in any manner in consummating the sale" and that "payment of the consideration is part of the consummation of the sale."

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, 1959, 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
New Orleans 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

Four exchanges have been 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 Actions

Each national securities exchange reports to the Commission disciplinary actions taken against its members for violation of the Securities Exchange Act of 1934 or of exchange rules. During the year 4 exchanges reported 23 cases of such disciplinary action, including imposition of fines aggregating $27,550 in 14 cases, the suspension of two individuals from allied exchange membership, and censure of a number of individuals and firms.

Commission Rate Study

On February 20, 1959, the Commission announced the completion by its staff of a study of commission rates charged by members of the New York Stock Exchange undertaken as a result of an increase in commission rates adopted by the Exchange on May 1, 1958. The study was made in view of the responsibilities and duties imposed upon the Commission by section 19(b) of the Securities Exchange Act of 1934 with respect to the rules of national securities exchanges including rules relating to the fixing of reasonable commission rates.

In line with suggestions of the Commission, the Exchange took steps falling into three general areas. First, the Exchange reduced commission rates on transactions ranging from $100 to $2,400 by approximately 5 percent. These modifications were suggested in view of the fact that the May 1958 percentage increases on transactions from $100 to $2,400 were relatively greater than the average percentage increase. The Exchange also eliminated the so-called "round turn" commission rate under which a reduced rate was granted to persons whose purchase and sale of the security was completed within 14 days. It was the view of the Commission that this type of transaction was not entitled to a special discount and the Exchange felt this rate had not achieved its desired objective.

Following the action of the New York Stock Exchange other registered national securities exchanges, including the American Stock Exchange, adopted a schedule of commission rates identical with that of the New York Stock Exchange.

Second, it was decided that an Exchange committee would study the use of a so-called volume or block discount for transactions involving multiple round lot units. The Exchange also agreed to study the possibility of further developing its income and expense survey of member firms as a source of data in connection with commission rates and to work with the staff of the Commission and consultants employed by the Exchange to prepare an outline for the basis of a cost study being made by the Exchange.

Third, the Exchange amended its rules to provide that any proposed constitutional amendment to change commission rates or other charges would be announced 30 days in advance of action by the Board of Governors of the Exchange. Also, it was agreed that the Commission would be advised of any steps taken by the Exchange looking toward changes in commission rates or other charges.

Activities of Floor Traders and Specialists

As a result of a study made by the staff of the Commission of the activities of floor traders and specialists on the American Stock Exchange, certain steps have been taken by that Exchange to impose further controls upon the activities of these members. The Commission concluded from the study that further restrictions were necessary upon floor trading activities on that Exchange; that these restrictions should prevent floor traders from stimulating public interest in a stock by active and concerted buying; and that floor traders should be restricted from aggravating demand in present markets where many issues on the Exchange are peculiarly susceptible to extreme fluctuations because of a small floating supply. The Commission permitted the Exchange to put into effect on an experimental basis for six months a rule which the Exchange believes will minimize the undesirable features of floor trading, yet preserve certain asserted benefits. The effect of the rule is to impose restrictions upon floor trading purchases in a rising market.

In line with suggestions of the Commission, the Exchange has also taken certain steps to regulate further the activities of specialists. Several new rules relating to specialists have been adopted, the most important of which makes subject to Exchange approval all off-floor transactions, with certain limited exceptions, by specialists in securities in which they are registered. The Exchange also has instituted a program for making periodic inspections of specialist dealer transactions in the securities in which they are registered. Under the program specialists will be required to report to the Exchange several times each year the details of their dealings for unannounced periods selected at random by the Exchange.

REGISTRATION OF SECURITIES ON EXCHANGES

A member of a national securities exchange or a broker or dealer may not effect any transaction in a security on an 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, including 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 mid-year financial data. Current reports on Form 8-

K are required to be filed for each month in which any of certain specified events have occurred 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 30,1959, a total of 2,236 issuers had 3,808 classes of securities listed and registered on national securities exchanges, of which 2,631 were classified as stocks and 1,177 as bonds. 1,294 issuers had 1,512 stock issues and 1,124 bond issues listed and registered on the New York Stock Exchange. Thus, 58 percent of the issuers, 57 percent of the stock issues and 95 percent of the bond issues were on the New York Stock Exchange.

During the 1959 fiscal year, 73 issuers listed and registered securities for the first time on a national securities exchange, while registration of all securities of 73 issuers was terminated. The total number of applications for registration of classes of securities on national securities exchanges filed during the 1959 fiscal year was 203.

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 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, 1959, there were 1,503 such issuers, including 247 also registered under the Investment Company Act of 1940.

[table omitted]

MARKET VALUE OF SECURITIES TRADED ON EXCHANGES

The market value on December 31, 1958, of all stocks and bonds admitted to trading on one or more stock exchanges in the United States was approximately $419,585,963,000.

[table omitted]

The New York Stock Exchange and American Stock Exchange figures were reported by those exchanges. There is no duplication of issues between them. The figures for all other exchanges are 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 of issues as shown excludes those suspended from trading and a few others for which quotations were not available. The number and market value as of December 31, 1958, 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 $27.1 billion. The aggregate market value rose to $89.7 billion in 1929, declined to $15.6 billion in 1932, and was $298.8 billion in June 1959. 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]

At the time of passage of the Securities Exchange Act of 1934, stock prices were rising from their low point, reached in 1932, and a substantial recovery occurred through 1936. Indices turned downward with the stock market decline in 1937. Share volumes on the exchanges dropped from 962 million in 1936 to 221 million in 1942 and dollar volumes thereof from $23.6 billion in 1936 to $4.3 billion in 1942. Thereafter, recovery set in. For the calendar year 1958, the exchange turnover reached 1.4 billion shares with $38.4 billion dollar volume of sales, and for the first 6 months of 1959, the turnover reached nearly a billion shares with over $28 billion dollar volume. The number of stocks listed on the registered exchanges fell from 2,961 in 1937 to 2,584 in 1945, and recovered to 2,643 on June 30,1959. Growth of the issuers is reflected by the increase in their outstanding shares as reported below:

[table omitted]

Shares listed on the New York Stock Exchange reached half a billion in 1926,1 billion in 1929, 2 billion in 1948, and 5 billion in 1958. A further increase to 5.46 billion shares listed on this Exchange during the first 6 months of 1959 brings the total shares available for trading on all exchanges to around 7.5 billion as of June 30,1959.

Assets of Domestic Companies with Common Stocks on Exchanges

The assets of all domestic companies having common stocks on the stock exchanges were roughly equal to the $291.4 billion market value of such common stocks on December 31,1958. The equivalence owes to the preponderance of industrial stocks on the exchanges; it is not unusual for industrial stocks to sell for as much as or more than reported assets. The assets included about $280.8 billion for domestic companies with common stocks listed on registered exchanges and $11.4 billion for domestic companies with common stocks unlisted on the exchanges or listed on the exempted exchanges. The $280.8 billion listed aggregate included $266 billion on the New York Stock Exchange,

$9.8 billion on the American Stock Exchange, and $5 billion exclusively on regional exchanges. The $11.4 billion unlisted and exempted aggregates included $8.2 billion on the American Stock Exchange and $3.2 billion exclusively on regional exchanges. The assets represent a conglomerate of individual and consolidated company reports and various treatments of such matters as reserves for depreciation.

Foreign Stock on Exchanges

The market value on December 31,1958, of all shares and certificates representing foreign stocks on the stock exchanges was reported at about $12.5 billion, of which $11.1 billion represented Canadian and $1.4 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.

Comparative Over-the-Counter Statistics

Annual over-the-counter transactions of as much as $200 billion United States Government bonds, centered in the offices of 5 banks and 12 specializing dealers, are about 5 times the total bond and stock volumes on all the stock exchanges, and earn for the over-the-counter industry the distinction of being the world's largest securities market. Government bonds have in the past been actively traded on stock exchanges, reaching $2.9 billion per annum on the New York Stock Exchange in the 1919-20 price recovery, but the last significant Exchange volume was reported 20 years ago, in 1939, and current volumes on the Exchange are around $100,000 per annum.

Securities representing upward of $50 billion State and local government debt are, with few exceptions, sold only over the counter. These bonds are usually issued in serial form, with a comparatively small amount for each maturity date, and have a specialized market owing to their tax-exemption features.

Corporate bond sales on the stock exchanges are only about $1.5 billion per annum, much less than those over-the-counter.

The over-the-counter potential for dealing in stocks is enormous, since there are perhaps a million corporations whose shares might come into the market. [Footnote: U.S. Treasury Department "Statistics of Income" reported 924,961 corporation income tax returns for 1956-57, an increase of 82,836 over 1955-56. About 8,500 of the returns accounted for 75 percent of the $949 billion total reported assets. There have been well over 100,000 new Incorporations per annum over the past decade and this rate nearly doubled In the first 6 months of 1&59 upon passage of laws granting certain tax elections to corporations with not over 10 shareholders] However, less than 1 percent of these corporations appear to have the size and share distribution to command a continuing public market for their stocks. The following over-the-counter data are derived from a continuing survey of the standard security manuals, the National Quotation Bureau Services, and reports to the Commission.

Somewhat over 700 domestic banks have stocks with 300 or more reported holders which are not on any stock exchange. Practically all are common stocks. Their aggregate market value on December 31, 1958, was about $15 billion, which was close to 10 percent of the $155 billion assets on that date of the issuing banks. The corresponding market value of bank stocks on stock exchanges aggregated about $237 million for 24 issues. [Footnote: Of the 22 bank stocks remaining on stock exchanges on June 30, 1959, 1 was listed and registered, and 5 were listed and exempted from registration, on the Washington branch of the Philadelphia-Baltimore Stock Exchange, and 16 were listed on the exempted Richmond, Wheeling, and Honolulu Exchanges.]

About 300 domestic insurance companies have stocks with 300 or more reported holders which are not on any stock exchange. Nearly all are common stocks. The aggregate market value of their quoted stocks on December 31,1958, was about $11.5 billion, which was close to 40 percent of their $29 billion assets on that date. The corresponding value of insurance stocks on stock exchanges aggregated about $1.6 billion for 17 issues of 16 issuers.

About 500 issuers are registered under the Investment Company Act of 1940, and their aggregate assets are about $20 billion. On December 31, 1958, 39 of these issuers, with about $2.2 billion net asset value, had stocks on stock exchanges with about $1.9 billion aggregate market value. [Footnote: With 2 exceptions, all investment trust shares on the stock exchanges are of closed-end issuers. Purchases and sales of closed-end investment trust shares are ordinarily made in the open market such as a stock exchange affords. Holders of open-end investment trust shares ordinarily buy them from distributors and redeem them at their liquidating values. The 2 open-end issuers on stock exchanges are Coca Cola International Corporation and General Capital Corporation, whose shares are listed on the New York Stock Exchange and the Boston Stock Exchange respectively, with no exchange volume reported during 1958 in either issue.] Over-the-counter market or redemption values of the remaining issuers' securities would bear a close correspondence to their approximate $17.8 billion net asset value.

About 2,500 additional domestic industrial, utility, and miscellaneous issuers have stocks with 300 or more reported holders which are not on any stock exchange. The aggregate market value on December 31, 1958, of their shares was about $32.5 billion. About $2.5 billion consisted of preferred stocks. The $30 billion common stocks were of companies with aggregate assets of about $39 billion on that date. Nearly all widely-held railroad stocks and a preponderance of widely-held utility and industrial stocks are on exchanges.

In all, some 3,500 domestic corporate issuers (excluding registered investment companies) have stocks with 300 or more reported holders which are not on any stock exchange, and whose aggregate market value on December 31,1958, was approximately $59 billion. The assets of the issuers having over-the-counter common stocks aggregated about $223 billion on that date, of which nearly 70 percent ($155 billion) was of banks.

As in case of issuers having securities on stock exchanges, the number of such issuers of over-the-counter stocks has not changed greatly in recent years. The constant additions are substantially offset by losses through new listings on stock exchanges, mergers, sales of assets, liquidations and reduction in number of shareholders in some instances. [Footnote: Purchases of stocks for control sometimes reduce holders below 300. Holders of preferred stocks, of real estate stocks issued in reorganizations, and of stocks distributed ("spun-off") by large companies to their numerous stockholders tend to decrease over the years.] Share price changes have kept pace with those of stocks on stock exchanges. Aggregate share values of $238.8 billion on stock exchanges on December 31, 1955, were about 5.3 times the $45 billion over-the-counter values as computed for that date in our 22d Annual Report (1956), and the $312.7 billion stock exchange values on December 31, 1958, were similarly about 5.3 times the $59 billion over-the-counter values as above computed.

The domestic over-the-counter stock values of $59 billion, as computed above, included $15 billion of stocks of banks, which report to their own regulatory agencies. Of the $44 billion of other stock values, about $24 billion, or over 50 percent, were of issuers reporting to the Commission pursuant to requirements of the Securities Exchange Act of 1934. The $24 billion included about $20.7 billion stocks of domestic issuers reporting under section 15(d) of the 1934 Act, by reason of registrations of securities for public sale, and about $3.3 billion over-the-counter stocks of issuers reporting because they have other securities listed on registered exchanges.

Taking into account the share values of registered investment companies which do report, and those of banks which do not report to the Commission, it is evident that the total values of shares of domestic issuers reporting to the Commission is more than half of the total domestic over-the-counter share values, as above computed.

DELISTING OF SECURITIES FROM EXCHANGES

Pursuant to rule 12d2-1(b) under section 12(d) of the Securities Exchange Act, applications may be made to the Commission by issuers to withdraw their securities or by exchanges to strike any securities from listing and registration on exchanges. The Commission may not deny such applications if made in accordance with the appropriate exchange rules, but may impose such terms as it may deem necessary for the protection of investors.

During the fiscal year ended June 30,1959, the Commission granted applications by issuers and exchanges to remove 39 stock issues and 1 bond issue from listing and registration pursuant to rule 12d2-1(b). There were 41 removals, since 1 stock was delisted from 2 exchanges. The number of issuers involved was 37. The removals were as follows:

[table omitted]

The applications by exchanges were based in general upon the ground that the issues were no longer suitable for exchange trading, by reason of reduced public holdings, small values, few holders, inconsequential trading volumes on the exchanges, or a combination of these factors. Some of the issuers were not operating, or were in process of liquidation. Failure to file reports with the exchange was cited in three instances. In six of the applications made by exchanges it was stated that the issuers had requested the action.

The five applications by issuers were for removal of stocks from various regional exchanges. The stocks remained listed on other exchanges where the principal trading volume therein occurred.

From July 1, 1936, through June 30, 1959, there have been 533 delistings of securities on application of exchanges and 279 on application of issuers. Delistings from the New York Stock Exchange numbered 282 pursuant to its applications and 6 pursuant to applications by issuers. Delistings from the American Stock Exchange numbered 58 pursuant to its applications and 25 pursuant to applications by issuers. Delistings from the regional exchanges numbered 193 pursuant to their applications and 248 pursuant to applications by issuers. Thus, about 2 percent of the New York Stock Exchange delistings, 30 percent of the American Stock Exchange delistings, and 56 percent of the regional exchange delistings were pursuant to applications by issuers.

As indicated above, delisting applications filed by exchanges are ordinarily based on lack of adequate public interest in the security issues concerned. The usual exchange application cites diminution in number of holders and publicly held shares or the moribund condition of the issue or issuer. The reduction in the number of holders and publicly held shares frequently results from acquisitions involving an offer of exchange into other listed shares of the same or another issuer. In some cases, a company will have sold its assets for cash and distributed all but small final payments in liquidation. The specific reason given in an application in case of a moribund condition may be that the issuer has failed to file reports required by the listing agreement and registration, or has discontinued transfer and registrar facilities, or faces insolvency proceedings. Some exchanges, upon learning that an issuer has determined to delist an inactively traded issue, will make the application as a matter of good public relations, stating that it is made at the request of the issuer by reason of its inactivity on the Exchange. The New York Stock Exchange, as the leading exchange in number of listings and number of removals, has developed and published criteria on the basis of which it will consider initiation of a delisting application. Some of the stocks delisted upon its application have remained or become listed on other exchanges. [Footnote: Examples include Kalamazoo

Stove and Furnace Company and DTM Corporation stocks remaining on Midwest Stock Exchange, and Spear & Company, Clopay Corporation, and Davega Stores Corporation stocks which became listed on the American Stock Exchange.] One of the stocks delisted upon its application has since become prominent. [Footnote: The number of holders of American Express Company stock, delisted in 1939 when it was nearly all owned by Amerex Holding Corporation, increased from under 100 to over 25,000 in its spin-off by the latter 11 years later.] In general, however, there are very few instances of substantial public interest in securities after their delisting upon application by exchanges.

Delistings upon application by issuers fall into three classes: those which have little value, those which remain listed on other exchanges, and those which are good over-the-counter material. Upon the market break in 1937 and the subsequent drying up of exchange activity, from 962 million shares in 1936 to 221 million in 1942, and from $23.6 billion to $4.3 dollar volume respectively, there was a plethora of issuer applications. In this period, the Commission frequently required issuers to notify their stockholders of the pending application and to advise them of their right to be heard. Response of the holders was inconclusive, but the contents of the notifications were made the cause of denials or dismissals in some instances. [Footnote: The letters received were about equally divided for and against delisting, and personal appearances at the hearings were few in number.] For some time after the low point of the decline in share volumes was reached in 1942, the flow of delisting applications by issuers continued, and the Commission in three cases during the period 1944-46 required important issuers to put their decisions to a vote of stockholders. [Footnote: In none of these cases did the issuer pursue its delisting: application further after imposition of the voting requirement.] However, volumes on the exchanges were recovering. New delisting applications by issuers dropped to an average of about 7 per annum in the 15 years to June 30, 1959, compared to over 21 per annum in the 8 years to June 30,1943. Notifications to stockholders were required in only a few instances after 1943, the last being in 1954; no voting requirement has been ordered by the Commission since 1946. On occasion, either voluntarily or in compliance with a rule of an exchange, issuers have put the matter of delisting to vote of their stockholders before submitting applications. Since 1947, the Commission has held hearings on delisting applications only if requested by an interested party, and only three such hearings have been held since that date, all on delisting applications of the New York Stock Exchange.

Most of the delistings pursuant to applications by issuers during the period have been with respect to issues having little value or issues remaining listed on other exchanges. [Footnote: Delistings on application of issuers during the period originally comprised about 117 with no substantial trading value, 95 remaining listed on other exchanges, and 67 which became good over-the-counter trading material. Since delisting, about half of the 67 last-mentioned issues have been exchanged into listed stocks of other companies or passed out of existence in other ways.] Excluding a number of open-end investment company stocks, originally listed to qualify for sale under blue sky laws and not suitable for exchange trading, issues having a current market value of around $500 million have been removed to over-the-counter trading by delistings pursuant to applications by issuers during the period. [Footnote: This amount is less than 0.2 percent of the market value of stocks on the exchanges.] The reporting requirements of the Commission pursuant to section 13 of the Securities Exchange Act seem not to have been much of a factor in the deliberations of the issuers with respect to delisting, since about $400 million of the market value is of issuers continuing to file similar reports under section 15(d) of the act.

Delisting Proceedings under Section 19(a)

Under section 19(a)(2) the Commission may suspend for a period not exceeding 12 months, or 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. Shown below is the number of such proceedings during the 1959 fiscal year.

[table omitted]

The six proceedings which were terminated during the fiscal year were terminated during the early part of the year and were described in the Commission's 24th Annual Report.

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 1959 fiscal year the Commission found it necessary and appropriate in connection with three pending proceedings under section 19(a)(2) to use its authority summarily to suspend trading in securities registered on a national securities exchange. Only one of these suspensions remained in effect at the end of the fiscal year.

UNLISTED TRADING PRIVILEGES ON EXCHANGES

The classical method by which stock exchanges evolved was for a group of local brokers to commence trading in any available securities. For more than half a century after the historic 1792 meeting under the buttonwood tree, any security could be called up for trading on the New York Stock Exchange at the pleasure of any member. By 1856, vote of a majority of members present came to be required for the placing of a security on the list to be called, but upon payment of a 25-cent "fine" any member could have any other security temporarily inserted. Unlisted trading on the New York Stock Exchange was finally abolished in 1910, upon the recommendation of the New York Governor's Committee on Speculation in Securities and Commodities (the "Hughes Committee") and because most of the stocks in the unlisted department were in any event becoming listed.

The leading regional stock exchanges began trading in much the same way. For example, the rule on the Philadelphia Stock Exchange as late as 1876 was that "members may call up the various stocks of any chartered company, whether on the regular list or not." As their growth in trading volumes and prestige enabled them to impose formal listing agreements and listing fees upon issuers, many of these exchanges came to abolish unlisted trading entirely, as the New York Stock Exchange has done, or to restrict it to issues listed upon other leading exchanges. [Footnote: The listing process has had a long evolution. As early as 1847, the New York Stock Exchange called for transfer books to be located in New York City. Its Committee on Stock List, created in 1869, promulgated rules protecting against forgery and over-issuance of securities, and sought to obtain statements of condition and lists of officers of issuers. The regular files of printed listing statements date from 1884. By 1900, the Exchange had commenced to call upon applicants for agreements to publish detailed statements and annual reports. The issuers' agreements with the Exchange became more comprehensive over the years, providing for periodic earnings statements, independent auditing, prompt notifications of issuer actions affecting their security holders, etc. With the advent of the Commission, the requirements of the listing agreements were supplemented by the requirements for registration along with listing.] A resolution adopted by the Boston Stock Exchange in 1869 provided that "securities dealt in at the New York or Philadelphia Stock Exchanges may be called once, after the regular list, without charge ..." The rule on the Philadelphia Stock Exchange by 1932 was that no securities could be admitted to unlisted trading which were not listed on the New York Stock Exchange, New York Curb Exchange, as it was then styled, Boston Stock Exchange, Pittsburgh Stock Exchange, or Chicago Stock Exchange.

The American Stock Exchange (known as the New York Curb Exchange until 1953) is the principal center of exchange trading on an unlisted basis. In 1931-32 it had over 1,800 stock and 850 bond issues on its unlisted roster. As a result of the New York State Attorney General's examination of unlisted trading practices, the number was substantially reduced during 1933-34 by removal of issues inactively traded on the Exchange. The New York Produce Exchange provided facilities for security trading from 1928 to 1935, and had about 750 stock and 150 bond issues available for unlisted trading. The New York Real Estate Securities Exchange operated from 1929 to 1941, and had about 100 stock and 200 bond issues available for trading on an unlisted basis. A number of other exchanges on which unlisted trading occurred ceased to operate in the early days of the Commission. The net number of securities admitted to unlisted trading on the exchanges prior to 1934 is not available, but clearly ran into thousands.

Under section 12(f) of the Securities Exchange Act of 1934 the Commission may approve applications by national securities exchanges to admit securities to unlisted trading privileges without action on the part of the issuers, if it finds such admissions are necessary or appropriate in the public interest or for the protection of investors. [Footnote: The original bills proposed abolition of unlisted trading on stock exchanges. The proposals were opposed by the American Stock Exchange and other smaller exchanges as presenting too sharp a transition. Congress directed the Commission to study the problem and submit its recommendations, which was done in a "Report on Trading in Unlisted Securities upon Exchanges," dated January 3, 1936. The recommendations were adopted and the present section 12(f) was enacted in May 1936.] Such admissions impose no duties on issuers beyond any they may already have under the act. Section 12(f) provides for three categories of unlisted trading privileges. Clause(1) provides for continuation of unlisted trading privileges existing on the exchanges prior to March 1, 1934. Clause(2) provides for granting by the Commission of applications by exchanges for unlisted trading privileges in securities listed on other exchanges. Clause(3) provides for granting by the Commission of applications for unlisted trading privileges conditioned, among other things, upon the availability of information substantially equivalent to that required to be filed by listed issuers.

Included under clause(1) of section 12(f) are securities which had unlisted trading privileges on some exchanges prior to March 1,1934, and (a) were also listed and registered on some other exchange or exchanges, or(b) were admitted only to unlisted exchange trading. Issuers of securities in group(a) are subject to the statutory reporting requirements by reason of the listing and registration of their securities. Issuers of securities in group(b) may or may not be issuing public reports. Of the issues in group(b), only 246 stock and 20 bond issues remained in that status as of June 30, 1959. The attrition has been due to many factors. Bond and preferred stock issues have been retired. Companies have merged or liquidated. Marginal exchanges opening around the 1929 peak of market activity ceased operations thereafter. Many leading common stocks traded on an unlisted basis have subsequently been listed or exchanged for listed stocks of merging companies.

The stocks with only unlisted trading privileges on the exchanges had an aggregate market value of $21.4 billion as of December 31, 1958. Standard Oil (New Jersey) held 52.5 percent of this total in stocks of Creole Petroleum Corporation, Humble Oil & Refining Company, Imperial Oil Limited, and International Petroleum Company, Limited. An additional 17.5 percent of the total was of 58 issues of 55 issuers reporting as fully as though they were listed, by reason of registrations under the Securities Act, the Public Utility Holding Company Act, the Investment Company Act, or because the issuers in some cases had other securities listed on registered exchanges. The residue in public hands of such unlisted stocks accordingly amounted to only about $6.5 billion, and of this amount, about $4.2 billion was of 70 Canadian and other foreign stocks and American depositary receipts for foreign shares. The reported volume of trading on the exchanges in stock admitted to unlisted trading only, for the calendar year 1958, was about 32.3 million shares or about 2.5 percent of the total share volume on all the exchanges. Over 90 percent of this 32.3 million share volume was on the American Stock Exchange.

Unlisted trading privileges on exchanges in issues listed and registered on other exchanges, granted under clause(1), are for the life of the issue, while those granted under clause(2) are only for the duration of the issue's listing and registration on another exchange. [Footnote: Ordinarily, delisting occurs upon termination of the existence of an issue, and so the unlisted trading privileges therein, whether under clause(1) or clause(2), also end, Occasionally, however, an unlisted trading privilege on one exchange granted under clause(1) has continued after the issue has been delisted from another exchange upon application by the issuer or by the exchange or because a listing was dropped upon merger of exchanges. Currently, 4 such unlisted trading privileges continue in stocks which were formerly listed on other exchanges.] The number of unlisted trading privileges granted under clause(1), in issues listed on other exchanges, were 991 in stocks and 75 in bonds on December 31, 1935. Similar privileges were thereafter granted under clause(2) for 1,410 stock issues and 8 bond issues. Mergers of exchanges, mergers of issuers, etc., have reduced the number of such privileges, which as of June 30, 1959, comprised 1,492 in stocks and 1 in bonds. The reported volume of trading on the exchanges pursuant to these unlisted trading privileges for the calendar year 1958 was about 38.7 million shares or about 3 percent of the total share volume on all the exchanges. About 15 percent of this 38.7 million share volume was on the American Stock Exchange and 85 percent was on the regional exchanges.

On June 30, 1959, unlisted trading privileges existed pursuant to clause(3) of section 12(f) in only 12 bond and 4 stock issues, and 2 of the stock issues have also become listed on other exchanges. There have been no applications under clause(3) since 1949.

Applications for Unlisted Trading Privileges

Applications by exchanges for unlisted trading privileges in stocks listed on other exchanges, made pursuant to clause(2) of section 12(f) of the Securities Exchange Act, were granted by the Commission during the fiscal year ended June 30,1959 as follows :

[table omitted]

Rule 12f-2 under section 12(f) of the Securities Exchange Act provides that when a security admitted to unlisted trading on an exchange is changed in more than certain stipulated minor respects, the exchange may apply for Commission determination that the unlisted trading privileges may continue on the ground that the changed security is substantially equivalent to the security theretofore admitted to unlisted trading privileges. During the fiscal year the Commission granted applications by the American Stock Exchange for continuance of unlisted trading under this rule in three stock issues and two bond issues.

BLOCK DISTRIBUTIONS REPORTED BY EXCHANGES

Rule 10b-2 under the Securities Exchange Act of 1934 in substance prohibits any person participating or otherwise financially interested in the primary or secondary distribution of a security from paying any other person for soliciting a third person to buy any security of the same issuer on a national securities exchange. This rule is an antimanipulative rule adopted under section 10(b) of the act which makes it unlawful for any person to use any manipulative or deceptive device or contrivance in contravention of Commission rules prescribed in the public interest or for the protection of investors. Paragraph(d) of rule 10b-2 exempts transactions where compensation is paid pursuant to the terms of a plan, filed by a national securities exchange and declared effective by the Commission, authorizing the payment of such compensation in connection with the distribution. The Commission in its declaration may impose such terms and conditions upon such plan as it deems necessary or appropriate in the public interest or for the protection of investors.

At the present time two types of plans are in effect to permit a block of securities to be distributed through the facilities of a national securities exchange when it has been determined by the exchange that the regular market on the floor of the exchange cannot absorb the particular block within a reasonable time and at a reasonable price or prices. These plans have been designated the "Special Offering Plan," essentially a fixed price offering based on the market price, and the "Exchange Distribution Plan," which is a distribution "at the market." Both plans contemplate that orders will be solicited off the floor but executed on the floor. Each plan contains certain anti-manipulative controls and requires specified disclosures concerning the distribution to be made to prospective purchasers.

In addition to these two methods of distributing large blocks of securities on national securities exchanges, blocks of listed securities may be distributed to the public by a "Secondary Distribution" on the over-the-counter market, after the close of exchange trading. The exchanges generally require members to obtain the approval of the exchange before participating in such secondary distributions.

The following table shows the number and volume of special offerings and exchange distributions reported by the exchanges having such plans in effect, as well as similar figures for secondary distributions which exchanges have approved for member participation and reported to the Commission:

[table omitted]

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 studies 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 for 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 discover rapidly 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 Commission is much concerned with indications of increased manipulative activity in present securities markets. Accordingly, the Commission has placed greater emphasis in its enforcement work upon the detection and prevention of manipulation and a substantial number of investigations are now in progress in this area.

Active securities markets are particularly susceptible to manipulation because of the ease with which public interest can be generated. Devious schemes may be employed to take advantage of this public interest. These include schemes to increase the quoted over-the-counter prices for relatively obscure issues being distributed without registration hi asserted reliance upon some exemption, or the creation of fictitious markets for such issues. Such schemes are not uncommon in connection with distributions effected by "boiler rooms." These activities when conducted with ingenuity through numerous intermediaries are difficult to detect. Persons engaged in, or proposing distribution of a security not outstanding in the hands of the public may place orders for the purchase and sale of small amounts of a security with numerous brokers and dealers, or arrange to have others do this, with the result that such brokers and dealers will publish quotations for the security at prices specified in the orders, thus creating the appearance of an active over-the-counter market for the security, when in fact no such market exists except as generated by the distributors. When the distribution is completed, the orders are withdrawn and the "market" disappears.

The investigation and prosecution of a manipulation case requires careful and painstaking work usually over a period of many months. Investors must be identified and interviewed, books and records of brokers, dealers and others must be examined and analyzed, and the information thus obtained then has to be developed in a form which would permit its introduction in evidence in legal proceedings.

The following table shows the number of quizzes and formal investigations pending at the beginning of fiscal 1959, the number initiated in fiscal 1959, 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. One thousand and fifty-five registered offerings having a value of $15,657 million and 854 offerings exempt under section 3(b) of the Securities Act, having a value of about $170 million were so observed during the fiscal year. Two hundred and seventy-four other offerings, such as secondary distributions and distributions of securities under special plans filed by the exchanges, having a total value of $715 million, were also kept under surveillance.

Stabilization

When, in 1934, the provisions of the Securities Exchange Act were being drafted, Congress concluded that at times it would be necessary to stabilize offerings of securities in order to raise funds for industry and to protect existing investors while doing so. But rather than set stabilizing standards as a matter of law, Congress delegated to the Commission the authority to adopt rules to govern this little-understood function.

When the Commission was organized, one of its first tasks was to study the subject of stabilizing, decide what was improper and consider the adoption of rules. The principal difficulty has been that stabilizing is a form of market manipulation. The problem was to retain the benefits while removing those antisocial practices which might cause loss to investors. The Commission proceeded slowly, as many new facets of the problem were revealed, and it was difficult to devise a simple formula which had the particularity required in a rule binding on all who dealt in securities, without literally strangling the business.

Until it gained more expertise in the field, the Commission encouraged issuers, underwriters and their counsel to consult with it and the staff concerning problems which might arise in this area. Each such problem was judged on its own merits in the light of whether or not the interests of investors might be adversely affected. As the Commission gained experience, general principles were laid down. It was held, among other things, that stabilizing was not improper if it did no more than prevent or retard a price decline during an offering; that stabilizing purchases should be confined to the fewest transactions necessary to accomplish such a purpose; that stabilizing levels must be based on an existing independent market and not some level believed desirable by the person stabilizing; and that it was improper for a stabilizer to follow a rise in price too closely. Releases were issued from time to time to publicize the Commission's viewpoint with regard to stabilizing. In addition, the Commission expressed its viewpoint in its decisions and opinions.

From time to time it was suggested that what had now become a rather extensive list of settled practices be codified in specific rules, but in various conferences, the industry claimed that any code must necessarily be too rigid to allow for changing conditions.

However, on December 30, 1952, the Committee on Interstate and Foreign Commerce of the House of Representatives recommended that the "Commission should earnestly and expeditiously grapple with the problem of stabilization with the view of either the early promulgation of rules publicly covering these operations, or of recommending to the Congress such changes in legislation as its experience and study show now to be desirable." The Commission therefore undertook to codify the stabilizing practices which had been developed over the years.

The Commission requested and obtained the assistance of the securities industry in formulating its stabilizing rules. An ad hoc committee of the public was formed. This committee conferred with and submitted proposals to the staff, which were considered by the Commission together with the recommendations of the staff and views obtained in a public hearing held prior to the adoption of the rules.

The rules as finally adopted are extremely technical. They have, however, served well their purpose of facilitating distributions and preventing unlawful manipulations. Rule 10b-6 restricts the trading activities of those who issue or participate in the distribution of securities. Rule 10b-7 governs the times, methods and prices at which stabilizing transactions are permissible. Rule 10b-8 deals with the peculiar problems arising in an offering of securities through rights. The Commission is continuously reexamining the effect of these rules and if it appears necessary, it will amend them to conform to any developing practice of the industry which appears to be in the public interest.

During 1959 stabilizing was effected in connection with stock offerings aggregating 32,097,212 shares having an aggregate public offering price of $770,503,662 and bond offerings having a total offering price of $129,038,300. In these offerings, stabilizing transactions resulted in the purchase of 710,015 shares of stock at a cost of $18,146,077 and bonds at a cost of $2,938,340, and 4,461 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 confidential 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 equity 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. Increasing interest in this publication is evidenced by the increase in the total circulation from a rate of about 6,000 at the end of the 1958 fiscal year to more than 8,000 at the end of the 1959 fiscal year.

During the fiscal year, 39,275 ownership reports were filed. This represents a considerable increase over the 33,126 reports filed during the 1958 fiscal year. The following table shows details concerning reports filed during the fiscal year ended June 30,1959.

[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 ex-emptive 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 section 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 also provides means whereby any security holders so desiring may communicate with other security holders when management is soliciting proxies, either by distributing their own proxy statements or by including their proposals in the proxy statements sent out by management.

Copies of proposed proxy material must be filed with the Commission in preliminary form prior to the date of the proposed solicitation. Where preliminary material fails to meet the prescribed disclosure standards, the management or other group responsible for its preparation is notified informally and given an opportunity to 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 1959 fiscal year 1,975 proxy statements in definitive form were filed under the Commission's regulation 14 for the solicitation of proxies of security holders; 1,959 of these were filed by management and 16 by nonmanagement groups or individual stockholders. These 1,975 solicitations related to 1,814 companies, some 150 of which had more than one solicitation during the year, generally for a special meeting not involving the election of directors.

There were 1,790 solicitations of proxies for the election of directors, 152 for special meetings not involving the election of directors and 33 for assents and authorizations for actions 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 1959 fiscal year of their proxies, consents and authorizations with respect to the following types of matters:

Mergers, consolidations, acquisitions of businesses, purchases and sales of property, and dissolutions of companies: 103

Authorizations of new or additional securities, modifications of existing securities, and recapitalization plans (other than mergers, consolidations, etc.): 270

Employee pension and retirement plans (including amendments to existing plans): 71

Bonus, profit-sharing plans and deferred compensation arrangements (including amendments to existing plans and arrangements): 21

Stock option plans (including amendment to existing plans): 178

Stockholder approval of the selection of management of independent auditors: 608

Miscellaneous amendments to charter and by-laws, and miscellaneous other matters (excluding those involved in the preceding matters): 410

Stockholder Proposals

During the 1959 fiscal year, 48 stockholders submitted a total of 156 proposals which were included in the 99 proxy statements of 99 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 by-laws to provide for cumulative voting for the election of directors, limitations on the granting of stock options and their exercise by key employees and management groups, the sending of 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 management of 20 companies omitted from their proxy statements under the Commission's rule 14a-8 a total of 65 additional proposals submitted by 25 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) 18 proposals related to the ordinary conduct of the company's business;

(b) 17 proposals involved the election of directors;

(c) 13 proposals concerned a personal grievance against the company;

(d) 11 proposals were not a proper subject matter under State law;

(e) 5 proposals were resubmitted after not having received sufficient affirmative votes at a previous meeting; and

(f) 1 proposal was not submitted timely.

Ratio of Soliciting to Non-Soliciting Companies

Of the 2,236 issuers that had securities listed and registered on national securities exchanges as of June 30, 1959, 1,985 had voting securities so listed and registered. Of these 1,985 issuers, 1,544 or 78.7 percent, solicited proxies under the Commission's proxy rules during the 1959 fiscal year for the election of directors.

Proxy Contests

During the 1959 fiscal year, 19 companies were involved in proxy contests when nonmanagement persons filed detailed statements as participants, or proposed participants, under the requirements of rule 14a-11 when proxies are to be solicited from stockholders for the election of directors. A total of 259 persons, including both management and nonmanagement, filed such statements in 11 cases for control of the board of directors and in 8 cases for representation on the board.

Management retained control in 8 of the 11 contests, opposition nominees won in 2, and 1 was settled by negotiation. Of the 8 cases where representation on the board was involved, management retained all places on the board in 5 and in the other 3 cases nonmanagement persons were elected to the board.

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

Registration

The Securities Exchange Act requires under section 15(a) that brokers and dealers, with certain exceptions, using the mails or instrumentalities of interstate commerce to engage in securities transactions on the over-the-counter market must register with the Commission. Brokers and dealers whose business is exclusively intrastate or exclusively in exempt securities are not required to register.

The chart below sets forth statistics regarding the registration of brokers and dealers and applications for such registration during the fiscal year 1959.

[table omitted]

Administrative Proceedings

Section 15(b) of the Securities Exchange Act provides that the Commission shall revoke a firm's broker-dealer registration or deny broker-dealer registration to an applicant if, after appropriate notice and opportunity for hearing, it finds such action is in the public interest and that the registrant or applicant or any partner, officer, director or other person directly or indirectly controlling or controlled by such broker-dealer or applicant is subject to one or more of the disqualifications set forth in the act. In addition, pending final determination whether any registration shall be revoked, the Commission shall by order suspend such registration if after appropriate notice and opportunity for hearing, suspension shall appear to the Commission to be necessary or appropriate in the public interest or for the protection of investors.

The disqualifications referred to above, are briefly:

(1) conviction in the past 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;

(2) willful false or misleading statements in the application or documents supplementing the application;

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

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

Under section 15A of the Securities Exchange Act brokers and dealers may be suspended or expelled by the Commission from membership in a national securities association, and under section 19(a)(3) from national securities exchanges, for violations of the federal securities laws or the regulations thereunder. Registration may not be denied to an applicant absent evidence of misconduct specified in the act. Other factors, such as bad reputation or character, lack of experience in the securities business or even conviction of the applicant of a felony unrelated to securities transactions, do not constitute statutory grounds for denial of registration as a broker-dealer.

Section 15A(b)(4) of the Securities Exchange Act of 1934 provides that in the absence of the Commission's approval or direction, no broker or dealer may be admitted to or continued in membership in a national securities association 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 revocation 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, among other things, with administrative proceedings instituted to deny and revoke registration and to suspend and expel from membership in an exchange or a national securities association:

[table omitted]

Administrative proceedings in which action was taken during the year included the following:

Suspension Proceedings

During the past year the Commission suspended the registration of several broker-dealers pending final determination as to whether their registrations should be revoked. Since suspension has the effect of stopping all securities business by the registrant, this sanction is imposed only in the most serious type of cases where the Commission finds, on the evidence adduced at a hearing, that such action is required, in the public interest and for the protection of investors.

A. G. Bellin Securities Corp. -- The registrant was found, in connection with the sale of unregistered stock in General Oils & Industries, to have made false and misleading statements regarding, among other things, prospects of profits, payment of dividends, increase in market price, listing on exchange, merger, interest of officials of prominent oil companies in General, and the issuers' ownership of and production from oil and gas properties. In addition, registrant was preliminarily enjoined from selling stock of General.

The Commission, on the basis of these findings, held that a sufficient showing had been made to require suspension of registration in the public interest and for the protection of investors. In determining this the Commission stated, "... we are required ... to suspend registration where the record before us on the suspension issue contains a sufficient showing of misconduct to indicate the likelihood that after hearings on the revocation issue registrant will be found to have committed willful violations or any of the other grounds prescribed with respect to the revocation in section 15(b) will be established, and that revocation will be required in the public interest." The Commission also stated that under the suspension provision, "... we are only directed to inquire into the question of whether the public interest or the protection of investors warrants suspension, and there is no requirement that suspension be based upon findings of willful violation or the other grounds specified with respect to revocation." At the close of the fiscal year revocation proceedings were pending against registrant.

Herman Bud Rothbard, doing business as Jonathan & Company. -- Rothbard admitted that he filed a false and misleading financial statement with his application for registration, violated the net capital rule, failed to amend his registration to disclose transfer of control of his business, failed to file a required financial report, and maintained materially deficient books and records and he consented to suspension of his broker-dealer registration. The Commission concluded that suspension was appropriate in the public interest and for the protection of investors. In addition, on June 30,1959, the Commission revoked Rothbard's registration. This is discussed in more detail later in this report.

Jean R. Veditz Co., Inc. -- Registrant consented to suspension of its broker-dealer registration. The Commission found suspension to be appropriate in the public interest and for the protection of investors. The order instituting proceedings charged registrant, Jean R. Veditz, its president and sole stockholder, and Ben Goldstein, its sales manager, with violation of the antifraud provisions of the federal securities laws in the offer and sale of stock of Universal Drilling Company. Registrant and Veditz were stated in the order to have been enjoined by the Supreme Court of New York, County of New York, from engaging in certain activities in connection with the purchase and sale of securities. Revocation proceedings against registrant were pending at the end of the fiscal year.

Philip Newman Associates, Inc. -- In the latter part of 1958 registrant's books showed sales through the use of the mails of 124,520 unregistered shares of the common stock of Monarch Asbestos Co., Limited. Evidence at the suspension hearing established that, to induce purchase of this stock, registrant made numerous false representations, including among other things, that Monarch was an operating company with highly profitable production, and that Monarch's asbestos mine was adjacent to that of Johns-Manville Corporation and contained asbestos superior to that produced by the latter. It was also falsely represented that Johns-Manville Corporation had determined to acquire or to merge with Monarch and that the market price of Monarch stock had risen and would increase from $5 to $16 per share in from 1 to 6 months. The Commission held that there had been a sufficient showing of willful violations by registrant, including a course of conduct replete with fraud, to make it necessary and appropriate in the public interest and for the protection of investors that registrant's registration be suspended until final determination on the question of revocation. Proceedings on the question of revocation of registrant's broker-dealer registration were pending at the end of the fiscal year.

Alexander Dvoretsky, doing business as Dennis & Company. -- The Commission found on the basis of stipulations entered into by Dvoretsky that he employed individuals who were permanently enjoined from engaging in certain securities practices and that he willfully violated provisions of the Securities Exchange Act and rules thereunder in that his application for registration denied existence of such injunctions and that he failed to file any correcting amendment to the application to state their existence. He was also found to have willfully violated the Commission's net capital rule and books and records requirements. These violations, the consent and the record so far made, were held to be a sufficient showing to require suspension of registration in the public interest and for the protection of investors. At the end of the fiscal year proceedings to revoke Dvoretsky's registration were still pending.

Denial Proceedings

Kelly Rubenstein, Inc. -- William Rubenstein, president and a director of applicant, was found by the Commission to have willfully made a false and misleading statement in the broker-dealer application of Washington Securities Corporation. Both Rubenstein and Washington were found to have willfully violated section 15(b) of the Securities Exchange Act of 1934 and rule 15b-2 thereunder in not promptly filing an amendment correcting the inaccuracy of this information. In addition, the Commission found that Rubenstein, while president, treasurer and a director of Keith Richard Securities Corp. caused that firm to willfully violate Commission rules concerning keeping of books and records. Under all the circumstances, the Commission found it in the public interest to deny the application of applicant and found Rubenstein to be a cause of the denial. However, the order stated that the above findings did not necessarily mean that

Rubenstein was permanently barred from registration or from employment by a registered broker-dealer in a supervised capacity upon a proper showing.

Alan Russell Securities, Inc. -- The Commission denied broker-dealer registration to applicant and named Nathan L. Batterman and Omos Maiers as causes of the denial. The action was based on a permanent injunction issued by the United States District Court for the Southern District of New York against applicant, Batterman and Maiers. The decree, entered by consent, enjoined applicant, Batterman and Maiers from making untrue and misleading statements in connection with the sale of International Ceramic Mining Limited

stock in violation of the antifraud provisions of the Securities Act.

Leonard Burton Corporation. -- Broker-dealer registration was denied applicant and Leonard Burton was named the cause of denial based on willful violations of the antifraud provisions of the Securities Act of 1933 and the Securities Exchange Act.

The Commission found that Leonard Burton while employed as a securities salesman by Steven Randall & Co., Inc. made misleading representations in connection with the offer or sale of Texas Union Oil Company stock. Burton represented that there would be no commissions on the sale of the stock and failed to state that Steven Randall & Co., Inc. was selling the stock as principal. Burton also presented an optimistic picture of large and quick increases in the market value of the stock based on actual production without apprising investors of the speculative and contingent factors known by him. The statement that a stock is likely to go up was deemed to imply, "... that there is an adequate foundation for such prediction and there are no known facts which make such a prediction dangerous or unreliable." The Commission rejected registrant's allegation that the practicalities of merchandising the stock excused the registrant from the requirements of disclosure necessary to render the statements made not misleading.

Washington Securities Corporation. -- The Commission denied broker-dealer registration to applicant and named Joseph Freundel as a cause of denial. Freundel, president, director and sole stockholder of applicant, was permanently enjoined, with others, on August 19, 1958, by the United States District Court for the District of New Jersey from making untrue or misleading statements in connection with the sale of common stock of Saskalon Uranium and Oils Limited. On the basis of the injunction against Freundel and his control of applicant, it was found in the public interest to deny applicant's registration.

Revocation Proceedings

Pilgrim Securities, Inc. -- This broker-dealer registration was revoked by the Commission on findings of fraud in the sale of securities, sales of unregistered securities, making of false records, failure to keep required records, failure to file promptly an amendment to the registration application, filing of an amendment containing a false statement and failure to file a report of financial condition for 1957 as required.

The Commission found that registrant and Joseph Leo Gruber, Jr., president of registrant, sold over 23,000 unregistered shares of Eagle Oil and Supply Company to at least 32 investors. In connection with some of these sales Gruber and registrant made false representations regarding a stock split, dividends, sales quotas and expected profits. The Commission found Gruber to be a cause of the revocation.

John D. Ferris, doing business as Ferris & Co. -- The Commission found that Ferris engaged in the securities business without disclosing that he was insolvent, issued bad checks, failed to pay for securities sold and delivered, and failed to meet his obligations arising from the purchase and sale of securities. In addition, registrant failed to furnish a customer a confirmation of sale, failed to comply with the net capital rule, failed to maintain accurate and current books and records and failed to file a report of financial condition for 1956. Accordingly, the broker-dealer registration of Ferris was revoked. The Commission held, "The conduct of a securities business involves implied representations of solvency and a readiness and ability to meet all attendant obligations as they arise and to consummate transactions in the usual manner in accordance with trade custom." By failure to disclose his insolvency and repeated failure to meet his responsibilities in connection with his securities transactions, Ferris was held to have engaged in a course of conduct which operated as a fraud and deceit upon persons with whom he conducted business in violation of the antifraud provisions of the Securities Act of 1933 and the Securities Exchange Act.

Sills and Company. -- In this case also revocation was in part based on effecting securities transactions without disclosing insolvency. In addition, the Commission found that registrant converted to its own use customer's funds in connection with the purchases and sales of securities, filed a false financial report, failed to comply with the net capital rule, failed to keep accurate books and records, and failed to correct information in its registration application. It was determined that registrant and Robert Bernard Sills, president and a director of registrant, converted to their own use funds of 19 customers, totaling $28,240, which had been obtained upon the false representation that registrant would use funds for the purpose of purchasing securities for the customers. The Commission named Sills as a cause of the order of revocation. [Footnote: On February 5, 1959, Sills and Arthur P. Green, sales manager for Sills and Company, were indicted by the United States District Court for the Southern District of Florida. Both were charged with violating the Securities Exchange Act by filing false information with the Commission and with violations of the antifraud provisions of the Securities Act and the Mail Fraud Statute.]

William Rex Cromwell, doing business as Cromwell & Co. -- Revocation of Cromwell's registration was based in part on his retaining funds received from the sale of securities for customers, amounting to $15,700, for periods of from 2 to 5 years. Also, Cromwell misappropriated funds received from customers for the purchase of securities amounting to almost $9,000 and failed to return the money or deliver the securities for periods of about 1.5 to 4 years. In addition, Cromwell was found to have failed to comply with the net capital rule, to make and keep current required books and records and to make his books and records available for reasonable inspection. He failed to file a report of financial condition for the year 1957 and failed to correct information in his registration application.

William Harrison Keller, Jr., doing business as W. H. Keller, Stockbroker. -- The Commission revoked the broker-dealer registration of Keller based in part on the sale of securities to customers at prices not reasonably related to and substantially in excess of prevailing market prices as evidenced by registrant's contemporaneous cost. In 54 transactions with customers while acting as principal, Keller sold securities at markups over cost ranging from 6.25 to 40 percent with profits to Keller of over $20,000, representing an average markup of over 16 percent. Thirty-seven of these sales took place on the same day that Keller purchased the securities, and in 13 of the transactions involved the purchases were effected from other customers. In connection with all of these sales, Keller failed to disclose to the customers the prices paid for the securities or the current market price established by other broker-dealers. In addition, Keller failed to comply with the net capital rule, to make and keep current required books and records, and to amend his application for registration to disclose employment of a person subject to a court injunction. Also, on April 29, 1958, he was permanently enjoined from effecting securities transactions in violation of the net capital rule by the United States District Court for the Southern District of Indiana. Keller was also expelled from membership in the National Association of Securities Dealers, Inc.

Allied Securities Corporation. -- The Commission revoked this broker-dealer's registration and expelled it from membership in the National Association of Securities Dealers, Inc., naming Jack R. Parkman and William E. Powell causes of the order of revocation and expulsion. The Commission found that registrant sold unregistered securities of Life Insurance Company of South Carolina and Georgia Pacific Underwriters, Inc., and made false and misleading statements concerning the market prices and value of these securities and the financial condition of the issuer. Additional grounds for revocation were violation of the net capital rule, failure to keep accurate books and records and violation of regulation T.

Richard A. Sebastian, doing business as Sebastian & Company. -- Sebastian sold shares of Canada General Fund to a customer without revealing that the stock was pledged to secure a loan and would not promptly be released from such lien. In addition, Sebastian violated the net capital rule and failed to keep current required books and records. Consequently, the Commission revoked Sebastian's registration and expelled him from membership in the National Association of Securities Dealers, Inc.

Graham & Company. -- The broker-dealer registration of Graham & Company was revoked based on various false and misleading representations made to purchasers of stock of Hard Rock Mining Co. and Texas Adams Oil Company. These false representations included statements concerning the market for and the price of Hard Rock stock and statements that securities would be delivered to customers promptly; no disclosure was made of the fact that the registrant and Hard Rock were under common control. In addition, registrant offered, sold and delivered stock of Hard Rock in violation of the registration provisions of the Securities Act of 1933. Also, securities in both these companies were sold at prices not reasonably related to the current market prices. The Commission expelled registrant from membership in the National Association of Securities Dealers, Inc. and found E. W. Sterling Graham and Susan P. Graham causes of the order of revocation and expulsion.

J. H. Lederer Co., Inc. -- Registrant was found by the Commission to have sold over 1 million shares of stock of Continental Mining Exploration, Limited

at prices ranging from $2.85 to $3.70 per share in violation of the registration requirements of the Securities Act of 1933. The shares were sold through long distance telephone solicitation in which false and misleading statements were made concerning, among other things, dividends to be paid, appreciation in the market price and registration of the securities. The Commission revoked the broker-dealer registration of J. H. Lederer Co., Inc., expelled registrant from membership in the National Association of Securities Dealers, Inc. and found Joseph Herbert Lederer a cause of the order of revocation and expulsion. In addition, pursuant to a complaint filed by the Commission, the United States District Court for the Southern District of New York permanently enjoined J. H. Lederer Co., Inc., and Lederer from further violations of the registration provisions of the Securities Act of 1933 in the offer and sale of the common stock of Continental Mining Exploration Limited.

Shelley, Roberts & Company of California. -- The Commission found that Billy E. Boyle, president and controlling person of registrant, while an officer and a director of another broker-dealer, caused that broker-dealer to make various false and misleading statements in the sale of stock of United Mercury Corporation in violation of the antifraud provisions of the Securities Acts. These misrepresentations concerned, among other things, prospective increases in market prices, guarantees against loss, and listing on an exchange. Also, Boyle was found to have caused the other broker-dealer to extend credit in violation of regulation T. Registrant was found to have refused to make its books and records available for reasonable inspection. The Commission revoked the broker-dealer registration of Shelley, Roberts & Company of California and found Boyle a cause of the revocation.

Gill-Harkness & Co. -- This broker-dealer registration was revoked by the Commission on findings that registrant solicited and effected securities transactions without disclosing it was insolvent. Bruce A. Johnston, registrant's president and controlling stockholder, induced customers with whom he was in a relationship of trust and confidence to lend him funds and securities for purposes of supplying capital to registrant and sold to other customers shares of stock in registrant, and failed to inform any of these customers of the registrant's operating losses and insolvency. Alan D. Selditch, general manager of registrant's securities department, made false and misleading statements in the offer and sale of registrant's stock to two customers in violation of the antifraud provisions of the Securities Acts. He represented that registrant was in good shape, had a capitalization of $100,000, was expanding and would pay dividends, none of which was true. Registrant was found to have failed to keep accurate books and records, violated the net capital rule and failed to correct information in its registration application. The Commission's order of revocation also expelled registrant from membership in the National Association of Securities Dealers, Inc., and found Johnston and Selditch causes of the order of revocation and expulsion.

Benjamin and Company, Inc., David Joel Benjamin, doing business as Benjamin and Company. -- David Joel Benjamin was found by the Commission to have sold and delivered 243,000 shares of stock of Hardy-Griffin Engineering Corporation in violation of the registration provisions of the Securities Act of 1933. Furthermore, a notification and offering circular used in selling the securities contained untrue statements concerning the sale of unregistered stock within the previous year, Benjamin's ownership of shares of the stock, payments made to Hardy-Griffin by its officers, directors, and pro-motors, and the number of shares that would be outstanding upon completion of the offering, all in violation of the antifraud provisions of the Securities Acts. David Joel Benjamin was also found to have violated the net capital rule and failed to make and keep current required books and records. Based on this record, the Commission revoked the broker-dealer registration of Benjamin, and Benjamin & Company, Inc. In addition, the latter was expelled from the National Association of Securities Dealers, Inc. and Benjamin was found to be a cause of the order of revocation and expulsion.

Whitney Phoenix Company, Inc. -- The Commission revoked the broker-dealer registration of registrant and found Strabo V. Claggett, president and director of registrant, a cause of the order of revocation.

Registrant and Claggett offered and sold stock of Selevision Western, Inc. (Western) and its parent, Selevision Corporation of America (Selevision) by means of false and misleading information in willful violation of the antifraud provisions of the Securities Acts. The Western offering circular and other sales literature falsely stated that registrant had increased its stock holdings in Selevision by purchase of an additional 65,000 shares and contained optimistic statements regarding Selevision's business prospects and future operations, but failed to disclose that Selevision had recently discontinued an important part of its business. Also, Claggett falsely stated to two purchasers of Selevision's stock that the stock would double or triple in price and, "that things were rolling along like a house afire."

Registrant sold Western's securities pursuant to a filing with the Commission under regulation A. However, in the offer and sale of these securities, it used letters soliciting the purchase of the stock which were not filed with the Commission as required. In addition, registrant sold the stock in jurisdictions other than those indicated in the filing. Since it failed to comply with the provisions of regulation A, the exemption from registration was not available and the sale and delivery of Western stock by registrant and Claggett was in willful violation of the registration requirements of the Securities Act of 1933.

In addition, registrant violated the net capital rule, failed to comply with record requirements and refused to permit inspection of its records.

Herman Bud Rothbard, doing business as Jonathan & Co. -- The Commission revoked the broker-dealer registration of Rothbard and expelled him from membership in the National Association of Securities Dealers, Inc. The Commission had previously suspended his broker-dealer registration.

Rothbard, in the sale of about 40,000 shares of stock of U.S. Electronics Development Corporation (EDCOR), used circulars which stated that EDCOR was operating at a profit and that a dividend might be expected when in fact EDCOR had suffered losses and had an earned surplus deficit. Based on these findings the Commission held that Rothbard willfully violated the antifraud provisions of the Securities Acts.

Rothbard also violated the registration requirements of the Securities Act of 1933 in that he sold 93,333 unregistered shares of EDCOR's stock. The sale of these shares was held not to be an exempt private offering for it was clear that the purchasers took for resale and not for investment and the ultimate offerees were members of the general public.

In addition, Rothbard was in violation of the net capital rule on several occasions, filed a false financial statement with his registration application, failed to amend his registration application to reflect a change in control, failed to keep required books and records and failed to file a report of his financial condition for 1957.

J. A. Latimer & Co., Inc. -- The revocation of this broker-dealer registration was based in part on false and misleading statements in its application for registration concerning control of registrant. In addition, the Commission found that registrant effected wash sales in the stock of U.S. Hoffman Machinery Company and Artloom Company on the New York Stock Exchange, while Hyman Marcus, the person who controlled registrant, was Chairman of the Board of each of these companies. Moreover, registrant was found to have made purchases of these securities while participating in the distribution of such securities in violation of section 10(b) of the Securities Exchange Act and rule 10b-6 thereunder, and to have borrowed money on these securities from unqualified persons in willful violation of section 8(a) of the Securities Exchange Act and regulation T thereunder. Besides revoking registrant's registration, the Commission expelled registrant from the National Association of Securities Dealers, Inc. and found John Albert Latimer and Marcus to be causes of the order of revocation and expulsion. [Footnote: On July 2, 1959, subsequent to the close of the fiscal year, Latimer was indicted by the United States District Court for the Southern District of New York. The indictment contained 51 counts and charged violations of the antimanipulative provisions of the Securities Exchange Act of 1934 in connection with a series, of transactions in the stock of the American Tractor Company listed on the American Stock Exchange.]

Gotham Securities Corporation. -- The Commission revoked this broker-dealer registration on the basis of a permanent injunction obtained in the United States District Court for the District of New Jersey barring registrant, Joseph Fruendel, a director and president of registrant, and Rico Tomasco, Jr., a director and secretary-treasurer of registrant, from making various untrue or misleading statements in connection with the sale of stock of Saskalon Uranium and Oils Ltd. Fruendel and Tomasco were named as causes of the revocation.

Steven Randall & Co. Inc. -- The broker-dealer registration of registrant was revoked and it was expelled from membership in the National Association of Securities Dealers, Inc., with Frank M. Naft, its president, being named a cause of the order. Registrant and Naft were subject to a permanent injunction issued by the United States District Court for the Southern District of New York, pursuant to a complaint filed by the Commission, barring further sales of unregistered stock of Swan-Finch Oil Company. Another permanent injunction was issued by the Supreme Court of the State of New York, New York County, barring Steven Randall & Co., Inc. from conducting a securities business in the state of New York. The complaint filed by the Attorney General of the State of New York charged registrant with distributing fraudulent literature and engaging in other fraudulent practices in connection with the sale of securities of Texas Union Oil Corporation. In addition, registrant was found to have failed to amend its registration statement to indicate existence of the injunctions.

Frederick Securities Corporation -- Fred Kaufman, doing business as Fred Kaufman Co. -- The broker-dealer registrations of these registrants were revoked based on findings by the Commission that registrants were permanently enjoined by the United States District Court for the District of New Jersey from offering and selling stock of Ben Franklin Oil & Gas Corporation in violation of the registration provisions of the Securities Act of 1933. In addition, both registrants failed to file a report of financial condition for 1957. Fred Kaufman, president and sole stockholder of Frederick Securities Corporation, was found to be a cause of the order of revocation issued against that corporation.

William Harold Hilbert. -- Hilbert was found to have sold stock of Great Fidelity Life Insurance Company (Great Fidelity) and Farm & Home Agency, Inc. (Agency) to customers in several states in violation of the registration requirements of the Securities Act of 1933 and while he was not registered as a broker-dealer. The United States District

Court for the Southern District of Indiana in an action instituted by the Commission permanently enjoined Hilbert and others from selling unregistered shares of Great Fidelity. Later, the same court permanently enjoined Hilbert and others from selling unregistered stock of Agency. Hilbert failed to send customers confirmations of transactions, failed to maintain and preserve books and records and failed to correct his registration application to state his correct business address and the existence of the injunctions. Accordingly, the Commission revoked Hilbert's broker-dealer registration.

James C. Graye, doing business as J. C. Graye Co. -- The broker-dealer registration of Graye was revoked based on three injunctions entered against him. On April 3, 1958, the United States District Court for the Southern District of New York, pursuant to complaints filed by the Commission, issued two permanent injunctions against Graye barring him from further violations of the antifraud provisions of section 17 of the Securities Act of 1933 in the sale of stock of Atlas Gypsum Corporation Limited

(Atlas) and from further violations of the Commission's net capital rule. The decree enjoining the sale of Atlas stock barred the use of false statements and misleading omissions concerning the market price of Atlas stock, listing on a national securities exchange and plans to merge Atlas with other corporations, among other things. An injunction was also entered by the Supreme Court of New York on February 17, 1958, permanently enjoining Graye from engaging in securities transactions in the state of New York. In addition, Graye was found to have failed to amend his application for registration to indicate existence of the injunctions and failed to file a financial report for the year 1957 as required.

Tannen & Co., Inc. -- Registrant and Philip Tannen, president, director and sole stockholder of registrant, were subject to two permanent injunctions issued by the United States District Court for the Southern District of New York pursuant to complaints filed by the Commission. On June 27,1957, registrant and Tannen were enjoined from the sale of unregistered shares of stock of Swan-Finch Oil Corp. and on October 11, 1957, from selling unregistered shares of stock of Cornucopia Gold Mines, in violation of the registration provisions of the Securities Act of 1933. The Commission revoked the broker-dealer registration of registrant and found Tannen to be a cause of such revocation.

Carl J. Bliedung. -- Bliedung was subject to a permanent injunction entered in the United States District Court for the District of Columbia on March 16, 1955, barring him from effecting financial transactions unless promptly recorded in his books and records pursuant to Commission rules and requiring him to account for and record all financial transactions not recorded in his books and records. Bliedung also used customer funds for his own benefit, failed to deliver customers' securities promptly and sold securities at prices not bearing a reasonable relationship to the market prices. In addition, he sold securities to a customer and prior to delivery permitted securities of a like kind owned by him to remain subject to a lien for a loan made to him, in violation of the Commission's rule prohibiting hypothecation of customer securities. The broker-dealer registration was revoked and Bliedung was expelled from membership in the National Association of Securities Dealers, Inc.

McGrath Securities Corporation. -- The Commission found that registrant and Robert C. Leonhardt, its president and sole stockholder, sold 447,614 shares of stock of Micro-Moisture Controls, Inc. (Micro-Moisture) in violation of the registration provisions of the Securities Act of 1933. As a result of a complaint filed by the Commission, registrant and others had been enjoined from selling and delivering the stock of Micro-Moisture in violation of the registration provisions of the Securities Act of 1933. Registrant stipulated that the Court's findings and conclusions be considered as facts in the administrative proceeding. The Commission accordingly found that Micro-Moisture issued over 2 million shares of its unregistered common stock to a Canadian corporation in exchange for the latter's assets and the latter in turn distributed such stock to its shareholders. Shortly thereafter a group of these stockholders who were then in control of Micro-Moisture sold over 700,000 shares to various broker-dealers, including the shares later sold by registrant and Leonhardt. The Commission concluded that registrant and Leonhardt were underwriters with respect to the unregistered shares sold by them. Accordingly, the Commission revoked the broker-dealer registration of McGrath Securities Corporation, expelled it from membership in the National Association of Securities Dealers, Inc., and found Leonhardt a cause of the order of revocation and expulsion.

Keith Richard Securities Corp. -- Registrant was found by the Commission to have sold stock of Arliss Plastics Corporation (Arliss) to purchasers in over 30 States principally through the use of local and long distance telephone calls. The Commission concluded that in connection with these sales, Julius Silver, president and sole shareholder of registrant, Samuel Goldberg, former sales manager, and G. Norman Waldman and Hyman Germanowitz, salesmen of registrant, made false and misleading representations concerning, among other things, prospects of a merger, payment of dividends, listing on a stock exchange, increase in market price of Arliss' stock and Government contracts held by Arliss. In addition, registrant, aided and abetted by Silver and William E. Rubenstein, former president of registrant, was found to have failed to keep current required books and records. Registrant, aided and abetted by Silver, was also found to have willfully violated the net capital rule.

In February 1959, based on a complaint filed by the Commission, the United States District Court for the Southern District of New York preliminarily enjoined registrant from engaging in the securities business while not making and keeping current books and records required by Commission rules. The Commission revoked the broker-dealer registration and found Silver, Rubenstein, Goldberg, Waldman, and Germanowitz causes of the order of revocation.

In separate actions, the Commission revoked the broker-dealer registration of Owens & Co. (Owens) and Churchill Securities Corp. (Churchill), and denied requests for withdrawal of registration. Revocation in each instance was based on a permanent injunction and violation of the net capital rule. Owens was enjoined by the United States District Court for the District of Colorado on January 24, 1958, from further violations of the net capital rule. Churchill was enjoined on May 2,1957, by the Supreme Court of the State of New York, County of New York, from engaging in the securities business in that State. In addition, the Commission expelled Churchill from membership in the National Association of Securities Dealers, Inc. and found Nat Girsky, Emanuel Bisgeier and Melvin Heiman, officers of Churchill, to be causes of the order of revocation and expulsion. John Cuthbert Owens, president, director and controlling stockholder of Owens, was found to be a cause of the order of revocation entered against Owens.

The Commission determined that J. D. Creger & Co. had violated the Commission's net capital rule, failed to make and keep current required books and records, and kept inaccurate records. Also, pursuant to a complaint filed by the Commission, registrant was permanently enjoined from doing business with inadequate net capital by the United States District Court for the Southern District of California, Central Division, on September 16, 1957. The Commission revoked the registration of J. D. Creger & Co. and found James D. Creger, president, director and controlling stockholder of registrant, a cause of the order of revocation.

The Commission revoked the broker-dealer registration of William Whitehead upon a determination that he had failed to comply with the net capital and record keeping requirements of the Securities Exchange Act of 1934 and was permanently enjoined by the United States District Court for the State of New Jersey from further violations of these provisions on the basis of a complaint filed by the Commission.

The registration of Vickers Brothers 68 was revoked by the Commission based on findings that between December 31, 1957, and October 30, 1958, registrant was in violation of the Commission's net capital rule on eight different occasions. In addition, Vickers Brothers was expelled from membership in the National Association of Securities Dealers, Inc. and Henry G. Vickers and Norman L. Martin, general partners in registrant, were found to be causes of the order of revocation and expulsion.

Lynne B. Fenner, president and principal stockholder and a director of **The Fenner Corporation**, had been permanently enjoined by the Supreme Court of the State of New York on April 30, 1957, from engaging in securities transactions in that State. On January 24, 1958, the United States District Court for the Southern District of New York entered a decree of consent permanently enjoining Fenner and registrant from violations of the Commission's net capital rule based on a complaint filed by the Commission. Accordingly, the Commission revoked the broker-dealer registration of The Fenner Corporation and found Fenner to be a cause of revocation.

The Commission revoked the broker-dealer registration of **John T. Pollard & Co., Inc.**, now known as **Webb Securities, Inc.** Registrant had misstated its capital in a financial statement filed with its application for registration, engaged in transactions while in violation of the Commission's net capital requirements and made false entries in its books and records. The Commission, in addition, found John T. Pollard, president and a director of registrant, and Louis H. Green-berg, vice president, treasurer and a director of registrant, to be causes of the order of revocation.

The broker-dealer registration of **Arthur R. Gilman** was revoked for failure to file a report of his financial condition, to keep and preserve current books and records and to correct information regarding his business address in his application for registration.

Ross Natale Barengo had his broker-dealer registration revoked based on findings that he made false and misleading statements in his application for registration regarding the name under which he would conduct business and the persons who controlled his business. In addition, he failed to file an amendment correcting such statements and failed to file required annual financial reports for the years 1956 and 1957.

The following broker-dealer registrations were revoked by the Commission for failure to file financial reports as required by section 17(a) of the Securities Exchange Act of 1934 and rule 17a-5 thereunder: **George D. Clarke, Ltd.**, **Walter O'Donnell**, **James A. Heaney, Jr.**, **Stacy, Bell & Co., Inc.**, **David Handel**, and **John B. Sullivan** doing business as **John B. Sullivan Company**.

Other Sanctions

Carl M. Loeb, Rhoades & Co. -- Dominick & Dominick. -- The Commission instituted broker-dealer revocation proceedings against registrants, based upon offers to sell or solicitation of offers to buy securities of the Arvida Corporation (Arvida) in violation of section 5(c) of the Securities Act of 1933. Registrants were the prime underwriters of the offering. Prior to the filing of a registration statement with the Commission, a partner of one of the registrants, with the consent of the other and of the issuer, composed a release for use in the New York papers. The release stated, among other things, that Arthur Vining Davis, holder of considerable real estate in Florida, was going to convey some 100,000 acres of properties, described in the release as in an area of the Gold Coast in three named Florida counties, to Arvida, that Arvida would have assets of over 100 million dollars, and that within 60 days there was going to be a public offering of Arvida's securities through an investment banking group headed by registrants. In addition, newspaper reporters were called to the office of one of the registrants, were told that the offering price would be in the vicinity of $10 or $11 per share and were given further information about Davis and his career. The information contained in the release, together with the additional information furnished orally, appeared in three New York newspapers on September 19, 1958, and in numerous other news media throughout the country.

A limited survey indicated that for the two business days of September 19 and 22, Loeb, Rhoades received indications of buying interest amounting to $500,000 with a total of 101 securities firms expressing an underwriting interest in the offering. Loeb, Rhoades made notations of selling group interest on the part of about 25 securities dealers. In addition, registrants received, prior to September 30, at least 58 expressions of interest from members of the public, including at least 17 specific orders to buy. Arvida did not file a registration statement under the Securities Act until October 27, 1958.

The Commission concluded that publicity, prior to the filing of a registration statement, by means of public media of communication, with respect to an issuer or its securities, emanating from broker-dealer firms who as underwriters or prospective underwriters have negotiated or are negotiating for a public offering of the securities of such issuer, must be presumed to set in motion or to be a part of the distribution process and therefore to involve an offer to sell or a solicitation of an offer to buy such securities prohibited by section 5(c) of the Securities Act of 1933. Therefore, the Commission held the press release and meeting and resultant publicity willfully violated section 5(c) of the Securities Act. However, under all the circumstances, including registrant's excellent reputation, and the fact that they acted on reliance of counsel and that no investors appeared to have been injured, the Commission found that no sanction was necessary in the public interest or for the protection of investors.

A related action brought by the Commission in the United States District Court for the Southern District of New York, in which a consent decree was entered permanently enjoining violation of section 5(c) by Arvida, registrants, and others, is discussed supra.

First Maine Corporation. -- Registrant, in violation of section 5(c) of the Securities Act of 1933, was found to have offered to sell or to have solicited offers to buy unregistered securities of Life Insurance Securities Corporation (LISCO) for a period of over 3 months before a registration statement was filed with the Commission. Burton M. Cross and Herbert L. Rackliff, president and beneficial owner of equity securities of registrant, respectively, were found to have caused registrant to distribute by mail, notices, circulars and other publicity which constituted the illegal offers to sell or solicitations of offers to buy LlSCO's stock. In addition, registrant, Cross and Rackliff were found to have violated section 5(b)(1) of the Securities Act by transmitting improper prospectuses after LlSCO's registration statement was filed.

Also registrant, Cross and Rackliff were held to have made false and misleading statements of material facts in offering the securities of LISCO, thereby violating the antifraud provisions of the Securities Act. The Commission found that the material distributed by registrant contained two general themes, (1) the attractiveness of stock of life insurance companies in which it was stated LISCO would invest, and (2) the knowledge, experience, ability and competency of LISCO's officers and directors, particularly Cross. This literature was materially misleading in stressing the investment opportunities of life insurance companies without disclosing that the funds of investors would be invested in a casualty insurance company organized by Cross and Rackliff and not yet in operation. The information in regard to the experience of LISCO's management was misleading for failure to state that the active officers have had only very limited experience with an operating insurance company.

The Commission, in view of the nature of the violations, ordered that registrant be suspended from the National Association of Securities Dealers, Inc., for 20 days and that Cross and Rackliff be named causes of the suspension.

Net Capital Rule

The Commission has adopted under section 15(c)(3) of the Securities Exchange Act rule 15c3-1, commonly known as the net capital rule, which is intended to provide safeguards for securities and funds of customers dealing with broker-dealers by limiting the amount of indebtedness which may be incurred by a broker-dealer in relationship to net capital. A broker-dealer subject to the rule may not allow his "aggregate indebtedness" to be more than twenty times his "net capital," as those terms are defined in the rule.

When it appears, from an examination of reports filed with the Commission or through inspection of books and records, that a broker-dealer is in violation of the net capital rule, an opportunity is generally afforded the registrant to correct such capital deficiencies. Failure promptly to bring the capital position into compliance with the rule may result in injunctive action to restrain further violations or the institution of proceedings to determine whether or not the registrant's broker-dealer registration should be revoked. Violations of the net capital rule were alleged in 13 injunctive actions filed by the Commission in the last fiscal year and in 22 revocation proceedings.

Broker-dealers participating in "firm commitment" underwritings must have sufficient net capital to permit participation in the underwriting for the amount they have agreed upon. The staff, in order adequately to protect issuers and customers of broker-dealers participating in such underwritings, carefully analyzes the latest information concerning the capital position of such a broker-dealer in order to determine if assumption of the new obligations involved in the underwriting is possible without violating the net capital rule. The Commission will refuse to accelerate the effectiveness of registration statements filed under the Securities Act when it appears that any of the underwriters would, by virtue of commitments in the underwriting, be in violation of the net capital rule. Broker-dealers named as underwriters in offerings of securities registered with the Commission who appeared to be inadequately capitalized to fulfill their commitments and, at the same time, remain in compliance with the net capital rule, were informed of the potential violation of the rule and the effect this would have upon the pending registration statement. Such broker-dealers either obtained sufficient additional capital, comply fully with the rule, 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

Under section 17(a) of the Securities Exchange Act, the Commission has promulgated rule 17a-5 requiring the filing of periodic financial statements by registered brokers and dealers. Under this rule, every financial report filed must be certified by a certified public accountant or a public accountant who is in fact independent, with certain limited exemptions applicable to situations where certification does not appear necessary for customer protection. Thus, under certain conditions, a member of a national securities exchange need not file such a certified report. Also, if since his previous report a broker has limited his securities business to soliciting subscriptions as an agent for issuers, transmitted funds and securities promptly, and has not otherwise held funds or securities for or owed monies or securities to customers, he is exempt from the certification requirement. An exemption from the certification requirements is also given a broker-dealer who, from the date of his last report, has only bought and sold evidences of indebtedness secured by liens on real estate and has not carried margin accounts, credit balances, or securities for securities customers.

The requirements for filing financial reports enable the Commission and the public to determine the financial responsibility of broker-dealers and enable the staff to analyze the reports in order to determine whether the registrant is in compliance with the Commission's net capital rule. Revocation proceedings are instituted against registrants who fail to make the necessary filing. However, it is the practice of the Commission to first inform a registrant of his obligations under rule 17a-5 prior to taking such action against him. During the past fiscal year, 4,560 reports of financial condition were filed, an increase of 87 over fiscal 1958.

Broker-Dealer Inspections

Section 17(a) of the Securities Exchange Act provides for regular and periodic inspections of registered broker-dealers. The Commission has continued to place emphasis on this program to insure a more adequate protection of investors. Inspection serves to assure compliance by broker-dealers with the securities acts and the rules and regulations promulgated by the Commission. The inspection device is one of the most useful instruments at the Commission's disposal in protecting investors and preventing and detecting violations of the Federal securities laws.

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

In addition, the inspectors also determine whether brokers and dealers keep their 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. Furthermore, a check is made to see if excessive trading in customers' accounts involving "churning" or "switching" has occurred. Inspections often turn up evidence of sale of unregistered securities or the use of fraudulent practices, including the use of improper sales literature or sales methods. Frequently, the inspections enable the Commission to nip in the bud situations which if not corrected, could result in loss to customers.

In 1956, the Commission inaugurated a policy of increasing the number of inspections over that of previous years. The same policy has been followed in the past fiscal year. Inspections completed during the year numbered 1,471.

In determining whether to institute action against a broker-dealer found to foe in violation of the statutes or rules as a result of an inspection, consideration is given to the nature of the 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 violation. 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 made to correct the improper practices. If the violation appears to be willful and the public interest or the protection of investors is best served by formal action, the Commission promptly institutes the appropriate proceedings.

The following table shows the various types of violation disclosed as a result of the inspection program during the fiscal year 1959:

[table omitted]

The principal stock exchanges, the National Association of Securities Dealers, Inc. and some of the States each have somewhat similar but not identical inspection programs to that of the Commission. Each agency conducts its inspections, examinations or audits in accordance with its own procedures and with particular reference to its own regulations and jurisdiction. Inspections by other agencies cannot be adequate substitutes for Commission inspections since they are not 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 organizations do afford added protection to the public. For this reason, the Commission and certain other inspecting agencies maintain a program, of coordinating inspection activities to obtain the widest possible coverage of brokers and dealers and to avoid unnecessary duplications of inspection. By this program, each inspecting agency makes available to all such agencies advice that it has started a particular inspection but the reports or findings of such an inspection are not exchanged between the parties. Information discovered in the course of such inspections or examinations indicating serious violations of regulations administered by another agency may, however, be called to the attention of such other agency. The program does not prevent the Commission from inspecting any firm recently inspected by another agency and such inspections are made whenever there exists good cause.

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 ("the 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 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.

At June 30, 1959, there were 4,018 NASD members, an increase of 198 during the year, as a result of 542 admissions to and 344 terminations of membership. At the same time, there were registered with the NASD as registered representatives 77,917 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 12,603 during the year as a result of 19,071 initial registrations, 11,043 re-registrations and 17,511 terminations of registrations. The membership and registered representative figures as of June 30, 1959, both represent all-time high marks.

NASD Disciplinary Actions

The NASD furnishes the Commission summaries of decisions on all disciplinary actions against members and registered representatives of members. Each such decision is considered by the Commission's staff to determine whether the underlying facts indicate conduct in violation of the statutes administered by the Commission or the rules thereunder and whether the Commission should, on its own motion, call up a particular case for review. This staff consideration often includes an examination of the Association's complete file on a particular case. Where such action appears warranted by the available facts, independent Commission inquiry or action is initiated through the appropriate regional office.

During the fiscal year the NASD forwarded to the Commission 248 disciplinary decisions on 209 formal complaint cases. It is not unusual for there to be more than one decision on a particular case for all decisions of District Business Conduct Committees are appealable to or reviewable by the Board of Governors which may affirm, modify, or reverse such decisions or remand them for reconsideration. Final Association decisions were reported to the Commission during the year in 175 formal complaint cases.

Each formal complaint must rest on allegations that a member firm had violated specified provisions of the NASD Rules of Fair Practice, although registered representatives of members and other persons controlling or controlled by members may also be cited for violations or for having been the cause of violations. Of the 175 decided cases, 103 were based on complaints solely against members. Eight such complaints were dismissed on findings that the allegations had not been sustained, whereas in 95 cases it was found that the alleged violations had occurred, and a penalty was imposed on the member. The remaining 72 cases involved allegations of violations against the member firms concerned and 108 of their registered representatives or associates. Two such complaints were dismissed as to the two members and three individuals concerned and 21 others were dismissed as to the members involved, while 11 other individuals were found not to have been guilty of the alleged violations. Violations were found and a penalty was imposed on 49 members and 94 individual associates of members involved in this category of complaints. In all, there were disciplinary decisions adverse to 144 members and to 94 registered representatives.

The penalties imposed included censure, fine, suspension or expulsion of the member or suspension or revocation of the registration of a registered representative and in some cases a finding that an individual had been a cause of an expulsion, suspension or revocation. In many instances more than a single penalty was imposed and in a substantial majority of the cases some or all of the costs of the proceedings were assessed against those found to have acted improperly.

Thus 31 members were expelled; 4 were suspended for periods ranging from. 1 week to 18 months; the registrations of 28 registered representatives were revoked and 9 were suspended, also from 1 week to 18 months; and 16 individuals were held to have been the cause of an expulsion, suspension, or revocation. Moreover, 88 members were assessed fines as were 10 registered representatives, in amounts varying in each category from $25 to $5,000. The minimum penalty of censure was imposed on 18 members and 18 registered representatives. In the fiscal year the Association collected a total of $77,658.66 as a result of fines and costs imposed in disciplinary actions. In some cases, of course, fines or costs imposed on an expelled member or a revoked representative are never paid.

In addition to disciplinary action by formal complaint procedure, as described above, action was also taken against members pursuant to the Minor Violation Procedure, provided in the Association's Code of Procedure for Handling Trade Practice Complaints, for the disposition of disciplinary cases where the facts are not in dispute and where the matter involves minor or technical violations of the rules with no significant damage to customers or other parties. Under this procedure a member charged with violation of the rules may waive a hearing, admit the violations as alleged and accept a penalty not in excess of censure and a fine of $100. A member's rights of appeal are preserved as is the right of the Board of Governors to review action by a District Business Conduct Committee. A member, however, is not required to follow the Minor Violation Procedure and may elect to face formal charges and to require a hearing.

The Association reported to the Commission during the year the disposition of 31 complaints pursuant to Minor Violation Procedure. In 20 cases fines were imposed in amounts ranging from $25 to $100 and aggregating $1,325 and in 8 other cases the only penalty imposed was censure. In another case after the member admitted alleged violations and paid a fine of $100 under Minor Violation Procedure, the Board of Governors remanded the case to the appropriate committee for formal complaint treatment on the grounds that minor violation treatment was inappropriate where a member was charged with the repetition of acts for which it had previously been disciplined. The remand resulted in the filing of a formal complaint and a finding of violations for which a fine of $200 was imposed.

In two other cases members rejected Minor Violation Procedure and required the filing of formal complaints. In one such case, the member demonstrated to the committee's satisfaction at a hearing that it had not acted improperly and the committee dismissed the complaint. In the remaining case, the member rejected an offer to admit alleged violations and to pay a fine of $25. A formal complaint was then filed and the district committee found violations and imposed a $25 fine. The member appealed this decision to the Board of Governors which affirmed the findings of violations and increased the penalty to a fine of $300 plus costs.

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. The effectiveness of any penalty imposed by the NASD is automatically stayed pending determination in any matter which comes before the Commission for review. At the beginning of the fiscal year, two such review cases had been pending before the Commission. During the year eight other such petitions were filed and three cases were disposed of, leaving seven petitions pending at the year end.

The Commission dismissed an application filed by Samuel B. Franklin & Company seeking review of disciplinary action by the Association which had found that the firm had violated the Association's Rules of Fair Practice by selling securities to, and purchasing securities from, customers at prices which were not fair in view of all the relevant circumstances. An NASD District Committee had censured the firm, fined it $1,000 and assessed costs amounting to $773.80. The NASD Board of Governors on appeal affirmed this action and assessed an additional $153.29 in connection with the costs of the appeal.

According to the Commission's decision, the basic facts were not in dispute. Out of 731 transactions in which Franklin & Co. as principal sold securities to customers during the period between January and May 1956, not including sales of investment company shares and other securities sold in a public offering pursuant to a prospectus, 642 transactions involved markups in excess of 5 percent. The company, as principal, purchased securities from customers in 428 transactions and in 159 of these transactions its markdown exceeded 5 percent. In the 642 sales transactions the markups were more than 10 percent in 549 instances, more than 15 percent in 402 cases, more than 20 percent in 260 transactions, and ranged from 30 to 62 percent in 99 cases. On its 159 purchases from customers, the markdown in 68 transactions exceeded 10 percent, in 32 it exceeded 15 percent, in 20 it exceeded 20 percent, and in 6 cases it ranged from 30 to 37 percent. In discussing the gross dollar amount of transactions, the Commission pointed out that of the 731 sales, 498 were in the $100-$500 category, and 108 each involved more than $500, and that of these 606 transactions, the markups were 30 percent or more in 55 cases and in excess of 20 percent in 184 cases. The price range of the securities sold was less than 10 cents per share in 127 transactions, less than 50 cents in 477 transactions, and less than $1 in 499 transactions.

These markups were computed on the basis of the firm's own cost on same day or contemporaneous purchases of shares of the same securities except that, in a relatively small number of instances where such information was not available, the computations were made on the basis of quotations obtained from the National Daily Quotation

Service. The markdowns on the firm's purchases from customers were computed on the basis of same day or contemporaneous sales by the firm of shares of the same securities for its own account.

The applicant urged, among other things, that most of the transactions involved purchases or sales of so-called "penny" stocks selling for less than $1 per share; that in most cases the dollar value of a transaction was small; that the NASD 5 percent markup policy should not be applied to low priced securities sold in small dollar transactions; that it was justified in charging an amount over cost sufficient to cover expenses; and that its markups over cost were not greater than the differences between the published bid and asked quotations on typical penny stocks.

In its findings and opinion the Commission concluded that Franklin & Co.'s pricing practices clearly were unreasonable, at least in those transactions where the markups or markdowns were greater than 20 percent, as there was no showing of special circumstances such as unusual expenses, extraordinary services to customers or acquisition of inventory at special concessions. The Commission sustained the NASD finding that the firm had purchased and sold securities at prices which were not fair under all the relevant circumstances arid which were not reasonably related to current market prices, that such conduct was inconsistent with just and equitable principles of trade and that the penalties imposed were not excessive, having due regard to the public interest.

Two other applications for review of Association disciplinary action were dismissed by the Commission, consideration having been stayed pending determination of administrative proceedings against the parties concerned. These petitions had been filed by Batkin & Co. and Churchill Securities Corp. Dismissal of the petitions as moot followed action by the Commission revoking the broker-dealer registration of Batkin & Co. and expelling it from the Association and similar action as to Churchill Securities Corp.

Commission Review of NASD Action on Membership

Section 15A(b) of the act and the by-laws 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 by-laws. By these provisions Commission approval is a condition to the continuance in Association membership of any broker-dealer who, among other things, controls a person whose registration as a broker-dealer has been revoked or who was found to have been a cause of a Commission order of revocation.

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 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 whose application is refused Association sponsorship, however, may file an application directly with the Commission. The Commission reviews the record and documents filed in support of the application and, where appropriate, obtains additional evidence. At the beginning of the fiscal year one such petition was pending before the Commission; during the year six petitions were filed and three were disposed of; and four were pending at the year end.

The three disqualified individuals whose employment was thus approved were: William A. Spanier, formerly president of Bennett, Spanier & Co., Inc., a firm revoked as a broker-dealer and expelled from the NASD by the Commission on May 28, 1952, on findings that, among other things, it had engaged in manipulative activities and had sold unregistered securities; Kenneth E. Goodman, formerly sole stockholder of Kenneth E. Goodman & Co., a firm similarly revoked and expelled by the Commission on April 23, 1958, on findings that it had falsely stated its bank balance on its books and had effected securities transactions in violation of the Commission's net capital rule; and Leonard H. Whitaker, whose registration as a broker-dealer had been revoked by the Commission in 1952 because of certain securities violations, including, among other things, the sale of unregistered securities and conversion to his own use of a payment from a customer for securities. Whitaker's employment by another NASD member firm had earlier been approved by the Commission under specified conditions. This second approval petition was necessary because Whitaker had changed employers. In each case the Commission found it appropriate in the public interest to approve the NASD applications in view of all the circumstances, including the lapse of time and supervision of the representatives.

LITIGATION UNDER THE SECURITIES EXCHANGE ACT OF 1934

In order to protect the public, the Commission is authorized to institute actions to enjoin broker-dealers and other persons from engaging in activities which violate the provisions of the Securities Exchange Act of 1934. Some of these activities also violated provisions of the Securities Act of 1933 and are discussed above.

Anti-Fraud Litigation

In discharging its obligation to prevent frauds upon the public, the Commission filed a number of complaints during the past year. Final judgment enjoining Louis E. Wolf son from further violating the anti-fraud and antimanipulative provisions of the Exchange Act was obtained. This case is discussed at length in the 24th Annual report. The complaint alleged that Wolfson and others had attempted to defraud the public and to manipulate the market of American Motors stock; that he and his associates caused to be published in a financial newspaper an article stating that they owned 460,000 shares of that stock at a time when they had disposed of 200,000 shares, and that they later caused an article to be published stating that Wolfson had disposed of one-quarter of his 400,000 shares and would sell the rest during the coming months. Wolfson, according to the complaint, omitted to disclose that he had disposed of all his holdings in American Motors, had in fact sold short, and was attempting to buy stock to cover his short position. Judgment against Wolfson was entered by consent.

In S.E.C. v. Wilkes, the Commission's complaint charged violations of the short selling and antifraud provisions of the Exchange Act and the Commission's rules in that defendant caused four broker-dealers to sell for his account on the American Stock Exchange an aggregate of 29,100 shares of Hazel Bishop, Inc. common stock, by falsely representing to the brokers that he owned such stock. A final decree enjoining further violations of the act was entered on consent of defendant.

Three cases involved violations of the Exchange Act with regard to over-the-counter sales. In S.E.C. v. McDonald the complaint alleged that the corporate defendant broker-dealer accepted moneys and securities and represented that it would fulfill its obligation to deliver securities or moneys due when in fact it could not and did not intend to do so. Affidavits filed in support of a motion for a temporary restraining order alleged, among other things, that a broker-dealer firm had paid defendant $50,000 for the purchase of securities which were never delivered, that employees of defendant stated that members of the public had paid more than $250,000 for securities which were not delivered, and that the Dayton Aviation and Radio Equipment Corp., which had engaged defendant as underwriter for its offering of some 500,000 shares of common stock, had received proceeds from the sale of only 274,200 shares although in fact the whole issue had been sold. A permanent injunction was obtained by default against the firm and its president.

In S.E.C. v. Campbell and in S.E.C. v. Rosen the Commission charged defendant brokerage firms with accepting customers' orders and deposits of money and securities upon the representation that they were ready and able to meet all obligations, when in fact they were insolvent and unable to meet current liabilities. Permanent injunctions were entered in both cases.

Cases under the Net Capital Rule

The "net capital rule" provides an important protection to investors against loss of securities or monies, due to financial straits of broker-dealers, by requiring every broker-dealer to limit his aggregate indebtedness to all persons to 2,000 per centum of net capital. During the year injunctions were obtained to enjoin broker-dealers from further violations of the net capital rule in S.E.C. v. Trigg, S.E.C. v. Wagner, S.E.C. v. Sano, S.E.C. v. The Christopher Corp., S.E.C. v. Empire State Mutual Sales, Inc., and S.E.C. v. Green.

In the Empire State and Green cases, and in S.E.C. v. Aronson and S.E.C. v. Carroll the Commission charged defendants with violations of the fraud and record-keeping provisions of the Exchange Act, as well as the net capital rule.

M. J. Shuck v. S.E.C., 264 F. 2d 358 (C.A. D.C., 1958), involved a petition for review of a Commission order denying withdrawal and revoking petitioner's registration as a broker-dealer. The Commission's revocation was based on findings that petitioner had been enjoined by a district court from violating the Commission's net capital rule and that revocation would be in the public interest. The Court of Appeals for the District of Columbia, in affirming the Commission's order, held, first, that the Commission had observed the fundamental purposes of section 9(b) of the Administrative Procedure Act and, second, that under the circumstances of this case, the Commission properly found revocation was in the public interest. Service on the petitioner of the temporary restraining order and the Commission's complaint in the action for the preliminary injunction as well as the issuance of the injunction itself met the requirement in 9(b) that written notice of the facts warranting a revocation be sent to the licensee prior to the agency proceeding. The Court stated that the record shows that even prior to the district court proceedings the Commission's staff had discussed with Shuck the matter of compliance. In addition, the court proceedings, the Court held, afforded petitioner a further opportunity to demonstrate compliance.

Moving to the merits of the case, the Court concluded that it is not required that the injunction contain an express finding of willfulness as petitioner had contended where revocation is based on the entry of an injunction. Evidence of willfulness, however, might be considered by the Commission in applying the public interest criterion. The record of Shuck's action in the past supported the Commission's findings that the violation of the net capital rule was not unintentional or inadvertent. This past record coupled with the District Court's finding that Shuck would not maintain the required standards in the future could properly justify the Commission's revocation for the future protection of the investing public. Nor did the Court feel that Shuck's expressed wish to withdraw from the securities business or his alleged satisfaction of creditors precluded the Commission from taking this step. The Court stated that the Commission could hold its hearing which would reflect the facts shortly after they occurred and take prompt and appropriate action without waiting until Shuck re-entered into business. The Court of Appeals restated its ruling in Hughes v. S.E.C. that willfulness means "no more than that the person charged with the duty knows what he is doing.

Litigation Involving Broker-Dealer Registration and Reporting Requirements

Gilligan, Will & Co., et al. v. S.E.C., 267 F. 2d, 461 (C.A. 2, 1959) involved a petition for review of the Commission's order suspending Gilligan, Will & Co. for 5 days from the National Association of Securities Dealers, Inc. for violations of section 5 of the Securities Act and finding James Gilligan and William Will causes of the order. Petitioners challenged the Commission's findings that they were underwriters with respect to 1955 and 1956 transactions in Crowell-Collier debentures and stock. The Court upheld the findings and conclusion of the Commission that the resale of securities contemplated and executed by petitioner was a distribution or public offering and hence petitioners were underwriters. The Court rejected petitioners' argument that they took for investment where they intended to retain the stock only if the issuer continued to operate profitably.

Some of the cases brought by the Commission involved failure of the defendants to file the reports required by the Exchange Act. In S.E.C. v. Alexander L. Guterma, and F. L. Jacobs Co. the complaint sought to enjoin the company and its then president and controlling stockholder, Guterma, from continuing to violate the antifraud and reporting requirements of the 1934 Act and the antifraud and registration requirements of the 1933 act. After Guterma resigned and disposed of his interest in the company, the new management consented to entry of a mandatory injunction ordering the company to prepare and file with the Commission all information, documents and reports required by the act.

Upon application of the Commission the District Court at New York City appointed receivers for the assets of the company. Immediately thereafter a petition for reorganization under chapter X of the Bankruptcy Act was filed and is now pending in the District Court at Detroit, Mich. The Commission is participating in these proceedings.

In S.E.C. v. Interworld T. V. Films, Inc., the court entered a mandatory injunction requiring the filing of reports on Forms 8-K, 9-K, and 10-K and restraining future violations of the reporting requirements. In a companion case, S.E.C. v. Guild Films Co. the court ordered reports to be filed correcting a previously filed Form 10-K and enjoined future violations.

A mandatory injunction was entered by consent in S.E.C. v. Peruvian Oil Concessions Co., Inc. requiring the company to file annual reports for fiscal 1955,1956 and 1957.

In S.E.C. v. First Lewis Corporation defendant was charged with failing to make available for examination by representatives of the Commission the books and records required to be kept by the Exchange Act. The Court enjoined the defendant from doing business in securities while failing to make such books and records available. A permanent injunction was also entered in S.E.C. v. Bradford for failure to make available books and records and for failure to file a report of the financial condition of a brokerage firm.

Proxy Litigation

The Commission appeared as plaintiff in one case of proxy litigation. In S.E.C. v. Central Foundry Co., et al., the Commission obtained a court order delaying the effect of votes cast by stockholders of the company at the Annual Meeting, charging both management and the opposing Independent Stockholders Protective Committee with violations of the proxy rules. The management filed a notice of appeal from the order and the case was set for hearing on the Commission's complaint. However, before any further action was taken, the next Annual Meeting was held from which the stockholders' faction emerged victorious by a substantial margin. Neither side was charged with illegal practices in connection with the second meeting. The management faction then stipulated to dismissal of its appeal. Thereupon the Commission stipulated to dismissal of its complaint.

Contempt Proceedings

In S.E.C. v. East Boston Co., Bernard Gold-fine, et al. the Commission found it necessary to bring a contempt action to enforce an injunction order previously obtained. The respondents were found in civil contempt for failure to file the semi-annual report of the company required under the Exchange Act. The respondents consented to payment of a $2,500 fine by the individuals. The company had earlier paid $3,000 compensatory damages.

Participation as Amicus Curiae

As noted in the last annual report, the Commission filed briefs in two cases in which the validity of rule 16b-3, insofar as it exempts the exercise of stock options from section 16(b) of the Exchange Act, was brought into question. In the first of these cases, Perlman v. Timberlake, the judge of the United States District Court for the Southern District of New York declared in dictum that the rule is invalid, but held that the defendants were protected from liability because of their good faith reliance upon the rule. The other case, Van Aalten v. Hurley, now pending before another judge of the same court, has not yet been decided.

In Taylor, et al. v. Janigan (USDC D. Mass, No. 85-1056), the case arose out of the purchase by the President of Boston Electro Steel Casting, Inc. of substantially all of the outstanding stock from the shareholders. The plaintiffs brought suit under section 10(b) of the Exchange Act and rule 10b-5 thereunder, charging that they were induced to sell by defendant's misrepresentation. The defendant moved to dismiss on the grounds of lack of jurisdiction and failure to state a cause of action. Defendant also argued that 28 U.S.C. § 1331, which requires a $10,000 amount to be in controversy, governs the implied right of action under the Exchange Act and the rules under it.

The Commission filed a brief amicus curiae. The court supported the Commission's arguments, denying the motion to dismiss. The court stated that section 10(b) and rule 10b-5 gave rise to the cause of action and to Federal jurisdiction, and that interveners need not comply with the requirement as to amount in controversy, because section 27 of the Exchange Act grants jurisdiction without reference to amount.

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

The Public Utility Holding Company Act of 1935 provides for the regulation by the Commission of interstate public-utility holding company systems engaged in the electric utility business or in the retail distribution of gas. The matters dealt with embrace intricate and complex questions of law and fact, and generally involve one or more of three major areas of regulation. The first of such areas 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 area of regulation 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 area of regulation 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.

The staff functions under the act are performed in the Branch of Public Utility Regulation of the Division of Corporate Regulation.

COMPOSITION OF REGISTERED HOLDING COMPANY SYSTEMS -- SUMMARY OF CHANGES

On June 30,1959, there were 21 registered holding company systems subject to regulation under the act. Of these, 3 systems, namely, (1) Cities Service Company, (2) Electric Bond and Share Co., and (3) Standard Gas and Electric Co., do not own as much as 10 percent of the voting securities of any public-utility company operating within the United States. The remaining 18 systems are referred to herein as "active registered systems."

Included in the 18 active registered systems there were 19 registered holding companies of which 13 function solely as holding companies and 6 function as operating companies as well as holding companies.

In addition, in these systems there are 99 electric and gas utility subsidiaries, 42 nonutility subsidiaries, and 16 inactive companies, totaling 176 system companies.

The following tabulation shows the number of holding companies, electric and gas utility companies and nonutility companies in each of the 18 active registered systems as at June 30, 1959, and their aggregate assets, less valuation reserves, as of December 31, 1958:

[table omitted]

During the fiscal year the Commission granted an exemption to Central Public Utility Corporation, a registered holding company. The exemption was granted pursuant to section 3(a)(5), which affords exemption to companies having no domestic public-utility companies. Further discussion of this matter is at page 132 of this report. Also during the fiscal year American Electric Power Company, Inc., a registered holding company, sold the assets of a subsidiary, The Seneca Light & Power Company, to Ohio Power Company, another subsidiary of American Electric Power. New England Electric System disposed of one subsidiary, Pequot Gas Company, by sale to a nonaffiliate.

While most of the section 11 problems existing at the time of the passage of the act have been resolved, there still remain a substantial number of issues which have not as yet been determined. Examples are: In its order under section 11(b)(2) with respect to Cities Service Company the Commission required that company to eliminate the minority interest in its subsidiary, Arkansas Fuel Oil Corporation, or to dispose of its holdings therein. A proceeding which is pending before the Commission with respect to this matter is discussed at page 132 of this report. In its order under section 11(b)(1) with respect to The Columbia Gas System, Inc., the Commission reserved jurisdiction concerning the retainability in the system of the properties of ten companies (subsequently reduced to six) and in this connection there is a proceeding pending before the Commission which is discussed at page 126 of this report. There is a problem under section 11(b)(1) of the act with respect to Consolidated Natural Gas Co. relating principally to the retainability of nonutility pipe-line properties. With respect to Delaware Power & Light Co. there exists the question of whether the gas and electric facilities are retainable under common control. The Commission, by order dated April 14, 1950, directed the disposition of the gas properties of Blackstone Valley Gas & Electric Co., a subsidiary of Eastern Utilities Associates. This system has pending before the Commission a plan designed to accomplish the disposition of the gas properties required to be divested. That matter is discussed at pages 126-127 of this report. There is pending before the Commission an application filed by Electric Bond and Share Company for an exemption pursuant to section 3(a)(5) and this matter is discussed on page 133 of this report. In the Middle South Utilities, Inc., system there exist problems with respect to the retainability of certain gas and transportation properties and the elimination of a minority interest in a subsidiary. National Fuel Gas Co. system has oil, real estate, and gas transmission businesses, the retention of which has not been determined. There is also a problem relating to a minority interest in one of its subsidiaries. There is pending before the Commission a proceeding under section 11(b)(1) of the act with respect to New England Electric System to determine whether the system's gas properties are retainable together with its electric properties. [Footnote: The Commission has previously determined that the electric properties of New England Electric System constitute an integrated public-utility system.] In addition there exists a problem in respect of the minority interests in the common stock of five subsidiaries. There is a problem under section 11(b)(1) of the act which has not been resolved whether Utah Power & Light Co. may retain its subsidiary, The Western Colorado Power Co.

The maximum number of companies subject to the act as components of registered holding company systems at any one point of time was 1,620 in 1938. Since that time additional systems have registered and certain systems have organized or acquired additional subsidiaries, with the result that 2,387 companies have been subject to the act as registered holding companies or subsidiaries thereof during the period from June 15, 1938, to June 30, 1959. Included in this total were 216 holding companies (holding companies and operating-holding companies), 1,023 electric and gas utility companies and 1,148 non-utility enterprises. From June 15, 1938, to June 30, 1959, 2,064 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 323 companies, 176 are members of the 18 active systems listed in the table on page 121 and 147 are members of the additional 3 systems named above at page 120, which are also subject to regulation under the act.

Of the above-mentioned 2,064 companies 924 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 1,140 companies includes 777 which were released from the regulatory jurisdiction of the act as a result of dissolutions, mergers and consolidations and 363 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.

DEVELOPMENTS IN INDIVIDUAL REGISTERED SYSTEMS

There is discussed below each of the active registered systems and the other systems in which there occurred during the fiscal year 1958 significant developments other than financing transactions. The financing activities of registered holding companies and their subsidiaries are treated below in a separate section of this report.

A. DEVELOPMENTS IN ACTIVE REGISTERED SYSTEMS

American Electric Power Company, Inc.

At December 31,1958, this system had consolidated assets, less valuation reserves, of some $1,391 million. The system had consolidated operating revenues of about $296,547,000 for the calendar year 1958.

Although no significant corporate changes took place in the system during the fiscal year, there was substantial activity with respect to its expansion program and the financing arrangements therefor. This system is the largest electric holding company system subject to the act having generating capability of 5,432,000 kw. During the fiscal year Ohio Power Company acquired the assets of The Seneca Light & Power Company, a wholly owned subsidiary of American Electric.

The system carries on research along many avenues of technology and, during the fiscal year, continued to concentrate on nuclear research and development based upon a long-term, rather than a short-term, approach to the usefulness of atomic power. Three system companies are members of the East Central Nuclear Group which consists of 14 utility companies in the general Ohio Valley area. This group is in the process of developing a program involving research and development of a high-temperature, gas-cooled, heavy water-moderated, pressure-tube reactor of 50,000 kw. capacity. The AEP system's contribution to this project's pre-operational research and development is expected to be approximately $1,650,000 over a 5-year period. If the reactor proves economically feasible and is built, an additional contribution for post-operational work is expected to amount to about $650,000, likewise spread over a subsequent period of 5 years. American Electric Power Co., Inc., is also a member of Nuclear Power Group, Inc., and, as such, continues to derive technological and practical experience from the research and design activities in Commonwealth Edison Company's 180,000-kw. boiling-water reactor being installed at Dresden, Ill. The plant is expected to be in operation in 1960. Nuclear Power Group is contributing $15 million of the research and development cost of this plant, of which the AEP system's share is approximately $3 million.

The system's service corporation designed and engineer the power plants of Ohio Valley Electric Corp. American Electric owns 37.8 percent of the voting securities of OVEC, 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 pending before the Commission at the close of the fiscal year the issue of whether the acquisition of OVEC's stock by American Electric and other sponsoring companies meets the standards of section 10 of the act. This issue and the organization and financing of OVEC and Indiana-Kentucky Electric Corp. are discussed on pages 126-129 of the Commission's 23d Annual Report.

American Natural Gas Co.

This registered holding company and its subsidiary companies, as at December 31,1958, had consolidated assets, less valuation reserves, of approximately $693,121,000. The system had consolidated operating revenues of about $204,543,000 for the calendar year 1958.

On April 7, 1958, the Commission issued its findings and opinion and order directing American Natural to take appropriate steps to eliminate its outstanding $25 par value $6 nonredeemable preferred stock from the holding company system. In November 1958, American Natural filed a plan under section 11(e) of the act to eliminate such preferred stock by a payment of $32.50 per share to the holders thereof. Public hearings on the plan have been concluded. Briefs and replies thereto have been filed. Oral argument was heard on May 19,1959, and the matter was pending before the Commission for decision at the end of the fiscal year.

Central and South West Corp.

This registered holding company and its subsidiaries, as at December 31, 1958, had consolidated assets, less valuation reserves, amounting to approximately $628,684,000. The system had total consolidated electric operating revenues of about $146,806,000 for the calendar year 1958.

Three system subsidiaries are members of Texas Atomic Energy Research Foundation which consists of a group of 11 electric utility companies in Texas. The Foundation was organized in 1957 for the purpose of engaging in research in the atomic energy field as applied to the generation of electric power. These system subsidiaries are committed to contribute a total of about $1 million, of a combined total of $10 million, for the research program which has for its object studying heavy hydrogen or fusion reactions at high temperature under controlled conditions. Two system subsidiaries have joined with 13 other electric utility companies in the formation of Southwest Atomic Energy Associates which, for research and development purposes is financing the construction of an epithermal thorium power reactor.

The Columbia Gas System, Inc.

This registered holding company and its subsidiaries, at December 31, 1958, had consolidated assets, less valuation reserves, of about $1,150,600,000. The consolidated gross operating revenues for the calendar year 1958 were approximately $427,443,000.

During the fiscal year Columbia's wholly-owned subsidiary, Columbia Gulf Transmission Company, acquired the assets of Gulf Interstate Gas Company, a nonaffiliated company, in exchange for 3,574,337 shares of common stock of Columbia and the assumption by Columbia Gulf Transmission Company of Gulf Interstate's liabilities, including $141,400,000 of its publicly-held first mortgage pipeline bonds. The assets acquired consist principally of 389 miles of pipeline which is used to gather gas purchased by the Columbia system in Louisiana, and 845 miles of transmission line, which is used to transport such gas to eastern Kentucky where it is delivered to other facilities of the Columbia system.

The Columbia system follows the policy of having its publicly-held securities solely at the holding company level and the assumption of the Gulf Interstate Gas Company bonds by a subsidiary of Columbia was a departure from this policy, which, if allowed to continue, would have resulted in the system having substantial amounts of long-term debt at two separate levels, creating a pyramiding of system securities, which was one of the evils the Public Utility Holding Company Act of 1935 was designed to prevent. To correct this situation, Columbia has exchanged its debentures for the Columbia Gulf debentures.

As indicated at page 132 of the 22d Annual Report there was pending before the Commission a motion filed by Columbia requesting the release of jurisdiction with respect to the retainability of certain properties controlled by the system. Both the Division of Corporate Regulation and Columbia have filed proposed findings of fact and conclusions of law. The Division recommended that the Commission should not, on the basis of the record so far made in the proceeding, find the properties involved are retainable. Columbia submitted that the properties involved are properly a part of its integrated gas system or are reasonably incidental thereto and are retainable. The matter was pending at the close of the fiscal year.

Eastern Utilities Associates

This registered holding company and its subsidiary companies, as at December 31, 1958, had consolidated assets, less valuation reserves, of about $105,396,000 and its consolidated operating revenues for that year were approximately $33,059,000.

On April 4, 1950, the Commission issued an order directing EUA to sever its relationship with the gas properties of its subsidiary, Blackstone Valley Gas Company. In 1956 Valley Gas Co. was incorporated for the purpose of acquiring and operating such gas properties. In February 1957, an application-declaration was filed covering several transactions designed to effectuate compliance with the Commission's order of April 4, 1950. Included in the transactions was a proposal that EUA issue 25-year debt securities. The Division of Corporate Regulation opposed the issuance of the long-term debt securities by EUA and on December 15, 1958, the Commission published its findings and opinion in which it concluded that the proposed bonds could not be approved. On February 6, 1959, EUA filed a plan, pursuant to section 11(e) of the act, designed to accomplish the disposition of the Blackstone Gas properties, but which did not include the issuance of long-term debt securities by EUA. Hearings on the plan were concluded and the matter was before the Commission for decision at the close of the fiscal year.

Middle South Utilities, Inc.

This registered holding company and its subsidiaries, as of December 31, 1958, had consolidated assets, less valuation reserves, amounting to approximately $699,861,000.

The system had total consolidated operating revenues for the year 1958 of above $182,927,000.

Hearings were held in 1957 with respect to issues related to the acquisition by certain companies, including Middle South, of the capital stock of Electric Energy, Inc., an electric generating company which has a long-term contract for the sale of firm power to an installation of the Atomic Energy Commission. During the hearings, Middle South, as a result of negotiations with Kentucky Utilities Company, entered into a formal contract to sell its 10 percent stock interest in EEL Middle South filed a declaration under section 12(d) of the act and rule 44 thereunder (file No. 70-3595), requesting Commission permission to sell its stock interest in EEI and Kentucky filed an application under section 10 of the act (file No. 70-3596) requesting Commission approval to acquire such interest. The Middle South-Kentucky proposed transactions were consolidated with the pending proceedings and a supplemental hearing was held.

On November 28, 1958, the Commission issued its findings and opinion and order, pursuant to section 10, approving the acquisitions by Union Electric Company, Illinois Power Company, and Kentucky Utilities Company of their proposed respective interests in the EEI stock. In addition, the Commission permitted Middle South's declaration for the sale of its interest in EEI to become effective.

New England Electric System

This registered holding company and its subsidiaries, as at December 31, 1958, had consolidated assets, less valuation reserves of about $600,135,000 and, for that year the consolidated operating revenues amounted to approximately $166,959,000.

On August 5, 1957, the Commission instituted a proceeding in respect of NEES and its subsidiaries for the purpose of determining the extent to which the electric, gas, and other business operations of the NEES holding company system satisfied the integration standards of section 11(b)(1) of the act. The hearing was initially devoted exclusively to the issue of whether or not the electric operations of the NEES system constitute those of a single integrated public-utility system within the meaning of section 11(b)(l). On February 20, 1958, the Commission issued its findings and opinion and order in which it held that the electric properties of the NEES holding company system satisfied the standards delineating an integrated public-utility system. At the close of the fiscal year, there was pending for further hearing and determination the question of whether the NEES system may retain all or any of its gas properties.

In July 1958, NEES filed a plan under section 11(e) of the act to eliminate the minority interests in the common stocks of those of its subsidiaries engaged solely in the electric business. Proceedings were instituted by the Commission under section 11(b)(2) for the purpose of determining whether the existence of the public minority interests in these subsidiaries constituted an unfair and inequitable distribution of voting power and the two proceedings were consolidated for hearing and determination. On May 14,1959, the Commission approved the plan and on June 15, 1959, the plan was approved and ordered enforced by the United States District Court for the District of Massachusetts.

The system holds a 30 percent stock interest in Yankee Atomic Electric Company, which is constructing an atomic electric plant. The organization of Yankee and its initial financing transactions are discussed at pages 162-164 of the 22d Annual Report, and steps in the formulation of Yankee's overall financing program are discussed on pages 130-131 of the 23d Annual Report. During the fiscal year the Commission approved the permanent financing of Yankee and the plant is scheduled for completion in 1960. The total capital requirements of Yankee, including construction costs and working capital, are estimated by Yankee at $57 million, of which $20 million will consist of first mortgage bonds, $17 million of unsecured promissory notes and $20 million of common stock.

Ohio Edison Company

Ohio Edison is a registered holding company and an operating electric utility company. The system consists of Ohio Edison itself and three electric utility subsidiaries, Pennsylvania Power Company, Ohio Valley Electric Corp., and its wholly-owned subsidiary, Indiana-Kentucky Electric Corp. Ohio Edison and its subsidiary, Pennsylvania Power Co., had consolidated assets, less valuation reserves, of approximately $587,375,000 at December 31, 1958, and their consolidated operating revenues for the year 1958 amounted to $137,650,000.

Ohio Edison and Pennsylvania Power are 2 of the 15 electric utility companies that sponsored the organization of Ohio Valley Electric Corp. (OVEC) and its subsidiary, Indiana-Kentucky Electric Corp., which supply the power requirements of a gaseous diffusion plant of the Atomic Energy Commission located near Portsmouth, Ohio. The interest of Ohio Edison in the common stock of OVEC is 16.5 percent. Further details with respect to OVEC are set forth at pages 126-129 of the 23d Annual Report. In the Commission's order authorizing the acquisition of OVEC's securities, jurisdiction was expressly reserved to determine at an appropriate future time whether the companies subject to the act could retain such securities. On November 19, 1956, the Commission reopened the proceeding and ordered a hearing in respect of the reserved issues. Hearings have been completed and at the close of the fiscal year, the matter was in process of preparation for submission to the Commission.

Ohio Edison and Pennsylvania Power and 12 other electric utility companies are members of East Central Nuclear Group formed about 2 years ago to formulate plans for undertaking a program of nuclear research and development. In December 1957, this group and Florida West Coast Nuclear Group presented a proposal to the Atomic Energy Commission for research and development on a partnership basis with that agency of a 50,000-kw. high-temperature gas-cooled, heavy-water-moderated reactor of the pressure-tube type. It will be designed as a prototype of a natural uranium 200,000 kw. reactor. Subject to necessary regulatory approvals, Ohio Edison and Pennsylvania Power may be obligated to expend approximately $425,000 per year over the 1958-62 period in connection with preoperational research and development.

The Southern Company

This registered holding company and its subsidiaries had, at December 31, 1958, consolidated assets, less valuation reserves, of approximately $1,130,863,000 and for that year the consolidated operating revenues totaled about $272,134,000.

Southern and its subsidiaries have continued their participation in research and development of nuclear power through Power Reactor Development Co., a nonprofit corporation in the process of constructing an experimental fast breeder atomic reactor in Michigan. The system's service company is one of the 21 member companies which formed PRDC. Further details with respect to PRDC are set forth at pages 164-166 of the 22d Annual Report and at pages 129-130 of the 23d Annual Report. The four direct subsidiaries of Southern have agreed to contribute $2.4 million over a 6-year period toward the construction of this atomic reactor and Southern has guaranteed the payment of 8 percent of the principal and interest of the borrowings made from various banks by PRDC under a loan agreement providing for such borrowings of $15 million by the end of 1958.

Alabama Power Company and Georgia Power Company, subsidiaries of The Southern Company, have undertaken the joint construction of a 1,000,000-kw. steam electric generating station to be owned and operated by Southern Electric Generating Company (SEGCO), which is to be owned equally by Alabama and Georgia. The estimated cost of the station, scheduled for completion in 1962, is $161 million and is to be financed by the issuance and sale of $105 million of first mortgage bonds to the public, the balance to be supplied as common equity by the owner companies. During the past fiscal year the Commission approved the first issuance and sale of first mortgage bonds of SEGCO in the principal amount of $25 million. The Commission noted in its findings and opinion that while SEGCO would not be consolidated with Alabama or Georgia for the purpose of financial reporting, nevertheless, for purposes of financial analysis, the Commission considered it appropriate to impute 50 percent of the outstanding publicly-held securities and of the surplus of SEGCO to Alabama and 50 percent to Georgia.

On November 4, 1955, the Commission rescinded its previously issued order authorizing the issuance and acquisition of up to 55,000 shares of the common stock of Mississippi Valley Generating Company, of which 11,000 shares had been issued to and acquired by Middle South Utilities, Inc. and The Southern Company, leaving the balance of 44,000 shares authorized but not yet issued. In respect of the 11,000 shares already issued, the Commission reserved jurisdiction for future determination of the action to be taken thereon.

Union Electric Co.

Union Electric Co. is a registered holding company and an operating electric utility company. As at December 31, 1958, the consolidated assets, less valuations reserves, of Union and its subsidiaries amounted to approximately $552,236,000 and their consolidated operating revenues for 1958 totaled about $131,650,000.

Heretofore the Commission reserved jurisdiction over the acquisition by certain companies, including Union Electric, of the capital stock of Electric Energy, Inc., an electric generating company which has a long-term contract for the sale of firm power to an installation of the Atomic Energy Commission. On November 28,1958, the Commission issued its findings and opinion and order granting approval of the applications of Union Electric Company to acquire 40 percent, of Illinois Power to acquire 20 percent, and of Kentucky to acquire 20 percent, of the common stock of Electric Energy, Inc., pursuant to section 10 of the act and released the jurisdiction previously reserved under that section. The Commission dismissed the application of Central Illinois Public Service Company to acquire 20 percent of the EEI stock on the ground that it Was not, and would not become, as a result of the proposed acquisition, an affiliate of EEI and of any other public-utility company and that, absent such an affiliated relationship, no approval of the acquisition of the common stock of EEI need be obtained.

On March 26, 1956, Union Electric filed an application for exemption from the provisions of the Holding Company Act pursuant to section 3(a)(2) thereof. On January 13,1959, Union Electric filed an amendment to bring the exemption application up to date. The matter was pending at the close of the fiscal year.

In the fiscal year there were four cases before the courts arising out of objections by J. Raymond Dyer, a stockholder of Union to solicitation of proxies by the company's management and by solicitation by Dyer. For a discussion of the background of this litigation see the 24th Annual Report at pages 119-120. On April 10, 1959, the Court of Appeals for the Eighth Circuit affirmed the Commission's orders entered in March 1958 allowing a declaration filed by management to become effective as a basis for proxy solicitation for the 1958 stockholder's meeting. The Court rejected all of Dyer's numerous contentions on the merits and held that within the scope of its review functions, there is nothing which the Commission did or failed to do which would entitle petitioners to have the orders reversed. Moreover, the Court found that the questions presented had not become moot or inoperative because the stockholder's meeting had been held. As set forth in the 24th Annual Report, Dyer had filed a petition for certiorari in the Supreme Court of the United States to review the Eighth Circuit's dismissal as moot of his petition for review of the Commission's orders relating to Union's 195T meeting. On May 18, 1959, the Supreme Court granted certiorari, vacated the judgment and remanded the case to the Eighth Circuit for further consideration in view of that Court's opinion in the 1958 proceeding. At the end of the fiscal year the case was pending before the Court for a decision on the merits. In addition, Dyer has filed a petition to review the Commission's orders in connection with the 1959 solicitation of proxies for Union's meeting. The related injunction action in the district court referred to on page 120 of the 24th Annual Report was decided adversely to Dyer subsequent to the end of the fiscal year.

B. DEVELOPMENTS IN OTHER SYSTEMS

Central Public Utility Corporation

This company registered under the act as a holding company in 1938, at which time the system consisted of 47 operating companies located in 19 States and in areas outside of the United States. In order to effectuate compliance with section 11(b) of the act, the system consummated a number of section 11(e) plans and on June 1, 1955, filed an application for exemption under section 3(a)(5) of the act, stating that it had disposed of all its domestic public-utility subsidiaries and had substantially simplified its capital structure. On April 3, 1959, following several amendments to and a hearing on the application, the Commission issued an order granting Cenpuc an exemption from the act, subject to a number of terms and conditions, which included consummation of a proposed consolidation of Cenpuc with one or more companies within 6 months of the date of the order (subsequently extended for 1 month) and the right of Cenpuc shareholders objecting to the consolidation to receive $28 per share in lieu of shares of the consolidated corporation. Cenpuc agreed that the consolidation, in and of itself, would constitute a change of circumstances within the meaning of section 3(c) of the act; thus, the Commission may revoke the exemption if the circumstances existing after the consolidation prove to be detrimental to the public interest or the interest of investors. Subsequent to the exemption order, Cenpuc publicly announced and filed proxy material with the Commission relating to a proposed consolidation of itself, Consolidate Electronics Industries Corp., and Philips Industries, Inc. into a new corporation to be named Consolidated Electronics Industries Corp. and into whose shares Cenpuc's capital stock would be converted on a share for share basis. The Commission, after examining the proxy material, released the jurisdiction which it had reserved thereover. On October 16, 1959, following the requisite stockholder approval, the proposed consolidation was consummated.

Cities Service Co.

On September 20, 1957, the Commission issued an order pursuant to section 11(b)(2) of the act requiring Cities to eliminate the 48.5 percent minority interest in Arkansas Fuel Oil Corporation or to dispose of its holdings of 51.5 percent. Cities, Ark Fuel and a stockholder of Ark Fuel petitioned the United States Court of Appeals for the Third Circuit for review of the order. On July 22, 1958, the Court affirmed the order of the Commission. On September 18, 1958, Cities filed a plan pursuant to section 11(e) for the purpose of eliminating the minority interest in Ark Fuel. The plan provided for division of the assets of Ark Fuel into two new companies, one to be owned by Cities and the other by the minority interest. Subsequently, the plan was withdrawn and a new plan filed providing for the exchange of one share of Cities common stock for each 2.4 shares of Ark Fuel common stock. Hearings on the latter plan were commenced on March 31, 1959, and were still in progress at the close of the fiscal year.

Electric Bond and Share Company

Electric Bond and Share Company, which no longer holds as much as 5 percent of the outstanding voting securities of any domestic public-utility company, has pending before the Commission an application, filed pursuant to section 3(a)(5) of the act, for exemption as a holding company from provisions of the act. In the event such exemption is granted, it is the intention of the company to convert its status to that of an investment company and register under the Investment Company Act of 1940. The proceeding on the exemption application involves a number of very difficult and complex issues, among which is the question as to whether Bond and Share, through its wholly-owned engineering and consulting service company subsidiary, Ebasco Services, Incorporated, exercises controlling influence over, or is affiliated with, certain public-utility and holding company clients of Ebasco which formerly were controlled by Bond and Share. Hearings were concluded on March 26,1959, and the matter was under advisement for decision by the Commission at the close of the fiscal year.

Standard Gas and Electric Company

Standard Gas and Electric Company, a registered holding company, was formerly a subsidiary of Standard Shares, Inc. On September 23, 1958, the Commission granted an application of Standard Shares under section 5(d) of the act for an order declaring it not to be a holding company and its registration as such thereupon ceased to be in effect. Standard Shares, formerly known as Standard Power and Light Corp., upon the issuance of such order, completed its registration as an investment company under the Investment Company Act of 1940 and is subject to the requirements of that act and to the Commission's jurisdiction thereunder.

Standard Gras and Electric owns 45.6 percent of Philadelphia Company, also a registered holding company. Neither owns directly or indirectly 10 percent or more of the voting securities of a public-utility company and both are required by orders issued under section 11(b)(2) of the act to liquidate and dissolve. Each of these registered holding companies is in a position to effectuate dissolution except that there exist undetermined questions relating to Federal income taxes for the years 1942 through 1950.

Other Matters

As previously reported at pages 114-115 of the 23d Annual Report, International Hydro-Electric System ("IHES") was reorganized pursuant to section 11(d) of the act and IHES is now registered as an investment company under the Investment Company Act of 1940 and subject to the Commission's jurisdiction thereunder. The only remaining matters under the Holding Company Act are fees and expenses to be awarded in connection with the reorganization. After hearings, oral argument was heard by the Commission and the matter was pending for decision at the end of the fiscal year.

There are also pending before the Commission applications for the allowance of fees and expenses in connection with a plan filed and consummated by The United Corporation pursuant to section 11(e) of the act for its conversion into an investment company. Hearings on such applications have been held, oral argument heard, and the matter was under advisement for decision by the Commission at the close of the fiscal year.

FINANCING OF ACTIVE REGISTERED PUBLIC UTILITY HOLDING COMPANIES AND THEIR SUBSIDIARIES

During the fiscal year 1959 active registered holding companies and their subsidiaries sold to the public and to financial institutions, pursuant to authorizations granted by the Commission under sections 6 and 7 of the act, 25 issues of long-term debt and of stocks aggregating $477 million. This is in contrast to fiscal year 1958 when there were 36 such issues with aggregate gross sales value of $583 million. All but five of the active registered holding company systems sold long-term debt or stock to the public in varying amounts and of various types in fiscal 1959.

The following table presents by systems the financing by active registered holding companies and each of their subsidiaries classified by amounts and types of securities.

[table omitted]

In addition to common stock issued for cash listed in the above table, The Columbia Gas System, Inc., through a subsidiary, exchanged with the public 3,574,373 shares of its stock in connection with the acquisition by the subsidiary of the assets of Gulf Interstate Gas Company, a nonaffiliated natural gas pipeline company. The market value of the stock at the time of issuance was approximately $78 million. This issuance was excepted from the competitive bidding requirements of rule 50, the Commission concluding that compliance with competitive bidding was not necessary or appropriate in the public interest or for the protection of investors or consumers to assure the receipt of adequate consideration or the reasonableness of the fees or commission to be paid with respect to such issuance. Details of the transaction are more fully discussed at page 125 hereof.

The table also does not reflect the issuance of short-term notes to banks by any of the system companies, nor does it include intrasystem financing represented by the issuance of securities by subsidiaries to their holding companies. These issuances also required authorization by the Commission except in the case of the issuance to banks of short-term 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 as defined in section 6(b) of the act. The issuance of such securities is exempted by that section 6(b).

It may be noted from the table that the total of $477 million is made up of $194 million bonds, $80 million debentures, $18 million preferred stock, and $185 million common stock. No bonds were sold during the first half of the fiscal year; the three debenture issues aggregating $80 million were sold during that period.

Competitive Bidding

All but 3 of the 25 issues sold for cash and listed in table 1 were offered at competitive bidding pursuant to the requirements of rule 50. An order granting exception from competitive bidding was entered in only one of the three instances, the other two being automatically excepted by paragraph (a)(1) rule 50. General Public Utilities Corp., a registered holding company, issued and sold 530,000 shares of its $5 par value common stock for $20 million. This was a nonunderwritten rights offering in connection with which it was proposed that the unsubscribed shares would be sold through brokers on the New York Stock Exchange. Although it appeared that the sale of the unsubscribed shares would be exempt under paragraph (a)(4), the Commission granted the company an exception from the provisions of the rule to the extent it might become applicable to the transaction.

Consolidated Natural Gas Company, also a registered holding company, sold 821,256 shares of its $10 par value common stock for $39 million. This was also a nonunderwritten rights offering to its stockholders and was automatically excepted from the competitive bidding requirements by the provisions of paragraph (a)(1) of the rule. It was not proposed that the unsubscribed shares be sold.

The remaining issue not sold through competitive bidding was the issuance of $15 million of common stock by Yankee Atomic Electric Company, a subsidiary of New England Power Company, which in turn is a subsidiary of New England Electric System, a registered holding company. New England Power Company purchased $4,800,000 of the issue and Montaup Electric Company, a subsidiary of Eastern Utilities Associates, a registered holding company, purchased $720,000 thereof. The remainder of $9,480,000 was purchased by the other nine owner companies of Yankee Atomic Electric Company. Since this stock was offered to existing stockholders, which had agreed to subscribe for their pro rata share the transaction was excepted from the rule pursuant to paragraph (a)(1) thereof.

During the period from May 7, 1941, the effective date of rule 50, to June 30, 1959, a total of 767 issues with a sales value of $10,957 million were sold at competitive bidding under the rule. Those totals compare with 224 issues of securities with an aggregate sales value of $2,311 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)36 thereof. The numbers of issues and the amounts of various classes of securities which have been sold pursuant to exception granted under paragraph (a)(5) are set forth in the following table:

[table omitted]

Of the total amount of securities sold pursuant to orders of exception granted under paragraph (a)(5) of rule 50, 122 issues with a dollar value of $1,841 million were sold by the issuer and the balance of 102 issues with a dollar value of $470 million were portfolio sales. Of the 122 issues sold by the issuers, 68 were in amount of $1 million to $5 million and 2 bond issues were in excess of $100 million.

Protective Provisions of First Mortgage Bonds and Preferred Stocks of Public Utility Companies

In passing upon issuances of first mortgage bonds and preferred stocks of public-utility companies, the Commission examines the mortgage indenture and charter provisions to determine whether or not there is substantial conformity with the applicable Statements of Policy which were adopted by it in 1956.39 These Statements of Policy represent substantially a codification of certain principles or policies prescribed for the protection of investors in these securities developed on a case-by-case basis over a period of years, as modified in the light of experience and comments received from interested persons who had been invited to submit their views. Conformity with the Statements of Policy is required except where deviations are clearly warranted by the circumstances of a particular case.

During fiscal year 1959 applications or declarations with respect to IT first mortgage bond issues aggregating $248,950,000 principal amount, and three preferred stock issues with a total par value of $19 million, were filed by public-utility companies under the act.

The Statement of Policy with respect to first mortgage bond issues requires a restriction, under certain circumstances, on the distribution of earned surplus to common stockholders. In the case of 6 of the 17 bond issues with respect to which applications were filed during the fiscal year, existing indenture provisions adequately conformed with this requirement of the Statement of Policy. In the case of nine issues, an additional restriction was required and was either proposed by the issuer or evolved in informal discussions between the Commission's staff and representatives of the issuer. The two remaining bond issues were proposed by two newly-organized companies having no previous records of earnings or dividends. In both cases, the indenture contained certain restrictions against future distributions of earned surplus to holders of the common stock, all of which, in each instance, was jointly held by groups of other utility companies. To avoid unnecessary rigidity, the restrictive dividend provisions generally included the further provision that the restrictions could be modified upon application of the issuer to, and approval by, the Commission.

A further provision contained in the Statement of Policy regarding first mortgage bonds relates to the renewal and replacement of depreciable utility property which is subject to the lien of the mortgage. It requires, in essence, that the issuer construct additions to its property, or else deposit cash or bonds with the indenture trustee, in an amount which on a cumulative basis will provide for the replacement in cash or property of the dollar equivalent of the cost of the depreciable mortgaged property during its estimated useful life. The Statement of Policy provides that the requirement be expressed as a percentage of the book cost of depreciable property, except that if the existing indenture provision expresses the requirement on a different basis, as, for example, in terms of operating revenues, no change will be required if the company can demonstrate that the existing provision provides an amount at least equal to a requirement based on the book cost of depreciable property. As in the case of earned surplus restrictions, the Commission, in the interest of flexibility, has permitted the issuer to insert a provision under which the issuer, upon application to, and approval by, the Commission may modify the percent of depreciable property requirement.

Of the 17 bond issues, the indentures of 12 expressed the renewal and replacement fund requirement as a percent of depreciable property which was deemed to be appropriate; the indentures of 4 expressed the requirement as a percent of revenues and were found acceptable by the Commission since they appeared to afford at least as much protection to the bondholders as would be afforded by an appropriate percent-of-property formula; and the indenture of the remaining 1 bond issue contained no renewal and replacement fund requirement in view of another requirement of the indenture -- unusual for an electric utility company -- for a 100 percent cash sinking fund repayment of the bonds by the maturity date thereof. [Footnote: The usual sinking fund provision for electric utility bonds, which generally have a 30-year maturity, provides for annual sinking fund payments aggregating, over the life of the issue, approximately 30 percent of the principal amount of the bonds.]

During the fiscal year 1959, the Commission has continued to adhere to the principle, set forth in the Statements of Policy for both bonds and preferred stocks, that the securities be freely refundable at the option of the issuer upon reasonable notice and payment of a reasonable redemption premium, if any. [Footnote: The significance of the refunding privilege, both as a matter of conformity with the standards of the act and as a matter of practical finance, was discussed at some length in the 24th Annual Report.] An exception was made by the Commission in the case of Yankee Atomic Electric Company, a new company organized for the purpose of building and operating an experimental nuclear power plant in New England. In light of the Unusual circumstances of the construction and financing of the plant, the Commission approved an indenture covenant providing that none of the company's proposed $20 million principal amount of first mortgage bonds could be redeemed for refunding purposes during the period of plant construction; that during a 5-year period thereafter the bonds could be refunded only upon payment of redemption premiums higher than customary under the Commission's usual standards;

but that following such 5-year period the bonds would be freely refundable by the company upon payment of the normal lower scale of redemption premiums.

Continuing studies made by the Commission's staff of electric and gas utility bond issues sold at competitive bidding indicate that restrictions on free refundability of bonds have had no significant bearing upon the interest cost to the issuer. [Footnote: This finding has also been made by others who have made intensive studies of the problem. See W. J. Winn and A. Hess, Jr., "The Value of the Call Privilege," The Journal of Finance, May 1959, page 189.] The staff's studies also indicate that the presence or absence of a restriction on free refund-ability 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. These findings were based on an examination of all electric and gas utility bond issues (including debentures) sold at competitive bidding between May 14, 1957, and June 30, 1959, by companies subject to the Holding Company Act as well as those not so subject. It was on the former date that a public-utility company not subject to the Holding Company Act instituted a practice, which has been followed in competitive bidding by various other public-utility companies not subject to the Holding Company Act, of including a provision prohibiting the issuer, during a period of years, generally five, from refunding its outstanding bonds at lower interest rates.

During the above period, there was a total of 178 electric and gas utility bond issues offered at competitive bidding, aggregating $3,763 million principal amount. The refundable issues numbered 137 and accounted for a total of $2,507 million, while the nonrefundable issues -- all except 1 being nonrefundable for a period of 5 years, and the one being nonrefundable for a period of 7 years -- numbered 41 and totaled $1,256 million principal amount. The number of refundable issues thus represented 77 percent of the total number of issues, while, in terms of principal amount, the refundable issues accounted for 66.6 percent.

The weighted average number of bids received on the refundable issues was 4.56, while on the nonrefundables it was 4.27. The median number of bids on both groups was the same -- i.e., 4. With respect to the success of the marketing of the bond issues, an issue was considered to be 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, 75.2 percent of the refundable issues were successful, while 73. 2 percent of the nonrefundables were successful. In terms of principal amount, 73.0 percent of the refundables were successful, while 74.7 percent of the nonrefundables were successful. Extension of the comparison to include the aggregate principal amounts of 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 89.2 percent of the combined principal amount of all the refundables were so sold, as compared with 89.1 percent for the nonrefundables. The substantially similar 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 Holding Company Act.

In the 24th Annual Report, mention was made (at page 131) of a comprehensive study of redemption provisions of corporate bonds being conducted at the Wharton School of Finance and Commerce of the University of Pennsylvania, and that a member of the staff of the Commission was serving on an advisory committee with respect to such study. A preliminary draft report on the study was completed shortly after the close of fiscal year 1959.

Of the three preferred stock issues with an aggregate par value of $19 million with respect to which applications or declarations were filed during the fiscal year, two issues had charter provisions in substantial conformity with the Statement of Policy. The other issue failed to conform in certain respects relating to, among other things, restrictions against(a) amending the charter in a manner adverse to the preferred stockholders, (b) mergers or consolidations, (c) re-acquisitions by the issuer of any of its outstanding preferred stock, and (d) issuance or assumption of short-term unsecured debt. Accordingly, the Commission, in approving the proposed issue of preferred stock, conditioned its order so as to require the necessary investor protection.

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

The role of the Commission 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 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 and investors on matters arising in such proceedings and, where the Commission considers it appropriate, it may file advisory reports on reorganization plans. Thus, the facilities of the Commission's technical staff and its disinterested recommendations are simply placed at the service of the judge and the parties, affording them the views of disinterested 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.

In any case where the scheduled indebtedness of a debtor corporation does not exceed $3 million, the judge under section 172 of chapter X may, before approving any plan of reorganization, submit such plan to the Commission for its examination and report. If the indebtedness exceeds $3 million, the judge must submit the plan to the Commission before he may 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 reorganizations 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 officers' 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 49 reorganization proceedings involving 69 companies (48 principal debtor corporations and 21 subsidiaries of those debtors) during the past fiscal year. The stated assets of these 69 companies totaled approximately $583,626,000 and their indebtedness totaled approximately $540,501,000. The proceedings were scattered among district courts in 18 states, as follows: 11 proceedings in New York, 6 in Illinois, 5 in Kentucky, 4 in Nevada, 3 in Pennsylvania, 2 each in Florida, Texas and Oklahoma, and 1 each in Washington, Iowa, Virginia, Maryland, North Dakota, New Jersey, Louisiana, Connecticut, Colorado, and Utah. During the year, the Commission entered its appearance in 14 new proceedings under chapter X involving companies with aggregate stated assets of approximately $62,037,000 and aggregate indebtedness of approximately $39,165,000. They involved the rehabilitation of companies engaged in such varied businesses as uranium mining, motion picture production, hotel and country club operations, and the manufacturing of precision instruments, building materials and miscellaneous products. Proceedings involving 4 principal debtor corporations were closed during the year. At the end of the year, the Commission was actively participating in 45 reorganization proceedings involving 67 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 the fact that the administrative burden of participating in every one of the approximately 90 cases instituted during the fiscal year would be insurmountable with its present staff, many of the cases involve only trade or bank creditors and a 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, other facts indicated that the Commission could perform a useful service or the judge requested the Commission to participate.

PROCEDURAL MATTERS

The Commission, when a party in chapter X proceedings, has been diligent to urge upon the court the procedural safeguards to which all parties are entitled. The Commission also attempts in its interpretation of the statutory requirements to encourage uniformity in the construction of chapter X and the procedures thereunder.

Prior to the filing of an involuntary petition for the reorganization of the F. L. Jacobs Company in the United States District Court for the Eastern District of Michigan, the United States District Court for the Southern District of New York appointed receivers for the debtor company to preserve its assets and to protect the interests of the stockholders, creditors, employees and the general public. This receivership grew out of an extensive investigation by the Commission's New York regional office with regard to possible violations of the Securities Act of 1933 and the Securities Exchange Act of 1934. An injunction to restrain the receivers was issued by the United States District Court in Michigan on March 23,1959. The receivers petitioned that court to dismiss the chapter X petition on the grounds that it was collusively filed and that the debtor's principal place of business was New York, or in the alternative, to transfer the proceeding to New York. The Commission participated in the hearing to develop the facts regarding the debtor's place of business.

The court held that the petition was properly filed and denied the relief requested. An appeal by the receivers was pending in the United States Court of Appeals for the Sixth Circuit at the close of the fiscal year.

There was also a venue problem in the proceeding involving Verdi Development Company, whose common stock was withdrawn in 1958 from listing and trading on the San Francisco Mining Exchange by Commission order.

The debtor filed a petition for reorganization in the United States District Court of Nevada and the Commission filed a motion to transfer the case, on the ground that the company's principal place of business was not, as alleged, in Nevada. This motion became moot because the Court dismissed the petition. A new petition, filed in the Central District of Utah, was approved.

The appeal in the Selected Investments case 4 involved the questions whether public investors in a trust fund were creditors, despite provisions in their "certificate bonds" consistent with those of an equity security, and whether the separate entities of the trust fund and the corporation controlling it could be disregarded where the corporation's only business was the management of the fund and where, in the sale of the certificate bonds to public investors, the corporation had led the investors to believe that they were lending their money to it. The Commission supported the trustee in successfully urging the Court of Appeals to affirm the District Court's order approving the petition for reorganization.

In the Shawano Development Corporation case, the Commission sought the removal of the president of the debtor as additional trustee on the ground that he was a substantial stockholder and creditor of the debtor, and so was not a disinterested person as required by sections 156 and 158 of chapter X. In addition, it was urged that no operations were being conducted by the debtor and hence there was no need for an operating trustee. The additional trustee resigned after the Commission's motion was filed.

Under the act, the trustee's counsel, like the trustee himself, must be disinterested, since each plays a key role in the reorganization. In the previously mentioned Jacobs case the Commission took the position that the attorney for the trustees was not disinterested. The Commission stated that the trustees' attorney had actively collaborated with the attorney for the debtor who had referred to him two of the three petitioning creditors, that he had first appeared as attorney for the petitioning creditors, and that these facts indicated the existence of a materially adverse interest. The attorney resigned while a decision on an application for his removal was pending.

PROBLEMS IN CONNECTION WITH THE ADMINISTRATION OF ESTATES

During the course of the reorganization proceedings involving Selected Investments Corporation, the court sua sponte ordered a distribution of one-third of the assets of the debtor to the creditors. The Commission, joined by certain creditors, objected on the ground that a liquidation of such a substantial portion of an estate undergoing a reorganization could be accomplished only pursuant to a plan of reorganization, but the judge overruled these objections. The Commission joined a creditor on a motion for a stay to the United States Court of Appeals for the Tenth Circuit. The appellant's request that no supersedeas bond be required was supported by the Commission on the ground that to require a bond in a matter such as this would in effect defeat the right of creditors and stockholders to take appeals under chapter X. On January 30, 1959, the Court of Appeals stayed the distribution, but the matter became moot with the confirmation of a plan of reorganization in July 1959.

In the Swan Finch Oil Corporation case, the court had enjoined Doeskin Products, Inc., a former subsidiary of the debtor, from transferring any of the stock or assets of Keta Gas & Oil Company, which had been a wholly-owned subsidiary of the debtor. There had been a purported transfer of 1,140,390 shares of Keta to Doeskin in exchange for 800,000 shares of Doeskin stock. The trustees secured an order requiring Doeskin to show cause why it should not be required summarily to turn over the Keta stock and its assets to the trustees. Doeskin and Keta moved the court to vacate this order on the grounds (1) that the court lacked jurisdiction over Keta, and (2) that since Doeskin had a substantial adverse claim to the Keta stock and assets, summary jurisdiction did not lie. Evidence at the hearings indicated the Keta stock and assets were turned over to Doeskin in an unauthorized manner and that consequently Doeskin had no valid claim to the stock and assets. The Commission contended that Doeskin knew or should have known of the unauthorized nature of the transaction, and that under these circumstances, the reorganization court had summary jurisdiction to determine the question of title. The court denied the trustees' motion for a summary order and an appeal was taken. The Commission filed a brief expressing the view that the trustees' position was correct.

In the Ludman Corporation case, certain creditors petitioned the court to adjudicate the debtor a bankrupt. As a result of the Commission's representation that there was a good possibility the company could be successfully reorganized, the reorganization proceeding was continued. A plan was subsequently filed with the court and referred to the Commission for an advisory report, which was under consideration at the end of the year.

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 directors, officers, 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 the Texas Portland Cement Company case, the Commission participated in an extensive investigation under section 167 by the trustees into the tangled financing of the debtor and related questions. The debtor had initially sold 500,000 shares of unregistered stock to residents of Texas. It issued approximately 400,000 additional shares in bonuses, commissions for assistance in procuring loans, and special transactions with promoters and creditors. At the suggestion of counsel for the Commission the trustees secured injunctions against the transfer of most of the additional shares by the holders thereof, pending determination of the validity of their issuance and other questions involved. [Footnote: Approximately 35 witnesses were examined. Two of the witnesses, a former director and his business associate, were indicted in the Southern District of Texas for perjury allegedly committed in the course of their respective examinations under section 167.]

The trustee's investigations in the reorganization proceedings involving Selected Investments Corporation and Selected Investments Trust Fund, disclosed that the debtor had been subjected to fraudulent mismanagement by its officers and directors. The trustee obtained a judgment against these corporate insiders for approximately $12 million in damages, on which some recovery has been had, and suits are pending against the bonding companies for the balance.

ACTIVITIES REGARDING PROTECTIVE COMMITTEES

The Commission has constantly been alert to insist upon the honesty of fiduciaries in their relationship to the estate and to investors, and has always sought to disqualify security holder committees subject to a conflict of interest from acting in chapter X proceedings.

In the above mentioned Selected Investments Trust Fund and Selected Investments Corporation case, a committee formed to represent certificate holders of the trust fund, had solicited from public investors $1 for each $1,000 of thrift certificates. Commission counsel objected to this solicitation and the court required the committee to return all funds received. After the committee qualified as a duly constituted committee, representing approximately 3,000 certificate holders whose claims exceed $16 million, it applied to the court for permission to solicit contributions from certificate holders to finance its activities. The Commission contended that the committee should be denied the right to make mass solicitations, recommending that the committee make appropriate arrangements for the financing of its activities by contributions from its members or individual security holders. The Commission's contention was upheld.

In the Texas Portland Cement Company case, a common stockholders' committee, composed of a New York attorney and four of his relatives, attempted to solicit powers of attorney from stockholders generally. The Committee members had acquired their stock in one of the transactions being investigated by the trustees, in settlement of a relatively small cash advance to the debtor, and the committee chairman was asserting a large unliquidated claim against the debtor for services and expenses allegedly rendered in procuring a mortgage commitment which the debtor had rejected. The Commission joined with the trustees in opposition to recognition of this committee, on the ground of the conflict between the interests of its members and those of common stockholders generally. The District Court ruled that the committee was disqualified to act as a representative of stockholders. There has since appeared in the proceedings another common stockholders' committee, composed of local stockholders who acquired their shares in the original public offering.

Some of the members of a creditors' committee in this proceeding owned stock of the debtor either directly or indirectly. The Commission joined the trustees in opposition to the recognition of this committee because of the conflict of interests involved in the dual status of committee members. This committee also was disqualified.

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 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 equitably allocating compensation on the basis of a claimant's contribution to the administration of an estate and the formulation of a plan.

In the Third Avenue Transit Corporation case the District Court granted fees and expenses totaling $2,068,505. The Commission had recommended awarding fees and expenses of $1,818,476, and upon appeal to the Court of Appeals for the Second Circuit, that Court set the amount at $1,849,005.18 In so doing, the Court listed the factors which bear on the granting of allowances in reorganization cases: (a) economy of administration, (b) the burden the estate can safely bear, (c) value of the services, (d) duplication of service by counsel representing the same interests, and (e) the reasonableness and fairness of the compensation to each applicant. It noted that the recommendations of the Commission "are entitled to great weight."

The District Court had found that an oral agreement between an attorney and a firm to share equally in the compensation they received from the reorganization contemplated as well as an equal division of work. The Court of Appeals upheld in principle the award by the district judge of separate compensation to each. The Court of Appeals also upheld the Commission's contention that section 249 of the Bankruptcy Act prevented the awarding of a fee where the fee applicant had pledged securities of the debtor after assuming to act in a representative or fiduciary capacity in a reorganization and the securities were subsequently sold.

In this case, further, the wife of an attorney in the reorganization had sold securities of the debtor. The District Court found that the wife's decision to sell was based on the advice of her investment broker and not on any inside information possessed by the husband and held that section 249 did not bar a fee to the attorney although he had knowledge of the sale of the securities by his wife. The Commission took the position that a fee should be denied the attorney since he had knowledge of his wife's transaction and derived an indirect benefit from it. The Court of Appeals sustained the Commissions position and held that the facts warranted the statutory disqualification.

In the Stardust, Inc. case, the court confirmed a plan of reorganization which provided for a sale to reorganized Stardust, Inc. of a group of five hotel units, in various stages of completion, for $1,500,000 cash and a $2,800,000 note secured by a deed of trust on the properties. Subsequently it appeared that the costs for completion had been underestimated and, as a result, the reorganized Stardust was unable to meet the first payment on the note. A petition for modification Was approved by the court under section 222 of chapter X.

Applications for fees and expenses in connection with the modification of the plan aggregated $58,460. The Commission took the position that the creditors, preferred stockholders, and the trustee and his counsel were primarily interested in preserving the terms previously determined and fixed under the plan, and that the modifications, as amended, were essentially a compromise and reflected, in greater or lesser degree, the efforts of all participants. Under a commitment pursuant to order of the Court, the proponent of the modification, who was in control of the reorganized debtor, was obligated to pay the fees and expenses in connection with the modification. The Commission urged that nevertheless chapter X standards should be followed, in accordance with the provisions in section 221(4) which make "all payments ... promised by the debtor or by a corporation... acquiring property under the plan or by any other person" subject to the governing standards of chapter X. The Commission recommended fees totalling $23,860, and the judge awarded the applicants $29,881.

In the Adolf Gobel, Inc. case, applications were filed for fees in the aggregate amount of $374,370. The Commission submitted its recommendations aggregating $170,000 and the court awarded $178,000. The Commission recommended denial of compensation to the debtor's attorneys who also acted as attorneys for the principal stockholder and plan proponent, and to an attorney for an individual creditor whose claim was the subject of litigation, asserting that the activities of these attorneys were principally for the benefit of their clients and only collaterally of benefit to creditors generally, and therefore each should look to his client for his compensation. The court denied these requests for allowances.

ADVISORY REPORTS ON PLANS OF REORGANIZATION

During the fiscal year, the Commission issued two advisory reports and One supplemental advisory report. Such reports represent the principal means by which the Commission records its views publicly. Generally speaking, an advisory report is prepared only in a case involving a substantial public investor interest and in which significant problems exist. On occasion, because of the exigencies of time or for other reasons, no written report is filed but instead Commission counsel makes a detailed oral presentation of the Commission's views and the reasons therefor.

Usually advisory reports are prepared at the close of the hearings after the completed record contains sufficient material upon which to formulate an opinion as to a plan's fairness and feasibility. However, in the reorganization proceeding involving Alaska Telephone Corporation the judge requested the Commission to prepare written comments on three proposed plans of reorganization and to submit them to the court prior to hearings on the plans. In his decision, the judge followed rather closely the lines of analysis and comments in the memorandum submitted to the Court by the Commission.

In proceedings in Nevada for reorganization of the San Souci resort hotel the Commission advised the court on four plans of reorganization. Only two plans were considered worthy of consideration and the Judge requested that additional views be presented orally by Commission counsel on these plans. The trustee's plan Contemplated an arrangement providing an extension of maturities on the senior debt, and conversion of junior debt to stock. The second plan also contemplated amortization of the existing debt, but on different terms.

A feasible plan under chapter X requires a debt structure reasonably geared to prospective earnings. The Commission felt that the plans were not feasible on an earnings valuation, and that under the proposed plans the debtor would be insolvent or on the brink of insolvency at the very beginning of its new life. However, the court approved the trustee's plan and submitted it to the creditors for acceptance.

On February 25, 1959, the Commission filed objections to a plan of reorganization proposed in the Selected Investments Corporation and Selected Investments Trust Fund case. Under the plan, the debtor would have transferred some $10 million of assets to a new corporation which would engage in the general loan and finance business. Creditors of the debtor were to receive $5 million of preferred stock of the new corporation and $5 million in cash which was to be borrowed by the new corporation. Additional capital was to be provided to the new corporation through the private sale of $500,000 of common stock. The Commission pointed out, among other things, that creditors would only be entitled to elect a minority of the board of directors for their $5 million investment, whereas purchasers of the $500,000 of new common stock would elect a majority of the board. The Commission also questioned the feasibility of the plan. The plan was approved by the court and accepted by the requisite majority of creditors but it was not confirmed by the court due to the filing of a new plan of reorganization.

On April 23, 1959, the Commission filed an advisory report on the second plan of reorganization. The new plan proposed that the reorganized debtor issue to the certificate holders $11 million in 20-year debentures and 16,500,000 shares of common stock, $1 par value per share, out of a total of 18,150,000 shares to be authorized. The remainder of the 1,650,000 shares was reserved for options to proposed management.

The stock options contemplated by the plan provided that the stock would be available to certain specified persons at $1 per share for 5 years. The plan also provided that there would be a restrictive stock option to employees at the same price as the options to proposed management.

The Commission stated that the amended plan was not fair in a number of respects, particularly in that it would permit creditors desiring to withdraw and receive cash to receive the same amount as those who stayed in and took securities. The Commission also expressed doubts as to the propriety of including stock options in a plan of reorganization and urged that they be eliminated completely or substantially modified.

In a supplemental report following amendments to meet the Commission's recommendations, the Commission concluded that the amended plan was fair and equitable and feasible. This plan was approved by the court, accepted by the requisite majority of creditors, and confirmed by the court. The plan is in the process of being consummated.

In the Inland Gas Corporation case a petition was filed by three debenture holders of Kentucky Fuel Gas Corporation for the alteration and modification of the plan of reorganization confirmed by the court on April 28, 1958, and affirmed on appeal, 260 F. 2d 510 (C.A. 6), cert. den. April 27, 1959. The modification was based upon a proposed underwriting whereby the estate would receive cash in an amount greater than the valuation of the enterprise upon which the plan was based. The Commission submitted a memorandum stating that the court had jurisdiction to consider proposed alterations and modifications and that the alterations and modifications proposed in the petition appeared to have sufficient merit on their face to warrant a hearing upon due notice to security holders.

The District Court denied the petition and on appeal by the creditors, which the Commission supported, the Court of Appeals for the Sixth Circuit granted a stay of the order of consummation of the plan.

The Hudson & Manhattan Railroad Company owns and operates office buildings in New York City and an interurban rapid transit electric railway between New York City and points in New Jersey. In the reorganization proceeding of this company, the trustee filed with the court an amended plan designed to permit only the senior bondholders to share in the value of the mortgaged assets, but recognizing the claims of junior bondholders against certain assets allegedly not subject to the mortgage liens (free assets). It also provided for a contingent interest for junior bondholders in the proceeds of the sale of the railroad, if such a sale realized more than was required to meet the claims of the senior bondholders. Under the plan, the debtor would continue only as a real estate company, and a new company would be organized as a subsidiary of the real estate.

The real estate company would issue to the senior creditors $10,038,100 principal amount of 20-year 6 percent first mortgage bonds and 590,476 shares of a new class A common stock, which would constitute 91 percent of the common stock equity. The junior creditors would receive 58,849 shares of a new class B common stock, which would represent the remaining 9 percent of the equity. The class B stock was intended to recognize the interest of junior bondholders in the free assets of the debtor and generally to provide for their right to receive the remaining proceeds of any sale of the railroad company property after satisfaction of the claims of senior bondholders. No participation was provided for the present preferred and common stock since the debtor was insolvent. The new class A and B stocks would be alike except in respect of the election of directors and adjustments in relative participation of proceeds of the sale of the railroad properties in excess of $17 million.

The Commission's advisory report found the amended plan fair and equitable and feasible except in one minor respect. The amended plan proposed that the initial boards of directors of the real estate company and the railroad company would be appointed by the court after consideration of nominations by the bondholders or their representatives, but the court was not required to accept any of the nominees. Representatives of senior bondholders proposed that the initial boards of directors be designated by the court from among nominees of bondholders, with the seven class A directors of the real estate company and the five class A directors of the railroad company to be chosen from among nominees of senior bondholders, and the two class B directors of each of the reorganized companies to be chosen from among nominees by junior bondholders. The Commission believed that this proposal was appropriate and the court agreed and incorporated the proposal into the plan.

A notice of appeal has been filed by common stockholders.

Frank Fehr Brewing Company, a relatively small, long-established brewery in Louisville, Ky., filed a voluntary petition for reorganization under chapter X on August 16, 1957, following several years of losses. Its preferred stock was widely held by public investors.

A plan of reorganization was filed on December 26, 1958, based on an offer by a group of local business men to supply a substantial amount of cash for all the common stock of a reorganized company. Creditors were to be paid in cash and 5-year mortgage bonds and the rights of the preferred stockholders altered. The old common stock was excluded. The Commission initially opposed the plan, primarily on the ground that the preferred stockholders were not being fairly treated. The Commission counsel participated in a series of negotiations culminating in amendments satisfactory to a preferred stockholders committee and upon Commission recommendation the court confirmed the amended plan.

The president of the debtor, who was also the majority common stockholder, appealed from the order of confirmation. The trustee moved to dismiss the appeal on the grounds, among others, that the appellant had failed to object formally to the order of confirmation and had failed to appeal from the order of approval. The appellant had participated actively in the proceedings and had made his opposition to the plan known at several stages, but had remained mute at the hearing on confirmation. The appellant's counsel had withdrawn prior to that hearing.

The Court of Appeals for the Sixth Circuit denied the motion to dismiss on May 26, 1959, saying -- "The preliminary approval of the plan by the court is but one step in a continuous process leading to confirmation." It held that appellant's statements at the prior approval hearing "adequately presented to the district judge, and presents to this court also, applicant's contentions and objections to the plan." This decision was in accordance with the position taken by the Commission on this issue in its brief.

Thereafter, on the merits, the Court of Appeals affirmed on June 16, 1959,[30] the order of confirmation, and the plan is now being consummated.

The Commission had advocated affirmance of the order in its brief, with one reservation. The trustee, apparently by inadvertence, had supplied the preferred stockholders group, which was then soliciting rejection of the plan, with an old stockholders list, and had subsequently made available a current list to a group soliciting acceptances. It was contended that enough acceptances had been received to make the discrepancy between the two lists immaterial and the objecting preferred group later withdrew its opposition to the plan as the result of further amendments.

The Commission considered that these circumstances would require reversal of the order of confirmation, on the ground that the plan had not been properly accepted, in the absence of a showing that the error was not prejudicial. The Court of Appeals concluded "Although that might be the proper remedy under some circumstances, we do not think the particular circumstances of this case warrant taking that procedure." It stressed the fact that the old list was delivered in good faith and clearly dated, that no request was made for a later list and there was no indication that it would have not been supplied if requested, and that the parties directly involved had withdrawn their objections and were not supporting the plan. The Court said: "Under the circumstances, we find no such unfairness which would cause us to invalidate the entire vote of the preferred stockholders at the request of one who appeals as a common stockholder only ..."

In the Magnolia Park case the Court approved a plan of reorganization which included a provision for the trustee to enter into an agreement with outsiders to operate the track. Sportservice Corporation, which held a concession agreement with Magnolia and was a creditor and stockholder, had objected to the plan unless it could continue as operator of the concession. As a result of Sportservice's vote against the plan, there was not the requisite majority voting acceptance of the plan. Sportservice by the actions and statements of its representatives appeared to be primarily interested in upsetting the plan because it was not given the concession, and Commission counsel urged that the vote of Sportservice had not been in good faith and should be disregarded pursuant to section 203 of chapter X. All other creditors voted in favor of the plan. The vote of Sportservice was disqualified by the Court. Sportservice has filed notices of appeal, and applied to the Court of Appeals for a stay. An agreement was reached whereby the motion for stay was withdrawn. Subsequently, a compromise was effected with the aid of Commission counsel and the plan was confirmed after the close of the fiscal year.

PART VIII
ADMINISTRATION OF THE TRUST INDENTURE ACT OF 1939

Bonds, notes, debentures, and similar securities publicly offered for sale, except as specifically exempted by the Trust Indenture Act of 1939, must be issued under an indenture which meets the requirements of the act and has been duly qualified with the Commission. Indentures to be qualified are required to include specified provisions which provide means by which the rights of holders of securities issued under such indentures may be protected and enforced. These provisions relate to designated standards of eligibility and qualification of the corporate trustee to provide reasonable financial responsibility and to minimize conflicting interests. The act 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. Exculpatory provisions formerly used to eliminate all liability of the indenture trustee are outlawed.

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]

PART IX
ADMINISTRATION OF THE INVESTMENT COMPANY ACT OF 1940

Companies engaged primarily 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 the finances and investment policies of these companies, 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.

Investment companies which offer securities to the public must file appropriate registration statements under the Securities Act. Registered investment companies must also file periodic reports and are subject to the Commission's proxy and insider trading rules. Both the Division of Corporation Finance and the Division of Corporate Regulation assist the Commission in the administration of this statute, the former being concerned with the disclosure provisions and the latter with the regulatory provisions.

COMPANIES REGISTERED UNDER THE ACT

During the fiscal year ending June 30, 1959, 70 new companies registered under the act while the registrations of 11 companies were terminated. The following classes of companies were involved:

[table omitted]

None of the 70 new registered companies were deregistered during the year. Eight of the new registrations were filed by small business investment companies which had received from the Small Business Administration notice to proceed to qualify for a license under the Small Business Investment Act of 1958.

As of June 30,1959, there were 512 investment companies registered under the act, and the estimated aggregate market value of their assets on that date was $20 billion. These figures represent an overall increase of 59 registered companies and an increase of roughly $3 billion in the market value of assets over the corresponding totals as of June 30, 1958. The total registered companies by classification are as follows:

[table omitted]

GROWTH OF INVESTMENT COMPANY ASSETS

The following table illustrates the striking growth of registered investment company assets during the past 18 years, and particularly in recent years:

[table omitted]

PROGRAM FOR INSPECTION OF INVESTMENT COMPANIES

The Commission, as indicated in its 23d and 24th Annual Reports, has initiated a program for the periodic inspection of investment companies pursuant to the statutory authority under section 31 of the Investment Company Act. Up to the fiscal year 1958, 16 companies had been inspected. Fourteen companies were inspected in fiscal 1959, the third year of the inspection program. These inspections were undertaken by staff teams usually consisting of one attorney or analyst from the Division of Corporate Regulation and one securities investigator from the appropriate field office in order to combine the specialized training and knowledge of the staff concerning the regulatory requirements of the Investment Company Act with the field experience and investigative expertness of field office personnel.

Inspections made in the past 3 years indicated, in some instances, noncompliance with regulatory provisions of the Investment Company Act. For example: (1) improper selling practices by salesmen who promoted the sale of mutual fund shares just prior to dividend payment dates without explaining that the amount of dividend to be paid was included in the purchase price of the shares on which a sales-load was paid and that receipt of the dividend would represent a return of capital on which the shareholder would be liable for income taxes; (2) deviations from fundamental policy without approval of stockholders; (3) improper composition of boards of directors because of the affiliation of directors; (4) acquisition of securities during an underwriting where an affiliated relationship existed between underwriter and company; (5) sale of securities to a company by an affiliated person acting as a principal; (6) failure to file appropriate fidelity bond; (7) noncompliance with the requirements for the custody of the portfolio securities of a company under section 17 of the act; and (8) failure to obtain approval of stockholders or the Board of Directors for an investment advisory contract.

In addition to noncompliance with various regulations and standards required under the act, there were instances where books and records of the companies were inadequate or lacking. For example: (1) failure to record the date and time of requests for redemption, thus making it impossible to determine whether the investors received their correct net asset value; (2) failure to maintain purchase and sales journals; failure to maintain ledger accounts for broker-dealers used by the company for its portfolio security transactions; and (3) failure to keep proper vouchers for out-of-pocket expenses. In addition, the staff noted instances where the custodian did not adhere to the terms of the custodianship agreement, or the Commission's regulations on the safekeeping of portfolio securities of the company. In some instances, there was a considerable delay in the transmission to the investment companies of funds received by dealers selling mutual fund shares.

In cases 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. The Commission's experience to date shows that this aspect of the inspection program will prove to be particularly helpful to the newly organized or the smaller investment company, and of benefit to the investing public.

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 is now conducting a fact-finding survey in connection with a study of the problems created by the growth in size of investment companies (see 24th Annual Report, p. 148). This inquiry, made pursuant to the direction contained in section 14(b) of the Investment Company Act, is being conducted, at present, through the use of a questionnaire directed to the various investment companies. The questionnaire was prepared by the staff of the Wharton School after discussion with the Commission and representatives of the investment company industry and was distributed by the Commission early this year. Shortly before the close of the past fiscal year the Wharton School submitted to the Commission a progress report on its size and study activities.

The report indicates that substantial data in reply to the early phases of the questionnaire have been obtained and are being processed. In the initial stage of the work, detailed processing is being concentrated on the replies of open-end companies. A preliminary report on certain phases of the size study is planned early in the next fiscal year. It is anticipated that later other preliminary reports covering other aspects of the study will be available.

When it receives the full report from the Wharton School on the size study survey, it is expected that the Commission will be in a position to determine whether the increased size of investment companies has created any problems which require specific remedial legislative recommendations 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 1958 fiscal year:

[table omitted]

The foregoing statistics do not reflect the numerous filings of revised prospectuses by open-end mutual funds 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.

In addition to these recurring activities, the Commission in the past year has performed other duties in connection with the Small Business Investment Act of 1958. 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 on SBA Form 414, to determine the status of the Proposed Operator under the Investment Company Act and the other statutes administered by this Commission. Both the Proposed Operator and the SBA are notified as to the staff's conclusion in each case.

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. For this reason one of the principal activities of the Commission in its regulation of investment companies is the processing 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), 11(a), 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 145 applications under various sections of the Investment Company Act pending before the Commission during the fiscal year 1959. 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]

Although, as a rule, the applications for exemptions under the act are processed without holding formal hearings, there are occasions when the applicant will request a hearing, or the Commission feels that the relief sought is such that a hearing should be held.

Two hearings resulted from applications pursuant to section 17(b) of the act, requesting exemptions from the statutory prohibition against dealings between investment companies and their affiliates or between persons controlled by an investment company. In Atlas Corporation, the applicant, a closed-end investment company, requested an exemption for certain transactions incident to a merger of five companies engaged in uranium mining. Four of the five companies involved are affiliates of, and presumed to be controlled by, the investment company under the act. Consequently, they are prohibited by section 17(a) from dealing with each other in connection with the merger in the absence of an exemptive order. The Commission before granting an exemptive order in such a case must determine whether the terms of the proposed transactions, including the considerations to be paid or received, are reasonable and fair and do not involve overreaching on the part of any person concerned. In addition, it must decide whether the proposed transactions are consistent with the policies of the investment company, Atlas Corporation, as recited in its registration statement and reports filed pursuant to the act, and are consistent with the general purposes of the act. Hearings were held and the Commission is considering the record to determine whether there has been compliance with the above-listed statutory requirements.

Another hearing, involving an application under section 17(b), in which the Commission determined that the terms of a merger of an investment company with its affiliate were in compliance with the statutory standards was held in New York Dock Company. In that case New York Dock Company, a closed-end investment company, requested the order in connection with its merger into its affiliate, Dun-hill International, Inc. After considering the record the Commission granted the exemption. Another hearing held pursuant to an application filed during the past fiscal year involved Dunhill International, the surviving corporation of the above merger. After acquiring New York Dock Company's securities portfolio as a result of the merger, the surviving company conceded that it came within the statutory definition of an investment company in that it owned investment securities valued at more than 40 percent of its total assets. However, it filed an application pursuant to section 3(b)(2) of the act for an order declaring it to be primarily engaged in a business other than that of an investment company. A public hearing was held, but before its completion, Dunhill International registered under the act and withdrew the application it had filed under section 3(b)(2).

Another hearing resulted from an application by Investors Diversified Services, Inc. and others for an order of exemption permitting sale of their shares on the basis of a reduced sales load to certain associations for the account of the individual members of the associations. A decision is pending.

Other hearings held during the year which resulted from applications filed in prior years included cases involving National Department Stores Corporation and Civil and Military Investors Mutual Fund, Inc. In National Department Stores Corporation the hearings were concluded and the Commission handed down its findings and opinion during the past year. The company, which previously had engaged directly and through wholly-owned subsidiaries in the retail department store business, had disposed of most of such interests and invested the proceeds so that directly and through a controlled subsidiary it engaged primarily in the mining and oil business. The Commission held that the company was primarily engaged directly or through a controlled company in business other than that of an investment company.

In Civil and Military Investors Mutual Fund, Inc. a hearing was held pursuant to the application of the investment company for modification of the Commission's order finding and declaring that the above name was deceptive and misleading in violation of section 35(d) of the act. Exceptions have been field to the decision of the hearing examiner and it is expected that the case will be argued before the Commission some time next year.

In The Great American Life Underwriters, Inc., where the applicant is seeking an order pursuant to section 6(c) or in the alternative an order under sections 8(f) and 6(c), the hearing examiner filed his recommendations shortly before the end of the last fiscal year. Exceptions have been filed to the recommended decision and the matter was pending before the Commission at the end of the fiscal year.

LITIGATION UNDER THE INVESTMENT COMPANY ACT

Variable Annuities

In S.E.C. v. Variable Annuity Life Insurance Company of America, et al., 359 U.S. 65 (1959), the Supreme Court reversed the Court of Appeals for the District of Columbia which had upheld the district court's dismissal of the Commission's complaint charging violation of the registration provisions of the Investment Company Act and the Securities Act of 1933. The district court had held that the McCarran-Ferguson Act placed exclusive regulatory jurisdiction over the defendant's sale of variable annuity contracts in the insurance authorities of the State and the District of Columbia. The Court of Appeals had affirmed the district court's decision on the ground that the variable annuity contracts sold by the defendants are exempt from registration by section 3(a)(8) of the Securities Act, which excludes the ordinary annuity contracts issued by insurance companies. In addition, the Court of Appeals had held that defendants were insurance companies within the provision of section 3(c)(3) of the Investment Company Act. The Supreme Court held that the defendants were not issuing contracts of insurance within the exemption provisions of the Securities Act, Investment Company Act and the McCarran-Ferguson Act. In so holding the court concluded that insurance involved some investment risk-taking on the part of the insurer and noted the absence here of such an assumption by the companies, since in these contracts they guarantee essentially only an interest in a portfolio of common stock which interest "may be a lot, a little or nothing" depending on the investment results of the company. In a concurring opinion, Justice Brennan added that he considered the contracts as containing elements of both insurance and investment contracts and since they raise regulatory problems of the sort contemplated by the Congress when it passed the Securities Act and the Investment Company Act, he concluded that Congress did not intend to exclude these contracts by reason of the insurance exemption. Four dissenting judges viewed the contracts as a bona fide experiment in the insurance field, and even though this particular development has securities aspects, felt that regulation should be left to the states as contemplated by the exemptions in the federal legislation.

The effect of the Supreme Court decision is to make the defendants subject to registration as investment companies under the Investment Company Act. Prior to the close of the fiscal year extensive staff conferences were held with these entirely new kinds of investment companies to consider proposals for changing their methods of operation so as to bring them into compliance with the underlying purposes and provisions of the Investment Company Act. Administrative proceedings were instituted after the close of the year, and are pending, in connection with applications of these companies to exempt them from literal compliance with certain provisions of the act.

Other Litigation

During the year, the American-Hawaiian Steamship Company filed a notification of registration under the Investment Company Act, and thereby became a registered company under the terms of the act. Previously the Commission had filed suit to enjoin the company from engaging in any securities transactions until it had registered.

Prior to 1953 the company either directly or through subsidiaries, was engaged in intercoastal shipping operations. Thereafter the company sold its vessels, suspended its intercoastal shipping services, closed its branch offices, and cancelled its intercoast tariffs on file with the Interstate Commerce Commission. It engaged in no shipping whatever in 1957 or 1958. In the years prior, it had incurred operating deficits from shipping, while its principal income was obtained from dividends and interest on its investments. As of December 31, 1957, the company and its two wholly-owned subsidiaries had consolidated assets of about $30 million, of which 95 percent was in cash and securities, the rest in office and other equipment.

The object of the Commission having been achieved, a stipulation was entered into, discontinuing the action.

In S.E.C. v. McPhail (S.D.N.Y.) the Commission brought suit under section 36 of the Investment Company Act against the directors and officers of the McPhail Candy Corporation, a registered investment company. The Commission's complaint, which sought to enjoin the defendants from serving as directors or officers of the corporation, as well as an accounting and the appointment of a receiver, charged Russell McPhail, the president arid controlling stockholder of the corporation with the fraudulent diversion, waste and misuse of corporate assets, and charged the other defendants with failure to discharge their obligations to enforce the corporation's rights against McPhail. The complaint also stated that the corporation had been an investment company since 1953 but had failed to register under the act until 1957 in violation of section 7.

In October 1957, the defendants moved to dismiss the complaint on the ground that the acts complained of by the Commission had occurred prior to registration, but the motion was denied. Thereafter the defendants offered to settle the Commission's action on the basis of (1) the entry of a consent decree enjoining the defendants from acting as officers or directors of any investment company; (2) the payment by McPhail to the Corporation of $325,000; (3) the extension by McPhail of an offer to purchase publicly held common shares of the corporation at their net asset value, and publicly held preferred shares of the corporation at their redemption price, including all unpaid dividends. The settlement was accepted by the Commission and approved by the Court subject to the acceptance of the purchase offer by a sufficient number of stockholders to cause the corporation to fall outside the scope of the Investment Company Act and the compromise of a stockholder's suit now pending in the Delaware Chancery Court. [Footnote: 12 Section 3(c)(1) of the act provides an exception to the statutory definition of an investment company if the outstanding securities of an issuer are beneficially owned by not more than 100 persons and it is not making and does not propose to make a public offering of its securities.]

PART X
ADMINISTRATION OF THE INVESTMENT ADVISERS ACT OF 1940

The Investment Advisers Act of 1940 requires persons engaging for compensation in the business of advising others concerning securities to register as investment advisers. The registration requirements, however, do not apply in certain limited situations. For example, an investment adviser is not required to register when he furnishes investment advice only to persons who are residents of the state in which he maintains his principal place of business and he does not provide advice or analysis concerning securities listed on a national securities exchange or admitted to unlisted trading privileges on such an exchange. The act also provides an exemption for any investment adviser whose only clients are investment companies and insurance companies. An investment 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, is likewise exempt from registration.

It is unlawful for registered investment advisers to engage in practices which constitute fraud or deceit upon clients or prospective clients. Registered investment advisers violating any of the various provisions of the act are subject to appropriate administrative, civil or criminal remedies. Investment advisers who also effect transactions as brokers or dealers, are required to disclose any interest they may have in transactions effected for clients, if acting as an investment adviser in regard to such transaction. In addition, the act prohibits a registered investment adviser from entering into an agreement with his clients, under which his compensation is based on a share of capital gains or appreciation, and also prevents him from assigning an investment advisory contract without the consent of the client involved. Likewise, a registered investment adviser partnership which changes its membership must notify clients of such an occurrence.

The Investment Advisers Act does not empower the Commission to inspect the books and records of an investment adviser. Nor, under the act, may the Commission deny or revoke the registration of an investment adviser unless: (1) he has been enjoined by a court of competent jurisdiction from activities in connection with his conduct as an investment adviser or from action involving securities or certain other activities; (2) he has been convicted in the past ten years of a crime involving securities, the securities business or certain related activities; or (3) has falsified his application for registration.

During the past fiscal year, the number of registered investment advisers increased substantially, reaching a total of 1,671, an increase of 7 percent over the previous year. The following table contains statistics concerning registration of investment advisers and applications for such registration during the fiscal year:

[table omitted]

ADMINISTRATIVE PROCEEDINGS

Security Forecaster Co., Inc. -- Registrant, publisher of a weekly investment letter known as Financial Forecaster, devoted an entire issue of the latter to an article on Anacon Lead Mines, Ltd. (Anacon). This article recommended the purchase of Anacon stock in extravagant and enthusiastic terms, stating that for several weeks registrant had been conducting an extensive research program on Anacon which showed beyond a shadow of a doubt that, among other things, Anacon was the "sleeper" of the year among Canadian mining stocks. It also projected a potential recovery of gold in Anacon properties of some $50 million or more, stated that Anacon had paid more than a million dollars in dividends, and that Anacon's investments had a value of more than $16 million as of December 31, 1957. The report failed to disclose that Anacon had no proven gold deposits on these properties, that no dividends had been paid since 1952, and also failed to disclose that in contrast with the reported $16 million estimated value of Anacon Investments in shares of a mining corporation, the same shares had a value as indicated by a then existing market price of only $2,212,000. Registrant was also found to have willfully filed an application for registration incorrectly listing an individual as a director.

In an action brought by the Commission, a permanent injunction was issued by the United States District Court for the Southern District of New York against registrant and Melvin A. Johnson, its president, director and sole stockholder. The decree barred them from using false and misleading statements concerning the potential recovery from Anacon's investments, profits realized in stock of other companies managed by the president of Anacon, profits that could be realized from investing in Anacon, and the present financial condition of Anacon and its history of dividend payments. Registrant consented to entry of the decree without admitting any of the allegations of violations contained in the complaint.

In the revocation proceeding, which followed the injunction, registrant urged that Johnson was the subject of a continuing investigation and had properly, and on advice of counsel, refrained from testifying in the revocation proceeding in order to avoid the possibility of waiver of his constitutional privilege against self-incrimination. Accordingly, it was contended registrant was deprived of the testimony of the person most qualified to present registrant's defense. The Commission rejected this argument, holding that registrant was given due notice of the hearing on the charges against it and at that hearing registrant had participated with counsel.

Based on the injunction, finding of a willful violation and substantial departure from the standards of care and responsibility and fair and impartial analysis expected of a registered investment adviser, the Commission revoked the investment adviser registration of Security Forecaster Co., Inc.

William H. Keller, Jr., doing business as Insurance Stock Information Service. -- Keller's investment adviser registration was revoked based on an injunction issued by the United States District Court for the Southern District of Indiana, Indianapolis Divisions permanently enjoining him from violations of the Commission's net capital rule in connection with his activities as a broker-dealer. The Commission also revoked Keller's broker-dealer registration based on the injunction and violations of the antifraud, record keeping, and other provisions of the federal securities laws. That action is described in a prior portion of this report.

Albert J. Gould, doing business as Gould Investment Service. -- The Commission revoked the Investment Adviser registration of Gould based on a finding that he was permanently enjoined by the United States District Court for the Southern District of New York from effecting transactions in securities at a time when A. J. Gould & Co., Inc. was in violation of the Commission's net capital rule. In that injunctive action, the court found that A. J. Gould & Co., Inc., a registered broker-dealer firm of which Gould was president and a director, had willfully violated the net capital rule.

PART XI
OTHER ACTIVITIES OF THE COMMISSION

COURT PROCEEDINGS

Civil Proceedings

At the beginning of the fiscal year 1959 there were pending in the courts 54 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 60 additional proceedings were instituted and 58 cases were disposed of, leaving 56 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 7 proceedings in United States District Courts under section 11(e) of the Public Utility Holding Company Act and in 18 miscellaneous actions. The Commission also participated in 59 civil appeals in the United States Courts of Appeals. Of these, 20 came before the courts on petition for review of an administrative order, 17 arose out of corporate reorganizations in which the Commission had taken an active part, 17 were appeals in actions brought by or against the Commission, 1 was an appeal from an order entered pursuant to section 11(e) of the Public Utility Holding Company Act, and 4 were appeals in cases in which the Commission appeared as amicus curiae. The Commission also participated in 4 appeals or petitions for certiorari before the United States Supreme Court resulting from these or similar actions.

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 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 they are forwarded to the Attorney General. Commission employees familiar with the case often assist the United States 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, 45 new cases were referred to the Department of Justice for prosecution. This represents the highest number of criminal referrals in the past 17 years and the 5th highest in the Commission's history. Also during the fiscal year 27 indictments were returned against 111 defendants, the highest number since fiscal year 1943, and there were 24 convictions in 13 cases. There were six appeals in criminal cases during the fiscal year. In three instances the appeals were dismissed. The conviction was affirmed in the only appeal decided on the merits. The remaining two cases were still pending at the close of the period. Two criminal contempt proceedings were instituted during 1959, which were still pending at the end of the year.

From 1934 to June 30, 1959, 2,487 defendants have been indicted in the United States District Courts in 602 cases developed by the Commission and 1,319 convictions obtained in 555 cases. Thus, over the past 25 years, convictions have been obtained and upheld in over 85 percent of the cases completed.

As in past years, the criminal cases developed and prosecuted during the year covered a wide variety of fraudulent practices. They included frauds in the sale of securities of established as well as new businesses, frauds on the part of securities broker-dealers and their representatives, frauds in the sale of securities relating to oil and gas promotions and mining ventures, and fraudulent securities promotions of alleged inventions. In addition, defendants in a number of cases also were charged with violating the registration provisions of the Securities Act. The filing of a false registration statement under the Securities Act and the failure to file reports required under the Securities Exchange Act also were charged in certain of the cases. The "Ponzi" technique whereby promoters pay back to investors out of the investors' own funds monies which are falsely represented to be profits or interest on their investments was a part of the fraud alleged in a number of the cases in which convictions were obtained during the year.

In U.S. v. Selected Investment Corporation et al., (W.D. Okla.), after 3 weeks of trial, Hugh A. Carroll was convicted and sentenced to a term of 7 years on all counts of a 31-count indictment which charged violations of the antifraud provisions of the Securities Act of 1933, violations of the Mail Fraud Statute and conspiracy to violate both statutes. Three other defendants received sentences ranging from a suspended sentence with 5 years probation to 5 years imprisonment. The two corporate defendants were each fined $1,500 and one defendant was acquitted. The indictment alleged that the defendants employed a scheme to defraud in connection with the sale of certificate bonds of Selected Investments Trust Fund by means of false and misleading representations and by concealment of material facts. It was charged that the defendants paid dividends out of capital while representing to investors and prospective investors that such dividends were paid from profits earned by the trust fund created and managed by defendant Selected Investments Corporation; that false financial statements of the trust fund were distributed to investors; that the defendants illegally converted to their own use properties of the trust fund; that the defendants falsely represented that there were adequate safeguards to protect investors from loss and that their funds were invested in sound income producing securities.

Convictions also were obtained after trial against two defendants in U.S. v. Monarch Radio and Television Corporation et al. (S.D. N.Y.). Prior to trial one defendant pleaded guilty. Two defendants were acquitted and the case dismissed as to the four remaining defendants. This indictment charged the defendants with making various misrepresentations in the sale of Monarch stock and with issuing false financial statements and paying dividends out of stock sale proceeds while representing that such dividends came from company earnings when the company had no earnings.

A sentence of 18 months imprisonment was imposed upon Roy W. Adams (N.D. Texas) following his conviction of charges arising out of the fraudulent sale of stock of Central Finance Service, Inc. A codefendant, Council Mayo Forsyth, had previously been sentenced to 2 years imprisonment for the fraudulent sale of the same stock. The indictment charged that the defendants falsely represented to investors that the Central stock being offered was unissued stock and that the money received from the sale of such stock would be used by Central in its business operations; that Central was realizing substantial profits from its business operations and would pay substantial dividends and that investors would receive a return of all money invested in Central stock upon request.

The promotion of alleged inventions resulted in convictions in U.S. v. Arnold E. Vandersee et al. (D.N.J.) and U.S. v. Gailon A. Bell (S.D. Calif.). After 6 weeks of trial in the Vandersee case defendants Vandersee and the Vandersee Corporation were found guilty on 11 counts of a 15-count indictment charging fraud in the offer and sale of common stock of the Vandersee Corporation The indictment alleged that as part of a scheme and artifice to defraud purchasers the defendants falsely represented, among other things, that the Vandersee Corporation had contracts with General Motors, General Electric, Ford Motor Company and other large corporations; that the corporation was producing equipment used in the manufacture and production of atomic energy, radio tubes, aircraft engines, printed circuits, and other electrical equipment; that the corporation had an order for $1 million from Bell Telephone and General Electric; and that the corporation had obtained title to two patents issued to Arnold E. Vandersee. The indictment also charged that the defendants failed to advise the public investors that some of the shares being offered by Vandersee were his personally owned shares, or the personally owned shares of other defendants. Vandersee was sentenced to a total term of 8 years and fined $5,000. The defendant corporation was fined $5,500. Two remaining defendants were found not guilty.

In the Bell case defendant was found guilty on three counts charging violations of the antifraud provisions of the Securities Act, and two counts charging violations of the registration requirements of that act in connection with the sale of stock of Nil-Form Batteries, Inc. A sentence of 5 years probation was imposed upon Bell who was also ordered to make restitution. The indictment charged that Bell falsely represented that funds invested in Nu-Form Batteries stock would be used to acquire additional production facilities when, in fact, the defendant intended to and did appropriate such funds to his own use and benefit; that Bell had invented the Nu-Form Battery; that the battery would soon be distributed nationwide; that an affiliate of Nu-Form Batteries was equipped to assemble 2,000 batteries per day; and that Nu-Form stock would be listed on a national securities exchange. The indictment further charged that defendant failed to disclose that earlier attempts to manufacture and market the Nil-Form Batteries on a commercial basis had been unsuccessful and that earlier experience had indicated that the company could not generate sufficient revenue to cover operating expenses.

In U.S. v. Albert Hefferan (W.D. Mich.) the defendant was sentenced to a prison term of 3 years following his plea, of guilty to various counts of an indictment charging violations of the antifraud provisions of the Securities Act in connection with the sale of promissory notes purportedly secured by shares of stock. The indictment alleged that as part of a scheme and artifice to defraud, the defendant placed a series of newspaper advertisements soliciting investors to advance him sums of money. It was represented in these advertisements that the defendant would furnish collateral variously described as "listed, high-grade securities" and "grade A negotiable listed securities," having values substantially in excess of the amounts of the investments solicited. The indictment charged that the defendant did not intend to and did not pledge genuine securities as collateral for his promissory notes issued to investors, but delivered to them forged certificates which he falsely represented to be genuine. In addition, the indictment alleged that Hefferan falsely represented to investors that investments in his notes collateralized by purported shares of stock would be absolutely safe and involve no risk of loss; and that he had ample income from his business and investments to pay the monthly installments of principal and interest provided in his notes.

In U.S. v. Paul H. Collins (S.D. Ill.) the defendant, who was the representative of a broker-dealer, pleaded guilty to ten counts of a twenty count indictment charging him with violations of the Securities Act and the Mail Fraud Statute. Collins' sentence was suspended and he was placed on probation for 3 years.

PI ugh C. Van Valkenburgh (D. Neb.) entered a plea of nolo contendere to four counts of an indictment charging fraud in the sale of securities of Instant Beverages, Inc. The defendant was fined $11,500 and placed on probation for 3 years. The other defendant, Abraham Schapiro, had previously pleaded guilty to eight counts of the indictment and had been placed on probation for 30 months and fined $2,000. The indictment charged that the defendants employed a scheme to defraud purchasers of the securities of Instant

Beverages, Inc. by misrepresenting that the proceeds from the sale of defendants' shares of stock would be used by Instant Beverage, Inc. to begin production, whereas the defendants converted the proceeds to their own use; and that formulae held by the company for an effervescent soft drink were perfected and that Instant Beverage, Inc. would soon cause to be produced a stable product in marketable quantities, whereas the defendants knew that the formulae and processes were incomplete and not perfected and that a stable product could not be produced therefrom. In addition, it was charged that the defendants sold stock to the public at $5 a share for which they had paid 1 cent per share, without disclosing to the investors the original cost of the shares.

In U.S. v. Harold W. Danser Jr., et al (D. Mass.) the defendants are charged with violations of the antifraud provisions of the Securities Act in the sale of the common stock and warrants of Ultrasonic Corporation, and with conspiracy to file false registration statements under the Securities Act pursuant to which the stock offering was made and to defraud the United States by impeding and obstructing the Commission in its protection of public investors. The indictment charges, among other things, that the defendants, in the offer and sale of the Ultrasonic securities used financial statements, included in the prospectuses furnished to investors, which represented that the Ultrasonic Corporation was operating at a profit and had substantial assets, when in fact the corporation had suffered substantial losses and the assets were substantially less than the amount stated.

In U.S. v. Charles M. Berman, et al. (S.D.N.Y.) numerous defendants were indicted for violations and conspiracy to violate the Securities Act. The indictment charges the defendants with employing a scheme to defraud investors in the offer and sale of shares of John Inglis, Ltd. and other securities. The indictment alleges that as a part of this scheme defendants caused Cornelis de Vroedt, Inc. to obtain a broker-dealer registration with the Commission and arranged to supply securities to be sold through Cornelis de Vroedt, Inc. According to the indictment, defendants caused Cornelis de Vroedt, Inc. to contract to sell, as commission agent for certain foreign trusts, large quantities of the John Inglis, Ltd. shares and defendants inserted advertisements in financial journals, newspapers and periodicals, purchased mailing lists and distributed literature to the said mailing list to condition the public for the extensive telephone sales campaign that followed.

It is further charged that the defendants, in effecting the sale of the Inglis shares, falsely represented to investors that the defendant Cornelis de Vroedt, Inc. was a long established securities firm; that the purchasers could place their trust and confidence in the firm; that the firm maintained an independent research department which issued impartial advice to its customers; that the firm was advising the purchasers to invest and reinvest in the Inglis shares as a result of an impartial analysis of that security by its research department, which analysis was based upon facts and information not generally available to the public at large; that the firm, the officers thereof and the salesmen had purchased large quantities of Inglis shares for their own accounts; that the firm was offering and selling Inglis shares to a special group of customers at bargain prices with no commission charge to said customers in order to add such customers to its existing regular clientele; that the purchasers would suffer no loss and were assured of immediate large specified profits because of imminently impending designated mergers, increased earnings, declarations of dividends and new listings on registered securities exchanges; and that in order to participate in these guaranteed profits, it was necessary for the customers to make immediate purchase of the Inglis shares since they were "blue chips" in short supply and soon would be unavailable at the then existing low prices.

The indictment charges further that the defendants would send confirmations to persons who had not ordered securities and thereafter threaten to make trouble for them with the Securities and Exchange Commission if they did not buy the securities, and that the defendants destroyed or falsified records of the company for the purpose of impeding, impairing and obstructing the investigative functions of the Commission.

The indictment in U.S. v. Alexander L. Guterma, et al (S.D.N.Y.) charged violations of, and conspiracy to violate, the reporting requirements of the Securities Exchange Act of 1934. The indictment charges that Guterma, Robert J. Eveleigh, and Comficor, Inc., unlawfully failed to file with the New York Stock Exchange and the Commission a statement indicating beneficial ownership and the changes in such ownership in the common stock of F. L. Jacobs Co. at the close of specified calendar months. The indictment further charges that Guterma and Eveleigh delayed and obstructed the filing of the annual report of F. L. Jacobs Co. for the fiscal year ended July 31, 1958, and that Guterma and Eveleigh, who were officers, directors and owners of securities of F. L. Jacobs Co., unlawfully delayed and obstructed the making and filing of monthly reports of F. L. Jacobs Co. which would have disclosed the disposition by F. L. Jacobs Co. of a significant amount of assets otherwise than in the ordinary course of business.

Indictments in two cases charge fraud in connection with the transaction of business as a broker-dealer. Bryan H. Kyger was charged in an indictment returned in the Southern District of Texas with violations of the Securities Exchange Act, as well as the Securities Act and the Mail Fraud Statute. According to the indictment, Kyger solicited customers to purchase securities from his firm upon the representation that the firm was financially able to execute such orders and to deliver securities and money due customers when he did not intend to and did not execute such orders or deliver to customers the securities ordered by them. The indictment also charges that Kyger appropriated to his own use and benefit the monies received by him from his customers in payment of securities purchased by them, and that he sold securities belonging to his customers without their knowledge and similarly misappropriated the proceeds.

In an indictment returned in U.S. v. Robert Bernard Sills et al (S.D. Fla.), the defendants were charged with similar violations. The indictment in this case charges, among other things, that the defendants, operating through Sills and Company, a registered broker-dealer of which Sills was president and controlling stockholder and for which defendant

Green was sales manager and a salesman of securities, employed a scheme and artifice to defraud by soliciting and inducing customers to purchase from and sell to Sills and Company certain securities, and that, instead of effecting such transactions, the defendants converted to their own use and benefit the funds received from customers in payment for such securities and the securities obtained from customers for the purpose of such sales. It is further alleged in the indictment that the defendants concealed from their customers that the firm was insolvent and that the defendants made and caused to be made false statements in a financial report filed with the Commission.

Indictments were returned in a number of cases involving alleged fraudulent promotions regarding securities of insurance companies. An indictment was returned in the District of Nebraska charging Charles F. Newell and others with violations of the antifraud and registration provisions of the Securities Act in connection with the sale of stock of Unity Insurance Company. The defendants are charged with investing funds derived from the sale of Unity Insurance Company stock in business ventures unrelated to the organization of an insurance company. According to the indictment, in the course of the sales of these securities the defendants falsely represented, among other things, that the purchaser of the stock could have his money back at any time; that the money raised from the sale of the stock would be placed in escrow until the insurance business license or franchise was issued by the State of Nebraska; that the stock was going to rise in price; that the company had the money to qualify and get its insurance license; that the company was doing so well that they would refund the money of the purchaser at any time with 5 percent interest; that the company was allowed by state law to spend only 24 cents per share for expenses; and that certain persons had made substantial investments in the Unity Insurance Company. In addition, the indictment charged that the defendants concealed that the principal organizers, officers and directors of the company did not invest any money in the company, and that the stock purchased by investors was stock optioned to an officer or director, and that the greater portion of the purchase price would be retained by the officer or director making the sale.

In U.S. v. James Lamar McMichael (D. Ala.), the indictment charges the defendant with violations of the antifraud provisions of the Securities Act, the Mail Fraud Statute and the Fraud by Wire Statute. McMichael, who had been a fugitive, was apprehended in January 1959 in Miami, Fla. The charges as laid in the indictment arose, in part, out of the sale of preorganization subscriptions and certificates for stock of United Security, Inc., a corporation proposed to be organized under the laws of South Carolina, which was promoted by McMichael for the purpose of acquiring a number of financially unstable insurance companies and consolidating them into one company; also, in part, out of personal transactions of McMichael with individual investors involving securities in their portfolios. It is alleged in the indictment that the defendant engaged in a scheme to sell preorganization subscriptions and certificates for both the original stock of United Security, Inc., and personally owned stock of the defendant to be issued after the corporation would be formed, by falsely representing to investors, among other things, that money paid for such securities would be deposited in escrow with The South

Carolina National Bank at Greenville, S.C., and that if the corporation did not obtain a charter before a specified date, the funds of the investors would be returned to them. The indictment further alleges that the defendant falsely represented to investors that if they would turn over to him certain stocks of established corporations which they owned, he would be able to sell them at advantageous prices, and that he would accept one-half of the profits as his commission. It is also alleged that he purchased securities from investors and gave them worthless checks in payment therefor.

Violations of the antifraud provisions of the Securities Act and of the Mail Fraud Statute also are charged in the indictment in U.S. v. William Isaac Lowry, et al. (D. Ariz.). This indictment charges the defendants with a scheme and artifice to defraud policyholders and stockholders of American Buyers Insurance Company, the beneficiaries of a certain trust of which the defendants were the trustees, and the stockholders of The American Buyers Insurance Company (a separate corporation). According to the indictment, the scheme to defraud was devised by the defendants for the purpose of obtaining control and ownership of the property, assets and insurance business of a group of insurance companies of which defendants were the principal officers and directors, and for the enrichment of defendants at the expense of investors and policyholders. As part of the scheme defendants induced those persons to invest funds in the insurance companies and to forego rights to which they were entitled as policyholders and stockholders. Further, it is alleged the defendants diverted insurance business from companies in which such persons were policyholders or stockholders to companies wholly or substantially owned by the defendants.

An indictment charging violations and a conspiracy to violate the registration provisions of the Securities Act was returned against Philip H. Meade and others (S.D. Ind.) in connection with the sale of the stock of Farm and Home Agency. According to the indictment, the defendants sold the stock to non-residents of the State of Indiana, which destroyed their claim to an intrastate exemption, and conspired to conceal the true identities of the purchasers of such securities and to create the appearance of sales to Indiana residents by the use of dummies and nominees.

An indictment was returned in the District of North Dakota charging Samuel Parker Pandolfo and others with violations of the antifraud and registration provisions of the Securities Act, violations of the Securities Exchange Act and violations of the Mail Fraud Statute in connection with the operation of a securities broker-dealer business. The indictment charges, among other things, that the defendant Samuel Parker Pandolfo acquired for himself and his close associates large quantities of securities of Great Northern Investment Company, Inc., and thereafter caused to be formed Universal Securities, Inc., to engage generally in the business of a broker-dealer, and particularly to make, maintain and support a market for the Class "A" stock of Great Northern Investment Company, Inc. The indictment also charges that the defendants engaged in a scheme to sell securities through Universal Securities, Inc. by falsely representing to the investors that the prices at which the securities were sold were prices determined by an actual bona fide demand for such securities; that a further rise in the prices of the securities could be expected in the near future because of a rapid rise in the intrinsic value of the shares; and that a rise in the market prices of the securities sold was sure to occur. In addition, the indictment charges that the defendants falsely represented that the Great Northern stock would double in value within a specified period; that investors could resell the securities any time at the price at which they paid for them; and that the price at which such securities were sold was the market price thereof, when in fact said market price was an artificial market price maintained by the defendants, which fact was not disclosed.

Abraham Rosen and another defendant were indicted in the District of Massachusetts on charges of violation of the antifraud provisions of the Securities Act and the Securities Exchange Act and the Fraud by Wire Statute. The indictment charges that the defendants solicited funds and securities from customers with the representation that the defendants would invest the funds and the proceeds from the securities for the benefit of the customers, when in truth and in fact, as the defendants well knew, they did not intend to, and did not, invest the moneys as represented, but appropriated the funds to their own use and benefit.

An indictment was returned in the Northern District of Tennessee charging Robert Lee Proffer and others with violations of the anti-fraud provisions of the Securities Act and the Mail Fraud Statute. The indictment charges, among other things, that the defendants induced investors to purchase shares of Old Line Legal Reserve Trust (later the Teachers-Professional Investment Company) by falsely representing to investors that the books of the corporation would be audited by a certified public accountant and that financial statements would be furnished to stockholders at least once each fiscal year; that as of a specified date the corporation had an earned surplus of $13,278.30; that moneys received from the sale of corporation stock would be used primarily to finance and refinance loans on automobiles for the school teachers of Texas; and that in the event investors who purchased stock on the installment plan failed to complete their purchase contracts, such investors would receive shares of stock of the corporation to the extent of the amount paid in. The indictment also alleges that as a further part of the scheme to induce school teachers to purchase stock of the corporation the defendants caused printed prospectuses to be distributed to school teachers, and that such prospectuses contained names and photographs of well-known educators throughout the State of Texas and representations that some of these individuals were directors of the corporation and that others were "Regional Directors of Areas."

In the Eastern District of New York an indictment was returned charging William Spiller and others with violating the antifraud provisions of the Securities Act and the Mail Fraud Statute in the sale of the 7 percent cumulative preferred stock of Budget Funding Corporation. The indictment charges that in the offer and sale of those securities the defendants falsely represented that the moneys invested would be used to place second mortgages on residential properties for home improvements on such properties and to place chattel mortgages on chattels owned by established businesses, that a dividend would be declared on the common stock of Budget Funding Corporation, that the common stock was in short supply and would soon be traded on the open market, and that the preferred shares would be called back at a higher price than the purchasers paid for them. In fact, the indictment charges, the defendant concealed from purchasers of the securities that the money received was being directed to the use of the defendant Spiller and corporations controlled by him.

As in the past, cases involving alleged fraudulent oil and gas promotions and mining ventures were numerous. In U.S. v. Dudley Pritchett South (D.N.J.) an indictment was returned charging violations and conspiracy to violate the registration and antifraud provisions of the Securities Act in connection with the sale of the common stock of Texas-Western Oil Company, Inc. The indictment charges that in the sale of that stock the defendants misrepresented that Texas-Western had acquired oil producing properties in Kansas and Oklahoma and had a working interest in other specified oil properties, that Texas-Western had a partnership interest in leases located in Nevada and in a 10,000-acre block in Wyoming, that Texas-Western owned a 55 percent interest in a mercury and antimony mine located in Mexico and was building an ultrasonic ore reduction mill on the site of that mine, that the company had an income from its oil producing properties in Kansas and Oklahoma, that dividends would be paid on the Company's stock, that the value of the stock would increase sharply in a short period of time and that the stock would be registered and listed on the New York and American stock exchanges,

In U.S. v. Thomas E. Robertson, et al (S.D.N.Y.) the indictment alleges that the defendants, in violation of the antifraud provisions of the Securities Act, employed a device, scheme and artifice to defraud investors in the sale of the common stock of American-Canadian Oil and Drilling Corporation; that Thomas E. Robertson, Inc., in exchange for certain oil and gas leases, acquired 500,000 shares of common stock of American-Canadian which it sold to the investing public at various prices without a registration statement being in effect with respect to said shares, and without disclosing that the shares being sold were shares already issued to Thomas E. Robertson, Inc., and that the proceeds from the sales would inure to the use and benefit of Thomas E. Robertson, Inc., and Thomas E. Robertson; and that the defendants made false and fraudulent representations concerning the payment of dividends, the value of the stock, approval by the Securities and Exchange Commission, listing of the stock on a national securities exchange, the value of the properties and their cost of acquisition. Numerous other misrepresentations and omissions also were charged.

Violations of the registration provisions of the Securities Act as well as the Mail Fraud Statute are charged in the pending indictment in U.S. v. Texas-Adams Oil Company (S.D.N.Y.) which also involved an oil promotion venture.

Alleged fraudulent promotions involving mining ventures led to indictments in U.S. v. Clement G. Cafarelli, et al, (D. Utah); U.S. v. Silas M. Newton et al, (D. Colo.); U.S. v.

Arthur L. Damon, et al (S.D. Cal.); and U.S. v. William J. Conrad (N.D. Ohio). In the Cafarelli case the indictment charges fraudulent sales of the common stock of Comstock Uranium Tungsten Co., Inc. According to the indictment, a Regulation A notification and offering circular covering the proposed public offering of 440,000 shares of common stock of Comstock were filed with the Commission, and defendants, instead of proceeding with the Regulation A offering, sold personally owned stock to the public using as an inducement false representations to the effect that the stock would appreciate in market value when it was offered for "public sale" and that the persons approached were being given a special prepublic offering price not afforded to the general public. Other false representations also are charged.

In the Newton case a superseding indictment was returned which charges, among other things, that the defendants devised a scheme to defraud investors by means of misleading and false statements and pretenses, which induced them to purchase participation certificates in trusts known as the Yellow Cat Royalty Trust and the Tennessee Queen Royalty Trust, and in fractional undivided interests in mining claims held by the Tennessee Queen Mining Company. The indictment also charges that in connection with the sale of these securities the defendants falsely represented that the properties were of great value; that the company was shipping ore, and the investors were absolutely assured of royalty returns on their investments; that the operators and their associates were highly experienced mining operators; that the operators agreed that they would repurchase or refund the purchase price to some of the purchasers upon demand; and that the investment to be made by the prospective purchasers was safeguarded because of bank trusteeship.

In the Damon case the indictment charges that the defendant made fraudulent representations to investors concerning the financial status of Nev-Tah Oil and Mining Company, the potential oil reserves of mining properties owned or leased by the mining company, and the company's earnings and ability to pay dividends. The indictment further charges that Damon acquired control of the company and caused the market price of its stock on the Salt Lake Stock Exchange to rise above 45 cents per share through the use of flamboyant and misleading reports, letters and oral statements; that he caused the company to issue stock into a series of escrows for release at prices ranging from 9 cents to 45 cents per share, and that he offered and sold escrowed stock at prices in excess of the escrow prices and at artificial exchange prices.

In the Conrad case, the defendant was apprehended after the close of the fiscal year, and pleaded guilty to an indictment charging him with the fraudulent sale of unregistered common stock of Condonna Uranium Mines Limited. In connection with the sale of that stock, according to the indictment, the defendant falsely represented to investors that Kennecott Copper Company would pay more than $10 million for the uranium mining properties owned by Condonna; that the profit to the investors would be more than $8,000 for each $100 invested; that a deal to sell the uranium mining properties to Standard Ore and Alloys Corporation was "signed, sealed and delivered" and the profit to the investors would be $60 for each $1 invested; that that Brush Beryllium Company would advance $500,000 to develop some beryllium mining claims allegedly owned by Condonna Uranium Mines Limited

and would buy all the beryllium ore produced at $600 a ton.

The Court of Appeals for the Ninth Circuit affirmed the conviction of Helen A. Davenport for conspiracy arising out of a securities fraud involving Edgar Robert Errion and Mount Hood Hardboard and Plywood Cooperative. The scheme to defraud the investing public included the sale of $1,000 memberships in Mount Hood. Appellant Davenport participated in the fraudulent scheme by allowing her name to be used as a cloak of respectability and her corporation as a conduit by which to siphon off the proceeds from the sale of the memberships. The Court of Appeals rejected appellant's attack on the indictment and held that it sufficiently charged her with a crime. In addition, the Court reviewed the evidence and found it sufficient to sustain the verdict of guilty.

In Tellier v. U.S. and Walters v. U.S. the Supreme Court of the United States denied petitioners' writs of certiorari. Tellier had been sentenced to 4.5 years imprisonment for his activities in running a boiler-room. Walters had received an 18-month sentence in connection with insurance company promotions. Both these cases are discussed in the 23d and 24th Annual Reports.

DISCIPLINARY PROCEEDINGS AGAINST PERSONS PRACTICING BEFORE THE COMMISSION

Private proceedings were instituted pursuant to rule 11(e) of the Commission's rules of practice to determine whether James T. DeWitt should be temporarily or permanently denied the privilege of practicing as an attorney before the Commission. DeWitt was retained by Cushman Foods Co., Inc. to represent it in connection with a proposed public offering under Regulation A under the Securities Act of 1933. He was given authority by his client to execute all papers necessary to qualify such offering under Regulation A for the purpose of obtaining an exemption from registration with respect to the proposed offering. Included in the notification were financial statements which, together with subsequent amendments thereto, were prepared and filed by DeWitt. These financial statements were false, and DeWitt knew that they were false when he filed them. In addition, he advised Cushman to sell the shares covered by the notification, although the time at which such sales would commence under the regulation had not arrived, and pursuant to that advice Cushman sold over 4,000 shares. DeWitt requested of Cushman moneys which he represented were to be distributed among employees of the Commission. Pursuant to this request he received $100, which he thereafter represented to Cushman he had "passed along" to such employees, whereas in fact, no moneys, gifts or inducements of any kind were given to any Commission personnel. At the private hearing there was entered of record DeWitt's "consent to order of disqualification", and thereafter the Commission issued its opinion in which it found that DeWitt had filed false financial statements, which he knew to be false, that he obtained moneys from his client under the false pretense that he proposed to use that money to exert an illegal influence on the Commission staff, and that in so doing he had engaged in unethical and improper conduct. It ordered that DeWitt be permanently denied the privilege of appearing or practicing before the Commission.

Proceedings under rule 11(e) with respect to Bollt and Shapiro, accountants, are discussed below at p. 197 in connection with the activities of the Commission in the field of accounting.

COMPLAINTS AND INVESTIGATIONS

Each of the acts administered by the Commission specifically authorizes investigations to determine whether violations of law have occurred. In most instances, the investigations conducted by the Commission are private and nonpublic. However, the Commission may, in its discretion, order a public investigation.

It is the policy of the Commission to conduct its investigations privately for a number of reasons. 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. Effective enforcement requires that investigations be private in order that suspected violators may not be warned and thereby frustrate the investigation. This policy is similar to that of most law enforcement agencies. The Commission investigates many situations 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 public investors with no countervailing public benefit. Moreover, members of the public would have a tendency to be reluctant to furnish information concerning violations if they thought their personal affairs would be publicized. Private investigations protect both those who furnish information and subjects of investigation against whom the evidence fails to warrant action. Accordingly, the Commission does not generally divulge the results of any investigation until they are made a matter of public record through proceedings before the Commission or in the courts.

The nine regional offices of the Commission, with the assistance of their branch offices, are chiefly responsible for the conduct of investigations. In addition, the special investigations unit of the Division of Trading and Exchanges of the Commission's home office conducts investigations dealing with matters of particular interest or urgency either independently or assisting the regional offices. Because of "boiler-room" operations in the New York area, much of the work of the special investigations unit is devoted to that area. The Division of Trading and Exchanges exercises general supervision over and coordination of the investigative activities of the regional offices. It examines and analyzes periodically the results of investigations and recommends appropriate action to the Commission, giving serious consideration to the recommendations of the regional offices in each instance.

There are several sources of information which eventually lead to investigations. A primary source of information comes from complaints of members of the public concerning the activities of persons involved in the offer and sale of securities. The Division of Trading and Exchanges and the regional offices of the Commission give careful attention to this information and if it appears that violations of the federal securities laws may have occurred, an investigation is commenced. If the complaint is received by the Division of Trading and Exchanges, the information contained in the complaint is forwarded to the appropriate regional office for such investigative activity as may be deemed advisable. Other sources of information which are of great help to the Commission in carrying out its enforcement responsibilities are national securities exchanges, brokerage companies, state and Canadian securities authorities, Better Business Bureaus and the National Association of Securities Dealers, Inc. Many times information from these sources is helpful, for it comes from persons who are often familiar with the operation of the federal securities laws and are interested in seeing full protection of these laws afforded to the investing public.

If, after careful consideration of information received from these and other sources, it appears that violations may have occurred, a preliminary investigation may be made. Many times this investigation discloses a violation due to a misunderstanding or ignorance of the law. In these cases, where no harm to the public has occurred, it is the policy of the Commission to inform the offender of the violation and to make sure that necessary steps are taken for future compliance. Should the offender fail to conform with the requirements of the law, then the Commission takes appropriate action.

When the preliminary investigation indicates a serious violation, or appears to require more extensive investigation, including examination of books and records or interviews with more than a few persons, a case is docketed and a full investigation is made. At times it is necessary for the Commission to issue a formal order of investigation which appoints members of the staff as officers to issue subpoenas and take testimony under oath. As is often the case, this step is taken when the principals and others involved in the investigation are uncooperative, and it is necessary to use the subpoena power in order to determine the exact nature of the activities involved. During the past year, 94 formal orders were issued in connection with the investigations handled through the Division of Trading and Exchanges, an increase of nearly 25 percent over the previous year.

In addition investigations are initiated and conducted by the staff of the Division of Corporation where necessary to assist in ascertaining facts with respect to disclosures required to be made or omissions of material information in connection with its examination of registration statements filed under the Securities Act and preliminary proxy soliciting material and reports required to be filed under the Securities Exchange

Act. Where necessary, such investigations are conducted with the assistance of the staff of other divisions and regional offices.

Upon completion and review of an investigation by the regional office concerned and the Division of Trading and Exchanges, or the Division of Corporation Finance, the Commission takes under consideration the recommendations of its staff concerning the investigation. The Commission, where action is necessary, has the choice of several avenues. When required in the public interest, the Commission may refer the case, including evidence and exhibits, to the Department of Justice for criminal prosecution. Should this occur, members of the staff familiar with the case assist the Department of Justice and the United States Attorney handling the case in presenting it to the grand jury. When an indictment is returned, members of the staff aid in the trial of the case.

The Commission may, when appropriate, authorize institution of civil proceedings for injunctive relief. In such event, the complaint is filed in the appropriate United States District Court and the case presented by a member of the Commission's staff. The Commission may also institute administrative proceedings when the investigation indicates 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 the Commission is violating the federal securities laws.

The following table reflects in summarized form the investigative activities of the Commission during fiscal 1959.

[table omitted]

ENFORCEMENT PROBLEMS WITH RESPECT TO CANADIAN SECURITIES

Enforcement problems relative to the unlawful offer and sale of securities by Canadian issuers and broker-dealers continue to be serious. In such enforcement activities the Commission is severely handicapped in that ordinarily both the violator and essential evidence are in Canada, where persons, books and records are beyond our investigative and subpoena powers. It is therefore difficult, and in most instances, impossible to obtain admissible evidence with respect to such violations. Even when evidence is obtainable, sanctions, such as civil or criminal prosecution or administrative proceedings, cannot be utilized unless personal jurisdiction over defendants can be secured.

Despite these difficulties, the Commission, acting within its jurisdictional limitations, has made aggressive efforts to deal with the situation. Hundreds of investigations have been made, injunctions have been secured whenever jurisdiction over violators could be obtained, and a substantial number of criminal indictments have been entered. However, in a test case under the Supplementary Extradition Convention consummated in July 1952, the details of which were furnished in our 22d Annual Report, the Canadian courts denied extradition of a person who engaged in the fraudulent sale of securities by mail and telephone to United States residents. Through appropriate diplomatic channels negotiations are still continuing in an effort to correct this situation. In the meantime the Commission is almost wholly dependent upon voluntary cooperation of the Canadian provincial enforcement authorities.

Canada does not have federal securities legislation nor a federal regulatory body. Such matters are regulated on a provincial basis somewhat similar to the blue sky laws administered by State commissions. In general excellent cooperation has been obtained during the fiscal year from the provinces in the enforcement work of the Commission.

One of the most encouraging developments in this area has been the outstanding cooperation afforded by the Saskatchewan Securities Commission. On May 1,1959, this Commission concluded an arrangement with the Saskatchewan Securities Commission under which the latter will require broker-dealers in that Province to refrain from distributing issues of securities into the United States unless the broker-dealer is registered in compliance with the Securities Exchange Act of 1934 and the security is registered in compliance with the Securities Act of 1933. This is the only such arrangement which the Commission has with any province in Canada and reflects the desire of the Saskatchewan Securities Commission that only legitimate issues be distributed from that Province into the United States.

During the past fiscal year the Commission has brought 10 civil actions and instituted three criminal actions in which the illegal sale of Canadian securities in the United States was involved. Details concerning these actions: S.E.C. v. Ralph L. Loomis and F. Payson Tood, S.E.C. v. Canadian Javelin Limited

et al, U.S. v. Robert M. Sherwood, S.E.C. v. Scott Taylor and Co., Inc., S.E.C. v. Sidney B. Josephson et al, S.E.C. v. A. G. Bellin Securities Corp. et al, S.E.C. v. Albert and Company, Inc. et al, S.E.C. v. I. B. Norton and Company, Inc. et al, S.E.C. v. Gotham Securities Corp. et al, S.E.C. v. Philip Newman Associates et al, U.S. v. Charles M. Sermon et al, S.E.C. v. Lincoln Securities Corp. et al, and U.S. v. William J. Conrad are described above in the section on Litigation under the Securities Act of 1933 and the section on Criminal Proceedings.

To cope further with the Canadian problem the Commission continues to maintain its Canadian Restricted List, which is a list of Canadian issuers 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. The list and supplements thereto are issued to and published by the press, copies are mailed to all registered broker-dealers and are available to the public. They serve as a warning to the public and alert broker-dealers to the fact that transactions in the securities named therein may be unlawful. As a practical matter most United States broker-dealers refuse to execute transactions in such securities. During the fiscal year 1959, 27 supplements (compared to 14 in fiscal year 1958) were issued in which 85 names (compared to 50 names in fiscal year 1958) were added to the list. On May 20, 1959, the list was revised and consolidated, resulting in the deletion of 29 issuers concerning whose securities the Commission had no evidence of a public offering or sale in the United States during the past 3 years. In many instances the companies were no longer in existence due to mergers, charter surrenders, etc. The number of names on the list as of June 30,1959, was 210.

The current list, reflecting additions and deletions to November 25, 1959, follows:

CANADIAN RESTRICTED LIST

Aero Mining Corporation

Alba Explorations Limited

Aldor Exploration and Development Company Limited

Algro Uranium Mines Limited

A. L. Johnson Grubstake

Alouette Mines Limited

Amador Highland Valley Coppers Limited

Americanadian Mining & Exploration Co. Limited

Amican Petroleum and Natural Gas Corporation Limited

Anthony Gas and Oil Explorations Limited

Apollo Mineral Developers Inc.

Arcan Corporation Limited

Atlas Gypsum Corporation Limited

Augdome Exploration Limited

Ava Gold Mining Company Limited

Baranouri Minerals Limited

Barbary Gold Mines Limited

Barite Gold Mines Limited

Basic Lead and Zinc Mines Limited

Beaucoeur Yellowknife Mines Limited

Bengal Development Corp. Limited

Black Crow Mines Limited

Cable Mines and Oils Limited

Cameron Copper Mines Limited

Canada Radium Corporation Limited

Canadian Alumina Corporation Limited

Canadian Natural Resources Limited

Can American Copper Limited

Canso Mining Corporation Limited

Cartier Quebec Explorations Limited

Casa Loma Uranium Mines Limited

Casgoran Mines Limited

Cavalier Mining Corporation Limited

Centurion Mines Limited

Cessland Gas and Oil Corporation Limited

Colville Lake Explorers Limited

Concor-Chibougamau Mines Limited

Consolidated Easter Island Mines Limited

Consolidated Exploration and Mining Co., Limited

Consolidated Quebec Yellowknife Mines Limited

Consolidated Woodgreen Mines Limited

Continental Consolidated Mines and Oils Corporation Limited

Copper Prince Mines Limited

Courageous Gold Mines Limited

Cove Uranium Mines Limited

Cree Mining Corporation Limited

David Copperfield Explorations Limited

Demers Chibougamau Mines Limited

Dencroft Mines Limited

Derogan Asbestos Corporation Limited

Desmont Mining Corporation Limited

DeVille Copper Mines Limited

Diadem Mines Limited

Dolmac Mines Limited

Dolsan Mines Limited

DuBar Exploration Limited

DuMaurier Mines Limited

Dupont Mining Company Limited

Eagle Plains Developments Limited

Eagle Plains Explorations Limited

East Trinity Mining Corporation

Eastern-Northern Explorations Limited

Embassy Mines Limited

Explorers Alliance Limited

Export Nickel Corporation of Canada Limited

File Lake Explorations, Limited

Fleetwood Mining and Exploration Limited

Font Petroleums Limited

Franksin Mines Limited

Gasjet Corporation Limited

Golden Algoma Mines Limited

Golden Hope Mines Limited

Goldmaque Mines Limited

Granwick Mines Limited

Hallmark Explorations Limited

Halstead Prospecting Syndicate Harvard Mines Limited

Hercules Uranium Mines Limited

Hoover Mining and Exploration Limited

Huddersfleld Uranium and Minerals Limited

Inlet Mining Corp. Limited

International Ceramic Mining Limited

Irando Oil and Exploration Limited

Jacmar Explorations Limited

Jaylac Mines Limited

Jilbie Mining Company Limited

Jomac Mines Limited

Judella Uranium Mines Limited

Kaiser Development Corporation Limited

Kamis Uranium Mines Limited

Kateri Mining Company Limited

Kelkirk Mines Limited

Kelly-Desmond Mining Corporation Limited

Key West Exploration Company Limited

Kimberly Copper Mines Limited

Kipwater Mines Limited

Korich Mining Company Limited

Kordol Explorations Limited

Kukatush Mining Corporation

Lake Kingston Mines Limited

Lake Otter Uranium Mines Limited

Lama Exploration and Mining Company Limited

Larnbton Copper Mines Limited

Landolac Mines Limited

Langis Silver and Cobalt Mining Company Limited

Larutan Petroleum Corporation Ltd.

Lavandin Mining Company

Lavant Iron Mines Limited

Lee Gordon Mines Limited

Lindsay Explorations Limited

Lithium Corporation of Canada Limited

Lucky Creek Mining Company Limited

Lynwatin Nickel Copper Limited

Mack Lake Mining Corporation Limited

Madison Mining Corporation Limited

Mallen Red Lake Gold Mines Limited

Marian Lake Mines Limited

Marpic Explorations Limited

Marpoint Gas & Oil Corp. Limited

Masters Oil and Gas Limited

Megantic Mining Corporation

Mercedes Exploration Company Limited

Mexicana Explorations Limited

Mexuscan Development Corporation

Mid-West Mining Corporation Limited

Milmar-Island Mines Limited

Mina-Nova Mines Limited

Min-Ore Mines Limited (formerly Ryan Lake Mines Limited)

Monarch Asbestos Company Limited

Monpre Mining Company Limited

Montclair Mining Corporation Limited

Montco Copper Corporation Limited

Mylake Mines Limited

Nationwide Minerals Limited

New Campbell Island Mines Limited

New Faulkenham Mines Limited

New Goldvue Mines Limited

New Hamil Silver-lead Mines Limited

New Jack Lake Uranium Mines Limited

New Metalore Mining Company Limited

New Spring Coulee Oil and Minerals Limited

New Surpass Petrochemicals Limited

New Vinray Mines Limited

New West Amulet Limited

Norcopper and Metals Corporation

Normalloy Explorations Limited

Normingo Mines Limited

Norseman Nickel Corporation Limited

North American Asbestos Company Limited

North Gaspe Mines Limited

North Lake Mines Limited

North Tech Explorations Limited

Northwind Explorations Limited

Nortoba Mines Limited

Nu-Gord Mines Limited

Nu-Reality Oils Limited

Nu-World Uranium Mines Limited

Obabika Mines Limited

Ordala Mines Limited

Palliser Petroleums Limited

Pantan Mines Limited

Paramount Petroleum and Minerals

Corporation Limited

Peace River Petroleums Limited

Plexterre Mining Corporation Limited

Prestige Lake Mines Limited

Principle Strategic Minerals Limited

Prudential Petroleums Limited

Purdex Minerals Limited

Quebank Uranium Copper Corporation

Quebeck Developers and Smelters Limited

Quebec Graphic Corporation Queensland Explorations Limited

Quinalta Petroleum Limited

Regal Minerals Limited

Regal Mining & Development Limited

Resolute Oil and Gas Company Limited

Ridgefield Uranium Mining Corporation Limited

Riobec Mines Limited

Roberval Mining Corporation

Rockroft Explorations Limited

Rothsay Mines Limited

Saskalon Uranium and Oils Limited

Sastex Oil and Gas Limited

Savoy Copper Mines Limited

Sentry Petroleums Limited

Senvil Mines Limited

Sheba Mines Limited

Sheraton Uranium Mines Limited

Shoreland Mines Limited

Sico Mining Corporation Limited

Skyline Uranium and Minerals Corporation Limited

St. Pierre & Miquelon Explorations Inc.

St. Stephen Nichel Mines Limited

Stackpool Mining Company Limited

Strathcona Mines Limited

Sudbay Exploration and Mining Limited

Surety Oils and Minerals Limited

Tabor Lake Gold Mines Limited

Taiga Mines Limited

Tamara Mining Limited

Tamicon Iron Mines Limited

Taurcanis Mines Limited

Temanda Mines Limited

Territory Mining Company Limited

Three Arrows Mining Explorations Limited

Torbrook Iron Ore Mines Limited

Trans Nation Minerals Limited

Trenton Mines Limited

Tri-Cor Mining Company Limited

Trio Mining Exploration Limited

Trojan Consolidated Mines Limited

United Copper and Mining Limited

United Uranium Corporation Limited

Upper Ungava Mining Corporation Limited

Val Jon Exploration Limited

Valray Explorations Limited

Vanguard Explorations Limited

Venus Chibougamau Mines Limited

Vico Explorations Limited

Viscount Oil and Gas Limited

Wakefield Uranium Mines Limited

Webbwood Exploration Company Limited

Westville Mines Limited

Whitney Uranium Mines Limited

Windy Hill Mining Corporation

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 clearing house for other enforcement agencies of 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 United States 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 69,013 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 9,576 persons, including 3,450 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 of persons wanted on securities violations charges. The bulletin is distributed to 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 3,730 "securities violations" letters or reports and dispatched 944 communications to cooperating agencies.

APPLICATIONS FOR NON-DISCLOSURE 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 the 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, and under section 24(b) of that act written objection to public disclosure of information contained in any such material 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 persons who apply to the Commission for a determination that public disclosure is not necessary in a particular case.

The number of applications granted, denied or otherwise acted upon during the year are set forth in the following table:

[table omitted]

ACTIVITIES OF THE COMMISSION IN ACCOUNTING AND AUDITING

Successive reports of the Commission have called attention to the fact that the detailed provisions of 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 statutes administered by the Commission or included in other material available to stockholders or prospective investors, are indispensable to investors as a basis for investment decisions.

The Congress recognized the importance of these statements and that they lend themselves readily to misleading inferences or even deception, whether or not intended. It accordingly dealt extensively in the several statutes administered by the Commission with financial statement presentation and the disclosure requirements necessary to set forth fairly the financial condition of the company. 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 more comprehensive power is embodied in the Investment Company Act and the Holding Company Act.

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. Out of this initial provision in the Securities Act and the rules promulgated by the Commission, and the action taken by the Commission in certain cases, have grown concepts of accountant-client relationships that have strengthened the protection given to investors.

As shown above, the statutes administered by the Commission give it broad rule-making power with respect to the preparation and presentation of financial statements. Pursuant to authority contained in the statutes 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 82 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, prescribe accounting to be followed only in certain basic respects. In the large area not covered by such rules, the Commission's principal reliance for the protection of investors is on the determination and application of accounting principles and auditing standards which are recognized as sound and which have attained general acceptance.

Since 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, accounting and auditing procedures cannot remain static and continue to serve well a dynamic economy. It is necessary for the Commission to be informed of the changes and new developments in these fields and to make certain that the effects thereof are properly reported to investors. The Commission's accounting staff, therefore, engages in studies of 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 constant contact and cooperation 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, 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 regularly appoint committees which maintain liaison with the Commission's staff.

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. This day-to-day activity of the Commission and the need to keep abreast of current accounting problems cause the chief accountant's staff to spend much time in the examination and re-examination of sound and generally accepted accounting and auditing principles and practices. From time to time members of this 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.

Inquiries in ever-increasing volume as to the propriety of particular accounting practices come from accountants and from companies not presently subject to any of the acts administered by the Commission who wish to have the benefit of the Commission's views and thus utilize and apply the Commission's experience to the facts of their own case. Teachers of accounting and their students also use the public files and confer with the staff in the study of accounting problems.

Shortly before the opening of the year under report the Commission amended rule 2-01 of regulation S-X relating to the independence of accountants certifying financial statements filed with the Commission for the purpose of giving formal recognition to administrative practices which have been in the process of development for some time. The revision makes no material change in the policy set forth in prior decisions of the Commission and in published opinions of the Chief Accountant.

In the revision of this rule the Commission has recognized the impact of mergers and the growth of corporations through widespread affiliations. The emphasis in the rule has been changed to make it clear that where relationships described in the rule exist the Commission will find that an accountant is in fact not independent with respect to the company involved, but in those instances where lack of independence is not established the Commission will make no finding with respect to the accountant's independence.

A few months after the revision of rule 2-01 of regulation S-X mentioned above, the Commission announced the publication of an additional release in its Accounting Series dealing with independence of accountants. In connection with the revision of rule 2-01 practicing accountants had indicated that an interpretative release similar to Accounting Series Release No. 47 would be a helpful guide to the profession. This new release, which summarizes previously unpublished rulings on independence in the Commission's experience under rule 2-01 since the publication of Accounting Series Release No. 47 on January 25,1944, together with prior releases and Commission decisions reflects the development of policy regarding the practice of accountants before the Commission over a period of some 25 years.

In Accounting Series Release No. 47 it was stated that it was not feasible to present adequately in summarized form the circumstances existing in particular cases in which it was determined not to question an accountant's independence. The growth of the accounting profession since 1944 and the number of inquiries received from public accountants unfamiliar with the rules suggested the need for publication of rulings in this category. In view of this development it was determined to review the administrative rulings in this area and to state briefly in the new release the relationships which existed in select cases where an accountant was not denied the right to certify the financial statements because under the circumstances it was concluded that the independence of the accountant was not prejudiced.

During the fiscal year the Commission issued its Findings, Opinion and Order in a proceeding instituted under rule 11(e) of its rules of practice against Bollt and Shapiro, Theodore Bollt and Bernard L. Shapiro. The Commission found that the respondents had failed to comply with rules and regulations of the Commission and with generally accepted accounting standards, and had engaged in improper and unethical professional conduct. Specifically, the Commission found that where a partner of an accountant certifying the financial statement in a registration statement pursuant to the Securities Act of 1933 is the principal officer and controlling stockholder of the registrant, the certifying accountant is not independent with respect to the registrant. The Commission concluded that where the partner in the firm of certified public accountants who was the principal officer and controlling stockholder of the company which filed a registration statement with the Commission caused the other partner to certify registrant's financial statements as an independent public accountant knowing that the certifying partner was not qualified to furnish an independent certification and sought to conceal the partnership relationship, the privilege of practicing before the Commission should be denied to the firm and the partner controlling the registrant until they obtain the prior approval of the Commission to practice before it in the future. The Commission further concluded that the privilege of practicing before the Commission, of the certifying accountant should be suspended for 30 days.

During the year the conflicting views of public utilities, public accountants, and regulatory agencies with respect to accounting for deferred taxes reached a stage requiring formal public review by the Commission. The matter arose because the effect of section 167 (liberalized depreciation) and section 168 (accelerated amortization) of the Internal Revenue Code of 1954 is to permit the tax-free recovery from operations of capital invested in a plant at a faster rate than would be possible by depreciation methods previously permitted for income tax purposes and because there is a lack of uniformity in the related accounting regulations issued by the several state utility commissions. [Footnote: That this was the Intent of these sections of the Code Is disclosed by the Report of the House Committee on Ways and Means and Report of the Senate Committee on Finance. See H. Rep. No. 1337 (83d Cong., 2d Sess.), p. 24, and Sen. Rep. No. 1622 (83d Cong., 2d Sess.), p. 26.] A tax deferral is recorded when liberalized and accelerated methods of depreciation and amortization are adopted for tax purposes and straight line methods are followed on the books. Most public utility companies have classified the resulting accumulated balance sheet credits to reserves or deferred credits or other nonequity accounts. Others have classified the accumulated amounts as a part of restricted earned surplus in the equity capital section of the balance sheets, while a few others, although identifying them as restricted earned surplus, have not included them in the equity section of the balance sheet. Still other utility companies have riot employed deferred tax accounting but have followed what has been called the "flow-through" method and have shown in the income statement normal depreciation charges and the actual current income tax provision without provision for future income taxes.

In September 1958 a public utility subsidiary of a registered holding company filed with the Commission a registration statement under the Securities Act of 1933 and a declaration under the Public Utility Holding Company Act of 1935 with respect to the proposed issue and sale of first mortgage bonds at competitive bidding. In the financial statements submitted by the registrant company, which are also subject to the accounting jurisdiction of the Federal Power Commission, the balance sheet carried the accumulated credits arising from the use of deferred tax accounting in respect of both liberalized depreciation and accelerated amortization as restricted earned surplus and stated them as a part of the equity capital of the company. [Footnote: Federal Power Commission Orders No. 203 and No. 204 do not make mandatory the use of deferred tax accounting for financial accounting purposes by those companies which elect to deduct liberalized depreciation or accelerated amortization in their Income tax returns. Rather they provide that where the company does employ deferred tax accounting, the balance sheet credit shall be classified In a new account (Account No. 266) entitled "Accumulated Deferred Taxes on Income."] The Commission's staff questioned the classification in light of Order No. 204 of the Federal Power Commission. It should be noted that an order of a state regulatory commission to which this company is subject as to a minor portion of its utility operations authorized a restricted earned surplus classification. The state commission having jurisdiction over the company's major distributing facilities had recently issued an order directing the company to transfer the accumulated credits from restricted earned surplus to a reserve account. The company initiated an appeal from this order. [Footnote: Later, on September 8, 1959, the State commission issued a supplemental order amending its earlier order to permit each utility subject to its jurisdiction to elect to follow-either the reserve or the restricted retained income treatment for accumulated deferred taxes.]

Rule 28 promulgated by this Commission under the 1935 Act prohibits a registered holding company or a subsidiary thereof from distributing to its security holders, or publishing, financial statements which are inconsistent with the book accounts of such company or with financial statements filed by it with the Commission. One of the considerations raised by the staff of the Commission in the above described case was whether the applicability of Order No. 204 of the Federal Power Commission to the registrant rendered the publishing of any financial statements inconsistent therewith violative of the provisions of rule 28.

In view of the controversial nature of the subject matter and its importance to many registrants, the Commission permitted the registration statement to become effective and the securities to be sold on the basis of full disclosure in footnotes to the financial statements of the different positions taken by the several regulatory agencies concerned with this company's affairs.

As a result of this case, the substantial amounts involved in the industry, and in consideration of differences of opinion as to the proper interpretation of Accounting Research Bulletin No. 44 (Revised), the Commission issued on December 30, 1958, a "Notice of Intention to Announce Interpretation of Administrative Policy." [Footnote: Federal Power Commission statistics indicate that as of Dec. 31, 1957, the aggregate amount of accumulated balance sheet credits attributable to both liberalized depreciation and accelerated amortization in respect of electric utility companies and natural gas and pipe line companies is $792,755,000.] [Footnote: The import of this bulletin, issued in July 1958 by the Committee on Accounting Procedure of the American Institute of Certified Public Accountants, has since been clarified by a statement of that Committee that: "A provision in recognition of the deferral of income taxes, being required for the proper determination of net income, should not at the same time result in a credit to earned surplus or to any other account included in the stockholder's equity section of the balance sheet".]

The notice proposed that any financial statement which designates as earned surplus or its equivalent or includes as a part of equity capital (even though accompanied by words of limitation such as "restricted" or "appropriated") the accumulated credit arising from deferred tax accounting in respect of liberalized depreciation or accelerated amortization would be presumed by the Commission "to be misleading or inaccurate despite disclosures contained in the certificate of the accountant or in footnotes to the statements provided the matters involved are material."

Many comments were received in response to the Commission's invitation for views and comments. These views have been analyzed and summarized. Public hearings on the proposed policy statement were held before the full Commission on April 8 and 10, 1959, and the Commission has the matter under advisement.

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT AND INTER-AMERICAN DEVELOPMENT BANK

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. The Commission has, pursuant to the above authority, 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.

By virtue of Public Law 86-147, approved August 7, 1959, which authorizes United States participation in the new Inter-American Development Bank, a similar exemption has been provided for certain securities which may be issued by the new bank. The Commission is considering appropriate rules and regulations with respect to the new bank of the character presently in effect with respect to the International Bank.

The International Bank for Reconstruction and Development sold in the United States during the fiscal year only one issue of its primary obligations, in the amount of $100 million, of which $4,300,000 was for delayed delivery. At the end of the fiscal year the total funded debt of the bank was approximately the equivalent of $1.9 billion, of which $1.6 billion was payable in United States dollars. At the same time the subscribed capital stock of the Bank aggregated $9.6 billion of which $7.6 billion constituted the uncalled portion of the subscriptions.

Bank lending during the 12 months ended on June 30, 1959, continued at the high level reached in the previous fiscal year aggregating the equivalent of approximately $703 million. As indicated in the bank's 14th Annual Report, because of the implications of the new level of bank lending in recent years, the governor of the bank for the United States proposed during the fiscal year consideration of an increase in the capital of the bank. This resulted in a proposal by the executive directors of the bank that member countries should be invited to double their capital subscriptions. The executive directors also agreed to recommend additional increases over and above the general 100 percent increase in the subscription of 17 member countries. It was proposed that the authorized capital of the bank be increased from $10 billion to $21 billion. The proposal envisaged that the entire amount of the additional general subscription would be left subject to call and that the board of governors of the bank should decide that calls would only be made if required by the bank to meet its obligations on borrowings or guarantees.

These proposals were adopted and, at the end of the fiscal year, legislation necessary to carry the increased subscriptions into effect was being enacted in many member countries. As of September 10,1959, the proposal to increase the capital of the bank became effective when 34 countries had increased the subscribed capital by $7,664.7 million. At that date total subscribed capital was $17,221.2 million.

OPINIONS OF THE COMMISSION

Opinions are issued by the Commission 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 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 of this office 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 participates in the drafting of opinions.

Opinions 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 1959, the Commission issued 143 opinions and other rulings of an adjudicatory nature.

STATISTICS AND SPECIAL STUDIES

At its inception the Commission organized a large Research Division to assist in the drafting of rules and regulations to carry out the provisions of the Securities Act and the Securities Exchange Act. The division was staffed with a large number of experts from various phases of the securities business, economists, and statisticians. Many of the Commission's policies and rules, as well as further securities legislation, were based on special studies prepared by the research staff. By 1940 most of the initial research work required by the Commission for the formulation of rules and regulations had been completed, and the Research Division was dissolved and certain of its activities and general statistical work was transferred to the Division of Trading and Exchanges.

While subsequent research and statistical work was of a more routine nature and was chiefly carried out for internal purposes, the Commission began to provide more information of a broader economic character as related to the capital markets. During this period the Commission began publication of its series on individuals' saving, corporate liquid position, plant and equipment expenditures and quarterly financial report for manufacturing corporations. Several of these series are joint undertakings with other Government agencies. As public interest grew in the various data prepared and collected by the SEC, more of the statistical material was released and the publication of a monthly statistical bulletin was begun.

In recent years, the statistical activities have been coordinated with the overall Government statistical program under the direction of the Bureau of the Budget. As the need arises, new surveys are made. One of the most significant in the last few years is the Commission's survey of corporate pension funds. All of the series published by the Commission are studied continuously in order to expand and improve them in answer to demands of Government agencies, business and the general public.

The regular statistical series which are prepared include data on securities effectively registered under the Securities Act of 1933, offerings of securities by all corporations in the United States (including issues not registered with the Commission, such as privately placed issues and railroad securities), retirements of corporate securities, net change in corporate securities outstanding, stock prices and trading. In addition, the research and statistical activity carried out under the direction of the Bureau of the Budget includes individuals' saving in the United States, income flow and investments of private pension funds of United States corporations, current liquid position of United States corporations, sources and uses of corporate funds, anticipated expenditures for plant and equipment by United States businesses, and a quarterly financial report for all United States manufacturing concerns.

The statistical series described below are published in the Commission's statistical bulletin and in addition, except for data on registered issues, current figures and analyses of the data are published in quarterly press releases. The Commission's stock price index is released weekly, together with the data on round-lot and odd-lot trading on the two New York stock exchanges.

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.

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.

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.

Stock Market Data

Statistics are regularly compiled on the market value and volume of sales on registered and exempted securities exchanges, round-lot stock transactions of the New York exchanges for accounts of members and nonmembers, odd-lot stock transactions on the New York exchanges, special offerings and secondary distributions. Indexes of stock market prices are compiled, based upon the weekly closing market prices of 265 common stocks listed on the New York Stock Exchange. The indexes are composed of 7 major industry groups, 29 subordinated groups, and a composite group.

Individuals' Saving

The Commission compiles quarterly estimates of the volume and composition of individuals' saving in the United States. The series represent 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 Commerce Department 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 United States 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 United States 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 United States 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.

PUBLIC DISSEMINATION OF INFORMATION

Public disclosure and dissemination of information with respect to securities offered for public sale and those traded on exchanges is essential if public investors generally are to benefit by the disclosure requirements of the Federal securities laws and if an evaluation of the worth of securities is to be made by a broad segment of the investing public. This is accomplished in part by distribution of the prospectus of offering circular on new offerings, and by filing of annual and other periodic reports with exchanges and the Commission by listed companies. Much data filed with the Commission obtains widespread currency through published securities manuals, investment advisory services, statistical services and otherwise.

To facilitate public dissemination of the financial and other proposals filed with and actions taken by the Commission, a daily News Digest is issued which contains a resume of these findings and actions. This digest is distributed initially to the press, and is distributed on a semiweekly basis to a mailing list comprising nearly 7,000 names. The daily digest, for example, contained a summary of the pertinent facts with respect to the proposals for public offering of securities contained in the 1,226 registration statements filed during the past fiscal year. During the year, also, the daily digests contained an informative discussion of each of the 888 orders, decisions and rules issued by the Commission. Much of the information is published in the daily newspapers and in financial and other periodicals. Other releases of an informational nature issued by the

Commission include its various Statistical Series releases and announcements of actions, civil and criminal, which arise out of the enforcement of the laws.

Members of the Commission and its staff also deliver addresses from time to time before professional and other groups, and participate in radio or television discussions, to explain the nature and scope of the Commission's functions and activities.

Information Available for Public Inspection

During every fiscal year thousands of requests for information are received by mail and through telephone calls and personal visits. Most of these requests are answered by employees in the Commission's public reference rooms in Washington, Chicago, and New York City.

The files of the Commission provide information of interest to a large cross section of the public. Numerous people visit the public reference rooms seeking information on which to base decisions to buy or sell securities; they are furnished the files which contain financial and other information about the issuers of the securities. Many other visitors consult Commission records. They may be representatives of legal and accounting firms, corporations and labor unions; they are interested largely in gathering information to be used as specimens, as precedent material, or for other specialized purposes. The inquiries received through the mails and over the telephone follow the same pattern.

Copies of any public information filed with the Commission may be examined at the principal office in Washington, D.C. Such information includes registration statements, applications and declarations filed under the various statutes administered by the Commission, together with the records of agency action. In Washington, as in the regional offices, space considerations have necessitated the transfer of some of this material to warehouse-type space in nearby federal records centers. Files from these centers are usually available within 24 hours.

The New York Regional Office has copies of recent filings made by companies having securities listed on exchanges other than the New York Stock Exchange and the American Stock Exchange, and copies of current filings of many companies which have effective registration statements under the Securities Act of 1933. The Chicago Regional Office has copies of recent reports of companies which have securities listed on the New York and American stock exchanges. Reports of listed companies on the New York, American and Midwest stock exchanges may be seen at the exchange offices.

All regional offices have copies of prospectuses used in recent public offerings of securities registered under the Securities Act, of active broker-dealer and investment adviser registration applications originating in their respective regions and of regulation A letters of notification filed in their respective regions.

The public reference room in Washington had 4,800 visitors during the fiscal year. Requests were filled for an additional 30,513 persons who were sent 630,869 copies of Commission publications. During the fiscal year 128,149 photocopy pages were sold pursuant to 2,021 orders. Additional thousands of persons made use of the facilities provided by the New York and Chicago public reference rooms.

PUBLICATIONS

Publications currently being issued include:

Monthly:

Statistical Bulletin.

Official Summary of Security Transactions and Holdings of Officers, Directors, and Principal Stockholders.

Quarterly:

Financial Reports, 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.

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 and examiners, accountants, engineers and administrative and clerical employees. An organization chart of the Commission is set forth on the following page.

Under the Commission's program of continuing review of its functions and organization, several changes were made in the Division of Corporate Regulation. In March 1959, the position of Chief Financial Analyst was established, and a Branch of Reorganization was created in the Office of the Chief Counsel of the Division.

[chart omitted]

PERSONNEL, BUDGET AND FINANCE

The following comparative table shows the personnel strength of the Commission as of June 30, 1958 and 1959:

[table omitted]

The table on the opposite page shows the status of the Commission's budget estimates for the fiscal years 1950 to 1960, from the initial submission to the Bureau of the Budget to final enactment of the annual appropriation.

The Commission is required by law to collect fees for 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 appropriations, total fees collected, percentage of fees collected to total appropriation, and the net cost to the taxpayers of Commission operations for the fiscal years 1957,1958, and 1959:

[table omitted]

A chart showing the ratio of average employment in the field offices to total average employment for fiscal years 1951-59 follows.

[chart omitted]

Personnel Program

In fiscal 1959, the Commission continued to emphasize the recruiting of outstanding college and law school students with the specialized academic training required for the Commission's fields of work. By maintaining close contact with placement offices of various colleges and universities, and through on-campus interviews, the Commission placed a substantial number of applicants of college caliber for its starting professional level positions.

In January 1959, the Commission adopted four Merit Promotion Plans covering the following groups of employees:

1. Professional and technical employees in the Headquarters Office.

2. Secretarial, wage board and clerical employees in the Headquarters Office.

3. Professional and technical employees in the regional offices.

4. Clerical employees in the regional offices.

The purpose of these plans is to apply the Commission's promotion policy systematically and otherwise to comply with Civil Service Commission requirements in that area. Members of the staff were consulted and afforded opportunity for review and comment prior to formal adoption. In April 1959, representatives of the Civil Service Commission inspected the Commission's operation under the plans and found them to be effective and in compliance with its Government-wide Merit Promotion Program.

As required by the Government Employees Training Act of 1958, a review was made of the Commission's overall training needs and plans were formulated to meet these needs. On a cooperative basis with other regulatory agencies, arrangements were made for a supervisory training course for middle and top management officials. In addition, the Commission's Division of Corporation Finance and New York Regional Office continued to conduct training sessions for their professional staffs.

Under its Incentive Awards Plan the Commission recognized the long service of its career employees by presenting 10- and 20-year service pins and certificates for service with the Commission to a total of 90 employees. In addition, cash awards totaling $6,325 and certificates of merit were presented to 55 employees.

The outstanding achievements of members of the Commission's staff continued to receive public recognition in the form of awards made by other organizations. In February 1959 Thomas G. Meeker, General Counsel of the Commission, received an Arthur S. Flemming Award of the Junior Chamber of Commerce of Washington, D.C., as 1 of the

10 outstanding young men in the Federal service. In March 1959, the National Civil Service League awarded certificates of merit to 5 Commission employees -- William Green, Atlanta Regional Administrator; Vito Natrella, Chief Economist, Division of Trading and Exchanges; J. Arnold Pines, Chief Financial Analyst, Division of Corporate Regulation; Harry Pollack, Director of Personnel; and Byron D. Woodside, Director, Division of Corporation Finance. In April 1959, a Rockefeller Public Service Award, 1 of 11 such awards made throughout the Federal service, was granted to Harry Heller, Assistant Director, Division of Corporation Finance. In May 1959, an attorney in the Chicago Regional Office, Sidney Sosin, was awarded a Certificate and Citation of Merit by the William A. Jump Memorial Foundation. The Commission is justifiably proud of these distinctions earned by members of its staff whose loyal and efficient service has made such a significant contribution to accomplishing the statutory objectives for which the Commission was established.