

TWELFTH ANNUAL REPORT
Of the
SECURITIES AND EXCHANGE COMMISSION

Fiscal Year Ended June 30, 1946

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SECURITIES AND EXCHANGE COMMISSION

Central Office
18th and Locust Streets
Philadelphia 3, Pa.

COMMISSIONERS

Ganson Purcell, Chairman
Robert E. Healy
Robert K. McConnaughey
James J. Caffrey
Richard B. McEntire
Orval L. DuBois, Secretary

LETTER OF TRANSMITTAL

SECURITIES AND EXCHANGE COMMISSION,
Philadelphia 3, Pa., January 27, 1947

SIR: I have the honor to transmit to you the Twelfth Annual Report of the Securities and Exchange Commission, in accordance with the provisions of Section 23(b) of the Securities Exchange Act of 1934, approved June 8, 1934, Section 23 of the Public Utility Holding Company Act of 1935, approved August 26, 1935, Section 46(a) of the Investment Company Act of 1940, approved August 22, 1940, and Section 216 of the Investment Advisers Act of 1940, approved August 22, 1940.

Respectfully,
JAMES J CAFFREY, Chairman.

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

ROBERT E. HEALY
1883-1946

Robert E. Healy was appointed by the President's one of the original members of the Securities and Exchange Commission, and assumed the duties of that office on July 2, 1934. By virtue of three successive reappointments he held that office until his death on November 16, 1946.

To his duties he brought a wealth of knowledge and wisdom, a staunch integrity, an impeccable sense of fairness, and a boundless, untiring devotion. These qualities made him, inevitably, a powerful influence in the shaping and administration of the laws administered by the Commission.

His forceful expression of the principles that guided his decisions established a tradition deeply respected by all who knew him. He leaves more than one man's burden to be borne by those who remain. It would have been his will that we carry on, in spite of his loss, the tasks which still lie before us.

His was a spirit that recognized no limit to friendship. To the young people, whom he especially loved, he was particularly anxious to give help and encouragement. In all who knew him he inspired a deep and lasting affection.

We have resolved to memorialize herein our sorrow at his passing and to record our deep sympathy for the members of his family.

James J. Caffrey
Robert K. McCounaughy
Richard B. McEntire
Edmond M. Hanrahan

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FOREWORD

This review of the Commission's activities for the fiscal year ending June 30, 1946, was prepared, pursuant to law, for the information of the Congress. It is a factual report, and is in general limited to the activities for the fiscal year covered. The Commission's Tenth Annual Report contained a broader historical statement, and reference to the Tenth Annual Report should be made for a more adequate survey of the first decade of the Commission's operations.

The recent Congressional election has brought to the Congress many new members. We hope that this annual report will help to acquaint them with the work of the Commission. The report indicates the broad scope of the

Commission's concerns under the various laws administered by it and the significance of the policies embodied in those laws. The fields regulated by the Commission are complex and they are at the heart of the financial life of the American economy. The key to the most effective regulation in this field is to carry out the policies of the law with a minimum of interference with the normal operations of the facilities of securities distribution and trading.

A reading of the report will indicate the extent to which the Commission has adjusted its methods to achieve that aim. While the number of forms provided under the various acts may seem, at first glance, to result in complexity, the forms are, in reality, the result of constant adjustment to achieve simplicity and to minimize the burdens of those called upon to comply with the laws. The endeavor is always to find that method of administration which is most suitable and least burdensome to the particular individual or company affected.

The report describes instance after instance showing the effort of the Commission to bring the policy of the Congress into play with as much cooperation as possible with those concerned. The Commission's method of procuring corrections in registration statements by conference and negotiation rather than by formal proceedings is an example of this. The particular care exercised in conducting trading investigations so as to cause the minimum of disruption and embarrassment is another example. While, to the layman, many of the Commission's rules providing for exemptions and exceptions may appear to be complex and difficult to follow, they are the careful product of adjustment to the practical needs of the financial community.

The Commission has broad powers to bring about the geographical integration and corporate simplification of holding company systems. There are many ways in which such a far-reaching program may be effected. The dictation of plans by the Commission and their involuntary enforcement by the courts (which is one of the methods provided for under the Public Utility Holding Company Act) is one way. Another way is to indicate the Commission's findings as to the end results required by the Act and to leave wide latitude for the proposal of voluntary plans of compliance by the companies affected. The Commission has chosen the latter route. While many of the intricate problems dealt with by the Commission under the Public Utility Holding Company Act might have been disposed of more quickly by adopting harsh measures for enforcing involuntary changes, the Commission has consistently considered that fairer and more feasible results can be achieved by encouraging and assisting voluntary compliance.

Evident throughout the report is the constant concern of the Commission to keep open the channels of communication between itself and those with whom it deals. In terms of time and manpower spent the rendition of information, advice, and help to other governmental bodies, interested companies and members of the public bulks large. As indicated in this report and in prior reports of the

Commission the formulation of important administrative policies is, wherever possible, achieved through cooperation and consultation with those affected.

The Commission regards itself as having been charged with a public trust in the administration of the policies of the law. Its facilities are always available to those who seek information about its work. It applies to itself the principle of full disclosure embodied in all the statutes it administers.

COMMISSIONERS, STAFF OFFICERS, AND REGIONAL ADMINISTRATORS

Commissioners: --

Ganson Purcell -- Term expires June 5, 1947 [Footnote: Mr. Purcell resigned as of the close of business on June 30, 1946, being succeeded as chairman by Mr. Caffrey. Mr. Edmond M. Hanrahan, of New York, was appointed to the vacancy created by Mr. Purcell's resignation.]

Robert F. Healy-- Term expires June 5, 1951 [Footnote: Deceased, November 16, 1946.]

Robert K. McConnaughey -- Term expires June 5, 1949

James J. Caifrey -- Term expires June 5, 1950

Richard B. McEntire -- Term expires June 5, 1948

Secretary: Orval B. DuBois.

Staff officers

Baldwin B. Bane, Director, Corporation Finance Division.

Milton H. Cohen, Director, Public Utilities Division.

James J. Treanor, Jr., Director, Trading and Exchange Division.

Roger S. Foster, Solicitor.

William W. Werntz, Chief Accountant.

Herbert B. Cohn, Executive Assistant in Charge of Opinion Writing office.

Walter C. Louchheim, Jr., Adviser on Foreign Investments.

Hastings P. Avery, Director, Administrative Division.

Philipp L. Charles, Director of Personnel.

James J. Riordan, Budget officer.

Regional Administrators

Zone 1 -- Peter P. Byrne, Equitable Building (Rm. 2006), 120 Broadway, New York, N. Y.

Zone 2 -- Paul H. Rowen, Post office Square Building (Rm. 606), 79 Milk Street, Boston, Mass.

Zone 3 -- William Green, Palmer Building (Rm.. 415), Forsyth and Marietta Streets, Atlanta, Ga.

Zone 4 -- Charles J. Odenweller, Jr., Standard Building (Rm. 1608), 1370 Ontario Street, Cleveland, Ohio.

Zone 5 -- Thomas B. Hart, Bankers Building (Rm. 630), 105 West Adams Street, Chicago, Ill.

Zone 6 -- Oran H. Allred, New Federal Building, Tenth and Lamar Streets, Fort Worth, Tex.

Zone 7 -- John L. Geraghty, Midland Savings Building (Rm. 822), 444 Seventeenth Street, Denver, Colo.

Zone 8 -- Howard A. Judy, 625 Market Street (Rm. 1301), 625 Market Street, San Francisco, Calif.

Zone 9 -- Day Karr, 1411 Fourth Ave. Building (Rm. 810), Seattle, Wash.

Zone 10 -- William M. Malone, O'Sullivan Building (Rm. 2410), Baltimore, Md.

PART I ADMINISTRATION OF THE SECURITIES ACT OF 1933

The main objectives of the Securities Act of 1933 as amended, are to provide for full disclosure by means of registration statements and prospectuses of pertinent information regarding securities publicly offered for sale through interstate commerce or through the mails and to prevent misrepresentation, deceit, and other fraudulent practices in the sale of securities. The Act does not confer upon the Commission the power to approve or pass upon the merits of any security. Even though the act does not insulate investors against risk, it does make available to them information with which to gage the risk.

REGISTRATION OF SECURITIES UNDER THE SECURITIES ACT OF 1933

To achieve the end of full and fair disclosure of the material facts regarding securities offered for sale to the public in interstate commerce or by the use of the mails, the Act provides that, with certain exceptions, before securities may be so offered or sold, a registration statement must be filed with the Commission and must become effective. Each registration statement must be filed on the particular form prescribed by the Commission as appropriate to the type of security proposed to be offered.

The registration statement, which becomes a public document once it is filed, is designed to set forth all the material facts with regard to the company and its securities which are to be sold. This required information includes, for example, statements with regard to the character, size, and profitableness of the business; its capitalization; the purpose of the financing; options outstanding against securities of the issuer; the remuneration of officers and directors; bonus and profit-sharing arrangements; underwriters' commissions; and pending or threatened legal proceedings. Certified financial statements must also be included in the registration statement proper. In addition, the Act provides as an integral part of the registration procedure that the issuer must furnish to investors a prospectus setting forth in convenient form the basic or more important material contained in the registration statement.

The fact that a registration statement has been filed, or that it has been examined by the Commission's staff, or that it is in effect, does not imply any appraisal by the Commission of the merits of the security as an investment. The Securities Act does not authorize the Commission to pass judgment upon the soundness of any security covered by a registration statement. Actually, the statute makes any representation to the contrary a criminal offense. Thus, in administering the Act, the Commission does not direct the flow of capital or try to do so, although, of course, the requirement that registrants disclose the truth concerning security offerings may very well affect their public reception. In short, as pointed out in the headnote to this chapter, the basic policy of the Act is not to attempt to protect the investor by insulating him from risk but to make available to him the information with which to gauge the risk. It follows that, under the Act, even speculative or apparently unsound issues may be registered and sold to the public provided the whole truth is told.

One of the Commission's most important functions is to examine these registration statements for compliance with the statutory standards of full disclosure and to obtain amendments necessary to correct deficiencies discovered thereby before permitting the registration statement to become effective. The work of examining registration statements has to be accomplished with maximum dispatch, since the Act provides that the registration statement

shall, ordinarily, become effective on the twentieth day after it is filed. The filing of an amendment to the registration statement starts the period of delay running anew, unless the amendment is filed with the consent of or by the order of the Commission. In that event the running of the original 20 days is not interrupted. The Commission may, in its discretion, accelerate the effective date of the registration statement, having due regard to the adequacy of relevant information available to the public and with due regard to the interests of investors. The purpose of the 20-day waiting period is to give the public an opportunity to absorb the information in the prospectus or registration statement before making a commitment that would otherwise need to be made in haste or ignorance.

The Commission has endeavored in many ways to adapt its procedures to the accustomed practice of businessmen and distributors of securities insofar as this adaptation is consistent with the intent of the Congress and the protection of investors. A notable example is the "letter of deficiency" which the Commission sends to registrants as promptly as possible after the statements are filed to advise them of any material misstatements or omissions. Registrants are thus afforded an opportunity to file correcting amendments before the statements become effective. Another informal procedure which has proved exceptionally useful is the pre-filing conference in which representatives of registrants and underwriters discuss problems in connection with proposed filings with the Commission's staff so as to determine in advance what types or methods of disclosure would be necessary under the circumstances of the particular case. As a result of such informal advisory assistance rendered in an effort to simplify the registration procedure in every practicable way consistent with the public interest and the protection of investors, 1946 was the fifth consecutive fiscal year in which it has not been necessary for the Commission to issue a single order under the Act to prevent or suspend the effectiveness of any registration statement.

THE VOLUME OF REGISTERED AND EXEMPTED FLOTATIONS

Total of Registrations

The aggregate volume of securities effectively registered under the Securities Act of 1933 during the 12 months ended June 30, 1946, was \$7,073,280,000, the greatest amount in any fiscal year since the passage of the Act and very substantially greater than the previous high of \$4,851,465,000 in the 1937 fiscal year. [Footnote: The 1946 Volume was distributed over 661 statements covering 1,015 issues. Although the dollar volume represents a new high, both the number of statements and the number of Issues were less than the peak of 540 statements and 1,266 issues in the fiscal year 1937. The number of statements represented in these statistics, 661, differs from the 668 given in the table on p. 6, due to differences in the classification as to time of effectiveness of issues which became effective subject to further amendment.] of this total registered,

securities to be sold for cash amounted to \$5,895,840,000, of which about nine-tenths, or \$5,423,593,000, was registered for the accounts of the issuers of the securities (primary distributions). The amount to be sold for cash which was registered for the accounts of others than issuers, \$472,248,000, was the greatest amount ever registered for secondary cash distribution in any fiscal year and more than twice the previous high of \$189,722,000 in the 1941 fiscal year.

Volume of Stocks and Bonds

Of all securities registered to be sold for cash for the accounts of issuers, the volume of stocks was \$2,321,324,000 and the volume of bonds and other credit instruments was \$3,102,269,000. The volume of bonds and other credit instruments was only slightly less than the previous high of \$3,153,226,000 registered in the 1936 fiscal year. Although stocks accounted for the smaller part of securities registered for cash sale, the increase in stock registrations over previous years was substantially greater than the increase in bonds and other credit instruments over recent years. The volume of stock registrations was more than two and one half times greater than the \$863,363,000 registered in the 1945 fiscal year and almost double the previous high of \$1,208,520,000 in the 1937 fiscal year. The volume of equity securities other than preferred stock registered for cash sale, \$1,330,625,000, was in itself greater than the previous high for all stocks to be sold for cash; and the volume of preferred stocks to be sold for cash, \$990,699,000, was in itself greater than the total of all stocks registered by issuers for cash sale in the 1945 fiscal year.

Types of Issuers

Of all new issues registered to be sold for cash, an extremely high amount was registered by manufacturing companies. The \$1,750,752,000 so registered by this group was substantially greater than the previous high of \$1,195,349,000 in the 1936 fiscal year. Transportation and communication companies registered \$964,795,000 of new issues to be sold for cash, more than 80 percent greater than the \$529,516,000 of such registrations in the 1937 fiscal year. Finance and investment companies registered \$902,344,000 of new issues to be sold for cash, almost 40 percent greater than the previous high of \$649,475,000 of such registrations in the 1937 fiscal year. Only the volume of new issues registered to be sold for cash by electric, gas, and water companies, \$1,496,860,000, failed to exceed the previous high of such registrations by these companies, \$1,499,419,000 in the 1936 fiscal year, but only by less than \$3,000,000

Methods of Sale

Investment bankers were used for the distribution of 96 percent, \$5,195,867,000, of the volume of all securities registered for primary cash distribution. Eighty two percent, \$4,445,915,000, involved commitments by bankers to purchase for

resale and 14 percent, \$749,952,000, commitments to use their best efforts. Registrants planned to sell 4 percent, \$227,726,000, directly to investors.

Cost of Flotation

The cost of flotation of securities registered for primary cash distribution, as reported in the registration statements for such securities amounted to 5.3 percent of the aggregate dollar volume of such securities. A further break-down of this 5.3 percent indicates that 4.8 percent was to be paid as commissions and discounts and 0.5 percent for all other expenses incidental to the flotation of the securities, including all costs relative to registration. A study of the portion of aggregate gross proceeds paid as commissions and discounts to investment bankers on securities registered for sale to the general public through such bankers reveals a downward trend in recent years, as may be noted from the table below:

(CHART OMITTED)

Comparable statistics to reveal the trend prior to 1939 are not at present available. A trend similar to that noted in the chart may be noted with respect to bonds, subdivided on the basis of the investment risk involved.

Unregistered Issues

In addition to the \$5,424,000,000 of securities registered for primary cash distribution, some \$2,497,000,000 of unregistered new corporate securities are known to have been offered for cash sale by issuers during the fiscal year, counting only offerings in excess of \$100,000. Issues under the jurisdiction of the I. C. C. (mostly rails) accounted for \$1,317,000,000 of the total of unregistered issues; privately placed issues for \$991,000,000; new issues of bank securities for \$74,000,000; and intrastate offerings for \$4,000,000. The balance of \$112,000,000 consisted of securities offered in issues between \$100,000 and \$300,000 under Regulation A, as amended effective May 21, 1945. During the fiscal year under review there was an almost continuous rise in the volume of Regulation A offerings. In the final month of the fiscal year alone there were 83 such issues with an aggregate offering price of \$18,000,000.

[UNREADABLE TEXT] by investment companies) the volume of all new issues of corporate securities offered for cash sale in issues of more than \$100,000 during the 12 months ended June 30, 1946, including both those registered and unregistered, was \$7,124,000,000.

New Capital

The amount of proceeds from securities flotations applicable to expansion of fixed and working capital aggregated \$1,557,000,000. This is the highest volume

of new capital financing from securities in fifteen years and compares with the recent peaks of \$1,196,000,000 in the 1937 fiscal year and \$862,499,000 in the 1942 fiscal year. Industrial and miscellaneous companies accounted for more than 80 percent of the new money financing. Flotations by utilities and railroad companies were mainly for the purpose of refunding outstanding obligations.

Refinancing

The volume of refinancing through new issues of securities reached a record high of \$5,160,000,000, due in great part to the fact that many corporations took advantage of certain features of the tax laws and of the low level of interest rates to reduce their interest and fixed dividend costs. In addition, many corporations retired outstanding securities with cash from sources other than proceeds from the sale of new issues, such as treasury cash and bank loans, so that the aggregate volume of fixed income securities is estimated to have declined.

Volume of All New Issues

The addition of non-corporate to corporate issues brings the volume of all new issues of securities offered for cash sale in the United States during the 1946 fiscal year to \$35,948,000,000. The bulk of this volume consisted of long-term United States Government securities. The volume of such securities, \$27,258,000,000, was, however, the lowest volume of offerings by the Federal Government in 4 years. The amounts of securities offered for sale by other non-corporate issuers were: \$928,000,000 by states and municipalities; \$608,000,000 by Federal Land Banks; \$30,000,000 by foreign governments; and approximately \$500,000 by miscellaneous nonprofit organizations.

Statistics of Securities Registered Under the Securities Act of 1933

As shown below, the Commission last year received and examined 752 registration statements under the Securities Act of 1933. This was the largest number of registration statements filed in any year since 1937. As noted, the aggregate dollar value of the securities covered by these registration statements exceeded \$7,000,000,000, which is the greatest amount for any year since the passage of the Act in 1933.

Disposition of Registration Statements

(CHART OMITTED)

It may be helpful to call attention to the striking increase in volume of registration statements which the Commission's depleted wartime and post-war staff must currently process. To that end there is recapitulated below the number of registration statements originally filed in each fiscal year or other convenient

period since the passage of the Act, along with the corresponding dollar value of securities covered thereby.

Comparative number of registration statements filed, and corresponding value of securities involved, for specified periods since enactment of the Securities Act of 1933.

(CHART OMITTED)

These progressive annual increases in the number of registration statements filed in each of the past three fiscal years, compared to the next preceding year, measure 63 percent in 1944, 80 percent in 1945, and 88 percent in 1946. At the same time, the value of securities covered by the statements was also increasing by the staggering [UNREADABLE TEXT] indicated above, the number of these statements filed during the 1946 fiscal year was the greatest since 1937, while the dollar amount of securities involved reached by far the greatest total for any one of the 13 years that the Securities Act of 1933 has been in effect, exceeding by 38 percent the previous high in 1937.

EXEMPTION FROM REGISTRATION UNDER THE SECURITIES ACT OF 1933

Section 3(b) of the Act empowers the Commission, by Rule and Regulation, subject to such terms and conditions as it might prescribe, to exempt from registration issues of securities where the aggregate offering price to the public of such securities does not exceed \$300,000. [Footnote: The maximum amount was originally \$100,000. Six weeks before the beginning of the 1948 fiscal year Congress amended this Section to raise the maximum amount of \$300,000. The Commission promptly amended its Regulation A, effective May 22, 1945 to provide certain exemptions for issues up to \$300,000.]

The law permits the Commission to provide exemptions only when it deems that enforcement of the Act is not necessary in the public interest and for the protection of investors by reason of the small amount involved or the limited character of the public offering.

Under this Section, the Commission has adopted Regulation A, a general exemption for small issues; Regulation A-R, a special exemption for notes and bonds secured by first liens on family dwellings; [Footnote: Inasmuch as no reports or filings are required under this regulation no statistical data as to its application and use are available.] Regulation A-M, a special exemption for assessable; shares of stock for mining companies; Regulation B, an exemption for fractional undivided interests in oil or gas rights; and Regulation B-T, an exemption for interests in oil royalty trusts or similar types of trusts or unincorporated associations.

The availability of an exemption under any of these Regulations does not include any exemption from civil liabilities under Section 12 or from criminal liabilities for fraud under Section 17. In order to ensure the proper enforcement of these Sections, the conditions for the availability of the exemptions provided by these Regulations, with the exception of Regulation A-R, include the requirements that certain minimum information be filed with the Commission and that disclosure of certain information be made in sales literature.

Exempt offerings Under Regulation A

Last year a marked increase occurred in the number and dollar amount involved in public offerings under the general exemption provided by Regulation A. For example, the number of letters of notification received and examined pursuant to Regulation A more than doubled from the 578 of the preceding year and reached a total for the 1946 fiscal year of 1,348. At the same time a much more striking increase occurred in the aggregate offering price of the securities involved, which jumped from \$38,848,893 in 1945 to \$181,600,155 during the past year. It seems reasonable to attribute a very large part of this increase to the raising of the maximum limitation for a permissible exempt offering to \$300,000. Included in these offerings were 69 letters of notification, with an aggregate offering price of \$8,158,833 relating to oil and gas leases and securities of companies engaged in various phases of the oil and gas business.

This number of filings has placed an unprecedented load on the staff of experts maintained by the Commission to examine such filings. Under Regulation A, letters of notification must be filed at least 5 days prior to the first day when the securities are to be offered for sale, in order to permit the Commission's staff to examine the material and to check its files for other pertinent information about the company and persons involved in addition sales literature must similarly be filed before its use. Such filings must be made in the appropriate regional office, which examines the material primarily to determine whether any violations of the antifraud provisions of the Act are indicated and to ascertain that proper compliance has been made with the Rules applicable to the exemption claimed. If any deficiencies are discovered in the filing, the offeror of the securities is informed, by letter or telephone in order to prevent any violation of the Act or the provisions of the Regulation.

In addition to the initial examination by the regional office, the material filed is reviewed by a staff of experts at the Commission's central office. Such review involves a search for pertinent information in the Commission's extensive files and an examination to determine whether the exemption of the Regulation is applicable in the particular case and whether the information filed discloses and violations of any of the Acts administered by the Commission. The results of this review are made available promptly to the regional office involved. During the 1946 fiscal year 1603 such reviews were sent to regional offices.

As a further step in the administration of Regulation A, the staff at the central office of the Commission informs the proper authorities in the States in which the securities are to be offered of the fact that the offering is to be made, and gives such authorities certain pertinent data. A weekly report of letters of notification filed under this Regulation is compiled and mailed to interested persons, including the proper authorities in all the States and the regional offices of the Commission. This report includes information as to the name of the issuer of the securities; the offeror; the principal underwriter; the date the letter of notification was filed; the dollar amount of the offering and the number of shares being offered; the type of security being offered; and the States in which the offering is to be made.

Exempt offerings Under Regulation A-M

The Commission received and examined during the year a total of five prospectuses covering an aggregate offering' price of \$154,380 for assessable shares of stock of mining corporations conditionally exempt from registration pursuant to Rule 240 of Regulation A-M.

Exempt offerings Under Regulation B

Pursuant to Regulation B, which provides for the conditional exemption from registration of fractional undivided interests in oil or gas rights where the aggregate offering price does not exceed \$100,000 the Commission last year received and examined 173 offering sheets and 214 amendments to such offering sheets, with respect to which the following actions were taken:

Various Actions on Filings Under Regulation B

Temporary suspension orders (Rule 340(a)): 63

Orders terminating proceedings after amendment: 49

Orders consenting to withdrawal of offering sheet and terminating proceeding: 11

Orders terminating effectiveness of offering sheet (no proceeding pending): 20

Orders consenting to amendment of offering sheet (no proceeding pending): 74

Orders consenting to withdrawal of offering sheet (no proceeding pending): 7

Total Orders: 224

Confidential Written Reports of Sales Under Regulation B

The Commission also received and examined during the year 2,698 confidential written reports required pursuant to Rules 320(e) and 322(c) and(d) of Regulation B concerning sales made by broker-dealers or offerors to investors and by dealers to other dealers. This total consisted of 2,409 reports on Form 1-G and 289 on Form 2-G, representing sales in the aggregate of \$1,001,981 and \$582,634, respectively. If examination of these reports indicates that a violation of the law may have occurred, the Commission makes appropriate investigations and, in instances where the facts are deemed to warrant it, appropriate action is taken.

Oil and Gas Investigations

Among the investigations conducted by the Commission during the fiscal year to determine whether certain transactions had been effected in violation of Sections 5 (requiring registration) or 17 (prohibiting fraudulent sales) of the Securities Act of 1933 or Section 15 of the Securities Exchange Act of 1934 (regulating the conduct of brokers and dealers), a total of 147 involved oil and gas investments. Apart from the 1,500 letters written and 600 personal and telephone conferences held during the year by the staff of the Commission's central office engaged in work involving oil and gas securities, the engineers and geologists assigned to that specialized staff prepared 91 technical memoranda or valuation estimates, and also conducted scores of conferences in the oil and gas producing regions and other locations in the field, as a part of the Commission's oil and gas investigation activity. Eight of these investigations were closed during the year so that 139 were pending at the end of the year. A summary of these investigations is tabulated below:

(CHART OMITTED)

As an illustration of the results achieved in certain of these investigations, it may be noted that the persons concerned in four cases were enjoined from violating the registration or fraud provisions of the Securities Act of 1933; in three other cases the facts developed by the Commission were referred to the Department of Justice for criminal prosecution; and indictments were obtained in three additional cases which led to the following sentences: (1) George A. King and Erling L. Wernes, imprisonment for 30 months and 1 year and 1 day, respectively; (2) Frank V. Raymond, imprisonment for 1 year and 1 day and fine of \$10,000; and (3) C. Milton Smith, imprisonment for 6 months and suspended execution of an additional 2-year sentence during which he is to be on probation.

New Rule Adopted Under the Securities Act of 1933

The only additional Rule promulgated under the Securities Act of 1933 during the 1946 fiscal year was the one adopting the 40-hour workweek recommended for Federal agencies by the President.

DISCLOSURES RESULTING FROM EXAMINATION OF REGISTRATION STATEMENTS

The staff of the Commission makes prompt and intensive study of registration statements in order, by conference, to procure necessary amendments in advance of effectiveness of such statements. Because of the extent of this work the Commission has not needed to resort, in recent years, to the stop-order proceeding. Several typical examples of inadequacies found in registration statements and of corrective steps taken will be found in the following brief case histories.

Inside Dealings With Affiliated Companies

A registrant disclosed that it had entered into an arrangement whereby all of its goods were sold through two affiliated companies-- a general sales company which was owned and controlled by officers of the registrant and a specialty sales company which was owned and controlled by the wives of such officers, The terms of the contracts were such as to assure the selling companies a profit. Upon the Commission's insistence that, in addition, proper disclosure be made of the advantages secured by the officers and their wives at the expense of the registrant through these contracts, all such contracts were canceled and all profits which had accrued to the selling companies were restored to the registrant.

Effect of Issuance of Warrants

In order to apprise any prospective investor of the unfavorable effect upon any investment he might make, as a result of the distribution of warrants issued to the underwriters and promoters evidencing the right to subscribe to 60,000 shares of stock, the Commission requested and obtained the following disclosure in a registration statement:

For the life of the Warrants the Underwriters and the Promoters so long as any of them own any of the Warrants issued to them, will have at no cost, except as part payment of underwriting commissions and personal service contracts, the opportunity to profit at the expense of other stockholders from any rise in the market for the Common Stock of the Company above the prices at which such Warrants may be exercised; the Company presently has no need for additional working capital in excess of the amount to be realized from the sale of the Stock offered hereby; such Warrants were issued at the request of Underwriters in connection with the underwriting and at the request of the Promoters in consideration of their entering into employment contracts with the Company described herein; at any time when a substantial amount of the Warrants may be outstanding, the Company may be deprived of favorable opportunities to procure additional equity capital through the sale of Common Stock if it should be needed

for the purposes of the business; at any time when the holders of warrants might be expected to exercise them, the Company might be able to obtain equity capital if it needed capital then, by public sale of a new offering of Common Stock on terms more favorable than those provided for by the Warrants. Any price paid to an Underwriter for a Warrant or any price paid to an Underwriter for a share of Common Stock in excess of the Warrant exercise price may be deemed to be an Underwriting discount or commission.

Previous Violations of the Securities Act

Pursuant to an investigation by the Commission, it was ascertained that a company currently filing a registration statement had previously sold \$430,000 of stock in violation of the Securities Act of 1933. Disclosure of this violation, together with the rights of purchasers to rescind such purchases or to sue for damages, was required in the registration statement the company filed under the Securities Act. As a consequence of this required disclosure, stockholders forced the company to repurchase securities representing an aggregate price of \$102,000 plus interest.

Investment Position of Public Contrasted With That of Promoters

In order to disclose in summary fashion certain essential features of a particular offering, the staff of the Commission requested the placing of an introductory paragraph at the beginning of the prospectus disclosing that, upon completion of the financing, the public would, have paid \$1,852,500, or \$19.50 per share, for a 23.2 percent interest in the company whereas three promoters would have paid \$25,000, or 8 cents per share, for a 76.8 percent interest in the company. It was further disclosed in this introductory paragraph that in the last 3 years the company had earned the following per share: 6 cents (loss), 21 cents and 35 cents and that the book value of the shares to be offered at \$19.50 would, after the receipts of the proceeds by the company, amount to \$1.09 per share.

Position of Investor in Foreign Corporation

The Commission required a Mexican corporation to disclose in a prominent place in the prospectus that (1) the articles of incorporation of the company provided, as required by Mexican law, that every person other than a Mexican who acquires an interest or share in a company shall be deemed to be a Mexican with respect to such interest or participation and agrees not to invoke the protection of his government under penalty of forfeiting such interest or share to the Mexican government in case of breach of such agreement; and (2) the company knows of no provision of law in the United States which by its terms subjects the company, a Mexican corporation, and its nonresident directors and officers and the nonresident experts named in the prospectus, to the jurisdiction of the courts in the United States; and (3) the enforcement in the United States by investors of claims under the Securities Act of 1933 against the company and such directors,

officers, and experts as are not residents of the United States may therefore be difficult or perhaps impossible.

Significance of Contingent Liability

A company which was manufacturing its principal product without having first obtained a license from the owner of the patent covering a basic device embodied therein disclosed the fact that it had not secured such license but failed to disclose the possible disastrous results which would follow from institution of suit by the patent holder. By amendment required to the registration statement, the company, whose total capital, reserves, and surplus aggregated less than \$2,000,000, disclosed that while it was unable to state exactly the amount of its liability for such damages, it estimated that its liability for infringement to date would amount to approximately \$232,000; and that, moreover, any judgment upholding the validity of the patent would unquestionably result in an injunction against the continued use of the device by the company, thus requiring modification and possibly abandonment of further manufacture of the product in question.

Losses During Reconversion Period

A company whose peacetime business consists of the manufacture of personal type airplanes reported earnings of \$52,000 for the year 1945. Upon inquiry by the Commission as to the costs of reconverting and entering into peacetime business, the statement of earnings for 1945 was revised to show that although the company earned approximately \$600,000 in the first 8 months of 1945 from war business, it had lost approximately \$550,000 in the last 4 months of 1945 while it was converting to peacetime operations. It was further disclosed that losses were continuing in 1946.

Misleading Title of Security Revised

A registrant proposed to describe the securities to be offered as "second mortgage 4 percent non-cumulative income bonds." This title was considered by the Commission to be misleading, for the reason that the obligor actually promised to pay only 2 percent per annum, and would pay an additional 2 percent only in the sole discretion of its Board of Directors. In addition, all "income," as that term is generally understood was not available for payment of the original 2 percent of interest, for the reason that the indenture provided for the deduction of a fund for capital improvements in arriving at the amount available for interest. The title of the securities was accordingly changed, as disclosed in an amendment to the registration statement, to read "second mortgage non-cumulative contingent interest bonds," and this title was further qualified at the same time by placing a summary of the interest provisions on the facing page of the prospectus.

Stock Watering

The “watering of stock” in its original sense is almost a forgotten term. However, the issuance of stock at prices which bear little or no relationship to the issuer’s book values and earning power accomplishes the same purpose. A case in point is a New York corporation which filed a registration statement covering 450,000 shares of common stock and 120,000 stock purchase warrants. This company had 100,000 shares of common stock, 10 cent par value, outstanding, which were recapitalized immediately prior to the filing of the registration statement into 900,000 shares of common stock, 10 cent par value, the new authorized capitalization being 1,500,000 shares. The offering to the public of 450,000 shares of common stock was made at a price of \$6 per share, or an aggregate offering price of \$2,700,000. In this connection it is interesting to note that although the shares were to be sold to the public at \$6 per share, a few months prior to the offering one of the organizers and principal stockholders sold the equivalent of 207,000 of the recapitalized shares at an average price of approximately 30 cents per share to a company identified with the registrant at the time of the offering. The aggregate book value of the company’s outstanding stock prior to the public offering was approximately \$283,000. Based on the price at which the public was asked to purchase, i.e., at \$6 per share, the 900,000 outstanding shares owned by the insiders would have an aggregate value of \$5,400,000, an amount exceeding the aggregate book value by approximately \$5,117,000. Thus it will be seen that on a liquidating basis some \$1,700,000 of the \$2,700,000 contributed by the public as a result of the offering at \$6 per share would go toward swelling the book value of the outstanding stock held by insiders from about 31 cents to \$2.21 per share.

It should also be noted that the offering at \$6 per share was accomplished without even the support of past earning power. For each of the 3 years prior to the public offering the company’s earnings, based on its capitalization of 900,000 shares, were from a very small fraction of 1 cent per share to 2¼ cents per share. The company recognized that to realize a normal return on its capitalization after the public offering, its sales would have to increase from the maximum of \$2,600,000 achieved in 1945 to in excess of \$16,000,000, and that such sales were not a reasonable expectancy in the near future.

In the registration statement as originally filed, the above facts were either obscured or omitted. Information regarding other circumstances, such as the company’s dependence on substantial borrowed capital, the issuance of warrants to underwriters and insiders, the existence of competition with larger organizations having much greater resources, the company’s reliance upon rented rather than owned facilities, and its performance of only limited functions (since the products were to be obtained from outside sources and distributed through independent distributors), was also omitted or not adequately presented. Only after several amendments did the prospectus achieve clear and adequate disclosure.

INJUNCTION ACTIONS INSTITUTED UNDER THE SECURITIES ACT OF 1933

The Commission's enforcement activity under the Securities Act of 1933 is concerned generally with the prevention of fraud in the sale of securities and obtaining compliance with the full disclosure requirements of the registration process. Data with respect to civil cases and appellate proceedings instituted under that Act, including a brief discussion of all civil proceedings commenced or pending during the past fiscal year and their status at the close of the year, are included in Appendix Tables 24, 26, and 29.

Section 5 of the act requires registration where securities are offered to the public. [Footnote: Certain exemptions are set forth in Secs. 3 and 4 of the Act] Section 17(a) makes unlawful the use of any misrepresentations or fraudulent schemes in the sale of securities. A substantial part of the Commission's litigation activities involves injunctive actions to restrain violation of these Sections. For example, in *S.E.C. v. John Wight, Mondakota Development Company, et al.*, [Footnote: U.S. District Court, Montana, Sept. 20, 1945 False and misleading statements regarding the number and productive capacity of Mondakota's gas producing wells, the acreage under lease and the value of its leases and the assets and the prices at which stock would be sold in the future.] *S.E.C. v. Chemical Research Foundation, Inc. and Robert E. Carroll*, [Footnote: U.S. District Court, Delaware, Sept. 11, 1945. False and misleading statements regarding the Company's financial status, value of its securities, its dividend record and the success of its operations. Following the Commission's investigation, defendants were convicted on July 2, 1945, of violations of the fraud section of the Securities Act and Sec. 215 of the Federal Criminal Code (mail fraud) and Carroll was sentenced to 2 years' imprisonment to be followed by 3 years' probation.] and *S.E.C. v. James F. Morrissey*, [Footnote: U. S. District Court, N. D. (Fort Worth division), Texas, Dec. 19, 1945. False and misleading statements regarding the extent of defendant's leaseholdings, a "doodle-bug" device claimed by defendants to be unerringly capable of detecting oil in commercial quantities and the opinions of an expert concerning the prospects of finding oil.] The Commission obtained final judgment enjoining the defendants from violating the registration and fraud provisions.

In *S.E.C. v. Great Western Gold and Silver Mines Corporation, Walter H. Moore, et al.*, [Footnote: U.S. District Court, Colorado, Mar. 11, 1946] and *S.E.C. v. A. F. Blakesley, et ano.*, [Footnote: U.S. District Court, Colorado, Mar. 11 1946.] the Commission obtained final judgments enjoining the defendants from making false and misleading statements regarding the content and value of ore in the mining properties and the use of the proceeds received in the sale of stock.

In *S.E.C. v. Claude D. Adams, et al.*, [Footnote: U.S. District Court, New Mexico, June 4, 1946] *S.E.C. v. A. D. Beck*, [Footnote: U.S. District Court, N.D., Texas,

Mar. 14, 1946] *S.E.C. v. Paul J. Hunt*, [Footnote: U. S. District Court, W. D. northern division. Washington Feb. 15, 1946. As an offshoot of this case, the Commission obtained an order in the same district on Aug. 12, 1946, adjudging the defendant guilty of criminal contempt in violating the terms of the judgment] and *S.E.C. v. Bob Burch*, [Footnote: U.S. District Court, N. D., Fort Worth division, Texas, Nov. 8, 1945. On Jan. 28, 1944, the Commission obtained a final judgment in the U. S. District Court, W. D, Louisiana against The Bob Burch Company, Inc., and Bob Burch, enjoining them from violating the fraud provisions in the sale of their securities.] the Commission obtained final judgments restraining further violations of the registration provisions of the Securities Act. In *S.E.C. v. Milton F. Pulver*, [Footnote: U.S District Court, W.D., Washington, Nov. 19, 1945.] the Commission obtained an injunction restraining the defendant from violating the registration provisions in the sale of pre-organization subscriptions and promissory notes.

PART II

ADMINISTRATION OF THE SECURITIES EXCHANGE ACT OF 1934

The Securities Exchange Act of 1934 is designed to eliminate fraud, 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 listed on any national securities exchange; and to regulate the use of the Nation's credit in securities trading. The authority to issue rules on the use of credit in securities transactions is lodged in the Board of Governors of the Federal Reserve System, but the administration of these rules and of the other provisions of the Act is vested in the Commission.

REGULATION OF EXCHANGES AND EXCHANGE TRADING

Registration of Exchanges

The number of exchanges registered with the Commission as national securities exchanges and the number of exchanges exempted from such registration remained the same during the fiscal year; the numbers were 19 and 5 respectively.

Each exchange is required to keep its registration or exemption statement up to date by filing appropriate amendments or supplements reflecting all changes occurring in its constitution, rules, trading practices, and organization. A total of 113 such amendments or supplements were filed by the exchanges during the year, each of which was studied and analyzed for its effects upon the public

interest and its compliance with the relevant regulatory provisions. While the nature of the changes reported in this manner varied considerably, the more important included adoption by New York Stock Exchange and New York Curb Exchange of rules designed to regulate floor trading; adoption of a delisting rule by Salt Lake Stock Exchange; adoption by St. Louis Stock Exchange of rules to permit and regulate odd-lot trading in unlisted securities and of a rule to permit member firms to make or participate in secondary offerings of listed securities off the exchange; adoption of amendments to rules of Cincinnati Stock Exchange to permit issuance of limited memberships; and adoption by Los Angeles Stock Exchange and San Francisco Stock Exchange of rules requiring members and member firms to report with respect to substantial options relating to securities dealt in on their respective exchanges.

Value and Volume of Trading

Trading on registered securities exchanges during the fiscal year 1946 had an aggregate value of \$20,377,690,000 as shown in Appendix Table 7. This figure compares with \$15,160,875,000 in the preceding 12 months. Stock trading had a value of \$18,934,952,000 in the 1946 period, as against \$13,141,773,000 in the 1945 period. The volume of stock trading in the 1946 fiscal year was 826,777,000 shares as compared with 595,133,000 a year earlier.

Exchange Membership

As of the close of the fiscal year, according to Commission records, 2,880 individuals and 1,045 firms (sole proprietorships, partnerships, and corporations) were full or associate members of one or more of the registered exchanges, excluding the Board of Trade of the City of Chicago, which is primarily a commodities exchange. These figures represent an increase of 40 individuals and 70 firms over the previous year.

Disciplinary Actions

In connection with the Commission's investigatory activities, the exchanges have been requested to report to the Commission all cases of disciplinary action which they take against their members for violations of the Securities Exchange Act of 1934, any Rule or Regulation thereunder, or of any exchange rule. During the fiscal year, five exchanges reported taking such action against a total of 39 members, member firms, partners or employees of member firms. These disciplinary actions included fines ranging from \$100 to \$5,000 in 17 cases with total fines imposed aggregating \$24,750; a 6-month suspension from membership in 2 instances; the cancellation or suspension of registration of 11 registered representatives of member firms; the suspension of 2 specialists; and the warning and reprimanding of 8 individuals and firms. One of the specialists who was suspended was also fined in connection with the violation involved.

The disciplinary actions were occasioned by violations of various exchange rules, principally those regarding minimum rates of commission, margin trading, floor trading, handling of orders, partnership agreements, registered representatives, and specialists. The two members who were suspended from membership were alleged to have accepted and executed a customer's order to buy a sufficient amount of a designated stock to cause the last transaction therein on a given day to be above a stated price. It was the consensus of the exchange authorities that the execution of this order resulted in an improper increase in the price of the stock involved.

Special Offering Plans

Rule X-10B-2 permits special offerings of blocks of securities on national securities exchanges where such offerings are effected pursuant to a plan filed with and declared effective by the Commission. No new special offering plan became effective during the year; the plans of the seven exchanges mentioned in our last annual report, which had previously been declared effective, remained in effect throughout the year. The San Francisco Stock Exchange was the only exchange to file an amendment to its plan, such amendment being declared effective by the Commission on August 17, 1945. This amendment entitles brokers and dealers who had been approved by that exchange for preferred rates of commission to 25 percent of the special commission prevailing in special offerings. [Footnote: Rule X-10B-2 is in general designed to prevent the stimulation of the exchange market with respect to securities of given issuers while there is pending a distribution of any securities of such issuer. In recognition of the fact that special commissions might be paid to brokers acting for purchasers under plans providing for adequate safeguard to investors and the public the Commission adopted Rule X-10B-2(d)(1). This Rule permits special commissions to be paid to such brokers pursuant to plans filed with the Commission and permitted by the Commission to become effective, having due regard to the public interest and the protection of investors. One of the basic requirements provided in the Rule is that such special commissions can be paid only with respect to securities as to which adequate information is available under the various Acts administered by the Commission.]

Special offerings on registered exchanges in the 12 months ended June 30, 1946 accounted for sales of 622,629 shares of stock against 1,115,201 shares in the preceding 12 months. Special commissions amounted to approximately \$340,000 as compared with \$626,000 a year earlier. Offerings on the New York Stock Exchange accounted for 586,726 shares of the 622,629 shares total sold in special offerings on all exchanges having effective plans in the fiscal year 1946.

Regulation of the Distribution of Publicly Offered Securities

On April 16, 1946, the Trading and Exchange Division recommended the adoption of a rule pursuant to Section 15(c)(2) of the Securities Exchange Act of 1934 which would curb certain practices of some underwriters and selling group members with respect to securities being publicly offered. These persons withhold or divert substantial portions of their allotted shares from public distribution in the underwriting and thereafter sell them to the public at prices substantially above the offering price specified in the prospectus. A study conducted by the Division in connection with the proposed rule had shown such practices to be widespread and had indicated, moreover, that the withholding of shares from distribution frequently contributed to an artificial rise in the market price. The proposed rule was circulated among the trade for comment and suggestions and was under consideration at the end of the year.

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, quarterly, and other periodic reports, containing certain specified information. Such applications and reports must be filed on the Forms prescribed 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 that 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 on 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 sound 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 last year of an increasing proportion of all applications filed within considerably less time, inasmuch as the Commission issued requested orders accelerating the effective date of registration in a considerable number of cases. For example, except for the applications filed with respect to securities issued in connection with stock split-ups and stock dividends and the like-of which there was a phenomenal increase last year accounting for approximately half of all applications filed and in connection with which a temporary exemption from registration is generally available-acceleration was requested last year with respect to approximately 90 percent of the applications for registration. Since a registrant's 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 80 percent of all registrants have fiscal years corresponding to the calendar year, there is filed with the Commission a peak load of more than 2,000 annual reports at or about the end of April each year. Consequently, it is always necessary to spread the work of examining these annual reports over the ensuing months. While current reports should be examined during the month in which they are filed, and such was done prior to the war, there has been such a phenomenal growth in the volume of work flowing into the Commission, which has not been coupled with a corresponding increase in personnel, that there has necessarily arisen in recent years a growing backlog of current reports, as well as annual reports, that must be held in suspense for appropriate examination. This acute manpower situation has been aggravated during the past year particularly by the fact that more than 5,000 current reports were received during the past fiscal year, nearly double the number of such reports (2,752) received in the 1945 fiscal year. Further, it is estimated that the number of such current reports to be received in the current 1947 fiscal year will increase still further to a total of something like 7,500. The chief reason for this pronounced increase

arises from the adoption on July 23, 1945, of the Commission's Rule designated X-13A-6A requiring the filing of quarterly reports by certain companies engaged in war production (see discussion appearing at pp. 11-12 of the Commission's Eleventh Annual Report), and the adoption in substitution therefor of a new Rule on March 28, 1946, designated Rule X-13A-6B, providing for the filing of quarterly reports by certain listed companies. An explanation of this substitute Rule appears below.

New Rules Under the Securities Exchange Act of 1934

Rule X-13A-6B -- Quarterly reports by certain companies: The Commission announced on March 28, 1946, the adoption of a reporting program providing for the disclosure to investors and the public of current information as to the volume of business being done by most issuers having securities registered on a national securities exchange. At the same time the Commission announced the rescission of Rule X-13A-6A and paragraph (f) of Rule X-13A-6.

Under the provisions of the new rule, designated X-13A-6B, and the revised Item 11 of Form 8-K, most issuers filing annual reports pursuant to the requirements of Rule X-13A-1 will be required to file quarterly reports on Form 8-K, setting forth the dollar amount of sales or other gross revenues during the fiscal quarter. A report must be filed not later than 45 days after the close of each fiscal quarter beginning after December 31, 1945, or not more than 45 days after the effective date of the new Rule, whichever date is the later. Issuers previously filing reports under Rule X-13A-6A begin immediately to report under the new Rule so as to provide a continuous series of reports as to such companies, Insurance companies, investment companies, common carriers, and public-utility companies are exempted from the requirements of the new Rule due to the nature of their business and because, in the case of most listed public-utility companies, many Federal and State regulatory agencies to which such companies are generally subject presently require the filing of more extensive information on at least as frequent a basis.

Prior to adoption, comments upon drafts of the proposed new rule and of the amended Item 11 of Form 8-K were obtained from technical and professional associations, governmental agencies, national securities exchanges, individual companies, attorneys, and many other interested persons. Effect was given in the new Rules to a number of the suggestions received. A minority of those commenting on the proposed Rule, however, expressed varying degrees of doubt as to the desirability and feasibility of the proposed reporting program. For this reason it was decided to make public the following statement by the Commission outlining briefly the more important objections raised by those opposed to the program and the reasons for adopting the new Rule:

Section 13(a)(2) of the Securities Exchange Act of 1934 requires every issuer of a security registered on a national securities exchange to file such annual

reports, "... and such quarterly reports, as the Commission may prescribe." Pursuant to this subsection Rules calling for the filing of annual reports were adopted shortly after the effective date of the Act. Rules were later adopted calling for current reports on Form 8-K whenever any of certain special events occurred during the year. Since that time the problems involved in the requiring of regular quarterly operating reports have been under study from the point of view of both the usefulness of such reports to investors and their feasibility in the light of-contemporary business and accounting practices.

We have now concluded to initiate a regular quarterly reporting program applicable to most issuers having securities listed on a national securities exchange. Under the new rule, a company is required to furnish quarterly information as to the sales or other gross revenues derived from its operations. However, companies which regularly publish or distribute to stockholders quarterly financial statements or reports containing at least the above information may comply with the Rule merely by filing copies of such published reports as an exhibit to Form 8-K. The information called for is not required to be certified by independent public accountants.

As a result of extended study of the problem and of the comments received from those to whom preliminary drafts of the program were sent, we are of the opinion that companies should furnish investors and the public with regular interim information as to their operations, We are inclined to believe, moreover, that it would be desirable to obtain at quarterly intervals a condensed income statement showing not only gross revenues but also net income before and after Federal income taxes together with any nonrecurring items of income or costs and losses of an unusual size even though certain of the items could only be arrived at by the use of reasonable estimates or on the basis of certain assumptions. It appears, however, that a substantial number of listed companies do not now have their accounting and reporting practices so organized as to be in a position to make the determinations necessary to furnish reasonably reliable data of this character on a quarterly basis. Accordingly, we have determined for the present merely to require information as to sales or other gross revenues. On the other hand, companies customarily preparing more detailed information will be able to satisfy the requirements of the rule by filing copies of their regular quarterly statements or reports.

Objection to the program has been made on the ground that the required information as to sales or other gross revenues may be uninformative or misleading due to the seasonal nature of a business or to unusual events of the quarter. Somewhat similarly it is claimed that the information called for is useless since changes in sales volume may not be accompanied by a comparable change in gross or net profits, particularly for short periods or during periods when business conditions are unsettled. Although such difficulties clearly exist in varying degrees depending upon the type of company, we feel, to the contrary, that reports of sales volume when taken in conjunction with other known

information as to the business and as to business generally will be of substantial usefulness. Among other things, for example the information being required should at the present time provide an index of the extent to which a company has been able to reenter civilian markets or to maintain in the postwar period its wartime volume of civilian business. It is also our view that such information will aid in the formation and exercise of an informed investment judgment based on other available information as to the general nature of the operations of the company, its plans and prospects, for the future, its position with respect to other companies in the same industry, and many other factors which affect the financial success of a business.

Where in a particular case an issuer feels that its report as to sales or other gross revenues may not be representative because of the seasonal nature of the business or for other reasons, there are, of course, a number of possible procedures that may be utilized. In the case of a seasonal business an appropriate statement of the nature of the business could be given. In addition it would be appropriate and desirable to furnish along with the report for the particular quarter comparable figures for the same quarter of the previous year or for the 12 months period ending with the current quarter. Likewise, if in a particular case it is felt that sales or other gross revenues standing alone are inadequate because not indicative of the trend in gross or net profits, the report could include an appropriate explanation of the special circumstances, or there could be substituted a more complete though still condensed form of income statement such as is now regularly being published or sent to stockholders by many issuers.

The other principal objection was that the program imposed an unreasonable burden on reporting companies. As to the very large numbers of issuers now regularly issuing quarterly statements, we do not believe that the furnishing of the required information, either directly or by means of copies of the regular reports, involves any substantial burden. As to other companies we feel that any added burden involved in compiling the necessary information as to sales or other gross revenues is more than outweighed by the benefit to investors and the public of interim data as to a listed company's operations. Finally if under the circumstances of an unusual case it is impracticable to furnish the necessary information within the prescribed time, or if the required information is neither known nor available to the issuer, attention is directed to paragraphs 6 and 7 of the general instructions to Form 8-K which provide for special procedures in such cases.

It may be noted that shortly after the close of the fiscal year, on July 12, 1946, Rule X-13A-6B was amended so as to exempt from the Rule in addition companies primarily engaged in the production of raw cane sugar or other seasonal single-crop agricultural commodity since such producers will ordinarily have no sales in two or more of their fiscal quarters. The staff has, however, been directed to study the possibility of requiring such companies to furnish at

appropriate intervals other significant information as to the progress of the operations of such companies.

Rule X-12A-1, Temporary Exemption From Section 12(a) of Certain Securities of Banks

The Commission announced on December 5, 1945, an amendment to Rule X-12A-1. The previous Rule temporarily exempted from registration under the Act securities of banks as to which temporary registration expired on June 30, 1935, securities issued in exchange for or resulting from a modification of any securities of banks exempted from registration by the Rule, and common stock issued as a stock dividend on stock of the same class exempted from registration by the Rule. The amendment enlarges the third category of exempt securities by providing that any additional shares of common stock (whether issued as a stock dividend or otherwise) shall be exempt under the Rule if the issuer has common stock of the same class so exempted from registration. The amendment also removes from the Rule any reference to securities of bank holding companies since the exemption of such securities under the Rule has expired.

Amendment to Forms 10-K and 1-MD

The Commission on May 22, 1946, amended annual report Forms 10-K and 1-MD so as to secure a current restatement of the general character of the business in which registrants and their subsidiaries are engaged. This restatement was rendered desirable because of the major changes in many businesses as a consequence of war activities or occurring in the process of reconversion to peacetime activities. Moreover, in many cases changes not individually significant have occurred over a period of years the cumulative effect of which had been a substantial change in the general character of the business of a registrant and its subsidiaries or in one or more of the major lines of the business. The amendment requires the restatement only for the fiscal year ending on or after December 31, 1945. Where registrants had already filed their reports or are about to do so extensions of time for furnishing the additional information may be applied for.

Amendment to Forms 12-K and 12A-K

The Commission announced on February 19, 1946 (Securities Exchange Act Release No. 3787), the adoption of minor amendments to its annual report Forms 12-K and 12A-K (prescribed for companies required to file annual reports with the Interstate Commerce Commission or the Federal Communications Commission) The purpose of these changes was to revise the selected schedules so as to conform to certain changes made in Form A of the Interstate Commerce Commission for the year ended December 31, 1945.

Proceedings Under Section 19(a)(2)

Section 19(a)(2) of the Securities Exchange Act of 1934 authorizes the Commission, after appropriate notice and opportunity for hearing, to deny, suspend the effective date of, suspend for a period not exceeding 12 months, or to withdraw the registration of a security if the Commission finds that the issuer of such security has failed to comply with any provision of the Act or the rules and regulations thereunder.

Two proceedings under this Section were pending at the beginning of the year. During the year two additional proceedings were instituted, one for alleged inaccuracies in annual reports of the issuer, and the other for failure to file the required annual reports. The registration of the securities of one issuer was ordered withdrawn during the year for failure to file the required annual reports. At the end of the fiscal year, two proceedings were still pending.

Temporary Suspensions of Securities From Trading Pursuant to Section 19(a)(4) and Rule X-15C2-2

Section 19(a)(4) authorizes the Commission summarily to suspend trading in any registered security on any national securities exchange for a period not exceeding 10 days where the public interest so requires. Where the reason for a suspension under Section 19(a)(4) is to prevent fraudulent, deceptive, or manipulative acts or practices, Rule X-15C2-2 concurrently prohibits over-the-counter trading by brokers and dealers. During the year two securities were suspended from trading on exchanges pursuant to these provisions. In the first case, the common stock, \$1 par value, of Red Bank Oil Co. was suspended from trading on the New York Curb Exchanges. That security was then the subject of stop-order proceedings under the Securities Act of 1933 and delisting proceedings under Section 19(a)(2) of the Securities Exchange Act of 1934. The suspension was occasioned by the uncovering of information which raised a serious question relating to the independence of the accountants who had prepared financial statements previously filed with the Commission by the issuer. After the security had been suspended for several 10-day periods, the Commission found that the financial statements had not, in fact, been properly prepared and, pursuant to its powers under Section 19(a)(2) of the Securities Exchange Act, suspended the security from trading on the New York Curb Exchange for a period not to exceed 12 months pending final disposition of other matters at issue in the proceedings. [Footnote: The proceedings and the suspension under Section 19(a)(2) were still in effect at the close of the fiscal year. However, the expiration of the summary suspension orders under Section 19(a)(4) automatically removed the prohibition against over-the-counter trading under Rule X-15C2-2. *Red Bank Oil Co.*, Securities Exchange Act Releases, Nos. 3742 and 3770.]

The second suspension under Section 19(a)(4) involved the common stock, \$1 par value, of Interstate Home Equipment Co., a company which was in an advanced stage of liquidation. A suspension of trading on the New York Curb Exchange and the Chicago Board of Trade was ordered when it appeared that a sudden spurt in the market price of the security had carried the price far above the maximum amount which the stockholders could expect to receive upon completion of the liquidation. The suspension was continued in effect by further orders until current financial statements, which had been in preparation, were released to the public, and was then lifted. Thereafter the exchanges upon which the security had been traded elected to suspend trading on their own floors and they subsequently removed the security from listing altogether. With the lifting of the Commission's suspension, however, trading became permissible over the counter. [Footnote: *Interstate Home Equipment Co.*, Securities Exchange Act Release No. 3766.]

Statistics of Securities Registered on Exchanges

At the close of the fiscal year, 2,188 issuers had 3,585 security issues listed and registered on national securities exchanges. These securities consisted of 2,552 stock issues aggregating 2,440,707,313 shares, and 1,033 bond issues aggregating \$17,800,893,052 principal amount.

During the year the following applications and reports were filed in connection with the listing and registration of securities on exchanges:

Applications for registration of securities -- 668

Applications for "when-issued" trading -- 77

Exemption statements for short-term warrants -- 80

Annual reports -- 2,029

Current reports -- 5, 048

Amendments to applications and annual and current reports -- 1, 295

Annual reports of issuers having securities listed only on exempted exchanges -- 86

SECURITY TRANSACTIONS OF CORPORATE INSIDERS

The security ownership reports prescribed in three of the Acts administered by the Commission have as their main objective to furnish public security holder's with information as to the trading of insiders in the equity securities of their companies. [Footnote: Civil liability for the return of profits on short-term trading in equity securities is also provided for. The reporting requirements not only act to deter such trading but also aid in the enforcement of the civil liabilities.] The statutory requirement for the filing of these reports recognizes the fiduciary capacity of corporate insiders.

These ownership reporting requirement's were provided first by Section 16(a) of the Securities Exchange Act of 1934. Under that Section every person who is an officer, or director or principal stockholder (i.e., a person who is, directly or indirectly, beneficial owner of more than 10 percent of any class of registered equity security) of an issuer which has any class of equity security listed and registered on a national securities exchange must file with the Commission and the exchange an initial report disclosing the amount of every class of equity security of the issuer of which he is directly or indirectly the beneficial owner, 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 is under the duty to file with the Commission reports disclosing his direct and indirect beneficial ownership of every class of security of the registered holding company and its subsidiary companies, as well as all subsequent changes occurring therein. Later, when the Investment Company Act of 1940 was passed, it contained in Section 30(f) the requirement that every officer, director, principal security holder, member of an advisory board, investment adviser and affiliated person of an investment adviser of a registered closed-end investment company shall in respect of his transactions in any securities of such company (other than short-term paper) be subject to the same duties and liabilities as those imposed by Section 16 of the Securities Exchange Act of 1934. The Commission has adopted appropriate Rules in order to avoid any unnecessary duplication in the filing of ownership reports which are required by more than one of these Acts.

Each of these statutes provides that, for the purpose of preventing the unfair use of inside information, any profit realized by these corporate insiders from certain short-term transactions shall be recoverable by the issuer or by a security holder in its behalf if it fails or refuses to bring suit to recover within 60 days after request or fails diligently to prosecute the same thereafter. It is incorrect to suppose that these latter provisions have the capacity to prevent insider trading. They merely provide that, for the purpose stated, any profit the insider realizes from a so-called "short-swing" transaction (specifically, any purchase and sale or any sale and purchase within any period of less than 6 months) in securities of his company, shall be recoverable by the company. At the same time, it is undoubtedly correct to say that the successful operation of these ownership reporting requirements has appreciably reduced the amount of such short-term

trading by corporate insiders. It might be noted that since the constitutionality of the profit-recoverability feature of Section 16 was determined by the court in *Smolowe v. Delendo Corp.*, 136 F. (2d) 231 (C. C. A. 2, 1943), *cert. den.*, 320 U.S. 751 (1943), certain other civil actions for the recovery of such insider profits have been instituted; and it may also be pointed out that in several instances corporate insiders have informed the Commission that they have voluntarily paid over to their companies profits realized by them from such transactions.

[Footnote: See the section herein on "The Commission in the Courts," at p. 103]

The number of ownership reports filed on the various forms in accordance with the existing statutory requirements and examined by the Commission during the past fiscal year is set forth below:

Number of ownership reports of officers, directors, principal security holders, and certain other affiliated persons filed and examined during the fiscal year ended June 30, 1946

Description of Report [Footnote: Form 4 is used to report changes in ownership; Form 5, to report ownership at the time any equity securities of an issuer are first listed and registered on a national securities exchange; and Form 6, to report ownership of persons who subsequently became officers, directors, or principal stockholders of such an issuer, under Section 16(a) of the Securities Exchange Act of 1934; Form U-17-1 is used for initial reports and Form U-17-2 for reports of changes in ownership of securities. under Section 17(a) of the Public Utility holding company Act of 1935; and Form N-30F-1 is used for initial reports and Form N-30F-2 for reports of changes in ownership of securities under Section 30 (f) of the investment company Act of 1940.]

Securities Exchange Act of 1934:

Original reports -- Form 4, 14,321; Form 5, 835; Form 6, 1,809; Total, 16,905

Amended reports -- Form 4, 806; Form 5, 25; Form 6, 42; Total, 873

Public Utility Holding Company Act of 1935:

Original reports -- Form U-17-1, 80; Form U-17-2, 347; Total, 427

Amended reports -- Form U-17-1, 2; Form U-17-2, 18; Total, 20

Investment Company Act of 1940:

Original reports -- Form N-30F-1, 210; Form N-30F-2, 977; Total, 1,187

Amended reports -- Form N-30F-1, 2; Form N-30F-2, 76; Total, 78

Total: 19,550

The total of 19,550 reports filed during the 1946 fiscal year represents an increase of 18 percent over the number filed during the preceding year, and is greater than the total filed in any of the preceding 7 years. During the past 12 years 252,261 reports have been filed by more than 89,000 persons subject to the ownership reporting requirements. Most of these reports were filed without the necessity of any action by the Commission, and in relatively few instances has more than a simple reminder to the reporting person been necessary to secure the filing of the required reports.

The Commission's staff engaged in the work of examining these reports for compliance with the statutory requirements has need, as a practical administrative matter, to examine currently a wide variety of collateral sources of information available to the Commission. Among the more important of these sources are applications for registration of securities, annual reports, and quarterly and other current reports filed by issuers pursuant to the Securities Exchange Act of 1934; registration statements and prospectuses filed by issuers under the Securities Act of 1933; notifications of registration, registration statements, and annual supplements filed by registered holding companies under the Public Utility Holding Company Act of 1935; notifications of registration, registration statements, annual reports and quarterly reports filed by registered closed-end investment companies under the Investment Company Act of 1940; preliminary and definitive proxy soliciting material filed by issuers under the Securities Exchange Act of 1934, the Public Utility Holding Company Act of 1935 and the Investment Company Act of 1940; letters received from issuers; and the current publications of certain daily, weekly, quarterly and other periodic financial news services.

It is inevitable, in view of the volume of security ownership reports which are received by the Commission -- a volume which presently averages about 100 reports each work day -- that many questions involving the interpretation or application of the reporting requirements to particular situations are presented daily to the Commission's staff. Many such questions relate to indirect beneficial ownership of securities held by the reporter's spouse or other member of his intimate family group, his so-called holding company, or a personal trust in which he has some interest. But the problems extend also to a great variety of other phases of the requirements. Consequently, a considerable portion of the time of the examining section assigned to this work is spent in rendering informal administrative interpretations of the applicable statute or rules as they may relate to the particular facts and circumstances presented; in answering personal, telephone, and correspondence requests for advisory assistance as to the simplest method of preparing necessary forms; and in explaining the scope of the items of information contained in the forms. Of the 4,223 outgoing letters which originated last year in the examining section in charge of these ownership reports, it is estimated that one-half contained such informal advisory assistance

afforded in particular cases, while during the same period hundreds of telephone and personal inquiries seeking such help were also given appropriate attention.

The security ownership and transaction reports on all Forms are available for public inspection as soon as they are filed at the headquarters office of the Commission, and reports on Forms 4, 5 and 6 may likewise be inspected also at the particular exchange with which an additional copy of each report relating to the issuer concerned must be filed. For the purpose of making the information contained in all reports more readily accessible to interested investors, the Commission compiles and publishes such information in a monthly official Summary of Security Transactions and Holdings which is widely distributed among individual investors, newspaper correspondents and press services, and other interested persons. Copies of these summaries are also available to the public at each regional office of the Commission and each national securities exchange.

SOLICITATION OF PROXIES, CONSENTS, AND AUTHORIZATIONS

Under three of the Acts it administers -- Sections 14(a) of the Securities Exchange Act of 1934, 12(a) of the Public Utility Holding Company Act of 1935 and 20(a) of the Investment Company Act of 1940 -- the Commission is authorized to prescribe rules and regulations concerning the solicitation of proxies, consents, and authorizations in connection with securities of the companies subject to those Acts. Pursuant to this authority the Commission has adopted Regulation X-14, which is designed to protect investors by requiring the disclosure of certain information to them and by affording them an opportunity for active participation in the affairs of their company. Essentially, this Regulation makes unlawful my solicitation of any proxy, consent or authorization which is false or misleading as to any material fact or which omits to state any material fact necessary to make the statements already made not false or misleading. Under the Regulation it is necessary, in general, that each person solicited be furnished such information as will enable him to act intelligently upon each separate matter in respect of which his vote or consent is sought. The proxy rules set forth in this Regulation also contain provisions which enable security holders who are not allied with the management to communicate with other security holders when the management is soliciting proxies. In the Commission's view the development of these Rules has already contributed distinctly to a revitalization of the democratic process in the conduct of corporate affairs. [Footnote: An example of one type of regulatory problem presented under the proxy rules is formed in *S.E.C. v. Transamerica*, discussed herein at p. 106]

Statistically, it may be noted that last year the Commission received and examined under Regulation X-14 both the preliminary and definitive material required with respect to 1,670 such solicitations as well as "follow up" material employed in 390 instances.

UNLISTED TRADING PRIVILEGES ON EXCHANGES

On Registered Exchanges

As of June 30, 1946, 965 stock issues were admitted to unlisted trading on the registered exchanges. Of these, 569 issues were fully listed and registered on exchanges other than those on which unlisted trading privileges existed and 396 issues had only an unlisted trading status so far as the registered exchanges are concerned. [Footnote: Of the 396 issues, 9 were also listed upon exempted exchanges.]

The 396 issues having only an unlisted status aggregated 374,597,021 shares, or about 13.2 percent of the entire 2,832,452,776 shares admitted to trading on the registered exchanges. 316 of the issues were on New York Curb Exchange only, 13 were on that exchange and one or another of the exchanges outside of New York, and 67 were on the latter exchanges only. 296 of the issues were of domestic corporations, 70 were of Canadian corporations, and 30 were American depositary receipts for shares of foreign issues. Reported trading volume in the 396 issues for the calendar year 1945 was 54,271,815 shares, consisting of 43,191,756 shares traded in domestic issues, 8,083,380 in Canadian issues and 2,996,679 in the American depositary receipts, and amounting to about 7.1 percent of the total share volume traded on these exchanges.

As of June 30, 1946, 132 bond issues were admitted to unlisted trading on the registered exchanges. Of these, 16 issues were fully listed and registered on exchanges other than those on which unlisted trading privileges existed and 116 issues had only an unlisted trading status. The 116 issues aggregated \$1,155,904,721 principal amount and were practically all on New York Curb Exchange.

The decline in the aggregate of stock and bond issues admitted only to unlisted trading has continued in accordance with the expectation of Congress, as mentioned annually in these reports. Most of the net reduction of 37 stock issues during the past fiscal year was occasioned by retirement of preferred stocks and by the listing and registration of previously unregistered issues or their successors. The net reduction of 33 bond issues followed largely upon the progress made by utility holding companies in adjusting their capital structures pursuant to integration proceedings under the Public Utility Holding Company Act of 1935.

On Exempted Exchanges

As of June 30, 1946, 42 stock issues and 1 small bond issue were admitted to unlisted trading on the exempted exchanges. Of the stocks, 5 issues were also

listed and registered on one or another of the registered exchanges and 1 issue was admitted to unlisted trading on a registered exchange. The residue consisted of 36 issues aggregating 5,652,140 shares, all but 1 issue among these being on the Honolulu Stock Exchange, as was the \$140,000 bond issue previously mentioned.

Applications for Unlisted Trading Privileges [Footnote: For a Discussion of Section 12(f), pursuant to which unlisted trading privileges are granted, see Tenth Annual Report, pages 58-60.]

During the fiscal year applications filed pursuant to Clause (2) of Section 12 (f) of the Act were granted permitting unlisted trading on the Boston Stock Exchange with respect to 22 issues; Chicago Stock Exchange, 18 issues; Cleveland Stock Exchange, 8 issues; Philadelphia Stock Exchange, 15 issues; Pittsburgh Stock Exchange, 11 issues; and St. Louis Stock Exchange, 4 issues. All of the applications granted were for stocks. An application of the Pittsburgh Stock Exchange with respect to one stock issue was denied. Applications filed pursuant to Clause (3) of Section 12(f) of the Act were granted during the year to Chicago Stock Exchange and New York Curb Exchange with respect to common stock of the United Light and Railways Co., subject to certain terms and conditions. [Footnote: The United Light and Railways Co., Securities and Exchange Act Release No. 3788.]

Changes in Securities Admitted to Unlisted Trading Privileges

Whenever a security admitted to unlisted trading privileges is changed only with respect to its title, maturity, interest rate, par value, dividend rate, or amount authorized or outstanding, its privileges are retained on condition merely that the exchange notify the Commission, pursuant to Rule X-12F-2(a), of the change occurring in the security promptly after learning of it. During the year numerous such notifications were received from the exchanges.

In the event, however, that changes more comprehensive than those enumerated above are effected in an unlisted security, unlisted trading privileges in the altered security may be continued only if the Commission finds, upon application by the exchange pursuant to Rule X-12F-2(b), that such altered security is substantially equivalent to the security previously admitted to such privileges. During the year applications filed pursuant to this Rule were granted with respect to 1 bond issue on New Orleans Stock Exchange, 1 stock issue on Los Angeles Stock Exchange, 10 stock issues and 1 bond issue on New York Curb Exchange, and 1 stock issue on San Francisco Stock Exchange. In addition, New York Curb Exchange was permitted to withdraw applications involving 4 stock issues upon being advised by the Commission that the applications would be denied.

DELISTING OF SECURITIES FROM EXCHANGES

Securities Delisted by Application

Section 12(d) of the Act defines the Commission's powers with respect to applications by an issuer or an exchange to remove securities from listing and registration on an exchange. It provides that a security may be withdrawn or stricken from listing and registration in accordance with the rules of the exchange and upon such terms as the Commission may deem necessary to impose for the protection of investors.

Pursuant to this Section and in accordance with the procedure prescribed by Rule X-12D2-1(b), 3 issues, were delisted upon application of their issuers and 12 issues were delisted upon application of exchanges during the fiscal year. In three instances the same issue was delisted from two exchanges upon their respective applications so that the total delistings, including this duplication, numbered 18. In each of these cases the application was granted without the imposition of any terms upon the delisting. Of the three issues delisted upon application of issuers, one remained listed and registered on another exchange, one had become very closely held with only a few shares in public hands and with no exchange activity in recent years, and the issuer of one was in course of dissolution.

During the year the Commission considered the application of Suburban Electric Securities Company to withdraw its preferred and common shares from listing and registration on the Boston Stock Exchange. The application was granted subject (1) to the condition that the withdrawal should not become effective until after the applicant had submitted the delisting proposal to its shareholders and obtained their consent, and (2) to certain other conditions relating to adequacy of disclosure in the event the securities in question were withdrawn from listing and registration. [Footnote: Suburban Electric Securities Company, Securities Exchange Act Release Nos. 3822 and 3829.]

This was the third occasion on which the Commission had imposed material terms upon the granting of a delisting application; the first two such cases were those of Shawmut Association and The Torrington Company, each of which had applied to withdraw its Common stock from listing and registration on the Boston Stock Exchange. [Footnote: For a discussion of the two previous cases see Eleventh Annual Report, p. 19. During the fiscal year the Commission dismissed the application of the Shawmut Association. The Torrington Company and Suburban upon being advised that each had determined not to solicit its shareholders' consent to the proposed delisting.] The terms imposed in these three cases were similar to the extent that the assent of shareholders to the proposed delisting was required, although the precise terms of each in this respect differed. In the Suburban case the terms required that solicitation of

shareholders' assets be made by the applicant within 30 days from the date of issuance of the Commission order granting the application. Moreover, the order required consent by two-thirds of the company's common and preferred shareholders and by the holders of two-thirds of the shares of each class. Furthermore, the terms in the Suburban case provided, in the event delisting of the securities became effective, (1) that prior to purchasing any of its shares the applicant should furnish the seller with a statement stating that the applicant was the purchaser and setting forth specified information relevant to its securities, as well as a consolidated balance sheet, itemized surplus statement, and profit and loss statement of the applicant and its subsidiaries as of a specified date, and (2) that the applicant should mail to the Commission a copy of the financial statements intended to be furnished to security holders as mentioned above prior to the use of such statements and also mail to the Commission a monthly statement setting forth certain specified information relative to the number of its own shares that it had purchased. These latter terms were imposed in view of the fact that the Commission found financial statements issued by Suburban to its shareholders in the past had not set forth the status of the trust clearly or in accordance with sound accounting principles and that Suburban had been engaged in a consistent program of buying in its own shares from public holders while members of the management, familiar with the company's affairs and prospects, retained their shares, in effect using the company to increase their relative percentages of its outstanding securities.

Securities Delisted by Certification

Under Rule X-12D2-2(a) an exchange may remove from listing and registration, upon certification to the Commission, securities which have been paid at maturity, redeemed or retired in full, or which have become exchangeable for other securities. During the year 444 issues of 310 issuers were delisted upon certification by exchanges under this Rule. Some of these issues were delisted from more than one exchange; total delistings, including these duplications, numbering 510. In many instances successor issues of those delisted under this Rule were subsequently listed and registered on the exchange. Rule X-12D2-1(d) provides that an exchange may remove any security from listing and registration if trading therein has been terminated pursuant to a rule of the exchange requiring such termination whenever the security becomes listed and admitted to trading on another exchange. Pursuant to this Rule, six issues of six issuers were delisted from New York Curb Exchange when they became listed and registered on New York Stock Exchange.

Securities Removed From Listing on Exempted Exchanges

The listing of a security upon an exempted exchange may be terminated upon the filing by an exempted exchange of an appropriate amendment to its application for exemption. Four exempted exchanges filed such amendments during the year, terminating the listing of six issues of five issuers.

SECURITIES EXEMPTED FROM REGISTRATION

Exempted Securities Removed From Exchange Trading

During the year 13 issues of 8 issuers which had been previously admitted to exchange trading under a temporary exemption from Section 12(a) of the Act pursuant to Rules X-12A-1, X-12A-2 or X-12A-3 were removed from such trading by action of the exchanges involved. The reasons for these removals were that one issue had been paid at maturity; two had been called for redemption; two had had no exchange activity for many years; the three issuers of the remaining eight issues were involved in reorganizations as a result of which these issues had either been eliminated or become exchangeable for other securities which were not admitted to exchange trading.

Temporary Exemption of Substituted or Additional Securities

In order to provide continuity of exchange trading in cases where securities previously listed or admitted to unlisted trading privileges have come to evidence other securities, Rule X-12A-5 affords to such securities a temporary exemption from the registration requirements of Section 12(a) of the Act to the extent necessary to render lawful the effecting of transactions therein on the exchange.

Notification of the admission to trading under this Rule with respect to 144 issues of 127 issuers were received from the various exchanges during the year. In some instances the same issue was admitted to trading on more than one exchange, so that the total admissions to such trading, including these duplications, numbered 181. These figures include many instances in which the Rule was utilized to permit exchange trading in additional shares of stock resulting from the numerous stock split-ups and stock dividends which occurred during the year.

STABILIZATION AND MANIPULATION

Manipulation

In its administration of the provisions of the Securities Exchange Act of 1934 relating to the manipulation of securities markets, the Commission's policy is to attempt to detect manipulative practices at their inception, before the public has been harmed. At the same time, it seeks to avoid interfering with the legitimate functioning of the securities markets. In brief, the Commission's investigations in this area take two forms. The "flying quiz," or preliminary investigation, is designed to detect and discourage incipient manipulation by a prompt determination of the reason for unusual market behavior. If a legitimate reason

for the activity is uncovered, the ease is closed. If more extended investigation seems required, a formal order is sought of the Commission under which members of the staff are empowered to subpoena pertinent material and take testimony under oath. These formal investigations often cover substantial periods of time, and trading operations involving large quantities of shares are carefully scrutinized.

The Commission keeps confidential the fact that any security is under investigation so that the market in the security may not be unduly affected or reflections be unfairly cast upon individuals or firms whose activities are being investigated. As a result, the Commission occasionally receives criticism for failing to investigate situations when, in fact, it is actually engaged in an intensive investigation of those very matters.

(chart omitted)

Stabilization

During the fiscal year ended June 30, 1946, the Commission continued the administration of Rules X-17A-2 and X-9A6-1. Rule X-17A-2 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. Rule X-9A6-1 governs stabilizing transactions in securities registered on national securities exchanges, effected to facilitate offerings of securities so registered, in which the offering prices are represented to be "at the market" or at prices related to market prices.

Of the total registration statements filed during the 1946 fiscal year, about two-thirds, or 504, contained a statement of intention to stabilize to facilitate the offerings covered by such registration statements. Because of the fact that a registration statement sometimes covers more than one class of security, there were 660 offerings of securities in respect of which a statement was made, as required by Rule 827 under the Securities Act, to the effect that a stabilizing operation was contemplated. Stabilizing operations were actually conducted to facilitate 96 of these offerings. In the case of bonds, public offerings of \$188,195,000 principal amount were stabilized. Offerings of stock issues aggregating 18,797,323 shares and having an aggregate estimated public offering price of \$515,548,900 were also stabilized. In connection with these stabilizing operations, 9,154 stabilizing reports were filed with the Commission during the fiscal year. Each of these reports has been analyzed, thereby enabling the staff to determine whether the stabilizing activities were lawful.

To facilitate compliance with the Commission's Rules on stabilizing and to assist issuers and underwriters to avoid violation of the statutory provisions dealing with manipulation and fraud, many conferences were held with the representatives of such issuers and underwriters and many written and telephone requests were

answered. A total of 2,118 letters and memoranda of such conferences and telephone requests and memoranda to the regional offices of the Commission were written in connection with the administration and enforcement of the stabilization and manipulation statutory provisions and regulations.

REGULATION OF BROKERS AND DEALERS IN OVER THE COUNTER MARKETS

Registration

Brokers and dealers using the mails, or means or instrumentalities of interstate commerce, to effect transactions in securities on over the counter markets are required by Section 15(a) of the Securities Exchange Act to be registered with the Commission pursuant to Section 15(b) of that Act. An exemption is, however, granted to those brokers and dealers whose business is exclusively intrastate or exclusively in exempted securities. The following tabulation reflects certain data with respect to registration of brokers and dealers during the fiscal year ended June 30, 1946.

Registration of brokers and dealers under Section 15(b) of the Securities Exchange Act of 1934, fiscal year ended June 30, 1946

Effective registrations at close of preceding fiscal year: 4,046

Effective registrations carried as inactive: 93

Registrations placed under suspension during preceding fiscal year: 1

Applications pending at close of preceding fiscal year: 20

Applications filed during fiscal year: 644

Total: 4,804

Applications withdrawn during year: 13

Registrations withdrawn during year: 482

Registrations canceled during year: 45

Registrations denied during year: 1

Registrations revoked during year: 8

Registrations effective at end of year: 4,132

Registrations effective at end of year carried as inactive: 80

Applications pending at end of year: 43

Total: 4,804

Broker-Dealer Inspections

Broker-dealer inspections, undertaken pursuant to Section 17 of the Securities Exchange Act for the purpose of determining whether registrants are in compliance with the requirements of law, totaled 603 during the 1946 fiscal year. Infractions, which were discovered in about one-third of these inspections, were of varying degrees of seriousness.

Seventeen inspections revealed unsatisfactory financial conditions requiring immediate corrective action or continued surveillance. In 134 inspections, the reports revealed transactions at prices at such variance with prevailing market prices as to raise some question as to fair treatment of customers. In 108 inspections, the reports contained information indicating noncompliance with the provisions of Regulation T relating to the extension of credit. In 36 inspections, questions were raised concerning improper hypothecation and commingling of customers' securities and use of customers' free funds. In 25 inspections, it was discovered that firms took secret profits in agency transactions by misrepresenting the prices at which orders had been executed.

Whenever infractions are discovered, efforts are made to determine whether they are the result of carelessness or represent a policy of indifference or willfulness on the part of the responsible management. The Commission has continued its established policy in calling minor infractions to the attention of the firm at the time of the inspection so that corrective measures may be taken immediately. Subsequent check-ups are then made in order to determine whether the promised corrections have been effected. In some instances, however, the infractions are of serious nature, requiring further inquiry or investigation. During the 1946 fiscal year, 39 inspections resulted in inquiry or investigation beyond the scope of the inspection.

Administrative Proceedings

A summary of the administrative proceedings of the Commission with respect to brokers and dealers is given below.

Record of broker-dealer proceedings and proceedings to suspend or expel from membership in a national securities association instituted pursuant to Sections 15(b) and 15A of the Securities Exchange Act of 1934

Proceedings on revocation of registration pending at beginning of fiscal year: 2

Proceedings on revocation of registration and suspension or expulsion from NASD pending at beginning of fiscal year: 5

Proceedings ordered during year on revocation of registration: 6

Proceedings ordered during year on revocation of registration and suspension or expulsion from NASD: 4

Proceedings ordered during year on denial of registration: 5

Proceedings ordered on question of terms and conditions on withdrawal of registration: 1

Total: 23

Revocation proceedings and proceedings to expel or suspend from NASD dismissed, registration and membership continued: 1

Denial proceedings dismissed on withdrawal of application: 2

Registrations denied: 1

Registrations revoked: 8

Registrations revoked and firms expelled from NASD: 1

Firms suspended from membership in NASD: 1

Revocation proceedings pending at end of fiscal year: 2

Revocation proceedings and proceedings to expel or suspend from NASD pending at end of fiscal year: 4

Denial proceedings pending at end of fiscal year: 2

Proceedings pending on question of terms and conditions on withdrawal of registration: 1

Total: 23

Among those proceedings resulting in revocation of registration was the action against *Oxford Company, Inc.*, of Washington, D. C. The transactions upon

which the Commission made its findings were between the firm and two of its customers, elderly women to whom the firm owed fiduciary duties, and involved considerable cross trading between their accounts. In transactions with these customers, the firm habitually confirmed as principal and at a profit to itself. The Commission concluded that the firm, under the duty to act as a broker for these two customers, had obtained secret profits in effecting cross transactions between customer accounts as principal, and had willfully violated the antifraud provisions of Section 17(a) of the Securities Act and Sections 10(b) and 15(c)(1) of the Securities Exchange Act. The Commission emphasized that, under all the circumstances of the case, the riskless character of the transactions was itself evidence of an agency relationship. The firm had the complete trust and confidence of the customers; it solicited them to buy specific securities which it recommended; it knew that these securities were not in inventory and that it would have to go into the market to obtain them to fill orders; it knew also that it could obtain the securities without any risk of its own funds. The Commission held that under all of the circumstances the firm was under the duty to act as agent for the customer in the absence of explicit and informed consent to the firm's acting as principal.

In a case of considerable interest to underwriters and securities dealers generally, the Commission suspended from membership in the NASD for a period of 10 days, beginning March 16, 1946, the New York firm of *Van Alstyne, Noel and Co.* upon a finding that the firm had willfully violated Section 5(a)(1) of the Securities Act of 1933. On December 14, 1945, approximately a month and a half prior to the filing of a registration statement, this firm entered into arrangements with Andrew J. Higgins, President of Higgins, Inc., for the underwriting of 900,000 shares of common stock of Higgins, Inc. Having completed the formation of a so-called "underwriting group" consisting of itself and 74 dealers throughout the country, the firm on or about January 10, 1946, completed the formation of a selling group consisting of about 160 dealers throughout the country and allotted specific amounts of shares to these latter dealers, who in turn allotted shares to their customers. A registration statement covering this issue of securities was finally filed on January 30, 1946, some 20 days after the formation of the selling group. The Commission found, on these admitted facts, that there had been a sale of Higgins common stock prior to its effective registration. In reaching this conclusion, the Commission considered that clause of Section 2 (3) of the Securities Act which excepts "preliminary negotiations or agreements between an issuer and any underwriter" from the definition of "sale." The firm's activities, however, were found to have exceeded mere negotiations with underwriters and to have involved sales to members of the selling group and to members of the public. Commenting on the Congressional intent to outlaw offers or sales to selling group members prior to the effective date of the registration statement, the Commission also pointed out that a prohibition against making "offers to buy" had been expressly included in the prohibition of Section 5(a)(1) for the specific purpose of preventing underwriters from discriminating against dealers who did not make offers to buy

between the period of the filing of the registration statement and its effective date.

After prolonged proceedings, the Commission on January 22, 1946, issued its findings and opinion and ordered revocation of the registration of Norris and Hirshberg, Inc., of Atlanta, Ga. The Commission found that in fixing prices which were unaffected by the operation of a free, open and competitive market without disclosing the nature of its market, in dealing as a principal with uninformed customers and customers who had given it powers of attorney, and in trading excessively for accounts as to which it had discretionary powers, this firm had engaged in activities which were fraudulent and illegal under Section 17(a) of the Securities Act of 1933 and Sections 10(b) and 15(e)(1) of the Securities Exchange Act of 1934. On April 29, 1946, Norris and Hirshberg, Inc., filed a petition for review of the Commission's order in the United States Court of Appeals for the District of Columbia, and on May 2, 1946, the Court entered an order by stipulation staying the Commission's order pending further order of the Court. The Court conditioned its stay order upon conformance by the firm with its stipulation and agreement with the Commission not to engage during the pendency of the review in acts or practices violating the above-mentioned provisions of the statutes.

SUPERVISION OF NASD ACTIVITY

The National Association of Securities Dealers, Inc., continued to be the only national securities association registered as such with this Commission. During the year ended June 30, 1946, membership increased from 2,290 to 2,514, a gain of 224 members.

Disciplinary Proceedings

Final action of 19 disciplinary cases against members was reported to the Commission by the Association in the year ending June 30, 1946. Of these 19 cases, complaints were dismissed or withdrawn in 6 instances; in 4 cases violations were found and the members censured; and in the remaining 9 cases violations were found and the firms involved were fined an aggregate of \$3,950 in amounts ranging in particular cases from \$1,000 to \$200. In this last group of cases, collateral penalties such as censure or an agreement pledging future observance and compliance with the rules were sometimes also included and, in addition, in 3 such cases costs, in varying amounts up to \$250, were also imposed on the members found to have violated Association rules.

During the year the Commission found it appropriate to refer, for whatever action the association might find advisable, facts concerning the business practices of 11 different member firms. Three such cases had been pending at the beginning of the year. During the year, final action by the association was reported to the

Commission on seven such cases and seven cases were still in process at the year end.

Commission Review of Disciplinary Action or Denial of Membership

Section 15A (g) of the Securities Exchange Act of 1934 provides for review by the Commission, on application by an aggrieved party, of disciplinary action by the Association against any member or of denial of membership by the Association to any broker or dealer. Four such cases came before the Commission in the 1946 fiscal year, two of which were decided during the year and the remaining two were pending at the year end.

On August 7, 1945, the Commission by order, after hearing and oral argument, dismissed a review proceeding brought by Thomas Arthur Stewart, a member who had been found by the Association to have violated its rules of fair practice and had been suspended from membership for 1 year. [Footnote: Thomas Arthur Stewart, Securities Exchange Act Release No. 3720.] The Commission's opinion included findings that Stewart had violated the Association's rules of fair practice, and that his conduct had been inconsistent with just and equitable principles of trade in that he had recommended to and executed for certain customers purchases and redemptions of shares of open-end investment companies, timed in relation to dividend dates so as to obtain multiple dividends, without having reasonable grounds for believing his recommendations to be suitable for such customers and without making adequate disclosure as to (a) the manner of determining the prices of such shares, (b) the effect of dividends on such prices, and (c) the amount of selling charges included in the prices of shares purchased by the customer. In effect, the dismissal of the review proceeding affirmed the decision and the penalty imposed by the Association.

At the end of the fiscal year another such appeal from Association disciplinary action was also pending before the Commission. [Footnote: On July 12, 1946, the Commission issued a memorandum Opinion and order identifying this case without considering or deciding any of the substantive questions raised in the application for review, the Commission denied the motion of the applicant, Herrick, Waddell & Co., Inc., to open the record to admit evidence of business practices adopted after the completion of transactions forming the basis of disciplinary action, holding that such evidence was not relevant to show whether any transactions had been in violation of the Association's rules. See *National Association of Securities Dealers, Inc., District Business Conduct Committee, No. 11, v. Herrick, Waddell and Co., Inc.*, Securities Exchange Act Release No. 3831.] There was also then before the Commission a petition by Foelber-Patterson, Inc. seeking review by the Commission of action of the Association in denying membership to the applicant. [Footnote: On Sept. 4, 1946, the Commission by order set aside the action of the Association denying membership to Foelber-Patterson Inc., and required the admission of the firm to membership. The question at issue was whether the recent registration of

Foelber-Patterson Inc., with the Commission as a broker-dealer removed the disqualification from membership resulting from the Commission's revocation of the broker-dealer registration of Central Securities Corp., of which Foelber and Patterson had been officers and directors, on Apr. 3, 1942 (see Central Securities Corp., 11 S.E.C., 98 (1942)). In effect, the Commission held that the broker-dealer registration of Foelber-Patterson Inc., removed the disqualification insofar as the revocation order against Central Securities Corp. related to Foelber and Patterson. See *Foelber-Patterson Inc*, Securities Exchange Act Release No. 3847.]

Commission Action on Petitions for Approval of or Continuation in Membership

Section 15A(b)(4) of the Securities Exchange Act of 1934 and the bylaws of the Association bar from association membership persons under specific disabilities, including those who have been expelled from a registered securities association for violating any rule which prohibits conduct inconsistent with just and equitable principles of trade, unless the Commission approves or directs the admission of that person as appropriate in the public interest. In the year here under review, three cases came before the Commission pursuant to this statutory provision. One of the cases was decided during the year and two were pending at the year end.

The Commission on May 28, 1946, after hearing, by order approved a petition filed by the Association on behalf of John L. Godley for approval of his application for membership. [Footnote: See John L. Godley, Securities Exchange Act Release No. 3823.] Godley had been expelled by the Association in 1942 for violations of its rules of fair practice which prohibit conduct inconsistent with just and equitable principles of trade, and as a consequence, was ineligible for membership unless the Commission approved or directed his membership as appropriate in the public interest. The matter came before the Commission after the district committee of original jurisdiction and the Board of Governors of the Association had considered his application and recommended that the Commission admit him to membership.

At the year end, a somewhat similar petition filed by the Association on behalf of Greene & Company was before the Commission for decision. The petition on behalf of Greene and Company asked that the firm be continued in membership with W. F. Thompson acting as a partner or an employee. Thompson had been expelled by the association in 1942 for violations of the rules of fair practice which prohibit conduct inconsistent with just and equitable principles of trade. This expulsion created a barrier to membership by any firm employing Thompson, and made Thompson ineligible for direct membership, absent Commission approval or direction. As in the Godley case, the petition for Commission approval of the continuance of Greene & Company in membership

was filed by the Association after the District Committee and the Board of Governors had considered and conditionally approved the application.

The other pending case arose from a petition filed by Lawrence R. Leeb by for admission to membership in the Association notwithstanding the fact that the Association had expelled with from membership in 1942 and that the Commission had in 1943 revoked his broker-dealer registration. Leeb's petition requested that the Commission exercise its administrative discretion in his favor, as far as Association membership was concerned, and it was coupled with an application for registration with the Commission as a broker.

Registered Representative Rule

The Association on July 31, 1945, filed with the Commission as amendments to its registration statement, after requisite approval by the Board of Governors and the membership, a series of amendments to the bylaws and rules requiring that no member should permit any person to manage, supervise, solicit or handle securities business, trade in or sell securities or solicit investment advisory or investment management business, unless that person was registered with the Association as a "registered representative." Registered representatives must agree to be bound by the articles of incorporation, bylaws and rules of the Association, and duly authorized rulings, orders, directions, decisions and penalties. The rules also provide that a person may not become registered if he is subject to an order of the Association suspending or revoking his registration or if he is subject to any of the disqualifications for which brokers and dealers may be refused or discontinued in membership. However, under Section 15A(b)(4) of the Act, the Commission may approve or direct admission into or continuance of membership notwithstanding the member's control of a person with a disqualification.

The statute does not require affirmative Commission approval before amendments to the Association's rules may become effective, although it does require the Commission to disapprove any amendment unless it is found to be consistent with the applicable statutory standards. In order to give all interested parties an opportunity to be heard on the proposed amendments, the Commission held a public hearing at which arguments were made both for and against the proposal. In an opinion dated September 19, 1945, the Commission, after a detailed exposition of the reasons for the proposed amendments and their implications, found that they were consistent with the statutory standards and announced that it would not disapprove them. [Footnote: National Association of Securities Dealers, Inc., Securities and Exchange Act Release No. 3734]

On December 31, 1945, various members of the Association and a few nonmembers filed a petition in the District Court for the Southern District of New York to require the Commission to enter a formal order in connection with its determination not to disapprove the amendments, so that the petitioners might

take an appeal to the circuit Court of Appeals. After argument on a motion by the Commission to dismiss this petition for lack of jurisdiction in the District Court, the petition was withdrawn. Thereupon the same petitioners filed a similar petition in the Circuit Court of Appeals for the Second Circuit, which was denied without opinion on March 9, 1946. The Commission took the position that the statute did not contemplate a formal order when the Commission failed to exercise its veto power over amendments to the Association's rules.

As a result of these amendments and because of the Commission's residual supervisory duties, a substantial number of cases may come before the Commission on review of action by the association in denying membership to broker-dealers employing persons who are not qualified to be registered representatives.

LITIGATION UNDER THE ACT

During the past fiscal year the Commission instituted its first actions for injunction based solely on violation of Regulation T, the margin regulation promulgated by the Board of Governors of the Federal Reserve System for certain categories of broker-dealers pursuant to Section 7(c) of the Act. Effective February 5, 1945, the Board had increased the general margin requirement from 40 percent to 50 percent; effective July 5, 1945, it was increased to 75 percent; and effective January 21, 1946, it was made 100 percent. On October 16, 1945 the Commission instituted three companion actions in the United States District Court at Cleveland. One action was against Butler, Wick & Co., a New York Stock Exchange member house with offices in Youngstown, Ohio; another against Hirsch & Co., a member firm with offices in New York and Cleveland; and the third against two firms jointly, the S. T. Jackson & Co., Inc., an over-the-counter firm in Youngstown, and A. E. Masten & Co., a member house in Pittsburgh which acted as correspondent of the Jackson firm in effecting transactions on the New York Stock Exchange. Richard C. Brown, of Youngstown, and First Mahoning Co., an investment company controlled by Brown, were named as defendants in all three of the actions. [Footnote: S.E.C. v. Butler, Wick and Co., Richard C. Brown, and First Mahoning Company (N.D. Ohio); S.E.C. v. Hirsch and Company, Richard C. Brown, and First Mahoning Company (N.D. Ohio); S.E.C. v. A. E. Masten and Co., Richard C. Brown, and First Mahoning Company (N.D. Ohio)] The charges in these cases are that the first three broker-dealer firms repeatedly violated Regulation T by overextensions of credit to Brown and his investment company; that the Masten firm overextended credit directly to the Jackson firm, its over-the-counter correspondent, and indirectly through the Jackson firm to Brown and his investment company, customers of the Jackson firm; and that Brown and his investment company aided and abetted all of these violations. On November 16, 1945, the court entered a final injunction against the Jackson firm by default. On the same day the court entered preliminary injunctions by consent in all three cases restraining Brown and First Mahoning

Co. from inducing the four defendant firms or any other broker dealer to effect unlawful transactions of the types alleged in the complaints. At the close of the fiscal year Brown and First Mahoning Co. were in default of an answer, and the actions against the other three broker-dealer firms were awaiting trial.

In Securities and Exchange Commission v. Patrick A. Trapp, the Commission brought suit to enjoin a broker-dealer from selling oil royalties at prices unrelated either to his own contemporaneous cost or to reasonable estimates of recoverable oil. [Footnote: D. N. Dak., complaint filed June 12, 1946] Although this doctrine is to be newly tried in the courts, the basis thereof has been laid in quasi-judicial proceedings before the Commission. The Commission sought at the same time to enjoin Trapp, whose broker-dealer registration had been previously revoked for fraud in connection with the sale of such securities, from continuing to engage in the business of an over-the-counter broker-dealer without registration, and from selling oil royalties by means of various misrepresentations. The case was pending at the close of the fiscal year.

There were two cases in which the Commission sought mandatory injunctions to require registered broker-dealers to permit an examination to be made of their books and records pursuant to Section 17(a) of the Act and the Commission's bookkeeping rules. In the first case, Securities and Exchange Commission v. Maurice A. Sharkey, the District Court for the Western District of Washington entered a summary judgment of mandatory injunction on December 10, 1945. In the second case, Securities and Exchange Commission v. Nevada Oil Co., which was pending in the District Court for the Northern District of Texas at the end of the fiscal year the registrant, after refusing access to Commission investigators on several occasions, filed an application to withdraw from registration as a broker-dealer. [Footnote: The complaint was filed on June 18, 1946] Thereupon the Commission filed its action for mandatory injunction and at the same time, in order to prevent the withdrawal of the application from becoming automatically effective under the Commission's Rules, instituted an administrative proceeding to determine whether withdrawal from registration should be conditioned upon the company's first permitting the required examination of its books and records to be made. This administrative proceeding, which is the first of its kind ever instituted by the Commission, was likewise pending at the end of the fiscal year; the Commission had postponed the administrative hearing in order to permit the court action to go ahead first.

One manipulation case was Pending in the courts during the fiscal year. In Securities and Exchange Commission v. Frank W. Bennett and The Federal Corp., the Commission had filed a complaint in the District Court for the Southern District of New York on June 28, 1945, to enjoin the defendants from violating Section 9(a)(2) of the Act.

It was alleged that they had manipulated the market for the common stock of Red Bank Oil Co. on the New York Curb Exchange while a registration statement was

pending under the Securities Act of 1933 with respect to a proposed offering of a large block of that stock "at the market." On August 20, 1945, the court denied the Commission's motion for preliminary injunction. [Footnote: 62 F. Supp. 609.] The Commission's evidence that the defendants' raising of the price on the Curb from 1 and three quarters to 2 would increase the proceeds to them of the proposed offering by approximately \$100,000 was not held to be sufficient evidence of a manipulative purpose. [Footnote: Various administrative proceedings affecting the registration statements of Red Bank Oil Co. under the Securities Act of 1933 and the Securities Exchange Act of 1934 are described elsewhere in this report.] Instead of appealing from the denial of its motion for preliminary injunction, the Commission decided to go to trial on the merits, and the case was awaiting trial at the end of the fiscal year.

There were two civil actions during the year in which the Commission obtained injunctions against various fraudulent practices by broker-dealers. In *Securities and Exchange Commission v. Financial Service Inc.*, the District Court for the Southern District of Indiana, on August 28, 1945, enjoined the defendant, a registered broker-dealer, as well as Oscar F. Koenig, his wife, and Mrs. Mildred Martin, officers and directors of the company, from soliciting and accepting funds and orders from customers without disclosing to them that the firm was insolvent. The defendants were enjoined at the same time from falsely representing to customers the prices at which the firm effected purchases and sales, such misrepresentations having enabled the firm to realize secret profits while acting as agent for its customers. [Footnote: The Commission subsequently revoked the firm's broker-dealer registration. Securities Exchange Act Release No. 3774 (Jan. 8, 1946)] The Commission also sought the appointment of a receiver, but the company succeeded in paying off its obligations to its customers and the request was denied. In the second case, *Securities and Exchange Commission v. Gilbert M. Bates*, the defendant consented to the entry of an injunction by the District Court for the Northern District of Iowa restraining him from engaging in various fraudulent practices (the effecting of purchases and sales at prices not reasonably related to the market without disclosing that fact, taking secret profits by effecting transactions with customers at prices fixed by the defendant while he purported to act as their agent, and violating the confirmation requirements) as well as doing business as an over-the-counter broker-dealer without registration.

Judicial review of Commission action under the Securities Exchange Act was sought in two cases, both discussed elsewhere in this report. *Norris and Hirshberg, Inc., v. S.E.C.*, which is pending in the United States Court of Appeals for the District of Columbia, involves a petition to review a Commission order revoking the petitioner's broker-dealer registration for various violations of the antifraud provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934. The second case involved the Commission's opinion (previously discussed herein) announcing the reasons for its refusal to disapprove certain amendments to the bylaws of the National Association of Securities Dealers, Inc., setting up a system whereby employees of members have to be registered with

the association as “registered representatives.” Various persons sought unsuccessfully to obtain judicial review first in the District Court for the Southern District of New York and then in the Circuit Court of Appeals for the Second Circuit.

Civil Actions Instituted Under the Securities and Exchange Act of 1934

The 1946 fiscal year has witnessed a continuation of the ever-growing need to resort to the courts for injunctions under Rule X-10B-5 to protect investors. Rule X-10B-5, adopted pursuant to Section 10(b) of the Securities Exchange Act of 1934, contains a general prohibition against fraud in the purchase or sale of securities through certain channels. The violations which were enjoined during the year generally involved combinations of situations where controlling stockholders took advantage of investors in their companies by suppressing information relating to recent and sharp improvement in the volume of business, relating to increases in market value of portfolio securities, or other vital information. These situations are further examples of the need for preventative legislation asked for by the Commission in its report to the Congress of June 19, 1946, entitled “A Proposal to Safeguard Investors in Unregistered Securities.”

Violations of Rule X-10B-5 were sometimes coupled with infractions of other Sections of the Act as well as violations of the Securities Act of 1933. For example, in *S.E.C. v. Financial Service, Inc., et al*, [Footnote: U. S. District Court, S. D., Evansville Division, Ind., August 28, 1945. False and misleading statements to customers regarding prices of securities bought and sold, obtaining secret profits, and the omission to disclose insolvency while soliciting and accepting deposits of money and orders for the Purchase and sale of securities from customers.] and *S.E.C. v. Gilbert M. Bates*, [Footnote: U.S. District Court, N. D., Cedar Rapids Division, Iowa, March 7, 1946. Sales to and purchases from customers of securities at prices hearing no reasonable relation to prevailing market prices, obtaining secret profits, false and misleading statements to customers regarding the prices of securities bought and sold as well as the amount of the Commission. Bates was also enjoined from violating tile registration provisions of the Securities Exchange Act.] the Commission obtained final judgments enjoining the defendants from violating the antifraud provisions of the Securities Act as well as the antifraud sections of the Securities Exchange Act.

In *S.E.C. v. Boyd Transfer and Storage Co., et al* the Commission obtained a judgment enjoining violations of the fraud provisions of the Securities Exchange Act of 1934 in the purchase of the securities of the company. [Footnote: U.S. District Court, Fourth Division, Minneapolis, Minn., Dec. 5, 1945.] The case involved false and misleading statements in the acquisition of preferred stock regarding book value, net asset value, and net earnings of the company as well as the benefits to be received by the management (majority common stockholders) by the retirement of the preferred stock issues.

In *S.E.C. v. Albert M. Greenfield, et al.* the Commission instituted an action charging that the defendants had violated the antifraud provisions of the Securities Exchange Act in purchasing the debentures of Albert M. Greenfield & Co. [Footnote: U.S. District Court, E. D., Pennsylvania, complaint filed Nov. 7, 1945.] It was charged that the defendants had made misleading statements regarding the market price, and suppressed certain information, including the fact that the net profits during 1944 and the sharply increased profits for the first 6 months of 1945 of Albert M. Greenfield & Co. were sufficient to pay cumulative interest for past years as well as certain noncumulative interest obligations of the company. It was further charged that the defendants failed to disclose the identity of the purchaser and the market value of Albert M. Greenfield & Co.'s portfolio and that the assets attributable to each outstanding debenture were substantially in excess of the price offered. The action was dismissed on the Commission's motion upon the filing of a stipulation between the parties in which defendants agreed to furnish audits of books for the years 1944 and 1945 to the indenture trustee, to furnish copies of its certified annual reports including balance sheets, profit and loss statements, and other data to debenture holders, to offer to rescind its purchases of debentures since March 27, 1945, and to comply in the future with Rule X-10B-5.

In *S.E.C. v. Joseph M. Gentile*, [Footnote: U.S. District Court, S.D., New York, Jan. 30, 1946], *S.E.C. v. Frank Cohen, American Caramel Company and B. F. Rodda Candy Co.* [Footnote: U.S. District Court, E.D., Pennsylvania Dec. 11, 1945] and *S.E.C. v. Roy Irwin Mitchell* [Footnote: U.S. District Court, N.D., Eastern Division, Ohio, Aug. 6, 1945] the Commission obtained judgments enjoining the defendants from violating the antifraud provisions of the Securities Exchange Act in the purchase of securities.

The Gentile case involved false and misleading statements to security holders of Breck Distilled Products Corporation regarding current market price and omissions to advise security holders regarding the existence of an agreement by Gentile to sell his stock at \$6.13 per share and their right under such agreement to dispose of their securities at the same price. [Footnote: Gentile has made restitution in the approximate amount of \$60,000 to the minority stockholders concerned.]

The Cohen case involved false and misleading information regarding the book value, current asset value, and market price of American Caramel Company preferred stock, the control of American, the identity of the purchasers, material changes in American's business including significant increases in sales and profits and plans for the recapitalization and reorganization of American.

The Mitchell case involved false and misleading statements to stockholders by an employee of Empire Steel Corporation regarding the market price or value of

Empire's securities and the identity of the purchaser. Neither Empire nor its management was involved.

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

The Public Utility Holding Company Act of 1935 was enacted for the purpose of eliminating certain evils and abuses which the Congress found to exist in connection with the activities of holding Companies having subsidiaries which are electric utility companies, or which are engaged in the retail distribution of natural or manufactured gas. It was particularly designed to remove control of widely scattered utility properties from the hands of holding companies in large financial centers' and thus to afford to the operating companies the advantages of localized management and to strengthen local regulation. This objective finds its most direct expression in Section 11 of the Act. Section 11(b)(1) requires the operations of holding company systems to be limited to one or more integrated systems and to such additional businesses as are reasonably incidental or economically necessary or appropriate to the operation of the integrated systems. Section 11(b)(2) requires elimination of undue complexities in corporate structures of holding company systems and the redistribution of voting power among their security holders on a fair and equitable basis. The Act provides also for tile registration of holding companies (Sec. 5); regulation of security transactions of holding companies and their subsidiaries (Secs. 6 and 7); regulation of acquisitions of securities and utility assets by holding companies and their subsidiaries (Secs. 9 and 10); regulation of sales of public utility securities or assets, payment of dividends, solicitation of proxies, intercompany loans and other intra-system transactions (Sec. 12); control of services, sales and construction contracts (Sec. 13); and the control of accounting practices (Sec. 15).

SUMMARY OF ACTIVITIES

The volume of financing involved in applications and declarations filed under Sections 6 and 7 considered by the Commission during the 1946 fiscal year surpassed that of any previous year. The aggregate thereof, relating principally to subsidiaries of registered holding companies, involved security issues totaling \$2,375,000,000 as compared with \$1,305,000,000 during the 1945 year. There was also a substantial increase in the number of cases filed involving matters looking toward compliance with Section 11 and to give effect to the Commission's orders thereunder. Further noteworthy progress was made during the past year in effectuating the requirements of the Act relating to integration and corporate simplification. During this period, registered holding companies

disposed of nonretainable interests in 57 electric, gas, and other subsidiary companies having total assets of approximately \$1,726,000,000. [Footnote: Included in this figure is \$894,000,000, representing assets of Pacific Gas & Electric Co., which, during the year, ceased to be a subsidiary of a registered holding company.] These included 29 electric utility companies with assets of \$1,545,000,000; 8 gas utility companies with assets of \$22,000,000 and 20 other companies having assets of \$159,000,000. Section 11 orders were outstanding on June 30, 1946, requiring the divestment of holding companies nonretainable interests in 122 subsidiary companies having aggregate assets of \$3,352,000,000.

During the year the Commission instituted seven new proceedings directing compliance with Section 11. A summary of proceedings instituted by the Commission under Section 11(b) which were still pending at the close of the fiscal year follows:

Number of proceedings: 61

Number of systems: 36

Number of holding companies: 116

Number of subsidiary companies: 692

Total assets involved: \$13,895,000,000

Section 11(e) of the Act authorizes the Commission to approve voluntary plans of reorganization submitted by registered holding companies and their subsidiaries. Prior to June 30, 1946, 167 such plans had been filed. The Commission has approved 68 of these plans, 28 were withdrawn or dismissed, 3 were denied, and 68 were pending before the Commission in various stages of completion.

INTEGRATION AND CORPORATE SIMPLIFICATION UNDER SECTION 11

Summary of Progress

As indicated in the Tenth and Eleventh Annual Reports of the Commission the integration and simplification program has undergone three phases of development. The first phase, in which the public utility industry was invited to offer voluntary proposals for compliance with Section 11, had a limited success, due to failure of many companies to submit plans amounting to more than the preservation of existing systems. In the second phase, the Commission issued orders with respect to each holding company system directing compliance and indicating in general terms the changes which the systems must make to meet the geographical integration requirements of Section 11(b)(1) and the corporate

simplification and redistribution of voting power requirements of Section 11(b)(2). With the exception of a few minor problems, this phase is now complete. The third phase has embraced the processing of voluntary plans for reorganization or recapitalization filed by nearly all of the systems looking toward compliance with the orders issued by the Commission under Sections 11(b)(1) and 11(b)(2). This phase of the integration program has been the center of attention during the recent period.

Divestment and Simplification

The fiscal year ending June 30, 1946, witnessed a sharp rise in the market prices for utility securities, particularly common stocks. This provided substantial impetus to the divestment by holding companies of assets not retainable under the integration standards of Section 11(b)(1).

During the year ended June 30, 1946, the total consideration received by holding companies for their interests in subsidiaries divested and for miscellaneous properties sold was \$254,000,000 as compared with \$150,000,000 for 1945. Because of the fact that the interest disposed of usually consisted of no more than the parent company's holdings of common stock in the divested company, the total assets of the subsidiary company involved in the divestment are many times the consideration received.

Of particular significance among the divestments of the past year have been the increased cash sales to underwriters for public distribution by holding companies seeking to dispose of the common stocks of operating subsidiaries held in their portfolios. Among these sales during the past fiscal year were the following, all of which were sold at competitive bidding:

Subsidiary company: Proceeds to holding company

Central Hudson Gas and Electric Corp: \$4,157,175

Pacific Gas & Electric Company: \$27,272,200

Florida Power Corporation: \$6,445,227

Central Arizona Light & Power Co: \$10,432,800

Dallas Railway & Terminal Co: \$3,517,963

Colorado Central Power Co: \$1,418,769

Midland Realization Company: \$3,087,000

Scranton Electric Company: \$25,881,266

Columbus & Southern Ohio Electric Co: \$38,115,352

Dayton Power and Light Co: \$51,467,670

Tucson Gas,Electric Light and Power Co: \$5,558,070

Total: \$177,353,992

Also of interest is the recent distribution and sale of 2,000,000 shares of Cincinnati Gas & Electric Co. common stock through issuance of rights to the common stockholders of the holding company, Columbia Gas & Electric Corp., combined with an underwriting of the unsubscribed shares. Proceeds to the parent company resulting from this transaction approximated \$50,000,000. A number of other important divestments have been effected by means of distribution of subsidiary securities to security holders of the parent company in the form of liquidating dividends.

Prior to June 30, 1946, holding companies' nonretainable interests in 399 subsidiaries having aggregate assets of \$6,073,000,000 had been divested. Of this number, 343 companies with assets of \$4,580,000,000 are no longer subject to the Holding Company Act. Integration orders outstanding at the end of the fiscal year require additional divestments of interests in 123 subsidiaries with total assets of \$3,354,000,000.

(chart omitted)

Noteworthy progress has also been witnessed in the simplification of corporate structures and redistribution of voting power of holding company systems under Section 11(b)(2). Because of the fact that in many cases dissolution of unnecessary holding companies cannot take place until a series of involved transactions has been consummated, it is difficult to provide a precise statistical measure of the over-all simplification which has been achieved. The following table, however, covering the period from June 15, 1938 to June 30, 1946, indicates the sharp reduction which has taken place in the total number of holding companies, and utility and nonutility subsidiary companies subject to the Holding Company Act, This reflects the simplification which has occurred as a result of compliance with both the geographic integration requirements of Section 11(b)(1) and the corporate simplification requirements of Section 11(b)(2) .

Interpretation of Section 11

Recent interpretations of the geographic integration requirements of Section 11(b)(1) in the light of the definitions contained in Section 2(a)(29) have been of particular interest. In Texas Utilities Co., Holding Company Act Release No.

6373, the Commission held that the requirements of Section 10 precluded the acquisition of Dallas Railway & Terminal Co. by Texas Utilities Co., a registered holding company, in the absence of a showing of a substantial operating relationship which would qualify the combination of electric and transportation properties for retention under Section 11(b)(1).

Two other cases contained important interpretations of the statutory limits of bigness of an integrated public utility system, as applied to electric companies. In American Gas and Electric Co., Holding Company Act Release No. 6333, the Commission found that the holding company's principal group of properties, which was known as the Central System, constituted a single integrated public utility system within the meaning of Section 2(a)(29). These properties, which included gross electric utility plant of approximately \$443,000,000, had gross operating revenues of approximately \$102,000,000 and served an area of approximately 90,000 square miles in the States of Michigan, Indiana, Ohio, West Virginia, Virginia, Tennessee and Kentucky. The Commission noted, in particular, that practically all of the power requirements of the Central System were met by its own electric generating stations, that the Central System had a long historical record of having been developed and operated as a highly coordinated system under the central control of the holding company, that interchanges of energy among the component companies were frequent and substantial, and that it did not blanket the entire area, inasmuch as other important electric utility companies operated in the territory.

The Commission concluded that the Central System constituted a single integrated system and that it did not appear to be so large in any of the States in which it operated as to impair the effectiveness of regulation. Further, a relatively high degree of coordination of the system's utility facilities and its relatively economical operation were demonstrated. These characteristics were shown, in part, to be due to common control. In reaching this conclusion the important distinction was made that the Commission was not asked to approve the creation of a new holding company over the Central System, but merely to determine whether Section 11(b)(1) required the status quo to be affected. It also observed that "the Central System approaches the maximum size which we believe is consistent with the standards of localized management, efficient operation and effectiveness of regulation contained in Sections 2(a)(29) and 11(b)(1)." This limitation on the size of the Central System was clarified further in a subsequent case under Sections 9 and 10 of the Act, American Gas and Electric Co., Holding Company Act Release No. 6639, in which the Commission denied the application of American Gas & Electric Co. for permission to acquire the common stock of Columbus & Southern Ohio Electric Co. In its opinion, the Commission noted that Section 10, which governs extensions of control, permits a new acquisition only if the Commission can affirmatively find that such acquisition will tend toward the creation of an integrated system as defined in Section 2(a)(29). Section 10 requires disapproval of such acquisition if the Commission finds that the acquisition will "tend towards ... the concentration of control of public-utility

companies, of a kind or to an extent detrimental to the public interest or the interest of investors or consumers.” The marked difference between the standards of Sections 10 and 11, the Commission stated, “inheres in the difference between Section 11, as a compromise of the policy of ‘elimination’ of holding companies otherwise than as permitted by the Act (Section 1(c), and the ‘new acquisition’ standards of Section 10, which were designed as a more restrictive check on further growth of holding companies and further extension of their control.”

The Commission concluded that “the acquisition of Columbus and Southern Ohio would not be merely the addition of a spur or connecting link to the system, but would represent a major extension into new territory which very materially and very substantially enlarges the system, and that it would extend the system beyond the maximum limit deemed permissible in the earlier Section 11(b)(1) determination of whether the status quo should be affected. [Footnote: Holding Company Act Release No. 5970]

STATUS OF INTEGRATION PROGRAM -- 20 MAJOR SYSTEMS

There follows a brief summary of the status of the major holding company systems at the end of the fiscal year with respect to Section 11. A résumé of previously reported accomplishments is included together with a fuller description of the principal steps taken during the current year.

1. Electric Bond and Share Company

The parent of this system, Electric Bond and Share Co. (Bond and Share), controls five major subholding companies: National Power & Light Co. (National); American Power & Light Co. (American); Electric Power & Light Corp. (Electric); American & Foreign Power Co., Inc. (Foreign Power); and American Gas and Electric Co. (American Gas).

Bond and Share has filed Plans I, II, and III under Section 11(e) of the Act, setting forth a program for the retirement of its preferred stocks and the divestment of all remaining public utility investments in the United States. [Footnote: Holding Company Act Release No. 5970] After receiving Securities and Exchange Commission and court approvals, Bond and Share paid \$30 per share as a capital distribution on its outstanding preferred stocks and reduced regular preferred dividends by 30 percent (subject to any adjustment found by the Commission and approved by an appropriate court as fair and equitable), thus consummating Plan I. [Footnote: Holding Company Act Release No. 6121] Plan II-A was filed in June 1946 and provided for an additional \$70 per share capital distribution and the issuance of a certificate evidencing the further claim, if any, of the preferred stockholders, the amount of such claim to be made definite in a subsequent amendment to the plan. [Footnote: Holding Company Act

Release No. 6747] In order to raise the necessary cash for the capital distribution to the preferred stockholders, Bond and Share included as part of Plan II-A the proposal to sell its holding of the common stocks of American Gas, Pennsylvania Power & Light Co. (Pennsylvania), Carolina Power & Light Co. (Carolina), and Birmingham Electric Co. (Birmingham).

After the commencement of Section 11(b)(2) proceedings with respect to Bond and Share and certain of its subsidiaries, [Footnote: Holding Company Act Release No. 2051] the Commission ordered National to dissolve since it served no useful function and constituted an undue and unnecessary complexity in the system, [Footnote: Holding Company Act Release No. 2962] and indicated to National that prior to any disposal of its holdings of subsidiaries their accounts and corporate structures were to conform to the requirements of the Act with respect to distribution of voting power and other matters. [Footnote: Holding Company Act Release No. 3896] Plans to this end were filed by National and approved by this Commission with respect to Carolina, Birmingham, and Pennsylvania. [Footnote: Holding Company Act Release Nos. 3995, 4746, 4955, 6080, and 6167] The State commission in each of these cases, either alone or in conjunction with the Federal Power Commission, ordered the elimination from the companies' property accounts of certain write-ups (Account 107) and the elimination or amortization of acquisition adjustment items (Account 100.5).

Under the settlement approved by the Commission in May 1946, with respect to all suits and claims against Bond and Share by or on behalf of National and its subsidiaries and certain former subsidiaries, Bond and Share paid National and such other companies the amount of \$750,000. [Footnote: Holding Company Act Release No. 6663] This settlement was subsequently approved by the United States District Court; and in August 1946 National distributed the common stocks of Pennsylvania, Carolina, and Birmingham pro rata to its common stockholders. Thus, Bond and Share, which held 46 percent of National's common stock, received 46 percent of the common stock so distributed. With respect to National's only remaining subsidiaries -- Memphis Generating Co., The Memphis Street Railway Co., and Lehigh Valley Transit Co. -- plans are pending for the reorganization and divestment of the first two companies, while it is expected that a plan dealing similarly with Lehigh Valley Transit will be filed shortly.

American and Electric, two of the other subholding companies, were ordered to dissolve for reasons similar to those set forth for National. [Footnote: Holding Company Act Release No. 3750] These companies carried appeals to the United States Circuit Court of Appeals for the First Circuit, which affirmed the order of the Commission (141 Fed. (2d) 606). The companies' petition to the United States Supreme Court for a writ of certiorari was granted and arguments were concluded on November 16, 1945. After the death of Chief Justice Stone, the Court directed a re-argument of the case during the fall of 1946. Certain major steps taken by Electric and American and their subsidiaries in the overall process of complying with Section 11 are detailed below: Under a Section 11(e)

plan approved by the Commission for American in November and December 1945, American retired approximately \$36,400,000 principal amount of debentures [Footnote: Holding Company Act Release Nos. 6176 and 6258 Commissioner Healy dissenting)] The company had originally proposed to retire such debentures at 100 percent of principal amount plus accrued interest, but it amended its plan, pursuant to the Commission's findings and opinion, to provide for the retirement of its debentures at 110 percent of principal amount plus accrued interest and certain assumed debentures, non-callable until 1947, at 115 percent of principal amount plus accrued interest. The plan, as amended, was subsequently enforced by an appropriate district court.

The Commission approved the formation by American in October 1945 of a new Texas holding company, which acquired from American its interest in Texas Electric Service Co. and Texas Power & Light Co. and from Electric the latter's interest in Dallas Power & Light Co. for a cash consideration of \$17,350,000. [Footnote: Holding Company Act Release No. 1658] The new holding company, Texas Utilities Co., was to be disposed of by American within 1 year from October 1945. During the fiscal year American disposed of its interests in New Mexico Electric Service Co. [Footnote: Holding Company Act Release No. 6281] and Central Arizona Light and Power Co. [Footnote: Holding Company Act Release No. 6179] Minnesota Power & Light Co. [Footnote: Holding Company Act Release No. 6032] and The Montana Power Co. underwent debt refundings, the latter company also accomplishing an accounting reorganization. [Footnote: Holding Company Act Release Nos. 6128 and 5897]

A plan has also been filed by Electric under Section 11(e) of the Act. Under it Electric proposed an exchange offer of its holdings of the common stock of United Gas Corporation for its outstanding first preferred stock. [Footnote: Holding Company Act Release No. 6231] Thereafter, Bond and Share filed an alternative plan, following which, in July 1946, Electric and Bond and Share jointly filed a compromise plan. [Footnote: Holding Company Act Release No. 6768] The latter plan provides for the retirement of Electric's first and second preferred stocks; for the creation of a new southern electric holding company; and for the transfer by Electric to the new holding company of the common stocks of Arkansas Power & Light Co., Louisiana Power and Light Co., Mississippi Power & Light Co. and New Orleans Public Service Co. Electric's first and second preferred stockholders under the plan will be offered a choice of (a) shares of United Gas Corporation, (b) shares of the common stock of the new southern electric holding company, or (c) cash. Any portfolio securities not exchanged will be sold or distributed by Electric. It is provided that, upon consummation of all the above steps, Electric will withdraw its appeal from the Commission's dissolution order and dissolve. A compromise plan, on which hearings were held after the close of the fiscal year, is now pending before the Commission.

A. Section 11(e) plan approved for Utah Power & Light Co. provided that Utah would (a) recapitalize on a one-stock basis, the holders of the outstanding publicly held stock to receive new common stock for their holdings, (b) pay Electric \$650,000 cash, (c) release Electric from all claims in favor of Utah or any of its subsidiaries against Electric and assign to Electric all claims of Utah and its subsidiaries against Bond and Share or its wholly owned subsidiaries. In consideration of the foregoing, Electric surrendered to Utah for cancellation 3,000,000 shares of common stock and 2,100 shares of \$7 preferred stock having an aggregate stated value of \$30,210,000. [Footnote: Holding Company Act Release No. 6212 (Commissioner Healy dissenting in part)] The plan was subsequently enforced by the United States District Court for the District of Utah. As a result of the reorganization, in addition, to having its capital structure improved, Utah was separated entirely from the Bond and Share system.

Electric has disposed of its interests in Dallas Railway & Terminal Co., its remaining investments now consisting of its holdings of United Gas Corp.'s common stock and the common stocks of the four companies which are proposed to be transferred to the new Southern Electric Holding Co.

Proceedings on an application filed by American Gas, requesting approval of the continuance of its Central System together with continuance of the alleged South Jersey and Northeast Pennsylvania systems, were consolidated with Section 11(b)(1) proceedings instituted by the Commission in 1939. Hearings were held from time to time in such consolidated proceedings. The Commission concluded that properties comprising the Central System could be retained under common control under the standards of Section 11(b)(1) of the Act but that other properties must be divested if such Central System were to be retained. In April 1946, American Gas sold at competitive bidding its holdings of the common stock of Scranton Electric Co. leaving the Atlantic City Electric Co. to be divested in order for American Gas to meet fully the above-mentioned order. [Footnote: Holding Company Act Release No. 6565]

On October 26, 1944, Foreign Power filed a plan of reorganization under Section 11(e) of the act in which Bond and Share joined. Proceedings on the plan were consolidated by the Commission with the proceedings directed to Bond and Share and Foreign Power under section 11(b)(2) of the Act and hearings were thereafter held from time to time until July 8, 1946, on which date the record in the proceedings was closed as to the necessity and fairness of the plan. [Footnote: Holding Company Act Release No. 5388] The staff of the Public Utilities Division is preparing its Proposed Findings and Opinion for submission to the Commission, following which the parties and participants will be given the opportunity to file counter-proposed findings and briefs, and to argue orally before the Commission.

2. The North American Company

In Section 11(b)(1) proceedings instituted with respect to The North American Co. (North American), the Commission directed the company to confine its operations to a single integrated system built around the Union Electric Company of Missouri. [Footnote: Holding Company Act Release No. 1960] North American appealed from the order to the United States Circuit Court of Appeals for the Second Circuit, which court affirmed the order. [Footnote: 133 F. (2d) 148] Section 11(b)(2) proceedings have also been initiated with respect to North American Light & Power Company (Light & Power), a subsidiary holding company of North American. [Footnote: Holding Company Act Release No. 3168]

A writ of *certiorari* was granted by the United States Supreme Court to review the North American case, argument having been heard in November 1945. [Footnote: 318 U.S. 750 (1943)] The Court handed down its opinion on April 1, 1946, affirming the decision of the Circuit Court of Appeals and sustaining the constitutionality of Section 11(b)(1). [Footnote: U.S., 66 S. Ct. 785 (1946)] Thereafter, North American filed a plan pursuant to Section 11(e) of the Act providing for (a) disposition of the major portion of its interests in four principal subsidiaries, (b) the formation of a new company to hold the securities of the Union Electric Company of Missouri system and Illinois Power Co., and (c) the formation of a new company to hold miscellaneous non-utility investments and residual investments in certain utility properties. Hearings have been held on certain phases of the plan.

North American has continued its policy of paying common stock dividends in stock of Pacific Gas & Electric Co. In addition, it sold 700,000 shares of Pacific common, stock in a public offering and used the proceeds to retire its 6 percent preferred stock [Footnote: In December 1945 North American borrowed \$32,000,000 from certain banks at 1% percent interest and has used the proceeds, together with other funds to retire its 5 and three quarters percent preferred stocks. The company's capitalization, therefore, now consists solely of bank loans and common stock.] Pacific Gas & Electric Co., as a result of North American's disposition of holdings therein, has been declared not to be a statutory subsidiary in the North American system. A Section 11(e) plan was approved by the Commission for Union Electric Co. of Missouri. [Footnote: Holding Company Act Release No. 5776] Two of Union's subsidiaries were thereby eliminated and the company's corporate structure simplified.

The Commission entered an order of dissolution against Light and Power, a subsidiary holding company of North American, but its determination of a fair and equitable plan of dissolution has been delayed by consideration of the disposition of claims asserted by Illinois Power Co., a subsidiary of Light and Power. Extensive hearings have been held on these claims and briefs and reply briefs have been submitted.

The assets of Illinois Traction Co., a former subsidiary of Light and Power, have been transferred to Light and Power in the course of dissolution pursuant to the provisions of a Section 11(e) plan, which was approved by the Commission 31 and affirmed by the United States District Court for the District of Maine on December 19, 1945.

3. The United Gas Improvement Company

After Section 11(b)(1) proceedings were instituted with respect to the United Gas Improvement Co. (UGI), its integrated system was defined by the Commission as the electric properties in the Pennsylvania-Delaware-Maryland area, and orders of divestment were issued on the basis of this interpretation. [Footnote: Holding Company Act Release Nos. 2913 and 3511.] The company appealed these orders to the United States Circuit Court of Appeals for the Third Circuit, which court sustained the orders. [Footnote: 138 F. (2d) 1010] Voluntary plans under Section 11(e) were filed by UGI and its subsidiary, Philadelphia Electric Co., after argument before the court but prior to the issuance of its decision. The plan provided for the distribution to UGI stockholders of \$30,600,000 in cash and substantially all the stock holdings in two of its subsidiaries; Philadelphia Electric Co. and Public Service Corp. Of New Jersey. The plan was approved by the Commission and by the common stockholders. [Footnote: Holding Company Act Release No. 4173] Subsequently, UGI distributed to its stockholders its holdings of Delaware Power & Light Co. and subsidiaries. During the past fiscal year, UGI has disposed of its interests in three additional companies, namely, Nashville Gas and Heating, Arizona Power Corp., and Manchester Gas Co. [Footnote: Holding Company Act Release Nos. 5896, 5882, 5130 respectively]

Pursuant to another Section 11(e) plan filed on December 6, 1945 and designed to effect further compliance with the requirements of Section 11, UGI exchanged, for approximately 750,000 shares of its outstanding capital stock, its portfolio holdings of securities of four public utility holding companies, namely, American Water Works and Electric Co., Inc., The Commonwealth & Southern Corp., Niagara Hudson Power Corp., and Public Service Corporation of New Jersey. These securities had a market value at that time of approximately \$23,146,000. The Commission approved this plan on March 13, 1946. [Footnote: Holding Company Act Release No. 6474] On May 16, 1946, UGI filed a declaration concerning the sale of its holdings of the preferred stocks of Kansas City Gas Co. and The Wyandotte County Gas Co. (subsidiaries of Cities Service Co.) to each of these companies for a total consideration of \$5,150,000. Since the close of the fiscal year, the Commission permitted the declaration to become effective and the sale was consummated. [Footnote: Holding Company Act Release No. 6770]

4. The Commonwealth & Southern Corporation

In the Section 11(b)(1) and (2) proceedings which were instituted and consolidated with respect to this system, the Commission' directed the

Commonwealth & Southern Corp. (Commonwealth) to reduce its outstanding preferred and common stocks to a single class of new common stock. The Commission's order was appealed by the company to the Circuit Court of Appeals for the Third Circuit, and affirmed by the court. [Footnote: 134 F. (2d) 747]

Commonwealth's initial plan of recapitalization provided for the reclassification of its stock into a new class of common stock and a distribution of its holdings of the common stock of Consumers Power Co. to Commonwealth stockholders. An amended plan was later filed which proposed a change in the allocation between Commonwealth preferred and common stockholders as well as the distribution of its holdings in its other Northern subsidiaries in addition to Consumers Power Co. After the conclusion of hearings on the amended plan the Commission issued its findings and opinion stating that if the plan were amended in certain respects, it would be approved. [Footnote: Holding Company Act Release No. 5825] The requested amendments were filed and the Commission on June 30, 1945, entered its order approving the amended plan. [Footnote: Holding Company Act Release No. 5895] Among the provisions of this amended plan was the requirement that the plan receive the affirmative vote of the holders of a majority of each class of Commonwealth's stock before the Commission applied to an appropriate Federal district court for an order approving and enforcing the plan. Following the passage of several months without the completion of arrangements for conducting the vote contemplated in the plan, the Commission, by order dated November 1, 1945, modified its previous order so as to approve the plan on condition that the company delete that portion requiring a stockholders' vote. [Footnote: Holding Company Act Release No. 6177] Modifications of its plan, filed by Commonwealth on November 9, 1945, provided for the elimination of a stockholders' vote if the Commission would approve an extensive amendment of the plan which would essentially alter it.

On January 24, 1946, the Commission issued a memorandum opinion in which it stated that, in addition to the difficult questions of fairness posed by the changes suggested, the complicated and confusing nature of the modifications did not merit the scheduling of hearings. Further proceedings were withheld for a period of 60 days to March 25, 1946, in order to afford an opportunity to Commonwealth and to any person having a bona fide interest in reorganization to file a plan for compliance with the Commission's original order requiring the retirement of Commonwealth's preferred stock through the sale or other disposition of assets. By March 25, 1946, four plans for the recapitalization of Commonwealth, including one sponsored by the management had been filed with the Commission and hearings have been scheduled to consider these plans. On May 5, 1944, the Commission issued its order in the Section 11(b)(1) proceeding involving Cities Service Co. (Cities), the top company of a system. [Footnote: Holding Company Act Release No. 5028] The order directed Cities to comply with Section 11(b)(1) by reducing the operations of its system to certain

gas distribution properties located in the midcontinent section, together with certain gas production and transmission properties. The order, however, permitted the retention of the system's nonutility properties if Cities should choose to comply with Section 11(b)(1) by disposing of all its direct or indirect interest in utility companies. Cities elected to retain its non-utility properties, whereupon the Commission, on October 12, 1944, entered a supplemental order providing in substance, that Cities might dispose of its interests in utility properties in lieu of complying with the provisions of the earlier order. [Footnote: Holding Company Act Release No. 5350] Since the original order, Cities has disposed of its interest in 39 subsidiaries 46 and has been engaged in a program of refinancing certain subsidiaries preparatory to a divestment of its interest in Cities Service Power & Light Co. [Footnote: of these, three companies were direct subsidiaries and 36 companies were subsidiaries of Cities Service Power and Light Co. or of its subsidiary holding company, Federal Light and Traction Co.]

The order of May 5, 1944, also directed Arkansas Natural Gas Corp., a subsidiary holding company of Cities, to confine its operations to the natural gas business and to dispose of its interests in its non-utility subsidiaries. On appeal by Arkansas Natural Gas Corp., the United States Circuit Court of Appeals for the Fifth Circuit, sustained the order of the Commission. [Footnote: 154 F. (2d) 597 (1946).] Arkansas Natural Gas Corporation's petition to the United States Supreme Court for a writ of certiorari had been denied, *Arkansas Natural Gas Corp. v. S.E.C.*, U. S. Oct. 14, 1946.

On August 17, 1943, the Commission ordered Cities Service Power & Light Co. (Power & Light), a holding company subsidiary of Cities Service Co., to dispose of its interest in 43 companies, including Federal Light & Traction Co. (Federal) and the 14 subsidiaries of the latter company. [Footnote: Holding Company Act Release No. 4489] Since this order was issued, Power & Light has disposed of its interests in 36 companies and has dissolved. The order of August 17, 1943, required that Federal confine its operations to the electric utility business conducted by subsidiaries in the States of New Mexico and Colorado, jurisdiction being reserved with respect to certain properties in New Mexico and Arizona. On March 3, 1944, the Commission granted Federal an option to retain as its utility system either the properties in New Mexico and Colorado or those in Arizona. [Footnote: Holding Company Act Release No. 4960] Federal has disposed of all its subsidiaries except the four companies operating entirely in New Mexico and has filed an application for the merger of such subsidiaries into one company. The Commission, after close of the fiscal year, approved the merger, and it has been consummated. [Footnote: Holding Company Act Release No. 6887] Federal has also filed an application for dissolution, which application is still pending.

6. Associated Gas and Electric Company (now General Public Utilities Corporation)

In 1940 Associated Gas and Electric Co. (Ageco) and its subsidiary holding company, Associated Gas and Electric Corp. (Agecorp), filed petitions in the United States District Court for the Southern District of New York for reorganization under Chapter X of the Bankruptcy Act. Both companies were registered holding companies. The court appointed, as trustees of Agecorp, Denis J. Driscoll and Willard L. Thorp, who also registered as a holding company. [Footnote: On Mar. 27, 1946, the Commission issued an order declaring that the trustees have ceased to be a holding company, their resignation as trustees having become effective pursuant to a district court order dated Feb. 6, 1946, Holding Company Act Release No. 6513.] On August 13, 1942, the Commission issued an order pursuant to Section 11(b)(1) in which it directed the trustees, among other things, to dispose of their interest in 116 companies, reserving for further consideration questions relating to the retainability of certain other properties. [Footnote: Holding Company Act Release No. 3729] By subsequent orders, seven companies were removed from this divestment order. The trustees have divested themselves of most of the companies cited in the order, so that as of June 30, 1946, only eight of the companies cited are still in the system. The companies which are still retained consist of five non-utility companies, one utility holding company, and two operating utilities. Plans have been proposed, for distribution, sale or liquidation of such remaining companies.

On August 9, 1945, the United States District Court for the Southern District of New York confirmed a comprehensive reorganization plan proposed by the trustees, pursuant to Chapter X of the Bankruptcy Act and Section 11 (f) of the Holding Company Act, which plan had been approved, by the Commission on April 14, 1944. [Footnote: Holding Company Act Release No. 4985] The Circuit Court of Appeals affirmed the order, and on October 8, 1945 the United States Supreme Court denied a petition for certiorari. [Footnote: U.S., 66 Sup. Ct. 45.] The plan of reorganization under Chapter X of the Bankruptcy Act has been consummated pursuant to an order of the reorganization court dated January 14, 1946.

Following the institution of proceedings pursuant to Section 11(b)(2) with respect to General Gas and Electric Corp. (Gengas), a subsidiary holding company of Agecorp, Section 11(e) plans for the reorganization of Gengas were filed, and the hearings on this plan were consolidated with the Section 11(b)(2) proceedings. [Footnote: Holding Company Act Release No. 2543] On August 12, 1944, a revised plan was filed jointly by Agecorp and Gengas, which provided for the distribution by Gengas of either cash or securities of its subsidiaries among its public security holders. There would remain no claims against Gengas except those held by the trustees of Agecorp, who would turn in their holdings and receive in exchange an entire issue of new common stock of Gengas. This plan was approved by the Commission on July 25, 1945. [Footnote: Holding Company Act Release No. 5950] By orders dated October 15, 1945 and October 22, 1945, the District Court of the United States for the Southern District of New

York approved and ordered enforcement of the plan. As explained below, Gengas during 1945 disposed of all of its holdings in Florida Power Corp. by public sale, so that at June 30, 1946, its sole subsidiary was South Carolina Electric & Gas Corp. Following the close of the fiscal year Gengas distributed its remaining holdings to the common stockholders of its parent and dissolved.

On April 24, 1944, Gengas, Georgia Power and Light Co., a subsidiary of Gengas, and Florida Power Corp., an associate of Georgia, filed a joint plan proposing, among other things, the recapitalization of Georgia. The proposal included the donation by Florida to Georgia of \$1,400,000 in cash to be used in part for the reduction of the mortgage debt of Georgia and for a cash payment in the amount of \$150 per share in full satisfaction of the claims of the public holders of preferred stock of Georgia for par value and arrearages. The proposed plan of recapitalization, together with the related donation and an issue and sale by Florida of preferred stock through competitive bidding, was approved by the Commission on January 23, 1945, subject to the condition that Georgia divest itself of its ice and water properties within 1 year. [Footnote: Holding Company Act Release No. 5568] The plan was approved by the United States District Court for the Middle District of Georgia on April 7, 1945. Subsequent to the approval of such plan, the common stock of Florida held by Gengas was sold at competitive bidding pursuant to an order of the Commission granting approval to such transaction. [Footnote: Holding Company Act Release No. 6124]

On September 29, 1943, the Commission instituted Section 11(b)(2) proceedings with respect to Tide Water Power Co., a subsidiary of Gengas, raising the issue whether the voting power of Tide Water was fairly, and equitably distributed. After appropriate hearings, the Commission issued its order providing, among other things, for a recapitalization of the Company by substituting a single class of common stock for the then outstanding classes of stock. [Footnote: Holding Company Act Release No. 5238] Thereafter, Tide Water filed a plan to comply with the Commission's one-stock order. [Footnote: Holding Company Act Release No. 5309] The plan was approved on December 22, 1944, subject to reservation of jurisdiction as to the percentage of new common stock to be received by Gengas. [Footnote: Holding Company Act Release No. 5512] On February 12, 1946, 3.5 percent of the new common stock was allocated to Gengas. [Footnote: Holding Company Act Release No. 6407]

On March 30, 1945, a plan of reorganization was filed by York Railways Co. a debtor in possession under Section 77B of the Bankruptcy Act, in a proceeding which had been pending since November 30, 1937. [Footnote: Holding Company Act Release No. 5744] The plan provided for the raising of sufficient cash to pay all public creditors and preferred stockholders the full amount of their claims and for the liquidation of York Railways Co. The plan was approved by the Commission on December 10, 1945, and subsequently by the United States District Court for the Eastern District of Pennsylvania. [Footnote: Holding Company Act Release Nos. 6285 and 6356]

On September 30, 1941, the Commission instituted proceedings under Section 11(b)(2) with respect to New England Gas and Electric Association (Negea), a registered holding company. After hearings were held but prior to the final order of the Commission, the trustees of Ageco and Agecorp and a subsidiary company in the Associated system instituted proceedings in both a State and Federal court asserting claims against Negea arising from various transactions in the years 1930 and 1932. It appeared to the Commission that before a determination could be made with respect to the recapitalization of Negea, the validity and rank of the asserted claims would have to be resolved. The Commission, therefore, instituted further proceedings with respect to these claims. [Footnote: Holding Company Act Release No. 4124] On March 29, 1945, Negea filed a plan of recapitalization pursuant to the provisions of Section 11(e). [Footnote: Holding Company Act Release No. 5730] During the course of the hearings on this plan, extended discussions were held among the interested parties, including committees representing holders of New England debentures and first preferred shares. These discussions resulted in the filing by New England of an amended plan dated March 21, 1946, which was supported by all interested parties and the committees. The stated purpose of the amended plan was to effectuate the provisions of Section 11(b)(2) and the settlement of the various controversies referred to above. After hearings, the Commission, on June 24, 1946, issued its order approving the amended plan. [Footnote: Holding Company Act Release No. 6729] By order dated July 17, 1946, the District Court for the District of Massachusetts approved and ordered enforcement of the amended plan.

On March 11, 1946, Associated Electric Co. and two of its subsidiaries, Pennsylvania Electric Co. and Pennsylvania Edison Co., jointly filed a plan pursuant to Section 11(e) of the Holding Company Act under which, among other things, the assets of Pennsylvania Edison Co. were to be transferred to Pennsylvania Electric Co., the bondholders of Pennsylvania Edison Co. were to receive the redemption value of their securities, and the preferred shareholders of such company were to receive the liquidation values rather than the redemption values of their securities. On March 26, 1946, the Commission instituted a proceeding, pursuant to Section 11(b)(2) and other Sections of the Act, directed to Associated Electric Co. and Pennsylvania Edison Co. and consolidated such proceedings with the other proceedings. [Footnote: Holding Company Act Release No. 6511] On June 19, 1946, the Commission approved the plan in part by permitting the transfer of the assets and the payment of the redemption value of the bonds to the bondholders of Pennsylvania Edison Co. The Commission also permitted the immediate payment of the liquidation values to the preferred shareholders of Pennsylvania Edison Co. but reserved jurisdiction to determine the additional amounts, if any, the preferred shareholders of Pennsylvania Edison Co. should receive. One million dollars cash was deposited in escrow by Associated Electric Co. for such additional

payment as might ultimately be determined. [Footnote: Holding Company Act Release No. 6723]

Section 11(b)(1) proceedings were instituted by the Commission with respect to Standard Power and Light Corp. (Standard Power), Standard Gas and Electric Co. (Standard Gas) and their subsidiaries, following which Section 11(b)(2) proceedings were instituted with respect to Standard Power. After subsequent hearings, the Commission issued an order requiring the liquidation and dissolution of Standard Power. [Footnote: Holding Company Act Release No. 3607] A dissolution plan for Standard Power was approved by the Commission on February 22, 1945. [Footnote: Holding Company Act Release No. 5625]

A Section 11(e) plan filed by Standard Gas and the proceedings as to this plan were consolidated with the Section 11(b)(1) proceedings. After hearings and oral argument, the Commission issued its findings and opinion, stating that it could not make the findings necessary for approval of the plan. [Footnote: Holding Company Act Release No. 5020] An amended plan subsequently submitted by Standard Gas was approved by the Commission. [Footnote: Holding Company Act Release No. 5430]

At the request of Standard Gas, application was made by the Commission to the United States District Court for the District of Delaware for an order of enforcement of the amended plan. The district court withheld approval of the plan on the basis that note and debenture holders were not being paid off in cash.

Approval was given, however, to the proposed allocation among stockholders. The Commission, Standard Gas, and several other parties to the proceedings appealed from the district court's decision to the United States Circuit Court of Appeals for the Third Circuit. The latter court's decision, rendered on September 14, 1945, reversed the district court and upheld the Commission's finding that the amended plan was fair and equitable to the note and debenture holders.

Subsequently, Standard Gas filed a motion with the district court requesting an order of the court disapproving the amended plan for recapitalization as unfair and inequitable because of changed conditions. The Company's motion also stated that it proposed first to borrow money with which, together with treasury cash, to call the notes and debentures and, secondly, to pay off bank notes then outstanding by the sale of portfolio securities. Such right of Standard Gas to call the notes and debentures was upheld in a decree of the United States District Court for the District of Delaware issued on December 29, 1945, and amended January 9, 1946. The Court also held that the securities should be called within 30 days or within such further time as the Commission might grant. [Footnote: Holding Company Act Release No. 6385. Notice of appeal from this court order has been filed with the Circuit Court of Appeals for the Third Circuit by a debenture holder.] By order dated February 26, 1946, the Commission approved

the issuance and sale of bank loan notes and authorized the call and payment of the notes and debentures. [Footnote: Holding Company Act Release No. 6435]

Northern States Power Co. (Delaware) filed its plan of liquidation pursuant to Section 11(e) concurrently with the Commission's institution of proceedings pursuant to Section 11(b)(2) and other Sections of the Act with respect to that company and each of its subsidiaries. After extensive hearings on the original plan and proposed amendments the Commission issued an order approving the plan, as amended, subject to certain reservations of jurisdiction. [Footnote: Holding Company Act Release No. 5745] On January 2, 1946, the Commission applied to the United States District Court (Minnesota) for enforcement of the plan. Subsequent to this application for enforcement, but prior to the date set for hearing, the Commission received numerous objections to enforcement of the plan and received suggested amendments by stockholders who stated that changed conditions made modification of the plan necessary. At the Commission's request the court granted a continuance for the purpose of considering the alternative plans. Hearings have been held thereon, briefs filed, oral argument heard and the matter is now before the Commission for decision.

Proceedings on the plan of recapitalization filed pursuant to Section 11(e) by Southern Colorado Power Co., a subsidiary of Standard Gas, were consolidated with those instituted by the Commission under Section 11(b)(2). The company's plan was approved by the Commission after the filing of certain amendments and later by the United States District Court in Colorado. [Footnote: Holding Company Act Release No. 4501] A group of preferred stockholders appealed from the district court's decision to the United States Circuit Court of Appeals for the Tenth Circuit, which upheld the decision of the lower court. The Supreme Court denied writ of certiorari, and on June 26, 1945, the District Court for the District of Colorado entered its order declaring the plan effective as of June 30, 1945.

8. Columbia Gas & Electric Corporation

Section 11(b)(1) and (2) proceedings which were commenced with respect to Columbia Gas & Electric Corp. (Columbia) were consolidated with the company's Section 11(e) plan. Such plan provided for the sale by Columbia Oil & Gasoline Corp., a subsidiary of Columbia, of its interest in Panhandle Eastern Pipe Line Co., the transfer of its five oil and gasoline subsidiaries to Columbia, the liquidation of Columbia Oil & Gasoline Corp., and other related matters. The Commission's order [Footnote: Holding Company Act Release Nos. 3829 and 3885] approving this voluntary plan was affirmed by the United States Circuit Court of Appeals for the Third Circuit, [Footnote: 134 F. (2d) 822] and the United States District Court for the District of Delaware entered its order approving the plan. [Footnote: 50 F. 965] Further proceedings were instituted by the Commission with respect to subsidiaries not included in the company's 11(e) plan, at the close of hearings on which the Commission issued its findings,

opinion and order designating the properties of Columbia which might be retained and reserving jurisdiction with respect to retainability of the remaining properties. [Footnote: Holding Company Act Release No. 5455]

A further plan filed by Columbia under Section 11(e), providing for its recapitalization, was opposed by The United Corporation, holder of 19 percent of the voting securities of Columbia. A modified program was later proposed, sponsored by both companies, which provided for the refunding of Columbia's debt and retirement of its preferred stock and for the sale of Columbia's interest in The Dayton Power and Light Co. and The Cincinnati Gas & Electric Co.

During the fiscal year, Columbia, in furtherance of the program outlined above, disposed of its interest in Dayton for \$51,467,670, dissolved a subsidiary, Columbia Corp., and with the proceeds of the sale of \$22,000,000 in bank loan notes, plus treasury cash, retired \$32,000,000 principal amount of outstanding debentures. Since the end of the fiscal year, Columbia has disposed of its interest in Cincinnati, redeemed its preferred stocks having an aggregate call price of \$119,848,075, retired its outstanding bank loan notes, and issued \$97,500,000 of new debentures.

9. Niagara Hudson Power Corporation

The Commission instituted proceedings pursuant to Section 11(b)(2) with respect to Niagara Hudson Power Corp. (Niagara Hudson), and its subsidiary, Buffalo, Niagara and Eastern Power Corp. (BNE), and their subsidiary companies. A public conference was thereafter held to explore means of resumption of dividend payments on preferred stock of the two holding companies. A plan, pursuant to Section 11(e), was filed by the company providing for the consolidation of principal public utility companies with BNE, the dissolution of Niagara Hudson, and payment in cash of all accrued and unpaid dividends. The consolidation, as contemplated, was disapproved by the New York Public Service Commission on January 21, 1944.

The Commission later denied the application of BNE for exemption as a holding company from provisions of the act insofar as applicable to Section 11(b)(2). The Commission's order also required BNE to substitute common stock for its then outstanding \$1.60 cumulative preferred, Class A and common stocks, and the extension of appropriate voting rights to its \$5 preferred stock. [Footnote: Holding Company Act Release No. 5115]

Thereafter BNE and its parent company, Niagara Hudson Power Corp., filed separate plans pursuant to Section 11(e) providing for the reorganization of BNE in order that the company might comply with the Commission's order. Both plans were substantially the same, providing for payment of all arrearages on the first preferred stock of BNE; the contribution by Niagara Hudson to BNE of \$63,000,000 to be obtained by the former from treasury cash, the sale of portfolio

securities, and a bank loan in the amount of \$40,000,000; the use of such funds by BNE for the retirement of its second preferred stock; the consolidation of BNE and three of its subsidiaries; and the reclassification of BNE's second preferred stock, Class A stock and common stock unto new common stock. These plans were approved by the Commission on October 4, 1945, and were consummated as of November 1, 1945. [Footnote: Holding Company Act Release No. 6108] During the fiscal year, Niagara Hudson disposed of its interest in Central Hudson Gas & Electric Corp.

10. International Hydro-Electric System

Proceedings involving International Hydro-Electric System (IHES) were instituted pursuant to Section 11(b)(2) and, after appropriate hearings, the Commission ordered IHES to liquidate and dissolve, finding that it performed no useful function. [Footnote: Holding Company Act Release No. 3679] Subsequently, the Commission ordered that Massachusetts Utilities Associates Common Voting Trust be liquidated and dissolved and that certain other companies be eliminated from IHES. [Footnote: Holding Company Act Release No. 4168] A stockholder and director of IHES filed petitions in the United States Circuit Court of Appeals for the Sixth Circuit for review of the Commission's order directing the dissolution of IHES. This petition was dismissed, thereby sustaining the order of the Commission. [Footnote: 137 F. (2d) 475] In July 1943, IHES notified the Commission that, because of certain asserted claims against its former parent, International Paper Company, it would be impossible for it to comply with the Commission's order without the aid of court enforcement. The Commission, therefore, instituted a proceeding under Section 11(d) to enforce compliance with its liquidation order and the court appointed Bartholomew A. Brickley of Boston, Mass., as special counsel, to investigate certain transactions alleged to give rise to a cause of action on behalf of IHES against International Paper Company. On November 13, 1944, the court appointed Brickley as trustee for IHES and he has effectuated a settlement between the two companies, which settlement was approved by the court on December 26, 1945. [Footnote: Notices of appeal to the Circuit Court of Appeals of the United States for the First Circuit from the decree of this court approving said settlement have been filed by certain stockholders and bondholders of IHES.]

In 1944, New England Power Association and its subsidiary holding companies filed an application for approval of a plan of simplification of the New England Power Association holding company system for the purpose of complying with the provisions of Section 11(b)(2) and with the Commission's previous order. After hearings on that plan were completed, the company was informally advised that the plan would not serve to effectuate the provisions of Section 11(b)(2) and the Commission's previous order, whereupon the company filed an amended plan.

After hearings had been completed, oral argument heard and briefs filed on the amended plan, the Commission approved the plan as amended on March 14, 1946. [Footnote: Holding Company Act Release No. 6470] On June 7, 1946, the plan was approved by the United States District Court for the District of Massachusetts. [Footnote: In the Matter of New England Power Association, unreported (Civil Action No. 50870)] Appeal from the district court's decision is now pending in the First Circuit Court of Appeals.

11. The Middle West Corporation

In connection with Section 11(b)(1) proceedings with respect to The Middle West Corp. (Middle West) and its subsidiaries, the Commission ordered Middle West to sever its relations with its subsidiary companies, except Central Illinois Public Service Co. (Cips) and Kentucky Utilities Co. (KU) and its subsidiaries, jurisdiction being reserved with respect to the joint retainability of Cips, KU and such interest as Middle West might obtain in Public Service Co. of Indiana, Inc. in connection with the reorganization of Midland United Co. and its subsidiaries. [Footnote: Holding Company Act Release No. 4846]

On May 9, 1944, a further hearing was ordered to permit the introduction of additional evidence with respect to the question of which properties constituted the integrated system of Central and South West Utilities Co. (Central.) and with respect to the retainability of certain other businesses. On February 16, 1945 and July 4, 1945 the Commission entered its opinions and orders with respect to the issues involved in the rehearing, finding that the major electric utility properties of the subsidiaries of Central form a single integrated system retainable by Central. [Footnote: Holding Company Act Release Nos. 5606 and 5906 respectively] The electric utility properties of Oklahoma Power and Water Co., a subsidiary of Middle West, were found to constitute a part of Central's integrated system. Central was ordered to dispose of its interest in its retail gas distribution properties as well as its interests in certain small isolated electric properties and was further ordered to dispose of its interest in certain of its nonutility properties. Nearly all of the nonutility properties and all of the isolated electric properties have been disposed of in compliance with these orders. Orders were entered by the Commission approving refinancing of Public Service Co. of Oklahoma and Central Power and Light Co., both subsidiaries of Central, on October 8, 1945 and December 13, 1945, respectively. [Footnote: Holding Company Act Release Nos. 6116 and 6296 respective to dates]

Middle West acquired approximately 20 percent of the common stock of Public Service Co. of Indiana, Inc., in the reorganization of Midland United Co. and its subsidiaries and, on August 23, 1945, a hearing was ordered concerning, among other things, the questions reserved by the Commission in its previous order regarding the retainability by Middle West of its interests in Cips, KU, and Public Service Co. of Indiana, Inc. and raising issues as to the continued existence of Middle West. Hearings have been held but are not yet completed. On September

5, 1945, the Commission approved the sale of the gas and water properties of Public Service Co. of Indiana, Inc. to Indiana Gas and Water Co., a newly formed subsidiary, preparatory to disposal of such interest by Public Service. [Footnote: Holding Company Act Release No. 6030]

Central and American Public Service Co. (American), two subsidiaries of Middle West, filed a joint application proposing a consolidation of the two companies. The Commission instituted proceedings under Section 11(b)(2) and ordered that the hearings on the two cases be consolidated. The proponents of the plan of consolidation contended that preferred stock was necessary in the new company in order to preserve the priorities of the holders of the prior lien and preferred stocks of Central and the preferred stock of American. The Commission ruled that the new corporation could have only common stock. [Footnote: Holding Company Act Release No. 3580] The respondents filed a petition for review in the United States Court of Appeals for the District of Columbia, which upheld the order of the Commission. [Footnote: 136 F. (2d) 273] Thereafter, Central and American filed an amended plan of merger to be effectuated through the issuance of a single class of capital stock. The plan also provided that Middle West would distribute to its stockholders the new shares of Central allocated to Middle West. On March 11, 1946 the plan was further amended, primarily with respect to a proposal to sell common stock of the merged company at competitive bidding in an amount sufficient to retire the publicly-held preference stocks of the two companies at their call prices, subject to the right of the holders of such stocks to exchange their shares under specified conditions for common stock of the new company. It was proposed that the remainder of such stock be issued in exchange for the publicly-held common stock and for the preference and common stocks held by Middle West. The plan was approved by the Commission on April 30, 1946, and enforcement was ordered on June 19, 1946 [Footnote: Holding Company Act Release No. 6606] by the United States District Court for the District of Delaware. [Footnote: Central and South West Utilities Company, et al. (D.C. Del., 19460, Civil Action No. 874] The sale of the common stock of the merged company at competitive bidding had not been consummated at the end of the fiscal year.

Proceedings pursuant to Section 11(b)(2) raised issues as to the equitable distribution of voting power among security holders of the North West Utilities Co. (North West) system, and also as to the continued existence of North West, a subsidiary holding company in the Middle West system. The proceeding was consolidated with a plan of recapitalization of North West which had been submitted by North West and Middle West. After hearings, the Commission held that the proposed plan of recapitalization fell short of effectuating the provisions of Section 11(b) and ordered that North West be liquidated. [Footnote: Holding Company Act Release No. 4552] Sale by North West of its subsidiary Northwestern Public Service Co., was approved by the Commission on March 28, 1946. [Footnote: Holding Company Act Release No. 6515] Recapitalization of North West's other subsidiary, Wisconsin Power and Light Co. (Wisconsin),

was approved on October 26, 1945, preparatory to its disposal. [Footnote: Holding Company Act Release No. 6169] A plan was filed by North West on April 22, 1946, proposing to distribute the common stock of Wisconsin held by North West to the public preference stockholders of North West in an amount, as determined by competitive bidding, equal to the liquidating value plus accrued dividends of such preference stock and to distribute the balance of such common stock to its parent, Middle West. Hearings have been held on the plan, but no decision has been entered by the Commission with respect thereto.

12. The United Light and Railways Company

Proceedings instituted, pursuant to Sections 11(b)(1) and (2), with respect to The United Light and Power Co. (United Light), were consolidated and the liquidation of United Light was ordered by the Commission under the standards of Section 11. An important step towards liquidation involved the distribution of the common stock of The United Light and Railways Co. (Railways), to preferred and common stockholders of United Light. The Commission disapproved the distribution originally proposed by the company but thereafter approved the plan as amended to allow the preferred stockholders approximately 95 percent of Railways common stock. [Footnote: Holding Company Act Release No. 4215] On June 30, 1943, Judge Leahy, of the United States District Court of Delaware, entered an order enforcing the plan (51 F. Supp. 217) and on April 10, 1944, the United States Circuit Court of Appeals for the Third Circuit affirmed the order (142 F. (2d) 411). A petition for certiorari to the United States Supreme Court was granted on June 12, 1944 (322 U. S. 724). On January 29, 1945, the Supreme Court rendered its decision affirming the Commission's approval of the plan. [Footnote: Otis and Co. v. Securities and Exchange Commission, 323 U.S. 624.] Following this decision, United Light accomplished its liquidation and dissolution in compliance with the Commission's initial orders. [Footnote: Holding Company Act Release No. 2636 Commissioner Healy dissented on the ground that the preferred stockholders were entitled to receive all the assets.] Railways, which has two subsidiary holding companies, American Light & Traction Co. (American Light), and Continental Gas & Electric Corp. (Continental), thus became the top holding company in the system.

On June 2, 1945, the Commission issued a memorandum opinion, concluding that the most appropriate means for achieving compliance with our order requiring Railways to dispose of its interests in certain subsidiaries was the liquidation and dissolution of American Light and the disposition by Railways of all securities received by it in such liquidation. [Footnote: Holding Company Act Release No. 5840] To accomplish this, American Light on July 2, 1945, filed an amended plan of liquidation and dissolution. This is to be accomplished by a retirement of its preferred stock by a cash payment to the holders thereof and by a pro rata distribution of the remaining assets to the common stockholders. This liquidation was held necessary to effectuate the provisions of Section 11(b), since the

continued existence of such company served no useful purpose. The principal point at issue in this plan relates to the amount which should be paid to the holders of the company's noncallable 6 percent preferred stock.

After hearings and oral argument the majority of the Commission concluded that the plan providing for the retirement of the 6 percent noncallable cumulative preferred stock by payment of cash equivalent to the liquidating preference of such stock, i.e., \$25 a share, could not be found fair in that it did not provide the equitable equivalent of the investment value of the liquidated stock. [Footnote: Holding Company Act Release No. 6603] It was held that \$33 per share would represent such investment value of the stock and that the plan must be so amended to be fair and equitable. Before such an amendment was filed, changes occurred in the membership of the Commission and a motion for a reconsideration of this point was granted. [Footnote: Holding Company Act Release No. 6750] Re-argument was heard August 27, 1946, and the matter has been taken under advisement.

During the 1946 fiscal year Railways and Continental filed a plan under Section 11(e) proposing sale of the stock interests in four companies to be received by Railways upon the liquidation of American Light. [Footnote: Detroit Edison Co., Madison Gas and Electric Co.; Michigan Consolidated Gas Co.; and Milwaukee Gas Light Co.] It is proposed to use these proceeds to retire senior securities. Other divestments and retirements are also proposed, together with intra-system adjustments necessary to comply with the Commission's order .

In May 1946 Continental sold its interest in Columbus and Southern Ohio Electric Co, represented by 744,455 shares of common stock, to underwriters at competitive bidding Proceeds to Continental aggregating \$38,115,352 were used to retire \$20 000,000 principal amount of 1 and three quarters percent secured 1-year notes and the balance of the proceeds were applied to the prepayment of its \$30,000,000 principal amount of 2 and one half percent unsecured 10 year notes. [Footnote: Holding Company Act Release No. 6621]

13. American Water Works and Electric Company, Inc.

This was the first registered holding company to file a corporate simplification plan pursuant to Section 11(e). The plan contemplated no divestments of any of the utility properties or utility investments of the system, but did provide for the elimination of several "second degree" holding company relationships and for certain other intra-system readjustments. Consummation of the main features of the plan was contingent upon the accomplishment of extensive refinancing.

The Commission approved the plan, with various modifications and reservations, holding that the applicant's interests in certain agricultural properties in California and in an office building in New York were not retainable, and that the distribution of voting power in the system was not fair and equitable; it reserved jurisdiction

with respect to the retention of American's interest in a water subholding company to afford it an opportunity to increase its equity therein and to recapitalize it; and also reserved for future consideration the question of adjustments of write-ups of system properties and investments. [Footnote: 2 S.E.C. 972 (1937)]

Since the date of this order, American has sold the agricultural properties and the office building referred to above; has voluntarily disposed of a portion of its interests in transportation, bridge, and water businesses; has eliminated or arranged for the disposition of certain write-ups in the property accounts of its electric and gas subsidiaries; and has effected some of the intra-system adjustments required. There are presently pending before the Commission two plans to bring a major portion of the American system into conformity with the requirements of Section 11. One of these plans proposes the divestment by American of substantially all the water properties of the system through the consolidation of these properties under a single water works holding company whose securities would be held outside the American system; the other plan proposes the liquidation of American itself, leaving The West Penn Electric Co. as the top holding company for all the subsidiaries of American other than those which are to be divested. These plans are to be followed by other plans relating to the corporate structure of The West Penn Electric Co. and its subsidiaries.

14. Engineers Public Service Company

In Section 11(b)(1) proceeding regarding Engineers Public Service Co. (Engineers) and its subsidiaries, the Commission ordered Engineers to dispose of its interest in Puget Sound Power & Light Co. and The Key West Electric Co. The Commission initiated Section 11(b)(2) proceedings with respect to a subsidiary of Engineers, The Western Public Service Co. (Western), a Maryland corporation. [Footnote: Holding Company Act Release Nos. 2897 and 2898] Subsequently, the Commission approved the sale of Western's Nebraska and South Dakota properties. [Footnote: Holding Company Act Release Nos. 3230 and 3245] Western then redeemed its publicly held securities and liquidated. [Footnote: For further details, see Tenth Annual Report] The Commission ordered the divestment of the remaining properties in the Engineers system except the electric utility properties of Virginia Electric and Power Co., allowing Engineers, however, 15 days within which to petition for leave to retain instead the electric utility properties of Gulf States Utilities Company. [Footnote: Holding Company Act Release No. 3796] Engineers appealed to the United States Court of Appeals for the District of Columbia, which on November 22, 1943 rendered an opinion upholding the Commission's order in most respects but setting it aside upon the ground that the Commission had misinterpreted the so-called incidental business clause of Section 11(b)(1). The Court indicated also that Engineers must be given a further right to designate the principal integrated utility system which it desired to retain. Both Engineers and the Commission filed petitions for writs of certiorari in the Supreme Court of the United States. On June 5, 1944,

the petitions were granted. Oral arguments were made before the Supreme Court in November, 1945. Because of the death of Chief Justice Stone, there was lack of a quorum of Justices and the matter was placed on the Court's calendar for reargument during the fall of 1946.

Engineers has divested itself of its interest in Puget Sound Power & Light Co., The Key West Electric Co., El Paso Natural Gas Co., El Paso & Juarez Traction Co., Baton Rouge Bus Co., The North Kansas Power Co., Missouri Service Co., Savannah Electric & Power Co., and the transportation businesses conducted by El Paso Electric Co. (Texas) and Virginia Electric and Power Co.

On September 10, 1945, Engineers filed a plan under Section 11(e) for the divestment of its interest in two of its public utility subsidiary companies, namely, Gulf States Utilities Co. and El Paso Electric Co. (Texas), the two remaining subsidiaries of Engineers ordered divested by the Commission. The plan thereafter contemplates the liquidation and dissolution, of Engineers. Hearings have been concluded on the plan as amended. Oral argument was heard before the Commission on September 5, 1946 and disposition of the matter is being considered.

15. The United Corporation

Proceedings, which the Commission had instituted under Sections 11(b)(1) and 11(b)(2) with respect to The United Corp. (United), were consolidated for hearing with a plan filed by United under Section 11(c). In its plan, United proposed to reduce its holdings in each of its statutory subsidiaries to less than 10 percent of the outstanding voting securities and, pending such reduction, to refrain from

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Engineers has divested itself of its interest in Puget Sound Power & Light Co., The Key West Electric Co., El Paso Natural Gas Co., El Paso & Juarez Traction Co., Baton Rouge Bus Co., The North Kansas Power Co., Missouri Service Co., Savannah Electric & Power Co., and the transportation businesses conducted by El Paso Electric Co. (Texas) and Virginia Electric and Power. Co.

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15. The United Corporation

Proceedings, which the Commission had instituted under Sections 11(h)(1) and 11(b)(2) with respect to The United Corp. (United), were consolidated, for hearing with a plan filed by United under Section 11(e). In its plan, United proposed to reduce its holdings in each of its statutory subsidiaries to less than 10 percent of the outstanding voting securities and, pending such reduction, to refrain from voting the securities without the prior approval of the Commission. After extensive hearings, the Commission disapproved United's plan and, pursuant to Section 11(b)(2), ordered that United change its existing capitalization to one class of stock and cease to be a holding company. [Footnote: Holding Company Act Release No. 4478]

On June 27, 1944, United filed another plan pursuant to Section 11(e) which provided for the exchange of substantially all of its holdings of the common stocks of Philadelphia Electric Co. and Delaware Power & Light Co. (Delaware), plus cash for approximately one-half of its outstanding preferred stock. [Footnote: Holding Company Act Release No. 4870] The plan was subsequently amended to provide for the exchange of only the Philadelphia Electric Company common stock and an increased amount of cash. The plan, as amended, was

approved by the Commission on November 24, 1944 and has since been consummated. [Footnote: Holding Company Act Release No. 5440]

On January 17, 1945, United filed a plan pursuant to Section 11(e) providing for the exchange on a voluntary basis of two shares of the common stock of Delaware and \$5 in cash for outstanding shares of United's \$3 cumulative preferred stock. The plan was subsequently amended to provide for the payment of \$6 in lieu of the \$5 in cash as originally proposed. The plan, as amended, was approved by the Commission on June 9, 1945, and has also been consummated. [Footnote: Holding Company Act Release No. 5859]

During the fiscal year, United disposed of a portion of its holdings of Columbia Gas & Electric Corp. common stock by sales in the market and tendered to The United Gas Improvement Co. (UGI) a portion of its holdings of common stock of that company pursuant to the exchange plan described previously (under the heading, "The United Gas Improvement Co."). As a result of this plan United's interest in the common stock of UGI was reduced to approximately 8 percent of such stock outstanding. Since the close of the fiscal year, United filed a declaration, which the Commission permitted to become effective, to purchase in the open market its preferred stock in an amount not to exceed \$5,000,000,

On June 12, 1946, the Commission instituted proceedings under Sections 11(b)(1) and 11(b)(2) with respect to Public Service Corp. of New Jersey (Public Service), a subsidiary of United, all of its subsidiaries. Since the close of the fiscal year, Public Service filed a plan pursuant to Section 11(e). This plan provides for the dissolution and liquidation of Public Service upon completion of certain steps and the transfer of its assets to and the assumption of its liabilities by its principal subsidiary.

16. Midland Realization Company and Midland Utilities Company

On April 7, 1945, the United States District Court for the District of Delaware confirmed a modified plan of reorganization wherein Midland United Co. -- the name of Midland Realization Co. (Midland Realization) prior to the reorganization -- and Midland Utilities Co. (Midland Utilities) were jointly reorganized. [Footnote: See *In the Matter of Midland United Co., Debtor* 58 F. Supp. 667 (1944), for opinion of the court approving the plan submitted pursuant to Section 11 (f) of the Act are contained in Holding Company Act Releases Nos. 5317 and 5317A (1944).] The modified plan provided, among other things, that Midland Realization and Midland Utilities would merge, and that such merged company would liquidate its assets expeditiously. On March 14, 1946, a proposed modification of the plan was filed pursuant to Section 77B of the Bankruptcy Act and Section 11(f) of the Holding Company Act, wherein the requirement of the merger of Midland Realization and Midland Utilities was to be eliminated. In lieu thereof, the liquidation of the two companies was to be accomplished by a distribution to the public holders of the two reorganized companies of most of the

shares of the common stock of their principal subsidiary, Northern Indiana Public Service Co., the sale of the balance of such stock through a public offering, and the distribution, as a liquidating dividend, of the remaining assets consisting of treasury cash and the cash proceeds to be realized from the sale of their interest in the only remaining subsidiary, Indiana Service Corp. (Indiana Service). [Footnote: Holding Company Act Release No. 6528] After the close of the fiscal year, both the Commission and the reorganization court approved the proposed modification.

A plan of corporate simplification for Indiana Service was filed by its parent, Midland Utilities, on October 29, 1945, under Section 11(e) of the Act. On May 7, 1946, an amendment was filed thereto providing for the elimination from the security structure of Indiana Service of its existing demand notes payable to Midland Utilities. It further provided, for the elimination of the present preferred and common stocks; the issuance of new common stock; the sale of such new common stock to American Gas and Electric Co., a subsidiary of Electric Bond and Share Co.; and the distribution of the proceeds therefrom to Midland Utilities and the preferred stockholders of Indiana Service. Hearings were held and the matter was pending at the end of the fiscal year.

17. New England Public Service Company

The Commission issued a Section 11(b)(2) order with respect to New England Public Service Co. (NEPSCO) directing it to recapitalize on a one-stock basis or to liquidate. Soon thereafter the company filed a plan for the stated purpose of complying with the applicable provisions of Section 11 of the Act. One public utility company of this system (Cumberland County Power & Light Co.) has been eliminated by merger into Central Maine Power Co. and another (Twin State Gas & Electric Co.) through conveyance of its properties to Public Service Co. of New Hampshire and Central Vermont Public Service Corp. [Footnote: Holding Company Act Release Nos. 3883 and 4711] On December 19, 1944, on the application of Central Maine Power Company, the Commission approved a plan for the divestment of Portland Railroad Co., a non-utility subsidiary. [Footnote: Holding Company Act Release No. 5506] On February 3, 1945 certain common stockholders filed a bill of complaint in the Supreme Judicial Court of Maine seeking a rescission of the sale of Portland Railroad Co. Hearings have been held and the matter is now pending before that court.

On October 25, 1944 NEPSCO filed an amended plan of reorganization. [Footnote: Holding Company Act Release No. 5477] Subsequently, the company again amended its plan deleting therefrom all reference to the distribution of its interest in its non-utility subsidiaries to its own security holders. An application was filed by NEPSCO for the approval of a plan regarding the sale of its holdings in its industrial subsidiaries and extensive hearings were held on this phase of the amended plan. On October 11, 1945, the Commission approved the sale of the industrial subsidiaries to a banking group for a

consideration of \$16,500,000. [Footnote: Holding Company Act Release No. 6123] The sale by NEPSCO of its industrial holdings was approved by the United States District Court for the District of Maine (Southern Division) An unsuccessful bidder and a stockholder of NEPSCO have filed petitions in the United States Circuit Court of Appeals for the First Circuit for review of the Commission's order of October 11, 1945. They have also appealed from the District Court's order. At the end of the fiscal year proceedings were still pending in the courts with respect to the sale of the industrial subsidiaries.

18. Federal Water and Gas Corporation

On December 31, 1942 proceedings were instituted by the Commission with respect to Federal Water and Gas Corp. (Federal) and its subsidiaries under Sections 11(b)(1) and 11(b)(2). The Federal system at that time consisted of a number of utility and non-utility companies conducting water, natural gas transmission and distribution, manufactured gas distribution and electric operations in a number of widely separated States. Federal's principal subsidiary was, and is, Southern Natural Gas Co., a registered holding company controlling four gas utility subsidiaries in Alabama, one in Mississippi and one in Tennessee, and directly owning and operating a natural gas pipeline extending from Texas into Georgia. Southern Natural's utility subsidiaries in Mississippi and Tennessee (Mississippi Gas Co. and Chattanooga Gas Co., respectively) were formerly controlled directly by Federal, but were sold by Federal to Southern Natural in June 1946 pursuant to Federal's Section 11(e) plan. [Footnote: Holding Company Act Release No. 6738] This plan also provided, among other things, for the distribution of Federal's interest in Southern Natural to Federal's stockholders and for the elimination of Federal as a separate corporation, as to which provisions the Commission reserved jurisdiction. The plan also provided for the disposition by Federal of its interests in all its other subsidiary companies, provided, however, that before disposing of its security holdings in Peoples Water and Gas Co., Scranton-Spring Brook Water Service Co., and New York Water Service Corp., these companies be recapitalized. The Commission approved the latter provisions of Federal's plan and directed that steps be taken to carry out those provisions. [Footnote: Holding Company Act Release No. 4113] In addition, Federal, Pennsylvania Water Service Co., and Scranton-Spring Brook were directed to cause the elimination of Pennsylvania Water Service Co. and the 63 inactive subsidiaries of Scranton-Spring Brook. Federal has caused the elimination of 62 inactive subsidiaries of Scranton-Spring Brook and has disposed of its interests in 15 companies (in addition to the above-mentioned sales to Southern Natural) and of the bulk of the properties of Alabama Water Service Co. After extensive hearings, Federal's plan for the recapitalization of Scranton-Spring Brook was approved by the Commission in March 1946. [Footnote: Holding Company Act Release Nos. 6458, 6510 and 6602] Federal is under obligation to dispose of its holdings of Scranton's new common stock received by Federal as a result of the recapitalization. Hearings

have been completed on Federal's plan for the reorganization of New York Water, and this matter is now pending before the Commission.

Federal itself was recapitalized in 1941. One aspect of that reorganization, relating to the Commission's decision therein that officers and directors of Federal should not be permitted to profit on securities of Federal purchased by them during the pendency of the reorganization, was appealed to the Supreme Court, which set aside the Commission's order and remanded it to the Commission. [Footnote: 318 U.S. 80. For a discussion of the issues in this case see the Commission's Tenth Annual Report, page 118.] In February 1945 the Commission issued its findings, opinion and order reaffirming its previous determination. [Footnote: Holding Company Act Release No. 5584] This order was reversed by the United States Court of Appeals for the District of Columbia in February 1946, whereupon the Commission petitioned for a writ of certiorari which was granted by the United States Supreme Court in May 1946. [Footnote: *Chenery Corp. v. S.E.C. F.* (2d)(C.A.D.C. Feb., 4, 1946)]

19. Ogden Corporation

Ogden Corporation (Ogden) is a successor corporation to Utilities Power & Light Corp. which went into bankruptcy in 1937. A plan of reorganization approved by this Commission provided, among other things, that Ogden would divest itself of all its interests in utility companies. [Footnote: 5 S.E.C. 483] Section 11 proceedings were instituted with respect to Ogden by the Commission and were consolidated with a Section 11(e) plan of Ogden. The Commission approved certain provisions of the Ogden plan and ordered. Ogden to divest itself of all its interests in Public utility companies and eliminate itself as a public utility holding company. [Footnote: Holding Company Act Release No. 4307] Ogden has divested itself of its interests in Derby Gas & Electric Corp., Missouri Natural Gas Co., The Laclede Gas Light Co. (Laclede), and Missouri Electric Power Co., which represent all of its interests in utility properties except those of Interstate Power Co. (Interstate) and certain residual assets of Central States Power and Light Corp. (Central States). Preliminary to Ogden's divestment of its interest in Laclede, the latter company underwent a thorough-going reorganization in conformity with the provisions of Section 11(b)(2). [Footnote: Holding Company Act Release Nos. 5062 and 5071.] Hearings have been held on a plan for the reorganization of Interstate and the divestment of Ogden's interest therein, such plan. providing for the company's reorganization while leaving for later determination the question as to whether Ogden's holdings in Interstate should be subordinated, in whole or in part, to Interstate's publicly held debentures and preferred stocks. Hearings are in progress on a plan for the distribution of the remaining assets of Central States. The assets of that company, consisting principally of cash, will be distributed upon a determination of the rights of the various classes of security holders, which involves the issue as to whether any portion of the securities of Central States held by Ogden should be subordinated to the claims of public security holders.

In April 1946 the Commission granted Ogden's application regarding a general program for the acquisition for investment purposes of non-utility securities and assets. [Footnote: Holding Company Act Release No. 6564]

20. Long Island Lighting Company

On October 25, 1945, Long Island Lighting Co. and three of its public utility subsidiary companies, Queens Borough Gas and Electric Co., Nassau & Suffolk Lighting Co., and Long Beach Gas Co. Inc., jointly filed a comprehensive plan under Section 11(e) of the Holding Company Act proposing the consolidation of the four companies, the recapitalization of the resultant consolidated company, and the distribution of the Preferred and common stocks of the recapitalized consolidated corporation to the public security holders of the constituent companies. On November 9, 1945, the Commission instituted proceedings pursuant to Section 11(b)(2) with respect to each of the companies and consolidated the proceedings. [Footnote: Holding Company Act Release No. 6218] Testimony in the consolidated proceedings was taken from time to time and the hearing was closed subsequent to the end of the fiscal year.

On August 22, 1945, Kings County Lighting Co. (Kings), a subsidiary of Long Island Lighting Co., filed a plan pursuant to Section 11(e) of the Holding Company Act with respect to its recapitalization and the redistribution of the preferred and common stocks of the recapitalized company among its existing stockholders. On August 27, 1945, the Commission instituted proceedings pursuant to Section 11(b)(2) directed to Long Island and Kings and consolidated the two proceedings. [Footnote: Holding Company Act Release No. 6011] On April 17, 1946, Kings filed an amended plan pursuant to Section 11(e) of the Act, which the Commission consolidated with the prior proceedings. [Footnote: Holding Company Act Release No. 6569] The hearing in the consolidated proceedings was closed on June 4, 1946, and at the end of the fiscal year the matter was pending.

REGULATION OF SECURITY ISSUES

Volume of Financing

In the fiscal year ended June 30, 1946, the Commission declared effective 117 applications and declarations pursuant to Sections 6 and 7 of the Act, pertaining to the issuance of securities totaling \$2,374,865,967. [Footnote: At the beginning of the 1946 fiscal year, 96 applications and declarations under Sections 6 and 7 were pending and 259 were filed during the year. Of these, 241 were declared effective, 7 were withdrawn and 1 denied, leaving 106 pending at the close of the fiscal year. Of the 241 effective declarations and applications, 197 pertained to security issuance, 35 to alteration of rights, and 9 to assumption of liability.] For

the preceding year, 71 such applications were declared effective with respect to \$1,304,522,550 of securities. The following table classifies the securities involved during the past fiscal year by type of issue:

(chart omitted)

The past year witnessed a continuation of the heavy debt refunding program which has been in progress for the last decade. Many utility companies refunded for a second time, as interest rates declined to new low ground. Until January 1, 1946, tax considerations facilitated these refunding operations since many of the companies were in excess profits tax brackets and could reduce their net income subject to excess profits tax by the amount of unamortized discount and expense and call premiums applicable to the refunded issues. After VJ-day the prospect of termination of the excess profits tax further stimulated these refundings, with the result that very heavy offerings were made during the fall of 1945. In October, alone, approximately \$210,000,000 of debt security issues were approved under Sections 6(b) and 7.

During the year, utility bond issues were sold on the lowest interest cost basis since the passage of the Act. For example, in February 1946, Madison Gas and Electric Co., sold at competitive bidding \$4,500,000 principal amount of 30-year, first mortgage, 2 and one half percent bonds at an interest cost of 2.427 percent. Sixteen bids were received for these bonds, 15 of which provided an interest cost of less than 2.50 percent. Other high-grade issues such as those of Gulf States Utilities Co., Philadelphia Electric Power Co., and Wisconsin Electric Power Co., involving amounts from \$27,000,000 to \$50,000,000, were sold at interest costs between 2.50 percent and 2.60 percent. Preferred stocks were likewise sold on a very favorable basis during the year, the cost of money in some instances approaching 3.30 percent.

COMPETITIVE BIDDING

Reflecting the volume of refunding during the 1946 fiscal year as well as the growth in dispositions of portfolio securities under Section 11, the amount of securities sold under the competitive bidding requirements of Rule U-50 was nearly as large as the combined volume during the four preceding years of the Rule's history. A total of 83 issues amounting to \$1,642,000,000 was sold during the 1946 fiscal year, bringing the total since May 7, 1941, the effective date of Rule U-50, to \$3,486,440,000, comprising 185 issues.

Aside from the increased number of issues submitted to competitive bidding by reason of the influences mentioned above; the process of competitive bidding has also been extended in two distinct fields. In November 1943, for example, the Commission considered it necessary to exempt from Rule U-50 the sale of \$21,000,000 of Public Service Co. of Colorado common stock because of the

size of the issue and because there were at that time few precedents for gauging public acceptance under competitive bidding of such a common stock offering. Prior to July 1, 1945, as a consequence, only eight issues of common stock amounting to \$47,734,000 had been sold at competitive bidding. In contrast, the past fiscal year has seen 16 common stock issues, aggregating \$215,787,000, sold under Rule U-50. These issues included \$38,115,000 of Columbus and Southern Ohio Electric Co. common stock during May and \$51,468,000 of Dayton Power and Light Co. common stock in the month of June.

A second extension in the practice of competitive bidding has occurred in connection with exchange offers on preferred stock. In these cases, generally speaking, the holders of the old preferred stock are given the right to exchange their holdings for new preferred stock and an underwriting commitment is secured to cover any unexchanged shares; sometimes, in addition, the underwriters assist in soliciting the exchange of the old preferred for the new. The development of competitive bidding in this field was based upon experience with the refinancing of preferred stocks by a variety of methods. During the year the Commission approved a direct exchange offer without underwriting by Cities Service Power & Light Co., [Footnote: Holding Company Act Release No. 5934] an exchange offer coupled with underwriting by Columbia Gas & Electric Corp., [Footnote: Holding Company Act Release No. 6120] and a reclassification of outstanding preferred stock pursuant to a vote of stockholders by Rochester Gas and Electric Corp. [Footnote: Holding Company Act Release Nos. 6093 and 6340] In the case of Columbus and Southern Ohio Electric Co., [Footnote: Holding Company Act Release No. 6150] it was announced that in future exchange offers the Commission would require as a minimum that bids for effecting exchanges under dealer-manager arrangements should be requested at least from a selected group of investment banking or other agencies qualified to perform the services involved. [Footnote: See Pennsylvania Power Company, Holding Company Act Release No. 6140, in which this procedure was followed.] After considerable study of the general problem of competitive bidding on preferred stock issues, the Commission in Oklahoma Gas and Electric Co. announced its view that, as a matter of future policy, preferred stock issues under the Holding Company Act should ordinarily be submitted to competitive bidding whether or not they involve exchange offers. [Footnote: Holding Company Act Release No. 6449]

Certain other important developments have occurred in connection with the maintenance of competitive conditions required by Section 12(d) of the Act. In the case of Western Light & Telephone Co., the Commission considered the question of whether an investment banking firm retained as a financial adviser by the issuer of securities might appropriately enter the bidding for such securities. [Footnote: Holding Company Act Release No 5902] It was concluded that any financial advisory services entailing the payment of a fee would necessarily involve continuing obligations to the issuer inconsistent with the role of bidder for the securities with respect to which advice had been given It was pointed out also

that an investment banking house acting in the role of financial adviser may have an unfair advantage over other bidders because of its early and close association with the transaction. Accordingly, the Commission announced that investment banking firms acting in such a capacity would be considered ineligible to bid for the securities involved.

The statutory standards regarding maintenance of competitive conditions were also considered in the case of Standard Gas and Electric Co., which involved the sale of securities of a public utility subsidiary operating in Mexico. [Footnote: Holding Company Act Release Nos. 6106 and 6557] This transaction was not subject to Rule U-50 inasmuch as the anticipated sales price was less than \$1,000,000. The Commission held that, although a transaction may be exempt from the formal competitive bidding procedure prescribed by Rule U-50, proper maintenance of competitive conditions within the meaning of Section 12(d) requires that a vendor, having solicited invitations for bids, must follow a selling procedure designed to afford to all interested persons a fair opportunity to make offers, and to secure for the vendor the maximum price reasonably obtainable. Upon a re-offering of the securities, the Commission stated its view that a bid of "\$10,500 plus the next highest bid" was not in legal effect a bid, and cited court precedents in which bids of a similar character were rejected as potentially destructive of fair competition. The Commission also indicated in its opinion that in the event more than one bid were submitted by the same party or by various persons under common control, it would reject all such bids as improper.

In the case of Interstate Power Co., the Commission disapproved a sale of utility assets on the ground that the procedure followed by the vendor was prejudicial to the competitive position of a prospective buyer, and thus failed to afford all interested persons! the equality of opportunity to bid for the property required by the "maintenance of competitive conditions" standard contained in Section 12(d). [Footnote: Holding Company Act Release No. 6516]

Exemptions From Rule U-50

By the terms of Rule U-50, exemptions from the competitive bidding procedure may be granted by the Commission under certain circumstances. Apart from the exchange of several issues of preferred stock for outstanding shares of old preferred, as discussed above, exemptions under Rule U-50 were granted during the past year in six instances involving securities in the amount of \$19,865,000. These exemptions were granted, in general, because the competitive bidding process was found to be unsuited to the circumstances of the case or unnecessary in the light of the public interest. In the case of United Public Utilities Corp., for example, an exemption was granted covering the sale of securities to a neighboring utility company, the Commission finding that ownership and operation of the properties by the acquiring' company were in the public interest. [Footnote: Holding Company Act Release No. 6142]

Protective Provisions for Senior Securities

In the administration of Sections 6 and 7 of the Act, which relate to the issue and sale of securities by registered holding companies and their subsidiaries, the Commission has adhered to and further developed the policy of securing inclusion in the corporate charters of certain preferred stock protective provisions. During the past year these provisions have become generally standardized, providing, among other things, that the holders of at least two-thirds of the issue must consent to the authorization of any prior ranking stock, the alteration of existing preferred stock provisions, and the issuance of additional shares at a time when earnings are below a stipulated level. Restrictions have also been placed upon the issuance or assumption of additional indebtedness and upon the merger or consolidation of the company with other corporations. Preferred stockholders are given the right to elect a majority of the Board of Directors upon default of four quarterly dividends. [Footnote: Jersey Central Power and Light Co., Holding Company Act Release No. 6637, and Monongahela Power Co., Holding Company Act Release No. 5902]

As an additional means of protecting senior security borders, the Commission has continued to insist upon suitable restrictions on the payment of dividends where common stock equity was considered inadequate. For example, in the case of Western Light and Telephone Co. the declarant agreed that:

If at any time the aggregate of the common stock and surplus (common equity) is or becomes less than 20 percent of the total capitalization, dividends on common stock in any fiscal year shall be limited to 50 percent of net income available for said common stock in such fiscal year and whenever such ratios shall be 20 percent or more but less than 25 percent, then not more than 75 percent of the earnings accumulated during such period otherwise available for such purposes shall be used therefor. No dividends shall be paid on common stock which will reduce such ratio to less than 25 percent. [Footnote: Holding Company Act Release No. 5902]

Exemptions From the Provisions of the Act

The renewed application of Pacific Gas and Electric Co. under Section 2(a)(8) for an order declaring it not to be a subsidiary of The North American Co., [Footnote: Holding Company Act Release No. 6122] was granted by the Commission upon finding that a substantial change in status had occurred since the entry of its order of September 10, 1941, denying the original application. [Footnote: Pacific Gas and Electric Co., Holding Company Act Release No. 2988, aff'd 127 F. (2d) 378, 139 F. (2d)(C.C.A. 9th, 1943), aff'd 324 U.S. 826 (1945)] During the intervening period the ownership of North American in Pacific had been reduced from 17.7 percent to 5.24 percent and of two directors of Pacific elected by North

American, one had already resigned while the other was prepared to resign when the disposition of North American's interest in Pacific had been completed.

During the past year the Commission granted exemptions to 8 holding companies under Section 3 of the Act and upon applications under Section 5(d) ordered that the registration of 5 holding companies should cease to be in effect. Twenty-two small holding companies claimed exemption from registration under Rule U-9, 24 claimed exemption under Rule U-2(a) and 35 subsidiary holding companies were exempt from registration under Rule U-2(b). In the case of Texas Utilities Co. the Commission had occasion to state that any automatic exemption available under Rule U-2 would be terminated promptly pending adoption of protective provisions on the preferred stock and completion of the original cost study of a subsidiary company, thereby assuring that no procedural step could be used to secure an exemption contrary to the public interest or to the interest of investors or consumers. [Footnote: American Power and Light Co., Holding Company Act Release No. 6158]

COOPERATION BETWEEN THE SECURITIES AND EXCHANGE COMMISSION AND STATE COMMISSIONS

During the past year the Commission has continued its established policy of cooperating with other Federal agencies and with State and municipal regulatory bodies in matters of mutual interest. This is in keeping with the spirit and policy of the Act in which the Congress inserted a number of specific provisions for this purpose. Reference is made to the Eleventh Annual Report for a detailed discussion of the principal Sections of the Act dealing with this matter.

The area of the Commission's activities in which State commissions have the most direct interest embraces the regulation of operating subsidiaries of holding company systems and usually relates to such matters as the adequacy of depreciation, accounting practices, and the removal of questionable items from property accounts. One of the most interesting cases in this category which came before the Commission during the past year involved a refinancing operation of the Jersey Central Power & Light Co. [Footnote: File No. 70-1272] Through the cooperative efforts of the Federal Power Commission, the Board of Public Utilities Commissioners of the State of New Jersey, and this Commission, there resulted a successful plan whereby senior securities of the company were reduced, unamortized debt discount and expense on retired issues was eliminated, and approximately \$10,000,000 of excess over original costs was removed from the property account. An important factor contributing to the feasibility of these adjustments was a capital donation of \$5,000,000 by the company's parent and. as a consequence of all of the transactions, the total capitalization of the company was reduced nearly \$7,000,000. There were eight other financing cases during the past year in which there were helpful interchanges of views and information with interested State commissions.

[Footnote: Mountain States Power Co., File No. 70-1099; Missouri Power and Light Co., File No. 70-1284; Milwaukee Electric Railway and Transportation Co., File No. 70-1236; Potomac Edison Co., File No. 10-1065; Public Service Co. of New Hampshire, File No. 70-1230; Pacific Power and Light Co., Northwestern Electric Co., File No. 70-1331; Alabama Power Co., File No. 70-1226; Pennsylvania Electric Co., Pennsylvania Edison Co., File No. 70-1250] In one of these cases the record of hearings before this Commission was received in evidence at concurrent hearings before the two State commissions having jurisdiction over the companies involved. [Footnote: Pacific Power and Light Co., Northwestern Electric Co., File No. 70-1331.]

The volume of cases of the type described above seems to have tapered off in recent years, apparently for the reason that the major portion of the problems of this character have been disposed of through the combined efforts of State commissions, the Federal Power Commission, and this Commission. Furthermore, in the past few years there has been a substantial increase in the number of reorganization plans filed with the Commission for the purpose of complying with the geographic integration and corporate simplification standards of Section 11(b). As a consequence the focus of cooperative efforts appears to be shifting to integration.

Cooperation in this type of case has touched upon a wide variety of circumstances most of which relate to the divestment of operating subsidiaries. During the past year the Commission has cooperated with local regulatory bodies in Section 11 proceedings involving the following companies:

Atlanta Gas Light Co., File No. 54-131

Central Arizona Light & Power Co., File No. 70-1156

Chattanooga Gas Co., File No. 70-1145

Minneapolis Gas Light Co., File Nos. 54-68 and 59-55

Potomac Electric Power Co., File No. 54-98

Southern Utah Power Co., File Nos. 54-125 and 52-27-1

Tucson Gas, Electric Light & Power Co., File No. 70-1263

The Act does not contain specific provisions for cooperation between this Commission and State commissions in Section 11 cases, but, in Section 19 of the Act, the Commission is required to admit any interested State, State commission, municipality, or other political subdivision of a State as a party in any proceeding before it. Pursuant to this provision, the Commission has uniformly followed the policy of inviting interested State commissions to

participate in any proceeding which may affect their work. As indicated by the above cases, a number have taken advantage of this invitation.

PART IV

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. 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 new proceedings under Chapter X, one of which was filed at the reorganization submitted to it by the courts in such proceedings. The Commission has no statutory right of appeal in any such proceeding, although it may participate in appeals taken by others.

SUMMARY OF ACTIVITIES

The Commission actively participated during the year in 104 reorganization proceedings involving the reorganization of 127 companies (104 principal debtor corporations and 23 subsidiary debtors). The aggregate stated assets of these 127 companies amounted to \$1,975,860,000 and their aggregate indebtedness was \$1,313,321,000. During the year, the Commission filed its notice of appearance in nine new proceedings under Chapter X, one of which was filed at the request of the judge and the remaining eight upon approval by the judge of the Commission's motion to participate. These nine new proceedings involved nine companies with aggregate stated assets of \$9,615,000 and aggregate stated indebtedness of \$11,636,000. Proceedings involving 15 principal debtor corporations and 2 subsidiary debtors were closed during the year.

At the close of the year, the Commission was actively participating in 89 reorganization proceedings involving 110 companies (89 principal debtors and 21 subsidiary debtors), with aggregate stated assets of \$1,918,142,000 and stated indebtedness of \$1,260,996,000.

COMMISSION'S FUNCTIONS UNDER CHAPTER X

In participating in proceedings under Chapter X of the Bankruptcy Act, the role of the Commission differs markedly from that under the other Acts which it administers. The Commission does not administer Chapter X. It does not initiate the proceedings, hold its own hearings, or adopt Rules and Regulations, but acts, as the representative of investors and as an aid to the court, in a purely advisory capacity. It has no authority either to veto or to require the adoption of a plan of reorganization or to render a decision on any other issue in the proceeding. The facilities of its technical staff and its impartial recommendations are placed at the services of the judge and the security holders, affording them the views of experts in a highly complex area of corporate law and finance.

In order to facilitate this work of the Commission, staffs of lawyers, accountants, and analysts have been stationed in various regional offices where they can keep in close touch with all hearings and issues in the proceedings and with the parties, and be readily available to the courts. At the central office of the Commission, the Corporation Finance Division is charged with the immediate supervision, of the Commission's Chapter X functions. As a party to the proceeding the Commission is represented at all important hearings and its views on the various problems arising in the proceeding are expressed to the court orally or through legal or analytical memoranda. Of equal importance is the regular participation by the Commission's staff in informal conferences and discussions with the parties in an endeavor to work out solutions to questions in advance of formal hearing and argument. In this way the Commission has often been able to bring facts, arguments, or alternative suggestions to the attention of the parties, and frequently the parties have been thereafter prompted to modify their proposed actions. In general the Commission has found these informal discussions an effective means for cooperation, and of great value in expediting the proceeding.

While the Commission as a party in interest has a right to be heard on all matters arising in the proceeding, it does not have the statutory right of appeal. The Commission, however, on appropriate occasions appears before the appellate courts when appeals are taken by others. The Commission has participated as a party or as *amicus curiae* in many appeals involving significant legal principles of bankruptcy reorganization law.

Through its nation-wide activity in Chapter X cases the Commission has been in an advantageous position to encourage uniformity in the interpretation and application of the provisions of Chapter X, and is often called upon by parties, referees and special masters, and judges for advice and suggestions. In this the Commission has been able to extend substantial assistance derived from its experience accumulated through participation in many cases.

THE COMMISSION AS A PARTY TO PROCEEDINGS

As a general matter the Commission has deemed it appropriate to seek to participate only in proceedings in which a public investor interest is involved. As a rough, administrative guide, proceedings are not considered to have sufficient public interest to warrant Commission participation if the amount of publicly held securities is less than \$250,000. But mere size is not, of course, the sole criterion. Often the Commission has deemed it appropriate to enter smaller cases where an unfair plan has been or is about to be proposed, where the public security holders are not adequately represented, where the proceedings are being conducted in violation of important provisions of the Act, or where other facts indicate that the Commission may perform a useful service by participating. During the past fiscal year, the Commission intervened in several such smaller cases because it considered that unfair plans were being proposed and violations of Chapter X provisions were occurring.

There is a multitude of diverse questions with which the Commission is concerned as a party to a Chapter X proceeding. Some of the more important matters which have arisen during the past fiscal year are discussed in the following paragraphs.

Problems in the Administration of the Estate

The Commission has continued its policy of scrutinizing the qualifications of trustees in the light of the standards of disinterestedness prescribed by the statute. Since the independent trustee has the duty of examining into the history and affairs of the debtor, ascertaining its financial and managerial problems, and formulating the plan of reorganization, it is obvious that the success of the reorganization depends largely upon his thoroughness and skill. In one case, the Commission objected to the retention of a bank as trustee where its trust officer, in charge of the reorganization proceeding for the bank, was closely affiliated with the management of the debtor and where it appeared that no investigation of the property, liabilities, and financial condition of the debtor, as required by Section 167 of the Act, would be made and reported to security holders. The judge did not sustain the objection to the retention of the trustee but did order the trustee to comply fully with the requirements of Section 167. [Footnote: Scottish Rites Masons Association, Western District of Texas, San Antonio Division.]

In connection with the preparation of the trustee's report, as in other phases of the case, the Commission has continued its practice of assisting the trustee through consultation on problems and in furnishing information. As the result of its experience in many cases, the Commission has been in a position to render considerable help to trustees in carrying out their duties, in this respect as well as others, without usurping their functions or controlling their activities.

The importance of a thorough investigation of the debtor's affairs by the trustee has manifested itself on many occasions during the Commission's experience in Chapter X cases. In one case during the past year, the Commission's staff

discovered evidence of misconduct on the part of the management of a company which owned an office building and it assisted the trustee in conducting an investigation. It was found that the manager and controlling officer of the debtor apparently had charged excessive management fees, used office space to which he was not entitled, and debited the company for expenses which he should have borne himself. After long negotiation a settlement was consummated favorably for security holders and approved by the court. In the same case, prior to the Commission's intervention, a plan had been proposed, at the instance of the company and its management, under which bondholders would have received common stock and cash equal to 30 percent of the face value of the old bonds, the cash to be derived from the proceeds of a new mortgage. With the thought that the common stock would not have a ready market and might not bring its true value if sold, and in view of the current rise in realty prices, the Commission urged, as preferable, the adoption of a plan under which the property would be sold at public auction at a fair upset price. The trustee submitted this type of plan and it was approved by the court, accepted by bondholders, and confirmed. At the sale, the property attracted bids much higher than the upset price.[Footnote: Fifth and Pierce Co., Northern District of Iowa, Western Division.] (See page 91 on the sale of properties as a method of reorganization under Chapter X.) As a result of this sale and the settlement with the manager, bondholders will receive close to 100 cents on the dollar in cash for their bonds.

The competence and efficiency of management is likewise an important subject for investigation by the trustee. In a case involving a large chain of restaurants which had suffered drastically from declining business prior to the war, the Commission endeavored to have the court order the trustee to retain experts to make a management survey. While the company's difficulties may have been due to causes other than incompetence or inefficiency of management, the Commission believed it essential to ascertain the responsibility of management for the plight of the company, first, because of its effect upon a judgment as to the earnings of the company for valuation purposes, and, second, because of the necessity for the court to pass upon the future Management of the reorganized company. Upon the trustee's assertion that he would present testimony on this subject at the plan hearings, the court denied the Commission's request.
[Footnote: Childs Co., S.D.N.Y.]

The responsibility of the trustee for the administration of the estate is equally as important as his duty with respect to the reorganization plan. The Commission has taken every opportunity to emphasize this aspect of the proceeding. In a case involving a large investment company with its major holdings consisting of the common stocks of two subsidiary investment companies, the Commission, during the early part of this year, urged that the speculative character of the enterprise be reduced in the interests of creditors and senior security holders of the debtor company. After conferences with the Commission and other parties, the trustees presented a program for the retirement of a large portion of the

senior capital of the subsidiaries, thereby reducing to a considerable extent the risks to the debtor's estate inherent in a high leverage position. The Commission supported this program before the court. The trustees obtained the approval of the court to the program despite the opposition of a preferred stockholders committee. [Footnote: Central States Electric Corp., Eastern District of Virginia]

Responsibilities of Fiduciaries

The Commission has consistently been alert to insist upon the absolute honesty of fiduciaries in their relationship to security holders and has urged that those in positions of trust who have deviated from the high standards imposed upon them should bear the full consequences of their actions.

Trading in securities of a debtor by trustees, directors or other insiders is a practice which has generally been condemned by the courts. During the fiscal year, in a matter in which the Commission actively participated, this rule was applied to the directors of a corporation in reorganization under Section 77B where they had purchased bonds of the corporation during their incumbency. [Footnote: *In re Philadelphia and Western Railway Co.*, 64 F. Supp. 738 (D.C.E.D. Pa., 1946).] The court held that the directors of the debtor corporation, which had been continued in possession of its property in the absence of the appointment of a trustee, should be limited in their claims on their bonds so purchased to the actual cost to them. Subsequently, a settlement was negotiated and approved by the court. [Footnote: A similar result was reached in the Fifth and Pierce Company case (*supra*), as a result of the insistence of the Commission, as a condition of settlement.]

In the proceedings to reorganize Jeffrey Terrace Building Corp. the Commission vigorously supported a petition for limitation to cost of bonds acquired by an individual, in a transaction in which that individual cooperated in what appeared to the Commission to be a breach of fiduciary obligations by an indenture trustee who was also manager of the properties. Instead of attempting to secure the maximum price for the debtor's property, in which bondholders had the sole interest, the indenture trustee for the bondholders entered into an agreement with the aforementioned individual. Under that agreement the trustee was to receive a commission, the amount of which would increase in proportion as the price paid for the property by the aforementioned individual went down. Thereafter the fiduciary, acting as agent for the purchaser, induced bondholders to sell their bonds at 50 cents on the dollar, making no disclosure of the sale of a large block of bonds to the purchaser at 65 cents on the dollar and not advising bondholders of his own interest in the transactions. The court entered an order limiting the purchaser to the cost of his bonds. Subsequently a settlement was negotiated and was approved by the court.

The remedy of limitation to cost is generally invoked in order to prevent a fiduciary from profiting by his trust. On the other hand, where the fiduciary's

derelictions have caused harm to the security holders or the estate the remedy of subordination may be pursued to prevent the fiduciary from sharing in the assets of the estate on a parity with these security holders. In the previous fiscal year the Commission filed an advisory report on plans of reorganization in proceedings involving Warner Sugar Corp. in which the Commission recommended that the doctrine of subordination be applied. In that report a detailed account was given of the manner in which various banks used their domination and control of the company to advance their own adverse interests to the detriment of public bondholders. It was pointed out that the banks, although occupying a fiduciary position, did not scrupulously observe the bondholders' rights but violated indenture provisions designed for their protection, obtained preferential treatment with respect to various assets and engaged in other practices to place bondholders at a disadvantage, even to the extent of preventing bondholders from ascertaining the facts and pursuing their appropriate legal remedies. [Footnote: The report recommended that the manager of the debtor's sugar mill and plantation should be limited to the consideration he paid for bonds acquired by him while he was acting in a fiduciary capacity.] After the filing of the Commission's report the trustee submitted a memorandum in which he recommended that the banks be subordinated in their claims against the debtor. [Footnote: He recommended also that the manager's claim on bonds be limited to the cost thereof.] After hearings, a plan was filed by the trustee on December 1, 1945, under which public bondholders were to receive the full principal amount of their bonds with interest at 6 percent from the date of default in 1931 to the date of payment. The plan embodied an offer of purchase of West Indies Sugar Corp., a large bondholder and owner of an adjoining sugar mill and plantation. As part of the plan the banks and the manager were to be paid merely the principal of their bonds with no interest. Since the bonds bore a 7 percent interest rate the plan was in effect a compromise of the issues of subordination and limitation to cost. Under the circumstances of the case the Commission concluded that the compromise was fair to the public bondholders and recommended that the plan be approved. Thereafter the plan was approved by the court, accepted by security holders and it has recently been confirmed by the court.

Another proceeding involving the subordination doctrine in which the Commission actively participated is that of Inland Gas Corp., American Fuel and Power Co., et al. In that case, during the previous fiscal year, the Commission had participated in an appeal to the Circuit Court of Appeals for the Sixth Circuit from a decision by the district court rejecting various claims of Columbia Gas and Electric Corp. against the debtor based on bonds, debentures and stock. In brief, the district court found that Columbia Gas and Electric Corp. had formulated and carried out a program to prevent Inland Gas Corp. and its parent company, American Fuel and Power Co., together with other subsidiaries, from expanding its business, primarily through the building of a pipe line from its field in Kentucky to Detroit. The Commission urged that the district court decision rejecting the Columbia Gas claims be affirmed for the reason that, irrespective of other

grounds for rejection such as violation of antitrust laws, the facts showed inequitable conduct by Columbia Gas and Electric Corp. toward the debtor corporations which warranted the rejection or subordination of its claims. The Commission argued that Columbia Gas and Electric Corp. secured control of the American Fuel and Inland Gas system to destroy a threat to its competitive position and that Columbia accomplished its purpose. It was pointed out that subordination or disallowance was particularly appropriate because of the difficulties of recasting the history of the enterprise so as to determine the extent of the loss suffered by the public security holders. On October 9, 1945 the Circuit Court affirmed the District Court judgment, modifying the decree, however, so as to provide for subordination of the claims and stock interests of Columbia Gas and Electric Corp. rather than rejection thereof. [Footnote: *Columbia Gas and Electric Corp., v. United States of America*, 151 F. (2d) 461 153 F (2d) 101 (C.C.A. 6, 1945, 1946)] The court rested its opinion not merely upon the existence of inequitable or illegal conduct of Columbia Gas and Electric Corp., but upon the injury caused the debtors and their security holders by reason of such conduct Application for a writ of certiorari was filed by Columbia Gas and Electric Corp. on May 29, 1946. The Commission has filed a brief in opposition to the application. [Footnote: Certiorari was denied by the Supreme Court on October 14, 1946]

Activities with Respect to Allowances

The Commission has taken an active part in the matter of allowances to those claiming to have rendered services and incurred expenses in the proceeding. In making allowances the courts seek to protect the estate from exorbitant charges, while at the same time providing equitable treatment to the applicants. The Commission has been able to provide considerable assistance to the courts in this matter.

The Commission itself receives no allowances from estates in reorganization and is able to present a wholly disinterested and impartial view. The Commission has consistently tried 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 applications of the various parties to the end that unnecessary duplication of services shall not be recompensed and that compensation shall be allocated on the basis of the work done by each claimant and of his relative contribution to the administration of the estate and the formulation of a plan. With these objectives in mind the Commission may undertake to make specific recommendations to the courts in cases in which the Commission has been party throughout the proceeding and is thoroughly familiar with the activities of the various parties and all significant developments in the proceedings. In cases in which it has entered the proceeding at an advanced stage the Commission may limit its advice to the court without specifying particular amounts deemed reasonable by it.

Where the activities of an applicant for compensation have constituted inequitable conduct or where an applicant has traded in securities, directly or indirectly, in violation of the provisions of Section 249, the Commission has urged that fees be denied. In several cases, the Commission took the position that purchases or sales of securities by the near relatives of a fiduciary come within the application of the provisions of Section 249 of the Bankruptcy Act and the rule of law which that Section codifies. In one case the Commission's contention was upheld; [Footnote: *In re Midland United Co.*, 64 f Supp. 399 (D.C. Del., 1946), appeal pending] in two cases it was not [Footnote: *In re Penn Timber Co.*, D.C. Oreg., No. B-23063; *In re Philadelphia and Reading Coal and Iron Co.*, 61 F. Supp. 120 (D.C.E.D. Pa., 1945), appeal disallowed by C.C.A. May 31, 1945.] In another case the Commission opposed an applicant's contention that Section 249 does not apply to attorneys who represent individual creditors. The Commission pointed out that Section 249 applied in terms to attorneys and that its purpose was to prevent a pernicious reorganization abuse-the buying and selling of securities by persons within stated groups on the basis of inside information about matters such as plans, prospects of reorganization, and the value of securities; information which they were in a strategic position to acquire and use for their own gain. It was pointed out that the case of *Young v. Higbee Co.* [Footnote: 324 U.S. 204 (1945).] (in which the Commission had participated) had suggested that even individual security holders themselves assumed certain representative obligations when their activities were for the benefit of the entire estate. [Footnote: *Abrams v. 188 Randolph Building Corp.*, 151 F. (2d) 357 (C.C.A. 6, 1945). cert. den.] In another case the Commission urged that compensation be denied to an indenture trustee and a bondholders' committee where the indenture trustee was acting for and at the instance of the committee. The district court agreed that a conflict of interest existed between the indenture trustee and the committee and denied compensation to the committee for services rendered up to the time of the removal of the indenture trustee. It denied any compensation to the indenture trustee. [Footnote: *Ritz-Carlton Restaurant and Hotel Co., of Atlantic City*, 60 F. Supp. 861 (D.C.N.J., 1945)]

On the other hand the Commission has taken the position that the fee provisions of Chapter X contemplate a broadening of the base for granting allowances as a means of encouraging participation in a reorganization proceeding by individual creditors and security holders whose personal financial stakes are seldom sufficiently great to pay their own counsel fees. With this principle in view the Commission is participating in support of an applicant who was denied compensation by the district court on the ground that his services were performed for the benefit of particular claimants rather than the estate as a whole. In an appeal from this denial the Commission urged that compensation be granted because applicant's services aided the proceeding by bringing before the court considerations applicable to a whole class of security holders who, in effect, were represented by the applicant. [Footnote: *In re Mt. Forest Fur Farms of America Inc.*, before the Circuit Court of Appeals for 6th Circuit.]

INSTITUTION OF CHAPTER X PROCEEDINGS AND JURISDICTION OF THE COURT

The Commission has striven for a liberal interpretation of the provisions of the Bankruptcy Act so that the benefits of Chapter X may be made fully available to security holders in accordance with the spirit and intent of the statute. In accordance with the principle enunciated in the Supreme Court decision in *Securities and Exchange Commission v. United States Realty and Improvement Co.*, the Commission has intervened during the fiscal year in a Chapter XI proceeding where the company seeking an arrangement appears to have a substantial class of public security holders. [Footnote: 310 US. 434 (1940)] The Commission's views, upheld by the Supreme Court, is that Chapter XI (relating to creditor arrangements) is not properly available to a debtor where a large public investor interest is involved since the provisions of Chapter XI do not contain the safeguards necessary to protect large classes of public security holders in the consummation of a fair, equitable, and feasible plan of reorganization, and that such a reorganization should take place under Chapter X. [Footnote: Carlton Crescent, Inc., S.D.N.Y.]

The Commission has also participated in several cases involving the question of good faith in the filing of a petition. The Commission's view in these cases was that the pendency of a prior State court proceeding was not a bar to a Chapter X proceeding since the prior proceedings in those cases did not contain safeguards for investors comparable with those in Chapter X. The contentions of the Commission were not upheld by the courts, generally on the ground that it had not been shown that the interests of security holders would not be best subserved in the prior State court proceedings. [Footnote: *Sheridan View Building Corp.*, 154 F. (2d) 532 (C.C.A. 7, 1945), *certiorari* denied October 8, 1945; *St. Charles Hotel Co.*, unreported opinion (C.C.A. 3, 1945), *certiorari* denied October 8, 1945]

The disregard of corporate entities in order to achieve a workable plan was upheld in the proceeding involving Pittsburgh Railways Co. The Commission actively supported a petition of the city of Pittsburgh to have the court assert jurisdiction for purposes of bankruptcy reorganization over various subsidiary companies and associated companies of the debtor, which were not nominally before the court, in order to effectuate a reorganization of the entire Pittsburgh street railway system. The Commission, pointing out the urgency of a system-wide reorganization, argued that the separate corporate entities of the so-called underlier companies should be disregarded under the facts of this case where the enterprise had always been conducted as a unit, operations unified, and affairs intermingled. The Circuit Court of Appeals for the Third Circuit upheld the position of the Commission and reversed the judgment of the district court which had denied the city's petition. [Footnote: *In re Pittsburgh Railways Co.*, F. (2d)(C.C.A. 3, 1946), cert. den. Oct. 14, 1946]

PLANS OF REORGANIZATION UNDER CHAPTER X

The ultimate objective of a reorganization is the formulation and consummation of a fair and feasible plan of reorganization. Accordingly, the most important function of the Commission under Chapter X is to aid the courts in achieving this objective.

Fairness

In appraising the fairness of reorganization plans under Chapter X the Commission has at all times taken the position that full recognition must be accorded claims in order of their legal and contractual priority, either in cash or new securities or both, and that junior claimants may participate only to the extent that the debtor's properties have value after the satisfaction of prior claims or to the extent that they make a fresh contribution necessary to the reorganization of the debtor. Hence, a valuation of the debtor is necessary to provide the basis for judging the fairness as well as the feasibility of proposed plans of reorganization. In its advisory reports, in hearings before the courts, and in conferences with parties to proceedings, the Commission has consistently stated that the proper method of valuation for reorganization purposes is primarily an appropriate capitalization of reasonably prospective earnings.

These principles as to the recognition of priorities and as to valuation are now firmly established as a result of the Supreme Court decisions in *Case v. Los Angeles Lumber Products Co. Ltd.* and *Consolidated Rock Products Co. v. DuBois* in which the Court sustained the positions urged in briefs filed on behalf of the Commission as amicus curiae. [Footnote: 308 U.S. 106 (1939) and 312 U.S. 510 (1941) respectively] During the past fiscal year these principles were reiterated in an appeal before the Circuit Court of Appeals for the Second Circuit in which the Commission actively participated. In this proceeding, United States Realty and Improvement Co and Trinity Buildings Corp. Of New York, the district court had excluded the preferred stockholders of Trinity Buildings Corporation from participation in a plan because the value of the debtor's assets on an earnings basis was found to be less than the amount of creditors' claims. The Commission urged that the district court's finding of value was substantially supported by the evidence and that it should be affirmed. The circuit court sustained the position of the Commission and affirmed the orders approving and confirming the plan of reorganization. [Footnote: *Trinity Buildings Corp. Preferred Stockholders' Committee v. O'Connell*, 155 F. (2d) 327 (C.C.A. 2, 1946)]

In connection with the fairness of plans, the Commission, as has been noted above, has been concerned among other matters with situations where mismanagement or other misconduct on the part of a parent company or

controlling person requires that its claims be subordinated to the claims of the public investors where a fiduciary's activities require that he be limited to the cost of his claims. Such matters must be given full consideration since they form an integral part of the concept of the "fair and equitable" plan.

The relative prosperity during recent years of many companies undergoing reorganization has enabled a number of debtors to make payments to creditors in cash either in part or in full. As a result, novel questions have been raised involving creditors' rights. The Commission, on behalf of the public investors, has participated in many of these controversies.

The Commission has urged that partial distribution of cash be made to creditors wherever possible, even though in advance of a formal plan of reorganization. The power of the court to make such distribution has been upheld whenever the question has arisen. With respect to payment in full to creditors the Commission has in general taken the view that all the rights of creditors to interest to the date of payment should be observed. In one case the Commission supported the position of debenture holders that they were entitled to have their claim of principal and accrued interest to the date of commencement of the Chapter X proceeding treated as an aggregate claim and to receive interest on such aggregate claim from the commencement of the proceeding up to the date of payment. The Commission urged that the aggregate claim of principal and interest accrued at the inception of the proceeding was in the nature of a judgment against the estate which carried interest on the full amount of the judgment to the date of payment. The reason for the rule is the fact that the Bankruptcy Act necessarily restrains creditors from pursuing their usual remedies by way of judgment and execution in order to avoid preferential treatment and forced liquidation and to assure equality of participation in the assets. The purpose of the stay of suits against the debtor is only to prevent the exercise by creditors of their procedural remedies and the stay should not be utilized to affect the substantive rights which would attach upon the acquisition of a judgment. By treating creditors' claims as judgments in computing the amount of the claims, those substantive rights are preserved and the debtor and its stockholders do not gain an advantage over their creditors. The district court sustained the Commission's position in this case. [Footnote: In re Realty Associates Securities Corp., 66 F. Supp. 416 (D.C.S.D.N.Y., 1946), appeal pending]

Feasibility

Although the representatives of security holders frequently regard the fairness of the plan as their principal concern, the provisions of the statute and the protection of investors' interests require also that the plan be feasible. To be feasible, a reorganization must be economically sound and workable. It must not hamper future operations or lead to another reorganization. The extent to which current reorganizations are attributable to lack of feasibility in previous

reorganizations is indicated by the fact that numerous Chapter X proceedings involved companies which had already undergone reorganization in equity receivership proceedings or under Section 77B of the Bankruptcy Act. In order to avoid a similar record as to Chapter X cases some years hence, with its attendant expense and injury to investors, the Commission gives a great deal of attention to the factors affecting feasibility. In this connection, the Commission is particularly concerned with the adequacy of working capital, the relationship of funded debt and capital structure to property values, the adequacy of corporate earning power in relation to interest and dividend requirements, and the effect of the new capitalization upon the company's prospective credit.

In recent years the Commission has encountered difficulties because the parties are disposed to base values and capital structures upon inflated war earnings, either because they overlook the extent to which earnings are inflated or hope such earnings will continue long enough to permit debt to be scaled down to manageable proportions. Another obstacle to the formulation of feasible plans in the current period of high tax rates is the reluctance of investors to scale down debt and thereby lose the deduction for interest payments.

Sale Plans

The increase in value of properties of corporations in reorganization has been particularly evident in the real estate field. In a number of these cases the Commission has felt that a sale of the property would be more beneficial for creditors than a plan involving exchange of securities. The legal basis for plans involving sales is derived from Section 216(10) of Chapter X and has been affirmed in several cases. In the leading case of *In re Lorraine Castle Apartments Building Corp., Inc.*, the Commission was an active participant in supporting the power of the Chapter X court to approve a plan providing for a sale of all of the debtor's property. [Footnote: *In re Lorraine Castle Apartments Building Corp., Inc.*, 149 F. (2d) 55 (C.C.A. 7, 1945), cert. den. October 8, 1945]

Consummation of Plan

The Commission also gives its attention to the drafting and preparation of corporate charters, by-laws, trust indentures, and other instruments which are to govern the internal structure of the reorganized debtor. The Commission strives to obtain the inclusion of various provisions in these instruments which will assure to the investors a maximum of protection, adequate information with regard to the enterprise, and a fair voice in the management. The Commission has generally opposed the control device of a voting trust except when its use has been justified by the special circumstances of the case and, when adopted, the Commission has sought to have the voting-trust agreement contain appropriate provisions in the interests of the investors.

ADVISORY REPORTS

Although the preparation of an advisory report is not the major part of the activity of the Commission in any particular case, such reports, because of their wide distribution, form one of the primary means of contact between the Commission and the public in Chapter X matters. Generally speaking, an advisory report is prepared only in connection with a proceeding involving significant problems and a relatively large company in which the investing public has a substantial interest.

Even though the Commission does not file a formal advisory report, it does, in all cases in which it is a participant, advise the court of its opinion with respect to any plan of reorganization under consideration by the court.

After the trustee has filed a plan, the customary procedure calls for a hearing at which this plan and any other plans that may have been proposed are considered. At this stage of the proceeding, the attorneys representing the Commission are concerned primarily with getting into the record sufficient data (1) to enable the judge to decide whether any proposed plan is worthy of consideration and (2) to supply the factual basis for the report of the Commission. If the judge finds one or more of the plans worthy of consideration, it or they may be referred to the Commission for report.

An advisory report provides the court with an expert independent appraisal of the plan indicating in detail the extent to which, in the opinion of the Commission, it meets, or fails to meet, the standards of fairness and feasibility. After the report is filed and copies are made available to the parties who have appeared at the proceedings, the judge considers the approval, modification, or disapproval of the plan. If the judge approves the plan, it goes to the security holders for acceptance or rejection accompanied by a copy of the judge's opinion and a copy of the report of the Commission, or a summary thereof prepared by the Commission. The report of the Commission, therefore, while not binding, aids both the judge and the security holders in determining whether or not to approve a plan.

During the fiscal year the Commission prepared a formal advisory report and a supplemental advisory report with respect to plans of reorganization in proceedings involving Chicago Railways Co., Chicago City Railway Co., Calumet and South Chicago Railway Co., and Chicago Rapid Transit Co. In its advisory report the Commission concluded that the plan proposed by the city of Chicago, pursuant to which the city was to bid for the Chicago surface lines traction properties a minimum price of \$75,000,000, was not fair, but could be made fair if the city waived its claim to a \$5,250,000 "City Compensation Fund," if it permitted the constituent companies to retain net earnings up to the date of actual transfer of the properties, and if the proceeds of the sale were reallocated among security holders along lines suggested by the Commission in order to satisfy the absolute priorities doctrine. The Commission also concluded that the upset price of

\$12,162,500 for the properties of Chicago Rapid Transit Co. was fair. Thereafter the plan was amended by the Chicago Transit Authority, as assignee of the city of Chicago, so as to adopt substantially the recommendations of the Commission's advisory report. In a supplemental report the Commission concluded that the amended plan was fair. The plan has been approved by the court, accepted by security holders and confirmed appeals have been taken by certain junior security holders from the order of approval and confirmation and they are presently pending.

The Commission also prepared a formal advisory report with respect to a plan of reorganization in the proceeding involving The Rocky Mountain Fuel Co. The Commission took the view that the plan was feasible and would be fair if it were amended to disclose to bondholders the extent of the powers of the new board of directors. The plan was amended in accordance with the Commission's suggestion and approved by the court.

The plan of reorganization in the latter case provided that certain bondholders, who had not assented to a prior voluntary plan for reduction in interest rate and extension of maturity of the bonds, should be paid an amount in cash equal to the reduced interest payments which had been made to assenting bondholders for a number of years before the Chapter X proceeding. This provision was intended to accord equal treatment to the holders of both assented and non-assented bonds because it was felt that such treatment was proper and equitable. In its advisory report the Commission approved the proposed treatment, pointing out that under the terms of the indenture, under the applicable State law, and under general equitable principles the assenting bondholders should not be subordinated to non-assenting bondholders but that, on the contrary, the plan was fair and equitable in providing for parity of treatment of all bondholders. Certain non-assenting bondholders appealed from the orders approving and confirming the plan, contending that they were entitled to a priority over assenting bondholders as to principal and interest. The Commission supported the plan before the circuit court, which affirmed the orders approving and affirming the plan of *reorganization*. [Footnote: Scherk v. Newton (In re Rocky Mountain Fuel Co.), 152 F. (2d) 747 (C. C. A. 10 1945).]

PART V

ADMINISTRATION OF THE TRUST INDENTURE ACT OF 1939

The Trust Indenture Act of 1939 outlaws the exculpatory clauses used in the past in trust indentures underlying corporate debt securities. Many of these clauses eliminated liability of the trustee for misconduct to such an extent that the word "trustee" was meaningless as applied to indenture trustees. The Act is designed to insure that the trustee will act in the interest of the bond or debenture owners and to insure his complete independence of the issuer and the underwriters. To

secure its objectives, the Act requires that bonds, notes, debentures, and similar debt 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 securities to be issued under a trust indenture is not permitted to become effective unless the indenture conforms to the requirements expressed in the Trust Indenture Act of 1939, and such an indenture is automatically "qualified" when registration becomes effective as to the securities themselves. An application for qualification of an indenture covering securities not required to be registered under the Securities Act of 1933, which is filed with the Commission under the Trust Indenture Act of 1939, is processed substantially as though such application were a registration statement filed pursuant to the Securities Act of 1933.

Statistics of Indentures Qualified

The number of indentures filed with the Commission during the year for qualification under the Trust Indenture Act of 1939, together with the disposition thereof and the amounts of indenture securities involved, are shown in Tables I and II below and the totals in Table III.

(charts omitted)

During the year the following additional material relating to trust indentures was filed and examined for compliance with the appropriate standards and requirements:

5 indentures as to which the Commission, under its authority granted by the Public Utility Holding Company Act of 1935, applies the standards of the Trust Indenture Act of 1939 as a measure of the provisions of an indenture although such indentures may be exempted from the Trust Indenture Act;

151 trustee statements of eligibility and qualification under the Trust Indenture Act of 1939;

51 amendments to trustee statements of eligibility and qualification.

118 Supplements S-T, covering special items of information concerning indenture securities registered under the Securities Act of 1933;

51 amendments to Supplements S-T;

41 application for findings by the Commission relating to exemptions from special provisions of the Act;

300 annual reports of indenture trustees pursuant to Section 313.

For a discussion of certain problems under the Trust Indenture Act dealt with by the courts during the fiscal year see the comment *infra* on *Continental Bank and Trust Co. v. First National Petroleum Trust*.

PART VI ADMINISTRATION OF THE INVESTMENT COMPANY ACT OF 1940

The Investment Company Act of 1940 requires the registration and provides for the regulation of investment companies, which are, generally, companies engaged primarily in the business of investing, reinvesting, owning, holding, or trading in securities. The Act requires, among other things, disclosure of the finances and of the investment policies of these companies, to afford investors full and complete information with respect to their activities; prohibits such companies from changing the nature of their business or their investment policies without the approval of the stockholders; bars persons guilty of security frauds from serving as officers and directors of such companies; prevents underwriters, investment bankers, and brokers from constituting more than a minority of the directors of such companies; requires management contracts in the first instance to be submitted to security holders for their approval; prohibits transactions between such companies and their officers and directors and other insiders except on the approval of the Commission; forbids the issuance of senior securities of such companies except in specified instances; and prohibits pyramiding of such companies and cross ownership of their securities. The Commission is authorized to prepare advisory reports upon plans of reorganizations of registered investment companies upon request of such companies or 25 percent of their stockholders and to institute proceedings to enjoin such plans if they are grossly unfair. The Act also requires face-amount certificate companies to maintain reserves adequate to meet maturity payments upon their certificates.

Summary of Activities

During the past year the Commission in its administration of the Act concerned itself primarily with the disposition of the applications filed pursuant to various provisions of the Act. There were 70 such applications pending at the beginning of the year and 90 additional ones filed during the year; 100 were disposed of in the course of the year, and 60 were pending at its close. These applications are classified below, together with an indication of the disposition made of them. It should be noted that the detailed figures in this summary are not totaled for the reason that some applications involved more than one section of the Act.

(chart omitted)

New Rules Adopted Under Investment Company Act of 1940

Adoption of Rule N-17D-1: On February 6, 1946, the Commission adopted a new rule under the Investment Company Act of 1940 regarding bonus, profit-sharing and pension plans provided by registered investment companies and their controlled companies for directors, officers and other affiliated persons. The rule provides that prior to the submission of any such plan to security holders for approval, or if not so submitted prior to the adoption thereof, an application regarding the plan shall be filed with the Commission and the Commission be given 10 days to scrutinize the plan and determine whether or not a hearing should be held thereon. The purpose of the rule is to protect registered investment companies and their controlled companies and the security holders of such companies against contributions to such plans on an unfair and inequitable basis. The rule provides that the Commission will, in passing upon such applications, be guided by the standards contained in the various pertinent Sections of the Act.

The type of situation which Rule N-17D-1 was designed to meet is illustrated by the following case: The management of a group of closely affiliated investment companies proposed that each investment company in the group adopt an "employees' incentive profit-sharing plan and trust." The proposed profit-sharing plan provided that each investment company should contribute the lesser of (a) 15 percent of the available profits of the investment company or (b) an amount which represented three times the contributions made by officers or employees. This latter amount was to be cumulative, provided that in any 1 year the investment company should not contribute more than 15 percent of its available profits. The employee contribution was fixed at an amount each employee might elect which would constitute not less than 2 percent nor more than 5 percent of the salary received by such employee during the year in which the contribution was made. The proposed profit-sharing plan made no provision for the payment of dividend arrearages prior to contributions to the profit-sharing plan, although at least one of the investment companies involved had dividend arrearages outstanding on its preferred stock. The plan also permitted officers and employees to include unrealized gains on securities as "profits" for the purpose of calculating the company's contribution to the plan. After consideration of the provisions of Rule N-17D-1, the management determined not to submit the proposed profit-sharing plan to the Commission under the Rule, and the plan accordingly was abandoned.

Adoption of Rule N-28B-1: On June 7, 1946, the Commission adopted an additional rule under the Investment Company Act of 1940 which authorizes real estate loans partially or wholly guaranteed under the Servicemen's Readjustment Act (the so-called GI bill) as qualified investments for face-amount certificate companies. Such companies are authorized to invest only in investments of a

kind which life insurance companies are permitted to invest in under the provisions of the Code of the District of Columbia, and such other investments as the Commission may authorize as qualified investments. Insurance companies are not authorized by the Code of the District of Columbia to invest in loans guaranteed under the GI bill but are so authorized by the GI bill itself. The effect of the new rule is to extend a similar authorization to face-amount certificate companies.

Statistics Relating to Registered Investment Companies

At the beginning of the year, 366 companies were registered as investment companies under the Act. During the year 13 additional companies became registered, while the registration of 18 companies was terminated and there remained 361 companies registered at the close, of the year. The assets of these 361 companies aggregated approximately \$3,750,000,000. The comparative number of documents filed under the Act during 1945 and 1946 fiscal years and certain other relevant statistics are shown below:

(chart omitted)

Civil Actions Instituted under the Investment Company Act of 1940

In *S.E.C. v. Diversified Fund Corp., Humberto Moreno, et al.* the Commission obtained a judgment enjoining Moreno from acting as trustee of Diversified Fund Shares, a trust fund registered as an investment company and sponsored by Diversified Fund Corp. [Footnote: U. S. D. C., N. M., April 29, 1946. The complaint charged defendants Moreno and Diversified Fund Corp. with gross abuse of trust in that they failed to comply with applicable provisions of the investment Company Act of 1940 in suspending the right of redemption and in restricting the transferability of securities issued by the corporation, in failing to have its securities verified by independent public accountants, and in failing to maintain and preserve records regarding transactions with the trustee of Diversified Fund Shares.] Diversified Fund Corp. was also enjoined from serving or acting as investment adviser, principal underwriter or depositor of Diversified Fund Shares. A receiver was appointed for the assets of both the trust fund and the sponsor corporation to hold the property and assets of the corporation subject to the order of the court for liquidation and distribution.

PART VII

ADMINISTRATION OF THE INVESTMENT ADVISERS ACT OF 1940

The Investment Advisers Act of 1940 requires the registration of investment advisers: persons engaged for compensation in the business of advising others with respect to securities. The Commission is empowered to deny registration to

or revoke registration of such advisers if they have been convicted or enjoined because of misconduct in respect of security transactions or have made false statements in their applications for registration. The Act also makes it unlawful for investment advisers to engage in practices which constitute fraud or deceit; requires investment advisers to disclose the nature of their interest in transactions executed for their clients; prohibits profit sharing arrangements; and, in effect, prevents assignment of investment advisory contracts without the client's consent.

Investment advisers' registration statistics, year ended June 30, 1946

Effective registration at close of preceding fiscal year: 780

Applications pending at close of preceding fiscal year: 9

Applications filed during fiscal year: 139

Total: 928

Registrations canceled or withdrawn during year: 61

Registration denied or revoked during year: 1

Applications withdrawn during year: 1

Registrations effective at end of year: 853

Applications pending at end of year: 12

Total: 928

In a proceeding brought by the Commission against *Investment Registry of America, Inc.* for the revocation of its registrations as a broker-dealer and investment adviser, the Commission branded as "outright and crude" some of the frauds committed by this firm as a broker-dealer in transactions with its customers, and revoked its registration as a broker-dealer upon a finding that the firm's practices violated the anti-fraud provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934. The practices involved taking secret profits and using customers' free securities. The connection between such frauds on customers and the devious methods deliberately employed by its officers and directors to extricate the firm from and conceal its financial difficulties was underscored by the Commission.

The firm was also in the business of investment adviser and many of its customers had agreed to pay the firm a fee for its "selection" of securities for their portfolios. This fee was 5 percent of the purchase price, or less if so reduced by

agreement. The firm, however, by taking secret and unauthorized profits, made charges to these customers as high as 9 percent, concealing these excessive charges by putting on its confirmation slips the phrase, "Includes I. R. A. charges," a device held by the Commission to be plainly misleading and obscure. The firm's application for registration as an investment adviser stated, in part, that the firm gave unbiased investment advice to clients and that its contracts provided for a maximum fee of 5 percent for the selection of securities, representations patently false. The Commission found that the firm had, by failing to amend its application, willfully violated Section 207 of the Investment Advisers Act and revoked its registration as an investment adviser.

PART VIII

OTHER ACTIVITIES OF THE COMMISSION UNDER VARIOUS STATUTES

THE COMMISSION IN THE COURTS

Civil Proceedings

A complete list of all instances in which the Commission appeared before a Federal or State court, either as a party or as *amicus curie* during the fiscal year, and the status of such cases at the close of the year, is set forth in Appendix Tables 19 and 24 to 34.

Summarizing these tables it appears that at the beginning of the fiscal year 18 injunctive and related enforcement proceedings instituted by the Commission were pending before the courts, in connection with fraudulent and other illegal practices in the sale of securities, 26 additional proceedings were instituted during the year, and 22 cases were disposed of, so that there remained 22 of such proceedings pending at the end of the year. In addition, the Commission participated in a large number of reorganization cases, in 24 proceedings in the district courts under Section 11(e) of the holding Company Act, and in 12 suits as *amicus curiae* to advise the court of its views regarding the construction of provisions of statutes administered by the Commission which were involved in private law suits. The Commission also participated in 50 appeals, exclusive of those involved in reorganization proceedings. Of these, 28 came before the courts on petition for review of administrative orders, 5 were appeals in actions brought by or against the Commission, 4 were appeals from orders entered pursuant to Section 11(e) of the Public Utility Holding Company Act, and 13 were miscellaneous appeals.

The issues before the courts related chiefly to apparent or threatened violations of the Securities Act of 1933 and the Securities Exchange Act of 1934, to applications to carry out voluntary plans of compliance with the corporate integration and simplification provisions of the Public Utility Holding Company Act

of 1935, to the fairness and feasibility of plans of reorganization, and to constructions of the Trust Indenture Act and Investment Company Act. Most of these cases have been discussed in detail in other portions of this report in connection with the particular statute under which the action originated. There will be discussed below certain of the significant decisions of general application and interest, which have not been treated elsewhere in the report, including the *amicus curiae* cases.

During the year the Supreme Court decided, in *S.E.C. v. Howey*, that a contract for the sale of land devoted to the cultivation of citrus groves, when coupled with a contract to service the groves, was an "investment contract," and therefore constituted a security within the meaning of the Securities Act of 1933. [Footnote Sup. Ct. 1100 (1946)] The defendant, who sought to secure public investment in this enterprise without complying with the registration provisions of that Act, was enjoined from doing so.

The case, though it dealt with only one type of situation, is nevertheless of vast importance in the Commission's administration of the Securities Act. It upholds the Commission's power to reach investment schemes involving securities which are masked under a variety of forms—such as purported sales of commodities and realty.

S.E.C. v. Penfield Co. of California, now pending before the Supreme Court on petition for certiorari, illustrates, irrespective of the issues presented by that petition, a difficulty which the Commission may encounter as a law enforcement agency owing to the time involved in the necessary steps for judicial enforcement and review of administrative subpoenas. [Footnote: F. 2d, 15 U.S. Law Week 2050 (1946)] While the Penfield litigation is still pending, the enforcement problem it presents merits full treatment herein. The extensive litigation there involved related to the Commission's efforts to examine certain documents in the course of an investigation into the sale of securities alleged to have been made by means of untrue statements of material facts and without registration. Under the Securities Act the Commission is authorized to issue subpoenas "for the purpose of all investigations which, in the opinion of the Commission, are necessary and proper for the enforcement of this title." It has similar broad powers of investigation and subpoena under other statutes administered by it. These statutes thus contemplate inquiries by the Commission into possible criminal violations similar to those which a grand jury would otherwise have to undertake. This parallel to the grand jury function has been recognized by the Supreme Court. Nevertheless, as illustrated in the Penfield case, there is always danger that litigation delays may prevent the completion of an administrative investigation in time to permit prosecution before the statute of limitations has become a bar. We do not, of course, wish to suggest that the Federal courts are unaware of the problem. [Footnote: See *S.E.C. v. Vacuum Can Co.*, F. (2d) (C. C. A. 7, 1946), where the court summarily dismissed an appeal from a subpoena enforcement order characterizing it as "clearly without merit," and "taken for delay

only.” See also the various recent decisions of the Supreme Court dealing with the scope as distinguishing from the time factor of judicial review of administrative subpoenas which have indicated that a relevant inquiry will not be curtailed by attempts to try out first in court the very issues of fact which it is the purpose of the administrative inquiry to determine. As Mr. Justice Frankfurter stated in *Cobbledick v. U.S.*, 309 U.S. 323, 325 (1940). “to be effective, judicial be effective, judicial administration must not be leaden-footed.”]

The order and supplemental orders directing the investigation were issued May 14, 1942, February 8, 1943, and April 8, 1943. The first subpoena *duces tecum* issued by the Commission was ignored and the Commission was obliged to apply to the district court for an enforcement order. As a result of the disclosures revealed under this subpoena, the supplemental orders were entered expanding the Commission’s investigation and a new subpoena *duces tecum* was served upon one of Penfield’s officials, requiring the production of specified items contained in Penfield’s books and records. Since Penfield also refused to comply with this subpoena, the Commission was again obliged to resort to a Federal district court for its enforcement. The district court issued its order directing compliance with the subpoena on June 1, 1943. An appeal followed to the Ninth Circuit Court of Appeals, which affirmed the action of the district court. Defendant then petitioned to the Supreme Court for and was denied *certiorari*. In spite of the judicially recognized lack of merit in the contentions advanced by defendant the subpoena was not obeyed, even after the mandate was spread upon the record of the district court. Consequently, on January 24, 1945, the Commission instituted civil contempt proceedings against the defendant. While this litigation was in progress, it was deemed necessary in view of the statute of limitations problem to submit the case to a grand jury prior to completion of the investigation and the Penfield Company and several of its officials were indicted. [Footnote: The indictment ultimately was dismissed as to several of the defendants; the remaining defendants were acquitted.]

Due to the pendency of this indictment the court, in the contempt proceeding, express doubt as to whether the Commission was entitled to obtain the evidence requested until after the conclusion of the criminal trial because that evidence might be used by the Government. Accordingly, the court postponed determination of the issue. The matter finally was heard on July 2, 1945, on which date the defendant was adjudged to be in contempt. The court, however, refused to grant a remedial decree calculated to coerce production of Penfield’s books and records. Instead it ordered defendant to “pay a fine of \$50, and stand committed until paid.” Since such an order did not enable the Commission to obtain access to the documents, an appeal was taken. The circuit court reversed, ordering the entry of a coercive decree, and the petition for *certiorari* takes exception to that decision. Thus, more than 4 years after the original order of investigation the Commission still seeks access to the documents it needs for its investigation.

The scope of the injunctive power granted in Section 36 of the Investment Company Act was subjected to judicial review in *Aldred Investment Trust v. S.E.C.* [Footnote: 151 F. (2d) 254 (C.C.A. 1, 1945) cert. denied. 326 U.S. 795 (1946).] In that case a securities broker and some associates purchased the equity in a registered investment trust for a nominal sum at a time when outstanding debentures were almost three times the market value of the securities in the portfolio and proceeded to manage the trust for their personal profit. They invested a large portion of the funds in a speculative enterprise, a race track, and installed themselves as officers of both the trust and the race track at excessive salaries. Upon application of the Commission the broker and his associates were enjoined from continuing in the management of the trust and a receiver was appointed.

In the first case to involve a construction of provisions of the Trust Indenture Act, *Continental Bank and Trust Co. of N. Y. v. First National Petroleum Trust*, the Commission filed a brief *amicus curiae* expressing its interpretation of the Sections involved. [Footnote: F. Supp. (1946)] The action was brought by an indenture trustee against the issuer to recover certain items of alleged overdue interest and certain charges and expenses incident to the action alleged to be owed by the issuer. The issuer set up as an affirmative defense the fact that the holders of a majority in principal amount of the debentures had directed the plaintiffs not to bring suit before July 1, 1947, and that Section 316 of the Trust Indenture Act, which had served as the basis for one of the provisions of the indenture, permitted the vote of a majority of debenture holders to determine when suit for these items could be brought.

The Commission took the view that a proper construction of Sections 316, 317 and 318 of the Trust Indenture Act prohibited the impairment of the right of a debenture holder to receive payment of interest unless (1) 75 percent of the debenture holders consented to a postponement in the payment, and (2) a provision of the indenture stated that such a postponement might be so obtained. The court entered judgment for the plaintiff, sustaining the Commission's construction of the statute, and finding there was neither the requisite 75 percent consent to the postponement of payment nor a provision in the indenture authorizing the granting of such consent.

Two actions during the year involved a construction of Section 14(a) of the Securities Exchange Act of 1934. In one, *S.E.C. v. Transamerica*, the Commission brought suit to restrain the defendants from using proxy materials obtained as a result of solicitations which did not include proposals which a minority stockholder, pursuant to the Securities Exchange Act and the Rules promulgated thereunder, desired to bring before the annual meeting. [Footnote: Civil Action No. 861, United States District Court for the District of Delaware.] The minority stockholder sought amendments to the corporate bylaws and resolutions (1) to permit the stockholders to amend the bylaws at any annual meeting without the requirement that such proposed amendments be contained

in the corporation's notice of meeting, (2) to cause annual meetings to be held in San Francisco, California, instead of Wilmington, Delaware, (3) to cause auditors to be elected by the stockholders and a representative of the auditors last chosen to attend the annual meeting, and (4) to require that an account of the proceedings at annual meetings be sent to all stockholders. [Footnote: The management voluntarily amended the bylaws to comply with this proposal.] The district court permitted the proxies to be used for the election of directors on condition that the meeting be adjourned to a subsequent date when such other matters as it might decide were proper subjects for action by the security holders would be considered. In the final judgment subsequently re-issued the court sustained the right of the minority stockholder to have the notice of the annual meeting include his proposal to amend the bylaws insofar as independent public auditors were concerned and enjoined the management from violating Section 14(a) of the Securities Exchange Act and proxy Rules X-14A-7 and X-14A-2 thereunder in any respect. After the close of the fiscal year, cross appeals were taken from the judgment of the court to the Third Circuit Court of Appeals. In the other action which arose under Section 14(a), *Wyatt v. Armstrong*, the New York Supreme Court sustained the Commission's contention that a proxy solicitation was defective which did not disclose that the directors elected had agreed prior to the solicitation to resign in favor of another slate of candidates. [Footnote: 59 N. Y. Supp. (2d) 502 (1945)]

Although for the most part, the Acts administered by the Commission incorporate specific statutes of limitation, the rights which these Acts create sometimes give rise to equitable remedies for which no limitation is prescribed. It had been decided, in *Guarantee Trust Co. v. York*, that when a State-created equitable action was instituted in a Federal court, due to the diversity of citizenship of the parties, the statute of limitations prescribed by the State was to be applied. [Footnote: 326 U.S. 99 (1945)] In *Holmberg v. Armbrecht*, the Commission appeared before the Supreme Court as *amicus curiae* to urge that when the jurisdiction of the Federal court is based upon a federally-created equitable right, the broader Federal doctrine should be applicable, which provides that where a party has been injured by fraudulent conduct, the bar of the statute of limitations does not begin to run until the fraud is discovered. [Footnote: 327 US. 392 (1946)] The Supreme Court, sustaining the Commission, ruled that federally-created equitable rights of action could not be barred, irrespective of State statutes of limitation, where delay in bringing suit was attributable to the fraud of the defendants.

Four cases which were litigated during the period covered by this report concerned constructions of Section 16(b) of the Securities Exchange Act of 1934. Under this Section any profit secured by officers, directors, and principal owners of equity securities in corporations registered on a national securities exchange as a result of purchases and sales of their corporation's securities within a 6-month period, inures to the benefit of the corporation. The actions, as the statute contemplates, were instituted by private litigants. However, the Commission

appeared in each case as amicus curiae to urge that construction of the Section which it deemed best effectuated the intention of Congress in enacting the legislation. In one case, *American Distilling Co. v. Brown*, the New York Court of Appeals refused to assume jurisdiction over the action on the ground that Section 27 of the Securities Exchange Act conferred jurisdiction over actions arising under that act upon the Federal courts only. [Footnote: 295 N.Y. 36 (1946)] This was in accord with views expressed by the Commission. The two other cases, *Kogan v. Schulte* [Footnote: 61 F. Supp. 604 (S.D.N.Y., 1945)] and *Park and Tilford v. Schulte* [Footnote: Civil Action No. 28-458, United States District Court for the Southern District of New York. An appeal is pending to the Circuit Court of Appeals.] involved the conversion of preferred stock into common stock by a controlling stockholder within 6 months of a sale of common stock by him. In both cases the Commission contended that the conversion was a purchase within the meaning of Section 16(b). The district court so held, and at the same time reaffirmed the constitutionality of that Section upon the authority of *Smolowe v. Delendo*, 136 F. (2d) 231 (C. C. A. 2, 1943), cert. denied, 320 U. S. 751. Kogan, a minority stockholder, was denied intervention in the Park and Tilford case by the district court but the circuit court reversed this action. [Footnote: Decision without opinion rendered Mar. 23, 1946. Case No. 28-458 (C.C.A. 2, 1946).] The Commission filed a memorandum in this case supporting the right to intervene on the ground that there existed a community of interest between the corporation and the defendant, an owner of a substantial number of its shares, which might militate against a completely adversary action.

In the other case, *Gratz v. Claughton*, which is still pending in the district court, the defendant contested the venue of the action, which was laid in the place where the transactions occurred, and the Commission filed a memorandum in support of that venue. [Footnote: Civil Action No. 35-410, United States District Court for the Southern District of New York.] It was the view of the Commission that the statute should be construed to provide as many alternative choices of venue as could reasonably be implied from the language of the Act in order that the express purpose of Congress, "to prevent" insider profits, might be realized. Otherwise a stockholder might be faced with the burden and expense of litigating his cause of action in a forum distant from and unrelated to the place where the significant acts or transactions occurred.

Criminal Proceedings

The statutes administered by the Commission provide for the transmission of evidence of statutory violations to the attorney general who, in his discretion, may institute appropriate criminal proceedings. As a matter of practice, the Commission, largely through its ten regional offices, thoroughly investigates suspected violations and, in cases where the investigation appears to disclose a foundation for criminal proceedings, prepares detailed reports of investigation which are forwarded to the Attorney General. When it is decided to institute criminal proceedings, the Commission assigns such of its employees as have

participated in the investigation to assist in the preparation of the case for presentation to the grand jury, in the conduct of the trial and in preparing briefs on appeal. Parole reports on offenders convicted also are prepared by members of the Commission's staff. Where the investigation discloses violations of statutes other than those administered by the Commission, reference is made to the appropriate Federal or State agency .

Up to June 30, 1946, in criminal cases developed by the Commission, indictments against 2,449 defendants have been obtained in 380 cases. In the cases disposed of, convictions were obtained against 1,205 defendants. During the past year 15 indictments have been returned against 45 defendants. Convictions were obtained against 32 defendants in 16 cases during the year. [Footnote: Including pleas of guilty or nolo contendere. Two of these cases are still pending as to other defendants.]

In the criminal appeals decided during the past year judgments of conviction were affirmed as to 14 defendants. [Footnote: These appeals involved a total of four cases.] One appeal was voluntarily withdrawn. There were no reversals of convictions. The status of all criminal cases pending during the past fiscal year is set forth in Appendix Tables 24 and 25. Some of the cases prosecuted during the past fiscal year are described below.

The types of fraud cases encountered during the past year are extremely varied. These include fraud in the promotion of new businesses and inventions, unlawful practices on the part of corporate officers, various frauds by broker-dealers, fraudulent whiskey warehouse receipts promotions, failure to keep books and records as prescribed by the statutes; and the filing of false financial statements and annual reports with the Commission.

Charges of fraud and unlawful conduct on the part of broker-dealers figured prominently in the cases prosecuted during the year. Among such cases was *U.S. v. W. R. Hempstead and Co., et al.* (D. R. I.) where it was charged, *inter alia*, that the company and three of its officers solicited and accepted customers' orders for the purchase and sale of securities and deposits of money and securities without disclosing that the company was insolvent. The indictment also charged that the defendants hypothecated the said securities and converted the proceeds to their own use and benefit. [Footnote: All defendants therein were convicted.] A somewhat similar case was developed by the Commission in *U.S. v. Edwin Paul Woodman, et al.* (D. Mass.) resulting in a guilty plea by the two defendants involved at the conclusion of the trial. *U.S. v. Maxwell and Co., Inc., et al.* (D. Mass.) involved the unauthorized pledging of customers' securities, the forgery of customers' checks, the forgery of signatures to assignments of customers' securities, and the printing and sale of spurious stock certificates and debentures. [Footnote: One defendant pleaded guilty, the remaining two defendants were found guilty after trial.]

In *U.S. v. Charles J. Callahan* (D. Mass.) conviction was obtained for the conversion of customers' securities, the filing of false reports with the Commission, and the failure to keep books and records as required by Section 17(a) of the Securities Exchange Act of 1933 and the rules thereunder prescribed by the Commission as necessary and appropriate for the protection of investors. *U.S. v. Glen J. Hildebrand* (S. D. Ill.) also involved the failure by a broker-dealer to keep books and records as required by the Commission's rules, and resulted in a plea of guilty. Another broker-dealer case pending during the year was *U.S. v. Florida Bond and Share, Inc., et al.* (S. D. Fla.). The indictment in that case charged fraud predicated upon the sale of securities to uninformed customers at prices not reasonably related to the prevailing market prices, without appropriate disclosure. After the close of the fiscal year, on July 11, 1946, convictions were obtained against four of the five defendants named in the indictment. [Footnote: This marks the third successful prosecution based on this type of fraud. Others were *U.S. v. Otto B. Dagg, et al.* (W. D. Wash. 1943), and *U.S. v. Guaranty Underwriters Inc., et al.* (S.D. Fla. 1944)]

In *U.S. v. Arthur Edwin Daye* (S.D. Fla.) conviction was obtained on a charge that defendant, representing himself to be a broker-dealer in securities, obtained securities from customers for the purpose of sale, thereafter selling the same and converting the proceeds. [Footnote: The indictment charged violation of the mail fraud statute (215 Federal Criminal Code). Defendant pleaded nolo contendere, and was sentenced to three years imprisonment.] A somewhat similar fraud was charged in *U.S. v. Arthur Briscoe Wilson* (N. D. Ill.) where a securities salesman converted to his own use the proceeds of the sale of customers' securities, the possession of which he had obtained through false representations. [Footnote: Defendant pleaded guilty]

A substantial number of the cases pending during the past fiscal year involved charges of fraud in connection with the sale of interests in oil properties. These were *U.S. v. Frank V. Raymond* (D. Md.) [Footnote: Defendant pleaded guilty]; *U.S. v. C. Milton Smith* (S. D. N. Y.) [Footnote: Smith was sentenced to 6 months and placed on probation for 2 years upon expiration of sentence. Indictment *nolle prossed* as to other defendants.] *U.S. v. Norman Benson, et al.* (W. D. Wis.) [Footnote: Benson was sentenced to 3 years imprisonment]; *U.S. v. Herman L. Schuh, et al.* (E. D. Va.); *U.S. v. Thomas P. Mulvaney, et al.* (S. D. Iowa) and *U.S. v. Stanley et al.* (S. D. N. Y.). [Footnote: All cases still pending]

In the Raymond case defendant was charged with employing the "Ponzi" type of swindle, paying the purchasers of interests in oil lands purported "returns" on their investments without disclosing that such funds were not derived from the operation of the properties but in fact were a portion of the monies which the investors had paid to the defendant.

A fraudulent "switch" scheme was alleged in *U.S. v. Mark A. Freeman, et al.* (N. Div. E. D. Ill.) which involved transactions in whiskey warehouse receipts. The

indictment charged that the owners of whiskey warehouse receipts were induced to exchange them for bottling contracts with a corporation which defendants had organized. It was charged that defendants had represented that the whiskey could be bottled, rectified and sold for the investors, for which the corporation would receive only a small fee, whereas in fact the defendants sold or hypothecated the warehouse receipts and converted the proceeds to their own use. [Footnote: Defendant Freeman found guilty after trial and sentenced to 5 years appeal pending. Jury disagreed as to five other defendants who later withdrew their pleas of not guilty and pleaded nolo contendere. One defendant found not guilty on nolo contendere plea. Verdict of not guilty directed as to one other defendant.] *U.S. v. Frank L. Ryan, et al.* (E. D. N.C.) also involved fraud in whiskey warehouse receipt transactions. [Footnote: Four defendants convicted] An indictment charging violations of Section 10(b) of the Securities Exchange Act of 1934 and Rule X-10B-5 thereunder, as well as the mail fraud statute (Section 215 of the Federal Criminal Code) was returned during the past year in *U.S. v. Edgar M. Griswold* (N. D. Ohio). It was charged that Griswold had defrauded various persons, principally tavern owners, in transactions relating to the stock of a prominent distilling company. Whiskey purchase rights were attached to the stock. Griswold, it was alleged, represented to purchasers that the stock would be worthless after the whiskey rights were exercised and that it could not be retained by the purchasers after such exercise. According to the indictment, Griswold, by virtue of these false representations and his failure to disclose that the stock had a market value of not less than \$24 a share after exercise of the whiskey rights, was enabled to obtain the stock for his own use and in fraud of the original purchasers thereof. The case is now pending.

A "front money" scheme in which persons desirous of obtaining capital for the financing of new businesses were defrauded was involved in *U.S. v. Ocie C. Walker* (N. D. Texas). It was charged that Walker devised a scheme to defraud persons who could be induced by false representations to turn money over to him upon his promise to arrange for the organization of corporations and to assist such persons in the sale of the stock of such corporations when organized. Defendant was convicted on his plea of nolo contendere.

A conviction for fraudulent misrepresentations in connection with the promotion of a new business was obtained in *U.S. v. Federal Fyr-Ex, et al.* (S. D. N. Y.). [Footnote: One defendant pleaded guilty and was sentenced to a term of 4 years imprisonment. Two other defendants were acquitted.] Also, during the past fiscal year a conviction was obtained in *U.S. v. Liggett and Myers Tobacco Co., et al.* (E.D. Pa.) for the making of false and misleading statements in reports required to be filed under the Securities Exchange Act of 1934. The indictment charged willful concealment in annual reports filed under Section 13 of facts relating to the existence of a profit-sharing plan for certain officers and employees of the company other than the president and vice presidents. The corporation was fined \$10,000 upon its plea of nolo contendere.

Fraud by officers in connection with the management of a corporation was involved in the indictment returned in *U.S. v. Alfred Epstein, et al.* (E. D. Mich.), which case is now pending. [Footnote: The indictment charged violation of Section 215 of the Federal Criminal Code (Mail Fraud Statute)]

In a number of cases Canadian mining company stocks were sold to residents of the United States by persons residing in Canada who operate from across the border without compliance with the statutes of this country. The Commission has been cooperating with the State Department and the Department of Justice in efforts to secure a treaty with Canada which would permit extradition of persons violating the Federal and State securities laws. The treaty was ratified in the United States Senate in April 1942, but to date it has not been ratified by the Canadian Parliament. Numerous cases of this type have been the subject of investigation by the staff of the Commission. Indictments have been obtained in a number of these cases. The criminal appeals decided during the past fiscal year were: *U.S. v. Hugh J. Carruthers*, 152 F. (2d) 512 (C. C. A. 7, 1945), cert. denied, 66 S. Ct. 805 (1946), in which judgment of conviction on charges of fraudulent sales of securities of an alleged fraternal and educational association was sustained; *Frank Mansfield, et al v. U. S.*, 155 F. (2d) 952 (C. C. A. 5, 1946), where the court sustained the convictions of 11 defendants for fraud in the sale of interests in oil properties; *U.S. v. George A. Earnhardt, et al.*, 153 F. (2d) 472 (C. C. A. 7, IL 1946), cert. denied, 66 S. Ct. 1350 (1946), in which conviction on a similar charge was sustained; and *Leslie G. Bowen v. U.S.*, 153 F. (2d) 747 (C. C. A. 8, 1946), cert. denied, 66 S. Ct. 980 (1946), sustaining a conviction for fraud in the sale of securities in a new small manufacturing enterprise.

COMPLAINTS AND INVESTIGATIONS

The Commission received during the year 7,669 items of mail concerned with alleged securities violations. This correspondence is classified administratively as "complaint enforcement" correspondence. This material constitutes one of the Commission's important sources of information concerning possible securities violations, while investigations made by the Commission's staff and contacts maintained with other governmental (Federal, State, and local) or private agencies provide additional sources of such information. Where it appears on the basis of any such data that any securities violation may have occurred, the Commission conducts appropriate investigations by means of correspondence or the assignment of cases to field investigators to ascertain the facts of the particular case. The extent of these investigatory activities of the Commission during the past years under the Securities Act of 1933, the Securities Exchange Act of 1934, Sections 12(e) and (h) of the Public Utility Holding Company Act of 1935, the Investment Company Act of 1940, and the Investment Advisers Act of 1940, is reflected in the following table:

(chart omitted)

To assist its continuing enforcement and registration activities, and to provide a further means of preventing fraud in the purchase and sale of securities, the Commission has established a securities violations file, consisting of a clearing house of information concerning persons who have been charged with violations of various Federal and State securities statutes. This clearing house has been kept up-to-date during the past year, as in previous years, through the cooperation of the United States Post Office Department, the Federal Bureau of Investigation, parole and probation officials, State securities commissions, Federal and State prosecuting attorneys, police officials and other public agencies, members of the National Association of Better Business Bureaus, Inc., and members of the United States Chamber of Commerce. By the end of the past fiscal year the Commission had assembled in these files data concerning an aggregate of 46,924 persons against whom Federal or State action had been taken in connection with securities violations. During the past year alone additional items of information relating to 3,706 such persons were added to these files, including information concerning 1,146 persons not previously identified therein.

The extensive use made of this clearing house of information is suggested by the fact that during the past year the Commission received, in connection with its maintenance, 2,394 "securities violations" letters or reports (apart from those mentioned above which are classified as "complaint enforcement") and dispatched 2,915 communications in turn to cooperating agencies.

ACTIVITIES OF THE COMMISSION IN ACCOUNTING AND AUDITING

The preparation, filing and, in some cases, other publications of financial statements for the information of the investing public and of the Commission is a fundamental requirement under the Securities Act of 1933, the Securities Exchange Act of 1934, the Public Utility Holding Company Act of 1935, and the Investment Company Act of 1940. To ensure the adequacy and reliability of such statements the Commission is given, under each of these Acts, broad authority in matters of accounting -- including important functions with respect to the basis, form, and content of financial statements. In those areas where specific rules and regulations as to the methods of accounting to be followed are neither practicable nor desirable, guides are found in accounting principles which have been recognized as sound by professional accountants generally. In this area chief reliance for the protection of investors and the public therefore rests largely in the administrative determination of the applicable accounting and auditing principles and procedures properly to be followed in the preparation of financial statements.

This large segment of the Commission's accounting activities presupposes constant contact and cooperation between the Commission and representative professional bodies and, in those cases where the accounting issue is of considerable importance and has wide application, may result in the publication of Accounting Series Releases. It would be difficult to express in quantitative terms the extent of the Commission's treatment of accounting questions by these administrative means. However, a very large portion of the time of the accounting staff is spent in the discussion of such cases with registrants and their accounting and legal advisers. In addition, there is an overgrowing volume of inquiries as to propriety of particular accounting practices being made by accountants, and by companies not presently subject to any of the Acts administered by the Commission, who wish to ascertain the Commission's policy in such matters and thus utilize and apply the Commission's experience to the facts of their own case.

The organization of the accounting staff of the Commission is especially designed to facilitate informal consideration of accounting matters. The Chief Accountant acts as the Commission's chief adviser and consulting officer on accounting matters and has general supervision over the establishment and execution of Commission policy with respect to accounting and auditing principles or practices. He is assisted directly by an assistant chief accountant and, in addition, an assistant chief accountant is assigned to and directly responsible for the examination of financial data and other accounting work in the three operating divisions, namely, the Corporation Finance Division, the Trading and Exchange Division, and the Public Utilities Division.

The majority of accounting problems arises as a result of examination of financial statements received. Where the examination of the statements reveals that the rules and regulations of the Commission have not been complied with or that applicable accounting principles have not been followed, the examining division directs the attention of the registrant to the deficiencies by letter. These letters of comment and the correspondence or conferences that follow continue, as in the past, to be a most convenient and satisfactory method of effecting corrections and improvements in financial statements.

Reconversion to Peacetime Activities and New Registrants

The past fiscal year has seen the cessation of hostilities and the lifting of wartime censorship and secrecy restrictions as they affected the publication of financial information. The effect on financial reporting of the termination of war contracts and the reconversion of business to a peacetime basis was anticipated in the last annual report. That report discussed the adoption in July 1945 of a program of quarterly reporting of dollar amounts of sales and unfilled orders showing separately sales made pursuant to war contracts. At the same time immediate reports were required in the event of the termination of a war contract the uncompleted portion of which amounted to over 20 percent of the registrant's total sales for the previous fiscal year. This program was designed to keep

investors and the public abreast of vital changes in the volume of business during the period of transition from war production to peacetime operations. [Footnote: Securities Exchange Act Release No. 3718, July 23, 1945]

The end of the war early in this fiscal year and the termination of war contracts led to the rescission of this reporting program and to the adoption of a general program of quarterly reports of the volume of business being done by most issuers having securities registered on national securities exchanges. [Footnote: Securities Exchange Act Release No. 3803, March 28, 1946] Prior to adoption, preliminary drafts of the proposed new rule and report form were modified to reflect comments obtained from technical and professional associations, governmental agencies, national securities exchanges, individual companies, public accountants, attorneys, and many other interested persons.

Of particular interest is the adoption of the suggestion that if the registrant publishes or issues to its stockholders a quarterly report containing the information required by the new rule, such report may be substituted for information called for in the form prescribed. Initially insurance companies, investment companies, common carriers, and public utilities were exempted by the rule. Following discussions with representatives of the sugar industry at the close of the fiscal year the rule was amended to exempt companies primarily engaged in the production of raw cane sugar or other seasonal single-crop agricultural commodity since such producers ordinarily have no sales in two or more of their fiscal quarters. [Footnote: Announced in Securities Exchange Act Release No. 3832, July 12, 1946]

An important problem of the current year which was forecast in our last annual report involves the proper disposition of war reserves and the treatment of war costs, losses, and expenses recognized during the year. Throughout the year extensive consideration was given by corporation and public accountants as well as the Commission to the question of the extent to which current repairs and maintenance, strike expenses, inventory losses, loss on war facilities, and plant reconversion expenses might properly be charged back against war profits, thus relieving the current income account. In view of the wide diversity in opinion as to the proper treatment of such items, the problems were submitted for comment to a large and representative group of registrants, professional and technical associations, financial services, accountants, attorneys, and others concerned. A substantial majority concurred in the staff proposal to deal with the problem during this transition period by requiring a specific form of disclosure in the financial statements.

The rule adopted therefore required that where war items are excluded from the income account and carried directly to surplus or reserve accounts, the net aggregate amount so excluded is to be set forth following net income for the period. [Footnote: Accounting Series Release No. 54, March 30, 1946] The nature, amount, and treatment of such items, including the tax effect of the

treatment employed, is to be explained. In addition, appropriate disclosure is required of any substantial war items included in the income statement. Finally, a statement is required of the principle followed in classifying particular items as attributable to conditions arising out of the war or its termination.

A second major problem arising from war conditions was precipitated by the President's termination on September 29, 1945, of the period for the tax amortization of war facilities. For tax purposes, emergency war facilities acquired after December 31, 1939, under certificates of necessity could be amortized over a 60-month period or less if the President declared the emergency ended prior to the elapse of 60 months. The result has been that many companies have kept their books on this tax basis and as of September 30, 1945, wrote their emergency facilities down to zero. For assets not largely amortized this resulted in a substantial amortization charge in 1945, often for facilities having continuing usefulness for peacetime operations. If this procedure is followed in the preparation of general financial statements, one result is that subsequent balance sheets may be viewed as understated because of the omission of substantial and useful assets. At the same time postwar earnings will fail to include any charges for the use of these assets, and to that extent may be viewed as overstated. This problem is being actively debated in business and professional accounting circles and is the subject of continuing study and research on the part of the Commission. Another development has been an almost unprecedented flood of registration statements for the sale of securities to the public. Elsewhere in this report it is noted that over 750 registration statements were filed during the fiscal year. Many of these were for companies with previous registration experience taking advantage of current low interest and dividend rates to refinance their bond and preferred stock issues. Many companies, however, were seeking new capital for the first time since the enactment of the Securities Act of 1933 and in other cases security holders in closely held enterprises were seeking to sell part of their holdings to the public. Even in the first group experienced accounting executives and public accountants with extensive experience with financial statements filed with this Commission encountered unique and controversial accounting problems largely of a war or reconversion origin. Of the latter group many had never before been subject to the financial reporting standards of a stock exchange or of a securities commission; hence, both the companies and in many cases their independent public accountants had to face many new problems.

Mention has been made in previous reports of the extensive use of informal conferences and correspondence as a means of dealing with difficult accounting and auditing questions. These administrative procedures have long proved extremely effective as a means of arriving at solutions of novel or complex questions since they afford an opportunity not only to arrive at a mutual understanding of the facts but also to work out a solution properly protective of investors' interests and agreeable to all involved. In the case of new registrants these conferences have been particularly useful in advance of filing as a means

of obtaining compliance with sound accounting and disclosure principles, thus avoiding deficiencies and delay when the filing is made. Because of their importance to the efficient administration of the Securities Acts, it is appropriate to describe two typical informal procedures of this kind.

The first illustration is a case which involved the propriety of a company's method of apportioning against income the loss in useful value of its fixed assets. The company followed an inventory and retirement method. While agreeing that the method had long ago been discredited among industrial companies generally (among public utility companies in more recent years), this industrial company contended that the method was appropriate under the particular facts of its case. After the initial correspondence four conferences were held, at three of which the company's independent public accountants were present. The Commission, after careful examination of the facts and of the contentions presented in a written memorandum from the company adopted the staff recommendation that depreciation methods be required in lieu of the inventory-retirement method, because the latter in fact resulted in an improper determination of profits as between years and in an overstatement of balance sheet assets. In order to allow the company ample time in which to make the change-over, if the company was permitted to give effect to the revision in its statements of the following year.

A second illustration involved the treatment of a stock dividend. In the company's application, filed with the New York Stock Exchange and with the Commission, for the registration of the necessary shares, the company indicated that this dividend would be charged against earned surplus at a per-share amount, stated in the application, representing the fair value of the shares to be issued. Later, in an amended application, the amount per share of the charge against earned surplus for the dividend was changed to a lesser amount represented by the par value of the shares. The staff advised the company that applicable accounting principles required a charge against earned surplus in the amount of the fair value of the shares. However, in the company's annual report filed shortly thereafter the accounting treatment to which the staff had objected was followed. Moreover, the report of the independent public accountants accompanying the company's financial statements contained an explicit exception to the company's failure to account for the dividend at fair value rather than the lower par value figure. The company was again requested to change its accounting treatment of the transaction, but declined to do so. After reconsidering its position and reviewing the case in detail, the staff again advised the company that the annual report should be amended in accordance with its earlier recommendations and those of the independent accountants. Failing this, the staff indicated it would consider the report false and misleading and would accordingly recommend that appropriate formal action be taken by the Commission to determine whether the company had failed to comply with the provisions of the Securities Exchange Act and the rules and regulations thereunder. Following this interchange of views the statements were amended without resorting to formal action.

Developments in the Field of Accounting Principles and Procedures

Certain developments in the field of accounting principles and procedures arising out of war conditions and reconversion to peaceful pursuits have been mentioned in preceding paragraphs. An associated problem, the proper treatment of corporate income taxes, was of particular importance due to the existence of high wartime rates and numerous differences in accounting treatment of substantial items in determining taxable income and income for financial reporting purposes. Extended discussions of this subject of "tax reductions" or so called "tax savings" which were in progress at this time last year between the Commission and representatives of professional accounting societies and others were concluded and the Commission's opinion was published as Accounting Series Release No. 53. [Footnote: November 16, 1945.] This opinion "In the Matter of 'Charges in Lieu of Taxes'" contains an extensive discussion of the Commission's views as to the procedures to be followed in accounting for reductions in income taxes as a result of premiums and expenses incurred in refunding bonds, substantial loss sustained on the abandonment of properties; and the taking of accelerated amortization on emergency war facilities.

This opinion dealt with a practice which had been growing up for some time, a practice tolerated by some accountants and sincerely advocated by others, pursuant to which the current income account charged, under the heading of income taxes or charges in lieu of income taxes, not only with the actual amount of income taxes expected to be paid by the company but also with an additional sum equivalent to the reduction in taxes brought about by unusual circumstances in a particular year. This additional charge against income is, in most cases, offset either by a credit to surplus or by utilizing the reduction for some special purpose such as eliminating a portion of unamortized discount on bonds. The amount of the estimated reduction has been colloquially termed a "tax saving" and the general problem, loosely referred to as the "treatment of tax savings." The principal conclusions announced in the opinion were that:

1. The amount shown as provision for taxes should reflect only actual taxes believed to be payable under the applicable tax laws;
2. The use of the caption "charges or provisions in lieu of taxes" is not acceptable;
3. If it is determined in view of the tax effect now attributable to certain transactions, to accelerate the amortization of deferred charges or to write off losses by means of charges to the income account, the charge made should be so captioned as to indicate clearly the expenses or losses being written off.

During the year, efforts were continued looking to a solution of a perennial accounting issue-whether there are circumstances under which certain items of income, expense, or loss may justifiably be excluded from the computation of net

income as shown by the profit and loss statement and carried directly to earned surplus. Accountants have not yet agreed upon any general principles as to the proper way of identifying such items and disposing of them. Nevertheless, depending on the treatment of particular items of a nonrecurring or unusual nature as between income or surplus, it is possible to vary reported earnings within very wide limits, thus making intelligent analyses and comparisons difficult and sometime impossible. A staff study of charges amid credits made directly to earned surplus, supplementing and extending earlier studies, reconfirmed the complete lack of consistency in the treatment of surplus entries as between companies, between accountants, between the same company's reports for different years, and between reports certified by the same accountants. In addition, a round table discussion to consider the subject was sponsored by the Commission and was attended by representatives of accounting organizations and others interested in the problem. The results of these studies have been made available to members of professional accounting groups specially interested in the problem and a free exchange of ideas between the staff and these groups has been a feature of the past year. A summary of the results of the current year's study was published in "The New York Certified Public Accountant." [Footnote: William W. Werntz and Earle C. King, "An Analysis of Charges and Credits to Earned Surplus," September 1946] It is believed that definite progress has been made toward a more uniform treatment of these perplexing items. Consideration of proposals for a thorough revision of the accounting requirements applicable to management investment companies as laid down in Article 6 of Regulation S-X was advanced considerably during the year. A restatement of Article 6 incorporating many of the recommendations of the National Association of Investment Companies and of the American Institute of Accountants was published accompanied by a comprehensive discussion of the proposals and explanation of remaining points of difference between the Commission's staff and outside commentators. Announcement was made on May 22, 1946, that a public conference would be held by the Commission on July 9, 1946, to consider the revised proposals. [Footnote: Accounting Series Release No. 55, May 22, 1946] All interested persons were invited to attend or to file any comments desired. It may be noted that the procedure followed in the consideration of these important amendments to the Commission's accounting rules conformed substantially to that required by Section 4 of the Administrative Procedures Act which became law June 11, 1946, and, as to rule making, is effective September 11, 1946.

Other examples of the Commission's practice of discussing particular problems with specialists in various fields include a conference with representatives of the New York Society of Security Analysts on the subject of financial data secured by the Commission. Further, attention was given to financial reporting by mining corporations and a helpful conference was held with the American Institute of Accountants' subcommittee on mine accounting.

On June 20, 1946, the Commission announced that it had submitted to Congress a report recommending the extension of certain protective features of the Securities Exchange Act of 1934 to unregistered corporations having at least \$3,000,000 in assets and at least 300 security holders. [Footnote: "A Proposal to Safeguard investors in Unregistered Securities," announced in Securities Exchange Act Release No. 3828, June 20, 1946.] The report contains studies of stockholders reports of unregistered companies, the principal, if not the only, source of public information as to the financial affairs of such companies. The study disclosed that in practically every case the statements failed to disclose information that is of considerable significance to investors. Frequently, such companies failed to make public a full set of financial statements. In many cases, the available financial statements were deficient as to the form and content of the balance sheet and income statement and failed to make adequate disclosures in footnotes. In some instances, it appeared that improper or unsound accounting principles had been followed. The study showed that in 90 percent of the cases the statements were certified by public accountants.

An important conclusion of the Commission as expressed in the report was that whatever a certifying accountant's personal views may be about the necessity or desirability of disclosure, it was apparent in the cases studied that management policy was the factor which determined the nature of the annual report and that unless accountants can point to legal requirements as to the extent of disclosure they are often unable to insist on a position contrary to that of the management. The Commission further concluded that accountants need and should have the support of the Commission's accounting regulations. [Footnote: See the stock dividend illustration above.] It was noted that a similar finding with respect to the position of accountants in Great Britain was made by a committee of the Board of Trade investigating the need for amendments to the Companies Acts. [Footnote: Report of the Committee on Company Law Amendment, Board of Trade, Great Britain]

Several cases involving the use of inadequate or deliberately false financial statements with the effect of working a fraud on investors were considered by the Commission during the year. In the Matter of Suburban Electric Securities Co. is a sequel to the case reported in this section of last year's report. [Footnote: Securities Exchange Act Release No. 3822] That case reported an action taken to force the registrant to correct grossly inadequate financial statements. The current case dealt with a request for withdrawal of the registrant's securities from listing and registration. It seemed clear that the inadequate financial information furnished to stockholders prior to the intervention of this Commission assisted the management in a program of repurchase of the company's senior securities while the management retained its own holdings of all classes of securities. The terms imposed for withdrawal from listing and registration and for the continuance of the repurchase program included a vote by stockholders who had first to be furnished with company and consolidated balance sheets, itemized

surplus statements, and profit and loss statements conforming to generally accepted accounting principles, as of a time within the past 12 months.

In the case of *Albert M. Greenfield and Co.*, an unregistered company, public investors had been sold long-term debentures which after business reverses and interests defaults sold in the over-the-counter market at a considerable discount. [Litigation Releases No. 302, Nov. 7, 1945 and No. 333, Apr. 3, 1946] In the spring of 1945, after a substantial improvement in financial conditions due to the war, the company through an affiliate (a relationship unknown to the investors) purchased some of the debentures at much less than their book value. Investigation disclosed that the debenture holders were consistently denied information but were referred to the indenture trustee who in turn was repeatedly denied audited financial reports required under the trust in denture. The Commission's court action was withdrawn after the company agreed to have its books audited by a representative firm of accountants, to furnish copies of the auditors' reports to the trustee, and to furnish debenture holders audited reports in a form satisfactory to the Commission. The company, also was required to offer to rescind all debenture repurchase transactions since the initiation of the program in March 1945.

Two cases in which broker-dealer registrations were revoked included elements similar to the cases just presented. In one of the cases material misrepresentations with respect to a company's financial condition assisted in inducing stockholders to sell their holdings to agents of officers of the company. [Footnote: Securities Exchange Act Release No. 3716] In this case the officers knew that the business was in a better condition than represented. In the other case, the company publicly offered and sold its preferred stock without disclosure that statements and figures in the prospectus used in, connection with the sale were based on false, fictitious, and misleading bookkeeping entries and on assets of doubtful value. [Footnote: Securities Exchange Act Release No. 3772]

Developments in the Field of Auditing Practices and Professional Conduct

Last year we reported on a case in which a certified public accountant failed to perform a satisfactory audit of the books of a securities broker-dealer. This field of auditing and reports of public accountants required by our Rule X-17A-5 has caused us some concern during the past year. The two cases mentioned in the preceding paragraph contained evidence of unsatisfactory work by public accountants. Examination of reports filed during the year and correspondence conducted in connection with some of the reports also indicate that many broker-dealer audits are performed by accountants unfamiliar with the Commission's requirements and apparently not well-versed in the general requirements of up-to-date auditing procedure as set forth in publications of the American Institute of Accountants and elsewhere. A thorough discussion of the problem was had with representatives of the American Institute of Accountants following which plans were made to undertake a program of education in an effort to improve the work

done in this special field. A general editorial calling attention to the problem in very strong terms was published in the Journal of Accountancy in June, 1946. [Footnote: "A Warning to Auditors," June 1946, p. 447]

In another field of business a case was considered by the Commission in which it was found that the auditor was not independent and the audits made were not in accordance with generally accepted auditing standards applicable in the circumstances. [Footnote: *Red Bank Oil Co.*, Securities Exchange Act Release No. 3770] The record in the case revealed that the accounting firm in question had certified the financial statements of the registrant over a 5-year period. In one of those years, the accountant engaged the treasurer and bookkeeper of the registrant to do the detailed auditing work including the preparation of working papers. In the other years, the detailed auditing work was done by a member of the accountants' staff who did not make that critical and objective examination which is the obligation of an independent accountant and in particular he failed to investigate adequately transactions between the registrant and its parent and affiliates and to disclose that substantial amounts of the receivables and payables were due from or to the parent and affiliates. In four of the years no adequate review of the auditing work was made either by the head of the certifying firm or by a certified public accountant who was engaged to review the working papers and to sign the report. It was also found that the business relations of the head of the accounting firm and the president of the registrant were so intimate as to preclude any independent approach to the audit.

STATISTICS AND SPECIAL STUDIES

Capital Markets

The Commission, during the fiscal year ended June 30, 1946, continued to compile and analyze statistics on the volume and characteristics of offerings and retirements of securities; the distribution of and the changes in ownership of securities among different groups of institutional, corporate, and individual holders; and various other aspects of capital markets statistics. Figures were released monthly showing the volume of all new issues of securities known to have been offered within the United States for cash sales in amounts of more than \$100,000, together with break-downs comparing the amounts of registered and unregistered issues, indicating the type of exemption; public offerings and private placements; bonds, preferred stocks, and common stocks; corporate and non-corporate issues; and the net proceeds intended for refunding and for expansion of plant and equipment and working capital of each principal industrial group. Additional break-downs of the dollar volume of securities registered under the Securities Act of 1933 were released regularly showing the amounts registered for exchange, conversion, etc., as well as for cash sale; the volume of secondary as well as primary distributions; the amounts offered through investment bankers and directly by the issuers; the volumes expected to be

absorbed primarily by the general public, by security holders, and by other special groups; and the distribution by investment banking firms of underwriting commitments and syndicate management activities. Some of these statistics have been summarized in Tables I through 4 of the Appendix to this report.

In addition to information published on the capital markets, many special adaptations of the basic data were made to problems met in the day-to-day operations of the Commission and to questions raised by other governmental agencies and by members of Congress. During the year a detailed study was made and a report prepared for internal purposes on new issues \$100,000 to \$300,000 in size exempted from registration under the Securities Act as a result of the amendment to Regulation A effective May 21, 1945. At the close of the fiscal year, several reports were in preparation including an analysis of the extent and significance of underwriters' speculative compensations (options, etc.), long-term bank loans as a substitute for public offerings, and private placements. Other studies planned for the next fiscal year are a comprehensive analysis of the cost of flotation of securities, an intensive study of the expenses involved in registration under the Securities Act, an investigation of the success of flotations of registered issues, a study of offerings to stockholders and by stockholders, including bail-outs, an analysis of the comparative experience of investors in registered and non-registered issues, and a study of the characteristics of investors in new securities.

Saving Study

The Commission continued its series of quarterly releases on the volume and composition of saving by individuals in the United States. These releases show the aggregate volume of individuals' saving, that is, the increase in their assets less the increase in their liabilities, exclusive of gains or losses from revaluation of assets. The figures also show the components contributing to this total, such as changes in securities, cash, insurance, consumers' indebtedness, and consumers' durable goods.

Financial Position of Corporations

The series of quarterly releases on the working capital position of all United States corporations, exclusive of banks and insurance companies, was continued. These releases show the principal components of current assets and current liabilities and an abbreviated analysis of the sources and uses of corporate funds. In addition semiannual supplementary tables were released showing a detailed break-down of current assets and liabilities for various industry and size groups of corporations registered with the Commission. It is intended in subsequent reports to present more detailed data on the sources and uses of corporate funds, including a few additional income account and balance sheet items, thus giving an up-to-date analysis of the financial condition of

corporations as well as a complete picture of the volume and composition of corporate saving.

In December 1945, the Commission, together with the Department of Commerce, inaugurated a series of quarterly releases on the plant and equipment expenditures by United States businesses other than agriculture. Shortly after the close of each quarter, these releases present industry totals on the actual capital expenditures of that quarter and anticipated expenditures for the next two quarters. It is intended in future reports to present additional data showing more detailed classifications of industry groups and a size-of-company break-down. These data provide a useful index of present and future activity in the capital goods industries and capital markets and a valuable barometer of business activity in general.

Survey of American Listed Corporations

During the past fiscal year, the Commission again released for public and Government use statistical data filed with the Commission by registrants under the Securities Exchange Act of 1934 and the Securities Act of 1933. These data are summarized in a series of reports known as the "Survey of American Listed Corporations" showing individual data for each company as well as industry totals for 1,546 registered companies. One of these series of reports, "Data on Profits and Operations, 1943-1944," was completed in the fiscal year. Principal items furnished in these reports on profits and operations are annual data on sales, costs and/or operating expenses; operating profits; net profit before and after income taxes; depreciation, depletion, etc.; maintenance and repairs; selling, general and administrative expenses; and return on net worth before and after taxes. Each of these companies' reports also shows data before and after renegotiations of all contracts, the amounts and effects of "carry-backs" of taxes and data on termination of contracts whenever reported. A summarization of data on profits and operations for the period 1936-1944, inclusive, was also publicly released. These data for registered corporations, both on an individual company and industry basis, are currently being carried through 1945.

Under Rule X-13A-6A, termination of war contracts and quarterly reports of registrants' total sales, war sales, and unfilled war orders at the beginning and at the end of each quarter were reported to the Commission. These data were made public weekly in a series of releases. Summarization of these data was also released showing complete industry totals for the second, third, and fourth quarters of the calendar year 1945. Under a new Rule, X-13A-6B, the majority of registrants with the Commission are required to furnish quarterly sales figures, and these data will be released each quarter as to both individual, companies and industry groups.

Investment Company Data

Data for closed-end and open-end management investment companies were compiled and released quarterly showing purchases and sales of their own stocks and bonds and changes in their portfolios and in their principal asset items.

Brokers and Dealers

During the past fiscal year, a study was made of the financial condition of 3,029 registered brokers and dealers reporting under Rule X-17A-5. The study showed their cash, aggregate indebtedness and net capital, customer's free credits, bank loans and firm securities, exempt and nonexempt, from which the ratios of the firms' cash to free credit balances, the firms' nonexempt securities to net capital and aggregate indebtedness to net capital are computed. This analysis was made for Commission use. A more detailed study of the resources and liabilities of these brokers and dealers is now in preparation for the current fiscal year.

Stock Market Statistics

The Commission continued to publish indexes of weekly closing prices of common stocks on the New York Stock Exchange; the monthly market value and volume of sales on registered and exempted securities exchanges; daily and weekly round-lot stock sales on the two New York Exchanges, including short sales, weekly round-lot stock transactions on the New York Stock Exchange for accounts of members and nonmembers, weekly round-lot and odd-lot transactions on the New York Curb Exchange for accounts of members and nonmembers, and daily odd-lot stock transactions on the New York Stock Exchange for odd-lot accounts of odd-lot dealers and specialists. A number of these series are presented in appendix tables.

Special Studies

The Commission's staff continued its studies on various aspects of trading in securities, including floor trading, margin trading, purchases and sales of domestic securities for foreign account, purchases and sales of security options, and general research on exchange rules and practices.

War Activities

As a continuation of the Commission's war activities, several members of the staff were loaned to various war agencies and committees for special economic investigations in Germany and Japan.

OPINION WRITING OFFICE -- FORMAL OPINIONS

The Opinion Writing office prepares drafts of the Commission's formal opinions in contested cases arising under the Securities Act of 1933, the Securities Exchange Act of 1934, the Public Utility Holding Company Act of 1935, the Trust Indenture Act of 1939, the investment Company Act of 1940, and the Investment Advisers Act of 1940. This office has also been assigned the additional functions of joint responsibility with the Solicitor's office in dealing with the problems raised by the Administrative Procedure Act and responsibility for the preparation of compilations of annotations of the various statutes administered by the Commission. It is contemplated that these annotations will include reference to all Commission opinions to significant court decisions and to other relevant material and will be prepared so that they may, when completed, be made available to the public. The work of this office is done by a group of attorneys under the direction of the Executive Assistant to the Commission who serves as Head of the office, an Assistant Head, and Supervising Attorneys.

While engaged in the preparation of opinions, the attorneys are completely isolated from persons actively participating in the proceedings. It is an invariable rule that the attorney assigned to prepare an opinion must not have had any connection with any previous phase of the case with respect to which the opinion is to be prepared. After hearings have been held, and after consultation with the Commission, an attorney in this office analyzes the entire record and prepares a draft of the formal opinion in accordance with the Commission's instructions. In most cases he also prepares a narrative abstract of the record. Commission experts are from time to time consulted on technical problems arising in the course of the preparation of the opinion, but these experts are never individuals who have participated in the preparation of the case or testified at the hearing. When the draft of the opinion and the abstract of the record have been completed, they are submitted to a supervising attorney, who reviews the entire case and, in conjunction with the drafting attorney, revises the draft. The revised draft is then submitted to the Assistant Head and the Executive Assistant to the Commission and, thereafter, to the Commission. After further discussion, the opinion may be modified, amended, or completely rewritten in accordance with the Commission's instructions.

In addition to the foregoing, the Opinion Writing office also assists the operating divisions in the preparation of opinions in uncontested cases and assists the office of the Solicitor in the preparation of appeals taken from formal decisions prepared by the Opinion Writing office.

The Commission, during the past year, issued over 200 formal opinions under the Securities Act of 1933, the Securities Exchange Act of 1934, the Public Utility Holding Company Act of 1935, the Trust Indenture Act of 1939, the Investment Company Act of 1940, and the Investment Advisers Act of 1940. Some of the more significant opinions are commented upon herein under the discussions of the various statutes administered by the Commission.

PUBLICATIONS

Public Releases

During the past fiscal year the releases issued by the Commission included 68 under the Securities Act of 1933; 220 under the Securities Exchange Act of 1934; 852 under Public Utility Holding Company Act of 1935; 125 under the Investment Company Act of 1940; and 3 under the Investment Advisers Act of 1940. In addition, three releases were issued concerning the Commission's activities in corporate reorganizations and one release was issued under the Trust Indenture Act of 1939.

The following is a partial classification by subject matter for the past fiscal year:

Findings, Opinions and orders: 280

Orders, excluding those with findings and opinions: 698

Reports on court actions: 68

Statistical data: 12

Survey series: 10

Accounting series: 3

Other Publications

Bound volume 12 of Decisions and Reports of the Commission (Sept. 1, 1942 to Mar. 31, 1943).

(Bound volumes 1 to 12 of Decisions and Reports of the Commission may be purchased from the Superintendent of Documents, U. S. Government Printing office, Washington, D. C., a price list of which will be furnished upon request.)

Tables of Decisions and Reports covering period Jan. 1, 1943 through Mar. 31, 1946.

Twelve monthly issues of the official Summary of Security Transactions and Holdings of officers, Directors and Principal Stockholders.

The 11th Annual Report of the Commission.

List of Securities Traded on Exchanges under the Securities Exchange Act of 1934, as of December 31, 1945, together with Supplements thereto.

Judicial Decisions, Volume II, Part 2.

Security Issues of Electric and Gas Utilities, 1935-45.

Financial Statistics for Electric and Gas Subsidiaries of Registered Public Utility Holding Companies.

Registered Public Utility Holding Company Systems.

Working Capital of 1,290 Registered Corporations, December 1939 to December 1944.

Working Capital of 1,228 Registered Corporations, December 1939 to June 1945.

Survey of American Listed Corporations, Balance Sheet Data, Parts 1, 2, and 3.
Survey of American Listed Corporations, Data on Profit and Operations, Parts 1, 2, 3, and 4.

A Proposal to Safeguard Investors in Unregistered Securities, recommending amendments to the Securities Exchange Act of 1934.

(A complete list of the Commission's publications, the Rules of Practice or the Guide to Forms will be sent upon request made to the office of the Commission in Philadelphia, Pennsylvania.)

INFORMATION AVAILABLE FOR PUBLIC INSPECTION

The Commission maintains public reference rooms at the central office in Philadelphia, Pennsylvania, and in its regional offices in New York City and Chicago, Illinois.

Copies of all public information on file with the Commission, contained in registration statements, applications, reports, declarations, and other public documents, are available for inspection in the public reference room at Philadelphia. During the past fiscal year 2,634 persons visited this public reference room seeking such information. In addition to providing facilities for personal inspection of registered public information, there were received in the public reference room thousands of letters and telephone calls from persons requesting registered information. (This does not include requests for copies of releases, forms, publications, etc.) Through the facilities provided for the sale of

copies of public registered information, 2,701 orders, involving a total of 209,478 pages, were filled.

In its New York Regional office, located at 120 Broadway, facilities are provided for the inspection of certain public information on file with the Commission. This includes copies of (1) applications for registrations of securities on all national securities exchanges, except the New York Stock Exchange and the New York Curb Exchange, together with 'copies of annual reports, supplemental reports and amendments thereto, and (2) annual reports filed pursuant to the provisions of Section 15(d) of the Securities Exchange Act of 1934, as amended, by issuers having securities registered under the Securities Act of 1933, as amended. During the past fiscal year 13,831 persons visited the New York public reference room, and more than 6,900 telephone calls were received from persons seeking registered public information, copies of forms, releases and other material.

In the Chicago regional office, located at 105 West Adams Street, copies of applications for registration of securities on the New York Stock Exchange and the New York Curb Exchange, together with copies of all annual reports, supplemental reports, and amendments thereto, are available for public inspection. During the fiscal year ended June 30, 1946, 3,533 members of the public visited this public reference room, and approximately 1,500 telephone calls were received from persons seeking registered public information, forms, releases, and other material of a public nature.

In addition to the material, which is available in the New York and Chicago public reference rooms, there are available in each of the Commission's regional offices copies of all prospectuses used in public offerings of securities effectively registered under the Securities Act of 1933, as amended. Duplicate copies of applications for registration of brokers or dealers transacting business on over-the-counter markets, together with supplemental statements thereto, filed under the Securities Exchange Act of 1934, and duplicate copies of applications for registration of investment advisers and supplemental statements thereto, filed under the Investment Advisers Act of 1940, are available for inspection in the regional office having jurisdiction over the zone in which the registrant's principal office is located. Also, inasmuch as letters of notification under Regulation A exempting small issues of securities from the registration requirements of the Securities Act of 1933, as amended, may be filed with the regional office of the Commission for the region in which the issuer's principal place of business is located, copies of such material are available for inspection at the particular regional office where filed.

In the Commission's San Francisco and Cleveland regional offices, in which are provided complete facilities for registration of securities and qualification of indentures, copies of registration statements and applications for qualifications of indentures filed at those offices are available for public inspection.

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

PUBLIC HEARINGS

The following statistics indicate the number of public hearings held by the Commission from July 1, 1915, to June 30, 1946:

Securities Act of 1933: 4

Securities Exchange Act of 1934: 39

Public Utility Holding Company Act of 1935: 131

Trust Indenture Act of 1939: 0

Investment Advisers Act of 1940: 1

Investment Company Act of 1940: 56

PERSONNEL

As of June 30, 1946, the personnel of the Commission consisted of 5 Commissioners and 1,176 employees (694 males, 487 females), 325 of whom were assigned to the field offices.

During the past fiscal year, 212 former employees who were separated from the military service under honorable conditions were restored to the staff of the Commission in an active duty status. During this period, the names of three former employees were dropped from the rolls of the Commission by reason of their death while in the military service.

FISCAL AFFAIRS

(charts omitted)

CONFIDENTIAL TREATMENT OF APPLICATIONS, REPORTS, OR DOCUMENTS

Under the Securities Act of 1933, the Securities Exchange Act of 1934, the Public Utility Holding Company Act of 1935, the Investment Company Act of

1940, and the Investment Advisers Act of 1940, confidential treatment may be granted, upon application by registrants, to information contained in reports, applications, or documents which they are required to file. Under the Securities Act of 1933 the Commission has adopted Rule 580, which provides that information as to material contracts, or portions thereof, will be held confidential by the Commission if it determines that disclosure would impair the value of the contracts and is not necessary for the protection of investors. The other four statutes referred to are, in general, without specific restriction in this respect and empower the Commission to hold confidential under certain conditions any information contained in any reports required to be filed under those statutes. Disclosure of information confidentially filed under the latter statutes is made only when the Commission determines that disclosure is in the public interest.

Although registrants may seek judicial review of decisions by the Commission adverse to them, no petitions for such judicial review were filed in any of these cases during the past fiscal year.

The following table indicates the number of applications received and acted upon during the past year, together with the number pending at its close:

(chart omitted)

COMPLIANCE WITH THE ADMINISTRATIVE PROCEDURE ACT

On June 11, 1946, Congress passed the Administrative Procedure Act (Public Law 404, 79th Cong., 2d sess., 60 Stat. 238), the stated purpose of which is "to improve the administration of justice by prescribing fair administrative procedure." This Act is applicable to most Federal administrative agencies, including this Commission. Among other things, it contains requirements respecting the publication of information; prescribes procedures to be followed in the adoption or revision of rules; specifies various procedural steps in the adjudication of cases, including the separation of prosecutory and investigatory functions from decisional functions in certain defined types of cases and the issuance of intermediate decisions by subordinate officers and final decisions by the agency; defines the status and powers of examiners and other hearing officers; and deals with the right and scope of judicial review. The Commission's existing organization and procedures in certain respects afford greater procedural safeguards to all interested persons than is required under the procedures specified in the Act, and the passage of the Act does not appear, therefore, to require any substantial change in the Commission's organization or any major modifications of the essential features of the Commission's present practice. The present procedure has been designed to afford a satisfactory solution of the particular procedural problems arising under those statutes. Descriptions of the Commission's organization and procedures have been made public, adequate

notice of and opportunity for the presentation of views on proposed rules and for participation in other Commission proceedings is provided, due publicity is given to all official acts of the Commission affecting members of the public, and advisory and interpretative services are rendered to persons to assist them in complying with the requirements of the statutes. In order to insure maximum impartiality in the preparation of the Commission's decisions, the Commission has maintained a separate Opinion Writing office, herein described, responsible directly to the Commission and functioning independently of any other divisions of the Commission's staff, to assist the Commission in preparing findings and opinions in contested cases and in other cases where a separation of the decisional function from the prosecutory function is desirable.

However, the Commission took several steps as a result of passage of the Act. Although some of these steps post-date the period covered by this report, we have deemed it important to comment on them herein. A study of the Act and its legislative history as they relate to existing Commission practice was undertaken and led to the drafting of revised Rules of Practice which were adopted by the Commission in time to become effective September 1, 1946, the date on which most of the provisions of the Act became effective. [Footnote: The Commission's revised Rules of Practice, effective Sept. 11, 1946, and applicable to proceedings instated after that date, were published in the Federal Registrar on Sept. 11, 1946. 11 Federal Registrar 177A-723.] It is expected that this study will continue and that later changes in the Commission's procedures may be made in the event further problems arise under the Act and in the light of any judicial interpretations which may be issued.

Section 3 of the Act requires publication in the Federal Register of certain information not heretofore published therein. In compliance with that requirement, the Commission prepared and published a detailed description of its central and field organization and of the methods by which persons may secure information, and make submittals and requests; [Footnote: This description was published in the Federal Registrar on Sept. 11, 1946. (11 Federal Registrar 177A-718.)] a description of informal and other procedures employed by the Commission and its staff; [Footnote: This description was published in the Federal Registrar on Sept. 11, 1946 (11 Federal Register 177A-729)] and a description of the various forms prescribed by the Commission under the several statutes it administers. [Footnote: This description was published in the Federal Registrar on Sept. 11, 1946 (11 Federal Register 177A-730)] Also prepared for publication is a compilation of interpretative opinions, issued under the several statutes administered by the Commission for the guidance of the public. [Footnote: This compilation was published in the Federal Register on Sept. 27, 1946 (11 Federal Register 10912 et seq.)] While it is not clear that publication in the Federal Register of interpretative opinions of this kind is required by the Act, the Commission considers such publication may be helpful to the public and that it falls within the spirit of the act. It is also contemplated that any future

interpretative releases of this nature will also be submitted for publication in the Federal Register.

THE COMMISSION'S STUDY OF UNREGULATED SECURITIES AND ITS RECOMMENDATIONS TO CONGRESS

On June 19, 1946, the Commission forwarded to Congress a recommendation for amending Section 12 of the Securities Exchange Act of 1934 so as to close certain gaps in the pattern of investor protection established by that Act and by other legislation administered by the Commission. The amendment proposed by the Commission would extend to investors in the larger unregistered corporations the same benefits as to financial information, informative proxy-soliciting materials, and protection against trading by corporate insiders as are now enjoyed by investors in the securities of registered corporations. Accompanying the proposed amendment was a 118-page report, based on a study made by the Commission, containing case histories and other illustrative material in support of the Commission's conclusion that abuses in unregulated securities are in some respects as great as anything the original Securities Exchange Act was designed to abolish. The Commission's proposed legislation was introduced by Representative Lea, chairman of the House Committee on Interstate and Foreign Commerce, as H. R. 7151, and was recommended by the President for earnest consideration by the Congress (House Doc. No. 682, 79th Cong.). The text of the Commission's report, "A Proposal to Safeguard Investors in Unregistered Securities," was printed as a House Document (House Doc. No. 682, 79th Cong.). However the bill was not submitted until the closing weeks of the session, and Congress adjourned without having taken any action on it.

Certain vital protections for investors are available respecting the publicly-held securities of many of the large corporations of the country either because they are listed on national securities exchanges or because the companies involved are subject to the Public Utility Holding Company Act of 1935 or the Investment Company Act of 1940. As to these securities there are available much basic data about the companies involved and issuers must file periodic reports with the Commission as to their financial condition, and earnings. These reports are public information; they provide the investor with the basis for a rational appraisal of the value of securities and for an intelligent decision as to whether to buy or sell. Without such information, securities trading tends to be a gamble, and the investor is at the mercy of insiders exploiting inside sources of information. As the House Interstate Commerce Committee stated in 1934, "There cannot be honest markets without honest publicity. Manipulation and dishonest practices of the market place thrive upon mystery and secrecy." [Footnote: H. Rep. No. 1383, 73rd Cong., 2nd Sess. (1934) 11] Under the Securities Exchange Act of 1934, the Public Utility Holding Company Act of 1935, and the Investment Company Act of 1940 the security holder is assured also that when his proxy is solicited he will be fully informed about the matters to be raised at the stockholders' meeting,

and that he will be able to present his own proposals through use of the proxy machinery. In addition, there are certain protections against trading abuses by corporate insiders. Officers, directors and principal stockholders may not sell, short the securities of their own company, must file public reports of their trading in such securities, and are accountable to the company for profits made in trading in the securities of the company within any 6 month period.

These provisions are contained in Sections 12, 13, 14, and 16 of the Securities Exchange Act, and in cognate provisions of the Holding Company Act and the Investment Company Act. They are not applicable in any degree to unregistered securities, with the result that, as revealed in special studies conducted by the Commission and discussed in its report, many of the old evils still persist.

The Commission found, for example, in a sample group of the larger type of unregistered company, that 50 percent of the balance sheets released to the public were materially deficient from the viewpoint of the information needs of the investor. Some 13 percent of the companies did not even issue income statements. Yet all these companies had substantial numbers of public stockholders. The proxy-soliciting practices of unregistered companies were found typical of the pre-1934 era. Photocopy reproductions in the Commission's report show solicitations unaccompanied by disclosure even of the names of the persons whom the proxy agents intended to elect as directors, blank check authorizations to the proxy agents to ratify anything done in the past and to vote for anything which conceivably could come up at the meeting. In some cases the entire announcement to the stockholder was set forth on the back of an ordinary post card.

To illustrate the practical effect upon the investor of such practices, the Commission presented in summary form sixteen case histories showing how in instance after instance unscrupulous promoters or insiders have exploited investor ignorance to rifle corporate treasuries and to buy and sell securities on the basis of information obtained in the course of their fiduciary duties at rates highly advantageous to themselves. A pattern typical of the war and postwar periods consists of (1) extraordinary earnings by the company, (2) failure to disclose such earnings to public security holders, and (3) purchase of the holdings of the public investor by corporate insiders, sometimes upon the open market without disclosure of the identity of the purchaser. Most such cases, the Commission observed, have involved unregistered securities. And while cases of this character are within the scope of the antifraud provisions of the securities legislation administered by the Commission, comparatively few can be reached in this manner. As the Commission noted in its report, prevention of such frauds through appropriate legislative safeguards is needed.

Many of the larger corporations, or their securities, are already registered under one or another of the statutes administered by the Commission. However, a substantial number of large corporations and important issues of securities are

not. Nor does this appear to be the result of any express design on the part of Congress. The original Securities Exchange Act was intended to provide safeguards for investors in unregistered securities similar to those enjoyed by investors in registered securities under Sections 12, 13, 14, and 16 of the Act. For reasons stated in our report, the achievement of this objective was not feasible in the early days of the Act, and a modification of the statute was effected to conform to existing conditions. However, Congress never abandoned its program of providing safeguards for investors in unregistered securities, and in a series of enactments since 1934 has taken concrete steps in that direction. Thus a 1936 amendment to the Securities Exchange Act extended the reporting requirements of that act to all new securities issues of substantial size, whether or not the securities involved were listed on exchanges. The Public Utility Holding Company Act of 1935 and the Investment Company Act of 1940 contained provisions substantially similar to the reporting, proxy-soliciting, and insider-trading features of Sections 12, 13, 14, and 16 of the Securities Exchange Act. The Trust Indenture Act of 1939 marked a further extension of reporting requirements. And public reports in some measure similar to those filed with the Commission are required under other statutes of companies subject to the jurisdiction of such agencies as the Interstate Commerce Commission the Federal Power Commission and the Federal Communications Commission.

The piece-meal development of the protective scheme has left a series of gaps, and the Commission's report stated that these gaps should now be filled, at least as to the larger corporations. The amendment recommended by the Commission to Congress would make the provisions of Sections 12, 13, 14, and 16 of the Securities Exchange Act of 1934 applicable to the securities of all corporations having assets of at least \$3,000,000 and at least 300 security holders. Exemptions would be available for banks, for mutual insurance companies, for public and charitable corporations, for corporations substantially all the securities of which are held within a single State, and for certain other categories. According to the Commission's estimates, some 1,500 companies which are not already registered would be subject to the proposed amendment, and some 500 of these are already filing reports with other public agencies which are comparable in their basic aspects to those required by the Commission. The rule-making powers of the Commission would be ample to prevent needless duplication of effort.

In its report the Commission discussed also the nature of the burdens that the amendment would place upon the companies affected. It observed that little or no administrative effort is required for compliance with the proxy and insider-trading provisions. As to the reporting provisions, companies which do not file reports with the Commission and which do not file comparable reports with other agencies could in most instances meet the reporting requirements without assuming any significant accounting burdens. The studies of sample companies conducted by the Commission and discussed in its report reveal, for example, that some 85 percent of the companies in the class which would be covered by

the proposed legislation already have their financial statements certified by public accountants. The information that would be required is already on the books of most of these companies, and the only question is whether it shall be made available to their security holders and to the investing public.

The Commission noted that one beneficial effect of its proposed program on the over-the-counter market would be that dealers in the over-the-counter market, like the investor, would have the tools with which to select securities on a truly informed basis. Dealers might also expect to benefit to the extent that uniform reporting requirements would tend to decrease such private placements as may be motivated by a desire to avoid the disclosure provisions applicable to public offerings under the Securities Act of 1933.

VOLUME OF INFORMAL INTERPRETATIVE ASSISTANCE

Attention is called throughout this report to the amount of informal interpretative and advisory assistance which the Commission furnishes to the public in connection with the various Acts administered by the Commission. This assistance is generally furnished by the staff directly concerned with the problem presented or charged with the responsibility for examining material filed with the Commission. The office of Chief Counsel of the Corporation Finance Division, however, maintains an interpretative unit staffed with lawyers who are available for aid as to the many problems which arise under the various acts administered by the Commission.

As further illustrating the very considerable volume of such assistance necessarily rendered by the staff to registrants and other interested parties concerned with the day-to-day regulatory work performed by the Commission, it may be noted that during the past year the interpretative unit established in the office of Chief Counsel of the Corporation Finance Division alone received and gave appropriate assistance in response to a total of 4,547 letters requesting such aid with regard to a great variety of the functions assigned to the jurisdiction of that particular division. In addition, assistance was given in many hundreds of conferences held by the lawyers of this unit with members of the public, either in person or over the telephone.

INTERNATIONAL FINANCIAL AND ECONOMIC MATTERS

At the request of other agencies concerned with foreign economic policy, the Commission has participated in various activities connected with the field of international finance, both as to the problems directly involved in such matters and as to domestic affairs which reflect themselves in foreign economic policy. To this end the Commission had, during the war years, loaned members of its

staff to other agencies and to the Army for specific assignments in foreign countries, the last of which was the recent survey of the Japanese Zaibatsu.

Further, the Commission has appointed representatives to various committees engaged in formulating and executing United States international economic policy. Among these are the Foreign Investment Policy Committee and the Committee on Private Monopolies and Cartels (which are both subcommittees of the Executive Committee on Economic Foreign Policy) and the Staff Committee and other committees of the National Advisory Council on International Monetary and Financial Problems. The Commission also appoints two representatives to the Federal Committee on International Statistics.

In the course of its operations, the Commission maintains a survey of various aspects of these markets and makes this information available to such other agencies, either through its representatives on the committees mentioned above or through its adviser on foreign investments. Further, the Commission makes or participates in special studies to aid other agencies concerned with foreign economic and financial problems, it has done so with respect to the debt status of foreign countries applying for credit; the appraisal of the credit status of foreign countries in the private capital market; the external interest rates of foreign borrowers and their effect on private investors; and a study of foreign laws with respect to securities and investments.

Indicative of the Commission activities is the present participation of the Commission in connection with the rendition of assistance and advice to the United States Executive Directors of the International Bank for Reconstruction and Development with respect to the effect of domestic laws and domestic markets on the flotation of its bonds and the bonds of foreign countries guaranteed by the bank. With respect to registration statements filed by foreign, corporations and governments seeking capital in the domestic market, the Commission maintains, through its adviser on foreign investments, facilities for liaison with other government agencies having jurisdiction of the problems involved, and for rendering of such aid and advice as it might be called on to give.