Sixth Annual Report
of the
Securities and Exchange Commission

Fiscal Year Ended June 30, 1940

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WASHINGTON, D. C.

LETTER OF TRANSMITTAL

SECURITIES AND EXCHANGE COMMISSION,
Washington, January 3, 1941.

SIR: I have the honor to transmit to you the Sixth Animal Report of the Securities and Exchange Commission, in compliance with the provisions of Section 23 (b) of the Securities Exchange Act of 1934, approved June 6, 1934, and Section 23 of the Public Utility Holding Company Act of 1935, approved August 26, 1935.

Respectfully,

JEROME N. FRANK, Chairman.

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

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SIXTH ANNUAL REPORT
OF THE
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D. C.

INTRODUCTION

When the Securities and Exchange Commission was organized in July of 1934, it was charged with administering two Acts, namely, the Securities Act of 1933, which had previously been administered by the Federal Trade Commission, and the Securities Exchange Act of 1934.

During the six years which have followed, the scope of the Commission's work has expanded substantially. At the present time the Commission administers six separate Acts, and has certain duties to perform under another Act. [Footnote: Securities Act of 1933; Securities Exchange Act of 1934; Public Utility Holding Company Act of 1935; Chapter X, National Bankruptcy Act; Trust Indenture Act of 1939; Investment Company Act of 1940; Investment Advisors Act of 1940. Administratively, the Maloney Act is considered as an amendment to the Securities Exchange Act of 1934.] Legislation adopted since the organization of the Commission provides for regulation or supervision of public utility holding company systems, trust indentures, investment trusts, and investment advisers, and permits the Commission to participate in corporate reorganizations by preparing advisory reports on plans of reorganization for the courts and investors. In addition to this legislation, the two original Acts under the jurisdiction of the Commission have been amended on several occasions. [Footnote: The Securities Act of 1933 -- amendments approved June 6, 1934, august 9, 1935,

and August 22, 1940. Securities Exchange Act of 1934 -- amendments approved May 27, 1936, and June 25, 1938.]

The laws administered by the Commission represent a comprehensive program for regulation and supervision of the Nation's securities markets. The legislation establishes substantial safeguards for the investor by protecting him against fraud and requiring disclosure of essential financial data, and safeguards the general public from the results of undue speculation and other unhealthy financial conditions.

While in this report, as in previous reports, it is necessary to review the details of the Commission's work in terms of accomplishments in the administration of each separate Act, the comprehensive pattern which the legislation assigned to the Commission presents in its entirety, and the interdependence of the Acts, must not be overlooked. For this reason it may be well to review briefly at this time the general scope and character of the Commission's work.

Under the Securities Act of 1933, as amended, corporations which sell new security issues publicly are required to file with the Commission full and complete information concerning the nature of their business, their financial condition, and the uses to which the proceeds from the sale of the securities are to be put. The Commission cannot prevent the sale of any security effectively registered with it as long as there is adequate disclosure of all material facts.

In the case of security issues offered by public utility holding companies or their subsidiaries, the Commission's powers are more substantial. Due to the necessity of providing machinery for eliminating the serious abuses which developed in the public utility holding company field, Congress passed the Public Utility Holding Company Act of 1935. Under this Act the Commission may require that the securities be reasonably adapted to the security structure of the Company and to the earning power of the issuer; that the financing be appropriate to the economical and efficient operation of the business; that fees, Commissions, and other remuneration paid in connection with the sale of the securities be reasonable and competitive conditions maintained; and that the terms of the sale be not detrimental to the public interest or the interest of investors or consumers.

In addition to this supervision of new security issues, the Commission is given power under the Securities Exchange Act of 1934 to regulate certain transactions in outstanding securities in order that the interests of investors be protected and the conduct of those who deal in such securities be fair, equitable, and free from fraud. Many securities are listed on stock exchanges. The Commission has power to require that complete and current information concerning the companies whose securities are so traded be kept on file with the Commission

and available for public inspection. Furthermore, the Commission supervises the trading activities of brokers and dealers who transact their business across the stock exchanges in order to prevent manipulation of market prices and misrepresentation. The stock exchanges themselves must also register with the Commission and various rules and is regulations governing the activities of member firms and their partners have been worked out in cooperation with the exchanges to give added protection for investors.

With respect to securities which are traded in the over-the-counter markets, i. e., not on stock exchanges, no filing of information concerning the financial condition and business of the issuers is generally pro required under the Securities Exchange Act of 1934. Under authority contained in the Maloney Act, an amendment to the Securities Exchange Act of 1934, however, any organization consisting of over 3,000 brokers and dealers who trade in the over-the-counter markets has been formed. This organization, which is known as the National Association of Securities Dealers, Inc., has established machinery designed to supervise and discipline its own members and has promulgated rules for fair conduct. The Commission exercises a general supervision over the activities of the association. In addition, the Commission supervises over-the-counter brokers and dealers through a simple registration system.

As part of its general program, the Commission has supervision over the type of proxies sent to security-holders by utilities and by corporations with securities listed on stock exchanges and its regulations in this connection are designed to assure full disclosure and to assist in giving scattered investors a genuine opportunity to participate in the affairs of their companies. The Commission also requires reports which reflect trading by members of stock exchanges and partners of member firms for their own account and obtains reports of security trading from large stockholders and officers of corporations whose securities are listed on stock exchanges in order that the market activities of “insiders “may be known to the general public at all times.

The Commission’s powers with respect to new security issues in the field of public utility companies has already been indicated. In addition, the provisions of the Public Utility Holding Company Act of 1935 are designed to eliminate improper security transactions by holding companies and their subsidiaries, to make certain that their acquisitions of securities and utility assets are in the public interest, and that dividend practices, the form of proxies issued, inter-company loans, and service, sales, and construction contracts are supervised. The basic purpose of this utility legislation is to eliminate or simplify uneconomic holding company structures and to return the operating companies to local control. The Commission’s approval of the reorganization plan is required for all utility holding companies reorganized.

Under Chapter X of the Bankruptcy Act, the Commission participates in certain types of reorganization proceedings and provides independent expert assistance on matters arising in such proceedings. It is empowered to prepare for the benefit of the court and investors advisory reports on such plans of reorganization. It also is influential in making certain that various procedural and technical steps in the reorganization designed to protect investors are closely adhered to. Closely related to its work in the reorganization field is the Commission's regulation of trust indentures through which it may act to protect investors from losses resulting from unfair or loosely drawn indentures and to assure appointment of truly independent trustees under such indentures.

Practically all of the regulatory powers and duties outlined above are made effective through criminal, civil, or administrative sanctions. No criminal prosecutions can be instituted by the Commission itself, but the statutes provide that the Commission may transmit evidence of criminal acts to the Attorney General who may, in his discretion, institute the necessary criminal proceedings. Civil remedies for enforcement of the statutes are vigorously sought by the Commission by means of suits for injunction instituted in the United States district courts, in which the Commission itself participates as plaintiff. Administrative sanctions are exercised by means of final orders of the Commission, entered only after appropriate notice and opportunity for formal hearing appealable under each of the statutes to the proper United States circuit court of appeals or to the court of Appeals for the District of Colombia.

As an aid to its regulatory and administrative functions, the Commission is empowered under many provisions of the statutes to promulgate general rules and regulations. These are both implementing and interpretative in character and include: (a) regulatory rules which impose duties and obligations upon classes of persons or classes of transactions; (b) exemption rules which relieve classes of persons or classes of transactions from duties and obligations; (c) procedural rules which set out procedural steps to be taken by persons outside the Commission and by the Commission itself or its employees; and (d) rules defining technical, trade, and accounting terms used in the statutes or in the rules and regulations issued thereunder. From the earliest days of the Commission, its policy has been to seek and to give careful consideration to the suggestions and advice of persons outside the Commission as to the form and content of proposed rules and regulations. With few exceptions, the regulatory and procedural rules and rules of definition that have been promulgated have first been submitted to expert representative groups and individual concerns affected by or directly interested in the subject matter thereof, and have been extensively amended and modified in the light of the suggestions and advice received. Exemption rules have usually been submitted to smaller groups, since fewer persons have a legitimate interest in them. It is the firm conviction of the Commission that this policy of consultation with informed members of industry

and the public, in the formulation of rules and regulations, is an essential feature of sound administration -- a feature that has gone far toward placing regulation on a basis of cooperation between the regulator and the regulated. The consultative process operates through personal conferences in different parts of the country and through correspondence over a course of weeks and, in some instances, many months. It provides an informal hearing which, in the Commission's opinion, is best adapted to bring about the constructive and thorough consideration required for the formulation of technical and often complex regulations.

During the fiscal year the Commission took several significant steps to perfect the administration of the various Acts under its jurisdiction. In general, these efforts were directed toward a simplification of the Commission's procedure, forms, and regulations. In order to expedite the handling of applications and declarations involving financial transactions under the Public Utility Holding Company Act of 1935, for example, the Commission adopted a new procedure which made formal hearings and findings of fact unnecessary on the majority of such applications and declarations, there being no controversy of any kind involved. [Footnote: Commissioner Healy dissented from the adoption of this new problem.] Substantial savings of time and expense have resulted for the utility industry. Hereafter, formal administrative hearings on such transactions will be necessary only where a hearing is requested or where, from a review of the application or declaration by the staff, it is apparent that substantial difficulties are presented.

The Commission also took the first public move in a program to regionalize the handling of registration statements filed under the Securities Act of 1933 and supplemental material to these registration statements required by the Securities Exchange Act of 1934. To date, the activities of the regional offices have been confined almost entirely to enforcement work. Experience with Chapter X of the Bankruptcy Act has demonstrated the practicality of using the facilities of the regional offices to a wider extent. Business men, investment bankers, and others who are in daily contact with the Commission's work have encouraged such a development and have even urged that the Commission provide facilities in its regional offices for the filing of registration statements and other forms. Many technical matters are involved and the Commission must move cautiously for any regionalization of its activities. In order to get practical experience in this field, it was decided to set up a special unit in the Commission's San Francisco Regional Office to determine to what extent the handling of registration statements and similar material could be regionalized. The San Francisco unit was set up and staffed to give both legal and accounting assistance to persons registering securities or filing supplemental material under the Acts indicated. The success of this experiment has been such that the Commission now anticipates that during the next fiscal year it will greatly expand its experimentations in this field

and that it will authorize registration statements and supplemental material to be filed in at least two of its regional offices on a trial basis. As a result of this additional emphasis of the regional offices, the annual report for this fiscal year contains for the first time a special section on the work of such offices.

During the fiscal year the Commission gave particular emphasis to the administration of the integration and corporate simplification provisions of the Public Utility Holding Company Act of 1935. After elaborate negotiations with the industry in an effort to encourage the filing of voluntary plans for integration and simplification proved successful, the Commission issued orders instituting formal proceedings in order to carry out the purposes of the Act in these respects. Integration proceedings were commenced with respect to nine major utility systems which comprised, roughly, 58 percent of the total consolidated assets of all systems registered under the Act. Simplification proceedings were also commenced in three instances. As a result of these orders, definite progress has been made toward integration and simplification. Furthermore, in the day to day handling of applications and other matters arising in connection with the Act, simplification has been encouraged in every possible way and the several major systems have taken steps, such as the elimination of intermediate holding companies and the regrouping or sale of properties, which have definitely advanced the broad program contemplated by Congress in the enactment of the Public Utility Holding Company Act of 1935.

During the year the program for the regulation of the over-the-counter markets envisioned by the Maloney Act became an actuality, with the effective registration, following a hearing before the Commission, of the National Association of Securities Dealers, Inc., on July 20, 1939. The Commission is in constant contact with the association's representatives, and there is a continual interchange of information and ideas to the end that the association will operate with maximum efficiency in accomplishing the purposes of the Maloney Act. The Commission has great hopes that the membership of the association will expand until eventually it includes all important brokers and dealers operating in the over-the-counter markets.

The soundness of market prices for securities traded on national securities exchanges which had been established while these exchanges were under the Commission's supervision met a severe test when the German war machine invaded the Lowlands. This startling event and subsequent activities on the European scene were certain to influence American securities markets. The Commission was alert to prevent any serious dislocation of normal trading activities and, if necessary, was ready to recommend the closing of the exchanges should trading show signs of panic. Fortunately, no drastic steps were required. Securities listed on the New York Stock Exchange and other exchanges responded with little extreme fluctuation in price, and no trading was

characterized by abnormal thinness or unhealthy spreads between the prices buyers were willing to pay and the prices for which sellers were willing to sell. The comparative absence of manipulative activities and the virtual elimination of pools undoubtedly contributed to this wholesome result. In the general field of the administration of the Securities Exchange Act of 1934, the Commission tightened its regulatory program by the revision and modification of various rules and regulations, and of course continued its vigilant scrutiny of trading activities. In its relations with the New York Stock Exchange, the Commission pursued its policy of cooperative regulation and continued to urge upon the exchanges the adoption of rules and regulations which have been under discussion since the Richard Whitney case and are designed to give greater protection to customers of member firms.

In the field of enforcement the Commission obtained indictments against 232 individuals and corporations and injunctions against 118 individuals and corporations. One of the most striking criminal prosecutions resulted from the Commission's investigations, under Section 12 (h) of the Public Utility Holding Company Act of 1935, into the political activities of certain officials of the Union Electric Company of Missouri, a registered holding company. Three former officials of that Company were indicted for perjury in connection with the Commission's investigation. Two of those indicted pleaded guilty, while the third stood trial and was convicted. Evidence developed by the Commission's investigators and presented during the perjury trial showed that over a period of years the Union Electric Company had made political contributions from a slush fund of over a half a million dollars built up from kick-backs or rebates received from attorneys and contractors, cash refunds on insurance policies, and padded expense accounts of certain employees.

Another striking enforcement activity was the Commission's work undertaken in cooperation with the Post Office authorities and directed toward the elimination of the "front money" or "advanced fee "racket. From time to time information had come to the Commission indicating that unscrupulous operators had been obtaining money on false pretenses from a wide variety of small business on the representation that they were qualified to successfully float securities for such businesses. The investigation disclosed that over the past six years hundreds of small concerns had been induced to pay money to these "front money" operators, aggregating hundreds of thousands of dollars,
on the representation that the operators would be able to sell securities for them. The investigation also showed, however, that there was not a single instance where the operators had actually sold shares of stock for the businesses victimized. The Commission's investigations resulted in 13 indictments on which several convictions have already been obtained.

The Commission also conducted several special studies during the fiscal year which have contributed to a better understanding of financial problems and aided in the protection of investors. Further reports were submitted to the Congress on the study of investment trusts and investment companies conducted under express authority contained in the Public Utility Holding Company Act of 1935. These and previous reports led to the unanimous enactment by both houses of Congress of the Investment Company Act of 1940 and the Investment Advisors Act of 1940, which were signed by President Roosevelt on August 22, 1940. In addition, hearings held on special studies of legal reserve life insurance companies and investment banking activities, undertaken in cooperation with the Temporary National Economic Committee pursuant to Public Resolution No. 113 of the 75th Congress, were completed and the special unit set up to carry out this work was discontinued. Testimony in the accounting study of the McKesson & Robbins matter was published during the fiscal year and in December of 1940 the Commission's report on its findings was released. During the year convictions of several defendants were obtained in the United States District Court for the Southern District of New York for violations of the mail fraud statute disclosed as a result of the inquest into the McKesson matter which the Commission made in cooperation with other authorities.

On July 3, 1940, Commissioner Jerome N. Frank was reelected Chairman of the Commission for the period ending June 30, 1941.

Commissioner Edward C. Eicher, of Iowa, was reappointed Commissioner on June 11, 1940, for the term ending June 5, 1945. Commissioner Eicher was originally appointed Commissioner on December I, 1939, for the term ended June 5, 1940.

Sumner T. Pike, of Maine, was appointed Commissioner on June 1, 1940, for the term ending June 5, 1943, vice George C. Mathews, who resigned as Commissioner on April 15, 1940.

On May 31, 1940, the S. E. C. Monopoly Study Division was dissolved; and the Investment Trust Study Division was abolished on June 30, 1940.

The Commissioners, staff officers, and regional administrators, as of the close of the past fiscal year, were as follows:

Commissioners:

Frank, Jerome N., Chairman.
Healy, Robert E.
Eicher, Edward C.
Henderson, Leon.

Pike, Sumner T.

Staff Officers:

Allen, James, Supervisor of Information Research.

Bane, Baldwin B., Director of the Registration Division.

Brassor, Francis P., Secretary of the Commission, Director of Personnel, and Director of the Administrative Division.

Burke, Edmund, Jr., Director of the Reorganization Division.

Davis, Sherlock, Technical Adviser to the Commission.

Lane, Chester T., General counsel.

Neff, Harold H., Foreign Expert.

Purcell, Ganson, Director of the Trading and Exchange Division.

Schenker, David, chief of the Investment Trust Study. [Footnote: On September 21, 1940, the Commission established the Investment Company Division and appointed Mr. Schenker as Director of that Division.]

Sheridan, Edwin A., Executive Assistant to the Chairman.

Weiner, Joseph L., Director of the Public Utilities Division.

Werntz, William W., chief Accountant.

Regional Administrators:

Alhed, Oran H., Fort Worth Regional Office.

Caffrey, James J., New York Regional Office.

Green, William, Atlanta Regional Office.

Judy, Howard A., San Francisco Regional Office.

Karr, Day, Seattle Regional Office.

Kennedy, W. McNeill, Chicago Regional Office.

Lary, Howard N., Denver Regional Office.

Malone, William M., Washington Field Office.

Moore, Dan Tyler, Cleveland Regional Office.

Rooney, Joseph P., Boston Regional Office.

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

The Public Utility Holding Company Act of 1935 deals with holding companies having subsidiaries which are electric utility companies or which are engaged in the retail distribution of natural or manufactured gas. The Act was passed for the express purpose of eliminating certain evils and abuses which the Congress had found to exist in connection with the activities of such companies, and was intended for the protection of both investors and consumers. It provides for the registration of holding companies; elimination of uneconomic holding company structures; supervision of security transactions of holding companies and their subsidiaries; supervision of acquisitions of securities and utility assets by holding companies and their subsidiaries; and the supervision of payment of dividends, solicitation of proxies, inter-company loans, and service, sales, and construction contracts. The Commission must pass upon plans for the reorganization of registered holding companies or their subsidiaries, and must require the geographic and corporate simplification of public utility holding company systems. The Commission does not have the power to regulate public utility rates.

SUMMARY OF ACTIVITIES

Pursuant to the provisions of the Public Utility Holding Company Act of 1935, there were registered with the Commission as of June 30, 1940, 144 public utility holding companies, the total consolidated assets of which amount to nearly 14.5 billions of dollars. These 144 registered holding companies constitute 55 public utility holding company systems, which include 1493 holding, subholding, and operating companies.

During the past fiscal year, the Commission concentrated on the administration of the integration and simplification provisions of the Act. Efforts to encourage the filing of voluntary plans for compliance with these provisions were unsuccessful, and the Commission found it necessary to begin formal proceedings in order to

carry out the administration of the law. Integration proceedings were launched with respect to nine major utility systems, comprising, roughly, 58 percent of the total consolidated assets of all the systems registered under the Act. Simplification proceedings were begun in three instances.

Several of the holding companies requested a tentative outline of the Commission's views as to what steps would be necessary in order to comply with the integration requirements set forth in the Act. These views were in the process of preparation at the end of the fiscal year. Several others took a contrary position. Other cases were delayed by petitions for additional time to prepare evidence or by motions for dismissal. Such motions were denied. Despite the delays resulting from these motions and petitions, the Commission feels that definite progress has been made in carrying out the integration and simplification provisions of the statute. Every effort is being made to expedite the proceedings.

Of particular importance to the industry and to the Commission were steps taken during the year to save time and expense in the handling of declarations and applications involving financial transactions. This was accomplished through the adoption by the Commission of a new procedure making hearings and findings unnecessary on the majority of such applications and declarations filed under the Act except in cases where substantial difficulties are presented. [Footnote: Commissioner Healy opposed this procedure on both legal and policy grounds He proposed an alternative procedure which he argued would be equally saving of time and expense and more closely related to good procedure. His views and those of a majority of the Commissioners to the contrary are set forth in detail in public memoranda dated April 1 and June 24, 1940, respectively.]

Three former officials of the Union Electric Company were indicted for having testified falsely before an officer of the Commission, in connection with the Commission's inquiry into business practices and the financial condition of Union Electric and certain associated companies. Two of those indicted pleaded guilty, while the third stood trial and was convicted. Evidence developed by the Commission's investigators and produced during the trial tended to show that over a period of years the Company had built up a cash fund of more than half a million dollars by means of "kick-backs" or rebates from attorneys and contractors, cash refunds on insurance policies, and fictitious or "padded" expense accounts of employees. Following the disclosures at the trial the matter was referred to the Department of Justice. Shortly after the close of the fiscal year, the Department of Justice announced the institution of a grand jury proceeding to investigate information that these companies had violated Federal statutes in making political contributions from this cash fund.

The Commission continued its scrutiny of the financial structure of utility companies floating new issues of securities in its endeavor to insure the

development of sound capital structures based upon a substantial amount of common stock equity. Wherever the existence of special conditions precluded the raising of new capital through the sale of common stock, the Commission insisted that the issuers of senior securities include provisions designed to increase the protective features of the securities and the amount of common stock equity or cushion.

The Commission gave increased attention to the adequacy of annual charges for depreciation, since that question is so closely allied to the problem of improving the capital structures of public utility holding companies and their subsidiaries. In the furtherance of this work, analyses are being made of the depreciation policies of all public utility companies subject to the Act.

The problem of maintaining arm's-length bargaining and competitive conditions in the underwriting and distribution of public utility securities was re-examined during the year. In existence was a rule designed to control the payment of fees to underwriters and "finders" who may be in a position, by reason of stock ownership or other relationship, to gain an unfair advantage in bargaining. By the terms of the rule no fee can be paid, except on the basis of competitive bidding, to underwriters and finders found to be within the scope of the rule, unless justification is clear or unless such underwriter merely has a participation of not more than 5 percent and the fee is the same as that paid to nonaffiliated underwriters. Alternative techniques, including some form of competitive bidding, are now under consideration in an endeavor to establish a procedure less burdensome to issuers and underwriters and more effective from the Commission's standpoint in enforcing the requirements of the Act.

The filing of forms was simplified during the year by the adoption of a single form to replace five outstanding ones for applications and declarations.

SIMPLIFICATION OF HOLDING COMPANY SYSTEMS UNDER SECTION 11 OF THE PUBLIC UTILITY HOLDING COMPANY ACT OF 1935

Section 11 of the Public Utility Holding Company of 1935 relates to the geographical and corporate simplification of holding company systems. Specifically, Section 11 (b) (1) directs the Commission to require that action be taken to limit the operations of each holding company system to a single integrated system as defined in the Act, together with such incidental businesses and additional systems as may be retained within. specified limitations. Section 11 (b) (2) directs the Commission to require registered holding companies and their subsidiaries to take such steps as are necessary to remove needless complications from corporate structures and to distribute voting power fairly and equitably among security holders.

The Commission is authorized to approve voluntary simplification plans submitted by registered holding companies and their subsidiaries, provided that the plans meet the geographical and corporate simplification requirements set forth in the Act.

The Commission commenced proceedings under Section 11 (b) (1) early in 1940 by the institution of proceedings with respect to nine major public utility holding company systems with aggregate consolidated assets of approximately $8,359,519,000, or about 58 percent of the total consolidated assets of all the systems registered under the Act. None of the public hearings in connection with these proceedings had been concluded at the end of the fiscal year. The systems involved in these proceedings may be briefly described as follows:

Electric Bond and Share Company (Proceedings commenced February 28, 1940; see Holding Company Act Release No. 1944.) -- Electric Bond and Share Company is one of the largest public utility holding company systems in the United States. In this country it controls 36 utility subsidiaries, which operate electric facilities in 27 States and gas facilities in 12 States, and 45 non-utility subsidiaries. The aggregate amount of the consolidated assets of its subsidiary holding companies and their subsidiaries (excluding American Gas and Electric Company and its subsidiaries) at December 31, 1939, was approximately $2,853,400,000 and the aggregate amount of the consolidated operating revenues of its subsidiary holding companies and their subsidiaries (excluding American Gas and Electric Company and its subsidiaries) for the year ended December 31, 1939, was approximately $346,000,000. Its principal offices are located in New York, New York. [Footnote: Although more than 10 percent of the voting securities of American Gas and Electric Company is owned by Electric Bond and Share Company, America Gas and Electric Company has filed an application under Section 2 (a) (5) for an order declaring it not to be a subsidiary of Electric Bond and Share Company. The Act provides for a temporary exemption where such on application is filed in good faith.]

Engineers Public Service Company. (Proceedings commenced February 28, 1940; see Holding Company Act Release No. 1945.) -- Engineers Public Service Company controls 10 utility subsidiaries, which operate electric facilities in 15 States and gas facilities in 3 States, and 9 non-utility subsidiaries. Its consolidated assets as of December 31, 1930, aggregated approximately $368,572,000 and the total consolidated operating revenues of its system for the year 1939 aggregated approximately $54,245,000. Its principal offices are located in New York, New York.

The Middle West Corporation. (Proceedings commenced March 1, 1940; ace Holding Company Act Release No. 1950.) -- The Middle West Corporation

controls 50 utility subsidiaries, which operate electric facilities in 16 States and gas facilities in 12 States, and 40 non-utility subsidiaries. Its consolidated assets as of December 31, 1930, aggregated approximately $448,094,000 and the total consolidated operating revenues of its system for the year 1939 aggregated approximately $64,194,000. Its principal offices are located in Chicago, Illinois.

The United Gas Improvement Company. (Proceedings commenced March 4, 1940; see Holding Company Act Release No. 1953.) -- The United Gas Improvement Company controls 38 utility subsidiaries, which operate electric facilities in 10 States and gas facilities in 7 States, and 48 non-utility subsidiaries. Its consolidated assets as of December 31, 1939, aggregated approximately $837,504,000 and the total consolidated operating revenues of its system for the year 1939 aggregated approximately $112,400,000. Its principal offices are located in Philadelphia, Pennsylvania.

Cities Service Power & Light Company. (Proceedings commenced March 4, 1940; see Holding Company Act Release No. 1954.) -- Cities Service Power & Light Company controls 36 utility subsidiaries, which operate electric facilities in 14 States and gas facilities in 1.2 States, and 22 non-utility subsidiaries. its consolidated assets as of December 31, 1939, aggregated approximately $415,959,000 and the total consolidated operating revenues of its system for the year 1939 aggregated approximately $62,246,000. Its principal offices are located. in New York, New York.

The commonwealth & Southern Corporation. (Proceedings commenced March 6, 1940; see Holding Company Act Release No. 1956.) -- The commonwealth & Southern Corporation controls 10 utility subsidiaries, which operate electric facilities in 10 States and gas facilities in 7 States, and 32 non-utility subsidiaries. Its consolidated assets as of December 31, 1939, aggregated approximately $1,143,160,000 and the total consolidated operating revenues of its system for the year 1939 aggregated approximately $140,650,000. Its principal offices are located in New York, New York.

Standard Power and Light Corporation; Standard Gas and Electric Company. (Proceedings commenced March 6, 1940; see Holding Company Act Release No. 1957.) -- Standard Power and Light Corporation is the top holding company controlling the Standard Gas and Electric Company system. The system controls 33 utility subsidiaries, which operate electric facilities in 19 States and gas facilities in 9 States, 65 non-utility subsidiaries, and 14 inactive subsidiaries. Its consolidated assets as of December 31, 1939, aggregated approximately $766,345,000 and the total consolidated operating revenues of its system for the year 1939 aggregated approximately $93,705,000. The principal office of Standard Power and Light Corporation is located in Jersey city, New Jersey, and

the principal office of Standard Gas and Electric Company is located in New York, New York.

The North American Company. (Proceedings commenced March 8, 1940; see Holding Company Act Release No. 1960.) -- The North American Company controls 24 utility subsidiaries, which operate electric facilities in 9 States and the District of Colombia and gas facilities in 7 States, 31 non-utility subsidiaries, and 18 inactive subsidiaries. Its consolidated assets as of December 31, 1939, aggregated approximately $939,698,000 and the total consolidated operating revenues of its system for the year 1939 aggregated approximately $122,325,000. Its principal offices are located in New York, New York.

The United Light and Power Company. (Proceedings commenced March 8, 1940; see Holding Company Act Release No. 1961.) -- The United Light and Power Company controls 25 utility subsidiaries, which operate electric facilities in 11 States and gas facilities in 12 States, and 20 non-utility subsidiaries. Its consolidated assets as of December 31, 1939, aggregated approximately $586,787,000 and the total consolidated operating revenues of its system for the year 1939 aggregated approximately $91,141,700. Its principal offices are located in Chicago, Illinois.

In the case of certain other large systems, action did not appear appropriate at the time the foregoing proceedings were commenced. For example, Associated Gas and Electric Company is the subject of reorganization proceedings pending in the District Court of the United States for the Southern District of New York, which proceedings are more fully described elsewhere in this report. Columbia Gas & Electric Corporation, another large holding company system, had filed a voluntary plan under Section 11 (e) which, among other things, included a request for an over-all finding that certain of its properties met the requirements of Section 11 (b) and which was pending before the Commission as of the end of the fiscal year. Shortly thereafter, reargument was scheduled on the question whether, in view of the exclusion of certain companies and the pending litigation under the antitrust acts, the Commission may properly consider the merits of that portion of the application which seeks a determination that the system (less the excepted companies) conforms to the standards of Section 11 (b) (1) of the Act.

In addition to the foregoing cases looking to the enforcement of Section 11 (b) (1), the Commission has instituted proceedings pursuant to Section 11 (b) (2) with respect to International Hydro-Electric System, Standard Power & Light Corporation, and Electric Bond and Share Company. [Footnote: Respectively, Holding Company Release Nos. 2122, 2095, and 2051.]

During the fiscal year the Commission gave consideration to several voluntary proceedings submitted by registered holding companies under the provisions of

Section 11 (e) Of these cases, particular mention should be made of the following:

Community Power and Light Company. -- In August 1939, community Power and Light Company, a registered holding company, filed an application under Section 11 (e) for approval of a plan to simplify its corporate structure and to redistribute its voting power in conformity with Section 11 (b) (2) of the Act. At that time, dividend arrearages on the company's preferred stock had accumulated to the extent of $46 per share. The company's corporate structure was complicated by these arrearages and by certain obligations redeemable only after payment of such arrearages. The preferred stock, despite the arrearages, had only 68,962 votes, while 10,000 shares of common stock had 250,000 votes. Under the plan, preferred dividend arrearages were eliminated and one class of stock, with one vote per share, was authorized. Approximately 95 percent of the new stock went to the old preferred stockholders and the remainder to the old common stockholders.

The Commission gave notice of and held a hearing on the proposed plan. On the basis of the record, the Commission issued its findings and opinion finding the plan to be fair and equitable and necessary to effectuate the provisions of Section 11 (b) (2). [Footnote: See Holding Company Act Release No. 1803. It should be noted that the Commission did not in its opinion pass upon compliance by community Power and Light Company with standards of paragraph (1) of Section 11 (b) or with respect to problems presented by Section 11 (5) (2) other than the corporate structure of the top holding company in the system.] Thereafter, the plan, in accordance with its terms, was submitted to the company's stockholders and received the approval of more than two-thirds of the preferred stock and of more than a majority of the common stock.

Community Power and Light Company, pursuant to the provisions of Section 11 (e), requested the Commission to apply to a Federal court to enforce and carry out its terms, This request was the first one made by a registered holding company for such enforcement. The Commission granted the request and made application for such approval to the United States District Court for the Southern District of New York. After hearings on the plan, and after considering and sustaining the constitutionality of the applicable provisions of Section 11, the court found the plan to be fair and equitable and appropriate to effectuate Section 11, and entered a decree enforcing its terms. [Footnote: In re community Power and Light Company, 33 F. Supp. 901 (1940).]

American Gas and Electric Company. -- During the latter part of 1939, hearings were commenced on an application filed by American Gas and Electric Company under Section 11 (e) for approval of a simplification plan pursuant to Sections 11 (b) (1) and 11 (h) (2). In connection with this proceeding, the Commission

instituted proceedings under Section 11 (b) (1) and 11 (b) (2), which were consolidated with those under Section 11 (e). Hearings in this matter had not been completed as of the close of the fiscal year.

ACQUISITIONS AND DISPOSALS OF SECURITIES, UTILITY ASSETS, AND OTHER INTERESTS

During the past fiscal year, holding company systems subject to the Act have continued to effect a gradual corporate and geographical simplification of their utility properties through the acquisition or disposal of securities, utility assets, and other interests under the supervision of the Commission In passing on acquisitions, the Commission is guided by the standards set forth in Section 10 which, among other matters, are designed to prevent undesirable corporate complexities and uneconomic and inefficient development of utility systems. Thus, the Commission may not approve an acquisition unless it finds that the transaction will serve the public interest by tending toward the economical and efficient development of an integrated public utility system. The Commission must also deny an application if it will tend toward interlocking relations or the concentration of control of public utility companies in a manner detrimental to the public interest or the interest of investors or consumers if the consideration to be paid is not reasonable; if the acquisition will unduly complicate the capital structure of the system; or if it will otherwise be detrimental to the public interest or the interest of investors or consumers or the proper functioning of the system.

Among the types of transactions which may result in geographical simplification is the sale of utility assets to operating companies having the same or a contiguous service area. Corporate simplification may be accomplished, among other ways, by the elimination of intermediate holding companies and the elimination of subsidiaries by the sale of securities to associate companies or to interests outside the particular holding company system.

Many examples may be cited to illustrate this gradual regrouping of utility properties in conformity with the integration and corporate simplification principles of the Act.

The Electric Bond and Share System eliminated an intermediate holding company, Lehigh Power Securities Corporation, which had total investments and advances of $103,338,000. The securities of Owego Gas Corporation (Associated Gas and Electric System) were sold to an associate Company, New York State Electric& Gas Corporation, for the purpose of merger, and East Tennessee Light & Power Company (Cities Service Power & Light System) filed a plan of reorganization to result in a merger of three companies. [Footnote: Respectively, see Holding Company Act Release Nos. 1678, 1863, and 1971.]

In a number of cases an associate Company acquired the assets of associate companies. Milwaukee Gas Light Company acquired the assets of four associate gas utility companies, the four associate companies to be dissolved, and Ebasco Services Incorporated (Electric Bond and Share System) acquired all the assets of a wholly-owned subsidiary service Company. The Kentucky Utilities Company (Middle West System) acquired the utility assets of its subsidiary, Lexington Utilities Company, the service areas of which were contiguous and interconnected. The scattered and disconnected electric utility properties of Traction Light and Power Company (Midland United System) were acquired by Central Indiana Power Company and Public Service Company of Indiana, associate companies. [Footnote: Respectively, see Holding Company Act Release Nos. 1638, 1759, 1821, 1855, and 1688.]

In two cases subsidiaries were eliminated by the sale of the voting securities to the public. Washington and Suburban companies sold the voting securities of Washington Gas Light Company to the public and the voting stock of Indianapolis Power & Light Company (Utilities Power & Light System) was sold to the public for $17,156,040. Prior to the sale to the public, Washington Gas Light Company acquired substantially all the outstanding securities of two associate companies, Alexandria Gas Company and Washington Suburban Gas Company. [Footnote: Respectively, see Holding Company Act Release Nos. 1670 and 2001.]

A number of subsidiary companies were sold to nonregistered systems. Consolidated Electric and Gas Company sold all the securities of two of its utility subsidiaries to nonaffiliated interests having no present relations with other public utility companies and Central U. S. Utilities Company (Associated Gas and Electric System) sold its subsidiary, Sioux Falls Gas Company, to a nonaffiliated operating company. [Footnote: Holding Company Act Release No. 1992.] In four cases subsidiaries were sold to individuals: Central States Power & Light Corporation (Utilities Power & Light System) sold three Canadian utility subsidiaries; Massachusetts Utilities Associates (New England Power Association System) sold Gardner Gas, Fuel and Light Company; Peoples Light and Power Company sold its sole operating property in the State of Kansas; and The United Light and Power Company sold all the securities of its subsidiaries, Fayetteville Natural Gas Company and Cleveland Gas Company, to an individual. [Footnote: Respectively, see Holding Company Act Release Nos. 1713, 1730, 1990, 1652, and 1891.]

In three instances small subsidiary companies have been sold to the local manager: American Utilities Service Corporation sold all the securities of Peninsular Utilities Company to the local manager of Peninsular Utilities Company; Walnut Electric & Gas Corporation, a registered holding company, sold the securities of two small utility subsidiaries to the local manager of one of

the subsidiaries; and Walnut Electric & Gas Corporation also sold all the securities of two of its utility subsidiaries to the manager of the two companies. [Footnote: Respectively, see Holding Company Act Release Nos. 1709, 1835, and 2049.]

A limited amount of regrouping took place between registered holding companies: General Water Gas & Electric Company (primarily a water holding company) acquired all the securities of California Water Service Corporation from Federal Water Service Corporation, a nonaffiliated registered holding company for $3,202,000 in cash; Iowa Central Utilities Company (American Utilities Service System) sold its gas utility assets to the nonaffiliated Iowa Public Service Company -- Iowa Central will be liquidated -- and The United Light and Power Company sold all the securities of its subsidiary, Chattanooga Gas Company, to another system, Federal Water Service Corporation . [Footnote: Respectively, see Holding Company Act Release Nos. 1708, 1853, and 2049.]

In four instances holding company systems acquired utility properties from nonregistered systems or from independent utilities: Peoples Light Company (The United Light and Power System) acquired the utility assets of The Bettendorf Company which served a suburb immediately adjacent to the properties of Peoples Light Company; Great Northern Utilities Company (North Continent Utilities System) acquired all the assets of citizens Gas Company, a subsidiary of a nonregistered company; The Sedan Gas Company (Central States Edison, Inc. System) acquired the gas utility assets of a nonaffiliated Company, Major Gas & Oil and West Coast Power Company (Peoples Light and Power Company System) acquired the utility assets of McCall Light & Power Company, a nonaffiliated Company. [Footnote: Respectively, see Holding Company Act Release Nos. 1869, 1976, 2067, and 2082.]

Houston Natural Gas Corporation, a registered holding company incorporated in Delaware, acquired all the assets of its subsidiary utility companies operating in the State of Texas and proposed to sell such assets to a Texas public utility Corporation, thereby becoming an operating Company and ceasing to be subject to the Act. [Footnote: Holding Company Act Release No. 2072.]

The Washington and Suburban companies, a holding company controlling the Washington Gas Light Company, and also controlling the New York and Richmond Gas Company through 11 subsidiary companies, referred to in the House and Senate Hearings on the Holding Company Act the “Tree companies,” was liquidated and dissolved during the past year. [Footnote: Hearings before the Committee on Interstate and Foreign Commerce of the House of Representatives on H. R. 5423, 74th Cong. 1st Sess., Part 1, p. 236.] The voting stock of the Washington Gas Light Company was sold to the public and the Washington Gas Light Company was found to be predominantly an operating

Company and therefore granted exemption from the Act. [Footnote: Holding Company Act Releases Nos. 1670, 1732, 1954, 2356, 2078.]

REORGANIZATION OF REGISTERED HOLDING COMPANIES

During the past fiscal year, the Commission passed on the plans for the reorganization of the following companies: Utilities Power & Light Corporation, National Public Utilities Corporation, Inland Power & Light Corporation and Commonwealth Light & Power Company, Community Power and Light Company, and East Tennessee Light & Power Company. [Footnote: Respectively, see Holding Company Act Release Nos. 1655, 1655-A, 1859, 1689, 1690, 2042, 2047, 1803, 1804, 1982, 1971, 1972.]

The plan of reorganization of Utilities Power & Light Corporation (now the Ogden Corporation), referred to in the Commission's Fifth Annual Report, has been consummated following approval by the Commission and confirmation by the United States District Court for the Northern District of Illinois. The plan set forth a program for conversion into an investment company through the disposal of assets. In accordance with this program the Corporation's investments in two of the utility subsidiaries, Indianapolis Power & Light Company and Newport Electric Corporation, have been disposed of already. [Footnote: Holding Company Act Releases Nos. 1545, 1552, 2001, 2087.] Although the proceeding instituted by the Commission under Section 11 (b) (1), referred to in the above-mentioned annual report, is still pending, the progress made through voluntary compliance justifies the expectation that it will be unnecessary for such proceeding to be pressed.

The National Public Utilities Corporation reorganization [Footnote: Holding Company Act Releases Non 1689, 1690.] concerned an insolvent Company with nominal income which had been in reorganization since 1933. The plan as approved by the Commission provides for the distribution of only one class of securities, common stock, which will be distributed to bondholders and other creditors. The bondholders and other creditors will also receive voting trust certificates of a subsidiary company, Great Lakes Utilities Company. The new Company will have no funded debt and its simplified security structure will facilitate liquidation.

The Commission denied as not feasible a plan of reorganization for The Commonwealth Power & Light Corporation and its subsidiary Inland Power & Light Corporation. The plan provided for the formation of a new company and the liquidation of the properties within two years and, in the event of failure to liquidate within that time, provided for the appointment of a trustee. The Commission noted the temporary character of the new Company and stated that

it was unable to see why the liquidation could not be accomplished as effectively by the present trustees as by a board of directors or by a new and perhaps strange trustee 2 years hence. [Footnote: Holding Company Act Releases Nos. 2042, 2047.]

PUBLIC UTILITY SECURITY ISSUES

During the fiscal year ended June 30, 1940, 111 applications or declarations filed by registered public utility holding companies and their subsidiaries were declared effective pursuant to Sections 6 and 7. These effective filings aggregated $1,002,05l,051 in principal amount, compared with $1,104,574,000 for the preceding year. This brought the total of new securities issued since the effective date of the Act, December 1, 1935, to $2,885,932,502, Fifty-one filings, aggregating $274,200,818, were pending at the end of the year. These figures do not include outstanding issues whose rights were altered under Sections 6 (a) (2) and 7 (e), nor do they include the guarantee of other issues.

The past year's effective filings, some of which covered more than one security issue, consisted of the following:

49 mortgage bond issues aggregating $618,030,800

8 debenture issues aggregating $104,550,000

52 note issues aggregating $104,043,135

11 preferred stock issues aggregating $126,581,109

33 common stock issues aggregating $48,846,007

Mortgage and debenture bonds, most of which were refunding issues, have represented 62.9 percent of all financing under the Act, while notes, 13.3 percent; preferred stock, 12.5 percent; and common stock, 11.3 percent, make up the remainder.

The recent flotation of $95,000,000 of 3.5 percent bonds by the Pennsylvania Power and Light Company was the second largest to come under the Act.

Each security issue to be declared effective by the Commission, unless exempt, must meet the standards of Section 7. In addition to other standards, the security must be reasonably adapted to the earning power and the capital structure of the issuer; the financing involved must be appropriate to the economical and efficient operation of the business in which the applicant is lawfully engaged or has an

interest; the fees, Commissions, and other remuneration paid in connection with the issue or sale of the security must be reasonable; and the terms and conditions of the issue or sale must not be detrimental to the public interest or the interest of investors or consumers.

One of the things most closely scrutinized in passing upon applications and declarations to issue securities is the ratio of bonds or bonds and preferred stock to total capitalization and to net tangible property. Consideration, however, is also given. to earning power. In the case of a large issue by Public Service Company of Colorado, a majority of the Commission believed that the favorable earnings record of the Company justified permitting a refunding operation which would effect substantial interest savings and result in future improvement in the capital structure, through compulsory debt retirement, notwithstanding the fact that the existing capitalization was the result of inflationary practices of an extreme character. [Footnote: Holding Company Act Release No. 1701.] The consolidated property accounts of the declarant, aggregating $86,885,703, contained $23,424,418 of inflationary items; and it appears that the parent holding company, Cities Service Company, through a complicated series of transactions, had obtained the entire common stock of $20,800,000, par value, without cost to it, and had also received $1,280,437 in cash in connection with the transactions. These shares were exchanged along with others for the stock of Cities Service Power and Light Company when the latter was organized in 1925. During the last 15 years Cities Service Power and Light Company has received over $26,000,000 of dividends on its holdings of the common stock of Public Service Company of Colorado.

Although the proposed financing slightly increased the amount of the already high funded debt, the Commission approved it because the increase was to be but temporary, as the retirement of debt by heavy sinking fund payments would rapidly improve the capital structure of the company, and the earnings were adequate. [Footnote: Although the amount of the debt was increased, the debt ration was not increased, largely because of the exchange of $2,190,000 of notes held by the holding company, for common stock, thus increasing the common stock “cushion.” See Chairman Frank’s concurring opinion in Southwestern Gas and Electric Company, Holding Company Act Release No. 1931.] In its final form, the trust indenture required rapid retirement of debt through annual sinking fund payments of $300,000 for the bonds and for the debentures. In addition, the indenture prohibited the payment of dividends from the then existing surplus and required that $500,000 of earnings be set aside each year as not available for dividends until the debentures had been retired. The annual credit to a maintenance and replacement fund, equal to 15 percent and 10 percent of gross electric and gas revenues, respectively, required by the indenture was also an improvement over previous conditions. The dividend restriction, replacement and maintenance funds were also made conditions of the

Commission's order allowing the issue to become effective. Furthermore, the corporate structure was simplified by consolidating nine issues into two refunding issues and the conversion of the parent's open account into common stock.

Commissioner Healy dissented from the majority's disposition of the case. Finding that the inflationary items totaled at least S24,184,352 (principally profits made by Cities Service Company on properly conveyed to the company, a substantial part of which had been bought with funds provided by the company), he demonstrated that the company's common stock owned by Cities Service Power & Light Company not alone cost the latter's parent and assignor, Cities Service Company nothing, but cost it a minus quantity of $4,993,255. In addition, it has received cash dividends of $26,910,567 in less than fifteen years. In view of these circumstances, he considered it inconsistent with the applicable statutory standards to permit a financing which would increase the publicly-contributed capital by $5,000,000 and increase the earnings distributable on the common stock which represented no actual investment. Commissioner Healy pointed out that if the net assets were adjusted by subtracting therefrom the amount of the inflationary items, the ratio of bonds and debentures to net assets so adjusted would be 90.5 percent, and the ratio would be increased to 101.22 percent if publicly held preferred stock were included. Accordingly, he concluded that the securities proposed to be issued were not reasonably related to the security structure of the company as required by Section 7 (d) (1) of the Act. Commissioner Healy stated that he believed that section, when read in light of the declaration of policy in Section 1 (b), makes clear that securities were not to be issued against write-ups and intra-system profits. He found that section excluded issues in excess of "actual investment," a standard which rejects self-serving declarations of value and arbitrary appraisals.

Although earnings may be substantial, the Commission believes that a reasonable capital structure calls for a substantial amount of common stock equity both as a protective cushion for the bonds and preferred stock and to prevent temporary declines in earnings from resulting in receiverships. To keep the financial structure of a growing concern strong, a substantial proportion of the new investment should be represented by common stock equity. It may come from earnings, from the parent corporation in the form of a capital contribution, or from a public sale of additional stock.

The possibility of strengthening the financial structure of a particular company is frequently limited by practical considerations. Despite a favorable market, equity financing may not be easily available to heavily bonded companies with inadequate depreciation and accumulated preferred stock dividend arrearages. With respect to the Consumers Power Company financing program, filed in December 1939 (Holding Company Act Release No. 1854) the majority of the Commission approved a refunding bond issue of $18,000,000, and the sale of

$3,524,188 of common stock (125,000 shares) to its parent, The Commonwealth & Southern Corporation, but refused to allow the Company to issue $i10,000,000 of additional mortgage bonds. [Footnote: The Commission, in its opinion, noted that the questions involved had not been adequately argued and, therefore, stated that as a matter of right it would, if requested, grant a rehearing and also, at the request of the company, would re-open the hearing for the taking of further pertinent testimony. The company subsequently asked for a rehearing, but before the date set therefor, withdrew its request.]

In a separate opinion, Commissioners Healy and Mathews recorded their disagreement with the majority's refusal to permit the Company to issue the full amount of the bonds it desired to issue. Agreeing with the majority as to the need for a substantial amount of common stock equity, they were not satisfied that issuing additional bonds would render the capital structure disproportionate. Conceding that additional debt financing was not necessary, they were not prepared to find that it was not "appropriate," in view of the fact that the terms of the financing were very economical to the Company and that the parent was making an additional investment in common stock of the Company of $3,500,000. They pointed out that of the $13,500,000 new money proposed to be raised by Consumers Power Company, over 25 percent represented common stock money.

The majority found that under Section 7 (d) (3), additional bonds were neither "necessary or appropriate to the economical and efficient operation of the business of the applicant" because --

(1) common stock financing was readily available on favorable terms to this Company, judged by its earnings record and by the market prices of other comparable common stocks;

(2) the common stock equity including surplus amounted to only 20 percent of total capitalization, a ratio considerably lower than corresponding ratios in the case of other comparable operating utilities; [Footnote: It should be noted that in his subsequent concurring opinion in West Penn Power Company, Holding Company Act Release No. 2509, Commissioner Healy expressed views in accordance with the principle that the maintenance of proper ratios of senior securities (debt and preferred stock) to net property as prerequisite to the approval of an issue of securities "is neither an innovation caused by the language of Section 7 (d) nor by the Commission," citing several State Commission decisions. He regards this as consistent with the indication of his views in the Consumers case that the ratio of debt to net property in the circumstances of that case was not out of line.]

(3) the balance of net property left for the common stock after allowance for bonds and preferred stock was approximately 11 percent of total depreciated property. This figure was likewise lower than corresponding percentages for comparable operating utilities;

(4) the ratio of debt to depreciated property was relatively higher than that of comparable companies.

The Commission does not consider it appropriate to permit companies to create large debt obligations whose rigid fixed charges may, in the future, force receivership through inability adapt itself to future changing economic conditions. This is especially so when a more desirable alternative, such as common stock financing, is available.

In considering refunding issues, the Commission has taken into consideration the fact that if too restrictive provisions are required the financing may not be consummated and the company will not secure the benefits of lower interest rates, extended maturities, and simplified debt structure. The Commission, however, has always insisted that the minimum standards of the Act be adhered to. Where this is impossible, recapitalization is recommended. The Commission is presently engaged in reexamining the extent to which it may properly differentiate between refunding issues and new issues.

[Footnote: In his concurring opinion in ***Southwestern Gas and Electric Company***, Holding Company Act Release No. 1931, Chairman Frank said:

"This Commission has consistently differentiated between

(a) the sale of bonds, the proceeds of which are to be used to refund or retire existing debt with a resultant decrease of fixed charges, and

(b)new issued of bonds which will add substantially to the existing corporate debt.

The Commission has accordingly permitted refunding bond issued to be sold where the ratio of debt to total capitalization was relatively high and where the ration of common stock and surplus (the common stock "cushion") to total capitalization was relatively low. See, e. g., ***Republic Service Corporation***, 2 S. E. C. 44 (1937). In some few of such cases the debt was increased by a relatively small amount in order to enable the company to meet the expenses attendant on the refunding operations; but in those cases the increase was temporary, provision having been made for a rapid retirement of the increased debt. See, e. g., ***Pennsylvania Power & Light Company***, Holding Company Act Release No. 1678 (1939). Of course, there may be circumstances in which we

could not permit bonds to be issued even for purposes of refunding. Our decisions are not to be taken to mean, therefore, that refunding bond issues will always be authorized, if debt ratios are dangerously high, or if other conditions exist which clearly transgress the applicable standards of the Act; indeed, adverse findings might be required even if, in such cases, the company is unable to procure funds for refunding through the sale of junior securities."

Chairman Frank also observed:

"Many cases of refunding issues have arisen under the express statutory exemption created by Section 6 (b). Accordingly, the requirements of Section 7, including, of course, Section 7 (d) (3), were inapplicable. See ***Public Service Company of Indiana***, Holding Company Act Release No. 1826 (1939); ***Central Illinois Electric and Gas Company***, Holding Company Act Release No. 1591 (1939); Northern Indiana Public Service Company, Holding Company Act Release No. 1836 (1939)."]

In February 1940, the Kentucky Utilities Company, a subsidiary of The Middle West Corporation, filed a declaration to issue $26,000,000 of first mortgage bonds and $6,000,000 of serial notes. (Holding Company Act Release No. 1965.) This plan was amended to cover an issue of $20,000,000 of first mortgage bonds, $6,000,000 of second mortgage sinking fund bonds, and $6,000,000 of serial notes. The bonded indebtedness amounted to 64 percent while the common stock equity equaled only 10 percent of the total capitalization. At the suggestion of the Commission, The Middle West Corporation agreed to contribute $500,000 to the company to retire debt. The Commission then approved this refunding program, because the heavy sinking fund provisions and serial retirements would rapidly improve the financial structure of the company. All savings due to lower interest rates were also to be applied to debt retirement.

In February 1940, the West Penn Power Company, a registered holding company and an indirect subsidiary of American Water Works and Electric Company, filed an application for exemption, under Section 6 (b), of the issue and sale of $5,000,000 of bonds and 24,023 shares of 4.5 percent preferred stock. (Holding Company Act Release No. 2009.) Subsequently, the applicant withdrew its application and filed a declaration, under Section 7, to issue and sell $3,500,000 of bonds and 160,000 shares of no par common stock at an offering price of $27 per share. The proceeds of the sale were to be used for the acquisition of improvements, additions, and betterments to its plant and property. Bonds and common stock equity represented 48 and 29 percent, respectively, of total capitalization. The ratio of debt and preferred stock to depreciated property and investments on a pro forma basis was equal to 75 percent. But, after eliminating large inflationary items, the ratio rose to 84 percent. The company,

however, has been earning its interest and preferred dividends by a wide margin and has regularly paid common stock dividends for the past 20 years.

The Commission considered the small amount of common stock equity and the presence of inflationary items undesirable. It indicated that a program of financing entirely with senior securities, when equity financing was available, would fall short of statutory standards. [Footnote: Commissioner Healy expressed the view that since the Company, though a registered holding company itself, was a subsidiary of a registered holding company it was entitled to have the matter treated under Section 6 (b) rather than under Section 7 of the Act, and pointed out certain problems which would be presented were the case considered under Section 7.]

Since the altered plan cut down the amount of bonds, eliminated the preferred stock, and raised over half of its immediate capital requirements by the public issue of common stock, no adverse findings were made as in the earlier case of Consumers Power Company. Because of the possible detriment to uninformed investors and the fact that there were no quoted prices to guide them, the Commission required that the offering prospectus include those parts of the opinion which discussed investment and property write-ups, equity and bond ratios, depreciation policies, and possibility of rate reductions. On the basis of its earnings for the year 1939, the proposed offering price of $27 per share amounted to 17.3 times the earnings applicable to the common stock. Since the common stock was to be sold to the public, the charter was amended to give it preemptive rights and to require that prejudicial changes in the rights of common stockholders must be approved by at least two-thirds of the outstanding shares.

Because the two parent companies, which owned all the outstanding common stock, were not in a position to subscribe for 160,000 additional shares, they were offered to the public. This is one of the first cases, since the passage of the Act, in which new money has been secured from the public by means of the sale of common stock. Other cases have been concerned principally with already outstanding shares or with stock issued to the parent or issued for the exchange of property or other securities. Pursuant to an approved plan of reorganization which called for a partial liquidation of the portfolio of the Utilities Power & Light Corporation, a registered holding company, and its conversion into an investment trust, the trustee offered to the public, through underwriters, 645,980 shares of the common stock of its operating subsidiary, the Indianapolis Power & Light Company, at $24 per share or 11 .7 times earnings. [Footnote: Holding Company Act Release No. 2087] At the same time, the operating company sold, through these underwriters, 68,855 new shares, to raise capital for plant expansion. Also in furtherance of this reorganization plan, the 11,910 one hundred dollar par value shares of the Newport Electric Corporation were split 5 for 1 and offered to the public at $20.50 per share, or 9.4 times earnings, by the

trustee. [Footnote: Holding Company Act Release Nos. 1545, 1552.] Pursuant to a plan to liquidate the Washington and Suburban Companies, 362,588 shares of its subsidiary, Washington Gas Light Company, were offered to the public at $29.50, or 11.0 times earnings. [Footnote: Holding Company Act Release No. 1670.] This block included 35,000 new shares which were being sold to raise additional capital for the operating company.

One of the objectives of the Act is to prevent an unfair or inequitable distribution of voting power. In the ***Southwestern Gas and Electric Company*** case, the Commission approved the alteration of the voting power of the common stock which resulted from giving the right to vote to the new preferred stock issued to replace one paying a higher dividend. The new preferred stock had the following voting rights:

1. One vote per share for the election of directors and upon all other matters.

2. When one year's cumulative preferred dividends have accrued, two additional directors elected by the preferred stock shall be added to the board of directors, while the remaining directors shall be elected by the common stock.

3. When three years' cumulative preferred dividends have accrued and until all dividends in default shall have been paid, the preferred stock, voting as a class, shall be entitled to elect a bare majority of the full board of directors.

4. Without the affirmative vote of a majority of the outstanding shares of preferred stock, or if one-third of the outstanding shares of such stock shall vote negatively, the company shall not

(a) authorize any prior or parity stock; or

(b) change any of the terms or provisions of outstanding shares of preferred stock so as to affect adversely the holders thereof; or

(c) issue any shares of preferred stock in excess of 75,000 shares of 5 percent preferred stock or any shares of any class of stock ranking prior to or on a parity with the preferred stock, unless net earnings available for dividends shall for a preceding twelve-month. period have been at least equal to twice the annual dividend requirement on all shares of preferred stock which would then be outstanding, and unless gross income for said period available for payment of interest shall have been at least one and one-half times the sum of funded debt charges and dividend requirements on all preferred stock then outstanding; or

(d) issue any shares of preferred stock if thereafter the aggregate par and stated value of all such outstanding shares would exceed the sum of $15,000,000 and

would also exceed an amount equal to twice the sum of (i) the capital of the company represented by stock junior to the preferred stock and (ii) earned and capital surplus of the company; or

(e) reacquire, or declare any dividends, or make any other distribution, upon shares of common stock or any other class of stock junior to the preferred stock, unless immediately thereafter the sum of (i) the capital represented by all stock junior to the preferred stock and (ii) earned and capital surplus, shall be not less than the sum of $5,800,000 plus an amount equal to twice the annual dividend requirement on outstanding preferred stock; or

(f) issue any unsecured form of debt other than for the refunding of outstanding unsecured securities, or the redemption of the preferred stock, if immediately after such issue the total principal amount of all such unsecured securities then outstanding would exceed 1.0 percent of the aggregate of (i) the total secured debt and (ii) the capital and surplus of the company; or

(g) merge or consolidate with or into any other corporation unless such merger or consolidation, or the issuance and assumption of all securities to be issued or assumed in connection therewith be ordered, approved, or permitted by the Securities and Exchange Commission under the Public Utility Holding Company Act of 1935. [Footnote: Holding Company Act Release No. 1931.]

Frequently the companies with high dividend preferred stocks have redeemed or exchanged them for new issues carrying lower dividend rates. In carrying out this refinancing, it has been found to be a convenient means of distribution to offer the old preferred shareholders the opportunity to subscribe to the new shares. To this end, they have been notified of the general plan several weeks in advance but have been informed of the final terms, such as price an d dividend rate, only two or three days before exchanged documents must be in the hands of the company or its underwriting agents. [Footnote: ***West Penn Power Company***, Holding Company Act Release No. 1639. ***American Gas and Electric Company***, Holding Company Act Release No. 1870. ***Southwestern Gas and Electric Company***, Holding Company Act Release No. 1931. ***Kansas Power and Light Company***, Holding Company Act Release No. 2024.] After investigation and observation of several cases, the Commission concluded that this length of time was insufficient and in the Kansas Power and Light Company opinion gave notice that thereafter any such exchange period ought to be not less than five days. [Footnote: Holding Company Act Release No. 2024.] Immediately thereafter, the Wisconsin Electric Power Company provided a ten-day exchange period for its old preferred stockholders. [Footnote: Holding Company Act Release No. 2026.]

The Commission has been giving increasing attention to the provisions of trust indentures securing mortgage bonds of public utility companies. The terms of these indentures relating to the obligations and activities of the trustee must now conform to the standards of the Trust Indenture Act of 1939. Other provisions of trust indentures also require examination to see that they in turn provide adequate protection for the investor. The Commission is making a general study of indenture procedures and provisions with a views to developing appropriate standards for the future.

In addition to its other regulatory duties relative to the issuance or sale of utility securities subject to its jurisdiction, the Commission is called upon to supervise the exercise of any privilege or right to alter the priorities, preferences, voting power, or other rights of the holders of outstanding securities. Under Section 7 (e), the Commission may not permit the exercise of any such privilege or right where it would result in unfair or inequitable distribution of the voting power or would be otherwise detrimental to the public interest or the interest of investors or consumers.

An important case illustrating the difficult problems that may arise in connection with this phase of the Commission's work involved the Philadelphia Company, a subsidiary of Standard Gas and Electric Company and principal source of income of that company. The Philadelphia Company filed a declaration with the Commission pursuant to Section 6 (a) (2) regarding a reduction in the stated value of its common stock from approximately $48,000,000 to approximately $34,800,000. The major investment of the Philadelphia Company is its ownership of the entire common stock of Duquesne Light Company, which operates in Pittsburgh Pennsylvania. The Philadelphia Company, however, also has a substantial investment in the street railway system of Pittsburgh carried on its books at more than $52,000,000. The Philadelphia Company sought to create a reserve of $23,000,000 to absorb an anticipated loss on its investment in the street railway system which was being reorganized. The reserve was to be set up by transferring $13,000,000 from existing surplus and a further $10,090,000 from capital surplus created by the proposed reduction of the stated value of the company's common stock. The effect of these transactions was to reduce the "cushion" or capital stock equity beneath the company's debentures to slightly over $74,000,000. Under the indenture securing the debentures, any further reduction in such cushion might have necessitated cessation of dividends until the full $74,000,000 of stock equity was restored. Standard Gas and Electric Company depended on these dividends for the payment of interest on its notes and debentures.

In its findings, the Commission seriously questioned the adequacy of the $23,000,000 reserve for losses on the traction investments, but permitted the declaration to become effective. The Commission noted that the company was

committed by its amended declaration to a provision whereby the sum of $500,000 a year out of earnings available for the payment of common stock dividends will be restricted in earned surplus until the amount so restricted amounts to $2,500,000 and no subsequent declaration of common dividends will be made which will impair this restricted surplus except with the consent of the Commission. The Commission indicated the necessity of providing for the contingency that the loss in the traction investments might exceed $23,000,000 and reserved jurisdiction over dividend payments under Section 12 (e) of the Act.

UNDERWRITERS' AND FINDERS' FEES

Under various provisions of the Act, the Commission is charged with the "maintenance of competitive conditions," and under Section 1 of the Act is directed to interpret the provisions of the Act so as to eliminate the enumerated evils including those "which result from an absence of arm's-length bargaining or from restraint of free and independent competition" in the transactions of public utility companies.

Under Section 7, the Commission is directed to withhold permission to issue or sell a security when it finds that the fees, commissions, or other remuneration are not reasonable or the terms and conditions are detrimental to the public interest or the interest of investors or consumers.

To regulate the activities and transactions between issuers and bankers where there may be an absence of free and untrammeled bargaining, the Commission has adopted Rule U-12F-22 (based on Section 12 (f) and other provisions of the Act) to control the payment of fees to underwriters and "finders" who may be in a position, by reason of stock ownership or other relationship, to gain an unfair advantage in bargaining. Persons affected by the rule are (substantially) those falling within the statutory definition of "affiliate" in Section 2 (a) (ii) of the Act, which includes, in addition to officers, directors, and persons having specified stock ownership, any person whom the Commission finds to stand in such a relation to the issuing company "that there is liable to be such an absence of arm's-length bargaining in transactions between them as to make it necessary or appropriate in the public interest or for the protection of investors or consumers that such person be subject to the obligations, duties, and liabilities" imposed upon affiliates. The rule, like the statutory provision which it parallels, recognizes the impracticability of precisely defining the facts which make for absence of arm's-length bargaining, and permits the disposition of each case in the light of the evidence therein developed. By the terms of the rule, no fee can be paid, unless on the basis of competitive bidding, to underwriters or "finders" subject to the rule, unless the justification is clear or unless such person merely has a participation of not more than 5 percent and the fee is the same as that paid to non-affiliated underwriters.

During the fiscal year, there were five proceedings under Section 12 (f) and Rule U-12F-2 relating to underwriters' and finders' fees:

Halsey, Stuart & Co., Inc., filed an application for determination of its status under the rule as a possible or a prospective underwriter of various securities proposed to be issued by Public Service Company of Colorado. On the record presented, the Commission found that the applicant did not bear to the Company any of the relationships specified in subdivision (a) of the rule. [Footnote: Holding Company Act Release No. 1707.]

Morgan Stanley & Co., Incorporated and Bonbright & Company, Incorporated filed an application for a determination of their status under Rule U-12F-2 as participating underwriters for an issue of first mortgage bonds of Consumers Power Company. It was stipulated that those two underwriters would not receive any underwriting fees in connection with the sale of the bonds in the event that they were found to be affiliates of Consumers Power Company and The Commonwealth & Southern Corporation within the meaning of the rule. (Holding Company Act Release No. 1854.) At the close of the fiscal year the case was pending.

The Commission instituted a proceeding under Rule U-12F-2 with respect to The Dayton Power and Light Company and Morgan Stanley & Co., Incorporated, in connection with the issuance and sale of first mortgage bonds of The Dayton Power and Light Company. The Commission accepted the suggestion of Morgan Stanley & Co., Incorporated that the financing be permitted to proceed as proposed on condition that Morgan Stanley & Co., Incorporated receive no fee pending final determination of the issues raised by the proceeding pursuant to Rule U-12F-2. [Footnote: Holding Company Act Release No. 1925. Commissioners Henderson and Eicher expressed dissenting views on this point in both the ***Consumers Power Company*** and ***The Dayton Power and Light Company*** cases, asserting that in their opinion the proceeding under Sections 6 (b) or 7 should not be disposed of until the issues involved in the affiliation proceeding under Rule U-12F-2 were determined.] At the close of the fiscal year the case was pending.

Following a preliminary investigation, the Commission instituted a proceeding pursuant to Rule U-12F-2 with respect to Northern Natural Gas Company and Dillon, Read & Co., in connection with the issue and sale of securities of Northern Natural Gas Company. Prior or to the hearing on the issues in this proceeding, Pillion, Read & Co. agreed to waive its right to claim or receive its finder's fee, with the .reservation that the claim might be reasserted in the event that Rule U-12F-2 should be held invalid or that subdivision (a) (3) of the rule should be repealed with retroactive effect.

The Commission also instituted a proceeding under Rule U-12F -2, with respect to Michigan Consolidated Gas Company and Dillon, Read & Co., in connection with the issue and private sale of bonds to two insurance companies. The Commission agreed to the respondents' request to postpone consideration of the issues raised by this proceeding on condition that no finder's fee in connection with the proposed transaction shall be paid to Dillon, Read & Co. pending completion of the similar proceedings involving Dillon, Read & Co. and Northern Natural Gas Company. [Footnote: Holding Company Act Release No. 1984.]

In a number of other instances where the question of affiliation under Rule U-12F-2 existed, the investment banking firms concerned limited themselves to an underwriting participation of not more than 5 percent, thereby avoiding the problems and issues involved in a proceeding under the rule. Since proceedings under Rule U-12F-2 may involve lengthy hearings on more or less intangible corporate relationships, the Commission has been considering alternative techniques which may be less burdensome from the standpoint of the issuer and more effective from the standpoint of the Commission in meeting the requirement of the Public Utility Holding Company Act of 1935 to preserve competition and arm's-length bargaining in the distribution of utility securities.

As it has done in other instances, the Commission has solicited the views of interested and informed members of the public as to a method that would best insure the reasonableness of fees and Commission, the fairness of the terms and conditions of any proposed issue and sale of utility securities, and the elimination of "transactions in which evils result from an absence of arm's-length bargaining or from restraint of free and independent competition."

The Commission has received numerous responses from investment bankers and utility executives, and conferences have been held with the National Association of Securities Dealers, Inc., and others. It is now considering the suggestions received for the improvement of its regulatory procedure relative to the issue and sale of securities.

DIVIDEND DECLARATIONS AND PAYMENTS

Pursuant to Section 12 (c), no dividends may be paid or securities redeemed in contravention of any rules or order which the Commission has deemed necessary to protect the financial integrity, to safeguard the working capital, to prevent the payment of dividends out of the capital or unearned surplus of public utility companies, or to prevent the circumvention thereof. Pursuant to this section, the Commission has promulgated Rule U-12C-2 which, except by specific order, prohibits the payment of dividends out of capital or unearned surplus.

In the matter of the Securities Corporation General, a subsidiary of International Utility Corporation, which had a deficit in the earned surplus account (there was a capital surplus), the Commission has permitted the payment of dividends out of currant earnings when it was for the purpose of making a distribution on preferred stock held by the public and its financial integrity was not jeopardized. [Footnote: Holding Company Act Release Nos. 1704, 1775, 1923.] Similarly, the International Utilities Corporation, which also had a deficit in the earned surplus account, was permitted to pay dividends out of current earnings on its two classes of preferred stock on two occasions. Subsequently, permission was granted to pay dividends only to the senior issue because current earnings were inadequate to cover both issues. [Footnote: Holding Company Act Release Nos. 1643, 1753, 1910, 1924, 2036.] The need of reorganization of both companies was noted.

The Commission, however, did not allow the payment of dividends out of what was alleged to be earned surplus after an accounting reorganization of the Associated Gas and Electric Corporation (hereinafter called AGECORP) because it was found to be, in fact, capital surplus. The Associated Gas and Electric Company (hereinafter called AGECO) is the top holding company in the Associated System in which the public has an interest. AGECO owns all the stock of AGECORP, which owns the stock of 5 subholding companies which in turn, directly and indirectly, own the controlling stocks of 70 electric and gas utility companies and 85 miscellaneous companies. The operating subsidiaries render services to a population of over 7,000,000 in more than 6,200 communities in some 20 States and the Philippine Islands. The system was put together by H. C. Hopson (now under indictment for alleged mail fraud and income tax violation) and his associates. Acquisitions of properties were financed to a large extent by the issuance of stock and debentures of Associated Gas and Electric Company and subholding companies in the system, over $1,000,000,000 of such securities having been issued in the process. About $270,000,000 of this money was represented by debentures of AGECO.

In 1933, AGECO found itself unable to meet the interest on these debentures. A few years before, the underlying system properties had been transferred to AGECORP. AGECO partially extricated itself from its difficulties by persuading the holders of approximately $200,000,000 of its debentures to accept therefor lesser principal amounts of fixed interest and income debentures of AGECORP. These conversions of AGECO debentures for AGECORP debentures constituted a large-scale recapitalization plan, generally called the Recap Plan. [Footnote: This Recapitalization Plan is critically examined in Part VII of this Commission's report on the Study and Investigation of the Work, Activities, Personnel, and Functions of Protective and Reorganization Committees, pp. 23-108.] The exchange of AGECO debentures for AGECORP debentures pursuant to the

Recap Plan was induced in part by the belief that the converters would thereby follow the system assets downstream and obtain a more direct claim to the income of the system. Holders of some $70,000,000 of AGECO debentures refused to exchange and thus remained dependent for their interest upon dividends paid by AGECORP up to AGECO. The interest of the holders of AGECO debentures demanded a flow of dividends from AGECORP irrespective of AGECORP's earnings. The interest of the AGECORP debenture holders was, of course, opposed to this. The interest of the management of the Associated System demanded that sufficient funds be brought up to AGECO to permit payment of interest and retention of themselves in office. This situation resulted in pressure upon the operating companies to pay up cash irrespective of its effects upon the operating properties and their consumers. Simultaneously with the flow of cash upstream there was a steady increase in bank loans throughout the System.

It was extremely doubtful whether the earnings and earned surplus account of AGECORP were such as to permit future payments of sufficient dividends to cover AGECO's interest requirements. Accordingly, on November 27, 1935, four days before the effective date of the registration provisions of the Act, AGECORP declared a dividend to AGECO consisting of $90,000,000 in notes. This dividend was declared out of an alleged capital surplus, the laws of Delaware, under which AGECORP was organized, permitting such dividends. Thereafter, over $16,000,000 was paid by AGECORP to AGECO on account of interest and principal on the above notes. This money was used by AGECO to meet its own interest obligations.

AGECO registered as a holding company on March 25, 1935, following the decision of the Supreme Court in the ***Electric Bond and Share*** case. From this date to November 13, 1939, AGECORP declared and paid no dividends, the payments on account of the above notes being the sole source of AGECO'S revenue.

Effective January 1, 1937, the Commission, acting pursuant to Section 12 (c) of the Act, adopted Rule U-12C-2 forbidding the payment of dividends out of capital or unearned surplus, except upon application to, and approved by order of, the Commission. Effective November 5, 1939, in order to prevent the circumvention of this rule, it adopted Rule U-12C-3, which forbade, except upon application to and order by the Commission, the payment of any indebtedness arising from a dividend declared out of capital or unearned surplus.

On November 1 3, 1939, AGECORP declared a dividend of $600,000 and paid $510,000 of this amount to AGECO. On November 21, 1939, the Commission issued an order to show cause why an order should not issue, pursuant to Section 12 (c) of the Act, forbidding the payment of further dividends. On

December 12, 1939, AGECORP filed an application, pursuant to Rule U-12C-3, for permission to pay interest on the balance of $71,805,120 due on one of the notes declared as a dividend out of capital surplus. The cases were consolidated and heard jointly. The Commission's decision forbidding the payment of dividends or interest was based upon its findings that such payments would be in violation of the legislative standards set forth in Section 12 (c) of the Act in the following respects:

1. Such payments would be made from capital or unearned surplus. It was found that on the application of proper accounting standards AGECORP had, instead of an earned surplus credit balance as represented, an earned surplus deficit of many millions of dollars. In particular, it was found that the AGECORP "accounting reorganization" of March 31, 1938, whereby the earned surplus deficit was charged off against capital surplus could not be given effect in determining whether AGECORP presently had an earned surplus. This accounting reorganization "was held to be not sufficiently thoroughgoing and, as a device for altering the earnings history of AGECORP, it was found to be deceptive upon the security holders affected by the Recap Plan.

2. Such payments would impair the financial integrity of AGECORP. The impairment was particularly striking in view of the approaching maturity, on March 15, 1940, of $8,589,080 of AGECORP'S 8 percent debentures which AGECORP professed to be unable to pay at maturity. [Footnote: "The Commission concluded its opinion as follows: "counsel for the respondent argue that it is unnecessary for see to enter orders forbidding payments of either dividends or interest by AGECORP to AGECO in view of the fact that all basis for such action can be removed by adoption of a plan of reorganization for the System under Section 11 (e) of the Public Utility Holding Company Act. Assuming that our powers under Section 11 (e) are broad enough to permit the clearing up of all the difficulties involved in this situation, the execution of such a plan involving a system as complicated as the Associated System is impossible in a period of less than several years. If we should permit the payments now proposed and the multitude of additional payments which the respondent admits would be necessary if AGECO is to meet its obligations pending the consummation of such a plan, we would be permitting for a period of years repeated payments in the face of our finding that such payments contravene the provisions of the statute.

The Commission recognizes that entering its order at this time will give the respondent scant opportunity to seek judicial review before AGECO must meet its interest obligations on January 15. Because of the serious consequences which may flow from failure to meet the interest date, this Commission might be inclined to withhold an order forbidding the particular payment from AGECORP to AGECO proposed to be made on January 15. However the president of the

respondent has indicated to us by letter that, after consultation with a majority of the directors and officers of AGECORP and AGECO and upon advice of counsel, he is authorized to request that the order, even if unfavorable, he issued immediately, and to state that 'the Company has no intention of seeking judicial review of the Commission's decision and, therefore, will not in any way be embarrassed even though the order will appear to be issued so closely before the dividend date.' We have therefore decided to issue the order at this time."]

On January 10, 1940, AGECO filed its petition for reorganization under Chapter X of the Bankruptcy Act, as amended AGECORP also filed a petition on account of its inability to meet its March 15th maturity. The case was assigned to the Honorable Vincent L. Leibell, District Judge in the Southern District of New York. Upon inquiry of Judge Leibell whether the Commission would accept, pursuant to the provisions of Section 11 of the Public Utility Holding Company Act of 1935, appointment as trustee of the estates of the two companies, the Commission responded that it did not desire such an appointment. Thereafter, Judge Leibell appointed Walter H. Pollak as Trustee of AGECO, and Willard L. Thorp and Dennis J. Driscoll as Trustees of AGECORP.

Four subsidiaries of the Columbia Gas and Electric Corporation were allowed to pay interest on notes, the principal of which might be construed to be dividends paid to the parent out of unearned surplus. It was found that the financial integrity of these companies would not be impaired by such a disbursement. [Footnote: Holding Company Act Release No. 1907.]

To protect the financial integrity of the companies and to maintain adequate working capital, the Commission, when necessary, has imposed restrictions on the payment of dividends from earnings or surplus in connection with orders permitting the issuance of securities under Sections 6 (b) and 7. A case in point involved The Toledo Edison Company, an indirect subsidiary of Cities Service Power & Light Company, which filed an application under Section 6 (b) for exemption from the provisions of Sections 6 (a) and 7 with respect to the issuance of additional bonds and debentures. During the preceding five years the company had paid out as dividends on its common stock an amount which was $1,800,000 greater than its earnings for the period. The Commission found that the effect of this dividend policy had been (1) to reduce the ratio of common stock and surplus to total capitalization; and (2) to place the company in such a position that when faced with an imperative need of cash for new construction its only source of such funds was through increasing its debt.

For the protection of present and prospective investors and to safeguard working capital, the Commission prohibited until further order, the payment of dividends from the earned surplus of $2,830,000 existing on December 31, 1939. [Footnote: Holding Company Act Release No. 2028.] It was further ordered that

$362,500 must be annually set aside out of earnings and made non-available for dividends. This amount was equal to the annual sinking fund requirement of its 3% percent sinking fund bonds.

Policies with respect to the payment of dividends from surplus created by a write-down of the par or stated value of a company's stock are set forth in the matter of Columbia Gas & Electric Corporation and reviewed in the Fifth Annual Report of this Commission. [Footnote: See also Holding Company Act Release No. 1417.]

General Public Utilities, Inc., a registered holding company and a partially owned subsidiary of Community Power and Light Company, proposed a dividend payable in common stock or cash at the option of the holder. [Footnote: Holding Company Act Release No. 1850.] Two earlier similar dividend proposals were sanctioned primarily because of the impact of the recently repealed undistributed profits tax provisions of the Revenue Act of 1936. [Footnote: Holding Company Act Release Nos. 889 (2 S.E.C. 866), 1376, and 1386.] The Commission denied permission to issue stock since the stock did not now meet the standards of Section 7, it was not claimed that the issuance was for the purpose of financing the business of the declarant as a public utility company. The Commission declared that the mere distribution of additional stock certificates which did not affect the Corporation's assets or the stockholders' interest in them cannot be said to represent an urgent or even necessary corporate purpose.

In addition to giving substantial voting rights to its preferred stock, the East Tennessee Light & Power Company, a registered holding company subsidiary of Cities Service Power & Light Company, in a program of liquidating three operating subsidiaries, also consented to an order of the Commission restricting dividends on its common stock. As long as any shares of the $6 preferred stock are outstanding, the Company may not declare any dividends if thereafter the common stock equity is less than an amount equal to the involuntary liquidating value of the preferred stock outstanding. [Footnote: Holding Company Act Release No. 1971.]

In permitting new security issues to become effective, the Commission regularly requires that substantial charges for depreciation and maintenance be made before computation of earnings available for dividends. [Footnote: ***Central Illinois Electric and Gas Company***, Holding Company Act Release No. 1592; ***Potomac Electric Power Company***, Holding Company Act Release No. 1834; ***Central Maine Power Company***, Holding Company Act Release No. 1809, ***Northwestern Electric Company***, Holding Company Act Release No. 1760; ***Public Service Company of Colorado***, Holding Company Act Release No. 1701.]

The Public Service Company of Indiana had a deficit of over $9,000,000, due primarily to losses on abandoned street railways.

Intangibles were not segregated and the property account included substantial write-ups. The depreciation reserve amounted to only 4.8 percent of the utility plant. The Commission, as a condition to its order exempting an issue of bonds and serial debentures, required the Company to charge annually to its depreciation expense account an amount equal to $1,700,000, plus 3 percent of the book value of its net depreciable property additions. [Footnote: Holding Company Act Release No. 1826.] Similarly, in permitting the declaration of the New Mexico Gas Company to become effective, the Commission imposed conditions requiring an annual charge for depreciation of a lump sum plus 3% percent of the book value of net property additions. [Footnote: Holding Company Act Release No. 1883.]

The Commission is now engaged in making an analysis of the depreciation policies of companies under its jurisdiction to determine their adequacy and to test the genuineness of earnings. During the year, a study of the preferred stock dividend arrearages of registered holding companies and their subsidiaries was made by the Public Utilities Division. As of December 31, 1938, the companies included in this report had outstanding preferred stocks whose involuntary liquidating value totaled $4,206,365,075, of which $3,590,730,690 was held by the public. Of the publicly held stock, $1,580,648,416, or 44 percent, was in arrears to the extent of $372,487,414, or 23.6 percent of the liquidating value of the stocks in arrears.

Still referring to publicly held stock, holding company issues amounted to $2,082,650,314 and those of operating companies to $1,508,080,376. Holding Company stocks in arrears totaled $1,168,911,229, or 56 percent of the preferred stock issued by such companies as compared with a total of $411,737,187, or 27 percent, for the operating companies. The arrearages accumulated on holding and operating company issues were in amounts of $282,519,502 and $89,967,822, respectively.

Of the 1,370, 550 public investors in holding and operating company preferred stocks, 733,308 held stocks not in arrears on which they received an aggregate dividend of $110,806,340. There were 595,697 investors who held preferred stocks in arrears. Of these, 321,670 received dividends of $37,323,017 with respect to annual requirements of $56,278,733, and 274,027 investors holding stocks with annual requirements of $42,792,639 received no dividends. An additional 41,545 investors held noncumulative stocks on which no dividends were paid in 1938.

The report of the Division concluded that

“The problem of dividend arrearages is materially greater with respect to the preferred stocks of the holding companies than with respect to the preferred stocks of operating companies.

“There are a number of operating companies and some holding companies which undoubtedly should be able to clear up their arrearages without recapitalization. However, there are some operating companies, and to a greater extent holding companies, where the arrearages are so great in relation to the earnings available for preferred stock dividends, that recapitalization is inevitable.

“This and other studies that we have made indicate that these are at least 20 holding companies with consolidated assets aggregating about $6,500,000,000 which must be recapitalized. It must be concluded, therefore, that the financial reconstruction of companies with unsound capital structures is one of the most pressing problems facing some of the holding company managements and the Securities and Exchange Commission.”

EXEMPTION OF COMPANIES FROM THE PUBLIC UTILITY HOLDING COMPANY ACT OF 1935

Sections 2 and 3 of the Public Utility holding company Act of 1935 authorize the Commission to exempt by regulation or order certain types of companies from the obligations, duties, and liabilities imposed by the Act. The form of such exemption may vary considerably. Pursuant to this power the Commission has exempted, by rule, all companies in a system whose total annual gross revenues from utility business are less than $350,000 or whose utility assets do not exceed $1,000,000. In other cases, a more individualized consideration is necessary and questions such as those of control, the predominant nature of the company’s business, whether or not it is a holding company only temporarily and how it came to be such, and similar factual matters are decisive.

H. M. Byllesby & Company, which has as its primary business the underwriting and distribution of security issues, and its parent, Byllesby Corporation, filed applications for orders declaring such companies not to be holding companies pursuant to Section 2 (a) (7) of the Act or in the alternative for exemption as holding companies under Section 3 (a) (3) (A) of the Act. H. M. Byllesby & Company owned 75 percent of the common stock, series B, of Standard Power and Light Corporation, a registered holding company, which in turn owned a majority of the voting stock of Standard Gas and Electric Company, also a registered holding company. The ownership of this common stock, series B, entitled H. M. Byllesby & Company to elect a minority of the Board of Directors of Standard Power and Light Corporation and further to influence the affairs of

Standard Power and Light Corporation in such a manner that a majority of the Board of Directors of Standard Gas and Electric Company would be persons who could fairly be said to be representatives or appointees of H. M. Byllesby & Company. The Commission held that the ownership of the certificates in a voting trust formed just prior to the filing of this application constituted ownership of "voting securities" within the meaning of the Act. The Commission found that a "controlling influence" over the affairs of Standard Power and Light Corporation had been exercised by H. M. Byllesby & Company and that the existence of such a controlling influence was not dependent upon the possession of the majority of the voting stock of the company. It was further held that the existence of this controlling influence was not affected by the creation of the voting trust.

H. M. Byllesby & Company, however, would be entitled to an exemption under Section 3 (a) (3) if it could show that it was only incidentally a holding company being primarily engaged in a business other than that of a public utility company and not deriving directly or indirectly any material part of its income from one or more of its public utility subsidiary companies. It was found in this connection that from 1930 to 1937, 46 percent of the investment banking business of H. M. Byllesby & Company had been received from companies in the Standard Power and Light Corporation system. Since the underwriting fees received therefrom represented a material part of its income, the application for exemption under Section 3 (a) (3) (A) was denied. [Footnote: Holding Company Act Release No. 1882.]

Another case, involving the question of control of one company over another, was that of the application of Manchester Gas Company for an order under Section 2 (a) (8) of the Act asking that it be declared not a subsidiary of The United Gas Improvement Company. About 45 Percent of the common stock of Manchester Gas Company was owned by The United Gas Improvement Company at the time the application was filed, but, due to default in the payment of preferred stock dividends, exclusive voting rights were vested in the preferred stock of which The United Gas Improvement Company owned about 9 percent. This case was consolidated with a proceeding which the Commission had instituted pursuant to paragraph (B) of Section 2 (a) (8) to determine whether or not the management and policies of the Manchester Gas Company were subject to a controlling influence by The United Gas Improvement Company so as to make it necessary or appropriate that the Manchester Gas Company be subject to the provisions of the Act. The record showed that although The United Gas Improvement Company owned but a small amount of the securities presently entitled to vote, it had been instrumental in changing the manager of the company from one who had been with the company since 1915 to a man whose sole operating experience had been with acknowledged subsidiaries of The United Gas Improvement Company; that the minutes of the Board of Directors of Manchester Gas Company had always been and were still being prepared by the

secretarial department of The United Gas Improvement Company; that the Tax Department of The United Gas Improvement Company regularly prepared the various tax returns of the Manchester Gas Company; that the plant of the Manchester Company was regularly inspected by The United Gas Improvement Company engineers in an exhaustive manner; and that the reports of such engineers and their recommendations were followed by the operating officers of the Manchester Gas Company. The Commission held in this case that it constituted a situation in which substantially every phase of the management and policies of the operating company were subject to a controlling influence by a large proprietary Company and that, even though The United Gas Improvement Company did not at that time own more than 10 percent of the voting securities of the Manchester Gas Company presently entitled to vote, Manchester Gas Company was subject to such a controlling influence that it was in fact a subsidiary. [Footnote: Holding Company Act Release No. 2002.]

The Union Electric Company of Missouri, which owns substantially all the voting securities of six public utility companies operating in territory contiguous to its operating area in Missouri, Illinois, and Iowa, filed an application for exemption as a holding company under Section 3 (a) (2) of the Act claiming to be predominantly a public utility company whose operations as such do not extend beyond the State in which it is incorporated and States contiguous thereto. In its opinion denying the application on the ground that the Company is not "predominantly" an operating company, the majority of the Commission emphasized the fact that the aggregate book value of the company's subsidiaries was 85 percent of that of its directly owned properties. [Footnote: Holding Company Act Release No. 1621.] The Commission further pointed to the substantial amount and proportion of the assets and earnings of the holding company system represented by the subsidiaries and the substantial public holdings of the senior securities of the subsidiaries, and held that the unified operation of the property of the parent and subsidiary companies was without significance relative to the company's application.

MUTUAL AND SUBSIDIARY SERVICE COMPANIES

An important phase of the Commission's duties is the regulation of service, sales, and construction contracts pursuant to Section 13. The primary purpose of this section of the Act is to prevent the charging of excessive or unearned fees and other charges which holding companies or their controlled service companies have exacted in the past from the controlled operating companies. Under Section 13 of the Act, registered holding companies are prohibited from servicing for a charge their associate public utility or service companies, except under special or unusual circumstances, while subsidiary or mutual service companies are required to perform service, sales, and construction contracts for associate companies so as to insure the efficient and economical performance of such

contracts for the benefit of the serviced companies at cost fairly and equitably allocated. The Commission has enforced these provisions by rules and regulations and by proceedings pursuant to the statute.

Two types of system companies are engaged in the performance of such contracts, namely, subsidiary and mutual service companies. Both of these types of companies must operate at cost and the basic requirements as to their standards for and method of operations are, for all practical purposes, similar.

The program of the Commission in the administration of Section 13 tends to fall in two major parts. The first part may be termed organizational and involves the original qualification of the mutual and subsidiary service companies. The second and perhaps more important part involves the continuing office and field studies of these companies which are operating under Commission jurisdiction.

Under the first part of the program, the Commission has passed on a majority of the service companies which have filed. Prior to Commission action many changes have been required in the methods of operation and functions of these companies in order to comply with the standards of the Act and the rules and regulations issued thereunder. A reasonable amount of standardization has been accomplished, particularly with respect to accounting and the elimination of investments and functions not related to the performance of service, sales, and construction contracts. There are, however, two major companies which the Commission has not passed on as yet with respect to their organizational features, namely, Ebasco Services, Inc., in the Electric Bond and Share System and The Utility Management Corporation in the Associated Gas and Electric System. During the past year, public proceedings have been conducted in connection with these two cases and some improvement and progress has resulted. In the case of The Utility Management Corporation, certain major changes have already been effected in the operations of this Company during the past year, resulting in substantial savings in its cost of performing contracts for associated companies.

Because, however, of the difficult problems encountered and the apparent necessity for further material changes with respect to these companies, they are still operating under the temporary exemption provided for in the rules and regulations. This same general situation also applies with respect to certain of the other service companies whose applications or declarations are still pending. The procedure followed by the Commission does not prejudice the rights of the service companies which have filed with the Commission, since the rules and regulations adopted by the Commission permit these companies to continue operations under temporary exemption until the Commission acts.

The cumulative experience obtained over the past dealing with service companies has been very helpful the organizational features of service companies.

During the past year, progress has been made in the second, and perhaps the most important aspect of service Company regulation, namely, the continuing office and field studies of service companies which have been previously passed upon by the Commission. Since there is no real uniformity in the functions and activities of the various service organizations, each case must be treated separately in order to obtain an effective analysis of the functions performed and the necessity for the services rendered. Such office and field studies have resulted in the withdrawal of approval of two service companies since the record indicated there appeared to be no further necessity for the continuance of their operations. Office and field studies have been undertaken in other situations which may result in further action by the Commission in these cases. The Commission is also engaged in determining whether some holding companies are directly or indirectly shifting holding company expenses upon the operating companies through the medium of controlled service companies or otherwise.

The orders of the Commission have in many instances been conditioned to require, if necessary, a reallocation or reapportionment of service company charges. One proceeding was conducted during the past year as a result of which a reallocation of past charges was required. [Footnote: ***In the Matter of Northeastern Water and Service Corporatio***n, Holding Company Act Release No. 1867.]

The Commission also had the occasion in the ***Ebasco Services, Inc.*** case to question the profits obtained from the servicing of foreign companies. These profits were drawn up to the top holding company, Electric Bond and Share Co. As a result of the proceedings all profits obtained through servicing foreign associate companies must be turned back to the intermediate holding company, American and Foreign Power Company, Inc., for the benefit of all its security holders. [Footnote: Holding Company Act Release No. 2255.]

The Commission, during the past year, amended its annual report form to require departmental analyses in the salary account of service companies. This information, contained for the first time in the annual reports for 1939, will be very helpful in connection with future studies of the functions and benefits of service companies. Additional information has also been required in the Form U-5S, Annual Supplement to Registration Statement, in order effectively to appraise and analyze the necessity for further regulations of service, sales, and construction contracts between the companies in utility systems and outsiders so that the Commission may prescribe such additional rules and regulations as may be necessary.

The Act, in its definition of service, sales, and construction contracts, gives the Commission complete jurisdiction over intercompany transactions and covers necessarily many and varied activities in the day-to-day operations of holding-company systems. The Commission's studies have brought to light certain methods and procedures whereby companies have contended that the transactions involved were beyond the sphere of Commission regulation. These and other problems are carefully studied in the light of the present rules and regulations in order to insure a more effective control of the transactions which appear to warrant regulation.

POLITICAL CONTRIBUTIONS

During the past year, the Commission carried on several investigations of alleged violations of Section 12 (h) of the Public Utility Holding Company Act of 1935, which prohibits registered holding companies and their subsidiaries from making any contributions to political groups or in connection with any political office. The most important of these investigations to date involved the Union Electric Company of Missouri and other subsidiaries of The North American Company. On May 6, 1940, the Commission, acting upon the basis of information which it had received from various sources, instituted a public proceeding pursuant to its powers of investigation under the Securities Act of 1933, the Securities Exchange Act of 1934, and the Public Utility Holding Company Act of 1935. This information tended to show that these companies had made substantial disbursements, purportedly for expenses and which were fictitious or "padded," to certain parties who rebated or "kicked-back" these sums to the company; also that substantial contributions had been made by and on behalf of these companies to political organizations and to influence and entertain certain public officials, and that such payments were not properly reflected on the books of the companies. [Footnote: At the request of the Department of Justice, the Commission has deferred for the present its public proceedings in connection with possible violations by The North American Company and Union Electric Company of Missouri of these Acts, and has submitted to the Department the results of its investigation.]

On November 11, 1939, Albert C. Laun, until recently a vice-president of Union Electric Company of Missouri, and Frederick J. Martin, a sales engineer employed by the same company, were indicted for perjury alleged to have been committed while testifying before an officer of the Commission with respect to the conditions and practices in question. On January 3, 1940, Martin was sentenced, on his plea of guilty, to imprisonment of six months and a fine of $501. On March 13, 1940, Laun was again indicted, together with Frank J. Boehm, also until recently a vice-president of Union Electric Company of Missouri, for perjury

alleged to have been similarly committed. Subsequently, Laun pleaded ***nolo contendre*** to the second indictment and was sentenced to imprisonment of one year and one day on each of three counts, the sentences to run concurrently, and fines aggregating $4,500. Boehm's trial was in progress at the end of the fiscal year. [Footnote: On July 26, 1940, Boehm was found guilty of perjury on two counts by a jury and was sentenced to five years imprisonment on each count, sentences to run concurrently, and fined $4,000. Witnesses, in the Boehm trial, testified to "kick-backs" or rebates totaling approximately $580,000.]

RULES, REGULATIONS, AND FORMS

The Commission is constantly studying the rules, regulations, and forms adopted under the Act to achieve the simplest requirements consistent with a vigorous administration thereof.

In February 1940 the Commission replaced all its outstanding forms for applications and declarations under the Public Utility Holding Company Act of 1935 by a single form. The new form is entitled Form U-1 and takes the place of Forms U-6B7--l, U-10-1, U-10--2, U-12D-l, and U-12D-2. Form U-l is used in connection with applications and declarations concerning any one or more of the following transactions: the issue or sale of securities and acquisition and sale of securities and assets; change of rights of outstanding securities; guaranty or assumption of liability; retirement or redemption of securities; declaration or payment of dividends; or any other transaction subject to rules under Sections 12 (b) or 12 (c) of the Act. In cases where a registration statement under the Securities Act of 1933 is filed as part of the transaction, the information filed under Form U-1 is substantially reduced and the applicant may omit answering any item concerning the financial conditions when corresponding, though not necessarily identical, information is given in the registration statement.

To expedite the administration of the Act and to save time and expense for the industry, the Commission drafted a rule to provide that applications or declarations under Sections 6, 7, 10, and 12 (other than Section 12 (e)), will be granted or permitted to become effective by order issuing as of course on the thirtieth day after filing or the fifteenth day after the filing of the last amendment, whichever is later, unless prior thereto the Commission shall have ordered a hearing. The Commission ,ay, at the request of the applicant or declarant, advance or postpone the effective date. If the Commission deems that a hearing is appropriate in the public interest or the interests of investors or consumers, it will issue an order for a hearing, and in that event the declaration or application shall not become effective or be granted except pursuant to further order of the Commission. To afford interested persons an opportunity to request a hearing, the rule provides for the publishing of notices of the filing of declarations or

applications in the Federal Register. A draft of the proposed rule was submitted to the industry and a conference with representatives of the industry was held on June 17, 1940. The representatives who attended indicated that they favored the new procedure and made a number of constructive suggestions. The rule became effective July 9, 1940. [Footnote: IN dissenting from the adoption of this rule, Commissioner Healy in a public memorandum dated April 5, 1940, set forth in detail his reasons for believing that the rule provided for an invalid procedure and that it was bad policy. He suggested an alternative procedure which he believed was better law and better policy and equally saving of time and money. The views of the majority of the Commission in support of the rule were set forth in a memorandum of June 24. See also Holding Company Act Releases Nos. 2161, 2164, and 2214.]

During the year the Commission amended its permanent registration form, Form U-5B, to require the filing of additional desirable data for the information of the Commission and the general public. In. addition, the supplemental annual report form, Form U-5S, was amended to clarify and simplify its preparation.

Rule U-12B-1 was amended to substantially expand the Commission's review of intercompany open-account transactions.

During the past year, the Commission adopted 5 new rules and repealed 2 rules. It also adopted 21 amendments to existing rules, of which 7 concerned procedural changes necessary upon the adoption of Form U-1 In addition, 5 forms were rescinded, 3 were adopted, and 2 amended.

The annual report filed by each registered holding company and the annual accounting report for service companies were revised. The annual report of registered holding companies was simplified as to the presentation of information and in some respects expanded to call for more information. The revised report calls for information in tabular form in order to simplify the work of reporting and increase the usefulness of the report to the Commission and to the public. Substantially more information was requested as to servicing contracts. The accounting report for service companies, which follows the uniform system of accounting for service companies, was expanded to secure additional information as to the allocation of charges for service, cost of construction work, and analyses of salaries. In anticipation of the new procedure whereby applications and declarations become effective automatically, unless the Commission orders a hearing, it was found necessary to ask for additional information in the registration statements. A special supplemental report was required calling for additional information as to revaluations, open accounts, depreciation, and consideration for securities sold. An annual statement was also required of companies claiming exemption from the Act pursuant to an exemption rule of the Commission.

Part II
PARTICIPATION OF THE COMMISSION IN CORPORATE REORGANIZATIONS UNDER CHAPTER X OF THE BANKRUPTCY ACT, AS AMENDED

Chapter X of the Bankruptcy Act, as amended in 1938, affords appropriate machinery for the reorganization of corporations (other than railroads) in the Federal courts under the Bankruptcy Act. The Commission's duties under Chapter X are, first, at the request or with the approval of the court, to act as a participant in proceedings thereunder in order to provide, for the court and investors, independent, expert assistance on matters arising in such proceedings, and second, to prepare, for the benefit of the courts and investors, formal advisory reports on plans of reorganization submitted to it by the court in such proceedings.

COMMISSION FUNCTIONS UNDER CHAPTER X

Under the provisions of Section 208 of the Bankruptcy Act, as amended, the Commission is given power to participate in Chapter X proceedings upon the request of the judge or upon its own motion if approved by the judge. Upon filing its notice of appearance under that section, the Commission is deemed to be a party in interest and has a right to be heard on all matters arising in the proceeding, but it may not appeal or file a petition for appeal in the proceeding. The Commission, however, appropriately appears before the appellate courts when appeals are taken by other parties to proceedings in which it is participating.

The Act also provides for the preparation by the Commission of advisory reports on reorganization plans. Section 172 of the Act provides that the judge shall, if the indebtedness of the debtor exceeds $3,000,000, and may, if such indebtedness does not exceed that amount, submit to the Commission for examination and report any plan or plans of reorganization which the judge deems worthy of consideration. Under the provisions of Section 173 of the Act, the judge may not approve a plan of reorganization in such a case until the Commission has filed its report or has notified the judge that it will not file a report or unless no report has been filed within the period fixed by the judge. Section 175 provides that, upon the approval of any plan by the judge, the Commission's report, if one has been filed, or a summary thereof prepared by the Commission, shall be transmitted to creditors and stockholders who are being asked to vote on the plan, along with certain other material.

The Commission has endeavored to exercise its functions in such a manner as to expedite the work of the courts and of the parties to the proceedings in which it participates. Units of the Reorganization Division have been established in the regional offices of the Commission. The attorneys in those offices, as representatives of the Commission, undertake the duties of attending hearings in proceedings, of conferring with the parties, and, with the financial analysts and accountants stationed in the regional offices, of gathering much of the information necessary for the Commission to perform properly its advisory functions under the Act.

STATISTICS ON REORGANIZATIONS UNDER CHAPTER X

Proceedings in which the Commission Participated.

Since the intention of the provisions embodied in Chapter X of the Bankruptcy Act is an assurance of greater protection for the interests of the public investor, the Commission has concerned itself primarily with those proceedings in which a definite public interest has been involved. For practical purposes, proceedings are considered to have a public interest sufficient to justify Commission participation if they involve securities in the hands of the public amounting to More than $250,000. The Commission may often enter smaller cases upon the request of the judge or if it may perform a useful service to a fairly sizeable group of public investors because of such matters as the proposal of improper plans of reorganization or violations of different provisions of the Act.

During the period from September 22, 1938 (the date on which the amended Bankruptcy Act became fully effective) to the beginning of the fiscal year, the Commission had filed its notice of appearance in 87 proceedings involving the reorganization of 105 corporations (87 principal debtor corporations and 18 subsidiary debtors). During the fiscal year, the Commission filed its notice of appearance in 47 additional proceedings involving the reorganization of 63 corporations (47 principal debtor corporations and 16 subsidiary debtors). Of these 47 proceedings, 33 were instituted under Chapter X and 14 under Section 77B. The Commission filed its notice of appearance at the request of the judge in 20 proceedings, while in the remaining 27 the Commission entered its appearance upon approval by the judge of its motion to participate.

The total assets and total indebtedness involved in these 47 proceedings were approximately $1,580,000,000 and $860,000,000, respectively.

Of the 134 proceedings in which the Commission has become a party between September 22, 1938, and July 30, 1940, 3 (involving no subsidiary debtors) were closed during the 1939 fiscal year and 20 (involving 29 principal debtors and 6

subsidiary debtors) were closed during the 1940 fiscal year, as far as the Commission's active participation was concerned. The remaining 102 proceedings, involving 102 principal debtors and 28 subsidiary debtors, were cases in which the Commission was actively participating as of June 30, 1940. Those debtors showed aggregate assets of approximately $2,080,000,000 and aggregate indebtedness of approximately $1,260,000,000. Almost 60 percent of this combined indebtedness was accounted for by 7 companies.

All Reorganizations under Chapter X.

The Commission has continued to issue periodic statistical analyses of proceedings under Chapter X. By virtue of Section 265a of the Bankruptcy Act, which provides that the clerks of the various Federal district courts shall transmit to the Commission copies of all petitions for reorganization and other specified documents filed under Chapter X, the Commission is enabled to make this information available for public use.

CHAPTER XI PROCEEDINGS

During the course of the past fiscal year there arose the possibility that the investor safeguards of Chapter X of the Bankruptcy Act might be nullified by improper resort to proceedings under Chapter XI of that Act. It was the Commission's opinion that only the provisions of Chapter X were properly available for the reorganization of corporations with securities in the hands of the public, and that Chapter XI was the proper medium for securing arrangements or compositions of unsecured indebtedness by individuals or corporations with no public investor interest. In order to secure an adjudication on this problem, the Commission in May 1939 intervened, with the permission of the district court, in the proceeding for an "arrangement" under Chapter XI filed by the United States Realty and Improvement Company in the United States District Court for the Southern District of New York. [Footnote: Before the intervention of the Commission in the ***United States Realty*** proceedings, it had taken a similar position in another case in the Northern District of Illinois. In the latter, the district judge suggested from the bench that, to avoid controversy, a petition be filed under Chapter X. The debtor thereupon filed such a petition, and the proceeding continued under Chapter X.] In this case the Commission moved to vacate the order approving the debtor's petition as properly filed, to dismiss the proceeding under Chapter XI, and to deny confirmation o the proposed arrangement.

Shortly after its intervention in the ***United States Realty and Improvement Company*** proceeding, the Commission filed a similar motion in a proceeding for an arrangement under Chapter XI filed by Credit Service, Incorporated, in the United States District Court for the District of Maryland The arrangement there proposed would have affected some $5,000,000 of debentures outstanding in the

hands of the public. The court reserved decision upon the Commission's motion and, after the opinion of the Second Circuit Court of Appeals in the United States Realty case, denied the Commission's motion to dismiss the proceeding and also its petition for leave to intervene. The Commission took an appeal to the Fourth Circuit Court of Appeals, which appeal was pending at the time the United States Supreme Court handed down its decision in the United States Realty case. The appeal to the circuit court of appeals was thereafter dismissed by stipulation, after the district court had adjudicated the debtor a bankrupt.

In the ***United States Realty and Improvement Company*** case, the debtor had outstanding in the hands of the public 900,000 shares of stock which were listed on the New York Stock Exchange and two series of debentures aggregating over $2,300,000. The debtor was also liable as a guarantor of payment of principal, interest, and sinking fund payments upon a series of publicly held mortgage certificates in the principal amount of $3,710,500 issued by a wholly owned subsidiary. These certificates, secured by a mortgage on two buildings which constituted the subsidiary's only substantial assets, were in default as to interest and sinking fund payments. The debtor, which was unable to pay its debts as they matured at the time it instituted the proceedings, had suffered large shrinkage in the value of its holdings and had operated at a loss for several years.

It was the debtor's intention to have a proceeding instituted n a State court for the subsidiary, to secure a modification of the latter's mortgage certificates by the extension of their maturity, a reduction in interest, and a modification of their sinking fund provisions. The purpose of the Chapter XI proceeding was to effect a corresponding modification of the debtor's guarantee, and this "arrangement" was to stand regardless of the outcome of the State court proceedings. None of the other securities of the debtor were to be affected. Assents to this plan were obtained from more than half of the certificate holders before the Chapter XI proceeding was initiated.

Although the Commission was allowed to intervene, its motions in the Chapter XI proceeding were denied by the district court. Upon appeal, the Circuit Court of Appeals for the Second Circuit held that, since the debtor was literally within the jurisdictional provisions of Chapter XI, the proceedings for an arrangement were properly brought under that Chapter, that the Commission's intervention in the proceedings was not authorized by any provisions of the Bankruptcy Act, and that it was not an aggrieved party, because it bad no interest affected by the Chapter XI proceeding which would entitle it to intervene under the Federal Rules of Civil Procedure. The circuit court therefore dismissed the appeal of the Commission from the order of the district court denying its motions and, upon appeal of the debtor, reversed the order of the district court allowing the Commission to intervene. [Footnote: ***Securities and Exchange Commission v.***

United States Realty and Improvement Company, 108 F. (2d) 794 (C. C. A. 2d, 1940).]

Upon petition by the Commission, the United States Supreme Court granted ***certiorari*** and thereafter reversed the decision of the Circuit Court of Appeals. The Supreme Court hold that since the provisions of Chapter XI were not adequate to secure to public investors the safeguards necessary for the consummation of a fair, equitable and feasible plan of reorganization and since the provisions of the Bankruptcy Act contemplated that the reorganization of such debtors should take place under the terms of Chapter X rather than Chapter XI, the district court, in the exercise of its sound discretion as a court of equity, should have dismissed the petition, thus relegating the respondent, if it were so inclined, to the initiation of a proceeding under Chapter X "in which it may secure reorganization which, after study and investigation appropriate to its corporate business structure and ownership, is found to be fair, equitable and feasible, and in the best interest of creditors."

The Supreme Court also held that the order permitting the Commission to intervene in a Chapter XI proceeding for the purpose of moving its dismissal was properly entered. The court, through Mr. Justice Stone, stated that

"The Commission's duty and its interest extends not only to the performance of its prescribed functions where a petition is filed under Chapter X, but to the prevention, so far as the rules of procedure permit, of interferences with their performance through improper resort to a Chapter XI proceeding in violation of the public policy of the Act which it is the duty of the court to safeguard by relegating the respondent to a Chapter X proceeding * * *

"If, as we have said, it was the duty of the court to dismiss the Chapter XI proceeding because its maintenance there would defeat the public interest in having any scheme of reorganization of respondent subjected to the scrutiny of the Commission, we think it plain that the Commission has a sufficient interest in the maintenance of its statutory authority and the performance of its public duties to entitle it through intervention to prevent reorganizations, which should rightly be subjected to its scrutiny, from proceeding without it." [Footnote: ***Securities and Exchange Commission v. United States Realty and Improvement Company***, 60 Sup. Ct. 1044 (1940).]

It appears, therefore, to be finally settled that resort to the provisions of Chapter XI is not appropriate in the reorganization of corporations with securities distributed in the hands of the public. Thus, in a recent case, in the Southern District of New York, a debtor which had originally filed under Chapter XI had the proceedings dismissed on its own motion after the Supreme Court's decision in

the ***United States Realty*** case and filed a voluntary petition under Chapter X of the Bankruptcy Act.

STATUTORY AMENDMENTS

During the fiscal year the Commission came to the conclusion that the provisions of Section 270 of the Bankruptcy Act, with respect to the basis of the debtor's property for income-tax purposes, were demonstrably unfair to a substantial number of the debtor corporations theretofore reorganized or then in the process of reorganization under Chapter X, and also that those provisions were frequently a serious obstacle to the development of a fair and feasible plan in that they provided argument for not reducing outstanding indebtedness even where a failure to do so would result in an unsound capital structure. In the discharge of its advisory functions under Chapter X, the Commission had, of course, an opportunity to observe the practical consequences of Section 270 in cases in which it was participating as a party pursuant to Section 208 of the Act.

The basis of property for income-tax purposes is important from at least two points of view: (1) the amount of depreciation (or depletion) which may be claimed annually in future income-tax returns, and (2) the determination of gain or loss resulting from future sales or exchanges of the property in question. Where a proceeding for "corporate reorganization" under Chapter X, for an "arrangement" under Chapter XI, or for a "real-property arrangement" under Chapter XII resulted in a cancellation or reduction of indebtedness, Section 270 under Chapter X and the corresponding sections under Chapters XI and XII required (with limited exceptions) that the basis of the debtor's property for income-tax purposes, State as well as Federal, be decreased by an amount equal to the amount of such cancellation or reduction.

The difficulty with Sections 270, 396, and 522 was that there was nothing in any of the three sections to prevent their application from resulting in a decrease of the basis of the debtor's property to a figure substantially below its fair market value, or even to zero. Where the basis was reduced to zero, the result was that (1) the reorganized company could not take any deduction for depreciation or depletion in future State or Federal income-tax returns, not even depreciation or depletion based on the present fair market value of its property, and (2) if the property should be sold, the entire proceeds would constitute taxable income, even if the sale should be at a figure less than its present fair market value and drastically less than its original cost. Where the basis was reduced to any other figure below the fair market value of the debtor's property, the onerous consequences to the reorganized company were only comparatively less severe.

Discussions were had with representatives of the Treasury Department, and with members of the National Bankruptcy Conference and the Committee on Bankruptcy and Reorganization of the New York City Bar Association. The problem was then presented to the Honorable Charles F. McLaughlin, Chairman of the Subcommittee on Bankruptcy and Reorganization of the House of Representatives and the Honorable Joseph C. O'Mahoney, Chairman of the corresponding subcommittee of the Senate. As a result, substantially identical bills were introduced in the House and Senate, which proposed to remedy the situation by establishing a fair market value "floor" below which the basis should not be reduced. The amendments proposed were favorably reported by the Treasury Department and the Commission, and all of the witnesses who testified at the hearings on the House bill agreed that it was essential that the three sections be amended at the earliest practicable date. The House bill was unanimously passed on June 17, 1940, and on June 22, 1940, was substituted for the Senate bill and unanimously passed by the Senate on the same day. This legislation was approved by the President on July 1, 1940 (Public, No. 699 -- 76th Congress -- Chapter 500 -- 3d Session).

THE COMMISSION AS A PARTY TO PROCEEDINGS

The provisions of Section 208, in making the Commission a party to proceedings, contemplate that it shall be prepared to participate with regard to any problems arising in a proceeding. Consequently, the Commission, immediately upon becoming a party to a case, proceeds to obtain and analyze all available information concerning the debtor and its affairs. By acquiring such information at the outset, the Commission is in a position not only to prepare expeditiously its advisory reports on plans of reorganization but also to perform properly its functions as a party with regard to the other problems arising in the proceeding, which may be many and complex.

The activities of the Commission as a participant in reorganization proceedings are not limited to formal appearances or the filing of legal or factual memoranda. In order to expedite the proceedings and to avoid unnecessary delays and wasted effort, the Commission's attorneys and analysts frequently participate in informal conferences with the parties concerning matters arising in connection with the formulation of a plan or the administration of the estate. By discussion before formal action is taken upon such matters, the Commission has often been able to bring facts, questions, or arguments to the attention of the parties which they had not previously considered, and parties have often been prompted thereafter to modify or alter their proposed action before formal steps were taken. In this way there is frequently avoided the delay incident to bearings on formal objections. It should be noted, of course, that the parties are under no requirement so to act and that modifications in advance of formal action are

undertaken only where such changes seem desirable to the parties because of the validity of the suggestions made by the Commission as an impartial party to the proceedings.

Through its Nation-wide activity in bankruptcy reorganizations, the Commission has been in an advantageous position to encourage the development of uniformity in the interpretation of Chapter X of the Bankruptcy Act and in procedure thereunder. Thus, the Commission has often been called upon by parties, referees, and special masters for advice and suggestions with regard to matters of procedure and the form and content of necessary orders in the proceedings. In this, the Commission has been able to afford substantial aid out of the store of experience accumulated through participation in many reorganization cases. The Commission has also been able, in this manner, to save the court officers and the parties much of the effort that would have been entailed in handling such questions ***de novo***, as well as the time and expense involved in retracing steps improperly taken. This work of the Commission has been of special value due to the fact that the solutions of most procedural and interpretative questions are not likely to find their way in to the official or unofficial reports and are, therefore, largely unavailable outside of the particular district of their decision. The Commission has also proceeded, primarily through the method of informal suggestion and conference, to call to the attention of parties any violations of or lack of compliance with the procedural provisions of Chapter X. Where these are the result of inadvertence or lack of precedent, such an informal suggestion has usually proved sufficient to obtain a correction. In other cases, it has been necessary for the Commission to file formal motions in court to secure compliance with the Act.

It is not possible in the brief compass of this report to do more than outline the full scope of the Commission’s activities in a reorganization proceeding. A few examples may serve, however, to indicate the varied type of issues with which the Commission has been concerned.

Miscellaneous Issues in Proceedings

The Commission has taken an active part in issues arising at the very outset of a proceeding, and a few examples illustrative of such activity may be outlined here. Thus, the Commission was instrumental in securing the transfer of the proceedings for the reorganization of the Associated Gas and Electric Company and the Associated Gas and Electric Corporation from the district in which the debtors had filed the petition to a district in which the proceedings might be handled with greater efficiency and economy, because the main offices of the debtors and the sources of information necessary to an understanding of their problems were present in the latter district.

In the same case, the question of the impounding of lists of security holders under Section 166 of the Bankruptcy Act was presented. The problem here was to keep such lists accessible for ***bona fide*** ends, so as not to impede the organization and activity of protective committees in the interests of the holders of the various issues of securities, while at the same time preventing use of these lists for improper purposes. The Commission took an active part in working out a solution of this problem which, while providing for the impounding of the lists, made them available for inspection by proper persons and committees upon authorization of the court. It was also provided that the trustees should, upon the tender to them of solicitation material with a payment of the costs of handling and mailing, send such material to the security holders.

In these cases the Commission has been alert to the possibility that security holders may be imposed upon by persons seeking to represent their interests. Thus, in the case of ***The Penfield Distilling Company***, the Commission ascertained upon becoming a party that two persons, in the name of a committee, had been soliciting authorizations to represent stockholders in the proceeding. At the same time, these persons solicited substantial deposits of funds by the stockholders to be represented. The "committee" secured such authorizations and deposits by fraudulently representing to the stockholders of the debtor that such action would enable them to obtain 70 percent to 100 percent of the par value of their stock while stockholders not represented by the "committee" would receive little or nothing. Payments were solicited as compensation for the expenses and services of the "committee." The Commission petitioned the district court for an injunction against further solicitation and an accounting of all funds obtained from the stockholders. An injunction and a decree for an accounting were entered by the district court. Upon an appeal to the United States Circuit Court of Appeals for the Sixth Circuit, the decree of the district court was affirmed without opinion. [Footnote: ***In the Matter of the Penfield Distilling Company***, decided June 27, 1940. (Application for rehearing now pending.)]

Problems in Administration of Estate.

In proceedings under Chapter X, the independent trustee has the duty of examining into the history of the debtor, ascertaining its financial and managerial problems and future prospects, and formulating the plan of reorganization. In addition, such trustees bear the primary responsibility for the operation of the business. It is therefore apparent that the success with which the reorganization proceedings are carried through depends in substantial measure upon the thoroughness and efficiency with which trustees perform their duties.

It has been found that early participation in a reorganization proceeding by the Commission has enabled it to aid the trustees with suggestions and information,

especially when the trustees and their counsel have not had previous experience in Chapter X reorganizations. In addition, the Commission's presence has emphasized for trustees and their counsel the importance of their functions and the necessity that their duties be performed with thoroughness, independence, and efficiency. In the last respect, for example, the Commission in one case was instructed by the court to make an investigation with a view to securing a reduction in the costs of operation by the trustee. Upon the suggestion of the Commission, the court ordered the trustee to make a report containing information concerning the operation of the business. After a hearing at which the Commission presented its views, the court ordered the trustee to take the action necessary to secure a reduction in costs of operation.

The Commission has, at all times, insisted that trustees prepare adequate reports to the security holders in fulfilling the requirements of Section 167 (5) of the Act. It is felt that such reports are necessary not only to enable the security holders to make suggestions for a plan but also to give them the necessary information for determining the desirability of accepting proposed plans. The Commission's staff has always been prepared to consult and has often consulted with trustees as to problems arising in connection with the preparation of such reports. It should be noted, however, that suggestions from the Commission have always been made in such fashion as to emphasize to the trustees the importance of their maintaining a proper independence of all parties in interest. The Commission has not attempted to usurp the functions of the independent trustee nor to control his activities.

The Commission has often been able to provide trustees with information useful in carrying out their duties. In addition, as the result of experience in corporate reorganizations, the Commission has been in a position to offer advice to trustees and to courts on such matters, for example, as the scope of the investigation to be made by accountants hired by independent trustees. Through its cooperation with such accountants and advice to trustees and courts, the Commission has been able to assist the trustee in obtaining the performance of a thorough job. Furthermore, the wide experience of the Commission has enabled it to aid the trustees and the court in determining the reasonable value of services performed by accountants and other experts in reorganization proceedings.

Activities with regard to Allowances.

The Commission has been concerned in every proceeding to which it is a party with the problem of allowances to the various parties for services rendered and expenses incurred in the proceeding. In making allowances from the limited funds available for the payment of reorganization expenses, the courts seek to protect the estate from exorbitant charges, while at the same time providing

equitable treatment to the applicants for allowances. The Commission has been able to provide considerable assistance to the courts in dealing with this problem.

The Commission itself receives no allowances from estates in reorganization and has no personal interest in the question of fees. It is therefore able to present a wholly disinterested and impartial view on the question. The Commission has constantly endeavored to secure a limitation of the total compensation to an amount which the estate can feasibly pay. In each case the Commission also makes a careful study of the allowances requested by the various parties to ascertain, first, that unnecessary duplication of services shall not be recompensed and, second, that compensation shall be allocated on the basis of the work done by each claimant and his relative contribution to the administration of the estate and the formulation of a plan. Where reductions in requested compensation are necessary because of the financial condition of the estate, the study and investigation by the Commission has provided the courts with impartial advice upon the basis of which a reduction may be ordered with regard to the comparative values of the services performed, rather than by a general reduction in requested fees which may be unjust to individual parties.

As the number of proceedings in which the Commission participates increases, the Commission acquires increasing experience as to the reasonable worth of the various services performed by the parties in reorganization proceedings. That the courts have considered the Commission's aid on the matter of allowances to be of value even where it has not theretofore been a participant in a proceeding is evidenced by the example of the proceeding for the reorganization of the Postal Telegraph & Cable Corp. In that case, which had been in reorganization under Section 77B for several years, the district court judge requested the participation of the Commission after the confirmation of the plan in order that he might have the aid of its investigation and advice with regard to the question of allowances.

The Commission has been active both in court and in conferences with parties in securing compliance with the requirements of the statute and of local rules by parties requesting compensation. One problem that has arisen in several cases has been that of interim allowances to trustees for their services in the operation of the business. It is at times harsh to require a trustee to await the conclusion of the proceedings before he may be compensated for his services. Nonetheless, the statute provides for allowances only for services already rendered, and compliance with its requirements as to bearing and notice on application for such allowances is necessary to avoid abuse. It would often be an expensive matter, however, to comply with the provisions of the Act regarding notice and hearing in the usual fashion upon each application if a trustee requested interim allowances at frequent intervals.

The Commission has aided in the formulation of a practical procedure to handle such matters with fairness to the trustee and at a minimum of expense. Under such procedure a notice is sent out and a hearing is set early in the proceeding on the question of the interim allowances for the trustee. This notice also sets a hearing on interim allowances before a master or referee for a certain day in each month or quarter thereafter. No further notices are sent unless the trustee in a subsequent monthly or quarterly petition seeks compensation in a greater amount than that set forth in the first notice. In this fashion the requirements of the statute are met without an undue burden upon the estate and an opportunity is afforded all parties, the security holders, and the court, for a periodic scrutiny of the value of the services being rendered. At the same time, the trustee is enabled to receive regular compensation for his work in the operation of the business. Of course, the trustee may in his final allowance, on proper notice, receive additional compensation for his services in the formulation of a plan or for special services in the administration of the estate.

Of particular importance has been compliance with Section 240 of the Bankruptcy Act, which provides generally that no committee or attorney, or other person acting in a representative or fiduciary capacity in reorganization proceedings, may receive allowances for services if such parties purchased or sold securities of the debtor while acting in the proceedings. The requirements of fiduciary responsibility make it necessary that the rule be inflexibly enforced, lest the standard itself be impaired. This position, advocated by the Commission, was unequivocally upheld by the United States Circuit Court of Appeals for the First Circuit in the case of ***Otis & Company v. Insurance Building Corporation***. [Footnote: 110 F. (2d) 333 (C. C. A. 1st, 1940)] The court held that Section 249 bars the compensation of a person acting in a representative capacity in a reorganization proceeding who had bought and sold securities of the debtor during the pendancy of the proceeding, regardless of his good faith or his profit or loss in the transactions. The argument that purchases or sales could be consented to or approved by the judge so as to remove the bar to compensation, as is permitted in the proviso of Section 249 with regard to other acquisitions or transfers, was rejected.

PLANS OF REORGANIZATION UNDER CHAPTER X

The ultimate objective of a reorganization under Chapter X is the formulation, acceptance, and consummation of a fair and equitable and feasible plan of reorganization. As a basis for its study of reorganization plans, the Commission, in each case in which it participates, assembles essential information concerning the physical and financial condition of the company, the cause of its financial collapse, the quality of its management, its past operating performance, and the reasonable value of its properties. Such information is usually obtained through

the voluntary cooperation of trustees and parties to the reorganization, through examination by the Commission's accountants of the books and records of the debtor, and through the examination of witnesses in court. This information is also complemented by the independent research of the Commission's analytical staff into the general economic factors affecting the particular debtor and the competitive conditions in the particular industry. In connection with the consummation of plans, the Commission also investigates the suggested personnel of the new management, upon whose qualifications the court must pass under Chapter X, in order to be able to advise the courts and the parties concerning their qualifications.

Feasibility of Plans.

As will be seen in the discussion below of the advisory reports prepared by it, the Commission has consistently objected to features of plans of reorganization which render likely a return of the debtors to the reorganization courts because of flaws inherent in the financial structure proposed in the plan. This question of feasibility has been presented to the Commission in some cases at the very outset of the proceedings. In such cases, the Commission has been asked to examine and comment on the affairs of the debtor with a view to ascertaining whether any plan of reorganization would be feasible. In cases in which the Commission has concluded that the condition of the debtor was such that no feasible plan of reorganization could be hoped for, it has submitted to the courts the bases for such belief. Much time and expense may be saved by avoiding futile attempts at reorganization.

Fairness of Plans.

The Commission has consistently taken the position that the applicable standard of fairness in reorganization proceedings requires that a plan, to be fair, must provide fully compensatory treatment for claims in the order of their legal and contractual priority, either in cash or new securities or both, and that the participation granted to junior claims must be based either upon the existence of an equity for them in the enterprise after the satisfaction of prior claims or upon a fresh contribution in money or money's worth necessary to the reorganization of the debtor. A valuation of the debtor is necessary to provide the basis for judging the fairness and feasibility of proposed plans of reorganization. In its advisory reports, in hearings before courts, and in conferences with parties to proceedings, the Commission has consistently taken the position that the proper method of validation for reorganization purposes is primarily the capitalization of reasonably prospective earnings.

Since the standard of fairness and equity which the Commission must apply in evaluating a plan in any particular case is determined by the courts, the

Commission has participated as ***amicus curiae*** on two recent occasions when that standard was under consideration. The most significant of these cases was ***Case v. Los Angeles Lumber Products Co., Ltd.***, decided by the Supreme Court on November 6, 1939. [Footnote: 308 U.S. 106.] That case went to the Supreme Court upon a writ of ***certiorari***, sought by an objecting bondholder, to a decision of the Ninth Circuit Court of Appeals affirming a district court order confirming a plan of reorganization. The debtor, admittedly insolvent, had assets worth some $840,000 on a going-concern basis. Its liabilities consisted of $2,565,000 principal amount of first-mortgage bonds upon which no interest had been paid since 1929. In January 1938, proceedings were initiated under Section 77B of the Bankruptcy Act. The plan provided for the formation of a new corporation with a capital structure of 1,000,000 shares of authorized $1 par value voting stock, to acquire the assets of the debtor. Of this stock, 811,375 shares were to be a 5 percent noncumulative preferred stock. The bondholders were to receive 641,375 shares of this preferred stock on the basis of 250 shares for each $1,000 bond and the remaining 170,000 shares were to be reserved for sale to raise working capital for the new company. The 188,625 shares of common stock were to be issued to the common stockholders of the debtor. This plan was accepted by overwhelming percentages of the bondholders and stockholders.

The Commission participated in the preparation of a brief and argument presented to the Supreme Court by the United States as ***amicus curiae*** on behalf of the Securities and Exchange Commission and the Interstate Commerce Commission. The Supreme Court unanimously sustained the position presented in that brief and argument, reaffirming as applicable to bankruptcy reorganizations the so-called doctrine of the ***Boyd*** case. [Footnote: ***Northern Pacific Railway Co. v. Boyd***, 228 U.S. 452.] The court held that a fair and equitable plan of reorganization must provide full recognition for senior claimants in the order of their legal and contractual priorities before junior classes may participate and that such junior classes may participate only if there is an equity for them in the enterprise or if they provide a fresh and adequate contribution in money or money's worth necessary or desirable for the debtor's operations in return for a reasonably equivalent participation under the plan. The Supreme Court also held that courts must reach an independent determination of the fairness of the plan without regard to the number of acceptances of a plan, the amount of the objector's holdings, or similar circumstances.

Subsequently, the United States Circuit Court of Appeals for the Ninth Circuit granted a rehearing in the case of Dubois v. Consolidated Rock Products Company [107 F. (2d) 96] for the purpose of considering the effect of the Supreme Court's decision. The circuit court of appeals had affirmed a district court order confirming a plan only a few days before the Supreme Court's opinion

was handed down. On the rehearing, the Commission filed a brief as ***amicus curiae*** upon the issue of the fairness of the plan.

The ***Dubois*** case involved the reorganization of a parent corporation, Consolidated Rock Products Company, and its two wholly-owned subsidiaries, Union Rock Company and Consumers Rock and Gravel Company, Inc. All the properties were operated as a single enterprise by the parent under an operating agreement. Each of the subsidiaries had outstanding an issue of bonds upon which there were accrued interest claims when the reorganization petition was filed; these bond issues aggregated $3,014,000 in principal amounts. The subsidiaries had a claim of about $5,000,000 against the parent, disputed in validity and amount, under the terms of the operating agreement. The parent company had an issue of preferred stock and an issue of common stock outstanding. Although there were no precise determinations of value, the district court found that the properties under the lien of each indenture were not sufficient to secure the bonds issued thereunder but that the value of the entire enterprise was sufficient to cover the claims of the bondholders and to leave some equity for the preferred stockholders of Consolidated Rock Products Company.

The plan of reorganization provided that the bondholders were to receive income bonds, secured by a mortgage covering all the properties of the enterprise, for 50 percent of the principal amount of their claims, preferred stock for the remainder of the principal amount of their claims, and warrants for the purchase of new common stock at prices, on an ascending scale starting at par, depending upon the time of exercise. The majority of the new common stock was to be issued to the preferred stockholders of Consolidated. A portion of the common stock was also reserved for issuance upon the exercise of stock purchase warrants to be issued to the common stockholders of Consolidated.

In its brief, the Commission took the position that the priority doctrine set forth in the ***Los Angeles Lumber*** case is applicable to solvent debtors as well as to insolvent debtors. It also submitted that the plan was unfair to the bondholders since the contract rights of the bondholders to full priority were substantially impaired by the cancellation of their secured interest, conversion of their fixed interest obligation into income bonds and noncumulative stock, the loss of their creditor status to the extent of one-half of their principal claim and the extension of the maturity of the remaining half of that claim, the reduction of the interest rate on their securities, and the elimination of their creditor protection for the benefit of the preferred stockholders of the parent, whose claims were junior to those of the bondholders. The Commission also indicated that there was no justification for the participation of Consolidated's common stockholders, since they had no equity in the enterprise and made no fresh contribution to it.

The circuit court of appeals, on the rehearing, altered its previous decision and reversed the order of the district court confirming the plan. [Footnote: ***DuBois v. Consolidated Rock Products Co.***, 114 F. (2d) 102. Petitions for writs of ***certiorari*** in this case were filed in September 1940.] The court held that the plan was unfair in depriving the bondholders of their right to fully compensatory treatment prior to the satisfaction of junior claims. The court also held that the priority doctrine of the ***Los Angeles Lumber*** case was the sole test of the fairness of a plan of reorganization, regardless of the solvency or insolvency of the debtor. The court also indicated that since it must of necessity pass independent judgment upon the fairness of the plan, the question of the amount paid for his securities by the objecting bondholder is immaterial upon consideration of the fairness and equity of the plan.

In an appeal to the United States Circuit Court of Appeals for the Third Circuit in the matter of ***Oscar Nebel Company, Inc.***, questions were raised as to the correctness of the finding of the district court that there was no value in the enterprise for the interests of the common stockholders of the debtor and as to the right of a junior class of stockholders whose interests are valueless to participate under a plan of reorganization. Upon the Commission's investigation in this case in the district court, it had appeared that the value of the debtor upon the basis of a capitalization of reasonably prospective earnings was insufficient to satisfy more than the claims of the creditors and part of the interests of the preferred stockholders. A plan was formulated which provided participation in the reorganized company only for creditors and preferred stockholders. This plan was approved by the district court. The chief holder of the common stock of the debtor appealed from the order approving the plan. In its brief upon the appeal, the Commission argued that a going concern value of the debtor obtained by a capitalization of reasonably prospective earnings showed no value for the interests of the common stockholders and that common stockholders of the debtor could not therefore be included, in a plan of reorganization. The order of the district court approving the plan of reorganization was affirmed by the circuit court of appeals without opinion. [Footnote: ***In the Matter of Oscar Nebel Company, Inc.***, decided July 10, 1940.]

The circumstances under which stockholders without an equity in a debtor may participate under its reorganization plan by providing a fresh contribution has also been considered. The Commission filed a supplemental memorandum in cases involving the Highland Towers Company, the Whitmore Plaza Corporation, and the Metropolitan Fielding Company in the United States Circuit Court of Appeals for the Sixth Circuit, taking the position that a "need" must be shown for the contribution of new consideration upon the basis of which stockholder participation was permitted and that stockholders have no vested right to participate in a reorganized debtor upon the basis of a contribution which may not be necessary for the benefit of the debtor and its senior security holders. The

circuit court of appeals held that the contributions of new consideration, in each case the cancellation of bonds of the debtor purchased by the stockholders, were inadequate to meet the requirements of the rule stated in the ***Los Angeles Lumber*** case.

A memorandum similar to the one outlined above was also filed by the Commission in the United States District Court for the Eastern District of Wisconsin in the matter of Associated Owners, Inc. In that case, the court expressly held that "in order for the stockholders to share in the new plan, they must not only make an adequate contribution, but it must be shown that there was need for such contribution." [Footnote: 32 F. Supp. 828 (E. D. Wis., 1940)]

ADVISORY REPORTS ON PLANS OF REORGANIZATION

Under the terms of the Bankruptcy Act, the Commission submits formal advisory reports on plans of reorganization submitted to it by the courts. The primary purpose of an advisory report is to provide an impartial survey and critique of a plan for the use of the judge in determining whether or not to approve a plan. If the judge approves the plan, copies of the Commission's advisory report, or summaries thereof prepared by the Commission, are submitted to all creditors and stockholders of the debtor who are affected by the plan. Thus, the advisory report also serves the function of aiding security holders in reaching their decision with regard to the acceptance or rejection of the plan.

Although the advisory report bulks largest in the public consideration of the Commission's work under the Bankruptcy Act, because of the fact that it is usually widely distributed, it by no means represents the major part of the Commission's activities in any particular case. As has been noted, the Commission in its capacity as a party to a proceeding may be, and usually is, actively interested in the solution of every major issue arising therein. Throughout a reorganization proceeding the Commission lends its assistance and advice as to legal and financial matters to the court and to the trustee and other parties. In order to enable the Commission to perform its duties as a party to the proceeding conscientiously, it is necessary to undertake in every case in which it participates the same intensive legal and financial studies as are necessary for the preparation of a formal advisory report. In every case in which it is expected that plans will be referred to it for advisory reports, the Commission seeks to become a party as early as possible in the proceedings, in order to be certain that its advisory reports represent matured and informed consideration. Furthermore, as has been indicated, the Commission undertakes the same burden of study and analysis respecting plans in cases in which plans are not likely to be submitted to it for a formal advisory report. In such cases, it is necessary for the Commission

to be prepared to comment in court upon the plans of reorganization and to discuss proposals with the parties while the plans are in a formative stage.

During the past fiscal year, the Commission submitted seven advisory reports on plans of reorganization. In addition, five supplemental advisory reports were filed in proceedings where advisory reports had already been submitted and one other supplemental advisory report was in the course of preparation at the end of the fiscal year. In twenty-seven other cases in which no plan of reorganization had as yet been approved and in which the indebtedness involved exceeded $3,000,000, plans will be referred to the Commission automatically for advisory reports before approval by the judge.

Of the seven proceedings in which the Commission filed advisory reports, three were instituted under Chapter X, while the remaining four were Section 77B proceedings in which the judge deemed it practicable to apply the provisions of Chapter X. In six of these seven cases, the indebtedness involved was in excess of $3,000,000 and reference of plans of reorganization to the Commission for advisory reports was mandatory. In the remaining case, instituted under Section 77B, the Commission was requested to file an advisory report. A brief discussion of these advisory reports follows:

LaFrance Industries, Debtor, and Pendleton Manufacturing Company, Subsidiary. -- Prior to the Commission's participation in this proceeding, three plans had been proposed but had failed of acceptance. After the Commission became a party, a further plan was filed which provided for a 6 percent first mortgage loan of $600,000 from the Reconstruction Finance Corporation; the issuance to the holders of $1,462,500 principal amount of 5 percent first mortgage bonds outstanding, on which $292,500 of interest had accrued, of 4 percent second mortgage bonds in the principal amount of $731,250 (half of the principal of the outstanding first mortgage bonds) and 6 percent cumulative preferred stock in the principal amount of $877,500 (half of the principal of the outstanding first mortgage bonds pins half of the accrued interest); the issuance of $173,735 of certificates of indebtedness in exchange for 50 percent of unsecured claims outstanding against the debtor and its subsidiary, and payment of the other 50 percent of such claims in cash; and the retention by the holders thereof of the 164,918 shares of debtor's common stock outstanding. The plan was later amended to provide also for the allocation of 15 percent of the common stock to the holders of the first mortgage bonds outstanding and, as so amended, was referred to the Commission.

The Commission concluded in its advisory report that the amended plan was not fair in that it required the first mortgage bondholders to relinquish contractual rights and priorities without adequately compensating them for their sacrifices. The Commission also concluded that the plan was not feasible, principally

because dividends on the new cumulative preferred stock could not be paid and large arrearages would accumulate while the Reconstruction Finance Corporation loan was outstanding.

Following submission of the Commission's report, the plan was further amended to provide for issuance to the first mortgage bondholders of additional 6 percent cumulative preferred stock in the principal amount of $146,250, representing the remaining half of the accrued interest on the bonds, and as so amended the plan was again referred to the Commission. In its supplemental advisory report, the Commission concluded that while this amendment eliminated one important element of unfairness in the plan, the debtor failed to meet the objections to fairness set forth in its advisory report and, furthermore, that the issuance of additional cumulative preferred stock rendered more acute the problem of feasibility. The amended plan was approved by the court.

Reynolds Investing Company, Inc. -- The debtor is an investment company with $3,439,900 of publicly held debentures and two classes of stock outstanding. As of December 31, 1939, its assets consisted of about $200,000 of cash and approximately $2,800,000 estimated value of securities in its portfolio. In addition, the Chapter X trustees reported that substantial causes of action existed against former officers and directors of the Company, the face amount of such actions being in excess of $3,000,000.

After an extensive investigation of the company's affairs, the trustees determined that the company should be gradually liquidated, this decision being based largely on the fact that a disproportionately large part of the company's portfolio was concentrated in so-called special situations rather than income-producing securities. Accordingly, the trustees filed a plan which, as later amended, referred to the Commission for examination and report under Chapter X.

The plan contemplated the gradual liquidation of the company over a maximum period of eight years. It provided that the assets of the company (exclusive of causes of action, which were to be prosecuted by the trustees) would be taken over by a new company to be called Reynolds Realization Corporation. The new company was to issue to the debenture holders new debentures in the same face amount and having the same interest rate as the outstanding debentures, Class A voting trust certificates representing ownership interests in new preferred stock, share for share for the outstanding preferred stock and Class B voting trust certificates representing ownership interests in the new common stock, at the rate of one share for each ten shares of outstanding common stock.

The plan, based on the assumption that the company would liquidate its assets and retire the debentures with all reasonable expedition, provided specifically that securities in the portfolio must be sold upon reaching certain prices,

prohibited reinvestment of the proceeds, and prescribed a certain rate of retirement for the debentures during the 8-year period. It was provided that no distribution would be made to the stockholders until complete retirement of the debentures and that all preferred stock must be retired before any distribution on the common. The plan permitted retirement of the debentures through tenders, open market purchases, and redemption by lot. The plan provided that the company should be managed by a board of five directors, three of whom were to be elected by debenture holders so long as any debentures were outstanding and the asset value of the debentures remained less than 200 percent of par.

In its report, the Commission qualified its approval of the plan by suggestions for its modification in certain particulars with a view to making the plan more consistent with liquidation principles. It was suggested that the plan provide for a speedier rate of liquidation in order that the senior security holders would not be subjected to risks of market depreciation beyond those necessarily incident to an orderly liquidation, that further consideration be given to the advisability of providing for retirement of the debentures by ***pro rata*** distribution, and that the debenture holders be represented by a majority of the board until all debentures had been retired, irrespective of the asset value of such debentures at any given time. It was further suggested that the new securities plainly indicate on their face that they represented interests in a liquidating rather than a continuing enterprise.

After the submission of the Commission's advisory report, the trustees filed an amended plan designed to meet the Commission's criticism of the original plan. This amended plan was referred to the Commission, which issued a supplemental advisory report finding the plan fair and feasible and recommending its approval by the court. The plan was thereafter approved by the district court, accepted by the security holders, and confirmed by the court.

San Francisco Bay Toll-Bridge Company. -- The plan originally filed by the trustee in this case provided for participation by bondholders, debenture holders, and two classes of stockholders, but, as a result of hearings at which representatives of the Commission developed testimony indicating that the value of the bridge did not justify participation by junior interests, this plan was amended to eliminate stockholders. As submitted to the Commission, it provided for the issuance of $4,303,000 of 6 1/2 percent income bonds and a Class A preferred stock to present bondholders, and for the issuance of Class B stock to debenture holders. The Commission's report concluded that the plan was not feasible because prospective earnings of the debtor's property would not be sufficient to meet the interest charges on the bonds, so that there was no reasonable prospect of paying the bonds in accordance with their terms prior to the expiration of the company's 37-year bridge franchise, and that the Class A and Class B stocks would be worthless for all practical purposes. The report also concluded that the plan, which was based on the assumption that all the debtor's

assets were subject to the lieu of the indenture securing the bonds, was unfair in recognizing debenture holders because the value of the assets was less than the bondholders' claims. At the time of filing the report, however, representatives of the Commission pointed out to the court and thereafter discussed with the parties the possibility that certain assets were not subject to the lieu of the bond indenture and that consequently debenture holders might be entitled to participation under the plan on the basis of such free assets.

Subsequent to the filing of the Commission's report, further hearings were held as a result of which an amended plan was filed and referred to the Commission. It provided for the issuance of $4,303,000 of 3 percent income bonds and all of the common stock of the reorganized company to bondholders. Debenture holders were offered, by reason of their claim to free assets, a cash payment of 1 1/2 percent of the face amount of their debentures. In its supplemental report, the Commission concluded that, subject to the determination of a legal question affecting the amount of participation by debenture holders, the amended plan was fair. The Commission further concluded, however, that the plan remained unfeasible, although manifesting in this regard a considerable improvement over the original plan. Basically, the Commission's criticisms of this aspect of the plan were predicated on the excessive debt structure proposed, which would cause the debtor to emerge from reorganization in an insolvent condition.

At the hearing upon approval of the amended plan., the Commission's representatives pointed out that the principal justification urged for retention of the excessive debt provided for by the plan, namely, alleged unfavorable tax consequences which it was claimed would ensue from reduction of such debt, had been eliminated by an amendment of Section 270 of the Bankruptcy Act. The plan was approved by the court.

Flour Mills of America. -- Two plans were referred to the Commission for an advisory report in this proceeding. One, filed by the trustee, provided for the issuance to the noteholders of 4 percent 20-year income notes in a face amount equivalent only to their claim for principal. No provision was made for the accrued interest on the notes. The preferred stockholders of the debtor were to receive all the new common stock; no provision was made for the old common stockholders since the value of the debtor was admittedly insufficient to compensate prior claimants. This plan was predicated upon an assumed valuation of some $3,200,000 which was in turn predicated upon anticipated average earnings of $250,000 per year, capitalized at 8 percent. From the Commission's investigation, it appeared that there was no adequate support for the estimated annual earnings of $250,000. The record of the debtor for the 5 preceding years had been largely a succession of losses. Furthermore, as a matter of financial judgment, it appeared that the risks of the enterprise were far greater than would justify an 8 percent capitalization rate.

The Commission stated in the advisory report its belief that the value of the enterprise did not equal the amount of the claims of the noteholders. Consequently, it expressed the opinion that the trustee's plan was unfair in allocating any participation to the preferred stockholders. The Commission further pointed out that even if the valuation sponsored by the trustee were used as a basis for judging the plan, the plan was nonetheless unfair since the securities to be issued to the noteholders did not have a value approaching even the principal amount of their claim and no compensation was allocated to them for their accrued interest. The Commission also indicated its belief that the plan of reorganization was not feasible, because a corporation such as the debtor, whose earning power was clouded with doubt, should not be burdened with debt securities. The fact that, under the terms of the notes, no default could occur until maturity, did not, in the opinion of the Commission, remove the basic defect in the structure. In any event, it was pointed out that the amount of debt securities to be issued was excessive even on the valuation of the debtor sponsored by the trustee.

The Commission was of the opinion that the plan filed by a noteholders' committee, which assumed that the debtor was insolvent and which provided for an issue of common stock to the noteholders as the only securities of the new company, was fair and feasible and should have been approved. The court, however, in a memorandum opinion indicated that it found the debtor to be solvent and that the trustee's plan would be fair if provision were made for the noteholders' accrued interest. The trustee's plan was amended to provide for the issuance of non-interest-bearing certificates for such accrued interest, for the issuance of some common stock to the noteholders, and for a more valuable conversion privilege. On the court's finding that the debtor was solvent, the plan, as amended, which allocated to the noteholders the above-mentioned notes, non-interest-bearing certificates for their accrued interest, common stock, and a conversion privilege that would enable them to convert their notes into common stock and thereby obtain a portion of the common stock roughly equivalent to the ratio which their claims bore to the value assumed by the trustee, could be considered fair. The Commission, however, in its supplemental advisory report, also pointed out that in its opinion the plan, as amended, appeared not feasible for the reasons set forth in its original report. The plan, as amended, was approved by the court.

Deep Rock Oil Corporation. -- Prior to the Commission's participation in this case, a minority committee for the preferred stockholders appealed to the United States Supreme Court from the confirmation of a plan of reorganization which allocated to the Standard Gas and Electric Company, the parent company of the debtor, 73 percent of the common stock of the new corporation in respect of its open account claim against the debtor. The Supreme Court disapproved the plan

in an opinion which stated that Standard's participation must be in subordination to the claims of the preferred stockholders of the debtor because of its record of spoliation and mismanagement of the debtor. [Footnote: ***Taylor v. Standard Gas and Electric Company***, 206 U.S. 207 (1939).] Upon the return of the case to the district court, it was proposed to file a plan of reorganization which would provide for the issuance of $11,000,000 of new notes to the old stockholders, $5,000,000 par value of Class A stock, with certain preference provisions, to the preferred stockholders, and an issue of common stock to be divided on the basis of 25 percent to the noteholders, 12% percent to the preferred stockholders, and 6 1/2 percent to Standard. Upon entering the proceeding, the Commission took the position that such a plan was not feasible on the basis of the past financial record of the company and that the Supreme Court's decision properly interpreted required the exclusion of Standard from the reorganization, since the value of the debtor's assets was insufficient to satisfy the prior claims of the noteholders and preferred stockholders.

Subsequently, the Reorganization Committee filed a plan providing for the issuance to the noteholders of $5,500,000 in new 6 percent notes and 80 percent of the common stock after a distribution to them of cash in partial compensation of accrued interest. The balance of the common stock was to be issued to the preferred stockholders. No participation was provided for Standard, since the district court had decreed that the Supreme Court decision required that the claims of the noteholders and preferred stockholders should first be satisfied and that thereafter there was no equity in the enterprise for Standard. The Commission, in its advisory report, pointed out that the value of the debtor was apparently less than the claim of the noteholders and that the preferred stockholders were therefore entitled to no participation. The Commission also considered the proposed plan in the light of the maximum value for the enterprise previously adopted by the court. The Commission concluded that, on the basis of the latter value, the proposed plan was fair. The Commission held that another plan, offered by the Independent Preferred Stockholders' Committee, which would have provided for $7,000,000 of new notes to the noteholders and a division of the common stock evenly between the noteholders and the preferred stockholders was unfair under either value.

At a hearing on the proposed plans, the district court reaffirmed its earlier decision o. the value of the debtor. The court indicated that in its opinion a somewhat greater participation should be given to the preferred stockholders. The Reorganization Committee's plan was thereupon amended to give 75 percent of the common stock to the noteholders and 25 percent to the preferred stockholders. The Commission, in a supplemental advisory report, indicated its belief that the new allocation of stock was not a change materially affecting its prior conclusions on the fairness of the plan. The Reorganization committee's plan, as amended, was approved by the court; the plan of the independent

preferred stockholders was disapproved. The plan approved by the court was accepted by the security holders and confirmed by the court on July 24, 1940.

Standard Gas and Electric Company appealed from the order by the district court determining that on the basis of the Supreme Court's decision it had no right to participate under any reorganization plan. The Commission filed a brief and participated in the argument of the case before the United States Circuit Court of Appeals for the Tenth Circuit, which in a unanimous opinion upheld the interpretation sponsored by the Commission and adopted by the district court that Standard had no right to participate under the plan until the noteholders and preferred stockholders were fully compensated for their claims. It has been indicated that a petition for ***certiorari*** from this decision would be filed with the Supreme Court of the United States. Standard has also appealed from the district court's orders of approval and confirmation of the plan, but such appeals have not yet been heard by the circuit court of appeals.

Penn Timber Company. -- As stated in the Commission's Fifth Annual Report, the Commission submitted an advisory report in which it concluded that the debtor's plan filed in this proceeding was neither fair nor feasible. As of the close of the 1939 fiscal year the matter was still pending. The trustee had since filed a petition for a hearing to consider whether the value of the debtor's assets warranted participation in any plan by interests junior to the first mortgage bondholders; the Commission also filed a petition for an order disapproving the plan and declaring Section 169 of the Bankruptcy Act applicable to the proceeding. At the hearings held on these petitions, additional evidence was introduced with respect to the value of the debtor's assets and, with the permission of the court, the Commission filed a supplemental advisory report on the basis of such additional evidence. In its supplemental report, the Commission concluded that the additional evidence did not warrant a finding of value for the debtor's assets sufficient to entitle junior creditors to participate in the plan. The court disapproved the plan, found that the value of the debtor's assets did not exceed the first mortgage debt, declared Section 169 applicable to the proceeding, and directed the trustee to file a new plan.

Porto Rican American Tobacco Company. -- The plan referred to the Commission provided for the sale of the assets of the chief operating subsidiary of the debtor to a competing Company for some $4,000,000 in notes. A new corporation was to be organized to hold the balance of the assets. Each bondholder of the debtor was to receive $940 principal amount of the notes for each $1,000 bond of the debtor or, at its option, $846 in cash. In addition, the bondholders were to receive 78 percent of the common stock of the new corporation; the remaining 22 percent was to be issued to the Class A stockholders of the debtor. The Class B stockholders of the debtor were found to have no equity and were excluded from participation in the plan. The

Commission, in its advisory report, concluded that the plan, which provided for an ultimate liquidation of all the assets of the debtor, was a reorganization plan; that the sale of the subsidiary to a competing company was reasonable and was being made at a reasonable price; and that the value of the notes to be received by the debtor for its interest in the subsidiary was such that the provisions for their issuance to the bondholders and for the division of the common stock of the new corporation were fair and equitable.

Upon an appeal to the Circuit Court of Appeals for the Second Circuit, the order of the district court approving the plan was affirmed. [Footnote: In re Porto Rican American Tobacco Co., 112 F. (2d) 655 (C. C. A. 2d, 1940)] The court of appeals held that the plan was a reorganization plan and that the division of securities was fair. It also accepted the going-concern value of the debtor's assets recommended by the Commission in its advisory report and adopted by the district court, which was based upon a capitalization of reasonably anticipated earnings, for the purpose of determining the reasonableness of the sale of the assets of the subsidiary, and indicated clearly that the strict priority doctrine is applicable to plans of reorganization for solvent corporations as well as for insolvent corporations. The requisite percentage of the Class A stockholders, however, failed to accept the plan and proceedings were instituted under Section 216 of the Bankruptcy Act to appraise their interest and to pay them for the value of their equity in the debtor.

Minnesota and Ontario Paper Company. -- The debtor is both an operating and a holding company, engaged primarily in the production and marketing of newsprint and specialty papers, insulating and building material, and other timber products in the United States, Canada, and Europe. These activities are carried on either directly by the debtor or through eighteen subsidiary corporations, all of whose securities are owned by the debtor or its subsidiaries. Seven of these subsidiaries are organized under the laws of the State of Minnesota, seven under the laws of the Province of Ontario or of the Dominion of Canada, and four under the laws of other foreign countries.

The debtor went into an equity receivership in 1931, which was superseded by a reorganization proceeding under Section 77B on July 11, 1934. The Commission filed its notice of appearance in this proceeding on February 10, 1939, pursuant to Section 208 of the Bankruptcy Act. The debtor's liabilities, with accrued interest to August 31, 1939, amounted to approximately $55,000,000, including $24,400,000 of first mortgage bonds and approximately $13,000,000 of accrued interest thereon. All but $950,000 principal amount of the $23,950,000 aggregate principal amount of first mortgage bonds of the debtor's subsidiaries and some of their stocks were directly or indirectly subject to the lien of the debtor's mortgage, and $22,500,000 of these bonds had the benefit of a floating charge which, under Canadian law, subjects all of the mortgagor's assets to the lien of the mortgage

in the event of a default. In addition, the debtor had outstanding $4,036,000 par value of preferred stock and $10,092,000 par value of common stock.

The trustees filed a proposed plan of reorganization dated October 16, 1939, and subsequently filed an amended plan dated December 4, 1939. The October 16 plan contemplated the issuance to the secured creditors of $9,760,000 principal amount of new 4-percent income bonds and 72.59 percent of the stock of the reorganized Company. The remaining 27.41 percent of the stock was to be issued to the unsecured creditors. The December 4 plan increased the principal amount of the proposed bond issue from $9,760,000 to $12,200,000 and allocated the stock of the reorganized company between the secured and unsecured creditors in the same percentages. After extensive hearings on these plans and on objections and proposed amendments thereto before the United States District Court for the District of Minnesota, Fourth Division, the plans, objections, and proposed amendments were referred to the Commission for examination and report pursuant to the provisions of Section 172 of the Bankruptcy Act. The Commission's report was filed on June 24, 1940.

All of the plans and proposed amendments which were referred to the Commission recognized the absence of any equity in the debtor's assets and therefore properly accorded no participation for either the preferred or the common stock. All of them also assumed that the capitalization of the reorganized company would include both bonds and stock. The basic questions were the principal amount of new bonds to be issued to the old bondholders and the distribution of the new stock between the secured and unsecured creditors. The solution of these questions required a determination of the value of the debtor's operating assets and the assets underlying its investments. The major questions involved in this determination were as follows:

1. Whether the value of such assets should be based primarily upon the reasonably prospective earnings derivable from the utilization of those assets or upon "the original cost of fixed assets, less accrued physical and functional depreciation," as proposed by the trustee,

2. Whether the relative participations of the several classes of claimants should be determined on the basis of the consolidated balance sheet or upon a valuation on an earnings basis of individual companies or groups of companies, and

3. Whether accrued interest since the date of the receivership should be taken into account in measuring the secured creditors' deficiency claim against "free" assets.

In its advisory report, the Commission took the position that it was possible to arrive at a valuation on an earnings basis of groups of companies which were functionally related; that such group valuations provided a proper basis for the allocation of valuation among the various classes of claimants; and that under the circumstances it was not necessary or proper to resort to a method of such doubtful propriety as the original cost basis in determining going-concern valuation or to determine the relative participations of the several classes of claimants on the basis of the consolidated balance sheet. On this basis, the Commission arrived at a total maximum going-concern value for the enterprise of approximately $25,594,000. The Commission also concluded that accrued interest since the date of the receivership should be taken into account in measuring the secured creditors' deficiency claim against free assets and that therefore a maximum of $23,018,000, or 90 percent, of the total maximum going-concern value of the enterprise was allocable to the claims of the secured creditors and a minimum of $2,576,000, or 10 percent, to the claims of the unsecured creditors.

On this basis, the Commission expressed its approval of the Trustees' Amended Plan dated December 4, 1939, if amended to provide for a 5-percent rate of interest on the new bonds to be issued, as proposed by the Bondholders' Protective Committee, and to include certain other amendments proposed either by that committee or by certain unsecured creditors or recommended in its report. Thereafter, the trustees filed an amended plan dated July 16, 1940, including those amendments and certain other amendments. The Commission was given an opportunity to file a supplemental report on these amendments, but did not deem it necessary to do so because the amendments which had not previously been referred to it and discussed in its original report appeared to be of a minor nature and did not affect its conclusion as to the fairness and feasibility of the plan. By order entered August 14, 1940, the Trustees' Amended Plan dated July 16, 1940, was approved by the court as fair and feasible and equitable. Thereafter, pursuant to Section 175 (3) of the Bankruptcy Act, the Commission prepared and filed a summary, dated August 26, 1940, of its advisory report for transmission to the creditors and stockholders affected by the plan.

Part III
ADMINISTRATION OF THE SECURITIES EXCHANGE ACT OF 1934

The Securities Exchange Act of 1934 is designed to eliminate manipulation and other abuses in the trading of securities both on the organized exchanges and in the over-the-counter markets which together constitute the Nation's facilities for trading in securities; to make available to the public information regarding the

condition of corporations whose securities are traded on any national securities exchange and to control the flow of the Nation's credit resources into its securities markets.

NATIONAL SECURITIES EXCHANGES

Relations with Exchanges.

The Securities Exchange Act of 1934 contains outright statutory prohibitions against many practices which the Congress found to be clearly inimical to the investing public or to the public interest. In addition, the statute marked out other areas within which the Commission is authorized to regulate the securities markets and the activities of their members by its own rules and regulations. Congress, in dealing with the problem of relationships between the Commission and the national securities exchanges, authorized the Commission, in Section 19 of the statute, to exercise a residual rather than a direct jurisdiction over many aspects of national securities exchanges which impinge upon the public interest and the welfare of American investors. [Footnote: Under Section 19 (b) of the Act these residual powers may be exercised by the Commission only after the national securities exchange concerned has been formally requested to take certain action and has failed to comply with the Commission's request.] For instance, the Commission is vested with indirect powers over matters such as the emergency suspension of trading upon national securities exchanges, safeguards for the financial responsibility of members, hours of trading, the manner, method, and place of soliciting business, and the fixing of reasonable rates of commissions and other charges. Those powers, whether they be direct or indirect in their nature, and even though they must be exercised in accordance with standards erected by Congress, are necessarily somewhat discretionary in their scope and operation. This approach to many of the more technical and complex problems of the securities business was adopted at the suggestion of the representatives of that business itself. As stated by the Committee on Interstate and Foreign Commerce of the House of Representatives which considered the legislation --

"Representatives of the stock exchanges constantly urged a greater degree of flexibility in the statute and insisted that the complicated nature of the problems justified leaving much greater latitude of discretion with the administrative agencies than would otherwise be the case." [Footnote: H. R. Rep. No. 1383, 73rd Cong., 2d Sess., p. 6.]

The story of the Commission's relations with the securities exchanges and the over-the-counter markets during the fiscal year ended June 30, 1940, therefore,

consists primarily of the action it has taken within those areas over which Congress has given it these rule-making powers.

The Commission's Program for Increasing Safeguards to Customers against the Risks of Brokerage Insolvencies.

Public protection against the manifold dangers attendant upon brokers' insolvencies, including the risk that their funds and securities may be misappropriated, was one of the more important problems which the Congress did not undertake to solve when it passed the Securities Exchange Act of 1934. Instead, Congress, by virtue of several sections of the Act, delegated the solution of these complicated problems, in large part at least, to the Commission.

The task of achieving adequate financial protection for brokerage customers was, in part, also left by Congress to the brokerage and stock exchange community. For the Commission, before adopting its own rules and regulations under Section 19 (b) to safeguard the financial responsibility of members of a national securities exchange, must first seek the cooperation of that exchange. Only if the exchange refuses to comply with the Commission's request that it amend or supplement its rules can the Commission adopt its own rules under Section 19 (b) to achieve the requested objective. It has, of course, been the consistent policy of the Commission to proceed as far as possible along the avenue of voluntary cooperation with the industry before resorting to its formal powers of direct regulation through the promulgation of rules under the Act.

In its Fifth Annual Report, covering the fiscal year ended June 30, 1939, the Commission discussed the stops which, in accordance with this policy, it had taken in the course of that year to bring about, on the part of the financial community itself, a higher measure of self-policing. Particular reference was there made to the proposal of "brokerage banks" as one method of removing the risks of fluctuating security values from brokers' performance of the substantial banking and custodial business which they do for their customers. That annual report described in detail the financial and economic importance of the billion dollar banking and custodial business which is now handled by brokers as an incident to the brokerage functions. The sources of the present dangers to customers, as they had been so tragically illustrated by the bankruptcy of Richard Whitney & Company, were also pointed out in their relation to possible solutions of the problem.

On June 23, 1939, Chairman Frank, still adhering to the policy of mutual cooperation rather than direct regulatory measures by the Commission, publicly asked that immediate study be given to "brokerage banks" or some other method either of eliminating or of properly protecting the conduct of the brokers' banking and custodial business. The proposal for a "Central Trust Institution" or, as it has

since been called, a “brokerage bank” had been first advanced by members of the financial community itself, later, in May 1935, by William O. Douglas, then Chairman of the Commission, and, most recently, by Jerome Frank, the present Chairman. Under this suggestion, a so-called “brokerage bank” would take over and thus safeguard all the banking and trustee functions of brokers. As a result, the president of the New York Stock Exchange, in July 1939, appointed a committee of non-members referred to as a “Public Examining Board”. [Footnote: This committee, of which Mr. Roswell Magill was chairman, was composed of Messrs. W. Randolph Burgess, Carle C. Conway, and Walter J. Cummings.] This committee was authorized to study the broad problem of adequate financial protection to customers, as well as the narrower question of the feasibility of the suggestion for a “brokerage bank.” Meanwhile, the Commission withheld its own direct action and refrained from promulgating any rules and regulations under the Securities Exchange Act of 1934 dealing with this problem pending the “Public Examining Board’s” study and the effectuation of the detailed recommendations which ensued.

Under date of August 31, 1939, the New York Stock Exchange’s committee published its report. Although the report of this committee urged a number of detailed improvements in brokerage practice, it expressed the view that certain objections to the suggestion for “brokerage banks” made it “undesirable in the present situation.” On the whole, the 14 specific recommendations of the committee seemed primarily designed to preserve, with some additional safeguards, the existing fusion of the brokerage with banking and trustee Inactions of holding customers’ funds and customers’ securities. The report of the New York Stock Exchange’s committee summarized its own affirmative recommendations as follows:

FREE CREDIT BALANCES

“1. Customers’ cash balances left in brokers’ hands should either be segregated from the broker’s own funds in special earmarked deposits in commercial banks, or the broker should receive from the customer specific authorization to use the deposit in his business.

“2. We recommend that the Stock Exchange and the Securities and Exchange Commission join in endeavoring to secure the adoption of amendments to the federal bankruptcy act to make it clear that balances so segregated and securities held in safekeeping and in segregation are not subject to the claims of the broker’s general creditors in case of his insolvency.

“3. The rules of the Exchange respecting capital requirements should be amended so that a member firm is not penalized (as at present) for placing customers’ credit balances in segregation.

“SERVICE CHARGES

“4. The Exchange should adopt by rule a schedule of minimum standard service charges such as, for example, a minimum monthly account charge, and a charge as reimbursement for snob services as the safekeeping and handling of securities.

“SEPARATE COLLATERAL LOANS

“5. The rules of the Exchange should make it clear that a customer, if he so desires, may request his broker to act as his agent in negotiating a separate individual loan from a bank, secured by the customer’s collateral.

“STOCK EXCHANGE INCOME AND RESERVES

“6. The income of the Stock Exchange should be increased out of service charges, a transaction tax, or otherwise, in an amount sufficient to balance its budget and also build up a substantial reserve fiend available to meet emergency or unusual needs which may arise.

“FIDELITY INSURANCE

“7. The rules of the Exchange should provide for standard minimum amounts of fidelity insurance on employees, to be maintained by member firms, and to the extent found feasible after further study these rules should be extended to cover insurance on partners.

“SEPARATION OF UNDERWRITING FROM BROKERAGE BUSINESS

“8. All firms making dealing and underwriting commitments in excess of their capital should be required, as soon as satisfactory mechanisms are devised, to separate their brokerage from their dealing and underwriting business either by

“(a) Incorporating their brokerage business (with full guarantee of the partnership), or

“(b) Incorporating their dealing and underwriting business.

“CAPITAL REQUIREMENTS

“9. We recommend an increase from $25,000 to $50,000 in the minimum capital requirements of member firms carrying customers’ accounts.

“MARGIN FOR COMMODITY ACCOUNTS

“10. We suggest that the Exchange consider the adoption of rules requiring for commodity accounts the same minimum margins as required by the rules of commodity exchanges.

“FINANCIAL STATEMENTS AND AUDITS

“11. Member firms should distribute to all customers, at least annually, a printed financial statement, audited and certified by a firm of public accountants. This document should contain a clear statement of the broker’s policy in the handling of customers’ free credit balances.

“12. The exchange rules should provide that every active member doing business as an individual should file a financial statement annually with the exchange.

“13. We recommend that the annual audit of member firms by public accountants be conducted on a surprise basis; and include a spot cheek of the firm’s records of receipts from and deliveries of cash and securities to individual customers.

“14. Since the Stock Exchange’s examining force and periodic inspections are it, principal mechanism for self-supervision, we recommend further strengthening of the examining staff.”

Between September 1, 1939, and the close of the past fiscal year, June 30, 1940, the exchange has done the following to effectuate the recommendations of this nonmember committee:

1. On September 15, 1939, minimum capital requirements for a member firm doing any business with anyone, other than members or member firms, were increased from $25,000 to $50,000.

2. On March 28, 1939, the Board of Governors of the Exchange referred to the Committee on Member Firms a report pursuant to which affiliated corporations may be formed on a permissive basis so as to insulate brokerage customers, at least partially, from the financial hazards of the underwriting and dealer business (the most dangerous phases of the securities business) which are engaged in by member firms. However, when the Committee on Member Firms was authorized to receive applications to form such affiliated corporations, it was also instructed not to compel the formation of such corporate underwriting and dealer affiliates. To date, one such corporation has been set up.

3. The exchange, on January 19, 1940, required that the annual independent audit of member firms be made on a surprise basis. However, the date for the surprise audit is selected not by the exchange but by the accountant employed by the member firm to be thus audited.

The following have not been done:

1. No action has been taken to require the segregation of free credit balances of customers who have not authorized the broker to use their funds in the conduct of his own business The exchange has expressed the view that such segregation might prove ineffective unless and until, through amendments to the Bankruptcy Act, such funds so segregated would be clearly recoverable by customers after bankruptcy.

2. Although counsel for the New York Stock Exchange has conferred with the Commission on the matter, it has not yet been possible, owing to technical and other difficulties, to have presented to Congress a specific amendment to Section 60 (e) of the Bankruptcy Act which would make it clear that customers' free credit balances so segregated and customers' securities segregated in safekeeping or as "excess margin" may be reclaimed by such customers. [Footnote: No action has been taken relative to the committee's recommendation that the exchanges capital requirement be relaxed in their application to firms carrying customers' free credit balances. However, in this connection it should be particularly noted that the suggestion of the "Public Examining Board" in effect that customers' free credit balances should not be considered as "aggregate indebtedness" of a brokerage firm for the propose of determining compliance with the exchange's minimum capital requirements, in no sense represents progress towards greater financial safeguards for brokerage customers. On the contrary, it represents an affirmative retrogression from the goal of reasonable safety since it would ignore the demand liabilities of a brokerage firm to its customers which had entrusted it with their funds.]

3. No rules have been adopted to "make it clear" that a customer may obtain, through his broker, separate individual loans from banks secured by the customer's own collateral. The exchange has taken the position that no action along this line is necessary since customers of a member firm always had and still have the right to request the firm to act as agent in negotiating a separate loan secured by the customer's collateral.

4. No steps have been taken to build up a reserve fund available to meet emergency or usual needs which may arise.

5. Although counsel to the New York Stock Exchange has conferred with representatives of the fidelity insurance industry, the technical problems involved

in such an extension of the principle of fidelity insurance have as yet prevented the adoption of rules to require standard minimum amounts of fidelity insurance on partners as well as on employees of member firms.

6. The exchange has taken no steps to require that member firms undertaking dealer and underwriter commitments in excess of their capital should be required to separate the financial risks of their dealer and underwriter business from their brokerage business.

7. The exchange has not adopted rules requiring minimum margins for commodity accounts.

8. Although the exchange, on September 19, 1939, did adopt a rule requiring its member firms to distribute to all of their customers annual printed statements showing their financial condition, this requirement was rescinded on November 13, 1939. Although the monthly statements to customers of member firms must advise customers that they may obtain copies of the firm's financial statement, customers have had this right since March 1938. The exchange also considers it inexpedient at this time to adopt the further recommendation of the "Public Examining Board" that member firms should endorse on financial statements a legend specifying the policy of the firm in handling customers' free credit balances.

9. Although the exchange, on March 1, 1940, made certain minimum service charges on customers' accounts effective, this requirement was rescinded on March 27, 1940.

10. The exchange has not required individual members to file financial statements with it.

11. The exchange has not, so far as the Commission is aware, taken any steps towards the further strengthening of its examining staff.

Exchanges Registered and Exempted from Registration.

During the past fiscal year, there has been no change in the number of exchanges registered with the Commission as national securities exchanges, but, for the first time in four years, there was a change in the number of exchanges exempted from such registration.

The Milwaukee Grain and Stock Exchange made application to the Commission on April 9, 1940, to withdraw its application for exemption from registration of a national securities exchange. In this application, the exchange stated:

“Trading in securities on this Exchange was suspended as of April 1, 1938, for the reason that the volume had declined to a very low point and a number of the firms relinquished their memberships. It was thought that trading could be resumed at a later date, but that appears very unlikely at present, and it therefore is deemed advisable to make application for withdrawal.”

This application was granted by the Commission in its order of May 1, 1940, wherein the Commission’s orders dated November 5, 1935, and March 7, 1936, under Section 5 of the Securities Exchange Act of 1934, granting said application for exemption, were set aside.

The 20 registered exchanges and the 6 exchanges exempted from registration as of June 30, 1940, are as follows

*Baltimore Stock Exchange.
*Board of Trade of the City of Chicago.
*Boston Stock Exchange.
Chicago Stock Exchange.
*Cincinnati Stock Exchange.
*Cleveland Stock Exchange.
*Detroit Stock Exchange.
*Los Angeles Stock Exchange.
*New Orleans Stock Exchange
*New York Curb Exchange.
*New York Real Estate Securities Exchange, Inc.
New York Stock Exchange.
*Philadelphia Stock Exchange.
*Pittsburgh Stock Exchange
St. Louis Stock Exchange.
*Salt Lake Stock Exchange.
San Francisco Mining Exchange.
*San Francisco Stock Exchange.
*Standard Stock Exchange of Spokane
Washington (D. C.) Stock Exchange.

EXEMPTED

Colorado Springs Stock Exchange.
*Honolulu Stock Exchange.
*Minneapolis-St. Paul Stock Exchange.
Richmond Stock Exchange.
*Seattle Stock Exchange.
*Wheeling Stock Exchange.

*Unlisted trading privileges with respect to certain issues of securities exist on these exchanges.

There have been the usual changes in the rules, practices, and organization of the registered and exempted exchanges as reflected in their applications for registration or exemption, consequently, during the past fiscal year, the national securities exchanges filed 154 amendments to their applications and 24 amendments were received from exempted exchanges. Each of these amendments was studied and analyzed, not only that the Commission might determine compliance with relevant legislation and regulations, but also to the end that appropriate comments and suggestions could be addressed to the exchanges concerned in order to facilitate the performance of their public obligations.

STEPS TAKEN TO GUARD AGAINST DISORDERLY SECURITIES MARKETS

Critical market conditions caused by the outbreak of war in Europe during the past fiscal year called for intense scrutiny by the Commission of day-to-day and even hourly developments. Section 19 (a) (4) of the Securities Exchange Act of 1934 authorizes the Commission

"* * * if in its opinion the public interest so requires, * * * with the approval of the President, summarily to suspend all trading on any national securities exchange for a period not exceeding ninety days."

It was apparent to the Commission that sudden military developments abroad might well create a condition in the securities markets requiring the exercise of this authority.

As early as April 1938, when Austria was annexed by Germany, the Commission had set up machinery for keeping itself informed of current developments in order to keep ahead of actual market response to various occurrences. Even at that time, the orders which would have been necessary for the exercise of the statutory powers had been prepared so as to be ready at a moment's notice if market conditions should make it imperative to use them. At the same time, extensive studies were made to determine as closely as possible what might be the impact upon our securities markets of an actual declaration of war in Europe. Recalling that it had been necessary for the New York Stock Exchange to close in 1914, when the World War began, efforts were made to determine what, if any, analogies existed between 1914 and 1935.

When, in September 1939, war actually was declared, the preparation which the Commission had made proved most valuable. Lines of direct communication to

valuable sources of information in the financial community were quickly reestablished. Liaison with each of the national securities exchanges was immediately developed through the regional offices of the Commission. In this way, the Commission was able to know currently about the volume and trend of orders in brokerage offices even before those orders actually reached the floors of the exchanges for execution.

Although the securities markets accepted the beginning of actual hostilities in Europe with equanimity, the Commission's experience gained during the September rally, together with the intermission for further study which was afforded by the strength of the market, was to prove most helpful when the invasion of the low countries by Germany, in May 1940, produced violent repercussions in our securities markets. During that intermission, the Commission had increased the efficiency of its mechanisms for gathering advance market, economic, and international information and, hence, was in a better position to appraise each succeeding development as it arose. Studies were made to determine the extent to which the nationals of each European country might liquidate American securities together with the likelihood that belligerent nations themselves might be required to finance their activities by liquidation of American securities. The domestic situation was also carefully reviewed and currently reanalyzed. This included a consideration of such technical factors as the extent of short positions and the volume of margin commitments. Plans were also worked out so that if it should become necessary to close the stock exchanges, "bootleg" markets would not grow up in the over-the-counter field and trading would be controlled in such markets by cooperative efforts.

Closing the exchanges -- the securities markets -- has always been regarded as a step which the Commission would initiate only with the greatest reluctance and only when completely convinced that it was absolutely necessary. The Commission is well aware of the importance of free securities markets to the American economy. Congress, however, in giving the Commission authority to take this drastic step, with the approval of the President, recognized that occasions could arise in which a chaotic securities market might so disrupt and demoralize general business and might so irreparably damage not only investors but the entire national economy that closing the markets would be the only alternative. Obviously, no hard and fast rules to govern the closing of exchanges could be laid down in a statute, for the reason that there could be no way of telling what particular kind of a critical situation might develop. But it is clearly the Commission's continuing duty to so prepare itself that no crisis can get so far out of hand that catastrophic damage can be done before the action can be taken.

A critical situation which bore danger signals to warn that the use of the statutory power might be essential developed immediately upon the invasion of the

Netherlands and Belgium early in May of 1940. To the casual observer, looking back at the chart of daily stock market movements, it might appear that a chaotic condition actually did exist. Daily market breaks ranged as high as 10 points a day for various averages of listed securities, and individual securities the daily declines were sometimes much greater.

The Commission, however, was not watching the market from the standpoint of daily movements. It was maintaining a constant minute-to-minute scrutiny. Through its machinery for gathering as much information as possible, it kept constant scrutiny over the volume and trend of orders as they came into the leading brokerage offices before those orders reached the floor. Each morning before the markets were opened, the Commission and its experts were in contact with its sources of information to find out the character and size of the brokerage orders which had accumulated over night. It kept track of the effect of market changes upon margin accounts. It received current reports on the size of short positions and the volume of short sales. It knew at all times the approximate condition of the books of the specialists in various leading stocks on the floors of the various exchanges. It was able, in cooperation with the New York Stock Exchange, the Treasury, and certain houses specializing in foreign dealings, to judge the trend and volume of foreign transactions.

The significant factor to be considered was the character of the market -- more than the trend of the market. was the market orderly or was it disorderly? A disorderly market is generally regarded as a market in which prices rise or fall several points between transactions -- or a market in which no transactions at all are possible because of the wide spread between the bid and asked prices. By these standards, the markets of May 1940 were generally orderly. Prices frequently declined rapidly, but in nearly every instance the breaks were limited to less than a point between transactions. At no time was the market frozen and buyers and sellers could always transact business at prices within a reasonable relation to the prices of preceding transactions. In short, although stocks lost many points during those first days of the invasion of the Low Countries and France, there was no time at which the market machinery failed to function smoothly.

The Commission was, nonetheless, constantly prepared to act if further developments should bring about the feared break-down. Members of the Commission were in constant contact with the White House and the President, at his request, was furnished with current reports throughout the crisis. In the event that market conditions should have become so fraught with danger as to make it advisable to close the exchanges, the Commission, with the approval of the President, would have been ready to act.

Although there has not been a recurrence of a crisis similar to that which existed in May 1940, the Commission is prepared again to put its machinery for minute-to-minute market surveillance into operation whenever the need should arise.

MARKET SURVEILLANCE

In enforcing the provisions of the Securities Exchange Act of 1934 outlawing manipulation of security prices, the Commission's policy of administration has been based upon the principle that it is far more in the public interest to prevent, rather than to punish, fraud. As a result, prompt action is taken whenever any deviation from normal in either price or volume is of such a nature, after consideration of all the facts, as to suggest a high degree of probability of a violation. Although the Commission believes in prompt action, it should be emphasized that it does not believe in any unnecessary interference with the proper functioning of the market place and, therefore, the greatest discretion is used in an authorization of an investigation. To some extent, the speed with which the Commission moves when it is deemed necessary, lessens the chances of successful punitive action against those responsible for the fraudulent trading since, in such cases, manipulation usually dies at its inception and, therefore insufficient evidence makes prosecution difficult.

The detection of manipulation is dynamic rather than static because the methods of the manipulator are continually changing. With his increased familiarity with the law, he experiments continually with new and more subtle methods of evasion to which the Commission must as continually adapt its technique of detection. The Commission receives many complaints from members of the public and it always appreciates the spirit of cooperation shown by those members of the public who are sincerely anxious to offer information which may be of assistance in the administration of the statutes. However, of the total number of complaints received, only a relatively small percent have to do with matters of manipulation. While all such complaints receive the most serious consideration, the task of detection could not be done satisfactorily if the Commission relied solely upon such sources of information.

The reports of security transactions filed by officers, directors, and principal stockholders under the provisions of Section 16 of the Securities Exchange Act of 1934, are of value in the work of detection, continuing studies of all secondary distributions, based upon information voluntarily furnished the Commission by certain of the exchanges, are also of value in providing necessary background information upon which judgment may be based. Stock tickers are maintained at both the Washington Office and at the New York Regional Office and the work of the tape readers is frequently of very real value in promptly detecting violations of certain rules of the exchanges themselves, but any violation of the anti-

manipulative provisions of the statute must rest upon the establishment of prohibited motives which are not immediately obvious from the printings on the tape.

Experience has shown, however, that the most effective method of detection lies in the Commission's systematic observation of the market behavior of all securities on all national securities exchanges and the interpretation of the price and volume movements of all securities on the basis of all factual information which can be obtained. To that end, there is maintained at the Washington Office of the Commission a trained staff of specialists with practical experience in trading, as well as economists and technicians, whose sole responsibility it is to observe systematically by broad industrial categories the movements in both price and volume of all securities and to develop from such studies probable cases of manipulation.

TRADING INVESTIGATIONS

The Commission's aim in its administration of the statutory prohibitions against stock market manipulation is a sufficient policing of the markets in order to accomplish the extinction of the prohibited forms of manipulation. On the other hand, the Commission recognizes that this policing must be carried out in a manner which will not interfere with the legitimate functioning of those markets. It is quick to track down any suspicious appearances of manipulation, but its technique of investigation has been developed to the point where a few well directed inquiries usually suffice to determine the presence or absence of a prohibited manipulation.

The method is to review and interpret all complaints and reports of suspicious market movements as well as the Commission's own firsthand observations in the light of increasingly more complete files of current data and its history of experience. In many cases the Commission readily satisfies itself, without recourse to outside inquiry, that there has been no violation of the anti-manipulative provisions of the Federal securities legislation. In other cases, the usual first resort is to a "flying quiz" for the purpose of quickly assembling any essential missing facts. A review of 175 quizzes conducted by the New York Regional Office shows that it requires only about four interviews to clear up the average case, most of the interviews being with exchange officials, members, and other brokers and dealers. With the returns from a "quiz" at hand, the case is again reviewed and is closed if no violation appears to have occurred. If the "flying quiz" confirms the Commission's original suspicion of manipulation, a preliminary trading investigation is next undertaken. Such an investigation involves a thorough analysis of all transactions.

Finally, a formal trading investigation may be authorized by the Commission, at which point, for the first time in the process, individual customers and other persons may be required to supply such information as is necessary to complete the history of the case. During the past year, improved technique and better coordination between all the offices of the Commission allowed a broadening of the sources of detection with an actual decrease in the number of quizzes in the number of preliminary and formal trading investigations initiated. However, 24 formal proceedings against the persons involved resulted from trading investigations, as against 18 such proceedings in the previous year.

Thus, during the past fiscal year, as a result of those investigations, 2 cases were referred to the Department of Justice for criminal prosecution, 7 persons were enjoined from continuing manipulative activities, 8 cases involving transactions by numbers of various exchanges were referred to such exchanges for appropriate action, proceedings were instituted for the revocation of registration of 2 broker-dealers, and 3 broker-dealers withdrew their registrations. On information proceeding from trading investigations in the first instance the Commission issued a stop order under the Securities Act of 1933 suspending the effectiveness of the registration statement with respect to one stock issue and authorized proceedings to determine whether the registration on a national securities exchange of another stock issue should be suspended or withdrawn.

RECORD OF PUBLIC ACTION TAKEN AS A RESULT OF TRADING INVESTIGATIONS

On October 18, 1939, James H. Rand, Jr., Winfred C. Hoty, James E. Reynolds, and Narnell, Inc., consented to being permanently enjoined by the United States District Court for the Southern District of New York from future violations of Sections 9 (a) (1) and 9 (a) (2) of the Securities Exchange Act of 1934. This action resulted from an investigation of transactions effected by these persons during 1936 and 1937 in Remington Rand, Inc., common stock listed on the New York Stock Exchange.

On November 29, 1939, Judge Harold Burke in the United States District Court for the Southern District of New York, imposed a sentence of two years imprisonment and a fine of $4,000 on Joseph J. Mascuch, president of Breeze Corporations, Inc. Mascuch was found guilty of both counts of an indictment charging perjury before an examiner of the Commission during an investigation of transactions in the common stock of his company which is listed on the New York Curb Exchange. This conviction was affirmed by the opinion handed down by the United States Circuit Court of Appeals for the Second Circuit on May 6, 1940.

On January 3, 1940, Ery Kehaya, president of Standard Commercial Tobacco Co., Inc., Standard Commercial Export & Finance Corp., Harry J. Rothman, Harry B. Meyer, and Louis C. George were indicted by the Federal Grand Jury of the United States District Court for the Southern District of New York for violation of the provisions of Sections 9 (a) (1) and 9 (a) (2) of the Securities Exchange Act of 1934 and for conspiracy in the sale of Standard Commercial Tobacco Co., Inc., common stock by means of false and fraudulent misrepresentations. On February 23, 1940, a second indictment was returned against the above-named defendants upon 19 additional mail frauds counts; 1 count for violation of Section 17 (a) (1) and 2 counts for violation of Section 17 (a) (2) of the Securities Act of 1933; and a final count for conspiracy in violation of the mail fraud statute, Sections 17 (a) (1) and 17 (a) (2) of the Securities Act of 1933, and Sections 9 (a) (1) and 9 (a) (2) of the Securities Exchange Act of 1934. This case was referred to the United States Attorney for the Second District of New York by the Commission in April 1939 and resulted from an investigation of the activities and transactions by the above parties during 1937 in Standard Commercial Tobacco Co., Inc., common stock then listed on. the New York Stock Exchange. This case was pending at the close of the fiscal year.

On January 29, 1940, Norman W. Minuse was sentenced to 2 years imprisonment and fined $5,000. Joseph E. H. Pelletier was sentenced to 15 months in prison and fined $1,000, and Russell VanWyck Stuart, previously sentenced to 2 years, received a suspended sentence and was placed on 2 years probation. Those sentences were imposed by Federal Judge Matthew T. Abruzzo in the United States District Court for the Southern District of New York after a jury had found these persons guilty of conspiracy to violate Sections 9 (a) (1) (a), (b), and (c) and Section 9 (a) (2) of the Securities Exchange Act of 1934. This case was referred to the Department of Justice for prosecution on May 12, 1935, and resulted from an investigation of transactions which occurred during 1935 and 1936 in Tastycast, Inc., Class A common stock listed on the New York Curb Exchange.

On February 14, 1940, George J. Morrison and Emil W. Jacques were each sentenced to one year and one day by Federal Judge Alfred C. Coxe in United States District Court of the Southern District of New York for violation of the anti-manipulative provisions of the Securities Exchange Act of 1934. Sentence was suspended as to Jacques, who was put on probation for two years. The defendants pleaded guilty after the Government's case had been presented. This action resulted from an investigation of transactions by such persons during November and December 1934 in B/G Sandwich Shops, Inc., common stock then listed on the New York Produce Exchange. The facts and evidence obtained in the Commission's Investigation were referred to the Department of Justice on April 19, 1935, for prosecution and an indictment was returned on November 16, 1937.

On May 3, 1940, Louis C. George of Madison, Wisconsin, Moses A. Isaacs of New York City, and Josiah M. Kirby of Cleveland, Ohio, were indicted by the Federal Grand Jury in United States District Court for the Southern District of New York charged with violations of the anti-manipulative provisions of the Securities Exchange Act of 1934, as well as of the mail fraud statutes and conspiracy. This action resulted from an investigation of the activities and transactions of these persons during 1936 and 1937 in Automatic Products Corp. Common stock listed on the New York Curb Exchange. This case was referred by the Commission to the Department of Justice on November 29, 1938, for prosecution. This case was pending at the close of the fiscal year.

On May 13, 1940, A. W. Porter, Inc., A. W. Porter, and Arthur H. Johnson consented to being permanently enjoined by the United States District Court for the Southern District of New York from further manipulative activities in violation of Section 9 (a) (2) of the Securities Exchange Act of 1934 and from selling stock in violation of the fraud provisions of the Securities Act of 1933. This action resulted from an investigation of transactions effected by these persons during 1939 in Pressed Metals of America, Inc., common stock listed on the New York Curb Exchange.

On May 20, 1940, the United States Circuit Court of Appeals for the Second Circuit upon review of the order of the Commission of February 25, 1935, expelling Charles C. Wright from membership on the New York Stock Exchange and four other exchanges, found that Wright had violated Section 9 (a) (2) of the Securities Exchange Act of 1934 and upheld the constitutionality of that section, as well as of Section 19 (a) (3) of such Act, pursuant to which proceedings were brought to determine whether Wright had violated the anti-manipulative provisions of the Act. The court hold that the evidence did not support the Commission's finding that Wright had also violated Section 9 (a) (1) in "matching" buying and selling orders. The court's opinion directed the Commission to consider modification of its expulsion order to one of suspension.

MARGIN REGULATIONS

Pursuant to the Securities Exchange Act of 1934, this Commission has the responsibility of enforcing Regulation T of the Board of Governors of the Federal Reserve System which comprises the margin regulations promulgated under Sections 7 and 8 (a) of the Act. During the past fiscal year, within the limits of available time and personnel, the Commission continued to conduct margin inspections of brokerage firms.

As during the previous year, emphasis was placed on the inspection of firms which are not members of national securities exchanges. Most of the inspections have been of a broad character designed to determine compliance on the part of brokerage firms with all applicable rules and regulations, including the margin regulations. During the past year, margin inspections were made of 100 member and nonmember firms. In accordance with the Commission's usual practice, the results of certain of these inspections hearing upon compliance with Regulation T were made available to the Board of Governors of the Federal Reserve System. Also, during the past year, the Commission received cooperation from the national securities exchanges with respect to the enforcement of Regulation T. Each national securities exchange, upon becoming registered with this Commission, agreed, pursuant to Section 6 (a) (1) of the Securities Exchange Act of 1934, "* * * to enforce insofar as is within its powers compliance by its members, with the provisions of this title, and any amendment thereto and any rule or regulation made or to be made thereunder; * * *." Pursuant to this agreement, the New York Stock Exchange reported to the Commission that it had censured and fined six member firms during the year for violation of Regulation T. During the past fiscal year, four more of the Commission's field offices have carried on margin-inspection work insofar as limited personnel made it possible. In addition to the New York, Boston, Chicago, and San Francisco Regional Offices and the Washington Field Office which were mentioned in the Commission's Fifth Annual Report, the offices at Atlanta, Denver, Detroit, and Fort Worth have submitted inspection reports which. included the results of margin inspections.

PEGGING, FIXING, AND STABILIZING OF SECURITY PRICES

On January 3, 1940, the Commission adopted rules and regulations, designated as Regulation X-9A6-1, effective February 15, 1940, governing transactions incident to the stabilization of security prices in certain limited types of situations. This regulation was promulgated pursuant to Section 9 (a) (6) of the Securities Exchange Act of 1934, which makes it unlawful to effect transactions for time purpose of stabilizing the price of any security registered on a national securities exchange "in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors." In taking this initial step toward the substantive regulation of stabilizing activities, the Commission sought to deal with only a narrow phase of the much greater problem of security price stabilization considered as a whole.

Differences of viewpoint between the Commission and the under-writing industry and between various representatives of that industry itself, coupled with the Commission's own awareness of the economic potentialities of its actions, resulted in its decision to attack the problem of stabilization piecemeal. It was felt

the safest progress into this field, where previously there had been no regulation under the statute, could be made by isolating particular segments of the larger problem, regulating those segments, and basing further regulation upon the experience thus derived.

Stabilizing to facilitate so-called “market offerings” where the price of the security is represented to be at or based upon open market prices is one segment of the problem of stabilization wherein lies the greatest potentiality of abuse. Before the Act, market operations to stimulate the success of this type of offering often constituted not stabilization, but the most flagrant type of “pool manipulation” outlawed by Section 9 (a) (2) of the Securities Exchange Act of 1934. It was because of the susceptibility of this particular kind of stabilizing to grave abuses that the Commission determined to single out this narrow field for the first test of its substantive regulation of stabilizing. Accordingly, Regulation X-9A6-1, by its terms, is applicable only where the stabilization of a registered security is undertaken to facilitate an offering of any registered security which is represented to be “at the market” or at a price related to the market price.

In general, Regulation X-9A6-1, although it unequivocally prohibits any marking up of prices to facilitate offerings or the rigid “pegging” of market prices in aid of this type of offering, is designed to permit no more than the maintenance of an orderly market on the securities exchange involved during the continuance of the offering. The regulation, which requires that all purchasers must be given notice of the stabilizing operation, also provides that during the continuation of stabilizing a “ceiling” shall be placed upon the price of the stabilized security by prohibiting the stabilizers from making any purchase or sale of a security involved in the stabilization above its “maximum price” as fixed by the rule. This provision is designed to remove, so far as possible, any incentive on the part of the stabilizers to create, directly or indirectly, a rise in the market price of any security involved in the stabilization.

As of the close of the past fiscal year, only one stabilizing operation had been undertaken which was subject to the requirements of the rule. On March 12, 1940, a notice of intention to stabilize the Class A and Class B common stock of the Columbia Broadcasting Corporation was filed by and on behalf of the underwriters of an offering of 20,000 shares of Class A stock and 80,000 shares of Class B stock. These stocks were all listed and registered on the New York Stock Exchange.

In promulgating Regulation X-9A6-1, the Commission, in its accompanying statement, expressly recognized that experience in the actual operation of the regulation may necessitate amendments from time to time and that the Commission’s staff will continue, as it has in the past, to cooperate with representatives of the investment banking industry in the further study of

problems incident to this and other types of stabilizing. As of the close of time past fiscal year, experience in administration of the rules had not indicated the desirability of making any further amendments in those rules.

Shortly after the promulgation of Regulation X-9A6-1, the Commission published a statement of its policy on the whole broad problem of the pegging, fixing, and stabilizing of security prices. This statement enunciated the legal, ethical, and economic aspects of the problem of stabilizing, described its fundamentals, outlined the arguments pro and con, and evaluated the alternative courses of possible Commission action. Pertinent excerpts from this statement which, for the first time, reached the formal conclusion that the Commission should adopt a broad program of regulation, are quoted below:

"It seems clear that time only course open to the Commission is to adopt regulations which can be revised from time to time as we see how they actually work. Such regulations must reconcile, as far as possible, the often conflicting objectives of protecting purchasers of securities, on the one hand, and of preserving the ready flow of capital into industry, on the other. Here, as in most other fields of human activity, perfection is an unattainable ideal. Compromise and adjustment are inescapable. A closer approach to the ideal than is now achievable may in the future be found in the development of investment banking or other underwriting institutions with sufficient resources so that the need for stabilizing can be substantially reduced, even entirely eliminated. But the growth of American industry cannot wait upon such a development. Consequently, the Commission has concluded that its immediate duty under the statute is to meet the situation through regulated stabilizing, frankly recognizing the experimental character of its approach to the problem."

In a separate statement designed to demonstrate that stabilizing was primarily for the benefit of the underwriters of securities and not the investors or issuers, Commissioner Healy attacked stabilizing as "a manipulation designed to help induce the public to exchange its money for a security which the underwriter is selling at a market price the decline of which, through his own acts, he is preventing or retarding." Expressing regret that the majority of the Commission was willing to accept stabilizing as "an integral part" of our system of security distribution, he wrote:

"I think that the worst possible situation in which to permit stabilizing is when the offering price is represented to be 'at the market.' Even when stabilizing is permitted in connection with an offering at a fixed price, the harm to investors is not to be overlooked for there the stabilized price may frequently mislead and injure those who buy. The investor, observing the exchange price or (as often happens) having had his attention called to it by salesmen, believes, as he has a right to, that the price is one made by the free play of supply and demand in a fair

and unmanipulated market. But when the offering price is ‘at the market’ the possibilities of deception and injury to investors are immeasurably increased. Securities issued ‘at the market’ are issued on the theory that the price is set not by the underwriter but by the interplay of the forces of supply and demand. Yet the regulation by permitting stabilizing of such securities permits an interference with the free forces of supply and demand and thereby tolerates the creation of a price mirage and the distortion of the price which would be set by the market if it were to function without artificial support.”

Commissioner Healy called attention to the fact that the regulation permitted stabilizing of secondary as well as primary distribution and reviewed the American system of security distribution which is characterized by the underwriter’s haste to dispose of issues -- a haste which he demonstrated was made necessary by their lack of capital which often made it impossible for them to enter into truly “firm” commitments. He concluded that stabilizing in connection with offerings “at the market” was not in the public interest and that prohibiting it was necessary for the protection of investors. He stated that Section 9 (a) (6) gave the Commission ample power to enact a rule forbidding stabilizing when the distribution was “at the market.”

During the fiscal year ended June 30, 1940, the Commission continued its administration of Rule X-17A-2, which requires the filing of detailed reports of all transactions incident to offerings in respect of which a registration statement has been filed under the Securities Act of 1933 where any stabilizing operation is undertaken to facilitate the offering. During the past fiscal year, 184 out of a total of 337 registration statements filed under the Securities Act of 1933 contained a statement of the intention to stabilize to facilitate the offerings covered by such registration statements. Because of the fact that registration statement in some cases covers more than one offering, there were a total of 205 offerings of securities in respect of which the statement required by Rule 827 of the rules and regulations under the Securities Act of 1933 was made to the effect that a stabilizing operation was intended to be undertaken. Stabilizing operations were actually conducted to facilitate 71 of these offerings. In the case of bonds, public offerings of $585,953,140 principal amount were stabilized. Offerings of stock issues aggregating 5,207,330 shares and having an aggregate estimated public offering price of $160,143,147 were also stabilized. Fifty-nine of the stabilizing operations commenced during the past fiscal year had been completed and notices of termination of stabilization filed with the Commission prior to June 30, 1940. Twelve such stabilizing operations were still in progress as of the close of the past fiscal year and the Commission was still receiving the reports of detailed transactions required by Rule X-17A-2 in respect of such operations.

REGISTRATION OF SECURITIES ON EXCHANGES

Purpose and Nature of Registration of Securities on Exchanges.

In order to make available currently to investors reliable and comprehensive information regarding the affairs of the issuers of securities listed and registered on a national securities exchange, Sections 12 and 13 of the Securities Exchange Act of 1934 provide for the filing with the Commission and the exchange of an application for registration and annual and other periodic reports, containing certain specified information. Such applications and reports must be filed on time forms proscribed by the Commission as appropriate to the particular type of issuer or security involved, which forms are designed to disclose pertinent information concerning the issuer, its capital structure and that of its affiliates, the full terms of its securities, warrants, rights, and options, the control and management of its affairs, the remuneration of its officers and directors, and financial data, including schedules breaking down the more significant accounts reflected therein.

In general, the Act provides that an application for registration shall become effective 30 days after the receipt by the Commission of the exchange's certification of approval thereof, except where the Commission determines it may become effective within a shorter period of time. It is unlawful under the statute for any member, broker, or dealer to effect any transaction in any security (other than an exempted security) on any national securities exchange unless registration is effective as to the security for such exchange.

Examination of Applications and Reports.

All applications and reports filed pursuant to Sections 12 and 13 of the Securities Exchange Act of 1934 are examined by the Commission to determine whether accurate and adequate disclosure has been made of the information required by the Act and the rules and regulations thereunder. This examination does not involve an appraisal and is not concerned with the merits of the registrant's securities. When the examination discloses that material information has not been furnished in accordance with the requirements, or that generally accepted accounting principles and procedures have not been followed in the preparation and presentation of financial statements, the registrant is so advised by letter, or in conference with its representatives, and any necessary correcting amendments are obtained and examined in the same manner as the originally filed documents. Where the examination discloses omissions which are clearly of an immaterial nature, particularly in connection with periodic reports under Section 13 of the Act, the registrant may merely be notified thereof by means of a letter containing suggestions which should be followed in the preparation and filing of future reports, without insistence upon the filing of an amendment to the particular report in question.

The examination of an application for registration is made as promptly as possible after it is filed in order that any material deficiencies may be brought to the attention of the registrant and the exchange before registration becomes effective in accordance with the provision of the statute. While the basic period available for this purpose is 30 days, it was necessary to complete the examination in considerably less time in approximately 40 percent of all applications filed during the past year, inasmuch as the Commission issued orders accelerating the effective date of registration in these cases.

Since the annual report is required to be filed within 120 days after the close of the fiscal year of the registrant and because of the fact that approximately 78 percent of all registrants have fiscal years corresponding to the calendar year, there is filed with the Commission a peak load of nearly 1,800 annual reports at or about the end of April each year. [Footnote: Of 43 changes in fiscal years during the year, 22 were from December to another month, 11 from another month to December, and 10 did not involve December.] Consequently it is necessary to spread the work of examining these annual reports over the ensuing months. Current reports are examined during the month in which they are filed.

That the Commission's examination procedure, together with the policy of publishing the opinions and decisions of the Commission and the opinions of its Chief Accountant has been of material assistance to registrants and their accountants is evidenced by an improvement, both immediate and cumulative noted in the presentation of factual information in applications for registration and supplemental periodic reports.

Proceedings under Section 19 (a) (2).

Section 19 (a) (2) of the Securities Exchange Act of 1934 empowers the Commission after appropriate notice and opportunity for hearing, to deny, to suspend the effective date of, to suspend for a period of not exceeding 12 months, or to withdraw, the registration of a security, if it finds that the issuer of such security has failed to comply with any provision of the Act or the rules and regulations thereunder. The following table indicates the numbers of issuers involved in proceedings under Section 19 (a) (2) during the past fiscal year:

Number pending July 1, 1939: 12
Proceedings instituted July 1, 1939 to June 30, 1940: 10

Disposition -- Dismissed: 8
Disposition -- Registration Withdrawn: 10
Disposition -- Number pending June 30, 1940: 4

The following table indicates, on a cumulative basis, the number of issuers involved in proceedings under Section 19 (a) (2) from July 1, 1935, when permanent registration of securities under the Act first became effective, to the close of the fiscal year ended June 30, 1940:

Proceedings instituted: 44

Disposition -- Dismissed: 16
Disposition -- Registration Withdrawn: 24
Disposition -- Number pending June 30, 1940: 4

Revision of Certain Registration Forms under the Securities Exchange Act of 1934.

Form 15, used for the registration of securities of incorporated investment companies on a national securities exchange, and Form 17, used for such registration of securities of unincorporated investment companies, were revised during the past fiscal year. The amendments add an item to the forms proper, requiring certain historical financial information which was previously furnished in a schedule to the financial statements. These amendments were necessary in order that the financial statements required by Forms 15 and 17 should conform with the revised instructions governing the form and content of financial statements contained in the new accounting Regulation S-X. Changes of a minor nature were also made in several of the other registration forms.

Statistics of Securities Registered or Temporarily Exempted from Registration on Exchanges.

Up to and including June 30, 1940, 2,898 issuers had filed a total of 5,162 applications for registration of securities under Section 12 of the Act and a total of 19,454 annual and current reports under Section 13 of the Act. As of June 30, 1940, the registration of securities of 2,405 of those issuers was in effect, and the registration of the securities of the remaining 490 issuers had ceased to be effective for a variety of reasons; e. g., withdrawal from registration, etc.

The number of applications, reports and amendments filed with the Commission during the past year relating to the listing and registration of securities on national securities exchanges and to the listing of securities on exempted exchanges are as follows:

Number of applications, reports, and amendments relating to the listing and registration of securities on exchanges -- Fiscal year 1940

Applications for registration on basic and supplemental forms: 272

Applications for “when issued” trading: 13

Exemption statements for issued warrants: 17

Annual and current reports: 4,737

Amendments to applications and annual and current reports: 2, 606

Annual reports of issues having securities listed on exempted exchanges: 118

Withdrawal or Striking of Securities from Listing and Registration on Exchanges.

In accordance with the provisions of Section 12 (d) of the Securities Exchange Act of 1934 and the rules and regulations promulgated thereunder, applications involving 66 issues were filed with the Commission during the fiscal year ended June 30, 1940, for the withdrawal or striking of such issues from listing and registration on national securities exchanges. As of June 30, 1939, applications involving 17 issues were pending. During the past fiscal year, the Commission granted applications involving 54 issues and suspended decision with respect to 1 issue; applications involving 7 issues were withdrawn by the applicants; and those involving the remaining 21 issues were pending as of June 30, 1940.

A considerable proportion of those applications derived from continuation of the policy of the New York Stock Exchange of seeking to remove from listing and registration thereon issues deemed no longer to have adequate public distribution, activity, or market value for trading on that exchange. Applications from that source involving 30 issues were filed during the past year. As of June 30, 1939, applications involving 7 issues were pending. During the fiscal year, the Commission granted applications involving 23 issues; applications involving 2 issues were withdrawn; and those involving the remaining 12 issues were pending on June 30, 1940.

During the past fiscal year, certifications of removal were received from national securities exchanges involving 201 issues stricken from listing and registration because of payment, redemption, or retirement. A number of the now applications for listing and registration on national securities exchanges, filed during the past year, were with respect to issues resulting from refundings and changes in capital structure in connection with these 201 issues.

Applications for the Granting, Extension, and Termination of Unlisted Trading Privileges on Exchanges.

National securities exchanges. -- Clause (1) of Section 12 (f) of the Securities Exchange Act of 1934 provides that the Commission, upon application by a national securities exchange, may continue unlisted trading privileges to which a security had been admitted on such exchange prior to March 1, 1934. On June 30, 1940, unlisted trading privileges under clause (1) continued in 1,505 stock and 321 bond issues. This is a reduction of 1,180 stock and 967 bond issues from the original total continued by the Commission under clause (1). Outstanding causes of this reduction under clause (1) lie in refundings, recapitalizations, mergers, and reorganizations involving substantial changes in characteristics of issues or substitutions or exchanges therefor. Such altered or new securities may be admitted to unlisted trading on an exchange only upon approval by the Commission of applications submitted under clause (2) or clause (3) of Section 12 (f).

Clauses (2) and (3) of Section 12 (f) provide that the Commission, upon application by a national securities exchange, may extend unlisted trading privileges thereon to any security duly listed and registered on another national securities exchange or in respect of which prescribed information is available, provided certain conditions as to public distribution in the vicinity of the exchange and other matters are satisfied. On. June 30, 1940, unlisted trading privileges under clauses (2) and (3) existed with respect to 159 stock and 20 bond issues, trading in odd lots only being authorized with respect to 16 of the stock issues. These issues represent the total extension by the Commission of unlisted trading privileges under these two clauses since May 27, 1936, when they became effective upon the amendment of Section 12 (f), except for 5 issues subsequently removed, viz, 1 by redemption, 1 by recapitalization, 1 by transfer from the New York Curb Exchange to the New York Stock Exchange, and 2 by termination of listing and registration on another national securities exchange. A number of these issues are of companies whose issues, or whose predecessors' issues, were admitted to trading upon the applicant exchanges in the past. In the case of the Boston and Philadelphia Stock Exchanges, substantial majorities of the shares an. share values to which unlisted trading privileges have been extended under clause (2) fall in this category.

The following tables summarize the disposition of applications under clauses (2) and (3) of Section 12 (1) of the Securities Exchange Act of 1934:

[tables omitted]

As indicated by the preceding text and tables, the disposition of applications by national securities exchanges is here accounted for. Since unlisted trading privileges in various issues have been applied for, and granted to, more than one exchange, the figures include substantial duplication of the net number of issues involved. This is particularly true with respect to the stock issues under clause (1). The duplication involved can be measured by comparing the aggregate 1,664 stock and 341 bond trading authorizations under clauses (1), (2), and (3) as of June 30, 1940, with the unduplicated totals of 1,194 stock and 340 bond issues admitted to unlisted trading privileges on national securities exchanges as of that date, which are indicated in table 32 of Appendix V. These unduplicated totals include 631 stock and 308 bond issues which are admitted to unlisted trading privileges only; the remaining issues are fully listed and registered (or, in a few cases, temporarily exempted from registration) on national securities exchanges other than those having unlisted trading privileges therein.

The national securities exchanges to which unlisted trading privileges have been granted number 15 -- unchanged for the year.

Exempted exchanges. -- During the past fiscal year, the Milwaukee Grain & Stock Exchange discontinued its securities department, resulting in removal from unlisted trading privileges of 72 stock and 9 bond issues, and reducing from 5 to 4 the number of exempted exchanges permitting unlisted trading in securities.

The Commission granted applications of the Wheeling Stock Exchange for the extension of unlisted trading privileges to 5 stock issues and denied applications involving 2 stock issues.

On June 30, 1940, the Seattle Stock Exchange had pending before the Commission applications to extend unlisted trading privileges to 7 stock and 3 bond issues.

The result of these actions has been a reduction from 157 stock and 12 bond issues admitted to unlisted trading privileges on 5 exempted exchanges as of June 30, 1939, to 90 stock and 3 bond issues admitted to such trading on 4 exempted exchanges as of June 30, 1940.

OVER-THE-COUNTER MARKETS

Registration of National Securities Association.

The program of cooperative regulation of the over-the-counter markets envisioned by the Maloney Amendment to the Securities Exchange Act of 1934 (now Section 15A of that Act), a program of self-regulation by the industry

working through associations registered under the Act and supervised by the Commission, became an actuality during the past fiscal year. The Investment Bankers Conference, Inc., with its charter, by-laws, and rules of fair practice amended to meet the minimum standards set by the statute and with its name changed to National Association of Securities Dealers, Inc., filed its application for registration as a national securities association on July 20, 1939. After a public hearing, the Commission granted this application on August 7, 1939. [Footnote: See Securities Exchange Act Release No. 2211.] No other association, either national or affiliated, applied for registration during the year ended June 39, 1940.

Membership in National Association of Securities Dealers, Inc. which is available to all over-the-counter brokers and dealers, except those barred by specific types of prior misconduct set forth in the statute, has practically doubled since the date of registration, reaching a total of almost 2,900 individuals, partnerships, and corporations located throughout the United States. Even in cases of previous misconduct, the ineligible broker or dealer may petition the Commission for an order directing his admission to membership in a registered securities association. One such petition was filed with the Commission during the past fiscal year and, after hearing before a trial examiner and argument before the Commission, the petition was denied. In this case the Commission, on the basis of an independent review of the record, found that a controlling partner of the petitioner had been guilty of conduct inconsistent with just and equitable principles of trade, had been expelled by the New York Stock Exchange because of such conduct, and had on prior occasions engaged in additional transactions detrimental to the welfare of an investment trust controlled by the petitioner. Therefore, the Commission determined that it was unable to find it appropriate in the public interest to approve or direct the admission of the petitioner to membership in National Association of Securities Dealers, Inc., and denied the application. [Footnote: ***In The Matter of J. A. Sisto & Co.***, Securities Exchange Act Release No. 2568.]

The Commission has kept in close touch with the regulatory and educational work of the association by daily contact and cooperation with the association's executive director and counsel in Washington and by group and individual conferences in many parts of the country with its governors and the members of its various committees. The investigations of complaints conducted by local business conduct committees of the association have been followed with especial care. Furthermore, the Commission has transmitted to the association information concerning transactions and business practices of certain members of the association which appeared ***prima facie*** to constitute violations of high standards of commercial honor and hence of the association's rules, although such transactions and practices did not necessarily constitute violations of law. Such information was usually obtained by the Commission from routine

inspections of registered over-the-counter brokers and dealers. The association has limited its activities for the protection of investors to investigations of specific complaints and does not undertake such routine examinations or surprise audits as are sometimes made by national securities exchanges of their members. For this reason, the inspection work of the Commission cannot be said to have been decreased by the association's activities.

On the other hand, the association has in several instances been of material assistance both to its members and to the Commission by adjusting, through prompt informal actions, situations which might otherwise have led to administrative or legal proceedings by the Commission, The association has also done much valuable work in explaining and "bringing home" to its members the significance of the Commission's various rules and regulations, designed for the protection of investors, under which the over-the-counter market functions. A notable instance of this educational activity appeared in connection with the rules and regulations requiring brokers and dealers to maintain and preserve specified memoranda and bookkeeping records respecting each transaction. These rules and regulations, which were the only new ones affecting the over-the-counter market to be adopted during the past fiscal year, were made the subject of a detailed analysis and explanation prepared by the association and sent to all of its members.

Supervision of Over-the-Counter Brokers and Dealers.

During the past fiscal year, the Commission continued its supervision of over-the-counter brokers and dealers registered under Section 15 (b) of the Securities Exchange Act of 1934 and expanded its program of inspection of such brokers and dealers which had been undertaken on an experimental basis as early as 1937. These inspections serve the twofold purpose of (1) ascertaining whether there is compliance with the requirements of the statutes administered by the Commission and the rules and regulations thereunder and (2) aiding brokers and dealers to a more complete understanding of the legal requirements imposed upon them. In those cases where, as a result of an inspection or other investigation, serious violations of law were discovered, the Commission employed its power to deny or revoke registration or obtained a decree of court enjoining further violation. Some of the more serious of these violations may be mentioned briefly.

One of the most serious over-the-counter problems that has received the attention of the Commission has been the practice on the part of certain dealers of selling a security to a customer at a price bearing no reasonable relation to the price at which the customer otherwise could have obtained the security, and under such circumstances that the customer, in reliance on the established custom of dealers in the securities business to effect transactions at fair prices,

reasonably believes that the dealer is effecting the transaction at a price that is fair. In a series of cases, the Commission has construed Section 17 (a) of the Securities Act of 1933 and Section 15 (e) (1) of the Securities Exchange Act of 1934 as prohibiting dealers from exploiting customers by means of security transactions effected at a price hearing no reasonable relation to the prevailing price. In ***In the Matter of Duker & Duker***, the firm induced customers to turn over to it securities which were to be sold and the proceeds invested in other securities. Thereafter, the firm, without disclosing that it was acting as a principal, sold other securities to the customers' accounts at prices far above the prevailing prices at which the firm had acquired such securities. The profits thus realized by the firm in such transactions ran as high as 56 percent. In holding that this practice constituted a violation of both Section 17 (a) of the Securities Act of 1933 and Section 15 (c) (1) of the Securities Exchange Act of 1934 and that the broker-dealer registration of Duker & Duker should be revoked, the Commission, in its opinion, said:

"Inherent in the relationship between a dealer and his customer is the vital representation that the customer will be dealt with fairly, and in accordance with the standards of the profession. It is neither fair dealing, nor in accordance with such standards, to exploit trust and ignorance for profits far higher than might be realized from an informed customer. It is fraud to exact such profits through the purchase or sale of securities while the representation on which the relationship is based is knowingly false. This fraud is avoided only by charging a price which bears a reasonable relation to the prevailing price or disclosing such information as will permit the customer to make an informed judgment upon whether or not he will complete the transaction * * * This opinion is not, of course, to be taken as a condemnation of all profits realized by dealers. Our decision is merely that a dealer may not exploit the ignorance of his customers to exact unreasonable profits resulting from a price which bears no reasonable relation to the prevailing price."

In ***In the Matter of Jensen and Company***, the Commission denied an application as a broker and dealer where the applicant was found to have engaged in the same practices as were condemned in the Duker case, with the added circumstance that the applicant had assured its customers that it would sell securities to them at the cost to the applicant plus a small commission.

Another type of fraudulent conduct is the obtaining by a broker of a secret profit by misrepresenting to the customer the price at which the order of the customer has been executed. In some instances, a broker has obtained a secret profit by representing to a customer that his order was executed at a certain price, when in fact the broker executed the order at a different price. Such conduct violates the obligation an agent owes to his principal. In ***In the Matter of Commonwealth Stock & Bond Co.***, the Commission revoked the broker-dealer registration of a

firm which had induced elderly persons, whose savings were invested in securities, to execute orders authorizing the firm to sell, for their accounts, their security holdings and to use the proceeds to purchase at the market other securities recommended by the firm, where the firm, knowing that its customers were ignorant of the market value of the securities recommended for purchase, callously abused the trust reposed in it by delivering to its customers securities having a market value substantially less than that of the securities turned over by the customers and retaining for itself an unconscionable and secret profit. In holding that this conduct constituted a violation of Section 17 (a) of the Securities Act of 1933 and Section 15 (c) (1) of the Securities Exchange Act of 1934, the Commission said:

“The registrant was entitled to be paid the customary commissions in transactions such as that described, but it is gross fraud and over-reaching to exploit the ignorance of a trusting customer to retain secret profits which, in fact, represent funds belonging to the customer.”

Instances have also been found of brokers and dealers operating with impaired capital or operating while actually insolvent. A. practice commonly known as “bucketing “was also discovered in a number of instances. In all such cases, the Commission has taken appropriate action.

In cooperation with a special committee of the National Association of State Securities Commissioners, the Commission has been working toward the development of a standardized form for the registration of brokers and dealers in the various States, which, if adopted by the different State regulatory authorities, would substantially simplify the problems of registration of over-the-counter brokers and dealers doing business in more than one State.

SOLICITATION OF PROXIES, CONSENTS, AND AUTHORIZATIONS

Pursuant to Section 14 (a) of the Securities Exchange Act of 1934, the Commission has adopted rules and regulations governing the solicitation of proxies, consents, and authorizations from the holders of securities listed and registered on national securities exchanges. It is well known that the only way in which the stockholders of a large corporation can participate in the management of their company’s affairs is through the use of proxies. Where the stockholders are uninformed concerning the matters upon which the proxies are to be voted and where the proxy machinery is available only to the existing management, it is impossible for the average stockholder to protect his investment through intelligent participation in the determination of corporate policies. Accordingly, the general purpose of the proxy rules is to insure that security holders who are requested to authorize or consent to proposed corporate action are furnished

with sufficient information to enable them to exercise an intelligent judgment on the matters involved, as well as an opportunity to indicate their approval or disapproval of such matters.

The fundamental requirement of the proxy rules is that corporate managements and others who solicit proxies, consents, or authorizations from security holders shall furnish to the security holders a proxy statement containing prescribed information as to each matter on which the proxies are to be voted. Furthermore, with certain exceptions, the persons soliciting such proxies, consents, or authorizations must give stockholders an opportunity to specify whether their proxies shall be voted for or against each proposal submitted. The Commission believes that the information now required to be disclosed in the proxy statement with respect to such vital matters as the election of directors, voluntary reorganizations, and mergers is the minimum which must be furnished to stockholders to enable them to act intelligently with respect to their investments.

The rules also require that managements give to minority stockholders an opportunity to present new proposals to their fellow stockholders. For example, a stockholder who desires to secure corporate action on a suggestion of his own can be assured that in most cases his proposal will be submitted to the other stockholders of the corporation if he gives timely notice to the management of his intention to present the matter at the annual meeting. Thereafter, if the management solicits proxies, it must include in its own proxy material a description of the proposal and must give the stockholders an opportunity to state whether their proxies shall be voted for or against the proposal. In cases where independent solicitation is deemed desirable, however, the proxy rules provide that a management soliciting proxies must cooperate in mailing soliciting literature of minority groups. The Commission believes that, to date, these provisions have operated as a desirable extension of corporate democracy.

The manner in which the proxy rules operate to assist security holders in protecting their own interests may be illustrated from actual cases. In one case, the management of a corporation solicited proxies which would authorize the issuance of a new preferred stock. The proxy statement contained no information as to the underwriter of the issue. An investigation revealed that plans were virtually completed for the sale of the entire issue of the stock through the private investment firm of the company’s president and that a substantial underwriting fee was to be paid to this firm. The Commission held that this information should be included in the proxy statement so as to be available to stockholders in deciding whether or not to authorize the new issue of preferred stock. As a result, the management postponed the scheduled stockholders’ meeting and agreed not to use the proxies already obtained until they should be expressly confirmed by the stockholders upon the basis of complete information concerning the

proposed underwriting arrangement. Subsequently, the management solicited proxies, but did not request authorization to issue new stock.

In another case, the management of a corporation solicited proxies to be used for the election of directors, the approval of the formation of a new company, the disposition of certain properties, the granting of options to purchase stock of the new company to persons to be named by the board of directors in their discretion, the purchase of certain timber lands, and other matters. Except with respect to the election of directors, the proxy statement was completely devoid of such information concerning these proposals as would enable the stockholders to decide intelligently whether to give or withhold the requested proxies. When the Commission pointed out the deficiencies in the proxy statement, the management agreed that the proxies which had been obtained would be used only to elect directors and that the other matters would not be acted upon until the stockholders had given new proxies based upon a supplemental proxy statement containing the required information.

The cases referred to above illustrate that under the proxy rules the Commission's role is to insure the disclosure to stockholders of the indispensable information. Other cases may be cited to show that stockholders who have been provided with such information are thereby aided in protecting their interests. Thus, the directors of a company which had been unable to meet the dividends on its $7 preferred stock and which had accumulated dividend arrearages in excess of $13,000,000, proposed to create a $4.50 cumulative preferred stock that would be offered to the existing preferred stockholders in exchange for their present holdings. The proposal also included the surrender of accumulated dividends on the preferred stock. The common stockholders, with whom the management's interest largely rested, were not to be called upon to give up any of their rights. When the management solicited proxies in compliance with the Commission's proxy rules, the stockholders' responses were so unfavorable to the plan that the management cancelled the scheduled special meeting of stockholders and withdrew the proposal. Subsequently, when the management solicited proxies for a revised plan which would compensate the preferred stockholders for their sacrifices by giving them debentures and common stock, the revised plan was approved by the stockholders.

Effective February 15, 1940, the proxy rules were amended to require that material to be used in connection with the solicitation of proxies be filed with the Commission for inspection at least ten days before the beginning of the solicitation. Formerly, the rules had only required that the material be filed by the date of the first solicitation. Prior to the amendment, many corporations were seriously embarrassed by the necessity of sending out supplemental material to correct deficiencies which could readily have been pointed out in advance by the Commission's staff. The present requirement of filing proxy material in advance

of solicitation has virtually eliminated this possibility of embarrassment. In particular cases, the ten-day waiting period may be shortened by the Commission upon a showing of unusual circumstances.

The solicitation of proxies from security holders of registered public utility holding companies and their subsidiaries (other than solicitations relating to reorganizations) is governed by the rules which the Commission has adopted pursuant to Section 12 (e) of the Public Utility Holding Company Act of 1935. These rules, in effect, subject such solicitations to the proxy rules discussed in the preceding paragraphs.

During the past fiscal year, 1,626 separate pieces of proxy soliciting material and 431 pieces of supplemental material were examined. Moreover, pursuant to the Commission's policy of furnishing every assistance to persons who desire to obtain informal opinions or suggestions in advance of the filing date, considerable time was devoted to hundreds of conferences with representatives of corporations who were preparing proxy soliciting material in compliance with the proxy rules. These conferences were, of course, in addition to the regular examination which is made of all proxy soliciting material filed with the Commission.

Part IV
ADMINISTRATION OF THE SECURITIES ACT OF 1933

The Securities Act of 1933 is designed to compel full and fair disclosure to investors of material facts regarding securities publicly offered and sold in interstate commerce or through the mails. Its provisions are also designed to prevent fraud in the sale of securities. Issuers of securities to be publicly offered and sold in interstate commerce are required to file registration statements with the Commission. These registration statements are required to contain specified information on the proposed offering, and are available for public inspection.

REGISTRATION OF SECURITIES UNDER THE SECURITIES ACT OF 1933

General Scope of Act.

The Securities Act of 1933 provides for full and fair disclosure of the material facts concerning securities to be offered to the public in interstate commerce or through the mails, but does not confer upon the Commission the power to approve or pass upon the merits of any security. In the latter connection it should be emphasized that neither the fact that a registration statement for a security has been filed or is in effect, nor the fact that a stop order is not in effect with

respect to that particular statement, is to be deemed a finding by the Commission that the registration statement is true and accurate on its face, or that it does not contain an untrue statement of a material fact, or a material omission, or be held to mean that the Commission has in any way passed upon the merits of, or given its approval to, the security. In fact the statute specifically prohibits any representation to that effect to a prospective purchaser. However, since the registration statement constitutes a record of the representations made in connection with the offering, such registration statement serves, where any such representations are false, to simplify the problem of proof in any legal proceedings which may result.

Registration Statement.

To register securities under the Securities Act of 1933, the Act provides for the filing with the Commission, on an appropriate form, of a registration statement meeting the requirements specified in that Act and the rules and regulations of the Commission promulgated thereunder and the elapse of a certain specified period of time after such filing. Registration forms have been prescribed by the Commission to meet the requirements peculiar to various types of securities. In each case, the form is designed to secure a fair disclosure of the material facts concerning the security proposed to be offered, in order that the investor may intelligently appraise its desirability as an investment an integral part of the requirements of each registration statement is a prospectus setting forth in condensed or summarized form the more essential information contained in the registration statement proper. The Act provides that no offering of the security or delivery of it after sale may be made in interstate commerce or through the mails unless accompanied or preceded by such a prospectus.

The registration statement becomes effective on the 20th day after its filing with the Commission, except in certain cases specified in the Act. [Footnote: On August 22, 1940, Section 5 (a) of the Securities Act of 1933, as amended, was amended (Public, No. 768, 76th Congress -- Title III) to confer upon the Commission discretionary authority to accelerate the effective date of registration statements filed under the previsions of the Securities Act of 1933. On August 23, 1940, the Commission announced its general policy under this discretionary authority (Securities Act of 1933 Release No. 2540).] Thus the investor is given a 20-day period in which to consider facts concerning the proposed security issue, and simultaneously the Commission is given a reasonable time within which to make an examination of the registration statement for omissions, incomplete disclosures, and inaccuracies. In connection with this 20-day period, the Commission adopted, effective on July 20, 1939, a revision of Rule 930 (b) of the General Rules and Regulations under the Securities Act of 1933, providing that such “twentieth day” shall begin immediately upon the close of business at the Commission at 4:30 p. m., Eastern Standard Time, after 19 days from the

date of filing have elapsed, counting weekdays, Saturdays, Sundays, and other holidays alike.

Where an amendment to a registration statement is filed prior to the effective date of the registration statement, such amendment has the effect of establishing a new filing date and starting a new 20-day period running, although the Commission is given the power to relate the filing of the amendment back to the original filing date when such action is not detrimental to the public interest. An amendment filed after the effective date of the registration statement becomes effective on such date as the Commission may determine, with due regard to the public interest and the protection of the investor.

Examination Procedure.

Where the Commission's examination and analysis of the registration statement discloses any omission or incomplete statement of material facts, or inaccuracy, it is the practice to send the registrant a so-called deficiency letter pointing out the weaknesses apparent in the statement. In such cases, the letter or memorandum specifying these deficiencies usually is sent to the registrant within approximately 10 days after the original filing date of the registration statement, which affords the registrant an opportunity to correct the statement by amendment before the indicated effective date and before the securities are offered for sale. In many cases, conferences are held with the registrant or its attorney. This informal procedure frequently reveals to the registrant what appear to be material misrepresentations or omissions in the data set forth in the registration statement and enables it to amend the data in these respects. Clearly the effect of this procedure constitutes not only fair treatment of the registrant, but also serves the main purpose of the Act, which is to insure that investors have the opportunity of exercising intelligent judgment based upon an adequate and accurate disclosure of the facts concerning the enterprise. In addition, it eliminates the alternative of allowing a defective statement to become effective and then either having the security sold upon such misrepresentations or instituting stop order proceedings to suspend the effectiveness of the registration statement.

The basic procedure outlined with respect to the examination of registration statements is also followed in the examination and analysis of amendments thereto, supplemental prospectus material, and annual reports filed by registrants subject to the Securities Act of 1933 under the conditions specified in Section 15 (d) of the Securities Exchange Act of 1934, as amended.

There may be instances where the registration statement is found upon examination to include untrue statements or omissions of material facts apparently in reckless or intentional disregard of the requirements of the statute.

Under such circumstances, the Commission is empowered by Section 8 of the Act to institute stop order proceedings to suspend the effectiveness of the registration statement. The Commission is also empowered by Section 8 to make an examination in any case to determine whether such proceedings should be instituted. This section further grants the Commission power to issue an order prior to the effective date, refusing to permit a registration statement to become effective, if after notice and opportunity for hearing it finds that the statement is on its face incomplete or inaccurate in any material respect.

Disclosures Resulting from Examination.

In order to give some indication of the result of the Commission's examination procedure in securing fair disclosure of material information required in registration statements, a few cases are briefly summarized below:

(1) ***Payment of $1,835,181 dividends made by investment trust out of capital***. -- A registrant which operated an investment trust was required, by the terms of its trust agreement, to distribute its total interest and dividend income. In addition, net profits, if any, arising from the sale of portfolio securities during the year were also distributed to holders of participation certificates in order that the trust could qualify as a mutual investment company under the Federal income tax laws. Provisions for taxes and other recurring expenses of the trust, together with net losses, if any, accruing in any year through the sale of portfolio securities, were charged to the capital account. The Commission objected to this accounting procedure for the reason that it failed to disclose clearly the aggregate amount by which the principal or capital contributed by investors had been impaired as a consequence of expenses and losses which had been incurred by the trust on the sale of portfolio securities. As a result the financial statements were completely revised to reflect the application of proper accounting principles, which resulted in showing a deficit, as of March 31, 1939, in the aggregate amount of $1,835,131 representing the amount by which distributions, expenses, and net loss on securities sold exceeded income.

(2) ***New aircraft company proposed to dilute stockholders' equity for benefit of promoters, and to place control in underwriters***. -- A newly organized aircraft company proposed to offer well over $2,000,000 of securities to the public, representing practically the entire cash investment in the enterprise. The nature of certain terms of the offering, vital to investors, was not clearly disclosed in the prospectus to be distributed to prospective investors in connection with the public offering. To illustrate the character of the terms in question, the promoters were to receive a substantial block of securities of the company for alleged services; in addition, despite the fact that the investors were asked to put up all the cash involved, the equity of the purchasers of these securities would have been subjected to almost unlimited dilution through the issuance of warrants to

underwriters and promoters, the proposed further issuance of stock at a later date to promoters for services to be rendered, and the denial of preemptive rights to the potential stockholders; and the underwriters were to control a majority of the board of directors. When the company was informed that the prospectus must make full and fair disclosure of these aspects of the offering, it substantially revised the terms thereof. Specifically, the company thereupon reduced the proportion of promotional stock to be represented in its capital structure, reduced the amount of warrants to be issued to underwriters, and eliminated the indicated underwriter control.

(3) ***Bus company carried at $1,277,363.02 franchise of predecessor street railway although abandoned -- Valuation reduced to $1.00.*** -- In the examination of the registration statement filed by a registrant operating a bus transportation system in a large city, it was noted that the total assets of $2,315,769.80 reflected in the current balance sheet included an intangible asset item of "Franchise and organization expense" valued at $1,277,363.02. It was discovered that this item represented largely capitalized cost of an abandoned street railway system which was supplanted by the bus system. The Commission considered it misleading under the circumstances to reflect the book value of the railway properties abandoned as an asset. Stop order proceedings were instituted. Subsequently the registrant filed amendments to the financial data reducing the item in question to a nominal figure of $1 and showing a corresponding increase in the deficit account.

(4) ***Mining claims overvalued $1,820,272.07.*** -- Intangibles not segregated. -- The gross valuation of mineral claims appearing in the balance sheet of a registrant engaged in gold mining and exploratory development was shown as $2,270,232.07. The Commission's examination of the registration statement developed information showing that this amount represented an arbitrary value placed upon the claims by former directors, and that the stock consideration included in this figure had been given for personal services, water rights, surface rights, and development expense. As a result of the Commission's inquiry into the facts of this situation, the registrant filed an amended balance sheet in which the valuation of mineral claims was reduced $1,820,272.07. The fact that stock had been issued at a discount of $1,650,000 was disclosed on the amended balance sheet. The aggregate value of development costs, financing services, surface rights, and water rights was recorded at $170,272.07. The amounts of reserves for depreciation, depletion or amortization applicable to each of these items were shown separately in the amended balance sheet, with a statement of the bases upon which these items and the mineral claims were being amortized, depleted, or written off.

(5) ***Hazards surrounding marketability of proposed mining products not set forth***. -- A mining company with property located in southeastern Canada filed a

registration statement covering an offering of securities from which the company expected to secure net proceeds of $600,000. This amount was to be used in developing the mining properties and, if warranted by these developmental operations, in constructing a mill for the treatment of the ores mined, the potential products being a zinc concentrate and a copper-lead concentrate. However, the omission from the registration statement of information concerning the existing of potential markets for these ultimate products and certain other pertinent information appeared to make the statement misleading in a material respect, and the Commission accordingly instituted step order proceedings. Following the taking of testimony, the registrant amended the registration statement to include the following information therein:

"It must be pointed out that the registrant has not investigated the marketing possibilities of its potential products; however, there is no market in Eastern Canada for the potential products of the registrant's mining properties, viz., zinc concentrate and lead-copper concentrate, nor are there any facilities for treating these products in existence or in the course of construction; that the producers of slick metals located in the same general area in which registrant's property is situated have found it necessary to ship products to Great Britain, France or Belgium where the prices are materially lower than on the market in the United States; that the existence of an available commercial market for the potential products of this mine in the United States is open to serious doubt and the registrant has not ascertained whether it will be able to dispose of said products at a profit in the United States and, further, if such products are shipped to the United States for sale same will be subject to a tariff of four cents per lb. on copper, 1.2 cents per lb. on zinc and 1 1/2 cents per lb. on lead."

(6) ***Gas utility's depletion reserve understated by $300,000***. -- The examination of the financial statements of a natural gas public utility company filed with its registration statement revealed that the policy of determining depletion reserve with respect to its investment in natural gas production, land, and leases apparently had no relation to the carrying value of such assets or to the estimated recoverable gas reserves.

The Commission raised the question of whether the depletion policy would provide a reserve sufficient to recover the carrying value of these assets. As a result of the Commission's inquiry, the registrant changed its depletion policy so that the reserve which would be created thereby would be sufficient to retire these properties at the end of their estimated productive life. The registrant also filed an amended balance sheet increasing the depletion reserve by more than $300,000 and reducing earned surplus by a corresponding amount.

(7) ***Oil company revises balance sheet, reducing assets from $400,000 to $50,000***. -- The registration statement as originally filed by an oil company gave

every indication that the par value of the promotional stock of the company had been arbitrarily charged to an asset account entitled “Leases and Options.” The Commission made inquiry of the registrant concerning the accuracy or the carrying value of the asset account. Subsequent to such inquiry the promoters returned to the company for cancellation $225,000 aggregate par value of this promotional stock. The examination by the Commission was also instrumental in the elimination from the balance sheet of an unsubstantiated write-up of $97,665 which was reflected in the so-called fixed asset accounts. Thus, while the original balance sheet dated September 30, 1939, included Leases and Options (appearing under “Fixed Assets”) valued at $353,225.30, total assets amounting to $399,309.32, Issued Capital Stock of $274,690, Unrealized Appreciation (as described above) to the extent of $97,665 and Deficit of $9,481.80, the amended balance sheet dated December 31, 1939, listed Total Assets of $49,213.79, Capital Stock of $73,380 and Deficit of $36,455.30.

Usual Length of Time Required to Obtain Effective Registration Statement.

The Commission makes every effort consistent with its powers and duties under the statute to give registrants the opportunity to secure effectiveness of registration statements with the least possible difficulty and delay. Obviously, where amendments to the registration statement are filed shortly prior to the 20th day after original filing, the time elapsing between the original filing and effective dates may extend beyond the basic 20-day period. However, the result of an analysis recently made on the basis of a representative sample of registration statements (excluding those involved in refusal order or stop order proceedings under Section 8) indicates that where there was an average elapsed time of 29 days from original filing to effectiveness for statements which became effective during the calendar year 1937, the corresponding elapsed time in 1939 was 21 days. Often the registrant not desiring the statement to become effective on the 20th day after filing, voluntarily and deliberately delays, for various reasons, the effective date by the filing of a simple amendment before the statement becomes effective.

New Forms and Rules Adopted under the Securities Act.

In connection with its administration of the Securities Act of 1933, the Commission adopted during the year a form designated as Form S-10, to be used for the registration of all types of oil or gas interests. This new form replaces both Form G-1 and Form G-2 heretofore used for the registration of producing and nonproducing oil and gas royalty interests, respectively. Form S-10 is designed to secure a clearer presentation of material information required under the Act, and to afford an appropriate medium for registration of certain types of oil and gas interests for which no special form had previously been available.

In conjunction with the rules and regulations promulgated under the Trust Indenture Act of 1939, discussed elsewhere in this report, it was necessary for the Commission to adopt a form supplementing the various registration statement forms under the Securities Act of 1933. The form adopted was designated as Supplement S-T. This supplement, which must be included in registration statements relating to securities to be issued under an indenture to be qualified under the Trust Indenture Act of 1939, requires certain additional information not called for by previously existing registration statement forms.

During the year the Commission also adopted Rule 890 which permits the inclusion of disclosures with respect to the stabilization of security prices in certain types of short-form notices of security offerings. Certain other changes in existing rules and regulations under the Securities Act of 1933, largely of a clarifying nature, were also made.

Statistics of Securities Registered under Securities Act of 1933.

At the beginning of the fiscal year, there were 4,115 registration statements on file, of which 3,249 were effective, 159 were under stop or refusal order, and 647 had been withdrawn, while 60 were under examination or held pending the receipt of amendments. During the period July 1, 1939, to June 30, 1940, inclusive, 338 registration statements were filed, and there were 323 registration statements which became effective during the period; a total of 3,529 statements were effective at the end of the period, 43 of those effective at the beginning of the period or during the period having been either withdrawn or placed under stop order.

The not number of registration statements withdrawn increased by 57 to a total of 704 on June 30, 1940. The net number of stop or refusal orders increased during the period by 13, a total of 172 of such orders being in effect on June 30, 1940. As of June 30, 1940, there were 48 registration statements in the process of examination or awaiting amendments.

A total of 1,027 amendments to registration statements were also filed during the past fiscal year requiring examination by the Commission, compared with a corresponding total of 1,275 during the preceding year. [Footnote: These amendments include 770 classed as “pre-effective” and 257 as “post-effective,” and do not take into account 367 others of a purely formal nature classed as “delaying” amendments.]

There were also filed during the year a total of 252 annual reports and 69 amendments thereto by certain registrants pursuant to Section 15 (d) of the Securities Exchange Act of 1934, as amended, requiring examination. These figures compare with figures for the previous fiscal year of 172 reports and 66

amendments to reports. In addition, the following figures show the volume of certain supplemental prospectus material filed during the past fiscal year under the Securities Act of 1933:

(1) 309 prospectuses were filed pursuant to Rule 800 (b) which requires the filing of such information within 5 days after the commencement of the public offering;

(2) 280 sets of supplemental prospectus material were filed by registrants to show material changes occurring after the commencement of the offering; and

(3) 323 sets of so-called 13-month prospectuses were filed pursuant to Section 10 (b) (1) of the Act. Thus during the past fiscal year there were filed in the aggregate 912 additional prospectuses of these 3 classes. At the same time, 274 supplementary statements of actual offering price were filed as required by Rule 970; and there were 34 instances where registrants voluntarily filed supplemental financial data.

Securities effectively registered. During the fiscal year ended June 30, 1940, effective registrations under the Securities Act of 1933 amounted to $1,787,000,000. This compared with a total of $2,579,000,000 for the preceding fiscal year and $2,105,000,000 for the fiscal year ended June 30, 1938.

Of the total of $1,787,000,000 of securities effectively registered during the past fiscal year, $1,433,000,000 was proposed for sale by issuers. Electric, gas, and water utility companies accounted for $639,000,000, or 44.6 percent of the total amount proposed for sale by issuers. Manufacturing companies ranked second in importance with $475,000,000, or 33.2 percent of the total. Financial and investment companies with $150,000,000, or 10.5 percent of the total, were next in importance. These three major industry groups, therefore, represented all but about 11 .7 percent of the total.

Fixed interest-bearing securities predominated with an aggregate amount of $1,113,000,000, or 77.6 percent of the total proposed for sale by issuers. This amount included $684,000,000 of secured bonds, or 47.7 percent of the total, and $429,000,000 of unsecured bonds, or 29.9 percent of the total. Common stock aggregated $161,000,000, or 11.3 percent of the total, followed by preferred stock with $110,000,000, or 7.7 percent, and certificates of participation with $49,000,000, or 3.4 percent. All equity financing combined amounted to less than one-fourth of total registrations.

A detailed breakdown of registration statistics for the fiscal year ended June 30, 1940, indicates that 306 statements covering 443 issues became effective in the amount of $1,787,000,000. Included in this total was $40,000,000 of substitute securities such as voting trust certificates and certificates of deposit. Securities

registered for the account of others equaled $60,000,000. There remained, therefore, $1,687,000,000 of securities other than substitute securities registered for the account of issuers. Of this total, however, $254,000,000 represented securities not proposed for sale by issuers. Among the larger of such items were $l75,000,000 of securities to be issued in exchange for other securities $51,000,000 of securities reserved for conversion, $24,000,000 of securities reserved for other subsequent issuance, and $2,000,000 for securities reserved for exercise of options. The remaining amount of $2,000,000 consisted of securities to be issued against claims, for other assets, and as compensations for issuing and distributing services.

After these various deduction items there remained $l,433,000,000 of securities proposed for sale by issuers. Compensations to be paid underwriters and agents equaled $43,000,000 or 3.0 percent of the total proposed for sale by issuers. Expenses were $9,000,000 or 0.6 percent of the total cost of flotation, therefore, was equivalent to 3.6 percent of the total.

Estimated net proceeds accruing after all issuing and distributing expenses aggregated $1,381,000,000. The bulk of these proceeds was to be applied for repayment of indebtedness and retirement of preferred stock. The amount to be used for repayment of indebtedness was $1,012,000,000 or 73.3 percent of the total, and for retirement of preferred stock $57,000,000 or 4.1 percent. New money purposes accounted for $163,000,000 or 11.8 percent of the total, including $64,000,000 or 4.6 percent, for plant and equipment; $90,000,000 or 6.5 percent, for working capital; and $9,000,000 or 0.7 percent, for all remaining new money purposes. The amount to be used for purchase of securities was $115,000,000 or 8.3 percent of the total. This included $113,000,000 or 8.2 percent of net proceeds to be used for the purchase of securities for investment.

Securities to be offered through underwriters amounted to $1,212,000,000, or 84.5 percent of the total proposed for sale by issuers. This compared with $l67,000,000 or 11.7 percent to be offered through agents and $54,000,000, or 3.8 percent, to be offered directly by issuers. Securities to be offered to the general public aggregated $1,312,000,000 or 91.5 percent of the total, as compared with $82,000,000, or 5.7 percent, to be offered to security holders and $39,000,000, or 2.8 percent, to be offered to all others.

Security offerings. Securities registered under the Securities Act of 1933 constitute only part of all new issues offered for cash. Furthermore, the statistics of new offerings include only actual offerings, whereas the statistics of registrations reflect registrants' intentions to sell securities. Comprehensive statistics of new cash offerings of securities for the period July 1, 1934, through June 30, 1940, are presented in tables 8 and 9 of Appendix V. The tables show

the estimated gross proceeds of issues offered for sale, classified by type of offering, type of security, and type of issuer.

In general, the data cover such issues over $100,000 in amount, and (for debt issues) of a maturity of one year or over at date of issuance as were reported as offered for cash in the financial press, in documents filed with the Commission, or in other available sources. The statistics include offerings irrespective of whether the issues were publicly or privately placed and regardless of whether they were registered under the Securities Act of 1933. The statistics of new offerings thus embrace certain corporate and non-corporate issuing groups exempt from registration under the Securities Act of 1933, by virtue either of the nature of the transaction or issuer, and include securities of common carriers, most issues placed privately, and Federal, State, and local governmental issues. New issues of securities offered for cash during the fiscal year ended June 30, 1940, amounted to $5,486,000,000, compared to $6,779,000,000 during the preceding year. Of the total issues floated during the past fiscal year, $2,320,000,000 was issued by corporations, $2,164,000,000 by the United States Government and Agencies, $952,000,000 by States and municipalities, $28,000,000 by foreign governments (sold in this country), and $22,000,000 by eleemosynary institutions. The principal instrument of flotation was the fixed interest-bearing security, 96 percent of the total new issues (corporate and non-corporate) having the form of bonds, notes, and debentures.

Of the corporate securities offered, public utility companies were the largest issuers, comprising 47 percent of the total, while industrial issues accounted for 28 percent, and rail and other issues accounted for 25 percent. Corporate securities privately placed totaled $757,000,000, or 33 percent of all corporate offerings, as compared with $788,000,000, or 32 percent of all corporate issues, during the preceding fiscal year. Corporate private placements consisted of $406,000,000 public utility issues, $101,000,000 industrial securities, and $250,000,000 railroad and other flotations.

Underwriting participations. -- During the fiscal year ended June 30, 1940, a revised series of statistics of underwriting participations was instituted on a quarterly and annual basis. Participations in underwritten registered issues were shown separately for the 50 largest New York City firms and for the 50 largest firms outside of New York City. The amount of issues managed was shown separately for the 20 loading firms in and outside of New York City. These statistics permit a determination of the distribution of the security underwriting business covering registered issues among the various investment banking firms. [Footnote: Statistics of underwriting participations covering the fiscal year ended June 30, 1939, as well as each of the four quarters included in that period, were presented in Statistical Series Release No. 323. Similar data for the three months ended September 20, 1930, were presented in Statistical Series Release No.

837, for the three months ended September 30, 1939, in Statistical Series Release No, 382, for the three mouths ended March 31, 1940, in Statistical Series Release No. 415, for the calendar year 1939 in Statistical Series Release No. 4111, and for the three months ended June 30, 1940, in Statistical Series Release No. 452.]

Cost of flotation. -- In May 1940, the Commission issued a study entitled, "Cost of Flotation for Small Issues 1925 - 1929 and 1935 - l938" submitted to it by the Research and Statistics Section of the Trading and Exchange Division. This study, consisting of 16 statistical tables, 9 charts, and explanatory text of 23 pages, presented detailed statistics regarding the cost of flotation for issues of less than $5,000,000 for two periods deemed to be representative of conditions prevailing prior to and subsequent to the enactment of the Securities Act of 1933. Data for the earlier period were obtained from questionnaires sent out by the Commission and for the latter period were based upon registration statements which became effective under the Act. Statistics were presented covering variations in cost of flotation according to type of security, size of issue, size of issuer, industry, method of offering, and yield. While the report contained detailed data for bonds and preferred stocks, no information was presented covering common stock issues because of the inadequacy of available data.

Current statistics on the cost of flotation of issues effectively registered under the Securities Act of 1933 were in process of preparation at the end of the 1940 fiscal year. Those data were scheduled for release during the succeeding fiscal year.

Security characteristics. -- Statistics on the characteristics of issues effectively registered under the Securities Act of 1933 were continued during the fiscal year ended June 30, 1940. This analysis indicates the extent to which certain security characteristics, such as voting and preemptive rights on stock issues and sinking fund, callable and convertible features on bond issues, are found in the case of registered securities. Statistics covering the three months ended September 30, 1939, were presented in Statistical Series Release No. 339, and for the three months ended December 31, 1939, in Statistical Series Release No. 377. Beginning with 1940, these statistics were published on a semiannual basis and data covering the six months ended June 30, 1940, were presented in Statistical Series Release No. 457.

EXEMPTION FROM REGISTRATION UNDER SECURITIES ACT OF 1933

The Commission is authorized by Section 3 (b) of the Securities Act of 1933 to adopt rules and regulations providing conditional exemption from registration under that Act for certain security issues where the public offering does not

involve an aggregate amount in excess of $100,000. In the exercise of this authority, the Commission has adopted Regulation A, governing such exemptions other than those relating to oil and gas interests; Regulation B, covering exemptions pertaining to fractional undivided interests in oil or gas rights; and Regulation B-T, providing exemptions of interests in an oil royalty trust or similar type of trust or unincorporated association. The Commission now has under consideration, a revision of Regulation A with a view to extending and simplifying, insofar as practicable, the exemptions thereunder. [Footnote: Copies of a draft of the proposed revision were sent for criticism and suggestions to about 700 persons, consisting of issuers of the types who would use the regulation, underwriters, brokers and dealers, attorneys, mining associations, and investment bankers. Of the replies received, the criticisms and suggestions offered seem to represent a very good cross-section of opinion in financial and business centers in all parts of the country. The criticisms and suggestions received were compiled and carefully studied after which the proposed regulation was revised in the light thereof. The Commission rescinded Rules 200 to 210, inclusive, of Regulation A, effective January 1, 1941, except as to issues of securities bona fide offered to the public on or before such date under any exemption contained in any of such rules, and adopted new rules under such regulation effective December 9, 1940.]

Regulation A. -- Proposed stock offerings of $100,000 or less (other than those of companies engaged in the oil and gas business) accounted for the filing during the year of 111 prospectuses under Rule 202, representing a total offering price of $7,950,000, and 197 letters of notification under Rule 210, involving a total offering price of $12,740,000. Stock offerings of oil and gas companies accounted for the filing of 14 additional prospectuses under Rule 202, representing a total offering of $1,015,750, and 16 additional letters of notification under Rule 210, representing a total offering of $896,944.

Numerous amendments which were required in order to correct deficiencies in the information set forth in the various prospectuses and letters of notification were also examined in the same manner as the documents originally filed.

Regulations B and B-T. -- From July 1, 1939, to June 30, 1940, 1,359 offering sheets were filed and examined, together with 841 amendments, pursuant to Regulation B. The aggregate offering price of the securities covered by these offering sheets was approximately $31,072,774. In addition, two prospectuses representing an aggregate offering price of $225,000 for the securities to be offered thereunder, were filed pursuant to Regulation B-T. The following list indicates the number of actions of various kinds taken by the Commission with respect to these filings:

Various actions on filings under Regulations B and B-T

Temporary Suspension Orders (Rule 340 (a)): 298

Orders Terminating Proceeding After Amendment: 228

Orders Consenting to Withdrawal of Offering Sheet and Terminating Proceeding: 73

Orders Terminating Effectiveness of Offering Sheet (No Proceeding Pending): 57

Orders Consenting to Amendment of Offering Sheet (No Proceeding Pending): 440

Orders Consenting to Withdrawal of Offering Sheet (No Proceeding Pending): 76

Orders Terminating Effectiveness of Offering Sheet and Terminating Proceeding: 6

Orders for Hearing (Rule 340 (a)): 1

Temporary Suspension Orders (Rule 380): 2

Orders for Hearing (Rule 380): 1

Orders consenting to Withdrawal of Prospectus and Terminating Proceeding (Rule 380): 2

Sale of Unregistered Oil Securities -- Mississippi and Illinois Areas.

During the past fiscal year, the Commission was confronted with the problem of regulating the sale of unregistered oil securities which, except for prompt action, could well have assumed major proportions and might have resulted in the loss of considerable money by the investing public.

The discovery of oil in commercial quantities in the Tinsley Field, located in Mississippi, and the extension of activity in the Centralia and Sale Fields in Illinois were attended by an unusual influx into those regions of promoters, security salesmen, and “confidence men,” whose operations have been the subject of close surveillance in other parts of the country. These persons were bent upon exploiting the potentialities of sudden wealth in the sale of highly speculative and, in some cases, entirely worthless securities. Some of the persons who descended upon these new oil centers had criminal records in security fraud cases, and others had been subjected to disciplinary action of various types.

The Commission moved to meet the dangers which the operations of such promoters indicated by the establishment of a temporary office at Jackson, Mississippi, and a subregional office in St. Louis, Missouri. Within a short time after the establishment of the Jackson office, final judgments had been obtained against several corporations and individuals conducting the more vicious types of promotions. These persons were enjoined from violating the registration and fraud provisions of the Securities Act of 1933 in the sale of various oil securities In addition, a final judgment was obtained against the publisher of a promotional newspaper enjoining publication of purported news articles “touting” various oil securities.

The publicity resulting from these various actions had an immediate deterrent effect. A number of known “confidence men” promptly ceased their activities and departed. Other persons, who probably through ill-advice or misinformation had violated statutory provisions, discontinued actions which appeared illegal and sought advice from Commission attorneys as to methods of procedure in compliance with the statute.

Considerable help was given by the staff of the Jackson office to those persons who manifested the desire to comply with the requirements. As a result of these measures, the situation in these areas is well under control, although a substantial amount of work in prosecuting past violations remains to be done.

The more recent establishment of the St. Louis office has had a similar salutary effect in that region.

Oil and Gas Investigations.

During the year investigations were conducted in 293 cases involving oil and gas properties or proposed offerings of oil and gas securities. These investigations, which arose largely out of complaints received by the Commission, were primarily conducted to ascertain whether transactions in oil and gas securities were effected in violation of either Section 5 or Section 17 of the Securities Act of 1933. However, in some cases facts and circumstances indicating possible violation of Section 15 of the Securities Exchange Act of 1934 were developed in the course of the investigation. Of the 293 investigations, 157 had been disposed of and 136 were pending at the close of the fiscal year. As a result of those investigations, in 22 cases the persons concerned were enjoined from violating the registration or fraud provisions of the Securities Act of 1933, and in 5 cases the facts were referred to the Department of Justice for criminal prosecution.

Part V

ADMINISTRATION OF THE TRUST INDENTURE ACT 0F 1939

The Trust Indenture Act of 1939 requires that bonds, notes, debentures, and similar securities publicly offered for sale, sold, or delivered after sale through the mails or in interstate commerce, except as specifically exempted by the Act, be issued under an indenture which meets the requirements of the Act and has been duly qualified with the Commission. The provisions of the Securities Act of 1933 and the Trust Indenture Act of 1939 are so integrated that registration pursuant to the Securities Act of 1933 of such securities to be issued under a trust indenture shall not be permitted to become effective unless the indenture conforms to the specific statutory requirements expressed in the Trust Indenture Act of 1939. The indenture is automatically “qualified” when registration becomes effective as to the securities themselves.

ENACTMENT AND SCOPE OF ACT

The Trust Indenture Act of 1939 (Public, No. 253 -- 76th Congress), which grow largely out of the study and investigation of the work, activities, personnel, and functions of protective and reorganization committees, together with the findings and recommendations, made by the Commission pursuant to the direction of Congress contained in Section 211 of the Securities Exchange Act of 1934, was enacted August 3, 1939. The Act, which adds a new title (Title III) to the Act of May 27, 1933, as amended, Title I of which is the Securities Act of 1933, was designed to correct certain defects which have heretofore existed in trust indentures and to provide means by which security holders under such indentures may protect their interests. It provides standards of eligibility for trustees with a view to assuring the choice of trustees who are disinterested and responsive to the needs of the security holders; establishes a procedure by which investors may obtain, prior to purchase of the indenture security, an analysis of the effect of the more important indenture provisions; and provides a further means whereby security holders will be furnished with material information through the life of securities issued under an indenture. There was included in the Act, however, an exemption for indenture securities sold or bone fide offered to the public within 6 months after the date of enactment.

In brief, the Trust Indenture Act of 1939, with certain exceptions, prohibits the public offering of notes, bonds, debentures, and similar securities by use of the mails and instrumentalities of interstate commerce, where such securities are required to be registered under the Securities Act of 1933 or, in certain other instances, where they are not subject to such registration requirements, unless they are to be issued under an indenture which conforms to specific statutory standards. An indenture, to be qualified under the Act, must incorporate certain specific provisions, including those governing the eligibility and qualification of

the trustee, and must provide for periodic reports by both the obligor and the trustee to the security holders with respect to compliance by the obligor with conditions and covenants contained in the indenture and the trustee's continued eligibility. The Commission is required to issue an order refusing to permit qualification of an indenture if the indenture does not conform to the statutory requirements or if the trustee has any conflicting interest as defined in the statute.

Where the indenture securities are to be registered under the Securities Act of 1933, the necessary information as to the trustee and the indenture must be contained in the registration statement. In the case of the two classes of securities which, although exempted from the registration requirements of the Securities Act of 1933, are not exempted from the requirements of the Trust Indenture Act, namely, 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, 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. The application becomes effective upon termination of the period prescribed for registration statements under the Securities Act of 1933 and is likewise subject to refusal order or step order proceedings.

The Trust Indenture Act of 1939 makes it unlawful for any person in issuing or selling any security to represent or imply that any action or failure to act by the Commission in the administration of this Act means that the Commission has in any way passed upon the merits of, or given approval to, any trustee, indenture or security, or any transaction or transactions therein, or that any such action or failure to act with regard to any statement or report filed with or examined by the Commission pursuant to the Act or any rule, regulation, or order thereunder, has the effect of a finding by the Commission that such statement or report is true and accurate on its face or that it is not false or misleading.

NEW WORK ARISING UNDER STATUTE

The enactment of this new legislation has resulted in the filing of additional material, all of which must be examined by the Commission. This examination must be completed with special promptness since, if refusal order proceedings should appear to be necessary, the statute requires that notice of opportunity for hearing be given within 10 days after the material is filed, and that the hearing be held within 10 days after such notice.

In order to assist prospective obligors and trustees in complying with the requirements of the new Act, members of the Commission's staff have followed

the practice of holding pro-filing conferences with their representatives and attorneys which, in a number of cases have disposed of questions prior to the filing of the registration statement or application for qualification and thus resulted in a substantial saving of time and expense to the applicant. Similar assistance has been given in response to written and telephone inquiries regarding the application of various provisions of the statute to particular situations.

RULES, REGULATIONS, AND FORMS

Following the enactment of the Trust Indenture Act of 1939, the Commission promulgated general rules and regulations thereunder, together with appropriate forms for the trustee's statement of eligibility and qualification and for the application for qualification of indentures covering securities not required to be registered under the Securities Act of 1933. The procedure thus provided for has been integrated with the related requirements of the Securities Act of 1933. Prior to the adoption of the new regulations and forms, they were submitted in tentative form to a number of individual banks, lawyers, underwriting houses, State and Federal banking authorities, and other interested persons in order to obtain the benefit of their criticism and suggestions.

Forms T-1 and T-2 are the forms prescribed for the necessary statement of eligibility and qualification of corporations and individuals, respectively, designated to act as indenture trustees. Each form is designed to show whether the trustee is eligible to act or has any conflicting interest as defined in the statute. Form T-3 has been adopted for use in making applications for qualification of indentures covering securities which are exempted from registration under Section 3 (a) (9) or 3 (a) (10) of the Securities Act of 1933. Forms for annual reports by obligors, who do not otherwise report under Sections 13 or 15 (d) of the Securities Exchange Act of 1934, are in the course of preparation. Those reports, in general, are required by the statute to disclose information with respect to continued compliance by the obligor with the conditions and covenants incorporated in the indenture.

Part VI
OTHER ACTIVITIES OF THE COMMISSION UNDER THE VARIOUS STATUTES, INTERPRETATIVE AND ADVISORY SERVICE

From its inception, the Commission has recognized that the technical nature of the statutes which it administers requires a substantial amount of interpretative and advisory assistance to the general public. During the past fiscal year, thousands of requests for such assistance have been responded to by

correspondence and in conferences. The questions thus presented fall into two groups, (1) difficult questions of statutory construction raised by persons who are generally familiar with securities legislation and (2) questions as to the general application of the statutes submitted by persons with little or no familiarity with the statutory requirements.

Many of the general inquiries pertain to small business enterprises seeking capital. The Commission is fully aware of the problems confronting such concerns and endeavors to assist them by furnishing, upon request, detailed advice as to the procedure for registration and the possibility of exemption from the registration. and prospectus requirements. Although the Commission answers abstract questions of general application, definite opinions are given only upon the presentation of all the facts of an actual or proposed transaction, including the names of the persons involved. The Commission does not render interpretative opinions with respect to possible civil liabilities, since it has no jurisdiction over those matters.

Compilations of interpretations have been prepared to assist in according uniform treatment to recurring situations. However, new problems of interpretation are continually presented which require not only the analysis of intricate factual situations, but a resort to legislative history and the analogies of judicial case law. Because of the great variety of circumstances under which almost every problem is presented, it has not been feasible to publish a comprehensive interpretative glossary on the statutes administered by the Commission. However, a number of interpretations of more general application have been made public as opinions of the General Counsel.

Recently, a number of unusual cases were presented relating to the definition of the term “security.” These cases involved the sale of real or personal property coupled with collateral arrangements, such as leases back to the seller. The subjects of the purported sales of property were objects as varied as foxes, rabbits, chinchillas, and oysters; tung and citrus groves; mechanical devices, such as parking meters and vending machines; and undivided interests in ships. In each such case where it appeared that the transaction actually constituted an investment by a member of the public in the hope of a return through the efforts of persons other than the investor, the Commission has held that a sale of a security was involved and that the purported sale of the real or personal property was merely camouflage and not the substance of the transaction. A number of judicial decisions involving this question are discussed elsewhere in this report.

Another matter of some importance during the past fiscal year was the problem of what constitutes control of a corporation under the Securities Act of 1933. In most cases, controlling security holders disposing of their shares must obtain registration of their shares by the issuer, whereas security holders not in control

are not required to register. Therefore, it is often important to determine whether particular persons proposing to sell a block of securities of a company are in control of that company. Congress has made it clear that the concept of control is not to be limited to ownership of 51 percent of the voting securities, but is to be applied in all cases where in fact control exists. The question is, therefore, one which frequently depends on intangible factors and requires careful consideration of each case as a separate problem. In some cases the Commission, at the request of a stockholder who is doubtful whether he should consider himself in a position of control, has conducted investigations, privately and informally, in order to determine what position it should take if sale of the securities without registration is proposed. At the conclusion of such inquiries, the Commission advises the stockholder either that it will take no action or that it will sue to enjoin the sale if such safe is proposed to be effected without registration.

COMPLAINTS AND INVESTIGATIONS

The Commission receives and replies to thousands of complaints annually with respect to fraudulent and otherwise illegal practices in the sale of securities. While the Commission is unable to assist investors directly in recovering money obtained from them in violation of law, it welcomes and investigates all complaints with a view to punishing those guilty of violation and preventing the continuance of illegal practices. The Commission also acts upon its own initiative to investigate possible violations indicated by its surveillance of trading activities and the examination of registration statements.

At the beginning of the past fiscal year, there were pending 773 investigations and legal cases under the Securities Act of 1933 and the Securities Exchange Act of 1934. During the year, 625 additional investigations were initiated. Out of this total of 1,401 cases, 705 were disposed of during the past year, leaving 696 cases pending as of June 30, 1940.

The Commission has long recognized the advantages to be realized from cooperation between Federal and State agencies and certain private organizations interested in the prevention of fraud in the sale of securities. Accordingly, in connection with the enforcement of the fraud and registration provisions of the Acts, the Commission has established through its Securities Violations Files a clearing house for information concerning fraudulent securities transactions. The information thus assembled with the assistance of State securities commissions and other public agencies, the members of the National Association of Better Business Bureaus, Inc., and members of the United States Chamber of Commerce, is made available only to those officials and agencies who are directly concerned with the suppression of fraudulent and other illegal practices in the sale of securities. During the past fiscal year, 5,775 items of

information pertaining to existing files and 2,504 new names were added to the files. As of June 30, 1940, the Commission had assembled data concerning 35,464 persons or corporations against whom State or Federal action had been taken in connection with the sale of securities.

LITIGATION

Civil Proceedings.

At the beginning of the fiscal year ended June 30, 1940, 24 civil proceedings instituted by the Commission were pending; during the year, the Commission initiated 56 additional proceedings, including 49 injunctive actions brought against 120 persons to restrain them from fraudulent and otherwise illegal practices in the sale of securities. Out of this total of 80 civil proceedings, 67 were disposed of during the fiscal year, including 56 cases which resulted in the entry of injunctions against 118 persons. The Commission was successful in every injunctive action disposed of during the year, although in a few instances it closed cases where further civil proceedings had become unnecessary because of the successful termination of criminal proceedings against the same parties. Thirteen civil proceedings were pending at the end of the year.

Since its inception, the Commission has instituted a total of 369 civil proceedings and disposed of 356. Permanent injunctions have been obtained against 775 firms and individuals.

Some of the more important or interesting of those cases are described in more detail below.

From the beginning, the Commission and the courts have had to deal with ingenious schemes to secure public investment in business enterprises without complying with the provisions of the Securities Act of 1933. These schemes usually are camouflaged as the “sale” of real or personal property coupled with an arrangement under which the promoter-seller retains possession of the property, representing that he will manage or resell it for the benefit of the purchasers. The test employed by the courts and the Commission in determining whether such transactions involve the sale of a security is well expressed in ***Securities and Exchange Commission v Universal Service Association***, in which the United States Circuit Court of Appeals for the Seventh Circuit defined the term “security” as “the investment of money with the expectation of profit through the efforts of other persons.” [Footnote: 106 F. (2d) 232, 237 (1939).]

During the past year, the Commission was successful in a number of actions to enjoin the sale of such securities in violation of the disclosure (registration and prospectus) and fraud provisions of the Securities Act of 1933.

Four cases in which the Commission obtained injunctions against the sale of unregistered securities involved the purported sale to the public of slot machines coupled with arrangements under which the vendor retained control of and serviced the machines and shared the profits with the owners. In ***Securities and Exchange Commission v. City Meter Service Corporation et al***, the defendants consented to the entry in the United States District Court for New Jersey of an order permanently enjoining them from further violating the registration provisions of the Securities Act of 1933 in the sale of securities evidenced by bills of sale for parking meter machines coupled with further agreements providing for the servicing of the machines by the vendor. In ***Securities and Exchange Commission v. Parking Meter Corporation of America***, judgment by default was entered by the United States District Court for the Northern District of Ohio enjoining the defendant from further violations of the registration and fraud provisions of the Securities Act of 1933. Here, also, the security sold was disguised as the outright sale of parking meter machines coupled with arrangement for the servicing of such machines by the seller. In addition, the defendant had violated the fraud provisions of the Act by making false representations to customers as to the number of machines owned, the existence of contracts with various municipalities for the installation of such machines, and the defendant's financial position. In ***Securities and Exchange Commission v. Woodward-Berkley Company et al.*** and ***Securities and Exchange Commission v. Monarch Sales Company et al.***, the defendants consented to the entry of orders by the United States District court for the Southern District of Ohio permanently enjoining them from further violation of the registration provisions of the Act in the sale of securities camouflaged as the sale of merchandise vending machines, together with an arrangement for the operation of the machines by the defendants.

In ***Securities and Exchange Commission v. Leo C. Pyne et al.***, the defendants purported to be engaged in selling to the public undivided interests in fishing boats entitling the purchasers to share in earnings which might result from the operation of the boats by the defendants. In granting a preliminary injunction restraining the defendants from further violating the registration and fraud provisions of the Securities Act of 1933, the United States District Court for the District of Massachusetts held that the so-called "ship shares" were securities. In ***Securities and Exchange Commission v. Gilbert et al***, the defendants sold to the public undivided chases or interests in cargo boats to be built and operated by the defendants with the "owners" sharing in the profits from shipping operations. The Commission commenced an action in the United States District Court for the Southern District of Ohio to enjoin the further sale of such interests without

registration. The defendants moved to dismiss the complaint on the ground that, as a matter of law, undivided interests in ships were not securities. On August 14, 1939, the court overruled the motion to dismiss and held that the allegation in the complaint that the defendants were selling securities presented a question of fact to be determined at the trial. On July 9, 1940, the defendants consented to the entry of a permanent injunction restraining them from the further sale of such securities except in compliance with the registration provisions of the Act.

In ***Securities and Exchange Commission v. Tung Corporation of America*** and in ***Securities and Exchange Commission v. Jack Franklin***, the defendants purported to be engaged in selling small tracts of land to the public. In connection with each sale, the defendants undertook to raise tung trees on its various plots and to divide the profits with the purchasers or to continue to care for the trees and harvest the crop for a fixed annual charge to be paid by the purchasers. In the ***Tung Corporation of America*** case, the Commission applied to the United States District Court for the Northern District of Illinois for an order requiring the corporation and its secretary to produce certain documentary evidence pursuant to the Commission's subpoena. The court, in overruling the defendant's objections to the proceeding, held that the transactions disguised as the sale of land coupled with leasing arrangements actually amounted to investment contracts. Subsequently, the documents requested by the Commission were produced and the proceeding was dismissed. In the ***Franklin*** case, another United States district court granted a preliminary injunction on April 10, 1940, restraining the defendant from further violation of the registration provisions of the Securities Act of 1933. Thereafter, the defendant consented to a permanent injunction.

Another variation of this pattern of unorthodox types of securities involves oil and gas properties. The Securities Act of 1933 specifically defines the term "security" as including fractional undivided interests in oil, gas, or other mineral rights. Attempts to evade the disclosure requirements of the Act in the financing of crude oil operations have fallen generally into two patterns. In ***Securities and Exchange Commission v. Crader***, the defendant had acquired oil and gas leases covering 6,000 acres of land under an agreement by which he was required to drill a well. To finance the drilling, the defendant sold assignments covering specifically described portions of such leases, but retained for himself the drilling block of 160 acres. The defendant represented that the funds obtained from the sale of assignments would be employed in drilling a test well on the block retained by the defendant and that, although the investors would not share in any production thus obtained, in the event commercial production was obtained from the well, the value of the assignments would be enhanced to the profit of the investors. In this and similar cases, the Commission has taken the position that the sale of a security was involved and has commenced several actions in each of which the defendants have consented to the entry of orders permanently

enjoining them from further violation of the registration and, in some instances, the fraud provisions of the Securities Act of 1933.

Another device which has been employed in the attempt to avoid registration is exemplified in ***Securities and Exchange Commission v. Futter et al***. Here the defendants purported to be engaged in Selling to the public tracts of land which were part of a unit subject to oil and gas leases providing that the landowners should receive a royalty on all oil and gas produced from the unit in proportion to their holdings. It was obvious that the read purpose of the transaction was to convey an undivided interest in an oil royalty, rather than to sell land. The defendants consented to the entry of an order permanently enjoining them from further violation of the registration and fraud provisions of the Act.

The Commission does not, of course, take the position that the ordinary sale of real or personal property involves the sale of a security. Much more than this was involved in the various types of cases just discussed. Slot machines and land were sold as investments in such small quantities that the only possibility of profitable operation was by common management. Investors were “switched” from their holdings of ordinary securities on the representation that the enterprise in question was a hotter “investment.” In every case, both parties to the transaction knew that the purchasers would not and could not themselves profitably manage the property which purported to be the subject of the sale. Invariably, the purchasers were concerned, not with acquiring title to, or possession of, specific property, but with obtaining profits from an enterprise to be operated by others -- usually the seller-promoter, and it is this factor, among others, which has led the Commission to contend and the courts to hold that such transactions involved the sale of a security.

Charles C. Wright v. Securities and Exchange Commission. -- On April 26, 1938, Charles C. Wright, a member of the New York Stock Exchange and other exchanges, petitioned the Circuit Court of Appeals for the Second Circuit for a review of an order entered by the Commission on February 28, 1938, expelling him from the exchanges of which he was a member. The expulsion order followed proceedings in which the Commission found that Wright had violated Sections 9 (a) (1) and 9 (a) (2) of the Securities Exchange Act of 1934 in transactions on the Los Angeles Stock Exchange in the stock of Kinner Airplane & Motor Company, Ltd.

On May 20, 1940, the circuit court of appeals uphold the constitutionality of the provisions of the Act authorizing the Commission to suspend or expel from national securities exchanges members who it finds have violated any provision of the Act. In sustaining the Commission’s finding that Wright had violated Section 9 (a) (2), the court said,

“It is plain that Wright effected a series of transactions in Kinner stock ‘creating actual or apparent active trading in such security’ and ‘raising the price’ thereof. The Commission found that he did so for the purpose of inducing the purchase of Kinner stock by others * * * we think there was substantial evidence to support the facts upon which the Commission predicated its finding that Wright manipulated the market in violation of Section 9 (a) (2) of the Act. If so supported the findings of fact are conclusive upon this court.”

The Commission had also found that in the course of the manipulation Wright had “matched” an order to sell 10,000 shares at 60 cents with two later “market” orders to buy 2,500 shares each, which orders met and partially crossed unexecuted portions of the earlier “sell” order. The court held that it could not accept the Commission’s argument that the orders were of “substantially the same size” even though it was the practice of the exchange to execute such orders in board lots of 100 shares each.

The court was divided on the question of its power to modify the Commission’s order from expulsion. to suspension. The majority hold that the court had no such power and remanded the case to the Commission in order that the Commission might determine, in its discretion, whether to modify the order in view of the fact that the court had found insufficient evidence to support the Commission’s determination that Wright had illegally matched orders. At the end of the fiscal year, the Commission had not taken any further action with respect to the case.

Otis & Co. v. Securities and Exchange Commission. -- On September 18, 1939, the United States Circuit Court of Appeals for the Sixth Circuit affirmed the order of the trial court enjoining Otis & Co. from further violating Section 17 (a) (2) of the Securities Act of 1933. [Footnote: 106 F. (2d) 579. See Third Annual Report, p. 158. The district court’s opinion is reported in 18 F. supp. 100.] The lower court had found that from June 1935 to February 1936 Otis & Co. had engaged in an over-the-counter distribution of the stock of Murray-Ohio Manufacturing Company. The stock was offered for sale “at the market” and customers were advised through sales literature that “higher earnings for the company would affect the market price accordingly.” No disclosure was made to purchasers that, during the period of distribution, Otis & Co. was making substantial purchases in the market as a result of which it dominated the demand side of the market for this stock on the Cleveland Stock Exchange, nor was any disclosure made that Otis & Co. had entered into agreements with principal stockholders of the issuer under which a substantial portion of the outstanding shares was withheld from the market during the period of distribution During this time, the exchange quotation for Murray-Ohio stock rose from 4 1/2 to 19.

The circuit court of appeals affirmed the trial court’s decision that the failure to disclose the withholding agreements and the extensive purchases while offering

the stock “at the market” was misleading and in violation of Section 17 (a) (2) The court also ruled that the trial court did not lack authority to issue an injunction merely because the defendant had discontinued the prohibited activity before the Commission brought suit for an injunction. In this connection, the court said:

“A dealer who saw the challenge of his activities that is implied in an investigation would probably discontinue them pending the investigation. It would seldom, if over, be possible to show that a dealer was engaged in or about to engage in prohibited acts or practices when suit began, since the necessary investigation would nearly always have warned the dealer to desist. Consequently, while Section 20 (b) does not expressly so provide, yet if it be assumed that it requires a showing that a dealer be ‘engaged’ in or ‘about to engage’ in prohibited acts or practices, we are of the opinion that it does not require that either condition continue until the commencement of suit. It is clear that appellant was violating Section 17 (a) (2) when the Commission began its investigation.’’

Securities and Exchange Commission v. Universal Service Association et al. -- The Commission’s Fifth Annual Report noted that the United States Circuit Court of Appeals for the Seventh Circuit had affirmed an order of the District Court for the Northern District of Illinois enjoining Universal Service Association and certain individuals from violating the registration and fraud provisions of the Securities Act of 1933 in the sale of subscriptions and memberships in the association and in the Universal Order of Plenocrats. On August 28, 1939, the circuit court of appeals denied a petition for rehearing and on January 2, 1940, the United States Supreme court denied ***certiorari***.

On January 4, 1940, the same circuit court of appeals unanimously affirmed the judgment of the district court sentencing C. Franklin Davis, one of the promoters, to six months in jail for criminal contempt of court in violating the injunction order, but reversed, for lack of sufficient evidence, the judgment of that court finding the Universal Service Association also in contempt. Davis’ petition for rehearing was denied on February 5, 1940, and the United States Supreme Court denied ***certiorari*** on April 22, 1940,

On May 1, 1940, an indictment was returned in the United States District Court for the Northern District of Illinois charging C. Franklin Davis, Justus Chancellor, Sr., Fred E. Bennett, Charles E. Oldenburg, Claude H. Carter, and V. E. Danner with violation of the fraud and registration provisions of the Securities Act of 1933 and the mail fraud statute in the sale of interests in the Universal Order of Plenocrats.

Securities and Exchange Commission v Timetrust, Incorporated, et al. -- In this case which started on April 5, 1939, the Commission is seeking to enjoin Timetrust, Inc., Bank of America National Trust Savings Association, Meredith

Parker, Ralph W. Wood, H. F. Blanchett, A. P. Giannini, L. Mario Giannini, and John M. Grant from continuing to violate Section 17 (a) of the Securities Act of 1933 by engaging in fraudulent acts and practices in the sale of Timetrust certificates and Bank of America stock. During the past fiscal year, all of the defendants filed answers denying the material allegations of the complaint and, with the exception of John MI.. Grant, filed cross-complaints seeking to enjoin the Commission's investigation. Thereafter, the defendants, other than Grant and A. P. Giannini, also filed interrogatories. The Commission answered many of the interrogatories but refused to answer others, principally upon the ground that the information requested was confidential and that its disclosure prior to trial might prejudice the Commission's case.

On February 24, 1940, the court dismissed the cross-complaints and sustained the Commission's refusal to answer such interrogatories. Thereafter, A. P. Giannini and Grant filed similar interrogatories. Again the Commission refused to answer certain of them and on May 10, 1940, the court sustained such action. The case went to trial on May 21, 1940, in San Francisco, California.

In re Verser-Clay Co. et al. -- In its Fifth Annual Report, the Commission noted that the United States Circuit Court of Appeals for the Tenth Circuit had affirmed an order of the District Court for the Western District of Oklahoma directing E. C. Clay, as president of Verser-Clay Company and the Mid-Continent Crude Oil Purchasing Company, to appear before an officer of the Commission and produce certain books, records, and documents of those companies which he had refused to produce in response to subpoenas duces tecum issued during the course of an investigation of alleged violations of the Securities Act of 1933. Previously, the district court had ordered the respondents to deposit the records with the clerk of that court pending appeal, and the respondents thereupon left with the clerk a package purporting to contain the records in question.

After the circuit court of appeals had affirmed the order and the United States Supreme Court had denied ***certiorari***, the package was delivered to the Commission's representatives and was found to contain only a small part of the specified records. Subsequently, the district court caused contempt proceedings to be initiated and, on February 17, 1940, found Clay and J. C. Verser, also an officer of the companies, guilty of criminal contempt of court. Each of the defendants was fined $500, but upon their failure to pay the fines, the court ordered that they be committed to jail. Clay later paid his fine and was released..

Securities and Exchange Commission v. Foundation Plan, Incorporated, et al. -- On December 19, 1939, the United States District Court for the Southern District of New York issued an order permanently enjoining Foundation Plan, Incorporated (formerly known as United Endowment Foundation, Inc.), Harry C. Williams, Robert B. Deans, James Conner, Jerry Scott, Benjamin Blumenthal,

and Kirk C. Tuttle from violating Sections 5 (b) (2) and 17 (a) (1), (2), and (3) of the Securities Act of 1933 by engaging in fraudulent acts and practices in the sale of securities designated as “periodic plan certificates,” “paid up plan certificates,” and “Foundation Trust Shares Series A.” This is another of the proceedings instituted by the Commission to bring about the discontinuance of the fraudulent selling practices of a group of “top” investment companies. Each of the companies involved in those cases was selling investment certificates or contracts which contemplated monthly payments over a period of years to a corporate trustee which immediately applied such payments to the purchase of shares of an underlying investment trust.

Foundation Plan, Incorporated, and the individual defendants denied the charges of fraud. The court found, however, that they had sold installment certificates upon the representation that an investment in such certificates was similar to a bank deposit while failing to disclose that the maturity value of such certificates depended solely upon the market value of the common stocks in which the purchasers’ funds were invested. The court also found that the defendants had represented to purchasers that the trustee, a well-known bank, was sponsoring and guaranteeing the plan while in fact the trustee’s functions were merely mechanical, and that the defendants had assured installment purchasers that their payments might be withdrawn in full at any time without disclosing that a “creation” or “service” fee, amounting to 71/2 percent of the face amount of a certificate, would absorb most of the first year’s payments.

Although the securities involved had been registered under the Securities Act of 1933, these fraudulent practices were facilitated by the defendants’ failure, as found by the court, to furnish purchasers with a prospectus containing the information which the Act requires to be made available to investors.

On June 8, 1939, Williams, Tuttle, Conner, Scott, Blumenthal, and the company were indicted for conspiracy to violate Sections 5 and 17 of the Securities Act of 1933. Subsequently, pleas of guilty were entered for all of the defendants except Scott, who was tried and acquitted On February 8, 1940, sentences were imposed as follows: Williams, one year and a day and $5,000 fine; Tuttle and Blumenthal, each six months and fines of $1,000 and $1,500, respectively; Connor, six months; and Foundation Plan, Inc., $2,500 fine. Because of the acquittal of Scott, which the court characterized as a miscarriage of justice, all of the prison sentences were suspended.

In ***Securities and Exchange Commission v. Louis Payne***, the Commission commenced an action in the United States District Court for the Southern District of New York to enjoin Payne from the further sale of securities without registration under the Securities Act of 1933. The Commission’s complaint alleged that the defendant was selling securities camouflaged as the sale of live

silver foxes coupled with an undertaking by the defendant to care for and breed the foxes. The purchasers were to receive the net proceeds from the sale of the offspring or their pelts. Pursuant to the Rules of Civil Procedure for the District Courts of the United States, the Commission served upon the defendant written interrogatories and requests for the admission of facts and of the genuineness of certain documents. The Commission consented to an order vacating the interrogatories. On January 19, 1940, a similar motion with respect to the Commission's notice to admit facts and the genuineness of documents was denied. At the close of the fiscal year, a motion by the Commission for summary judgment was pending before the court. [Footnote: On November 15, 1940, the court held that Payne was selling securities, granted the Commission's motion for summary judgment and enjoined Payne from further violating the registration provisions of the Act.]

Securities and Exchange Commission v. Leon Starmont et al. -- On October 31, 1939, the Commission commenced an action in the United States District Court for the Eastern District of Washington to enjoin Starmont and Mining Truth Publishing Company, of which Starmont was managing director and controlling stockholder, from further violating the registration provisions of the Securities Act of 1933. The defendants published a so-called investment advisory service known as "Mining Truth." Certain issues of "Mining Truth" carried the announcement of the proposed organization of a mining company and solicited subscriptions to the publication accompanied by agreements to accept stock in the proposed corporation, such stock to be assessable and registered with the Commission prior to issuance. The subscription requirement was eliminated in later issues which solicited an "indication of possible acceptance" of stock in the proposed company. On November 18, 1939, the district court found that this solicitation involved a sale of securities and issued a preliminary injunction restraining the defendants from further solicitation without complying with the Securities Act of 1933. On February 1, 1940 the injunction was made permanent.

Securities and Exchange Commission v. Henderson. -- On March 25 1940, Frank M. Henderson was permanently enjoined by the United States District Court for the Southern District of Mississippi from further violating Section 17 (b) of the Securities Act of 1933. Henderson was the publisher of the Mississippi Oil Review, in which, though not purporting to offer any security for sale, he described various oil securities, specifically the capital stocks of Yazoo Refinery, Inc., Eureka Petroleum Company, Inc., and Magnolia Royalty and Leasing Company, without disclosing that the publication of such articles was paid for by those companies and by underwriters and dealers in the securities. The purpose of Section 17 (b) in requiring the disclosure of such payments is to protect investors from relying upon descriptions of securities which, while purporting to be objective, are actually inspired and subsidized by persons seeking to promote

the sale of the described securities. Henderson consented to the entry of the injunction order.

Criminal Proceedings.

The statutes administered by the Commission provide for the transmission to the Department of Justice of evidence of violations of the criminal provisions of those statutes. Criminal proceedings are instituted in the discretion of the Attorney General. It is the policy of the Commission to make a thorough investigation of alleged violations of law before referring a case to the Department of Justice and to furnish to the Department the results of such investigation. Thereafter, if criminal proceedings are instituted, the members of the Commission's staff who participated in the investigation assist the United States Attorneys in the preparation of the cases for presentation to the grand jury and for trial.

Up to July 1, 1940, the Commission had referred to the Department of Justice 275 cases, including 64 cases which were referred during the past fiscal year. Since the organization of the Commission, a total of 1,656 defendants have been indicted in 217 cases, including 25 cases which had been referred to the Post Office Department. During the past year, indictments were returned against 232 defendants. [Footnote: These figures contain some duplication resulting from the fact that some persons were named as defendants in several indictments or in more than one case.]

Since the inception of the Commission, convictions have been obtained against 615 defendants in 156 cases, representing 92 percent of the 168 cases which have been disposed of as to principal defendants; 148 defendants, named in 53 cases, were convicted during the past year.

The foregoing figures include perjury proceedings arising out of Commission investigations. A total of 20 defendants have been so indicted, including 6 defendants against whom indictments were returned during the past fiscal year. Four defendants were convicted of perjury during the year, and at the end of the year indictments were pending as to 13 defendants.

The number of cases referred to the Department of Justice during the past fiscal year represents an increase of 25 percent over such references during the preceding year. Furthermore, the number of defendants convicted in such cases during the past fiscal year was not only 31 percent greater than the corresponding figure for the previous year, but is the largest number of defendants ever convicted in a single year in cases developed by the Commission. It is also interesting to note that of the total of 615 defendants convicted in cases referred by the Commission, 409, or two-thirds, were convicted on pleas of guilty or ***nolo contendre***.

Up to July 1, 1940, the Commission had secured the citation of 24 defendants in 7 proceedings for contempt of court orders which had been obtained by the Commission. Fourteen of these defendants were found guilty; 5 were found guilty during the past fiscal year. A more detailed description of some of the more important cases follows.

United States v. McGhie and Rothe -- "On July 12, 1940, George McGhie, Jr., a Chicago broker, pleaded ***nolo contendre*** to an indictment returned in the United States District Court for the Western District of Wisconsin, charging him and Lester W. Rothe, former Special Deputy Commissioner of Banking of the State of Wisconsin with perpetrating a fraud on the Banking Commission of Wisconsin and on certain closed banks and "segregated trusts" set up under the banking laws of that State. The scheme involved the payment by McGhie to Rothe, the indictment alleged, of secret bribes approximating $20,000, for which, Rothe induced the trustees of the "segregated trusts" to purchase securities from George McGhie & Company, and caused both the banks and the trusts to sell portfolio securities to George McGhie & Company at prices below the then current market for such securities, thereby enabling McGhie to resell at a substantial profit. McGhie was fined $1,500. The case is still pending against Rothe, who has been serving a prison sentence under a State charge arising out of the same practices.

Among the false pretenses and misrepresentations charged in the indictment were the following: that George McGhie, Jr., and Lester W. Rothe were acting independently and at arm's-length in transactions involving securities of the closed banks and "segregated trusts"; that McGhie was selling such securities "at the market" ; and that securities recommended by Rothe to the trustees of the "segregated trusts" were good investments and appropriate for such trusts.

United States v. Kenyon & Co., Inc. et al -- After a trial of seven and one-half weeks in the United States District Court for the Southern District of New York, Kenyon & Co., Inc., Samuel Sobel, Lucian A. Eddy, Edward F. Embree, Ernest K. Schwartz, and Well Management Company, Inc., were found guilty on November 22, 1939, under an indictment which charged violations of the fraud provisions of the Securities Act of 1933, mail fraud, and conspiracy. Previously, Charles Russell Kenyon, Norman F. Dizer, and George R. Grantham had pleaded guilty.

In general, the indictment alleged the defendants, together with Donald P. Kenyon, deceased, defrauded seven investment companies out of approximately $900,000. The scheme to defraud commenced with the acquisition of control by the defendants and Donald P. Kenyon of Alpha Shares, Inc., Monthly Income Shares, Inc. of New Jersey, United Sponsors, Inc., and Investors Fund of America, Inc. Thereafter, according to the indictment, the defendants and

Kenyon extracted funds from these companies by causing the companies, under the guise of legitimate business transactions, to pay approximately $460,000 for securities owned by Donald P. Kenyon or issued by other companies controlled by the defendants and at prices far in excess of their fair market value. Further, the defendants and Kenyon caused Monthly Income Shares, Inc., of New York to pledge securities owned by it as collateral for a loan and to advance the proceeds of the loan to the defendants; the defendants then used this money to purchase at approximately $50 per share, a controlling stock interest in the North Bergen Trust Company; thereafter, the defendants transferred 350 of such shares to Monthly Income Shares, Inc., of New York at the rate of $ 115 per share in cancellation of the advance made to the defendants by that Company. As a further example of the defendants' methods it appears that, after acquiring control of United Sponsors, Inc., and United Standard Oilshares Corporation, which had management contracts with Investors Fund of America, Inc., and United Standard Oilfund of America, Inc., the defendants caused $235,000 to be paid by the latter two companies as pretended consideration for the cancellation of such contracts, when in fact such payments were devoted to the use of the defendants and Kenyon. Of these payments, $34,000 was paid over to Kenyon and Co., Inc., purportedly in payment of a non-existent indebtedness.

Kenyon & Co., Inc., and Well Management Co., Inc., were fined $10,000 each; Sobel was sentenced to 2 years imprisonment on each of five counts, the sentences to run concurrently; and Eddy and Embree were each sentenced to imprisonment for 1 year and 1 day. Grantham, Dizer, and Charles Russell Kenyon were placed on probation for 5 years. Schwartz has not yet been sentenced.

United States v. Donnell et al. -- On December 2, 1939, Ethel Pitt Donnell, Edward J. Hartenfeld, and Robert D. Beckett were convicted in the United States District Court for the Southern District of Indiana for fraud in connection with the sale of the securities of American Terminals and Transit Company and its subsidiary, Green River Valley Terminal Company. The other defendant, John K. Knapp, was acquitted.

Mrs. Donnell and Hartenfeld were officers and directors of, and Beckett was sales agent for the companies. According to the indictment, the defendants defrauded numerous investors in Indiana, Ohio, and elsewhere by means of misrepresentations and other fraudulent devices. The indictment alleged that the defendants had represented that subsidiary companies were operating at a profit and that there were earnings available for payment of interest and principal on the companies' bonds and notes, when in fact the subsidiaries were only in the development stage and had had substantial deficits rather than profits; that a subsidiary coal company had had large production and sales of coal, when in fact such production and sales were infrequent, often interrupted, and always at a

loss; and that the proceeds from the sale of securities were to be used for plants and facilities, when in fact the proceeds were used largely for the benefit of the defendants and for purposes other than plants and equipment. It was also alleged that the defendants switched investors out of building and loan stocks and into the companies' securities by means of the misrepresentations, together with false statements as to the value of the building and loan stocks.

Hartenfeld and Mrs. Donnell were each sentenced to ten years imprisonment and fined $5,000, and Beckett was sentenced to eight years imprisonment and fined $2,500. Hartenfeld appealed from his conviction which, on June 11, 1940, was affirmed by the United States Circuit Court of Appeals for the Seventh Circuit.

United States v. Sidney J. Dillon et al. -- On November 27, 1939, Sidney J, Dillon and Lewis F. Crowley were sentenced in the United States District Court for the Southern District of Iowa upon their pleas of ***nolo contendre*** to an indictment charging violation of the fraud provisions of the Securities Act of 1933 and the mail fraud statute.

According to the indictment, the defendants made a number of misrepresentations in connection with the sale of shares in three investment trusts -- American Securities Trust, Mutual Trust Shares, and Cooperative Trust Shares. It was alleged that the defendants stated to customers that the trust funds would be invested only in listed securities or Government bonds; that returns to investors would be paid only from earnings; that the investors' contributions would be retained intact; that management expenses would be limited to one-half of one percent quarterly of the value of the trust assets; and that the trusts were complying with the regulations of the Iowa Securities Commission. The indictment charged that at the time these representations were made, the defendants knew and intended that a substantial portion of the trust funds would be diverted to the use of the defendants; that dividends would be paid out of capital; that the defendants would pay to themselves management fees several times greater than one-half of one percent quarterly; and that they had falsely represented the condition of the trusts to the Iowa Securities Commission.

Dillon was sentenced to five years imprisonment and fined $1,000, and Crowley was sentenced to three years imprisonment and fined $1,000. On July 16, 1940, the convictions were affirmed by the United States Circuit Court of Appeals for the Eighth Circuit.

United States v. McDermott et al. -- On February 7, 1940, a plea of guilty was entered by Frederick J. McDermott, one of seven defendants named in an indictment charging conspiracy to gain control of a group of investment trusts and other corporations with aggregate assets of over $60,000,000. The fourteen-

count indictment, returned on February 1, 1940, in Federal court at New York City, named, in addition to McDermott, the following defendants: Harold L. Bishop, Vincent J. Kennedy, Walter A. Stegman, Slagle J. Halsted, Arthur J. Keon, and Rinder Corporation.

Defendants Halsted and Keon, according to the indictment, posed as officers of fifteen non-existent corporations, for which fake bonds were printed. Stegman, a certified public accountant of New York, was charged in the indictment with having prepared the financial statements of these fictitious corporations. McDermott and Bishop were alleged to have engineered the operations of the plot to defraud banks, insurance companies, and investment trusts by using the bonds as collateral to obtain loans, with which they intended to purchase control of a number of companies, including the following: Reynolds Investing Company, First Income Trading Corporation, R. C. Williams and Company, Utility Equities Corporation, Eagle Warehouse and Storage Company, General Public Service Corporation, Manhattan Life Insurance Company, Eureka-Maryland Assurance Company, Colonial Life Insurance Company, Utility and Industrial Corporation, Franklin Life Insurance Company, and Universal Indemnity Company.

United States v. F. Donald Coster et al. -- On. May 22, 1940, the United States District Court for the Southern District of New York sentenced seven defendants convicted under indictments based upon the tremendous fraud perpetrated by Philip Musica, alias F. Donald Coster, president of McKesson & Robbins, Inc. Coster committed suicide. His three brothers, George, Arthur, and Robert, and Benjamin Simon pleaded guilty prior to the trial. During the trial, Leonard Jenkins and John Jenkins also entered pleas of guilty. The jury found John H. McGloon, vice president and comptroller of McKesson & Robbins, Inc., guilty of falsifying reports filed with the Securities and Exchange Commission, but acquitted Horace B. Merwin and Rowley W. Phillips, directors. The following sentences were imposed; Arthur Musica and Benjamin Simon, each three years imprisonment; George Musica, two years and six mouths imprisonment; Robert Musica, one year and six months imprisonment; John Jenkins, one year and one day imprisonment; Leonard Jenkins, suspended sentence of one year and one day; and John H. McGloon, one year and one day imprisonment and a $5,000 fine. McGloon has taken an appeal. On December 30, 1940, after the close of the fiscal year, McGloon’s conviction was affirmed by the Circuit Court of Appeals for the Second Circuit.

Evidence was introduced to show that there had, been a conspiracy and scheme to inflate the assets of McKesson & Robbins, Inc., and affiliated corporations by means of fictitious purchases and sales, which were reflected in false and misleading statements made in annual reports filed with the Commission, and the New York Stock Exchange.

United States v. S. W. Gongoll et al -- On April 8, 1940, sentences were imposed by the United States District Court for Minnesota on seven defendants convicted of fraud in connection with the sale of several million dollars face amount of investment contracts and other securities issued by a large number of investment companies, the securities of which were sold from coast to coast by S. W. Gongoll & Company, Minneapolis. The principal defendant, Stanley W. Gongoll, was given a prison sentence of 4 years; Frank F. Hofacre, office manager, W. S. Douglas, officer of several of the companies, and Paul J. Thompson, sales manager, were each given jail sentences of 15 months; sentence was suspended as to Stanley B. Newhall, salesman, Mildred V. Nylund, confidential secretary, and Elaine M. Wegfors, market trader, each of whom was placed on probation for 3 years.

When it was forced into bankruptcy, S. W. Gongoll & Company owed $2,800,000 to its clients and had cash assets of but $4,600. The Commission's investigation disclosed that the securities of the numerous companies controlled by the defendants were sold in California, Colorado, Iowa, Illinois, New York, Pennsylvania, North Dakota, South Dakota, Wisconsin, and Minnesota. Under the defendants' scheme, customers deposited securities and money, for which they received various forms of investment contracts and profit-sharing agreements, to be used by the defendants to speculate in securities. The indictment charged that the defendants misrepresented their earnings, their success in trading, the financial condition of the company, and the amount of reserves that had been set up to protect the accounts of the customers from loss. The indictment also charged that the defendants had sold unregistered securities in violation of the Securities Act of 1933.

United States v. Shideler et al. -- On September 25, 1939, Fred W. Shideler was sentenced in the United States District Court for the Southern District of Indiana to seven years imprisonment and fined $5,000 on his plea of guilty to an indictment charging him and William A. Shideler with the fraudulent operation of a securities business in Indianapolis. On January 11, 1940, William A. Shideler was found guilty under the same indictment and sentenced to eight years imprisonment.

The Shidelers, operating under the name of Shideler and Company, solicited money and securities from numerous customers for investment in trading accounts to be managed by the defendants on a profit-sharing basis. Under one of the plans, the investors were to get a monthly income which was represented to be advances against profits to be earned. To induce people to invest, the indictment alleged, the defendants falsely asserted that they were maintaining a $300,000 fund to pay losses in the event that the market declined. Evidence was adduced at the trial to show that members of the public invested on the basis of false representations which included statements that the defendants were

successful dealers in securities and expert stock market analysts, and that the firm had been making large profits for its customers. Further to deceive the investors, the indictment alleged, the defendants resorted to the device of making pretended profit distributions out of the very funds invested by the customers.

United States v. Fritz et al. -- An attorney, two New York City brokers, and a small loan company executive were convicted on November 1, 1939, in the United States District Court for Maryland on an indictment charging violation of the fraud provisions of the Securities Act of 1933 and the mail fraud statute in the sale of the stock of Allied Finance Corporation of Baltimore. During the trial, evidence was introduced to show that the prospectus filed with the Securities and Exchange Commission and used in the sale of the stock, misrepresented the amount of commission to be paid to the distributing brokers and the amount of the proceeds that would go into the capital funds of the company. The fraudulent scheme, it was charged, included the not uncommon device of impressing investors through the payment of dividends, even though the company was operating at a deficit. David Kohler and M. D. Schreiber, brokers of New York City, who conducted the stock distribution, were each given a prison sentence of 12 mouths; Andrew G. W. Fritz, president of Allied Finance Corporation, was given a prison sentence of 6 months; and Philip Birnbaum, of New York City, attorney for Kohler and Schreiber was placed on probation for 3 years. Birnbaum's appeal was dismissed by the Circuit Court of Appeals for the Fourth Circuit.

United States v. Rossignol et al -- On November 4, 1939, J. H. Rossignol and A. J. Crocy were found guilty in the United States District Court for the Northern District of Georgia under an indictment charging the employment of a fraudulent stock-trading scheme effected through the operation of Rossignol & Crocy, Inc., Atlanta, Georgia. The defendants held themselves out as expert investment counselors and by means of misrepresentations induced the public to entrust funds to the company for trading under a profit-sharing arrangement. The conviction of Rossignol, who had been sentenced to four years imprisonment, was affirmed on June 20, 1940, by the United States Circuit Court of Appeals for the Fifth Circuit. Crocy, who received a two and one-half year prison term, did not appeal. Evidence was produced at the trial to show that it was part of the scheme to defraud for the defendants to appropriate and convert both the funds invested and the collateral put up by investors, and to maintain an artificial market in the shares of Bankers Industrial Service, Inc., some of which were given to investors as evidence of the good faith of the defendants and were falsely represented to be equal in value to the money put up by the investors.

United States v. Holmes et al. -- The most severe sentence ever imposed in a criminal case under the Securities Act of 1933 -- 15 years imprisonment and a fine of $25,000 -- was received by Leo S. Holmes, of Omaha one of three

defendants convicted on May 4, 1940, in the United States District Court for Nebraska of fraud in connection with the sale of the securities of First Mortgage Acceptance Corporation, Omaha, Nebraska. When the Corporation went into bankruptcy in February 1939, it had outstanding $1,350,000 face amount of securities. Holmes was president of the company. George H. Hauser, vice President of the company, was sentenced to 6 years imprisonment and fined $1,000, and J. W. McCormack, a Chicago real-estate broker, the third defendant, was given a prison sentence of 15 months.

Evidence was introduced at the trial to show that Holmes and Hauser, who controlled First Mortgage Acceptance Corporation and its affiliates, Conservative Mortgage Acceptance Corporation and Nebraska Agricultural Corporation, purchased numerous real-estate mortgages from the defendant McCormack and others at large discounts front the face amount of these mortgages so that First Mortgage Acceptance Corporation and conservative Mortgage Acceptance Corporation could set up fictitious profits. The pretended profits were used, it was charged, to make interest and maturity payments on the securities sell to the public, a device which was effectively employed to induce additional investments and to conceal the insolvency of the company.

In ***United States v. Norman W. Minuse et al.***, the indictment charged a conspiracy to violate Sections 9 (a) (1) and (2) of the Securities Exchange Act of 1934, in that Minuse had obtained an option to purchase 79,000 shares of Tastycast, Inc., Class A common stock and had thereafter entered into a conspiracy with the other defendants, Joseph E. H. Pelletier and Russell Van Wycke Stuart, to raise the price of the stock on the New York Curb Exchange by means of “wash” sales, “matched” orders, and a series of manipulative transactions for the purpose of distributing the optioned stock at the higher prices. The “matched” orders were alleged to involve the entering of orders on one side of the market with the knowledge that orders of substantially the same size would be entered on the other side at substantially the same time and price, and with a manipulative purpose. Other market-rigging devices charged in the indictment included the payment of secret bonuses to various customers men for their services in inducing customers and clients to purchase the stock and the promise of rebates or discounts on the purchase price.

Minuse and Pelletier were found guilty and, on January 29, 1940, were sentenced in the United States District Court for the Southern District of New York -- Minuse to 2 years imprisonment and a fine of $5,000 and Pelletier to 18 months imprisonment and a fine of $1,000. Stuart, who had previously pleaded guilty, was sentenced to 2 years imprisonment, which sentence was suspended. However, on August 7, 1940, the United States Circuit Court of Appeals for the Second Circuit reversed the judgment of the lower court for errors at the trial

relating to the introduction of evidence and other rulings of the court and ordered a new trial.

United States v. George J. Morrison et al. -- Morrison and Emile Jacques were named as defendants in an indictment charging violation of Sections 9 (a) (1) and (2) of the Securities Exchange Act of 1934. Morrison had obtained an option to purchase 5,000 shares of the common stock of B/G Sandwich Shops, Inc., at prices ranging from 1 to 1 5/8. Thereafter, according to the indictment, Morrison and Jacques "rigged" the market for the stock on the New York Produce Exchange by means of "wash" sales and a series of manipulative transactions designed to create the appearance of active trading and to raise the price from $1.25 to $4.00 per share, for the purpose of distributing the optioned stock at the higher prices. These "wash" sales were alleged to involve transactions in the stock, without any change in beneficial ownership, between the two defendants and through accounts opened by them with different brokerage firms, and which resulted in fictitious quotations on the ticker tape. During the trial and after the Government's case, both defendants pleaded guilty and were sentenced in the United States District Court for the Southern District of New York to imprisonment for 1 year and 1 day each. Sentence was suspended as to Jacques, who was put on probation for 2 years.

United States v. Perry et al. -- The Commission's investigation into the fraudulent sale of securities issued by the Seminole Provident Trust resulted in the conviction of six defendants in the United States District Court at Minneapolis. The trust held options on interests in six oil and gas leases in the Seminole field in Oklahoma. The fraud charged in two indictments consisted of misrepresentations with respect to the amount of the proceeds from the sale of securities that would be applied to the purchase of oil and gas leases, the payment of distributions to investors out of the proceeds from the sale of units or securities under the pretense that these funds were derived from the sale of oil produced on the trust's properties, and that the properties would produce in excess of 4,000,000 barrels of oil, when in fact they could not be expected to produce more than 500,000 barrels. Due of the indictments also charged that the defendants, other than Ahlborg, had violated the prospectus requirements of the Securities Act of 1933 and had represented that the Commission had passed upon the merits of the securities issued by the trust, in violation of Section 23 of the Act.

On November 18, 1939, E. R. Perry and S. L. Dedman, "trustees" of Seminole Provident Trust, were each sentenced to 15 months imprisonment; John Ahlborg, operating under the name of Foreman & Company and the principal underwriter, received a prison sentence of 4 months and was fined $1,500; Otis Backenstock and Delbert R. Card who had conducted selling campaigns in Minnesota, were placed on probation for 2 years; R. B. Allport, who, holding himself out as a

petroleum valuation engineer, had participated in the scheme by writing letters concerning the accuracy of the valuation reports used in the sale of the units, was placed on probation for 1 year; and Kent K. Kimball was acquitted.

According to the registration statement filed with the Commission the defendants had proposed to sell securities in the aggregate amount of $800,000, divided into 8,000 units. In September 1937, the trustees consented to the entry of a stop order. Thereafter, a permanent injunction was issued against the defendants as the result of a suit brought by the Commission, and the broker-dealer registration of Foreman & Company was revoked.

United States v. Platt et al. -- On September 29, 1939, Moe Platt and John J. McKee were convicted in the United States District Court for the Southern District of New York on a charge of conspiracy to defraud the United States in connection with its governmental function of administering the Securities Act of 1933 and the Securities Exchange Act of 1934. The indictment alleged that McKee, while employed by the Commission as an accountant-investigator, had accepted bribes from Platt to assist Platt in obstructing an investigation by the Commission into his activities in connection with the sale of the stock of Backbone Mining Company. Each of the defendants was sentenced to two years imprisonment and fined $2,500.

Subsequently, Platt, together with Bernard Frankel, Bernard McNey, and Charles Lutz, pleaded guilty in the United States District Court for the Western District of Pennsylvania to indictments charging violation of the fraud provisions of the Securities Act of 1933 in the sale of the stock of Backbone Mining Company. It was alleged that the defendants in selling such stock had falsely represented that application had been made to list the stock on an exchange; that the stock would be placed on a regular dividend basis within a few months; that the stock, which was under option to the defendants at 75 cents a share, would advance to at least $20 a share within a few months; and that the distribution of the stock by the defendants had been approved by the Securities and Exchange Commission, The indictments also charged it to be a part of the scheme for the defendants, by means of various artificial devices, to raise the price of the stock from $1 to $6 a share, Platt was sentenced to imprisonment for two years and six months, to run concurrently with the earlier sentence, while each of the other defendants was placed on probation for two years and fined $200.

United States v. Buckman et al.; ***United States v. George et al.***; ***United States v. Kehaya et al***. -- Barton E. Buckman and Louis C. George, both of Madison, Wisconsin, were convicted on June 5, 1940, in the United States District Court for the Western District of Wisconsin under an indictment charging them with, fraudulent practices in connection with the operation of B. E. Buckman & Company, one of the largest securities firms in the Middle West. Evidence was

introduced to show that Buckman and George, officers of B. E. Buckman & Company, had organized, and dominated the affairs of, Continental Public Service Company, an Arkansas Corporation Gulf Coast Water Company, a Texas corporation; Dairyland, Inc., a Texas corporation; and Continental Service Company, a Delaware corporation, the stocks of which were sold by B. E. Buckman & Company at a time when the issuers of the securities were insolvent. Defendant Edgar C. Holt pleaded ***nolo contendre*** and defendants Edwin J. Crofoot, Richard E. George, Fielding T. Spain, Clarence C. Winebrenner, and Wilbur V. Malkson were acquitted. The indictment was ***nolle prossed*** as to defendants James C. Casey, Lewis P. Bracy, and Frank R. Shotola.

Part of the case presented was based upon falsification of the financial condition and earnings of B. E. Buckman & Company and the corporations, the securities of which were sold by the defendants. Evidence was introduced to show that it was a part of the scheme for B. E. Buckman & Company to borrow bonds and other securities from its customers in order that they might be converted into cash to be used by B. E. Buckman & Company, which was insolvent at the time. Buckman was sentenced to five years imprisonment and a fine of $2,000; George, to six years imprisonment and a fine of $2,000; and Holt, to four years probation and a fine of $500.

Pending against Buckman and George is an indictment returned in the United States District Court for the Northern District of Illinois charging them with perjury committed before an officer of the Securities and Exchange Commission. In this case, Perry Sletteland, an attorney of Madison, Wisconsin, is a codefendant. Another indictment, charging Louis C. George, together with two other defendants, with having effected a stock manipulation on the New York Curb Exchange, is pending in New York City. Moses A. Isaacs, of New York, and Josiah Marshall Kirby, of Cleveland, are the co-defendants. The indictment charges that the defendants created an artificial market in the stock of Automatic Products, Inc., by means of various manipulative devices, including the guarantee of purchasers against loss and the payment of commissions and bonuses for the purpose of drumming up buying power and thereby facilitating the distribution of 95,000 shares of the stock.

Louis C. George is also named in an indictment returned in New York which includes as defendants Ery Kehaya, Harry J. Rothman, and Harry D. Meyer. This indictment charges a manipulation of the New York Stock Exchange market for the stock of Standard Commercial Tobacco Company by means of wash sales, matched orders, and by touting customers men. It is charged that George's participation in this scheme occurred while he was vice president of B. E. Buckman & Company. At the time of the indictment, the United States Attorney estimated that the public had lost upwards of $4,000,000.

The “Front Money” Racket.

For some time the Commission has been concerned over the prevalence of the “front money” or “advance fee” racket, in which unscrupulous operators approach a wide variety of small business concerns with the suggestion that needed capital be obtained through the sale of securities. Frequently, the “front money” operator takes an exclusive option on such securities for the purpose of inducing the belief that the operator’s sole remuneration would consist of commissions from the sale of the securities. Thereafter, the victim is induced to make payments for various alleged services, such as incorporation, the employment of a registrar and transfer agent, dealers’ trips to inspect the business and to interest other dealers throughout the country, and the preparation and filing of a prospectus or registration statement with this Commission. These fees are alleged to represent the actual cost of such services, but in fact include large personal undisclosed profits to the operators of the scheme.

During 1938 and 1939, the Commission instituted proceedings resulting in the revocation of the broker-dealer registrations of three firms which were engaged in the operation of “front money” schemes. The Commission then submitted to the Post Office Department and the Department of Justice the evidence it had obtained in these and other cases in which the operators were not registered, but concerning whose activities the Commission had received complaints. The ensuing joint investigation disclosed that, for the past six years, hundreds of small concerns engaged in many types of business had been induced to pay to the “front money” operators fees estimated to aggregate hundreds of thousands of dollars. The investigation failed to reveal a single instance in which a share of stock had been sold for the victims.

On May 21, 1940, the joint investigation culminated in an indictment by a Federal grand jury in Cleveland, charging 12 defendants with violations of the mail fraud statute and with conspiracy to violate the mail fraud statute in the operation of an international “front money” scheme. Included among the defendants were the dominant figures in two of the three firms whose broker-dealer registrations had already been revoked by the Commission. The controlling person in the third firm has already been convicted of mail fraud and sentenced to the penitentiary. On June 20, 1940, an additional indictment was returned in Detroit, charging four defendants with similar frauds. Herbert C. Schelzel, one of the defendants named in the second indictment, has already pleaded guilty in the United States District Court for the Eastern District of Michigan and has been sentenced to 15 months imprisonment.

Civil and criminal cases in which *certiorari* was denied by the United States Supreme Court during the past fiscal year.

In United States v. William P. Buckner, Jr., et al., William P. Buckner, Jr., and William J. Gillespie were convicted of mail fraud and conspiracy and Felipe Buencamino of conspiracy in connection with the operations of a committee for the protection of holders of Philippine Railway bonds. On January 8, 1940, the Circuit Court of Appeals for the Second Circuit affirmed the convictions of Buckner and Gillespie on five mail fraud counts and the conspiracy count, reversing on two mail fraud counts. The conviction of Buencamino was also affirmed Buckner and Gillespie filed petitions for writs of ***certiorari***, which were denied on March 11, 1940.

In ***United States v. Harry H. Landay et al***., five defendants were convicted of violation of the registration and fraud provisions of the Securities Act of 1933 and conspiracy in connection with the sale of stock of R. Cummins & Company. On December 14, 1939, the Circuit Court of Appeals for the Sixth Circuit affirmed their convictions. Landay, Lane, Attix, and Brown filed petitions for writs of ***certiorari***. The petitions were denied on. April 1, 1940.

In ***Securities and Exchange Commission v. Universal Service Association***, six defendants were enjoined from violating the registration and fraud provisions of the Securities Act of 1933 in connection with the sale of subscriptions and memberships in Universal Service Association and Universal Order of Plenocrats. On June 23, 1939, the Circuit Court of Appeals for the Seventh Circuit affirmed the judgment of the district court. A petition for a writ of ***certiorari*** was denied January 2, 1940.

In ***Securities and Exchange Commission***, as relator, and ***Universal Service Association et al***., as respondents, two defendants were found to be in criminal contempt of court for violating the permanent injunction entered against them, on April 14, 1938. Both defendants appealed and, on January 4, 1940, the Circuit Court of Appeals for the Seventh Circuit affirmed the order of the district court as to C. Franklin Davis, but reversed the order as to Universal Service Association. Davis filed a petition for a writ of ***certiorari*** which was denied on April 22, 1940.

In ***United States v John Weber***, the defendant was convicted of fraud in connection with the sale of stock of three companies. Weber appealed and on April 18, 1939, the Circuit Court of Appeals for the Fifth Circuit dismissed the appeal on the ground that the bill of exceptions was not filed within the time allowed by court rules. Petition for ***certiorari*** was denied on October 16, 1939.

ACTIVITIES OF THE COMMISSION IN THE FIELD OF ACCOUNTING AND AUDITING

The McKesson & Robbins Case.

As explained in the Commission's Fifth Annual Report, public hearings in the McKesson & Robbins case were held pursuant to an order entered by the Commission on December 29, 1938, to determine (1) the character, detail, and scope of the audit procedure followed by Price, Waterhouse & Co., in the preparation of the registrant's financial statements; (2) the extent to which prevailing and generally accepted standards and requirements of audit procedure were adhered to and applied in the preparation of the financial statements; and (3) the adequacy of the safeguards inhering in generally accepted practices and principles of audit procedure to assure reliability and accuracy of financial statements. Following the close of the fiscal year, the Commission published a report on its investigation of this matter. [Footnote: Published Dec. 5, 1940. Copies may be secured from the Superintendent of Documents, Washington, D.C., at a cost of 60 cents per copy.] A summary of the principal facts in this case and the conclusions set forth in the Commission's report are reproduced below:

SUMMARY OF PRINCIPAL FACTS

"The securities of McKesson & Robbins, Incorporated (Maryland) were listed and traded on the New York Stock Exchange and registered under the Securities Exchange Act of 1934. Financial statements of the corporation and its subsidiaries for the year ended December 31, 1937 (the last before the disclosure of the fraud hereinafter described) certified by Price, Waterhouse & Co., filed with this Commission and the New York Stock Exchange, and issued to stockholders reported total consolidated assets in excess of $87,000,000. Approximately $19,000,000 of these assets are now known to have been entirely fictitious. The fictitious items consisted of inventories, $10,000,000; accounts receivable, $9,000,000; and cash in bank, $75,000; and arose out of the operation at the Bridgeport offices of a wholly fictitious foreign crude drug business shown on the books of the Connecticut Division of McKesson & Robbins, Incorporated (Maryland) and McKesson & Robbins, Limited (Canada), one of its subsidiaries. For the year 1937, fictitious sales of these units amounted to $18,247,020.60 on which fictitious gross profit of $1,801,390.60 was recorded. At the time of the exposure of the fraud on or about December 5, 1938, the fictitious assets had increased to approximately $21,000,000.

"The fraud was engineered by Frank Donald Coster, president of McKesson & Robbins since its merger with Girard & Co., Inc., in November 1926. In reality Coster was Philip M. Musica who, under the latter name, had been convicted of commercial frauds. In carrying out the fraud Coster in the later years was assisted principally by his three brothers George E. Dietrich, assistant treasurer of the corporation, who was in reality George Musica; Robert J, Dietrich, head of the shipping, receiving, and warehousing department of McKesson & Robbins at Bridgeport, Connecticut, who was in reality Robert Musica; and George Bernard,

who was in reality Arthur Musica, and who managed the offices, mailing addresses, bank accounts, and other activities of the dummy concerns with whom the McKesson companies supposedly conducted the fictitious business.

“To accomplish the deception, purchases were pretended to have been made by the McKesson companies from five Canadian vendors, who thereafter purportedly retained the merchandise at their warehouses for the account of McKesson. Sales were pretended to have been made for McKesson’s account by W. W. Smith & Company, Inc. and the goods shipped directly by the latter from the Canadian vendors to the customers. Payments for goods purchased and collections front customers for goods sold were pretended to have been made by the Montreal banking firm of Manning & Company also for the account of McKesson, W. W. Smith & Company, Inc., Manning & Company, and the five Canadian vendors are now known to have been either entirely fictitious or merely blinds used by Coster for the purpose of supporting the fictitious transactions.

“Invoices, advices, and other documents prepared on printed forms in the names of these firms were used to give an appearance of reality to the fictitious transactions. In addition to this manufacture of documents, a series of contracts and guarantees with Smith and Manning and forged credit reports on Smith were also utilized. The foreign firms to whom the goods were supposed to have been sold were real but had done no business of the type indicated with McKesson.

“The fictitious transactions originated early in the life of Girard & Co., Inc., Coster’s predecessor concern, incorporated on January 31, 1923, and increased until they reached the proportions mentioned above. The manner of handling the transactions described above was the one in vogue since the middle of 1935. Prior to that time the fictitious goods were supposed to have been physically received at and reshipped from the Bridgeport plant of McKesson. And prior to 1931 McKesson made actual cash payments directly for the fictitious purchases, which at that time were supposed to have been made from a group of domestic vendors, but recovered a large part of this cash purportedly as collections on the fictitious sales. The change from using actual cash to the supposed clearance through Manning & Company was not effected abruptly but for some time after 1931 both systems were used. The Canadian vendors, however, were used only in connection with the Manning clearance system. From the report of the accountant for the trustee in reorganization of McKesson & Robbins, Incorporated, it appears that out of an actual cash outgo from the McKesson companies in connection with these fictitious transactions of $24,777,851.90 all but $2,869,482.95 came back to the McKesson companies in collection of fictitious receivables or as cash transfers from the pretended bank of Manning & Company.

“CONCLUSION

“Our conclusion based upon the facts revealed by the record, the testimony of the expert witnesses, and the writings of recognized authorities is that the audits performed by Price, Waterhouse & Co. substantially conformed, in form, as to the scope and procedures employed, to what was generally considered mandatory during the period of the Girard-McKesson engagements. Their failure to discover the gross overstatement of assets and of earnings is attributable to the manner in which the audit work was done. In carrying out the work they failed to employ that degree of vigilance, inquisitiveness, and analysis of the evidence available that is necessary in a professional undertaking and is recommended in all well-known and authoritative works on auditing. In addition, the overstatement should have been disclosed if the auditors had corroborated the company’s records by actual observation and independent confirmation through procedures involving regular inspection of inventories and confirmation of accounts receivable, audit steps which, although considered better practice and used by many accountants, were not considered mandatory by the profession prior to our hearings.

“Price, Waterhouse & Co. maintain that a balance sheet examination is not intended and cannot be expected to detect a falsification of records concealing an inflation of assets and of earnings if accomplished by a widespread conspiracy carried on by the president of a corporation, aided by others within and without the recognized ranks of a corporation’s operating personnel, and that no practical system of internal cheek can be devised the effectiveness of which cannot be nullified by criminal collusion on the part of a chief executive and key employees. Such cases are so rare, in their opinion, that there is no economic justification for the amount of auditing work which would be required to increase materially the protection against it.

“The inference to be drawn from this position and from statements made by others in connection with this case is that a detailed audit of all transactions as distinguished from an examination based on tests and samples would have been necessary to reveal the falsification. However, as we view the situation in this case, a detailed audit of all transactions carried out by the same staff would merely have covered a larger volume of the same kinds of fictitious documents and transactions. While this might have brought under review more instances of what we have listed as circumstances suggesting further investigation, there is little ground for believing that this alone would have raised any greater question as to the authenticity of the transactions.

“Moreover, we believe that even in balance sheet examinations for corporations whose securities are held by the public, accountants can be expected to detect gross overstatements of assets and profits whether resulting from collusive fraud or otherwise. We believe that alertness on the part of the entire staff, coupled with intelligent analysis by experienced accountants of the manner of doing

business, should detect overstatements in the accounts regardless of their cause long before they assume the magnitude reached in this case. Furthermore, an examination of this kind should not, in our opinion, exclude the highest officers of the corporation from its appraisal of the manner in which the business under review is conducted. Without underestimating the important service rendered by independent public accountants in their review of the accounting principles employed in the preparation of financial statements filed with us and issued to stockholders, we feel that the discovery of gross overstatements in the accounts is a major purpose of such an audit even though it be conceded that it might not disclose every minor defalcation. In short, Price, Waterhouse & Co.'s failure to uncover the gross overstatement of assets and of earnings in this case should not, in our opinion, lead to general condemnation of recognized procedures for the examination of financial statements by means of tests and samples.

"We do feel, however, that there should be a material advance in the development of auditing procedures whereby the facts disclosed by the records and documents of the firm being examined are to a greater extent checked by the auditors through physical inspection or independent confirmation. The time has long passed, if it ever existed when the basis of an audit was restricted to the material appearing in the books and records. For many years accountants have in regularly applied procedures gone outside the records to establish the actual existence of assets and liabilities by physical inspection or independent confirmation. As pointed out repeatedly in this report, there are many ways in which this can be extended. Particularly it is our opinion that auditing procedures relating to the inspection of inventories and confirmation of receivables which prior to our hearings, had been considered optional steps, should in accordance with the resolutions already adopted by the various accounting societies, be accepted as normal auditing procedures in connection with the presentation of comprehensive and dependable financial statements to investors.

"We have carefully considered the desirability of specific rules and auditing steps to be performed by accountants in certifying financial statements to be filed with us. Action has already been taken by the accounting profession adopting certain of the auditing procedures considered in this case. We have no reason to believe at this time that these extensions will not be maintained or that further extensions of auditing procedures along the lines suggested in this report will not be made. Further, the adoption of the specific recommendations made in this report as to the type of disclosure to be made in the accountant's certificate and as to the election of accountants by stockholders should insure that acceptable standards of auditing procedure will be observed, that specific deviations therefrom may be considered in the particular instances in which they arise, and that accountants will be more independent of management. Until experience should prove the contrary, we feel that this program is preferable to its alternative -- the detailed prescription of the scope of and procedures to be followed in the audit for the

various types of issuers of securities who file statements with us -- and will allow for further consideration of varying audit procedures and for the development of different treatment for specific types of issuers."

The McKesson & Robbins Criminal Trial.

On March 30, 1939, the United States Grand Jury returned its third indictment in the matter of McKesson & Robbins, Inc., et al., naming, in addition to the three surviving Musica brothers, Benjamin Simon, John Jenkins, Leonard Jenkins, John H. McGloon, Horace B. Merwin, and Rowley W. Phillips. [Footnote: ***U.S. of America vs. George Musica, et al***., U. S. D. C., So. Dist. Of N. Y. No. 80995.] The indictment charged violation of the mail fraud statute, of Sections 13 and 32 of the Securities Exchange Act of 1934, and a conspiracy to violate the foregoing statutes The Musica brothers and Benjamin Simon pleaded guilty before trial. Insofar as the fictitious crude drug transactions were concerned, it appears that at an early date Simon performed some of the functions later carried on by George Bernard. John Jenkins and Leonard Jenkins, brothers-in-law of Coster, both pleaded guilty during the trial, the latter only to the conspiracy count. It appears that they signed contracts, checks, and so forth, in the names of persons supposedly connected with the fictitious concerns used to carry on the fraud.

Horace B. Merwin and Rowley W. Phillips, who were directors of McKesson & Robbins, Incorporated (Maryland), and of its predecessors and subsidiaries, McKesson & Robbins, Incorporated, (Connecticut), McKesson & Robbins, Limited, and Girard & Co., Inc., were acquitted by the jury on all counts. John H. McGloon, comptroller of McKesson & Robbins since 1928, was acquitted of being part of the conspiracy, of mail fraud, and of violating Sections 13 and 32 of the Securities Exchange Act of 1934 in connection with the 1935 and 1936 annual reports filed by McKesson & Robbins, Incorporated, but was found guilty of the count charging violation of Sections 13 and 32 of the Securities Exchange Act of 1934 in connection with the filing of the 1937 annual report, the last prior to the disclosure of the fraud. The sentences imposed by Judge Grover M. Moscowitz at the conclusion of the trial on May 22, 1940, were as follows: George Dietrich, two years and six months; George Bernard, three years; Robert Dietrich, one year and six months; Benjamin Simon, three years; and John Jenkins, one year and one day; all on one count of the indictment, sentences on other counts being suspended with periods of probation imposed to start after imprisonment. John H. McGloon was sentenced to one year and one day and was fined $5,000. Sentence as to Leonard Jenkins was suspended and he was placed on immediate probation. An appeal by McGloon is now pending.

Other Accounting Cases.

During the year, the Commission's staff has completed an examination of the books and accounts of Transamerica! Corporation, referred to in the Commission's Fifth Annual Report. Based upon data disclosed by this examination, an amended order has been issued enlarging the scope of the matters to be considered and directing that the hearings in this case be resumed.

In its opinion in ***In the Matter of Missouri Pacific Railroad Company***, a proceeding pursuant to Section 19 (a) (2) of the Securities Exchange Act of 1934, and in its report in ***In the Matter of Allegheny Corporation***, a procedure pursuant to Section 21 (a) of the same Act, the Commission severely criticized the accounting practices followed by those companies. In the Missouri Pacific case, the Commission held that the registrant's financial statements for the years 1934, 1935, and 1936 did not comply with the Commission's requirements in that they failed to disclose a liability of more than $12,000,000 arising out of certain contracts previously entered into with Terminal Shares, Inc. In the Allegheny Corporation case, the Commission held that the registrant's financial statements for the years 1934 to 1937, inclusive, were not in accordance with sound and generally accepted accounting principles in that in prior years bond discount and expense, and losses on sale of investments were charged directly to paid in surplus thereby overstating accumulated earned surplus in the succeeding years mentioned above, and in that no provision was made for a loss of more than $29,000,000 arising out of an agreement with the Chesapeake and Ohio Railway Company which provided for a sale or a contract to sell certain investments to the latter company. Amendments were filed by both of these registrants correcting the points mentioned.

During the fiscal year, 10 stop order opinions (in addition to three stop orders issued without opinion) under Section 8 (d) of the Securities Act of 1933 and 1 opinion on an application to withdraw a registration statement under stop order proceedings, were issued by the Commission. In all of these cases the financial statements of the registrants were held to be materially false and misleading. In 5 of them the accountants' certificates were criticized and in one instance the audit on which the accountants based their certificates was found not to measure up to the type of audit to which stockholders are entitled. The Commission's criticisms of the certifying accountants in the above-mentioned cases were brought to the attention of the American Institute of Accountants' Committee on Professional Ethics and the appropriate State authorities for disciplinary action.

Simplification of Accounting Requirements.

Accounting research work completed during the past year has resulted in the publication of seven accounting series releases. These deal with the inclusion and exclusion in consolidation of foreign subsidiaries of domestic corporations, the adoption of Regulation S-X, the form of accountants' certificate to be used

under special circumstances, problems arising out of quasi-reorganizations, and the natural business year.

As part of its program of seeking simplification of its accounting requirements, previously referred to in the Commission's Third and Fourth Annual Reports, the Commission about 3 years ago determined to delete from the various instruction books the requirements as to the form and content of financial statements and the several positive accounting rules that had been adopted. This determination rested on the known facts that the language of the several forms was not identical, due to the incorporation of improvements in the later forms and the difficulty of an amendment policy that necessitated change in all of the forms whenever an improvement or change in any one was made. In lieu of these many sets of instructions, it was determined to have a single pamphlet containing the accounting rules and the requirements as to the form, content, and detail of financial statements and schedules filed under the Securities Act of 1933 and the Securities Exchange Act of 1934. This would be applicable to nearly all statements filed under these two Acts, and would eliminate the possibility of inadvertent differences and inconsistencies between forms. Instructions as to the persons and periods for which statements mast be filed will continue to be found in the several forms. Upon adoption February 21, 1940, this pamphlet was designated "Regulation S-X" and was made applicable to all forms for applications for registration and annual reports under the Securities Exchange Act of 1934 except those for railroads and foreign issuers and to Form A-2 under the Securities Act of 1933. It is intended that Regulation S-X shall be extended to other forms under the Securities Act of 1933 as soon as such forms can be adapted to its use. Where special financial requirements are necessary, as in the case of outright promotional companies, fixed investment trusts, or oil and gas interests, these will constitute to appear in the individual forms.

Regulation S-X is the result of a comprehensive study of the experience gained under the financial requirements in use since 1935. First, the original provisions of Form A-2 and Form 10, the improvements that had been effected in later forms, and the opinions expressed in accounting series releases were integrated in a draft of a single set of instructions. Registration statements, deficiency memoranda, letters, and conference memoranda were reviewed for the purpose of ascertaining how particular provisions had worked out in practice, whether old provisions should be changed or deleted, or new provisions should be added. On the basis of this review, the first draft was thoroughly revised and submitted to several hundred individuals and professional groups outside the Commission, including among others, registrants, public accountants, controllers, attorneys, and State securities commissioners. The criticisms and suggestions received were carefully analyzed and considered in preparing a further revised draft. After consultation with public accountants and others, additional changes were made before the regulation was promulgated in its present form.

While Regulation S-X to some extent modified previous rules embodying the Commission's requirements as to accountants' certificates, the new requirements do not differ materially from the old. It is contemplated, however, that further modifications of the requirements as to accountants' certificates will be made upon completion of further study of auditing and auditing procedures.

Accounting Series Releases.

Accounting Series Release No. 13, published during the past fiscal year, deals with the form of the accountants' certificate in a particular case in which the registrant had not maintained cash books, journals, other books of original entry, or ledgers during the period covered by the financial statements filed by it with the Commission. The registrant's files, however, contained original underlying data such as cancelled checks, cheek stubs, bank statements, purchase orders, vendors' invoices, sales orders, and duplicate sales invoices. In order to prepare financial statements, it was deemed necessary by the independent accountants who certified the statements that the cash transactions and sales be recorded in books of original entry and in turn posted to a general ledger and that the books then be adjusted to an accrual basis. The entry and analysis of the transactions in formal books of account were carried out by one of the firm's junior accountants, loaned on a per diem basis, and by an officer of the company. The accountants maintained that this preliminary work consisted merely of classifying and summarizing records of transactions prepared by employees of the company at the time of the transaction. However, in many cases notations as to the purpose of disbursements had not been made on the cheek stubs contemporaneously with the transaction and accordingly it was necessary to rely in such cases upon the memory of an officer of the registrant in classifying the recorded disbursements. Upon the completion of this preliminary work, the certifying accountants found that satisfactory determination had not been made of the balances in certain of the registrant's asset, liability, and income and expense accounts. In the second or audit phase of the engagement, the accountants therefore deemed it necessary to undertake work of a special nature and in some instances to make original determination as to the amounts of such accounts.

Notwithstanding these unusual circumstances, the certificate furnished by the accountants to accompany the financial statements filed with the Commission, following a standard form, represented that the accountants' opinion was based upon a test-cheek audit and that the registrant had consistently maintained accepted principles of accounting during the period under review. In discussing this certificate, the Commission's accounting series release indicated that:

"* * * when a registrant during the period under review has not maintained records adequate for the purpose of preparing comprehensive and dependable financial statements, that fact should be disclosed. If, because of the absence or gross inadequacy of accounting records maintained by a registrant, it is necessary to have essential books of account prepared retroactively and for the accountant to enlarge the scope of the audit to the extent indicated in order to be able to express his opinion, these facts also should be disclosed, and * * * it is misleading, notwithstanding partial disclosure by footnotes as in the instant case, to furnish a certificate which implies that the accountant was satisfied to express an opinion based on a test-check audit. Moreover, it is misleading * * * to state or imply that accepted principles of accounting have been consistently followed by a registrant during the period under review if in fact during such period books of account were not maintained by a registrant or were grossly inadequate or if it has been necessary for the accountant to make pervasive and extraordinary adjustments of the character under consideration."

Many of the accounting problems confronting the Commission, particularly during the past year, have arisen in connection with what may be termed quasi- or accounting reorganizations. These problems have been discussed by the Commission in its opinions and by members of the staff in addresses before professional accounting organizations. In its opinion in ***In the Matter of Associated Gas and Electric Corporation***, a proceeding upon an order to show cause why an order should not be entered, pursuant to Section 12 (c) of the public Utility Holding Company Act of 1935, to prevent the declaration or payment of further dividends on its capital stock, the Commission discussing accounting reorganizations said: "An accounting reorganization permits a corporation to begin anew the accumulation of earned surplus. It, therefore, enables a company to pay dividends even though the total operations of the enterprise have resulted in an earned surplus deficit, such dividends ostensibly being paid out of earnings rather than contributed capital. It can be justified only if it accomplishes with respect to the accounts substantially what might be accomplished in a reorganization by legal proceedings -- namely the restatement of assets in terms of present conditions, corresponding modification of capital and capital surplus, and commencement of a new earned surplus account as of the date of the reorganization. In short, the enterprise must be put on substantially the same accounting basis as a new enterprise. And because the primary excuse for the device is that it accomplishes expeditiously what might otherwise have to be accomplished by legal proceedings, clear disclosure of the transactions should be made, and appropriate consents should be secured."

In this case the Commission rejected the proposition that an adjustment of assets is not a necessary element of an accounting reorganization and held that if the continuity of the surplus accounts is interrupted by an accounting reorganization,

that reorganization must be reasonably complete so as to obviate, so far as possible, the necessity of future reorganizations of like nature.

Accounting Series Release No. 15 requires that, following a quasi-reorganization, until such time as the results of operations of the company on the new basis are available for an appropriate period of years (at least three) any statement or showing of earned surplus, in order to provide additional disclosure of the occurrence and the significance of time quasi-reorganization, should indicate the total amount of the deficit and any charges that were made to capital surplus in the course of the quasi-reorganization which would otherwise have been required to be made against income or earned surplus. Formal consent of stockholders is an essential step in effecting a quasi-reorganization. When a company charges a deficit to capital surplus pursuant to a resolution of the board of directors, but without approval of the stockholders, such action being permissible under applicable State law, Accounting Series Release No. 16 requires a complete disclosure of all the attendant facts and circumstances and their effect on the company's financial position in each balance sheet and surplus statement filed with the Commission thereafter. In situations of this nature, it has been the administrative policy of the Commission to require as an additional disclosure that in the registration statement or other filing containing financial statements first reflecting such action by the directors there be included an explanation of the action taken and an indication of its possible effect on the character of future dividends.

While the Commission's formal opinions, rules, regulations, and accounting series releases have been influential in lifting the level of accounting standards, it is believed that even greater benefits have been derived from the Commission's day-to-day activities with respect to accounting matters under the securities Acts. Those cases in which accounting practices are clearly unsound are generally settled or corrected in conference between the staff and the registrant, its counsel, and accountants. For every formal opinion involving an accounting point there have been a score of cases in which accounting problems were adjusted in conference. Moreover, presentation in such conferences of what may be termed the most preferable method frequently leads to its adoption in lien of a method which, while recognized as acceptable, is generally considered not to be the most preferable.

Cooperation with Professional Organizations.

The development of uniform standards and practice in major accounting questions is a common objective of the Commission and the accounting profession. In many phases of its work the Commission's efforts have been directed toward this end. Representative bodies of the profession also have been active in seeking the advancement of accounting. In addition to their annual

meetings, various State societies of certified public accountants held regional conferences, and participated in accounting “institutes” or “clinics” held under the auspices of a number of prominent universities. These conferences and “institutes” or “clinics,” as well as the annual meetings of the American Institute of Accountants, the American Accounting Association, the Controllers Institute of America, and various other organizations were devoted principally to the discussion of technical accounting and auditing questions in which practitioners and teachers of accounting and representatives of government and business participated. Collections of papers read at some of these meetings and two monographs recently published by the American Accounting Association represent an important addition to writings on accounting. In May 1939, a report entitled “Extensions of Auditing Procedure” submitted by the Special Committee on Auditing Procedure of the American Institute of Accountants was adopted by the Council of the Institute and published. This report was modified and adopted at the Institute’s annual meeting, September 19, 1939. The Institute’s Committee on Auditing Procedure recently expressed its intention to proceed with revision of the bulletin, “Examination of Financial Statements by Independent Public Accountants.” In addition to their individual efforts the Commission and the profession in many ways have actively cooperated. The nature and extent of such cooperation is evidenced by the “Report of the American Institute of Accountants’ Special Committee on Cooperation with the Securities and Exchange Commission” which is reproduced herein as Appendix XI.

CONFIDENTIAL TREATMENT OF APPLICATIONS, REPORTS, OR DOCUMENTS

In three of the Acts which the Commission administers, namely, the Securities Act of 1933, the Securities Exchange Act of 1934, and the Public Utility Holding Company Act of 1935, provisions are made for persons to object to the public disclosure of information contained in reports which they are required to file. [Footnote: The Investment Company Act of 1940 and the Investment Advisors Act of 1940, approved by the President on August 22, 1940, contain similar provisions.] In the Securities Act of 1933 this provision is restricted to material contracts or portions thereof and the Commission is empowered to hold confidential any portion of such contracts if it determines that disclosure would impair the value of the contracts and would not be necessary for the protection of investors. In general, the provisions of the Securities Exchange Act of 1934 and the Public Utility Holding Company Act of 1935 are similar and empower the Commission to hold confidential under certain conditions any information contained in any reports required to be filed under those Acts.

At the beginning of the past fiscal year there were pending in the several United States Circuit Courts of Appeals or in the United States Court of Appeals for the

District of Columbia six petitions filed by issuers seeking to review determinations by the Commission denying applications for confidential treatment filed pursuant to Section 24 (h) of the Securities Exchange Act of 1934. During the year, five of these petitions were dismissed by stipulation and the material involved was made available for public inspection. In the remaining case, the action of the Commission in denying confidential treatment of information respecting the gross sales and cost of goods sold of American Sumatra Tobacco Corporation, contained in that company's profit and loss statements for the fiscal years ended July 31, 1935 to 1937, inclusive, was affirmed by the United States Court of Appeals for the District of Columbia in a decision handed down on January 2, 1940. [Footnote: 110 F. (2d) 117 (App. D. C. 1940).] American Sumatra Tobacco Corporation did not within the time allowed petition for a writ of ***certiorari***, and the information confidentially filed was made available for public inspection. No new petitions for judicial review of the Commission's determinations in cases of this character were filed during the fiscal year.

STUDY OF INVESTMENT TRUSTS AND INVESTMENT COMPANIES

During the past fiscal year, the Commission practically completed transmitting to the Congress the results of its study of investment trusts and investment companies conducted pursuant to Section 30 of the Public Utility Holding Company Act of 1935. This study and the preparation of the reports have been under the general supervision of Commissioner Robert E. Healy. The current functions of the study have been under the direct supervision of David Schenker.

The Commission completed the submission to the Congress of all of its supplemental reports and the reports so submitted during the past year, together with the dates of submission, consisted of the following:

Investment Counsel, Investment Management, Investment Supervisory, and Investment Advisory Services -- August 17, 1939.

Commingled or Common Trust Funds Administered by Banks and Trust Companies -- August 30, 1939.

Companies Sponsoring Installment Investment Plans -- September 22, 1939.

Fixed and Semifixed Investment Trusts -- January 15, 1940.

Companies Issuing Face Amount Installment Certificates -- March 13, 1940.

With the exception of the final Chapter (Chapter VII, treating with the management of assets of investment trusts, the Commission also completed and

transmitted to the Congress all of the remaining Chapters of Part Three of its over-all report, which relates to the abuses and deficiencies in the organization and operation of investment trusts and investment companies. The Chapters of Part Three completed and transmitted to the Congress during the past fiscal year are Section XI of Chapter II, which sets forth in detail the history of the Eastern Utilities Investing Corporation, submitted on August 10, 1939; Chapter III, which treats with the problems in connection with the distribution and repurchase of shares of open-end and closed-end management investment companies, submitted on October 12, 1939; Chapter IV, which relates to problems in connection with shifts in control, consolidations and mergers of management investment companies, submitted on November 20, 1939; Chapter V, which deals with problems in connection with the capital structures of investment trusts and investment companies, submitted on January 5, 1940; and Chapter VI, which is concerned with accounting practices and reports to stockholders of investment companies, submitted on February 12, 1940. Chapter VI is subdivided into three sections -- section 1 treats with the accounting practices of investment companies in general and sections 2 and 3 deal with the accounting practices of the United Founders Corporation Group of companies and contain in addition a study of the activities of these companies.

Part Four of the over-all report, the final part of the study, which deals with the economic significance of investment companies, is practically completed and will be submitted to the Congress during the coming fiscal year.

The basic recommendations contained in the various parts of the report described above were embodied in a bill (S. 3580; H. R. 8935) which was sponsored by Senator Robert F. Wagner in the Senate and Representative Clarence F. Lea in the House. A subcommittee of the Senate Committee on Banking and Currency held hearings on this bill extending over a period of approximately four weeks. At these hearings, while the immediate need for national legislation regulating investment companies was conceded by virtually every witness that testified representing the investment company industry, objections were made to some of the provisions of the bill. Many of the representatives of the industry joined in submitting to the subcommittee at the close of the hearings concrete proposals to regulate investment trusts and investment companies. Almost immediately after the conclusion of the hearings, representatives of the investment companies and of the Securities and Exchange Commission advised the chairman of the subcommittee that they believed it might be possible for them to reach a common ground in an agreement on the scope and provisions of the bill. The Chairman encouraged them in this endeavor and as a result of their cooperative efforts a substitute bill (S. 4108) was drafted and submitted to the Senate on June 6, 1940. On June 12, 1940, Congressman William P. Cole introduced the substitute bill (H. R. 10065) in the House.

[Footnote: On August 22, 1940, the Investment Company Act of 1940 and the Investment Advisors Act of 1940 were approved by the President.]

STUDY CONDUCTED FOR THE TEMPORARY NATIONAL ECONOMIC COMMITTEE

Insurance.

During the past fiscal year the Commission completed the study of life insurance which it conducted for the Temporary National Economic Committee pursuant to Public Resolution No. 113 of the 75th Congress.

Public hearings based upon information assembled through field investigation and questionnaire returns were held intermittently from August 1939 until March 1940. During the mouths of August and September, testimony was taken before a special subcommittee of the Temporary National Economic Committee on the subject of industrial insurance, a form of life insurance sold primarily to low-income families. This testimony included a historical and statistical summary of the industrial insurance business and a review of the activities of many principal companies operating in the field. Among other matters considered were the cost of industrial insurance, the methods by which it is sold, the various types of policies offered, and the resulting distribution of insurance among policyholders. To supplement these hearings the Commission undertook, in cooperation with the Work Projects Administration, a survey of the insurance holdings of certain low-income families residing in the greater Boston area. Detailed schedules were completed by WPA enumerators for over 2,000 families and in this manner information was obtained for the first time concerning family holdings of industrial insurance, the amount of income being spent for various types of insurance, and the relation between types of coverage and economic status.

Public hearings were also held before the committee with respect to the activities of officers and directors for personal gain and reinsurance and rewriting activities of promoters. In this connection, the history of the several companies which failed during recent years and the various factors which led to these failures were explored in detail. Testimony was also taken on the subject of sales and agency practices.

In February and March of 1940 the final insurance hearings, dealing with the operating results and investments of the 26 largest local reserve life insurance companies, were held. These hearings dealt primarily with the activities of the companies during the period from 1929 to 1938 and their experience with various lines of business including annuities and disability insurance. Funds available for investment and investments made were analyzed as were the assets and

liabilities of the companies. Detailed studies of various types of investments such as policy loans, collateral loans, bonds and stocks, farm and urban mortgages, and real estate were made and the company policies in calculating reserves and surplus were considered in detail. Net cost studies for principal types of policies at representative ages were presented as part of this general study. To provide the basis for these hearings on operating results and investments, comparative statistics, based upon replies to two investment questionnaires, were prepared by the Commission's staff.

During the entire period of investigation from November 14, 1938, to February 10, 1940, the Commission's field representatives examined approximately 30 life insurance companies located in the east and middle west sections of the country.

The staff of the Commission has completed two reports. One entitled "Families and Their Life Insurance," to be printed as Monograph No. 2 of the Temporary National Economic Committee, covers the results of the special survey made in cooperation with the Work Projects Administration. The other, to be printed as Monograph No. 28, is an overall report on the insurance study based upon public hearings and information obtained through questionnaires or other reliable sources. As of June 30, 1940, those reports had not been released by the Temporary National Economic Committee.

Testimony on the subject of life insurance taken before the Temporary National Economic Committee has been printed and may be purchased at nominal cost from the Superintendent of Documents, Washington, D. C. This testimony is contained in Parts 4, 10, 10-A, 12, 13, and 28 of the Hearings before the Temporary National Economic Committee, Congress of the United States, Seventy-sixth Congress, third session, pursuant to Public Resolution. No. 113 (Seventy-fifth Congress).

Investment Banking.

Certain aspects of investment banking were also presented in public hearings before the Temporary National Economic Committee in December 1939, and January 1940. The scope of the testimony was restricted to the following fields of inquiry (1) the manner in which the investment banking processes have been adjusted to conform with the provisions of the Banking Act of 1933; (2) the extent to which concentration exists in the industry; and (3) the manner in which business is negotiated between underwriters and issuers and among underwriters.

Testimony relating to the foregoing subjects was presented by witnesses representing the principal investment, banking house, several corporations, and the Commission. This testimony appears in Volumes 22, 23, and 24 of

“Investigation of Concentration of Economic Power,” Hearings Before the Temporary National Economic Committee.

A report on the problems incident to financing small business enterprises prepared at the direction of the committee was submitted by the Commission on June 10, 1940. The report embodies a survey of the following regions which represent a wide variety of economic conditions Fail River, Massachusetts; Scranton-Wilkes Barre, Pennsylvania Detroit, Michigan; Omaha, Nebraska; Birmingham, Alabama; Dallas-Houston, Texas; Denver, Colorado; Seattle, Washington; and Portland, Oregon. In addition to these field studies, the report includes a statistical analysis of the available data on the problems of the smaller business enterprises. This report is contained in Monograph No. 17, “Some Problems of Small Business,” published by the Temporary National Economic Committee.

REPORTS OF OFFICERS, DIRECTORS, AND PRINCIPAL STOCKHOLDERS

General Purpose and Scope of Reporting Requirements.

In order to make available information as to the amount of securities owned by persons closely identified with the management or control of enterprises, and changes occurring in their holdings, every person who is an officer, director, or principal stockholder (i. e., a person who beneficially owns, directly or indirectly, more than 10 percent of any class of registered equity security) of an issuer having any class of equity security listed and registered on any national securities exchange is required, under Section 16 (a) of the Securities Exchange Act of 1934, to file with the Commission and the exchange an initial report showing the amount of every class of equity security of the issuer which he owns beneficially, directly or indirectly, and a report for each month thereafter in which any purchase, sale, or other change in such ownership occurs. Under the corresponding provisions of Section 17 (a) of the Public Utility Holding Company Act of 1935, every officer or director of a registered holding company must file with the Commission reports disclosing his direct and indirect beneficial ownership of all securities of the registered holding company and its subsidiary companies, as well as all changes occurring therein.

Volume of Reports.

The following tabulation discloses the number of reports flied in accordance with these requirements and examined by the Commission during each of the past two fiscal years, and indicates that comparatively little change occurred in the volume thereof during the last year.

Reports of officers, directors, and principal stockholders filed and examined

Original reports -- Securities Exchange Act: 16,075 in FY1939; 16,305 in FY1940

Amended reports -- Securities Exchange Act: 2,248; 2,037

Original reports -- Holding Company Act: 867; 786

Amended reports -- Holding Company Act: 176; 117

Of the 16,305 original reports filed last year under the Securities Exchange Act of 1934, 14,215 were monthly reports on Form 4 reflecting purchases and sales and other current changes occurring in the amount of equity securities beneficially owned; 392 were initial reports of such stockholdings required to be filed on Form 5, where the issuer for the first time secured registration of any equity security on a national securities exchange; and 1,698 were initial reports of such holdings required to be filed on Form 6 by each additional person who became an officer, director, or principal stockholder.

In connection with the initial reports filed on Forms 5 and 6, it might be pointed out that a majority of the 2,090 persons who thus commenced reporting during the past year did so without the necessity for any action by the Commission. However, it was necessary to call the reporting requirements to the attention of 716 of these persons, before obtaining their necessary reports. Information as to the identity of persons who fail to comply with the requirements of the statute in filing reports is obtained by the Commission from a wide variety of sources; such as, for example, applications for registration of securities, annual reports, current reports, and proxy statements filed by issuers pursuant to the Securities Exchange Act of 1934; registration statements filed by issuers under the Securities Act of 1933; notifications of registration and annual supplements filed by registered holding companies under the Public Utility Holding Company Act of 1935; letters received from issuers; and the current releases of certain commercial daily, weekly, and quarterly financial news services.

At the close of the past fiscal year, the security ownership reporting requirements of Section 16 (a) had been operative for more than 5 years, and those of Section 17 (a) for more than 4 years, during which time an aggregate of nearly 150,000 original and amended reports were filed by more than 29,000 persons. Notwithstanding the large number of reports and persons involved, there has been practically no necessity for any formal action by the Commission in order to secure the filing of these reports.

Examination Procedure.

Where an original report discloses upon examination any material incompleteness, inconsistency or inaccuracy, a letter is sent to the person reporting, calling attention to the deficiency and an amended report is obtained. The amended report is subjected in turn to the same examination procedure as the original report. There are, of course, a number of cases in which it appears that the deficiency in the report is essentially immaterial and that the purposes of the statute would not be served by insisting upon the filing of an amended report. It is the practice in these cases merely to inform the reporting officer, director, or principal stockholder of the nature of the deficiency in the currently filed report and request his cooperation in the proper preparation of any additional report which may be required of him in the future. In addition to the large number of letters calling attention to deficiencies appearing in reports, numerous letters were written to officers, directors, and principal stockholders, and conferences were held with them and their representatives, in order to assist them in complying with the reporting requirements of the statute.

Publication of Security Ownership Reports.

Reports made by officers, directors, and principal stockholders on Forms 4, 5, and 6, and by officers and directors on Forms U-17-1 and U-17-2, are available for public inspection at the offices of the Commission in Washington, D. C., and reports on Forms 4, 5, and 6 may also be inspected at the particular exchange with which an additional copy of each report relating to the issuer concerned must be filed. In order to make the information contained in these reports more readily available to the public, the Commission compiles and publishes such information in a semimonthly Official Summary of Security Transactions and Holdings which is widely distributed among individual investors, newspaper correspondents, and other interested persons. Copies of these summaries are also available at each regional office of the Commission and each national securities exchange.

REGIONAL OFFICES

Approximately one-third of the Commission’s entire personnel is stationed in its 14 regional and subregional offices. The regional offices of the Commission are located at Boston, New York City, Atlanta, Cleveland, Chicago, Fort Worth, Denver, San Francisco, and Seattle. The Cleveland office has a permanent suboffice in Detroit; Chicago has permanent suboffices in Minneapolis and St. Louis; San Francisco has a permanent suboffice in Los Angeles; and the Oil and Gas Unit of the Registration Division has a permanent suboffice in Tulsa. These offices have since their inception been the first line of enforcement of the various laws administered by the Commission. Nearly all the investigations of stock frauds and violations of the provisions of the Securities Exchange Act of 1934 as

to brokers, dealers, and market manipulations have been conducted in the first instance from the field offices of the Commission. In 1939 the activities of these offices were enlarged so that first-line analysis and legal work in connection with the Commission's functions under Chapter X of the newly revised Bankruptcy Act could be carried on from the field.

The past fiscal year saw the initiation of an experiment to broaden further the role of the regional offices in the administration of the Commission's functions. On June 12, 1940, the Commission announced the establishment in the San Francisco Regional Office of an experimental unit to assist prospective issuers of securities and to advise them and their representatives on any problems arising in connection with their registration statements under the Securities Act of 1933.

Both an attorney and a financial examiner with long experience in the Registration Division of the Commission were assigned to the San Francisco office. These experts were instructed to confer with and assist prospective registrants in the preparation of registration statements before formal filing. After the statement had been filed in Washington, they were instructed and equipped to answer any questions which might arise in connection with the progress of the registration. A registrant could, if he wished, leave a copy of his statement in the San Francisco office for conference purposes. The Registration Division in Washington was instructed to forward to the San Francisco office a copy of all correspondence with the registrant, together with a copy of any staff memoranda on the statement, and the registrant was told by Washington that the San Francisco office would be equipped to answer any questions which this correspondence might create.

It was announced by the Commission that if this experiment appeared to be successful after a reasonable period of time, the same facilities for assistance to registrants would be extended to the other regional offices. [Footnote: On November 1, 1940, the Commission voted that in view of the success of this experiment in San Francisco, similar facilities will be provided in the other regional offices by January 1, 1941. It further voted that, for the first time, it will undertake an experiment in complete registration in the field offices. It will set up complete registration units in the San Francisco and Cleveland Regional Offices. This means that registrants having either their principal places of business or that of their principal underwriters in either of these regions will be able to file their registration statements in the field office and have them examined there. Only in exceptional cases will it be necessary for the registrant to have direct contact with Washington, although, of course, the Registration Division and the Commission will closely scrutinize all the actions of the regional office and the regional office will have to obtain the usual formal Commission action for the acceleration of the effective date. The registrant will be given the option of availing himself of these experimental facilities in the two regional offices or of

continuing to have his registration statements handled in Washington. In this event, facilities for pre-registration assistance and consultation on questions raised by Washington by the examination of the statement will be available in these two offices as well as in other regional offices. This complete registration experiment will continue until October 1, 1941, at which time it will be reviewed to determine whether or not it should be expanded to the other offices or abandoned.]

This development of the facilities of the regional offices was an outgrowth of the desire of the Commission to recognize the problems of distance which faced many of those having Commission problems. Originally set up largely as policing units, the regional offices have been increasingly called upon to aid members of the public in questions of interpretation of the various statutes and the rules and regulations under the statutes. To meet this demand, the Commission has stationed specially trained attorneys in each regional office and in some of the suboffices, who are qualified to answer these questions from persons who would otherwise have to go or write to Washington. During the past year, the regional offices handled 16,799 of such inquiries, making either verbal or written answers. Needless to say, there is a close coordination between the regional offices and the Washington Office in such matters in order to assure that confusing and injurious differences of opinion will not develop. All written opinions and interpretations issuing from the regional offices are sent to the office of the General counsel in Washington for review and all new questions, where there is any uncertainty in the regional office, are raised with Washington before an answer is given.

The enforcement activities of the regional offices continued to be increasingly productive during the past year. Again, it should be borne in mind that the activities of these offices are at all times closely supervised by the appropriate authorities on the Washington staff. These offices conducted 996 formal and informal investigations into violations of the Securities Act of 1933 during the year. Many of these were found to be outright frauds and resulted in criminal proceedings being instituted by the Department of Justice on the basis of the evidence unearthed in the investigation. All these matters were reviewed by the Washington staff and approved by the Commission before any formal action was taken. Many of the cases were referred to the regional offices by the Washington staff, but a very large percentage of the total were first initiated in the regional office as a direct result of its closeness to developments in the particular area under its surveillance.

Another important activity carried on through the medium of the regional office is the investigation of the activities of brokers and dealers and the inspection of their accounts as required under the Securities Exchange Act of 1934. The latter activity is particularly important inasmuch as it provides a check upon the

solvency of the broker or dealer and a protection against the diversion or misappropriation of the cash and securities of customers. To make these checks, the Trading and Exchange Division has assigned crews of inspectors to most of the regional offices. These inspectors make unannounced visits of inspection at the offices of the various dealers and brokers in the several regions. Very often the inspectors find that they can be of real service to the brokers and dealers in advising them, where no irregularity is found, in setting up their books and records in such a way as to run their businesses in a manner to comply with law and regulations. During the past year the regional offices made 560 such investigations in connection with the enforcement of the provisions of the Securities Exchange Act of 1934, furthermore, the regional offices have, during the past year, made 193 investigations or flying quizzes into situations where it appeared that there may have been a manipulation of the price or volume of a particular security.

As has already been stated, the activities of the Commission under Chapter X of the new Bankruptcy Act were largely regionalized almost from the outset. A substantial portion of the reorganization staff of the Commission is assigned to the various regional offices. From these offices analysts, accountants, and attorneys execute the Commission's role in these proceedings, including the drafting of reports on plans of reorganization and making the necessary court appearances Here again, of course, the work of the men in the field is closely reviewed by the Reorganization Division in Washington and by the Commission itself. During the past fiscal year, the regional offices of the Commission have worked on 758 reorganization matters, including both those in which the Commission ultimately became a party and those in which, while carefully studied, formal Commission participation was not found necessary under the statute.

PUBLIC HEARINGS

The following statistics indicate the number of public hearings held by the Commission from July 1, 1935, to June 30, 1940.

Securities Act of 1933: 339
Securities Exchange Act of 1934: 507
Public Utility Holding Company Act of 1935: 1,018
Trust Indenture Act of 1939: 3
Total: 1,867

FORMAL OPINIONS AND REPORTS

The Commission, during the past year, issued 292 formal opinions involving matters under the Securities Act of 1933, the Securities Exchange Act of 1934, the Public Utility Holding Company Act of 1935, and the Trust Indenture Act of 1939. In addition, the Commission adopted 5 formal reports on plans of reorganization under the provisions of Section 11 of the Public Utility Holding Company Act of 1935 and 12 advisory reports on plans of reorganization under the provisions of Chapter X of the amended Bankruptcy Act. The Commission also published a report of an investigation under Section 21 (a) of the Securities Exchange Act of 1934.

PUBLIC INSPECTION OF REGISTERED INFORMATION

Under the provisions of the several Acts administered by the Commission, certain information filed with the Commission is made available to the public under such regulations and reasonable limitations and at such reasonable charge as the Commission may prescribe Accordingly, there are available for inspection in the Public Reference Room of the Commission at Washington, D. C., copies of all public information contained in registration statements, applications, reports, declarations, and other public documents on file with the Commission. In addition to the thousands of letters and telephone calls received during the past fiscal year from members of the public requesting registered information, more than 6,500 members of the public visited this Public Reference Room during this period seeking such information. Also, through the facilities provided by the Commission for the sale of public registered information, more titan 4,000 orders for photocopies of material, involving 246,090 pages, were filled during the year.

In order to make public information further available for inspection, the Commission has, insofar as practicable, made registered information filed with it available to the public in its regional offices. Thus, in the Public Reference Room which is maintained in the Commission’s New York Regional Office at 120 Broadway, facilities are provided for the inspection of copies of (1) such applications for permanent registration of securities on all national securities exchanges, except the New York Stock Exchange and the New York Curb Exchange, as have received final examination in the Commission, together with copies of supplemental reports and amendments thereto, (2) annual reports filed pursuant to the provisions of Section 15 (d) of the Securities Exchange Act of 1934, as amended, by issuers that have securities registered under the Securities Act of 1933, as amended, and (3) prospectuses filed under rules exempting small issues of securities from the registration requirements of the Securities Act of 1933, as amended. The fact that during the past fiscal year more than 13,600 members of the public visited the Public Reference Room of the New York Regional Office seeking registered public information, forms,

releases, and other material indicates a continued demand for such information in this zone.

Likewise, in the Public Reference Room of the Chicago Regional Office, which is located at 105 West Adams Street, there are available for public inspection copies of applications for permanent registration of securities on the New York Stock Exchange and the New York Curb Exchange, which have received final examination in the Commission, together with copies of all supplemental reports and amendments thereto. During the fiscal year ended June 30, 1940, more than 3,860 members of the public utilized the facilities provided in this office by requesting registered information, forms, releases, and other material.

In addition, there are available for inspection in each of the Commission's regional offices copies of prospectuses used in public offerings of securities effectively registered under the Securities Act of 1933, 115 amended. Also, duplicate copies of applications for registration of brokers or dealers transacting business on over-the-counter markets, together with supplemental statements thereto, filed with the Commission under the Securities Exchange Act of 1934, are available for public inspection in each regional office having jurisdiction over the zone in which the principal office of the broker or dealer is located.

Duplicate copies of all applications for permanent registration of securities on national securities exchanges are available for public inspection at the respective exchange upon which the securities are registered.

Photocopies of registered public information may be procured from the offices of the Commission in Washington, D. C., only.

PUBLICATIONS

Releases.

The Commission informs the public of its activities through informational releases. These are made available currently to the press and are mailed free upon request to any person. Mailing lists are maintained for the benefit of those who wish to keep advised of the day-to-day activities of the Commission.

Releases include announcements of rules, findings and opinions, orders, registrations, annual reports, utility company applications and declarations, public hearing notices, stock-trading reports, etc.

Among those on the Commission's mailing lists, in addition to members of the public, are banks, insurance companies, brokerage firms, security dealers,

investment and financial services, statistical organizations, stock exchanges, corporations, law, accounting and engineering firms, universities, and libraries.

Included in the releases issued during the fiscal year ended June 30, 1940, were 281 releases relating to the Commission's activities under the Securities Act of 1933; 404 releases dealing with activities under the Securities Exchange Act of 1934; and 525 releases concerning matters under the Public Utility Holding Company Act of 1935. There were 2 releases under the Trust Indenture Act of 1939 (became effective February 4, 1940), and 14 releases concerning the duties of the Commission under Chapter X of the Bankruptcy Act.

In addition to continuing the daily publication of the figures showing odd-lot trading on the New York Stock Exchange, the Commission has continued its "Registration Record." The daily registration record presents a brief description of data filed with the Commission under the Securities Act of 1933 and the Trust Indenture Act of 1939 and contains such matters as thumb-nail sketches of registration statements, applications for qualification of indentures amendments thereto, effective dates, and certain information with respect to formal proceedings instituted by the Commission pursuant to these Acts. This publication is sent gratis upon request and about 4,000 persons have had their names placed on the mailing list to receive it currently as released. A classification of the releases issued by the Commission during the past fiscal year follows:

Opinions and orders -- 553

Filing of registration statements, applications, and other public documents -- 433

Reports on court actions -- 175

Statistical data -- 161

Rules, regulations, and interpretations -- 36

Investment Trust Study -- 9

Personnel changes -- 8

Accounting opinions -- 7

Miscellaneous -- 68

Other Publications

Other publications issued by the Commission during the year included the following:

Report to the Congress on the Study of Investment Trusts and Investment Companies:

Part Three -- Abuses and Deficiencies in the Organization and Operation of Investment Trusts and Investment Companies:

Chapter III -- Problems in connection with the Distribution and Repurchase of Shares of Open-end and Closed-end Management Investment Trusts and Investment Companies.

Chapter IV -- Problems in Connection with Shifts in Control, Mergers and Consolidations of Management Investment Companies.

Chapter V -- Problems in Connection with Capital Structure.

Chapter VI -- Accounting Practices and Reports to Stockholders Generally -- Accounting Practices of the United Founders Group of Companies with a Description of Their Activities.

Supplemental Reports:

Investment Counsel, Investment Management, Investment Supervisory and Investment Advisory Services.

Commingled or Common Trust Funds Administered by Banks and Trust Companies.

Companies Sponsoring Installment Investment Plans.

Fixed and Semifixed Investment Trusts.

Companies Issuing Face-Amount Installment Certificates.

Twenty-four semimonthly issues of the Official Summary of Stock Transactions and Holdings of Officers, Directors, and Principal Stockholders.

An alphabetical list of Over-the-Counter Brokers and Dealers registered with the Commission as of June 30, 1939, together with the supplements thereto.

List of Securities Traded on Exchanges under the Securities Exchange Act of 1934, as of June 30, 1939, and as of December 31, 1939, together with the supplements thereto.

Decisions and Reports of the Commission:

Volume 3, Part 2 -- July 1, 1935, to October 31, 1935.

Volume 4, Part 1 -- November 1, 1938, to January 31, 1939.

Volume 4, Part 2 -- February 1, 1939, to May 31, 1939.

Investigation in the Matter of McKesson & Robbins, Inc.: Testimony of Expert Witnesses.

PERSONNEL

At the close of the fiscal year ended June 30, 1940, the personnel of the Commission comprised 5 Commissioners and 1,665 employees. Of these 1,665 employees, 1,110 were men, and 555 were women.

Commissioners -- 5

Departmental:
Permanent -- 1,264
Temporary -- 40

Regional Offices:
Permanent -- 357
Temporary -- 4

Total -- 1,670
Subject to retirement act -- 974

FISCAL AFFAIRS

Appropriations for fiscal year 1940:

Salaries and expenses -- $5,40,000
Printing and binding -- $70,000
Total appropriated -- $5,470,000

Obligations for fiscal year 1940:

Salaries:
Departmental -- $3,313,019
Field -- $1,088,442

Expenses:
Mileage and witness fees -- $12,465
Supplies and material -- $223,618
Communications services -- $76,189
Travel expense -- $315,970
Transportation of things -- $5,694
Reporting hearings -- $43,333
Light and power -- $6,557
Rents -- $104,718
Repairs and alterations -- $11,496
Special and miscellaneous expenses -- $1,813
Purchase of equipment -- $175,931
Total obligations for salaries and expenses -- $5,379,245

Obligations for printing and binding -- $69,820

Grand total obligations -- $4,851,404

Unobligated balance -- $20,935

Appropriations -- $5,470,000

Part VII
APPENDIXES

APPENDIX I
RULES OF PRACTICE (as amended to December 1, 1940)

RULE I
BUSINESS HOURS -- REGIONAL OFFICES

The principal office of the Commission at Washington, D. C, is open on each business day, excepting Saturdays, from 9 a. m. to 4:30 p. m., and on Saturdays from 9 a. m. to 1 p. m. Regional offices are maintained at New York, Boston, Atlanta, Cleveland, Chicago, Fort Worth, Denver, San Francisco, and Seattle.

RULE II
APPEARANCE AND PRACTICE BEFORE THE COMMISSION

(a) An individual may appear in his own behalf, a member of a partnership may represent the partnership, a bona-fide officer of a corporation, trust, or association may represent the corporation, trust, or association, and an officer or employee of a state commission, or of a department or political subdivision of a state may represent the state commission or the department or political subdivision of the state, in any proceeding.

(b) A person may be represented in any proceeding by an attorney at law admitted to practice before the Supreme Court of the United States, or the highest court of any State or Territory of the United States, or the Court of Appeals or the District Court of the United States for the District of Colombia.

(c) A person shall not be represented at any hearing before the Commission or a trial examiner except as stated in paragraphs (a) and (b) of this rule.

(d) Any person appearing before or transacting business with the Commission in a representative capacity may be required to file a power of attorney with the Commission showing his authority to act in such capacity.

(e) The Commission may disqualify, and deny, temporarily or permanently, the privilege of appearing or practicing before it in any way, to any person who is found by the Commission after hearing in the matter

(1) Not to possess the requisite qualifications to represent others; or

(2) To be lacking in character or integrity or to have engaged in unethical or improper professional conduct.

(f) Contemptuous conduct at any hearing before the Commission or a trial examiner shall be ground for exclusion from said hearing and for summary suspension without a hearing for the duration of the hearing.

(g) For the purposes of this rule, practicing before the Commission shall include the preparation of any statement, opinion, or other paper by any attorney, accountant, engineer, or other expert, filed with the Commission in any

registration statement, application, report, or other document with the consent of such attorney, accountant, engineer, or other expert.

RULE III
NOTICE OF HEARINGS

(a) Whenever a hearing is ordered by the Commission in any proceeding, notice of such hearing shall be given by the Secretary or other duly designated officer of the Commission to the registrant, applicant, or other parties to the proceeding, or to the person designated as being authorized to receive notices issued by the Commission, such notice shall state the time, place, and subject matter of the hearing and, in proceedings instituted by the Commission, shall be accompanied, except as provided in paragraph (b) hereof, by a short and simple statement of the matters to be considered and determined. Such notice shall be given by personal service, registered mail, or confirmed telegraphic notice, a reasonable time in advance of the hearing.

(b) Whenever a hearing is ordered by the Commission in any proceeding pursuant to Section 8 of the Securities Act of 1933, as amended, notice of such hearing shall be given by the Secretary or other duly designated officer of the Commission to the person designated in the registration statement as being authorized to receive service and notice of orders and notices issued by the Commission relating to such registration statement. Such notice shall state the time and place of hearing and shall include a statement of the items in the registration statement by number or name which appear to be incomplete or inaccurate in any material respect, or to include any untrue statement of a material fact, or to omit a statement of any material fact required to be stated therein or necessary to make the statement therein not misleading. Such notice shall be given either by personal service or by confirmed telegraphic notice a reasonable time in advance of the hearing. The personal notice or the confirmation of telegraphic notice shall be accompanied by a short and simple statement of the matters and items specified to be considered and determined.

RULE IV
AMENDMENTS

(a) Whenever a hearing is ordered by the Commission in any proceeding pursuant to Sections of the Securities Act of 1933, as amended, and items in the registration statement which appear to be incomplete or inaccurate in any material respect, or to include any untrue statement of a material fact, or to omit a statement of any material fact required to be stated therein or necessary to make the statements therein not misleading, are not particularly specified in the

notice, such items shall be so specified by amendment to the notice prior to the taking of testimony in regard to such items. The trial examiner may grant or deny a motion for such amendment. Such motions shall be in writing, and may be filed with the trial examiner at any time prior to the termination of the hearing. On request of the registrant the trial examiner, alter granting such motion, shall grant a reasonable time within which the registrant may familiarize himself with such matters before taking testimony in regard to such items.

(b) In any other proceeding instituted by the Commission, amendment may be allowed to the order, rule to show cause or other moving papers, by the Commission on application to it, or by it upon its own motion.

(c) When issues not raised by the pleading of a party or the Commission's statement of matters to be considered and determined are tried by express or implied consent of the parties, they may be treated in all respects as if they had been raised in the pleadings.

RULE V
HEARINGS FOR THE PURPOSE OF TAKING EVIDENCE

(a) Hearings for the purpose of taking evidence shall be held as ordered by the Commission.

(b) All such hearings shall be held before the Commission, one or more of its members, or a duly designated officer, herein referred to as the trial examiner, and all such hearings, except hearings pursuant to the provisions of Clause 30 of Schedule A of the Securities Act of 1933, as amended, or Section 24 (b) of the Securities Exchange Act of 1934, as amended, or Section 22 (b) of the Public Utility Holding Company Act of 1935, shall be public unless otherwise ordered by the Commission.

(c) Hearings for the purpose of taking evidence shall be stenographically reported and a transcript thereof shall be made which shall be a part of the record of the proceeding. Transcripts of public hearings will be supplied by the official reporter at the prescribed rates. Transcripts of private hearings will be supplied at the prescribed rates to the parties.

(d) Objections to the admission or exclusion of evidence before the Commission or trial examiner shall be in short form, stating the grounds of objections relied, upon, and the transcript shall not include argument or debate thereon except as ordered by the Commission or the trial examiner. Exception to any such ruling must be noted before the trial examiner in order to be urged before the

Commission. Rulings by the Commission or trial examiner on such objections shall be a part of the transcript.

(e) In any proceeding the Commission or the trial examiner may call for the production of further evidence upon any issue, and, upon notice to all parties, may reopen any hearing at any time prior to the Commission's order disposing of such proceeding.

(f) Subpoenas requiring the attendance of witnesses from any place in the United States at any designated place of hearing may be issued by any member of the Commission or any officer designated by it for that purpose in connection with any hearing ordered by the Commission, upon written application therefor.

(g) Subpoenas for the production of documentary evidence will issue only upon application in writing, which must specify, as nearly as may be, the documents desired and the facts to be proved by them, in sufficient detail to indicate the materiality and relevance of the documents desired.

(h) Witnesses summoned before the Commission shall be paid the same fees and mileage that are paid to witnesses in the courts of the United States, and witnesses whose depositions are taken and the persons taking the same shall severally be entitled to the same fees as are paid for like services in the courts of the United States. Witness fees and mileage shall be paid by the party at whose instance the witnesses appear.

(i) In proceedings pursuant to the provisions of Clause 30 of Schedule A of the Securities Act of i933, as amended, or Section 24 (b) of the Securities Exchange Act of 1934, as amended, or Section 22 (b) of the Public Utility Holding Company Act of 1935, if a hearing for the purpose of taking testimony is requested, the Commission may in its discretion, prior to the hearing, require the registrant to furnish in writing additional information in respect of its grounds of objection. Failure to supply the information so requested within 15 days from the date of receipt by the registrant of a notice of the information required, shall be deemed a waiver of the objections to public disclosure of that portion of the information filed confidentially with respect to which the additional information required by the Commission relates, unless the Commission shall otherwise order for good cause shown at or before the expiration of such fifteen-day period.

RULE VI
MOTIONS

(a) Motions in any proceeding before a trial examiner which relate to the introduction or striking of evidence, or motions before a trial examiner in any

proceeding pursuant to Section 8 of the Securities Act of 1933, as amended, which relate to amendment of the notice of hearing to include additional items of the registration statement as provided in Rule IV (a), may be ruled on by the trial examiner. All other motions shall be ruled on by the Commission.

(b) Motions or similar pleadings calling for determination by the Commission shall be filed with the Secretary or other duly designated officer of the Commission in writing, provided that motions or similar pleadings calling for determination by the Commission but made in the course of a hearing, may be filed with the trial examiner in writing, who shall refer such motion to the Commission. Any such motion or similar pleading shall be accompanied by a written brief of the points and authorities relied upon in support of the same. Any party or counsel to the Commission may file a reply brief within 5 days after service upon him of such motion or other pleading as provided in Rule XIV, unless otherwise ordered by the Commission. Motions and similar pleadings will be considered on the briefs filed following the time for filing the reply brief, unless otherwise ordered by the Commission. No oral argument will be heard on such matters unless the Commission so directs.

RULE VII
EXTENSIONS OF TIME -- CONTINUANCES AND ADJOURNMENTS

Except as otherwise expressly provided by law, the Commission for cause shown may extend any time limits prescribed by these rules for filing any papers, and may continue or adjourn any hearing. A hearing before a trial examiner shall begin at the time and place ordered by the Commission, but thereafter may be successively adjourned to such time and place as may be ordered by the Commission or by the trial examiner.

RULE VIII
DEPOSITIONS

(a) The Commission may, for cause shown, order testimony to be taken by deposition.

(b) If any party or counsel to the Commission desires to take a deposition be shall make application in writing, setting forth the reasons why such deposition should be taken, the name and residence of the witness, the matters concerning which it is expected the witness will testify, and the time and place proposed for the taking of the deposition. Thereupon the Commission may, in its discretion, issue an order which will name the witness whose deposition is to be taken and specify the time when, the place where, and the designated officer before whom the witness is to testify. Such order shall be served upon all parties and counsel

to the Commission by the Secretary, or other duly designated officer of the Commission, a reasonable time in advance of the time fixed for taking testimony.

(c) Witnesses whose testimony is taken by deposition shall be sworn or shall affirm before any questions are put to them. Each question propounded shall be recorded and the answers shall be taken down in, the words of the witness.

(d) Objections to questions or evidence shall be in short form, stating the grounds of objection relied upon, but no transcript filed by the officer shall include argument or debate. Objections to questions or evidence shall be noted by the officer upon the deposition, but he shall not have power to decide on the competency or materiality or relevancy of evidence. Objections to questions or evidence not taken before the officer shall be deemed waived.

(e) The testimony shall be reduced to writing by the officer, or under his direction, after which the deposition shall be subscribed by the witness and certified in usual form by the officer. The original deposition and exhibits shall be forwarded under seal to the Secretary of the Commission with such number of copies as may be requested by the Secretary of the Commission. Upon receipt thereof the Secretary shall file the original in the proceedings and shall forward a copy to each party or his attorney of record and to counsel to the Commission.

(f) Such depositions shall conform to the specifications of Rule XV.

(g) Any part of a deposition not received in evidence at a hearing before the Commission or a trial examiner shall not constitute a part of the record in such proceeding, unless the parties and counsel to the Commission shall so agree, or the Commission so orders.

(h) Depositions may also be taken and submitted on written interrogatories in substantially the same manner as depositions taken by oral examination. The interrogatories shall be filed with the application in triplicate, and copies thereof shall be served on all other parties and counsel to the Commission by the Secretary or other duly designated officer of the Commission. Within 5 days any other party or counsel to the Commission may file with the Secretary his objections, if any, to such interrogatories, and may file such cross-interrogatories as he desires to submit. Cross-interrogatories shall be filed in triplicate, and copies shall be served on all other parties and counsel to the Commission, who shall have 3 days thereafter to file their objections, if any, to such cross-interrogatories. Objections to interrogatories or cross interrogatories shall be settled by the Commission or trial examiner. Objections to interrogatories shall be made before the order for taking the deposition issues and if not so made shall be deemed waived. When a deposition is taken upon written interrogatories and cross-interrogatories, neither any party nor counsel to the Commission shall be

present or represented, and no person other than the witness, a stenographic reporter, and the officer shall be present at the examination of the witness, which fact shall be certified by the officer, who shall propound the interrogatories and cross-interrogatories to the witness in their order and reduce the testimony to writing in the witness own words.

RULE IX
TRIAL EXAMINER'S REPORT

(a) Following any hearing before a trial examiner, except hearings in proceedings pursuant to the provisions of Clause 30 of Schedule A of the Securities Act of 1933, as amended, or Section 24 (b) of the Securities Exchange Act of 1934, as amended, or Section 22 (b) of the Public Utility Holding Company Act of 1935, the transcript of the testimony shall forthwith be filed with the Secretary of the Commission. Following any hearing before a trial examiner in the excepted cases, the transcript of the testimony shall forthwith be filed with the Chairman of the Commission.

(b) Following any hearing before a trial examiner other than (1) a hearing under the Public Utility Holding Company Act of 1935, or (2) a hearing on the question of postponement of the effective date of registration of a broker or dealer under Section 15 (b) of the Securities Exchange Act of 1934, as amended, pending final determination whether such registration shall be denied, or (3) a hearing pursuant to the provisions of Clause 30 of Schedule A of the Securities Act of 1933, as amended, or Section 24 (b) of the Securities Exchange Act of 1934, as amended, or (4) a hearing on the question of postponement of the effective date of registration of an investment adviser under Section 203 of the Investment Advisers Act of 1940 pending final determination whether such registration shall be denied, the trial examiner shall, within 10 days after service upon him by the Secretary or other duly designated officer of the Commission of a copy of the transcript of the testimony, file with the Secretary of the Commission his report containing his findings of fact.

(c) Such report shall be advisory only, and the findings of fact therein contained shall not be binding upon the Commission. The initial page of the report shall contain a statement to such effect. In any proceeding in which, under the provisions of Rule XIII (b) of the Rules of Practice of the Commission, the report is first to be made available to the public on the opening date of public argument on the merits before the Commission, or in the event of submission to the Commission without argument, upon final determination, of such proceeding, or pursuant to an order of the Commission, the initial page of the report shall also contain a statement to the effect that the report is confidential, shall not be made public and is for the use only of the Commission, the respondent or respondents

and counsel, but copies of the report issued after it is made available to the public may omit such statement.

(d) A copy of such report shall be forthwith served on each party and on counsel to the Commission by the Secretary or other duly designated officer of the Commission.

(e) Within 5 days after the receipt of a copy of the transcript of the testimony, if promptly at the conclusion of the hearing he has ordered a copy thereof, or if he has not ordered a copy, within 5 days after the filing of the transcript of the testimony with the duly designated officer of the Commission, any party or counsel to the Commission may submit to the presiding officer, or, in the case of a hearing before a trial examiner in respect of which no trial examiner's report is required to be submitted, to the officer designated in paragraph (a) of this Rule as the person with whom transcripts of testimony are to be filed, a statement in writing in terse outline setting forth such party's request for specific findings, which may be accompanied by a brief in support thereof. A copy of such request and brief in support thereof shall be served upon each party and upon counsel to the Commission as provided in Rule XIV in the case of a hearing before a trial examiner in respect of which no trial examiner's report is required to be submitted. A copy of such request and brief in support thereof shall be served upon each party and upon counsel to the Commission by the presiding officer in the case of a hearing in which a trial examiner's report is to be submitted in which event the trial examiner shall immediately certify the facts concerning such service, including the dates thereof to the Secretary of the Commission. In all cases where such requests and briefs in support thereof are served upon each party and upon counsel to the Commission by the trial examiner the provisions of Rule XIII (d) shall not be applicable. This paragraph shall not apply to any proceeding on the question of postponement of the effective date of registration of a broker or dealer under Section 15 (b) of the Securities Exchange Act of 1934, as amended, pending final determination whether such registration shall be denied, or to any proceeding on the question of postponement of the effective date of registration of an investment advisor under Section 203 of the Investment Advisors Act of 1940 pending final determination whether such registration shall be denied.

(f) All requests for specific findings filed pursuant to paragraph (e) of this rule shall be a part of the record.

RULE X
EXCEPTIONS

(a) Within 5 days after receipt of a copy of the trial examiner's report, any party or counsel to the Commission may file exceptions to the findings of the trial examiner or to his failure to make findings, or to the admission or exclusion of evidence. A copy of such exceptions shall be forthwith served on each party and on counsel to the Commission by the Secretary or other duly designated officer of the Commission. Exceptions shall be argued only at the final hearing on the merits before the Commission.

(b) Objections to the findings of the trial examiner or to his failure to make findings not saved by exception filed pursuant to this rule will be deemed to have been abandoned and may be disregarded. Objections to the admission or exclusion of evidence not saved by exception at the time of the hearing for the purpose of taking evidence and included in the exceptions filed pursuant to this rule will be deemed to have been abandoned and may be disregarded.

RULE XI
BRIEFS

(a) Any party to a proceeding or counsel to the Commission may file a brief in support of his contentions and exceptions within 15 days from the date of service on such party or on counsel to the Commission of a copy of the trial examiner's report. In a case where no trial examiner's report is to be filed and a request for specific findings is filed by a party to the proceeding or counsel to the Commission, any party to the proceeding or counsel to the Commission may file a brief in support of his contentions and exceptions within 15 days of the filing as provided in paragraph (e) of Rule IX hereof by such party or counsel to the Commission of such request for specific findings, or within 15 days from the date of service on such party or on counsel to the Commission of a copy of such request for specific findings, or within 15 days from the date of service on such party or on counsel to the Commission of a copy of such request for specific findings. In a case where no trial examiner's report is to be filed and where no request for specific findings is filed, any party to a proceeding or counsel to the Commission may file a brief in support of his contentions and exceptions within 15 days from the date when the transcript of testimony is filed with the Secretary or other duly designated officer of the Commission.

(b) All briefs shall be confined to the particular matters in issue. Each exception or request for findings which is briefed shall be supported by a concise argument and by citation of such statutes, decisions and other authorities and by page references to such portions of the record, as may be relevant. If the exception relates to the admission or exclusion of evidence, the substance of the evidence admitted or excluded shall be set forth in the brief with appropriate references to the transcript. Reply briefs shall be confined to matters in original briefs of

opposing parties. Reply briefs in proceedings held pursuant to the provisions of Clause 30 of Schedule A of the Securities Act of 1933, as amended, or Section 24 (b) of the Securities Exchange Act of 1934, as amended, or Section 22 (b) of the Public Utility Holding Company Act of 1935, will be received only by special permission of the Commission. Any scandalous or impertinent matter contained in any brief may be stricken, on order of the Commission.

(c) Exceptions and, in cases where no trial examiner's report is to be filed, requests for specific findings not briefed in accordance with Rule XI may be regarded by the Commission as waived.

(d) All briefs, including briefs filed pursuant to Rule VI, containing more than 10 pages shall include an index and table of cases. The date of each brief must appear on its front cover or title page. If briefs are typewritten or mimeographed, 10 copies shall be filed; if printed, 20 copies, provided that only 7 copies of briefs in proceedings held pursuant to the provisions of Clause 30 of Schedule A of the Securities Act of 1933, as amended, or Section 24 (b) of the Securities Exchange Act of 1934, as amended, or Section 22 (b) of the Public Utility Holding Company Act of 1935, need be filed in any instance. No brief shall exceed 60 pages in length, except with the permission of the Commission.

(e) Copies of briefs shall be served by the Secretary or other duly designated officer of the Commission on the parties to the proceeding and on counsel, to the Commission, and reply briefs may be filed within 5 days thereafter. Such reply briefs as are authorized ht the Commission in proceedings held pursuant to the provisions of Clause 30 of Schedule A of the Securities Act of 1933, as amended, or Section 24 (b) of the Securities Exchange Act of 1934, as amended, or Section 22 (b) of the Public Utility Holding Company Act of 1935, shall be filed, within 5 days after such authorization.

(f) Briefs not filed on or before the time fixed in these rules will be received only upon special permission of the Commission.

(g) Without regard to the foregoing provisions of this rule with respect to filing of briefs, in the event an application is submitted to the Commission for final determination, pursuant to paragraph (e) of Rule X-24B-2 under the Securities Exchange Act of 1934, as amended, or paragraph (c) of Rule U-22B-1 under the Public Utility Holding Company Act of 1935, either party or counsel to the Commission may file a brief in support of his contentions within 15 days from the time of such submission. In such proceeding, reply briefs will be received only upon special permission of the Commission.

(h) This rule shall, not apply to any proceeding (1) on the question of postponement of the effective date of registration of a broker or dealer under

Section 15 (b) of the Securities Exchange Act of 1934, as amended, pending final determination whether such registration shall be denied or (2) on the question of postponement of the effective date of registration of an investment advisor under Section 203 of the Investment Advisors Act of 1940 pending final determination whether such registration shall be denied, and in any such proceeding neither any party nor counsel to the Commission shall be entitled to file a brief.

RULE XII
HEARING BEFORE THE COMMISSION

(a) Upon written request of any party or of counsel to the Commission, which must be made within the time provided for filing the original briefs or, in the case of a proceeding on the question of postponement of the effective date of registration of a broker or dealer under Section 15 (b) of the Securities Exchange Act of 1934, as amended, pending final determination whether such registration shall be denied, or on the question of postponement of the effective date of registration of an investment advisor under Section 203 of the Investment Advisors Act of 1940 pending final determination whether such registration shall be denied, before the close of the hearing for the purpose of taking evidence, the matter will be set down for oral argument before the Commission; provided that, except upon order of the Commission, neither any party nor counsel to the Commission will be permitted to make oral argument before the Commission on matters arising out of proceedings pursuant to the provisions of Clause 30 of Schedule A of the Securities Act of 1933, as amended, or Section 24 (b) of the Securities Exchange Act of 1934, as amended, or Section 22 (b) of the Public Utility Holding Company Act of 1935.

(b) In a case where no trial examiner's report is made, the Commission shall determine the matter on the moving papers, the transcript of the testimony and exhibits received at the hearing, requests for specific findings, if any, the briefs of the parties and counsel to the Commission, if any, and oral argument before the Commission, if any.

(c) The Commission, upon its own motion or upon application in writing by any party or counsel to the Commission for leave to adduce additional evidence which application shall show to the satisfaction of the Commission that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence at the hearing before the Commission or the trial examiner, may hear such additional evidence or may refer the proceeding to the trial examiner for the taking of such additional evidence.

(d) Any petition for rehearing by the Commission shall be filed within 5 days after issuance of the order complained of and shall clearly state the specific grounds and the specific matters upon which rehearing is sought.

RULE XIII
FILING PAPERS -- DOCKET -- COMPUTATION OF TIME

(a) All reports, exceptions, briefs, and other papers required to be filed with the Commission in any proceeding shall be filed with the Secretary, except that all papers containing data as to which confidential treatment is sought pursuant to Rules 580, X-24B-2 or U-22B-1 of the Rules and Regulations of the Commission, together with applications making objection to the disclosure thereof, shall be filed with the Chairman. Any such papers may be sent by mail or express to the officer with whom they are directed to be filed, but must be received by such officer at the office of the Commission in Washington, D. C., within the time limit, if any, for such filing.

(b) All papers containing data as to which confidential treatment is sought pursuant to Rules 580, X-24B-2, or U-22B-1 of the Rules and Regulations of the Commission, together with any application making objection to the disclosure thereof, or other papers relating in any way to such application, shall be made available to the Public only in accordance with the applicable provisions of Rules 580 (h), X-24B-2 (i) or U-22B-1. The report of the trial examiner, exceptions thereto, requests for findings, and briefs in support of such requests or in support of or in opposition to such exception, which are filed in connection with any hearing shall, unless otherwise ordered by the Commission, first be made available to the public on the opening date of public argument on the merits before the Commission, or, in the event of submission to the Commission without argument, upon final determination of the proceeding by the Commission, and prior thereto shall be for the confidential use only of the Commission, the respondent or respondents and counsel.

(c) The Secretary shall maintain a docket of all proceedings, and each proceeding shall be assigned a number.

(d) Wherever under these rules, unless otherwise expressly provided, any limitation is made as to the time within which any reports, exceptions, briefs, or ether papers are required to be filed with the Commission in any proceeding, trial examiners and parties who are residents of the following states: Montana, Idaho, Wyoming, Colorado, New Mexico, Utah, Arizona, Nevada, Washington, Oregon and California, shall have an additional period of 5 days; and trial examiners and parties who reside beyond the confines of the continental United States shall have an additional period of 20 days within which to file such reports, exceptions,

briefs, and other papers. For the purposes of this rule the person upon whom service is made by the Commission is the party whose residence shall determine whether the additional time provided herein shall be granted.

(e) In computing any period of time prescribed or allowed by these rules or by order of the Commission, the day of the act, event, or default after which the designated period of time begins to run is not to be included. The last day of the period so computed is to be included, unless it is a Sunday or a legal holiday in the District of Columbia, in which event the period runs until the end of the next day which is neither a Sunday nor a holiday. Intermediate Sundays and holidays shall be included in the computation. A half-holiday shall be considered as other days and not as a holiday.

(f) Unless otherwise specifically provided in these rules, an original and 8 copies of all papers shall be filed, unless the same be printed, in which case 20 copies shall be filed.

RULE XIV
SERVICE OF REPORTS, EXCEPTIONS, BRIEFS, AND OTHER PAPERS

(a) All reports, exceptions, briefs, requests for specific findings, or other documents or papers required by these rules to be served on any party to a proceeding, or on counsel to the Commission, shall be served by the Secretary or other duly designated officer of the Commission, provided that such papers concerning applications for confidential treatment pursuant to the provisions of Clause 30 of Schedule A of the Securities Act of 1933, as amended, or Section 24 (b) of the Securities Exchange Act of 1934, as amended, or Section 22 (b) of the Public Utility Holding Company Act of 1935, shall be served by the Chairman.

(b) Subject to the provisions of Rule III (a) hereof, such service, except on counsel to the Commission, shall be made by personal service on the party or his attorney of record or by registered mail addressed to the party or his attorney of record.

RULE XV
FORMAL REQUIREMENTS AS TO PAPERS FILED IN PROCEEDINGS

(a) All papers filed under these rules shall be typewritten, mimeographed, or printed, shall be plainly legible, shall be on one grade of good unglazed white paper approximately 8 inches wide and 10.5 inches long, with left-hand margin 1.5 inches wide, and shall be bound at the upper left-hand corner. They shall be double-spaced, except that quotations shall be single-spaced and indented. If

printed, they shall be in either 10- or 12-point type with double-leaded text and single-leaded quotations.

(b) All papers must be signed in ink by the party filing the same, or his duly authorized agent or attorney, or counsel to the Commission, and must show the address of the signer.

(c) All papers filed must include at the head thereof, or on a title page, the name of the Commission, the names of the parties, and the subject of the particular paper or pleading, and the docket number assigned to the proceeding.

RULE XVI
SIGNATURE OF COMMISSION ORDERS

All orders of the Commission shall be signed by the Secretary or such other person as may be authorized by the Commission.

RULE XVII
INTERVENTION

(a) Any interested representative, agency, authority, or instrumentality of the United States, and any interested State, State commission, State securities commission, municipality, or other political subdivision of a State, shall be permitted to intervene in any proceeding upon written request. Any other person may be permitted to intervene in any proceeding upon written application to the Commission showing that he possesses or represents a legitimate interest which is or may be inadequately represented in such proceeding, but no person will be permitted to intervene if after examination the Commission finds that, for any reason (including the existence of undesirable conflicts in the interests possessed or represented by the applicant), his participation in the proceeding would not be in the public interest, or for the protection of investors, or, in a proceeding under the Public Utility Holding Company Act of 1935, for the protection of consumers. Intervention shall be subject to such terms and conditions as the Commission may prescribe, which may include a requirement that the applicant divest himself of specified interests which might conflict with the interests upon which his intervention is based.

(b) Any person filing an application, to intervene shall file therewith an affidavit setting forth in detail his interest or the interest to be represented by him in the proceedings, and stating whether the position which he may propose to take with respect to the pending matter is one already taken by any other party to the proceedings. In the case of a person desiring to intervene in a representative

capacity, his affidavit in addition (1) shall state all relevant material facts bearing upon the existence of any interest of the applicant or of any person represented by him which may conflict with the interests of any other person represented by him, including all affiliations of the applicant or of any person represented by him with any ether party to the proceedings; (2) if requested by the Commission shall state the names and addresses of the persons represented; and (3) shall be accompanied by copies of all circulars, other general literature, and forms of authorization used or intended to be used by the applicant.

(c) Upon request by any party or by counsel for the Commission, the trial examiner or the Commission may for good cause shown order the applicant to submit himself for examination with respect to his application.

RULE XVIII
CONSOLIDATION

By order of the Commission, or upon agreement between the parties and counsel to the Commission, proceedings involving a common question of law or fact may be joined for hearing of any or all the matters in issue in such proceedings and such proceedings may be consolidated; and the Commission may make such orders concerning the conduct of such proceedings as may tend to avoid unnecessary costs or delay.

RULE XIX
NONAPPLICABILITY OF RULES TO INVESTIGATIONS

These rules, other than Rule II, shall not be applicable to investigations conducted by the Commission pursuant to Sections 8 (e), 19 (b), and 20 (a) of the Securities Act of 1933, as amended, Sections 21 (a) and 21 (b) of the Securities Exchange Act of 1934, as amended, or Sections 11 (a), 13 (g), 18 (a), 18 (b), 18 (e) and 30 of the Public Utility Holding Company Act of 1935, or Sections 209 (a), (b), and (d) of the Investment Advisors Act of 1940.

APPENDIX II
GUIDES TO FORMS [Footnote: This guide is designed to aid in the selection of appropriate forms and is revised from time to time as circumstances require. Copies of the forms herein referred to will be furnished without charge upon request.]

GUIDE TO FORMS ADOPTED UNDER THE SECURITIES ACT OF 1933

FOR REGISTRATION STATEMENTS

FORM A-1 -- GENERAL FORM

(a) ***General Rule***. -- This form is to be used for registration under the Securities Act of 1933, as amended, of all securities for the registration of which no other form is specifically prescribed.

(b) ***Special Rule***. -- Notwithstanding the rules for the use of Form A-2 for corporations, Form A-1 may be used by any incorporated investment trust for registration under the Securities Act of 1933, as amended, of an additional block of securities of a class, part of which has previously been registered on Form A-1.

FORM A-O-1 FOR SECURITIES OF CORPORATIONS ORGANIZED WITHIN 2 YEARS TO ENGAGE IN THE EXPLOITATION OF MINERAL DEPOSITS (OTHER THAN OIL OR GAS)

This form is to be used for registration under the Securities Act of 1933 of securities of any corporation organized within 2 years prior to the date of filing the registration statement to engage primarily in the exploitation of mineral deposits (other than oil or gas) if such securities are to be sold to the public for cash or purchasers' obligations to pay cash.

This form shall not be used, however, by any corporation which (a) has any subsidiary, or (b) was organized to take over and continue the business of another person or persons, unless such other persons were organized within such 2 years.

FORM A-2-FOR CORPORATIONS

This form is to be used for registration statements, except such statements as to which a special form is specifically prescribed, under the Securities Act of 1933, as amended, by any corporation which files profit-and-loss statements for 3 years and which meets either one of the following conditions: (a) Such corporation has made annually available to its security holders, for at least 10 years, financial reports (which may be reports consolidating the reports of the corporation and its subsidiaries) including at least a balance sheet and a profit-and-loss or income statement, or (b) such corporation had a net income for any 2 fiscal years of the 5 fiscal years preceding the date of the latest balance sheet filed with the registration statement. If such corporation has subsidiaries, such income shall be

determined on the basis of consolidated reports for such corporation and its subsidiaries. Notwithstanding what is hereinabove prescribed in this paragraph, however, this form shall not be used by any corporation organized within 10 years, if the majority of the capital stock thereof was issued to promoters of the corporation in consideration of property or services, or if more than one-half of the proceeds of the sale of securities of such corporation has been used to purchase property acquired by the corporation from the promoters of the corporation.

This form may also be used for registration statements (except such statements as to which a special form is specifically prescribed) by a corporation organized for the purpose of distributing to its stockholders only, water, electricity, or gas, and prohibited from paying any dividends to its stockholders except upon its dissolution or liquidation, provided that:

1. The corporation has been in existence at least 15 years prior to the date of the filing of the registration statement;

2. There has been no default by the corporation upon any of its funded indebtedness within the period of 15 years prior to the date of the filing of the registration statement;

3. The registrant will have a total indebtedness, upon the issuance of the securities registered, not exceeding 50 percent of the amount, less valuation reserves, at which the total assets of the registrant are carried on the latest balance sheet of the registrant filed with the registration statement, giving effect to the proceeds of the -securities registered; and

4. Within the period of 10 years preceding the date of the filing of the registration statement, the corporation shall not have failed to levy and collect assessments in amounts sufficient to meet all current charges.

SPECIAL RULES AS TO THE USE OF FORM A-2 FOR CORPORATIONS

1. Notwithstanding that Form E-1 is specifically prescribed for use in cases involving an exchange of securities by the issuer thereof for others of its securities or a modification of the terms of securities by agreement between the issuer and its security holders, a registrant .otherwise entitled to use Form A-2 may, at its option, use Form A-2 in any such case if the registrant is not in reorganization pursuant to Section 77B of the Bankruptcy Act or in bankruptcy or receivership and if no default exists on any outstanding funded debt (other than a default in sinking fund payments which has been waived by the holders of at least 80 percent in principal amount of the issue outstanding). If Form A-2 is used

pursuant to this rule, the fee payable for registration shall be calculated in accordance with Instruction 7 in Form E-1, and the table setting forth the calculation shall be prepared as prescribed in such form.

2. Form A-2 may be used by a registrant if all the following conditions exist:

(a) The registrant was organized as the successor to a single predecessor, or to a group of predecessors one of which, at the time of succession, directly or indirectly owned substantially all of the outstanding stock of all the other predecessors;

(b) The registrant acquired all of the assets and assumed all of the liabilities of such predecessor or predecessors, and the capital structure of the registrant immediately following the succession was substantially the same as the capital structure of the single predecessor, or as the consolidated capital structure of the group of predecessors, except for such changes as may have resulted from the substitution of issuers incident to the succession or from changes in capital stock liability per share; and

(c) The single predecessor, or the parent company in a group of predecessors, could have used Form A-2 if the succession had not taken place.

In determining whether such single predecessor or such parent company in a group of predecessors could have used Form A-2, the record of the registrant in regard to income or annual reporting to security holders shall be considered a continuation of the record of such single predecessor or such parent company. In the case of a group of predecessor companies, the income of the parent company of the group shall be determined on the basis of consolidated reports for such parent company and its subsidiaries, the subsidiaries to be included in the consolidated reports whether or not they were combined with the parent company to form the registrant.

3. Notwithstanding the provisions of the last sentence of the rule for the use of Form A-2 for corporations, that form may be used by a corporation otherwise entitled to use the form, if the property acquired from promoters under the circumstances stated in such last sentence consisted principally of one or more going businesses, or of securities representing directly or indirectly more than 50 percent of the voting power controlling such businesses.

4. Notwithstanding the rules as to the use of Form E-1, or the rule as to the use of form A-2 for Corporations, Form A-2 may be used in the situation described below for registration statements, except those for which a special form (other than Form E-1) is specifically prescribed, by corporations which file profit-and-loss statements of their own or of their predecessors for 3 years and which, or

the predecessors of which, have in the past 15 years paid dividends upon any class of common stock for at least 2 consecutive years. The situation in which Form A-2 may thus be used is that of registration of securities issued or sold in the course of a “reorganization,” as defined in Rule 5 (1) as to the use of Form E-1, where the only operation which brings the transaction within the definition is the acquisition of assets of a subsidiary by the registrant in consideration of securities of the registrant, or the exchange of securities of the registrant for outstanding securities of a subsidiary. [Footnote: Rule 5 (1) defining the term “reorganization” is set forth below under the caption “Form E-1 for Securities in Reorganization.”]

5. Any corporation which was formed by the consolidation of two or more corporations may use Form A-2, if each of the constituent corporations which collectively brought in a majority of the assets,. as shown by the books of the constituent corporations prior to the consolidation, could have used Form A-2 if the consolidation had not taken place. In determining whether any such constituent corporation could have used Form A-2, the record of the registrant in regard to income or annual reporting to security holders shall be considered a continuation of such constituent corporation’s record. In this rule, all the corporations consolidated to form the registrant. are called the “constituent corporations.”

6. Form A-2 may be used by a registrant if all the following conditions exist:

(a) The registrant was a wholly owned subsidiary of a corporation which, either alone or with one or more of its other wholly owned subsidiaries, was merged into the registrant;

(b) The registrant acquired all the assets and assumed all the liabilities of the corporations merged into it; and

(c) The parent corporation could have used Form A-2 had the merger not taken place. In determining whether such parent corporation could have used Form A-2, the record of the registrant subsequent to the merger, in regard to income or annual reporting to security holders, shall be considered a continuation of the record of such parent corporation.

7. Notwithstanding the provisions of clause (b) of the rule as to the use of Form A-2 for Corporations, this form may be used by a corporation which has had a net income for only 1 fiscal year of the 5 fiscal years preceding the date of the latest balance sheet filed with the registration statement, if --

(1) The corporation was organized at least 5 years prior to the date of filing;

(2) Total assets of the registrant and its subsidiaries, after deducting valuation and qualifying reserves, amount to not more than $5,000,000, as shown by the most recent balance sheets filed with the registration statement; and

(3) The registrant is not an investment company, a bank holding company or a small-loan or other finance company.

FORM A-R FOR CORPORATE BONDS SECURED BY MORTGAGE INSURED BY FEDERAL HOUSING ADMINISTRATION

This form is to be used for registration under the Securities Act of 1933, as amended, of corporate bonds constituting part of an issue secured by mortgage insured by Federal Housing Administration under the authority of Section 207 of the National Housing Act.

FORM C-1 FOR SECURITIES OF UNINCORPORATED INVESTMENT TRUSTS

This form is to be used for registration under the Securities Act of 1933, as amended, of securities of unincorporated investment trusts of the fixed or restricted management type, having a depositor or sponsor but not having a board of directors or persons performing similar functions.

FORM C-2 FOR CERTAIN TYPES OF CERTIFICATES OF INTEREST IN SECURITIES

This form is to be used for registration under the Securities Act of 1933 of certificates of interest in securities of a single class of a single issuer, if the following conditions exist:

(1) The major part of the certificates are to be sold to the public for cash;

(2) Under the terms of the deposit agreement the depositor (as defined below) has no rights or duties as depositor, subsequent to the deposit of the securities with the depositary;

(3) Under the terms of the deposit agreement the power to vote or give a consent with respect to the deposited securities may be exercised only by, or pursuant to the instructions of, the holders of the certificates of interest, except a power, if any, to vote to effect a split-up of deposited stock in such manner as to cause no change in the aggregate capital stock liability of the issuer of the deposited securities;

(4) The securities deposited by the depositor are registered under the Securities Act of 1933 in connection with the sale of the certificates of interest.

FORM C-3 FOR AMERICAN CERTIFICATES AGAINST FOREIGN ISSUES AND FOR THE UNDERLYING SECURITIES

This form shall be used for registration under the Securities Act of 1933 of American certificates (for example, so-called American depositary receipts for foreign shares or American participation certificates in foreign bonds or notes) issued against securities of foreign issuers deposited or to be deposited with an American depositary (whether physically held by such depositary in America or abroad) and of the foreign securities so deposited.

FORM D-1 FOR CERTIFICATES OF DEPOSIT

In registering certificates of deposit issued in anticipation of or in connection with a plan of reorganization or readjustment, Form D-1 shall be used. If a plan of reorganization or readjustment is proposed at the time the call for deposits is to be made, Parts I and II of Form D-1 should be filed at the same time. If no such plan is proposed at the time the call for deposits is to be made, Part I may be filed alone, and Part II must then be filed before the plan is submitted to the security holders or deposits are solicited under the plan. Part II is an amendment of Part I and as such shall become effective on such date as the Commission may determine, having due regard to the public interest and the protection of investors.

In the event that a registrant is exempted from the necessity for filing Part I, he may nevertheless file Part II.

Before the issuance of the securities provided in the plan of readjustment or reorganization, Form E-1 is to be filed by the issuer of such securities, unless exempted from the necessity of such filing by the Act.

FORM D-1A FOR CERTIFICATES OF DEPOSIT ISSUED BY ISSUER OF SECURITIES CALLED FOR DEPOSIT

This form is to be used only where the issuer of the certificates of deposit is the original issuer of the securities called for deposit, and only if the certificates of deposit are issued in connection with a plan of reorganization or readjustment which involves the issue of new securities to the holders of certificates of deposit.

FORM E-1 FOR SECURITIES IN REORGANIZATION

This form is to be used to register securities (including contracts of guaranty but excepting voting trust certificates, certificates of deposit, and certificates of interest or shares in unincorporated investment trusts of the fixed or restricted management type not having a board of directors or a board of persons performing similar functions, but having a depositor or sponsor) sold or modified in the course of a reorganization. [Footnote: Attention is called to the rules as to the use of Form A-2 which permit the use of that foam in certain instances for securities in reorganization.]

The “Rules and Instructions Accompanying Form E-1” contain the following definition of the term “reorganization”:

5. As used in these rules and the accompanying instructions:

(1) The term “reorganization” includes any transaction involving:

(a) A readjustment by modification of the terms of securities by agreement; or

(b) A readjustment by the exchange of securities by the issuer thereof for others of its securities; or

(c) The exchange of securities by the issuer thereof for securities of another issuer; or

(d) The acquisition of assets of a person, directly or indirectly, partly or wholly, in consideration of securities distributed or to be distributed as part of the same transactions directly or indirectly to holders of securities issued by such person or secured by assets of such person; or

(e) A merger or consolidation.

FORM F-1 FOR VOTING TRUST CERTIFICATES

This form is to be used to register Voting trust certificates issued in the course of a reorganization or otherwise.

FORM S-10 FOR OIL OR GAS INTERESTS OR EIGHTS

Form S-10 shall be used for registration of landowners’ royalty interests, overriding royalty interests, participating interests, working interests, oil or gas

payments, oil or gas fee interests, oil or gas leasehold interests, and other producing or nonproducing oil or gas interests or rights.

SUPPLEMENT S-T TO REGISTRATION STATEMENTS UNDER THE SECURITIES ACT OF 1933

The special items comprising this Supplement S-T shall be applicable to issuers registering securities under the Securities Act of 1933 if any of the securities being registered are to be issued under an indenture required to be qualified under the Trust Indenture Act of 1939. The special items, together with the answers thereto, shall be inserted in the registration statement immediately after the last item of the appropriate form.

INFORMATION AND DOCUMENTS REQUIRED FOE EXEMPTION OF CERTAIN SECURITIES UNDER SECTION 3 (B) OF THE ACT

Certain issues of securities having an aggregate offering price to the public not exceeding $100,000 are exempted from the registration provisions of the Act by regulations of the Commission pursuant to Section 3 (b) of the Act upon compliance with certain conditions provided in the regulations. The pertinent regulations are available without charge upon request.

The Commission rescinded exemption Rules 200 to 210, inclusive, of Regulation A, effective January 1, 1941, and adopted a new Regulation A, effective December 9, 1940. In connection with the adoption of the new Regulation A the Commission also adopted Form S-3b-l which may be used in supplying the information required to be set forth in the letter of notification required by the new regulation.

FORM 1-G FOR REPORT OF SALE OF OIL OR GAS RIGHT

This form is to be used for reports of sales of oil or gas rights, required by Rule 320.

FORM 2-G FOR REPORT OF SALE OF OIL OR GAS RIGHT

This form is to be used for reports of sales of oil or gas rights, required by Rule 322.

GUIDE TO FORMS ADOPTED UNDER THE SECURITIES EXCHANGE ACT OF 1934

FOR REGISTRATION OR EXEMPTION OF A NATIONAL SECURITIES EXCHANGE

Form 1. Application for registration or exemption from registration as a National Securities Exchange. -- This form shall be filed in connection with the applications of securities exchanges for registration or exemption from registration.

Form 9. Amendatory and/or supplementary statement to registration statement filed by am exchange. -- This form shall be used for filing amendatory and/or supplementary statements to registration statements of national securities exchanges.

Form 9-A. Amendatory and/or supplementary statement to application for exemption from registration filed by an exchange. -- This form shall be used for filing amendatory and/or supplementary statements to applications for exemption from registration as national securities exchanges.

FOR APPLICATIONS FOR REGISTRATION OF SECURITIES ON NATIONAL SECURITIES EXCHANGES

Form 7. For provisional applications. -- Where the form for permanent registration of any particular class of security has not yet been authorized, and for a period of 90 days after the filing of applications on such form is authorized, a provisional application for registration of a security of such class may be filed on Form 7 pursuant to Rule X-12B-2. (Rule X-12B-2 sets forth the requirements of an :application filed on Form 7.)

Form 8. For amendments to applications for registration or amendments to annual reports. -- This form shall be used for amendments to applications for registration of securities pursuant to Section 12 (b) and (c) of the Securities Exchange Act of 1934 or amendments to annual reports pursuant to Section 13 of that Act.

Form 8-A. For additional securities. -- This form shall be used for applications for registration of securities on an exchange on which other securities of the registrant, whether of the same or a different class, are registered pursuant to Section 12 (b) and (c) of the Act if Form 10, 11, 13, 15, 17, 22, or 23 would be the form appropriate for registration in case the registrant did not have securities

so previously registered: Provided, That if Form 22 or 23 would be appropriate for original registration, this form shall be used only if securities of the registrant issued pursuant to the plan of reorganization or succession by reason of which Form 22 or 23 would be appropriate for original registration have been registered on such exchange pursuant to an application on such form.

Form 8-B. For securities issued in certain cases upon the registrant's successor to an issuer or issuers of previously registered securities. -- This form shall be used by an issuer, not having securities previously registered for applications filed on and after March 12, 1936, for the registration of securities, if the conditions set forth in the following paragraphs (a), (b), (c), and (d) exist:

(a) (1) The registrant, having no assets at the time other than nominal assets, succeeded to a single predecessor which had securities registered pursuant to Section 12 (b) and (c) of the Act on the exchange or exchanges on which registration is applied for on this form; or

(2) The registrant was organized as the successor to, or, having no assets at the time other than nominal assets, succeeded to, a group of predecessors consisting of a parent which had securities so registered and one or more wholly owned subsidiaries of such parent; or

(3) The registrant was a wholly owned subsidiary of a corporation having securities so registered, which corporation, either alone or with one or more of its other wholly owned subsidiaries, was merged into the registrant.

(b) Substantially all of the securities to be registered on this form were or are to be issued in exchange for or otherwise in respect of previously registered securities of one or more of the predecessors, or are securities which, having been previously registered, have become or are to become securities of the registrant by operation of law or otherwise upon the succession.

(c) The registrant acquired all the assets and assumed all the liabilities of its predecessor or predecessors.

(d) Except for such changes as may have resulted (1) from the substitution of issuers incident to the succession, or (2) from changes in capital stock liability per share, or (3) from the issuance of securities in satisfaction of dividends or interest in arrears on securities of predecessors, the capital structure of the registrant immediately following the succession was substantially the same as the capital structure of the single predecessor or the combined capital structure of the predecessors, or in a case falling within paragraph (a) (3) above, the combined capital structure of all the constituent corporations.

The term “wholly owned subsidiary” as used in this rule refers to a subsidiary substantially all the outstanding stock of which is held, directly or indirectly, by a single parent.

Form 8--C. For registration on an additional exchange. -- This form may be used for applications for registration of securities on an exchange upon which no securities of the registrant are listed and registered, if securities of the registrant are registered pursuant to Section 12 (b), (c), and (d) on another exchange.

Form 10. For corporations. -- This form shall be used for applications for the permanent registration of securities of corporations, filed on and after February 13, 1935, except the following: Securities of companies making annual reports under Section 20 of the Interstate Commerce Act, as amended, or Section 220 of the Motor Carrier Act of 1935, or Section 220 of the Motor Carrier Act of 1935, or under Section 219 of the Communications Act of 1934; certificates of deposit; American certificates against foreign issues, either government or corporate; securities of insurance companies, other than companies engaged primarily in the title insurance business; securities of banks and bank holding companies; securities of investment trusts; securities issued by any corporation organized under the laws of any foreign country other than a North American country or Cuba; bonds issued by any corporation organized under the laws of a North American country or Cuba, which are guaranteed by any foreign government; securities issued by any corporation, foreign or domestic, which is directly or indirectly owned or controlled by any foreign government: Provided, however, That this form shall not be used for applications for the permanent registration of securities of any corporation for which, at the time the application is filed, Form 22 or 23 is prescribed. And provided further, That this form shall not be used for applications for the permanent registration of securities of any corporation, if, at the time the application is filed, such corporation is in bankruptcy or receivership or in the process of reorganization pursuant to Section 77 or 77B of the Bankruptcy Act, and (a) a trustee or receiver appointed in such proceedings has title to or possession of a substantial portion of the assets of such corporation, or (b) such corporation is in possession of a substantial portion of its assets pursuant to an order entered under Subdivision (c), Clause (2) of said Section 77 or Subdivision (c), Clause (1) of said Section 77B. Any foreign issuer which by this paragraph is to file on Form 10 as to any class of securities other than bonds may also file on such form for such bonds; and any issuer of bonds which is organized under the laws of any foreign country may at its option file on Form 10 until 90 days after the proper form applicable to such foreign issuer shall have been published.

Form 11. For unincorporated issuers. -- This form shall be used for applications filed on or after March 30, 1935, for the permanent registration of securities of unincorporated issuers, except the following: Securities of companies making

annual reports under Section 20 of the Interstate Commerce Act, as amended, or Section 220 of the Motor Carrier Act of 1935, or Section 220 of the Motor Carrier Act of 1935, or under Section 219 of the Communications Act of 1934; certificates of deposit; voting trusts certificates; American certificates against foreign issues, either government or private; securities of insurance companies; securities of banks and bank holding companies; securities of investment trusts; securities issued by a national of a foreign country other than a North American country or Cuba; bonds issued by a national of a North American country or Cuba, which are guaranteed by any foreign government; securities of any issuer, foreign or domestic, which is directly or indirectly owned or controlled by any foreign government: Provided, however, That this form shall not be used for applications for the permanent registration of securities of any issuer for which, at the time the application is filed, Form 22 or 23 is prescribed. And provided further, That this form shall not be used for applications for the permanent registration of securities of any issuer, if, at the time the application is filed, such issuer is in bankruptcy or receivership or in the process of reorganization pursuant to Section 77 or 77B of the Bankruptcy Act, and (a) a trustee or receiver appointed in such proceedings has title to or possession of a substantial portion of the assets of such issuer, or (b) such corporation is in possession of a substantial portion of its assets pursuant to an order entered under Subdivision (c), Clause (2) of said Section 77 or Subdivision (c), Clause (1) of said Section 77B.

Form 12. For companies making annual reports under Section 20 of the Interstate Commerce Act, as amended, or Section 220 of the Motor Carrier Act of 1935, or Section 220 of the Motor Carrier Act of 1935, or under Section 219 of the Communications Act of 1934. -- This form shall be used for applications filed on or after April 10, 1935, for the permanent registration of securities of companies making annual reports under Section 20 of the Interstate Commerce Act, as amended, or Section 220 of the Motor Carrier Act of 1935, or Section 220 of the Motor Carrier Act of 1935, or under Section 219 of the Communications Act of 1934, except such companies in receivership or in process of reorganization pursuant to Section 77 of the Bankruptcy Act.

Form 12-A. For companies in receivership or bankruptcy and making annual reports under Section 20 of the Interstate Commerce Act, as amended, or Section 220 of the Motor Carrier Act of 1935, or Section 220 of the Motor Carrier Act of 1935, or under Section 219 of the Communications Act of 1934. -- This form shall be used for applications filed on or after June 17, 1935, for the permanent registration of securities of companies making annual reports under Section 20 of the Interstate Commerce Act, as amended, or Section 220 of the Motor Carrier Act of 1935, or Section 220 of the Motor Carrier Act of 1935, or under Section 219 of the Communications Act of 1934, and in receivership or in

bankruptcy (including proceedings under Sections 77 or 77B of the Bankruptcy Act).

Form 13. For insurance companies other than life and title insurance companies. -- This form shall be used for applications filed on r after May 7, 1935, for permanent registration of securities of corporations engaged, directly or through subsidiaries, primarily in insurance business, except corporations engaged primarily in the life or title insurance business. This form shall not be used corporations engaged primarily in the business of guaranteeing mortgages or mortgage-participation certificates.

Pending the authorization of a form for registration of securities of corporations engaged primarily in the life insurance business, and for a period of 30 days after the filing of applications on such form is authorized, such corporations may file application on Form 13 for Insurance Companies other than Life and Title Insurance Companies.

Insofar as Form 13 may be inappropriate to the life insurance business, a corporation engaged in the life insurance business filing on Form 13, pursuant to this rule, shall furnish information comparable to that required by Form 13; and, in lieu of financial statements required under the Instructions as to Financial Statements in the Instruction Book for Form 13, such corporation may file a copy of its last annual statement filed with its State regulatory authority.

Form 14. For certificates of deposit issued by a committee. -- T his form shall be used for applications on or after May 10, 1935, for the permanent registration of certificates of deposit issued by a committee.

Form 15. For incorporated investment companies. -- T his form shall be used for applications filed on or after May 15, 1935, for the permanent registration of securities of any corporation which is engaged, either directly or through subsidiaries, primarily in the business of investing and reinvesting, or trading in securities, for the purpose of revenue and for profit, and not in general for the purpose, or with the effect, of exercising control; except securities of such corporations in process of reorganization pursuant to Section 77B of the Bankruptcy Act or securities of such corporations in bankruptcy or receivership.

Form 16. For voting trust certificates and underlying securities. -- This form shall be used for applications filed on or after May 18, 1935, for the permanent registration of voting trust certificates and underlying securities.

Form 17. For unincorporated issuers engaged primarily in the business of investing or trading in securities. -- This form shall be used for applications filed on or after May 31, 1935, for the permanent registration of securities of any

unincorporated issuer which is engaged, either directly or through subsidiaries, primarily in the business of investing and reinvesting, or trading, in securities, for the purpose of revenue and for profit, and not in general for the purpose, or with the effect, of exercising control; except securities of such issuers in process of reorganization pursuant to Section 77B of the Bankruptcy Act or securities of such issuers in bankruptcy or receivership.

Form 18. For foreign governments and political subdivisions thereof. -- This form shall be used for applications filed on or after July 1,1935, for the permanent registration of securities of any foreign government or political subdivision thereof: Provided, however, That any public corporation or other autonomous entity in the nature of a political subdivision, except a State, province, county, or municipality or similar body politic, may, at its option, use Form 21 in lieu of this form.

Form 19. For America certificates against foreign issues and for the underlying securities. -- This form shall be used for applications filed on or after July 15, 1935, for the permanent registration of American certificates (for example, so-called American depositary receipts for foreign shares or American participation certificates in foreign bonds or notes) issued against securities of foreign issuers deposited with an American depositary (whether physically held by such depositary in America or abroad) and of the foreign securities so deposited.

Form 20. For securities other than bonds of foreign private issuers. -- This form shall be used for applications filed on or after July 15, 1935, for the permanent registration of securities other than bonds or other evidences of indebtedness (a) issued by a national of a foreign country other than a North American country or Cuba, or (b) issued by any corporation or unincorporated association, foreign or domestic, which is directly or indirectly owned or controlled by any foreign government.

Form 21. For bonds of foreign private issuers. -- This form shall be used for applications filed on or after July 15, 1935, for the permanent registration of bonds or other evidences of indebtedness (a) issued by a national of a foreign country other than a North American country or Cuba; (b) issued by a national of a North American country or Cuba which are guaranteed by any foreign government; (c) issued by any corporation or unincorporated association, foreign or domestic, which is directly or indirectly owned or controlled by any foreign government; or (d) issued by any public corporation or other autonomous entity in the nature of a political subdivision which shall at its option elect to use this form in lieu of Form 18, except that this form is not to be used by a State, province, county, or municipality or similar body politic.

Form 22. For issuers reorganized in insolvency proceedings or which have succeeded to a person in insolvency proceedings. -- This form shall be used for applications for registration of securities of any issuer which, pursuant to a plan --

(a) Has been or is being reorganized in insolvency proceedings; or

(b) Has acquired or is to acquire, directly or indirectly, substantially all of its business and assets (other than cash) from a person in insolvency proceedings or from such person and one or more of its subsidiaries, and is continuing or is to continue the business so acquired; or

(c) Being a subsidiary of a person in insolvency proceedings, has acquired or is to acquire directly or indirectly substantially all of its assets (other than cash and other than assets owned by it prior to such acquisition) from such person or from such person and one or more of its subsidiaries;

if the securities are, or are to be, outstanding or issued pursuant to the plan, or were or are to be issued after the consummation of the plan: Provided, That this form shall not be used by issuers for which Form 8-A, 12, or 12-A is prescribed, or for applications filed with the exchange after the expiration of a full fiscal year of the issuer commencing on or after the date on which the transfer or opening of accounts was made.

Form 23. For successor issuers. -- This form shall be used for applications for registration of securities of any issuer which has acquired, or is presently to acquire, directly or indirectly (through the acquisition of securities or otherwise) the major portion of its business and assets (other than cash) by acquiring all or a part of the business and assets of one or more other persons, and is continuing or is to continue, the business so acquired: Provided, however, That this form shall not be used by issuers for which either Form 8-A, 8-B, 12, 12-A, 20, 21, or 22 is prescribed, or for applications filed with the exchange after the expiration of a full fiscal year of the issuer commencing on or after the date of succession.

Form 24. For bank holding companies. -- This form shall be used for applications for the registration of securities of any person which is engaged, either directly or through subsidiaries, primarily in the business of owning securities of banks, for the purpose or with the effect of exercising control.

Form 1-J. For registration of unissued warrants for "when issued" dealing. -- This form is to be used for applications for registration of unissued warrants, pursuant to Section 12 (d) of the Securities Exchange Act of 1934 for "when issued" dealing on a national securities exchange.

Form 2-J. For registration of unissued securities, other than unissued warrants for "when issued" dealing. -- This form is to be used for applications for registration of unissued securities, other than unissued warrants, pursuant to Section 12 (d) of the Securities Exchange Act of 1934 for "when issued" dealing on a national securities exchange.

Form 15-AN. For statements in respect of exemption of issued warrants. -- This form is to be used for statements in respect of exemption of issued warrants, pursuant to Section 3 (a) (12) of the Securities Exchange Act of 1934.

FOR ANNUAL AND OTHER REPORTS OF ISSUERS HAVING SECURITIES REGISTERED ON NATIONAL SECURITIES EXCHANGES

Form 8-K. For current reports. -- This form is to be used for the current reports required by Rule X-13A-6. [Footnote: Rule X-13A-6. Current reports. (a) A current report on the appropriate form shall be filed by the issuer of a security registered on a national securities exchange (hereinafter called "the registrant") in case any of the events enumerated below occurred or shall occur at any time after the close of the first fiscal year or other one-year period for which an annual report is required to be filed by the registrant, or if the registrant had no security registered on a national securities exchange on December 31, 1935, at any time after the registration of any of its securities first became or shall become effective:

(1) A material amendment of any exhibit previously filed by the registrant pursuant to Section 12 or 13 of the Act;

(2) The execution of any voting trust agreement, contract, or indenture of a character required to be filed as an exhibit in the form of annual report appropriate for the registrant;

(3) A substantial restatement of the capital shares account of the registrant;

(4) The issuance of any new class of securities, or an aggregate increase or decrease of more than five percent in the amount of any class of securities of the registrant outstanding, as last previously reported, unless resulting from an ordinary sinking fund operation; provided that (i) no report need be made with respect to notes, drafts, bills of exchange, or bankers' acceptances having a maturity at the time of issuance of not exceeding one year, and (ii) for the purposes of this paragraph (4), securities held by the registrant shall not be deemed "outstanding";

(5) The granting or extension of any option to purchase equity securities of the registrant from the registrant, provided that a current report need be made only when one or more options calling for an aggregate principal amount of $50,000 or more of a single issue of convertible evidences of indebtedness, or an aggregate of 1,000 or more shares or other units of any other single class of equity securities, have been granted or extended and have not been previously reported;

(6) The exercise, in whole or in part, of any option to purchase equity securities of the registrant from the registrant, provided that a current report need be made only when a person or persons have acquired an aggregate principal amount of $50,000 or more of a single issue of convertible evidences of indebtedness, or an aggregate of 1,000 or more shares or other units of any other single class of equity securities, through one or more exercises which have not been previously reported;

(7) A person’s becoming, or ceasing to be, a parent or subsidiary of the registrant, provided that no report need be made as to any subsidiary the name of which would not be required to be furnished in the form of annual report appropriate-for the registrant;

(8) A substantial revaluation of the assets of the registrant;

(9) A substantial withdrawal or substitution with respect to property securing any issue of registered securities; provided however, That no report need be filed as to any event concerning which information substantially similar to that required by Form 8-K shall have been previously reported by the registrant.

(b) The current report shall be filed not more than ten days after the close of the calendar month during which occurred the event obligating the registrant to file the current report, or if the event occurred prior to December 1, 1936, not later than January 10, 1937.

(c) As used ha this rule, the term “previously reported” means previously reported in an application for registration or a report filed pursuant to Section 12 or 13 of the Act; the term “option” does not include options evidenced by an issue of securities, such as an Issue of warrants or rights; the term “unit” means that unit of a class of securities representing the smallest interest in the registrant or in property of the registrant, or having the smallest par or face value or denomination which is separately transferable by a holder thereof. Unless the context otherwise requires, all other terms used In this rule have the same meanings as in the Act, In the form appropriate for an annual report of the registrant, and In the Instruction book accompanying such form.

(d) The foregoing provisions of this rule shall not be applicable to Issuers of securities which are registered pursuant to an application on Form 18, 19, 20, or 21.]

Form 10-K. For corporations. -- This form is to be used for the annual reports of all corporations except those for which another form is specifically prescribed.

Form 11-K. For unincorporated issuers. -- This form is to be used for the annual reports of all unincorporated issuers except those for which another form is specifically prescribed.

Form 12-K. For companies making annual reports under Section 20 of the Interstate Commerce Act, as amended, or Section 220 of the Motor Carrier Act of 1935, or Section 220 of the Motor Carrier Act of 1935, or under Section 219 of the Communications Act of 1934. -- This form is to be used for the annual reports of companies making annual reports under Section 20 of the Interstate Commerce Act, as amended, or Section 220 of the Motor Carrier Act of 1935, or Section 220 of the Motor Carrier Act of 1935, and of carriers making annual reports under Section 219 of the Communications Act of 1934, except such companies in receivership or in bankruptcy, including proceedings for reorganization pursuant to Section 77 or 77B of the Bankruptcy Act, at the close of the fiscal year for which the report is made.

Form 12A-K. For companies in receivership or bankruptcy at close of fiscal year and making annual reports under Section 20 of the Interstate Commerce Act, as amended, or Section 220 of the Motor Carrier Act of 1935, or under Section 219 of the Communications Act of 1934. -- This form is to be used for the annual reports of companies making annual reports under Section 20 of the Interstate Commerce Act, as amended, or Section 220 of the Motor Carrier Act of 1935, and of carriers making annual reports under Section 219 of the Communications Act of 1934, if such companies were in receivership or in bankruptcy, including proceedings for reorganization pursuant to Section 77 or 77B of the Bankruptcy Act, at the close of the fiscal year for which the report is made.

Form 13-K. For insurance companies other than life and title insurance companies. -- This form is to be used for the annual reports of corporations engaged, directly or through subsidiaries, primarily in the insurance business, except corporations engaged primarily in the life or title insurance business. This form is not to be used by corporations engaged primarily in the business of guaranteeing mortgages or mortgage-participation certificates.

Form 14-K. For certificates of deposit issued by a committee. -- This form is to be used for the annual reports of issuers of certificates of deposit issued by a committee.

Form 15-K. For incorporated investment companies. -- This form is to be used for the annual reports of corporations engaged either directly or through subsidiaries primarily in the business of investing and reinvesting or trading in securities for the purpose of revenue and for profit, and not in general for the purpose or with the effect of exercising control.

Form 16-K. For voting trust certificates and underlying securities. -- This form is to be used for annual reports relating to securities evidencing a participation in a voting trust agreement or a similar agreement for the holding of securities for voting purposes and to securities held subject to such agreements.

Form 17-K. For unincorporated issuers engaged primarily in the business of investing or trading in securities. -- This form is to be used for the annual reports of unincorporated issuers engaged either directly or through subsidiaries primarily in the business of investing and reinvesting or trading in securities for the purpose of revenue and for profit, and not in general for the purpose or with the effect of exercising control.

Form 18-K. For foreign governments and political subdivisions thereof. -- This form is to be used for the annual reports of foreign governments or political subdivisions thereof, except any public corporation or other autonomous entity in the nature of a political subdivision, other than a State, province, county, or municipality or similar body politic which, at its option, has registered its securities on Form 21 in lieu of Form 18.

Form 19-K. For issuers of American certificates against foreign issues and the underlying securities. -- This form is to be used for the annual reports of issuers of American certificates (for example, so-called American depositary receipts for foreign shares or American participation certificates in foreign bonds or notes) issued against securities of foreign issuers deposited with an American depositary (whether physically held by such depositary in America or abroad) and of the foreign securities so deposited.

Form 20-K. For foreign private issuers registering securities other than bonds. -- This form is to be used for the annual reports of the following issuers with respect to securities other than bonds or other evidences of indebtedness: (a) Nationals of a foreign country other than a North American country or Cuba, and (b) corporations or unincorporated associations, foreign or domestic, which are directly or indirectly owned or controlled by any foreign government.

Form 21-K. For foreign private issuers registering bonds. -- This form is to be used for the annual reports of the following issuers with respect to bonds or other evidences of indebtedness: (a) Nationals of a foreign country other than a North

American country or Cuba, (b) nationals of a North American country or Cuba if such bonds or other evidences of indebtedness are guaranteed by any foreign government, (c) corporations or unincorporated associations, foreign or domestic, which are directly or indirectly owned or controlled by any foreign government, and (d) public corporations or other autonomous entities in the nature of political subdivisions which, at their option, have registered securities on Form 21 in lieu of Form 18.

Form 24-K. For bank holding companies. -- This form is to be used for the annual reports of any person which is engaged, either directly or through subsidiaries, primarily in the business of owning securities of banks, for the purpose or with the effect of exercising control.

FOR REGISTRATION OF BROKERS AND DEALERS TRANSACTING BUSINESS ON OVER-THE-COUNTER MARKETS

Form 3-M. For applications for registration of brokers and dealers, except applications for which Form 4-M is authorized. -- This form is to be used for applications filed on or after July 1, 1936, for the registration of brokers and dealers pursuant to Section 15 (b) of the Securities Exchange Act of 1934, as amended, except applications. for which Form 4-M is authorized to be used.

Form 4-M. For applications for registration of partnerships formed upon death, withdrawal, or admission of one or more partners in partnerships registered as brokers or dealers. -- This form is to be used (a) for applications filed by a registered partnership on or after July 1,1936, pursuant to Section 15 (b) of the Securities Exchange Act of 1934, as amended, for the registration of a partnership to be formed as the successor to the applicant by the withdrawal or admission of one or more partners in the applicant; and (b) for applications filed on or after October 10, 1936, pursuant to said Section 15 (b) and Rule X-15B-4, for the registration of a partnership formed as the successor to a registered partnership which has been dissolved by the death, withdrawal, or admission of one or more partners: Provided, That the application is filed within 30 days after such dissolution.

Form 5-M. For adoption of applications filed by predecessors. -- This form is to be used by a broker or dealer in adopting as its own an application for registration on Form 3-M or Form 4-M filed on its behalf by a predecessor.

Form 6-M. For supplemental statements to applications for registration of brokers and dealers. -- This form is to be used for correcting inaccuracies and reporting changes in the information contained or incorporated in any application filed on Form 1-M, Form 3-M, or Form 4-M or in any adoption filed on Form 5-M or in any supplemental statement filed on Form 2-M or Form 6-M.

FOR ANNUAL REPORTS OF REGISTRANTS UNDER THE SECURITIES ACT OF 1933 [Footnote: The filing of annual reports on these forms is required by Rule X-15D-l, pursuant to Section 15 (d) of the Securities Exchange Act of 1934, as amended.]

Form 1-MD. General form. -- This form is to be used for the annual reports, pursuant to Section 15 (d) of the Securities Exchange Act of 1934, of all issuers except those for which another form is specifically prescribed.

Form 2-MD. For investment trusts having securities registered on Form C-1.. -- This form is to be used for annual reports, pursuant to Section 15 (d) of the Securities Exchange Act of 1934, relating to securities of unincorporated investment trusts of the fixed or restricted management type, having a depositor or sponsor but not having a board of directors or persons performing similar functions.

Form 3-MD. For voting trust certificates. -- This form is to be used for annual reports, pursuant to Section 15 (d) of the Securities Exchange Act of 1934, relating to voting trust certificates.

Form 4-MD. For certificates of deposit. -- This form is to be used for annual reports, pursuant to Section 15 (d) of the Securities Exchange Act of 1934, relating to certificates of deposit issued by a committee.

FOR APPLICATIONS FOR REGISTRATION OF NATIONAL SECURITIES ASSOCIATIONS AND AFFILIATED SECURITIES ASSOCIATIONS

Form X-15AA-1. Application for registration as a national securities association or affiliated securities association. -- This form is to be used for applications for registration as national securities associations or affiliated securities associations.

Form X-15AJ-1. Amendatory and/or supplementary statement to registration statement of national securities association or affiliated securities association. -- This form is to be used for filing amendatory and/or supplementary statements to registration statements of national securities associations or affiliated securities associations.

Form X-15AJ-2. ***Annual consolidated supplement to registration statement of national securities association or affiliated securities association.*** -- This form is to be used for filing annual consolidated supplements to registration statements of national securities associations or affiliated securities associations.

FOR REPORTS TO BE FILED BY OFFICERS, DIRECTORS, AND SECURITY HOLDERS

Form 4. For reporting changes in ownership of equity securities. -- Every person who at any time during any month has been directly or indirectly the beneficial owner of more than 10 percent of any class of any equity security (other than an exempted security) which is listed on a national securities exchange, or a director or an officer of the issuer of such security, shall, if there has been any change during such month in his ownership of any equity security of such issuer, whether registered or not, file with each exchange on which any equity security of the issuer is listed and registered a statement on Form 4 (and a single duplicate original thereof with the Commission) indicating his ownership at the close of the calendar month .and such changes in his ownership as have occurred during such calendar month. Such statements must be received by the Commission and the exchange on or before the 10th day of the month following that which they cover.

Form 5. For reporting ownership of equity securities. -- In the case of an equity security (other than an exempted security) which is listed subsequent to February 15, 1935 on a national securities exchange, every person who at the time such registration becomes effective is directly or indirectly the beneficial owner of more than 10 percent of any class of such security or a director or an officer of the issuer of such security, shall file with each exchange on which any equity security of the issuer is listed and registered a statement on Form 5 (and a single duplicate original thereof with the Commission) of the amount of all equity securities of such issuer, whether registered or not, so beneficially owned by him at the, time such registration became effective. Such statement must be received by the Commission and the exchange on or before the 10th day of the following calendar month. If such person files a statement on Form 4 for the same calendar month in respect of the same securities, he need not file an additional statement pursuant to this paragraph.

Form 6. For reports by persons who have just become officers or directors or security holders of more than 10 percent of any class of equity security. -- Every person who becomes directly or indirectly the beneficial owner of more than 10 percent of any class of any equity security (other than an exempted security), which is listed on a national securities exchange, or becomes a director or an officer of the issuer of such security, shall file with each exchange on which any

equity security of the issuer is listed and registered a statement on Form 6 (and a single duplicate original thereof with the Commission) of the amount of all equity securities of such issuer, whether registered or not, so beneficially owned by him immediately after becoming such beneficial owner, director, or officer. Such statement must be received by the Commission and the exchange on or before the 10th day following the day on which such person became such beneficial owner, director, or officer. Such person need not file the statement required by this paragraph, if prior to such 10th day and during the calendar month in which he has become such beneficial owner, director, or officer, there has been a change in his beneficial ownership which will require him to file a statement on Form 4 with respect to the same securities.

FOR FILING NOTICE OF INTENTION TO STABILIZE AND FOR REPORTING STABILIZING TRANSACTIONS

Form X-9A6-1. For notice of intention to stabilize. -- This form is to be used for filing notice of intention to stabilize the price of a security pursuant to Rule X-9A6-1.

Form X-17A-1. For reporting stabilizing transactions. -- This form is to be used for reporting stabilizing transactions pursuant to Rule X-17A-2 (a) (1) or (3).

Form X-17A-2. For reporting stabilizing transactions. -- This form is to be used for reporting stabilizing transactions pursuant to Rule X-17A-2 (a) (2).

Form X-17A-3. For reporting stabilizing transactions. -- This form is to be used for reporting stabilizing transactions pursuant to Rule X-17A-2 (a) (4).

GUIDE TO FORMS ADOPTED UNDER THE PUBLIC UTILITY HOLDING COMPANY ACT OF 1935

Form U-A. Facing page. -- This form is to be used as a facing page for all amendments to applications, declarations, reports, and statements filed under the Act.

Form U-1. Form for applications and declarations. -- This form is to be used by a registered holding company or subsidiary company filing an application or declaration that includes an issue or sale of securities, acquisition or sale of assets, change of rights, guaranty or assumption of liability, or a transaction subject to rules under Sections 12 (b) or 12 (c) of the Act.

Form U-2. Declaration and periodic report. -- This form is to be used by a subsidiary of a registered holding company primarily engaged in business as a broker or dealer, which claims exemption under Rule U-3D-4 and also for the quarterly reports to be filed by such a company.

Form U-3A-2. Statement filed by holding companies claiming exemption. -- This form is prescribed for annual reports to be filed by holding companies claiming exemption from any provisions of the Act by virtue of Rule U-3A-2.

Form U-3A3-1. Semiannual statement filed by banks claiming exemption. -- This form is prescribed for semiannual reports to be filed by banks claiming exemption from any provisions of the Act by virtue of Rule U-3A3-1.

Form U-3D-13. Notification of acquisition of utility assets. -- This form is to be filed by the acquiring company in the event of an acquisition of utility assets exempted by Rule U-3D-13.

Form U-5-A. Notification of registration. This form is to be used for notification of registration pursuant to Section 5 (a) of the Act.

Form U-5-B. Registration statement. -- This form is to be used for registration statements to be filed by registered holding companies pursuant to Section 5 (b) of the Act.

Form U-5-S. Annual supplement to registration statement. -- This form is to be used by registered holding companies for the annual supplements to registration statements.

Form U-6B-2. Certificate of notification. -- This form is to be used for the filing of certificates of notification of certain issuances of securities by registered holding companies and subsidiaries thereof, as required by Rule U-6B-2.

Form U-12 (I)-A. ***Statement pursuant to Section 12 (i).*** -- This is a form of statement to be made by a person employed or retained by a registered holding company or a subsidiary thereof.

Form U-12 (I)-B. ***Statement pursuant to Section 12 (i).*** -- This is a form of an annual statement to be made by a person regularly employed or retained by a registered holding company or subsidiary company thereof. This annual form relieves persons, who are regularly employed or retained by holding companies or their subsidiaries and who frequently represents such companies, from the necessity of filing numerous reports on Form U-12 (I)-A.

Form U-13-1. Application for approval of mutual service company or declaration with respect to organization and conduct of business of subsidiary service company. -- This form is to be used, pursuant to Rule U-13-22, for an application for approval of a mutual service company or for a declaration with respect to the organization and conduct of business of a subsidiary service company.

Form U-13-60. Annual report of mutual and subsidiary service companies. -- This form is to be used for the filing of annual reports by each mutual service company and each subsidiary service company pursuant to Rule U-13-60.

Form U-13E-1. Report by affiliate service company. -- This form is to be filed pursuant to Rule U-13E-1 by an affiliate service company or by a company principally engaged in the performance of services.

Form U-14-1. Quarterly report of acquisitions. -- This form is prescribed for quarterly reports of acquisitions of securities to be filed by registered holding companies pursuant to Rule U-14-1.

Form U-14-3. Annual report of registered holding companies. -- This form is to be used for the filing of annual reports by registered holding companies pursuant to Rule U-14-3.

Form U-17-1. Reports of ownership by officers and directors. -- This form is to be used for statements of ownership required by Section 17 (a) of the Act to be filed by persons who are officers or directors of a registered holding company at the time when it is registered. A statement must be filed by every officer and director of a holding company following its registration and following his appointment or election after registration, even if be owns no securities of the company or its subsidiaries.

Form U-17-2. Reports of changes of ownership by officers and directors. -- This form is to be used by officers and directors of registered holding companies in reporting changes in their beneficial ownership of securities of such holding companies or any of their subsidiaries, as required by Section 17 (a) of the Act.

GUIDE TO FORMS ADOPTED UNDER THE TRUST INDENTURE ACT OF 1939

FOR STATEMENTS OF ELIGIBILITY AND QUALIFICATION OF TRUSTEES

Form T-1. For statements of eligibility and qualification of corporations designated to act as trustees. -- This form shall be used for statements of eligibility and qualification of corporations designated to act as trustees under

trust indentures to be qualified pursuant to Section 305 or 307 of the Trust Indenture Act of 1939.

Form T-2. For statements of eligibility and qualification of individuals designated to act as trustees. -- This form shall be used for statements of eligibility and qualification of individuals designated to act as trustees under trust indentures to be qualified pursuant to Section 305 or 307 of the Trust Indenture Act of 1939.

FOR APPLICATIONS FOR QUALIFICATION OF INDENTURES

Form T-3. For applications for qualification of indentures. -- This form shall be used for applications for qualification of indentures pursuant to Section 307 (a) of the Trust Indenture Act of 1939.

GUIDE TO FORMS ADOPTED UNDER THE INVESTMENT COMPANY ACT OF 1940

Form N-8A. For notification of registration. -- This form shall be used as the notification of registration pursuant to Section 8 (a) of the Investment Company Act of 1940.

Form N-30F-1. For initial statement of beneficial ownership of outstanding securities of registered closed-end investment companies. -- This form is used for initial statements of beneficial ownership of securities of registered closed-end companies, to be filed with the Commission by every person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of outstanding securities (other than short-term paper) of which such a company is the issuer, or who is an officer, director, member of an advisory board, investment adviser, or affiliated person of an investment adviser of such a company at the time when the company is registered. It is also to be used by persons who assume any of the above specified relationships with such a company after the date when the company has registered.

Form N-30F-2. For statement of changes in beneficial ownership of outstanding securities of registered closed-end investment companies. -- This form is used for statements of changes in beneficial ownership of securities issued by registered closed-end investment companies, to be filed with the Commission by every person who is required to file Form N-30F-1.

GUIDE TO FORMS ADOPTED UNDER THE INVESTMENT ADVISERS ACT OF 1940

Form 1-R. For application for registration. -- This form is to be used for application for registration of investment advisers pursuant to Section 203 of the Investment Advisers Act of 1940.