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SEC ADOPTS TWO RULES GOVERNING PLEDGING OF CUSTOMERS' SECURITIES

Regulations Are Designed to Furnish Added Protection Against Losses From Brokerage Failures

Effective on February 17, 1941

The Securities and Exchange Commission recently adopted two rules under the Securities Exchange Act of 1934 "carrying out the statutory principles governing the pledging of customers' securities as collateral" by members of national securities exchanges and other brokers and dealers.

"The new rules are designed to furnish added protection to customers against losses which may result from brokerage failures," according to the SEC. "It has not previously been illegal under the usual kind of 'customer's agreement' for a broker or dealer to commingle customers' securities with his own as collateral for loans used by

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SEC BROADENS EXEMPTIONS GRANTED SMALL ISSUES

The Securities and Exchange Commission recently announced a revision of its rules broadening the exemptions granted securities issues up to $100,000 under the Securities Act of 1933.

The change represented a substantial revision of the Commission procedure and rules in connection with the granting of exemptions and embraced the repealing of its present rules 200 to 210 inclusive and substituting a single simplified regulation containing a single integrated exemption which "in many respects substantially broadens the availability of the exemption."

Former Exemption $30,000

"Section 3 (b) of the Securities Act gives the Commission the power, under such rules and regulations as it may deem necessary in the public interest and for the protection of investors, to

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Manipulation Charged

COUNTER FIRMS 'INFLUENCED' MARKET FOR UNLISTED SECURITY, SEC SAYS

Hearing Ordered To Determine If Price of Stock Was Purposely Raised To Induce Purchases

In what is believed to be the first action taken by the SEC against over-the-counter firms for manipulation in connection with unlisted securities, the Commission recently ordered a hearing to determine whether Barrett & Company, Providence, Bond & Goodwin, Incorporated, Boston, and Satterfield & Lohrke, New York, all members of the Association, had "purposely influenced" the counter market for American Wringer Company, Inc., $10 par common stock "raising the price thereof for the purpose of inducing the purchase of said stock by others."

The hearing was originally set for December 16, 1940 in Boston, but was subsequently postponed to January 6, 1941. The Commission proposes through the hearing to determine "whether pursuant to Section 15A(1)(2) of the Securities Exchange Act of 1934 it is necessary or appropriate in the public interest or for the protection of investors to carry out the purposes of Section 15A of the Securities Exchange Act of 1934 to suspend for a period not exceeding 12 months or to expel from the National Association of Securities Dealers, Inc., a registered securities association," the three companies. Provisions of the Maloney Act, under which the Association was set up, pro-

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COMMITTEE RECOMMENDS PENALTIES IN PSI CASE

Urges Fines of $10 - $20 a Bond Up to $200 - $500 for Selling Group and Underwriters, Respectively

Fines of $10 a bond, not to exceed a total of $200, for selling group members and $20 a bond, not to exceed $500, for underwriters were recommended recently by the Executive Committee of the Association to District Business Conduct Committees as appropriate penalties for violations of the Association's rules in connection with the $48,000,000 offering of Public Service Company of Indiana securities.

A total of 84 complaints were filed against underwriters and selling group members charging violation of the Association's rules in failing to live up to the selling agreement. Some 14 of these complaints were subsequently dismissed after investigation or hearing by the Business Conduct Committee in the District in which the member's business is located. These dismissals do not necessarily mean that these complaints are closed as the national Business Conduct Committee, if it sees fit, may call them up for review.

Each Case Considered

The recommendations of the Executive Committee were made after a care-

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LANE OPINION DISCUSSES TERM 'INVESTMENT COUNSEL'

The SEC recently made public an opinion by Chester T. Lane, its General Counsel, on the use of the term "investment counsel" by persons who are registered under the Investment Advisers Act of 1940 and who are also registered or licensed under certain state laws as "investment counsel". The text of the opinion follows:

"You have raised the question of a possible conflict between the provisions of Section 208 (c) of the Investment Advisers Act of 1940 and the provisions of certain State laws regulating investment advisers. These State laws require, in one form or another, that a person giving advice with reference to security investments obtain a license to act as an 'investment coun-

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"PROTECTING YOUR DOLLARS"

Mr. Gesell, in his book, gives a brief history of the Securities and Exchange Commission from the hearings that led to the passage of the various securities acts, through the various stages of development of the SEC, to the present day. He has presented this material in an interesting and easily readable style. Mr. Gesell reveals how various frauds, manipulations, jiggles, swindles, etc., were operated, and how they were detected and brought to a halt by the Commission, through case histories which hold the attention.

He briefly reviews operations under the Securities Act of 1933, the Securities Exchange Act of 1934, the Public Utility Holding Company Act of 1935, the National Bankruptcy Act (Chapter X) of 1938, The Trust Indenture Act of 1939, the Investment Company Act of 1940 and the Investment Advisers Act of 1940. In reviewing these operations, Mr. Gesell gives the reasons behind certain requirements and actions of the Commission in connection therewith. For the viewpoint of the SEC on all aspects of the securities business and the other acts the Commission administers, as seen through the eyes of one of its staff, this book is required reading.

"Protecting Your Dollars" by Gerhard Alden Gesell, National Home Library Foundation, Washington, D. C., 50 Cents per Copy.

HYPOTHECATION

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the firm in its business as a dealer or trader for its own account. Likewise, it has not been illegal under such 'customer's agreements' for brokers and dealers to borrow more on their customers' securities than was owed them by the customers. Where the broker or dealer failed under such circumstances, the risk of loss to customers was substantially increased."

To this end, the rules, in effect, prohibit brokers and dealers from risking the securities of their customers as collateral to finance their own trading, speculating or underwriting ventures, according to the SEC.

Three Principles Laid Down

Subject to certain exemptions, the Commission explained, the rules put into operation three simple principles laid down in the three clauses of Section 8 (c) of the Act. The first is that brokers or dealers must not commingle the securities of different customers as collateral for a loan without the consent of each customer. Second, a broker or dealer must not commingle his customers' securities with his own under the same pledge. Finally, a broker or dealer must not pledge customers' securities for more than his customers owe him.

The rules were the subject of several months of discussion between the Commission's staff and the National Association of Securities Dealers, the national securities exchanges, certain banks making substantial brokers' loans and other representatives of the financial community. The SEC declared that many of the provisions of the rules are based upon suggestions made by these sources.

Effective February 17, 1941

"Because of the complexity of the credit mechanisms which these rules affect and because of the possibility that operation under the rules may entail some readjustment in the business methods of members, brokers and dealers, they will not become effective until February 17, 1941," the SEC stated. "The Commission suggests that brokers and dealers who will be subject to the new rules may find it desirable to conduct their businesses in accordance with these rules for some period prior to their effective date of February 17, 1941, in order that their operation may be studied and such readjustments made as may appear necessary before they become effective."

The two rules, designated as Rule X-8C-1 and Rule X-15C2-1, will provide uniformity of regulation with respect to all branches of the securities business regardless of whether those subject to the rules are exchange members, brokers or dealers doing a business through the medium of a member, or over-the-counter brokers or dealers who do not transact business through the medium of an exchange member, according to the SEC. Compliance with Rule X-8C-1 will thus automatically constitute compliance with Rule X-15C2-1, and vice versa.

Effect on Present Practices

It is important to note the effect of paragraphs (a) (2) and (a) (3) of the rules upon the present practices of banks and other lenders in making and handling brokers' loans, the Commission stated. Under the present type of loan agreement customarily used between a broker and a bank or other lender, the lender, of course, holds specific liens against the particular securities earmarked for each loan. In addition, the lender at present usually holds a general lien for the total amount of all brokers' loans, some of which may represent borrowings on the broker's own securities to finance his own trading activities. This general lien runs against all of the securities deposited as collateral, even though customers' securities are included among them.

"As may be seen," the SEC said, "the danger in this practice of pledging all securities, including customers' securities, under a single lien is that if the firm gets into financial difficulties, the customers' securities are in danger of facing the same loss as the firm's securities. Therefore, paragraph (a) (2) prohibits pledging customers' securities under such a general lien if the broker's or dealer's securities are also pledged under the same lien to obtain or increase the loan or as substituted collateral for customers' securities. Furthermore, the existence of such a general lien would result in a violation of paragraph (a) (3) of the rules if customers' securities are pledged thereunder for a sum greater than the total indebtedness of customers to the broker.

To Revise Loan Agreements

"Accordingly," the Commission continued, "to avoid these violations it will be necessary for members, brokers or dealers to revise their agreements with banks and other lenders such as other brokers or dealers, who may obtain liens on customers' securities so that such lenders will not have liens involving violations of the rules. The Commission understands that a substantial time before the rules become effective, banks which customarily do a loan business with brokers and dealers will have made appropriate revisions in their loan agreements designed to permit brokers and dealers to meet the requirements of the rules."

Most of the exemptions which are embodied in the rules were necessitated by the difficulties which might be created by a strict, minute-to-minute application of the three basic principles of the rules to certain types of day-to-day financing of customers' transactions, according to the SEC.

REVIEW REFUSED OF CASE HOLDING SELLER'S AGENT TO BE LIABLE FOR FRAUD

Supreme Court Upholds View Broker Is Chargeable for Mis-statements as Well As Owner of Securities

SEC Reports on Findings

EDITOR'S NOTE: *The Supreme Court recently refused to review this circuit court decision holding that brokers are liable under the Securities Act of 1933 for misrepresentations in selling securities owned by other parties. (Cady v. Murphy, No. 526.) The following is the SEC discussion of the Circuit Court decision.*

The Securities and Exchange Commission recently reported that the United States Circuit Court of Appeals for the First Circuit had rendered an opinion under Section 12 (2) of the Securities Act of 1933 holding that a broker acting as agent for the seller of securities was liable to the purchaser for misrepresentations made in the sale.

Clifford J. Murphy, a securities broker and dealer doing business in Portland, Maine, brought suit in the United States District Court for the District of Maine against Everett Ware Cady and other partners in a firm of stockbrokers carrying on a general brokerage business in New York and Boston under the name of Rhoades & Company. The complaint charged that an employee of the defendants had misrepresented material facts to the plaintiff in connection with a sale to the plaintiff of voting trust certificates for South American Utilities Corporation common stock, securities which it was alleged had no substantial value.

Appeal Taken

On appeal, the defendants contended that the District Court erred in ruling that Section 12 (2) imposed liability for misrepresentation upon them since they acted only as agents and were not themselves the "seller". The Circuit Court of Appeals rejected this contention. Judge Magruder, speaking for himself and Judge Mahoney, stated in his opinion:

> "We agree with the court below that § 12 (2) imposes a liability for misrepresentations not only upon principals, but also upon brokers when selling securities owned by other persons. This is not a strained interpretation of the statute, for a selling agent in common parlance would describe himself as a 'person who sells', though title passes from his principal, not from him. This broader interpretation of § 12 (2) is warranted by the definition of 'sell' in § 2 (3) and is also supported by comparison with other sections of the statute. If the security in question had been a security required by law to be registered, but as to which no registration statement was in effect, Rhoades & Company under the facts of the present case would certainly have been guilty of selling a security in violation of § 5 (a) (1), and would not have come within the exemption provided in § 4 (2). As a person who 'sells a security in violation of section 5', Rhoades & Company would have been under a civil liability to Murphy under § 12 (1). But the phrase 'any person who sells a security' occurs both in § 12 (1) and in § 12 (2), and would seem to mean the same thing in both subsections, one of which deals with selling an unregistered security and the other of which deals with selling a security by means of misrepresentation of material facts."

The majority opinion of the Circuit Court left open the question of whether or not section 12 (2) of the Securities Act of 1933 imposes liability upon one

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SMALL ISSUES

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exempt from the registration requirements of the Act security issues up to and including $100,000," the SEC said: "Heretofore the Commission has given total exemption on issues up to $30,000. As to other issues not in excess of $100,000, an exemption, up to now, has been available only upon varying terms and conditions, such as the compliance with the laws of the states in which the securities were sold, or the use of a prospectus containing certain specified information. Where prospectuses have heretofore been required, they have been examined in the Registration Division of the Commission.

"The new simplified procedure does not require the use of a prospectus in any case," the Commission continued. "To avail itself of the exemption, a domestic issuer will now need only to send the nearest Regional Office a letter notifying that Office of its intention to sell, together with any selling literature it may plan to use. This letter of notification need contain only such information as the name of the company, the name of the underwriters, the name of the issue to be sold and a brief summary of the intended use of the proceeds. The issuer can give this notice, as its option, either through an informal letter or through the use of a two-page form which will be supplied on request for its convenience. Where the issuer chooses to use a prospectus, the regulation indicates certain skeleton information to be included."

Exemption Broadened

A broadened exemption is available in several important respects under the new regulation, according to the SEC. For example, the Commission takes a new position as to future sales of the securities of the same issuer. Heretofore the Commission's rules have been such that, if the offering was a part of a larger financial program, involving the future sale of additional securities of the same class, the exemption was not available. The new regulation specifically states that the exemption is available even if "it is contemplated that after the termination of the offering an offering of additional securities will be made." This will apply in instances, among others, where issuers wish to make annual offerings of already outstanding securities for such purposes as employees' participation plans. In such instances, where the offering is not over $100,000, the exemption will be available.

The Commission explained that the exemption is now also available to issuers and their controlling stockholders even though each may wish to offer $100,000 under Regulation A within a single year. Heretofore, in such instances, a registration statement was necessary.

Administrative Emphasis Shifted

"The new regulation shifts the Commission's administrative emphasis from the disclosure requirements of the Act to the fraud prevention provisions," the SEC stated. "The examination procedure which has been followed in the past will be abandoned. The use of a prospectus is no longer required, although any selling literature which is employed must be forwarded to the appropriate Regional Office for its information. The new regulation will be administered from the Regional Offices under the usual supervision from Washington.

"It is hoped that the shifting of this activity to the Regional Offices will further simplify the problem of compliance with the Act by smaller issuers."

The new regulation became effective December 9, 1940.

MANIPULATION

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vide that the SEC may take such action.

Registration Never Effective

The order for hearing noted that American Wringer Company had only one class of authorized capital stock, to wit, 135,000 shares of $10 par common, of which over 100,000 had been issued and were outstanding. On January 8, 1940, the company filed a registration statement with the Commission covering 32,915 shares of stock to be offered at $12.50 per share, with the three member firms acting as underwriters; of the total registered, 23,715 shares represented stock authorized but presently unissued, 4,200 shares were outstanding and owned by Henry Salomon a director of the Company, and 5,000 shares were outstanding and owned by Barrett & Company. The registration statement never became effective and on February 12, 1940, the company requested permission to withdraw the statement, to which the Commission by order consented on February 14, 1940.

The Commission stated that members of its staff had reported, as a result of an investigation of the activities of the member firms, that evidence had been obtained tending to show that:

Distribution Plan

"(a) In August, 1939, W. Stanley Barrett, senior partner of Barrett & Company, and one William W. Nolan, who describes himself as an industrial and financial counsel, formulated a plan for the distribution of American Wringer stock at prices higher than the then market price of $5 per share; and

"(b) From early in August, 1939, until about the middle of December, 1939, Barrett & Company purposely influenced the over-the-counter market and effected a series of transactions in said stock, raising the price thereof, for the purpose of inducing the purchase of said stock by others; and

Option on Shares Secured

"(c) Early in November, 1939, Barrett secured an option from American Wringer Company, Inc., on certain shares of its unissued stock at $10 per share and said company agreed to register said shares under the securities Act of 1933 for distribution to the public by Barrett & Company, as underwriter, at an initial offering price of $12.50 per share; and

"(d) Later in November, 1939, Nolan induced Satterfield & Lohrke to join in said proposed distribution and to participate in activities for the purpose of influencing the over-the-counter market for said stock and raising the price thereof to induce the purchase of said stock by others; and

Market Influenced

"(e) During the latter half of December, 1939, Barrett & Company and Satterfield & Lohrke purposely influenced the over-the-counter market and effected a series of transactions in said stock, raising the price thereof, for the purpose of inducing the purchase of said stock by others; and

"(f) On or about January 2, 1940, Bond & Goodwin, Inc., agreed to join in said proposed distribution of and to participate in activities for the purpose of influencing the over-the-counter market for said stock and raising the price thereof to induce the purchase of said stock by others; and

Price of Stock Raised

"(g) From on or about January 2, 1940, until on or about January 26, 1940, Barrett & Company, Satterfield & Lohrke, and Bond & Goodwin, Inc., purposely influenced the over-the-counter market and effected a series of transactions in said stock, raising the price thereof, for the purpose of inducing the purchase of said stock by others; and

"(h) On January 8, 1940, American Wringer Company, Inc., filed a registration statement under the Securities Act of 1933 covering certain shares of its stock to be distributed to the public by Barrett & Company, Satterfield & Lohrke, and Bond & Goodwin, Inc., as underwriters, at an initial offering price of $12.50 per share. Said registration statement and the proposed prospectus submitted therewith stated that the stock had been generally traded by the public at prices varying from $4 per share in May, 1939, to $10.50 on January 3, 1940, but omitted to state that said proposed underwriters had purposely influenced the over-the-counter market for said stock and raised the price thereof. Said registration statement did not become effective but was withdrawn after Barrett had been advised that it would be necessary to amend the statement and the proposed prospectus to disclose clearly the trading activities of said proposed underwriters; and

Stock Purchase Induced

"(i) While engaged in the Acts and practices hereinbefore described, Barrett & Company, Satterfield & Lohrke, and Bond & Goodwin, Inc., induced others to purchase shares of American Wringer stock from them and effected said transactions by means of statements regarding the over-the-counter market prices for said stock but omitted to state that the prices at which said transactions were effected were based upon prices quoted in an over-the-counter market which they had purposely influenced, which fact was material and necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading and Barrett & Company, Satterfield & Lohrke, and Bond & Goodwin, Inc., knew or had reasonable grounds to believe that the omission to state said material fact was misleading; and

"(j) The acts and practices hereinbefore described operated as a fraud and deceit upon persons who purchased said stock during the periods hereinbefore mentioned and would have operated as a fraud and deceit upon persons who might have purchased said stock during the proposed distribution; and

"(k) Made use of the mails and of means and instrumentalities of interstate commerce to influence purposely the over-the-counter market for said stock and to effect transactions in said stock, raising the price thereof, for the purpose of inducing the purchase of said stock by others; and

Manipulation Alleged

"(l) Barrett & Company, Satterfield & Lohrke, and Bond & Goodwin, Inc., as more particularly set forth above, violated Section 15(c)(1) of the Securities Exchange Act of 1934 in that they made use of the mails and of means and instrumentalities of interstate commerce to effect transactions in and to induce the purchase of said stock otherwise than on a national securities exchange by means of manipulative, deceptive and other fraudulent devices and contrivances, as defined by Rules-15C1-2(a) and (b) of the Rules and Regulations promulgated by the Commission under said Act."

The Commission said that in view of the foregoing it deemed it necessary to order a hearing to determine whether the above is true, whether the member firms had violated Section 15(c)(1) of the Securities Exchange Act and whether the member firms should be suspended or expelled from the Association.

BOARD OF GOVERNORS, DISTRICT COMMITTEE MEMBERS NOMINATED

Candidates Named for Offices As Terms of Approximately One-Third of Groups Expire

To Be Inducted January 16, 1941

The terms of office of approximately one-third of the Association's Board of Governors and District Committee members will expire as of January 15, 1941. These Board and Committee members will be replaced by new members, as in no case is a member succeeding himself in these capacities.

Inasmuch as the election date varies from District to District, it is possible at this time only to supply the list of candidates (some of which have already been elected) for the various offices open. Unless otherwise indicated, terms of office are three years. New members take office January 16, 1941. The list of candidates follows by Districts:

District No. 1.

Board of Governors: Merville W. McInnis of McInnis, Van Dusen & Co., Seattle, to succeed Richard H. Martin of Ferris & Hardgrove, Portland.

District Committee: Beardslee B. Merrill of Richards & Blum, Inc., Spokane, to succeed Frank C. Paine of Paine-Rice & Company, Spokane; Frank A. Bosch of Warrens, Bosch & Floan, Portland, to succeed Henry J. Zilka of Conrad, Bruce & Co., Portland; and Archibald W. Talbot of Hartley, Rogers and Company, Seattle, to succeed Mr. McInnis, who resigned from the Committee and whose term expires January 15, 1943.

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District No. 2.

District Committee: Colis Mitchum of Mitchum, Tully & Co., Los Angeles, to succeed Sherman Asche of Page, Hubbard & Asche, Los Angeles; Warren H. Crowell of Crowell, Weedon & Co., Los Angeles, to succeed Rudolph J. Eichler of Bateman, Eichler & Co., Los Angeles; Thomas M. Hess of Gibbons & Hess, San Francisco, to succeed Richard Lawson of Lawson, Levy & Williams, San Francisco; Roy L. Shurtleff of Blyth & Co., Inc., San Francisco, to succeed A. E. Ponting of the same company; and L. M. Fabian of Bankamerica Company, San Francisco, to succeed Frank Richey of Stephenson, Leydecker & Co., Oakland, who resigned from the Committee and whose term expires January 15, 1943.

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District No. 3.

District Committee: W. R. Owen of O'Donnell-Owen & Company, Denver, to succeed Ralph G. Bulkley of R. G. Bulkley & Company, Denver; Jerry C. Vasconcells of Vasconcells, Hicks and Company, Denver, to succeed Oscar F. Kraft of Oscar F. Kraft & Company, Denver; and Wm. F. Nicholson of Harris Upham & Co., Denver, to succeed Paul Loughridge of Bosworth, Chanute, Loughridge & Company, Denver.

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District No. 4.

Board of Governors: Lawrence B. Woodard of Woodard-Elwood & Company, Minneapolis, to succeed Clifford S. Ashmun of C. S. Ashmun Company, Minneapolis.

District Committee: Stanley Gates of Stanley Gates & Co., St. Paul, to succeed Herbert K. Moss of The Milwaukee Company, St. Paul; Almon A. Greenman of Greenman & Cook, Inc., St. Paul, to succeed Mr. Woodard; and Elmer M. Williams of Allison-Williams Company, Minneapolis, to succeed Richard G. Egan of Mannheimer-Caldwell, Inc., St. Paul.

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District No. 5.

District Committee: Howard H. Fitch of Stern Brothers & Co., Kansas City, Mo., to succeed John H. Barret of the same company; and Eugene L. Young of Kansas City, Mo., to succeed Harvey A. Clayton of Harvey A. Clayton & Co., Kansas City, Mo.

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District No. 6.

District Committee: Elmer A. Dittmar of Mahan, Dittmar & Company, San Antonio, to succeed Benjamin F. Pitman, Jr., of Pitman & Company, San Antonio; and Robert E. Moroney of Moroney & Co., Houston, to succeed Chas. B. White of Chas. B. White & Co., Houston.

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District No. 7.

District Committee: James C. Ward of G. H. Walker & Co., St. Louis, to succeed William H. Burg of Smith, Moore & Co., St. Louis; and Joseph G. Petersen of Eckhardt-Petersen and Co., Inc., St. Louis, to succeed Henry L. Ruppert of H. L. Ruppert and Company, Incorporated, St. Louis.

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District No. 8.

Board of Governors: Francis F. Patton of A. G. Becker & Co., Inc., Chicago, to succeed Francis A. Bonner of Blair, Boner & Company, Chicago.

District Committee: M. D. Dearth of Murdock, Dearth & White, Incorporated, Des Moines, to succeed Arnold J. Boldt of A. J. Boldt & Co., Davenport; Paul S. Grant of the Milwaukee Company, Milwaukee, to succeed Gardner F. Dalton of Dalton, Riley & Co., Inc., Milwaukee; Howard F. Allen of the Central Republic Company, Chicago, to succeed James J. McNulty of Ames, Emerich & Co., Inc., Chicago; and W. E. Kistner of A. C. Allyn and Company, Chicago, to succeed R. Miles Warner of H. M. Byllesby and Company, Chicago.

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District No. 9.

District Committee: D. J. Lucas of G. H. Crawford Co., Inc., Columbia, S. C., to succeed I. M. Read of Frost, Read & Co., Inc., Charleston, S. C.; John B. Shober of Woolfolk, Huggins & Shober, New Orleans, to succeed Chapman H. Hyams, 3rd, of Hyams, Glas & Carothers, New Orleans; and Clement A. Evans of Clement A. Evans & Company, Atlanta, to succeed J. Fleming Settle of J. H. Hilsman & Co., Inc., Atlanta.

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District No. 10.

Board of Governors: Edward Brockhaus of Edward Brockhaus & Co., Cincinnati, to succeed Charles B. Merrill of Merrill, Turben & Co., Cleveland.

District Committee: Ray M. Brock of Greene & Brock, Dayton, to succeed J. M. Hutton, Jr., of W. E. Hutton & Co., Cincinnati; Peter Ball of Ball, Coons & Company, Cleveland, to succeed W. Yost Fulton of Maynard H. Murch & Company, Cleveland; and Robert J. McBryde of James C. Willson & Co., Louisville, to succeed F. Pennington Kemp of W. L. Lyons & Company, Louisville.

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District No. 11.

District Committee: Howard E. Demuth of Mackubin, Legg & Company, Baltimore, to succeed Edward K. Dunn of Robert Garrett & Sons, Baltimore; and L. Gordon Miller of Miller & Patterson, Richmond, to succeed William Frazier of Davenport & Co., Richmond.

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NOMINATIONS

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District No. 12.

District Committee: John C. Bogan, Jr., of Sheridan, Bogan Co., Philadelphia, to succeed T. Johnson Ward of Merrill Lynch, E. A. Pierce & Cassat, Philadelphia; Joseph Buffington, Jr., of Young & Co., Inc., Pittsburgh, to succeed F. J. McGuiness of Chaplin & Company, Pittsburgh; Ernest O. Dorbritz of Moore, Leonard & Lynch, Pittsburgh, to succeed Francis Crandall of Mellon Securities Corporation, Pittsburgh; and Holstein DeHaven Fox of A. C. Wood, Jr., & Co., Philadelphia, to succeed Robert F. Holden of Yarnell & Co., Philadelphia, who resigned from the Committee and whose term expires January 15, 1942.

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District No. 13.

Board of Governors: Lee M. Limbert of Blyth & Co., Inc., New York, to succeed Nevil Ford of the First Boston Corporation, New York; and F. Edward Bosson of Putnam & Co., Hartford, to succeed George S. Stevenson of the same company.

District Committee: Robert S. Morris of Robert S. Morris & Company. Hartford, to succeed Robert C. Buell of Robert C. Buell and Company, Hartford; George R. Cooley of George R. Cooley & Co., Inc., Albany, to succeed J. Taylor Foster of Spencer Trask & Co., New York; Gail Golliday of Bonbright & Company, Incorporated, New York, to succeed Mr. Limbert on the Committee; Meyer Willett of Bristol & Willett, New York, to succeed Oliver J. Troster of Hoit, Rose & Troster, New York; and Frank C. Trubee, Jr., of Trubee, Collins and Co., Buffalo to succeed Garnet C. Williams of Williams and Twichell, Inc., Buffalo, who resigned from the Committee and whose term expires January 15, 1942.

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District No. 14.

Board of Governors: Hermann F. Clarke of Estabrook & Co., Boston, to succeed Pliny Jewell of Coffin & Burr, Inc., Boston.

District Committee: Max O. Whiting of Whiting, Weeks & Stubbs, Incorporated, Boston, to succeed Albert T. Armitage of Coffin & Burr, Inc., Boston; Alvah R. Boynton of F. S. Mosely & Co., Boston, to succeed James J. Minot of Jackson & Curtis, Boston; and Lester Watson of Hayden, Stone & Co., Boston, to succeed Mr. Clarke, who resigned from the Committee and whose term expires January 15, 1943.

CANADA REVISES POLICY ON SECURITY TRANSFERS

Custodian of Enemy Property Announces Changes and Instructions for Compliance With Them

Attention of members is called to the revised policy announced by the Canadian Custodian of enemy property on November 18, 1940 in matters relating to the transfer, sale, redemption or payments on securities, under the "Regulations Respecting Trading with the Enemy (1939)" of Canada. The letter in which the revised regulations are announced sets forth certain instructions, "bona fide compliance with which will constitute protection to the transferee against any claim which the Custodian might otherwise assert", and further states:

"(a) Transfers of securities are prohibited which, according to the addresses on the books of the company or its transfer agents, or records in their possession, are registered in the names of, or beneficially owned by, persons who are enemies or which appear to be enemy owned as disclosed by a declaration of ownership substantially conforming to Form E attached. Such securities must be reported to the Custodian.

Ownership Declaration

"(b) Transfers of securities registered in the names of persons who, according to the addresses on the books of the company or its transfer agents, are located outside of enemy and proscribed territory and outside of Canada, the United Kingdom and the United States, must be accompanied by a declaration of ownership substantially conforming to Form E.

"Delivery of bearer securities must be accompanied by a declaration of ownership substantially conforming to Form F.

"PROVIDED HOWEVER: that if the registered holder's address on the books of the company or its transfer agents, or the address of the person beneficially interested as disclosed by the declaration of ownership is in Continental Europe, the transfer must not be effected without the specific approval of the Custodian.

"PROVIDED FURTHER: that transfers of securities registered in the names of banks, brokers, investment houses, trust companies, trustees (in whatever capacity they may be acting), or in the names of their nominees, who are located in Canada, the United Kingdom or the United States, must have attached a declaration of ownership substantially conforming to Form E, or endorsed thereon.

Signing Declarations

"(c) A declaration of ownership must be signed by an official of, a Canadian chartered bank, any bank in the United Kingdom, any bank within the Federal Reserve System of the United States, a Canadian Trust Company, any member of the Investment Dealers Association of Canada, a member of any Canadian stock exchange or curb market, or a member of the New York Stock Exchange or New York Curb Exchange, and so signed for or on behalf of the person whose beneficial interest in the security is being transferred."

The Office of the Custodian also advises that the Investment Bankers Association of America have been authorized to sign the forms.

As described in the instructions, " 'Enemy' means any resident of the Greater German Reich, Poland, Denmark, Norway, The Netherlands, Belgium, Luxembourg, Italy and possessions, Albania, The Channel Islands, Roumania, French territory in Europe and the contiguous territories of Andorra and Monaco, the French Zone of Morocco, Corsica, Algeria and Tunisia, and all other enemy occupied or proscribed territory, and any person included in the List of Specified Persons published in the Canada Gazette."

Sample copies of Forms E and F may be obtained from: the Office of the Custodian, Department of the Secretary of State, Room 45A Central Chambers, Ottawa, Canada, or National Association of Securities Dealers, Inc., District No. 13, 44 Wall Street, New York, N. Y.

MISREPRESENTATION

(Continued from Page 3)

who acts as the agent of the purchaser but held that the fact that the defendants may have acted as agents both of the purchaser and of the seller did not free them of the liability imposed by the Act. Judge McLellan, while concurring in the interpretation of Section 12 (2) of the Securities Act of 1933, dissented from the majority opinion on the ground that under the evidence he believed the defendants were agents solely for the purchaser, and as such could not, in his opinion, be held liable under Section 12 (2).

TYPICAL COMPLAINTS: HOW THEY ARE HANDLED BY CONDUCT COMMITTEES

Failure to Permit Inspection of Books Causes Cancellation of Membership in Association

Five Cases Referred to NASD by SEC

Case No. 1.

A formal complaint was filed by a District Business Conduct Committee against a member firm alleging that it had refused to permit an inspection of its books by an authorized representative of a local Business Conduct Committee as provided for in Section 5, Article IV, of the Rules of Fair Practice. This section provides that a refusal by a member to permit any inspection of its books as might be validly called for under this section is sufficient cause for suspending or cancelling the membership of the member in the Association.

The original complaint on which the request for inspection of the books was based was an informal one brought by the executor of an estate, who claimed that the firm, in certain transactions with the decedent, had been guilty of overreaching as well as chargeable with having made improper recommendations to its customer. Although action by the committee on the informal complaint was prevented by the fact that the transactions complained of had occurred prior to the effective date of the Rules of the Association, the local committee was of the opinion that these transactions were not isolated instances of wrongful conduct by the firm, but, on the contrary, typical of the firm's business. On this basis, the committee deemed further investigation necessary.

No answer was filed to the complaint within the time required and a second notice was sent. No answer having been received within the time required by the second notice, the committee, under the authority provided in Section 7 (b) of the Code of Procedure for handling formal complaints, treated the charges as admitted by the firm. Thereupon, the committee found the firm had neglected, refused and omitted to permit inspection of its books by a duly authorized agent of the local Business Conduct Committee, and further found that such action constituted conduct inconsistent with just and equitable principles of trade. On the basis of these findings, the firm's membership in the Association was cancelled.

Case No. 2.

For the purpose of this case history, five cases which were practically identical are being treated as a single informal complaint. All five of the cases were referred to the Association by the SEC and in each it appeared that in certain transactions between the firms and their customers, the profits taken were excessively large and possibly in violation of Association Rules.

An independent investigator was engaged in each case to review and verify the transcript of these transactions supplied by the Commission. After a review of these investigators' reports, it was decided each firm should have a hearing before a sub-committee at which it could attempt to explain the reason for and justify the spreads in the transactions in question.

The sub-committees, after reviewing the cases, reported to the District Committees that they were of the opinion that the firms' handling of the accounts in question were in violation of Article III, Section 1, of the Rules and recommended that a letter of censure be written to each firm. Section 1 relates to business conduct of members.

The District Business Conduct Committee thereupon directed the Secretary of the District Committee to write a letter of censure to each firm warning that the continuation of such conduct as had been complained of would expose the firm to a formal complaint brought by the Committee and possible disciplinary action pursuant thereto.

PSI PENALTIES

(Continued from Page 1)

ful study of reports from the Business Conduct Committees of the various Districts. The Business Conduct Committees had, in turn, considered each individual case and made either general or specific suggestions to the Executive Committee with respect to penalties.

The steps leading up to the present action by the Executive Committee were as follows: during distribution of the issue, rumors of violations of the selling agreement appeared; the Association sent out questionnaires to all underwriters and members of the selling group; these questionnaires were analyzed and some 107 apparent violations were discovered, 23 of these apparent violations subsequently were discovered to be not well taken; in the interests of uniformity, etc., the Washington office of the Association drew up the complaints, which were forwarded to the District Business Conduct Committees for filing and hearing; upon receipt of answers and recommendations from the latter groups, the matter was presented to the Executive Committee for its recommendations.

SECURITIES ACTS GROUP'S WORK APPROVED BY BOARD

Governors Hear Committee Reports at Meeting—Advisory Counsel Airs District Activities, Problems

The work of the special Securities Acts Committee of the Association received the approval of the Board of Governors at their recent meeting following a detailed report on every phase of this work by committee members. This group has been holding a series of conferences with the SEC on possible modifications and changes in the various securities acts. As a result of the conferences between the Commission, Association representatives and other interested groups, the SEC is expected to make a report to Congress on these subjects during the next session.

While the Securities Acts Committee is conducting the actual conferences, any recommendations it may make as to matters of policy or changes in the acts are subject to the approval of the Executive Committee of the Association, which is, in turn, answerable to the Board. The Committee report was presented by Nevil Ford, Vice Chairman of the NASD, Stewart S. Hawes, Chairman of the Committee, and Paul W. Frum of Counsel. Other Committee members are: E. C. Brelsford, James N. Land, John S. Loomis, Paul Nitze, C. Newbold Taylor, Karl A. Weisheit, R. S. Dickson, Robert F. Brown and Joseph T. Walker, Jr.

Reception of Reports

The first session of the Board meeting was devoted to routine work and the reception of other committee reports. In the afternoon of the first day, the Advisory Council, composed of the Chairman of the 14 Districts of the NASD, held a special meeting to discuss the activities and problems of the various Districts.

The Board also received a report from the national Quotations Committee. This group reported that during the past year, quotations on local over-the-counter securities had been extended to a point where 12 of the Association's 14 Districts are now offering this service. These local quotes supplement the nationwide service sent out from New York via the news wire services.

SEC STAFF RECOMMENDS COMPETITIVE BIDDING FOR UTILITY SECURITIES

Utility Division Holds Private Purchasers Should Compete in Open Market for Issues

Would Segregate Service Functions

The SEC Public Utilities Division, in a report to the Commission, has recommended "the adoption of a rule . . . requiring generally that competitive bidding be resorted to in the sale and distribution of securities of registered public utility holding companies and their subsidiaries."

The Utility Division, in addition, held that a competitive bidding rule should "at least in the first instance, make no distinction between possible purchasers (of utility securities) and no exception for private placements." This would mean that a private purchaser, such as an insurance company, could not negotiate for an issue of utility securities, but would have to bid in the open market along with investment bankers.

Segregating Service Functions

The report expresses a belief that the service function of investment bankers should be segregated from the underwriting function and the services relating to financial programs "be placed on a professional basis to the extent needed, and purchased as such."

The Utility Division recommended the repeal of Rule U-12F-2 (Arm's-Length Bargaining) and the adoption of one summarized as follows:

(1) It would apply to the issuance or sale of securities of registered public utility holding companies and their subsidiaries in an amount exceeding $1,000,000, with certain exceptions.

Inviting Sealed Bids

(2) It would provide that the Commission will not grant or permit any application or declaration subject to the proposed rule to become effective unless the applicant or declarant shall have invited sealed bids by published advertisement a reasonable period prior to entering into a contract for the sale of the securities involved.

(3) It would also provide that such sealed bids as may be received shall be opened publicly at the time and place that was specified in the published advertisement.

Information Required

(4) Finally, it would provide that as soon as practicable after the opening of bids, the applicant or declarant shall file a statement with the Commission setting forth (a) the action taken in compliance with the rule, (b) a copy of each sealed bid received, and (c) a statement of the action which the company proposes to take.

Exceptions mentioned above would include: the issuance or sale of any security pro rata to existing holders of securities of a company; unsecured bonds, notes or other evidence of debt of a maturity of 10 years or less, sold to a commercial bank, provided no fee was paid a third party; securities the acquisition of which had been approved by the commission; securities the total proceeds whereof will not exceed $1,000,000; and certain discretionary circumstances allowed the Commission.

INVESTMENT COUNSEL

(Continued from Page 1)

sel'. Under the Investment Advisers Act, on the other hand, if such person is not primarily engaged in the business of rendering 'investment supervisory services' (as defined in Section 202 (a) (13)), it will be unlawful for him 'to represent' that he is an 'investment counsel' or 'to use the name investment counsel as descriptive' of his business.

Purposes Not Conflicting

"Section 208 (c) of the Investment Advisers Act attempts to restrict the use of the term 'investment counsel' by persons registered under the Act to those who are primarily engaged in giving continuous advice as to the investment of funds on the basis of the individual needs of their clients. Although the state licensing laws referred to above use the phrase 'investment counsel,' the context in which the phrase is used indicates that the intent of the statutes is to establish a general descriptive category for administrative purposes rather than to distinguish between investment advisers who give general market advice and those who give individualized service. I believe that the purposes of the Investment Advisers Act and of the state statutes are not necessarily conflicting.

"A person who is registered under the Investment Advisers Act but who is not an investment counsel within the meaning of that Act should in his general advertisement and on his letterhead refer to himself as an investment adviser or some other appropriate term other than investment counsel. In so doing he certainly would not be violating the state statutes and he would be conforming with the Investment Advisers Act. On the other hand, if he were asked whether his company is licensed under a state law, it would be entirely proper to reply that he is licensed to do business in that state as an investment counsel. Similarly a certificate issued by a state authority setting forth that he has qualified under the law as an investment counsel can properly be hung on the wall of his office. In such cases the investment adviser would simply be advising concerning his technical legal status under the state law.

"In a large measure the whole question is one of good faith. As a practical matter, if the investment adviser confines reference to himself as an 'investment counsel' to those situations in which there is common-sense justification for pointing out his legal status under a State law, he will run no risk of violating Section 208 (c)."

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