THE CANADIAN PROBLEM

ILLEGAL SECURITIES OFFERINGS

1933 – 1955

Confidential Staff Report
March 30, 1955

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To : The Commission

From : A. H. Lund

Subject: Confidential report on the "Canadian Problem"

The report undertakes a rather complete review of illegal and fraudulent offerings from Canada and our efforts during the past 21 years to combat such offerings. While the record gives little basis for optimism there is also little basis for pessimism when it is borne in mind that fraud and chicanery in securities dealings have been recorded for more than 2,400 years. When the overall progress of the S.E.C. during this short span of 21 years in combating frauds is measured against time we find a basis for encouragement.

The report briefly alludes to certain types of frauds in securities dealings [_____] and the ineffective efforts prior to 1933 of the states the provinces and others to stop them; relates to the duties placed upon the S.E.C. in the fraud area and its early day clean-up efforts; develops chronologically through the regimes of 6 different Ontario Securities Administrators the abortive efforts of the Federal Trade Commission (initially) and then the S.E.C. to combat these Canadian frauds; outlines our efforts and the problems encountered in making investigations here and in Canada; in obtaining extradition treaty revisions; in getting injunctions, secret indictments and open indictments; in constituting ourselves as a clearing house for interchange of information with 700 other groups tracking the activities of securities violators; in fomenting

publicity; in getting postal fraud orders and fictitious name orders; in developing a "warning" letter technique; in inspiring the so called "black list;" in establishing liaison with provincial administrators; in allowing investment companies to register; in providing an exemption for small issues (Regulation D); in attempts to close the telephones to the violators; and in warnings to the public. The report also describes many other enforcement efforts.

The report is sprinkled throughout with registration and other statistics and deals rather extensively with the background differences, objectives and views north of the Border and the criticism of our efforts expressed there.

The report and the exhibits thereto lay out chronologically the injunctive, administrative or civil actions taken by the states and the provinces and shows the number of docketed S.E.C. cases and actions by the S.E.C., except for secret indictment data. The report develops in considerable detail, with supporting exhibits, the negotiations leading up to the adoption of the Regulation D exemption and the basis for the misunderstanding with Mr. Lennox.

The last four chapters of the report attempt to summarize our enforcement efforts to date (Chapter X); describe our failures . . . but indicate what we have learned (Chapter XI); show the problems we face at the present time (Chapter XII); and suggest a continuation of all past efforts plus efforts to obtain new legislation and other steps (Chapter XIII).

The source material, essential to a background setting for the problem we face today, was collected from various branches within the Commission, from the New York Regional Office and from our library. The various persons assigned the task of searching

their files and producing statistics have brought forth adequate material to provide a fairly complete report. We found each branch overloaded with work and too short-handed to assign personnel, so we used their people as little as possible. To the extent that this procedure did not hold up regular work it had advantages. Conversely however, the disadvantages are apparent in that the format of the report and the conclusions do not necessarily reflect the views of the branches. This report has not been discussed with them or anyone else.

The report and the exhibits have been reproduced (25 copies) as cheaply as possible but no effort has been made to reproduce the voluminous source material constituting appendix 1 (Reports by Kroll and others on Canadian problems and legal memoranda respecting the treaty revisions) and appendix 2 (excerpts from provincial and Dominion statutes relative to securities frauds, registration or other requirements).

We have attempted to follow the course set out in the Commission's November 30, 1954 minute directing this study and have only knowingly departed in one instance. We have not specifically discussed the November 18, 1954 report from the American Consul in Toronto. The report is marked "limited use" and most items of importance in it were available to us from other sources and were adequately covered in the report.

We suggest that the whole Canadian problem be given as much priority as possible and that the views of the staff, industry representatives and other interested parties be obtained in an effort to reach a workable solution. In order to avert a return to conditions existing in the past it is suggested that meetings with Mr. Lennox be scheduled as soon as appropriate. Mr. Lennox has indicated that he thinks the problem ". . . is still capable of solution." In the public interest it must be solved.

While at first glance the report appears too verbose, it should be noted that the period 1933-1948 covers less than 60 double spaced pages. Considerable detail was deemed essential to a full understanding of the misunderstandings with Mr. Lennox and this aspect has been dealt with fully.

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THE CANADIAN PROBLEM

Introduction-

The money which developed American industry and commerce came largely from the sale of securities by or on behalf of the promoters and pioneering corporations responsible for such developments. On occasion people were urged to buy securities in corporations which outwardly also appeared to be honestly managed only to learn later that the representations made at the time of sale were untrue and that frauds had taken place. Unscrupulous securities promoters and enterprises were often indistinguishable from the honest promoter and enterprise and certain of the states about 45 years ago began to develop forms of securities legislation to protect their citizens. The Canadian provinces followed closely in enacting similar protective legislation.

While the states and provinces sought the same goal, each shaped its securities legislation to meet its own individual needs and problems. Some required that the securities to be offered be qualified or registered; some required registration of the brokers or dealers handling such securities; some required both steps; and still others had no registration requirements at all but created statutes of the anti-fraud variety. These legislative steps generally were effective when a violator could be apprehended within the borders of the offended state or province. However, none of the securities laws extended jurisdiction into other states or provinces so a violator sending offerings or securities into a state or province from another jurisdiction generally could not be reached. There have been a few instances where the Federal mail fraud statutes gave

jurisdiction but absent this the violator was “safe” as extradition from one jurisdiction to another for securities violations was deemed impossible.

The various stock exchanges and securities groups were also taking steps, during this period, toward the elimination of fraudulent and unethical conduct. Their self-imposed standards of conduct while applicable to members in any jurisdiction were not applicable to non-members so that while many improvements were achieved only a portion of the securities industry was covered.

Efforts to obtain Federal legislation to protect the buyers of securities irrespective of the limited jurisdiction of the states had been unsuccessful as early as 1902. The Federal legislation was urged to afford jurisdiction over the violator when he sold in interstate commerce. Much similar securities legislation was introduced in Congress over the years but it was not until 1933 that the first Federal securities act was passed. The public demanded this legislation as a protection against the type of securities abuses prevalent in the 1920’s. The senate hearings produced evidence of many abuses in our securities markets and led to the passage of both the Securities Act of 1933 and the Securities Exchange Act of 1934. One type of abuse occuring during the 1920’s was given less prominence in the hearings and headlines but remnants of it still exist and in large measure account for our present day “Canadian problem”.

In the 1920’s and early 1930’s, small groups of stock racketeers operated both in the states and the provinces selling promotional securities by mail and telephone from temporary offices or “boiler rooms”. These offices were open for the period of the high pressure distribution, perhaps six months or less. The ringleaders of these groups, after a few encounters with enforcement officials so that they become “known”, concealed their

identities and operated through "fronts" who were usually reputable local persons. These fronts, once the fraudulent distribution was over, were discarded and remained in the locality as the target for victims trying to get their money back. The racketeers would move to another state and with new fronts, new names, and possibly new securities, repeat the operation. Various state enforcement officers and post office inspectors on behalf of the Federal government did their best to stop these stock racketeers. The enforcement people found, however, that they could not keep abreast of the frequent moves and devices of the fraud artists. Confronted with the additional jurisdiction created by the Federal securities laws, many of the violators fled to Canada and operated from there.

The Dominion of Canada has not enacted any types of securities laws comparable to our Federal securities laws.

CHAPTER II

1933 – 1937

1933-4

The Congress in 1934 vested certain duties and enforcement powers in the Securities and Exchange Commission.

Among its many duties, the Commission is responsible for the administration of the Securities Act of 1933 and the Securities Exchange Act of 1934. The former, in general, provides that anyone proposing to make an offering of securities in the United States by use of the mails or in interstate commerce must file a registration statement, absent an available exemption, respecting the securities. An offering from a foreign country into the United States involves "interstate commerce". The purpose of registration is to provide full and fair disclosure to purchasers and prospective purchasers of all pertinent information concerning the securities offered, thereby affording an opportunity for informed judgment regarding the merit of the securities. To this end the Act requires delivery of a prospectus containing such pertinent information. Section 17 of the 1933 Act is specific in its terms, and makes unlawful frauds and misrepresentations in the sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails.

The 1934 Act provides that underwriters, brokers, dealers and persons engaged in the buying and selling of securities in interstate commerce or through the use of mails must register with the Commission. Certain persons with injunctions and convictions against them for securities frauds and securities violations are barred from registration.

Since its inception in 1934 (and in fact even before its creation while the Federal Trade Commission was administering the Securities Act of 1933) the problem of protecting American citizens from non-registered offerings from Canada made by non-registered brokers and dealers has taxed the ingenuity of the Securities and Exchange Commission. The problem was not considered too important during the first 7 years or so but has become very important during the past 13 years as the violations increased. Despite the temporary successes achieved from time to time as new remedies or devices were employed, the ingenious securities fraud artists have found ways to peddle fraudulent, get-rich-quick securities in violation of United States federal securities laws and state securities laws.

Over the years thousands of complaints have been received from members of the American public respecting these illegal offerings and our investigations have disclosed that invariably each illegal offering was surrounded with grossly fraudulent misrepresentations.

In the spring of 1934, the Federal Trade Commission had studied the problem of the jurisdiction established by the 1933 Act. While the general rule of law is that "all legislation is prima facie territorial" and confined in its operations and effect to the territorial limits over which the lawmaker has general and legitimate power, the Commission's General Counsel on January 30, 1934, took the position that if the U. S. mails or interstate commerce were used, an offering made exclusively abroad had to be registered in the United States (Corporation Trust Company ruling). Clearly then, a foreign securities offering made into this country or partly into this country required registration.

Early in 1934, the Federal Trade Commission sent a man to New York City to learn the facts concerning a mail campaign into the United States from Canada. The registration requirements of the 1933 Act had not been met. An injunction was obtained against the violators. Another injunction was obtained in about June of 1934 against an American sponsoring a "tipster" sheet to sell Quebec securities exclusively to United States' residents. During 1934 an investigator was sent to Detroit to investigate unlawful offerings from Canada of gold mining stocks. These experiences coupled with information from some of the state securities authorities to the effect that they frequently experienced fraudulent and non-registered offerings from across the border moved the Securities Division to study the advisability of including as an extraditable offense in the Canadian Treaty the violation of the registration and other provisions of the 1933 Act.

The 1934 Act was passed June 6, 1934, and the study respecting extradition, at the suggestion of Mr. Bane, was broadened to cover both the 1933 and 1934 Acts. A memorandum (See Exhibit 1) dated October 24, 1934, was prepared and suggests that it would be futile to attempt to amend the treaty in these particulars. It points out that such an extradition provision would be novel inasmuch as actions which would violate our Securities Acts are not crimes in Canada. Moreover, the courts and law experts apparently had not contemplated a situation where a person could remain in one country and violate the laws of another in the sale of securities without ever entering the country where the crime is committed. Furthermore, the then existing treaty provisions called only for the extradition of fugitives.

This 1934 memorandum is also interesting in that it discusses the possible use of postal fraud orders to combat unlawful mail campaigns. The Commission explored the matter as indicated by its minutes for November 1, 1934:

> "The General Counsel was instructed to contact the Post Office Department with a view to determining what procedure might be followed in prohibiting Canadian securities being sold in the United States through the mails."

While the November 1, 1934, minute did not relate to mining securities, a minute of November 2, 1934, leaves no doubt that the Commission was faced with the problems of sales of mining securities as the minute relates to the "dilemma" of Detroit brokers as to whether they legally can sell Canadian gold mine securities in this country.

The discussion with the post office officials, under Mr. Donnelly as Solicitor, was quite discouraging. The post office took the position that the same proof would be required to obtain a postal fraud order as would be needed to get indictments in a criminal case. We were advised that in order to disprove any allegations made, as to a mine for example, it would be necessary to examine the mine, produce engineering reports, the books and records of the company, and any other evidence necessary to establish that there were fraudulent misrepresentations. Upon such showing we would be able to get a postal fraud order. Inasmuch as we had no jurisdiction to enter Canada and examine Canadian mines, books and records, we dropped the postal fraud order approach.

Mr. Bane recalls that the post office officials were also reluctant to step in because a substantial part of the actual selling was being done over the telephone. While everyone recognized that the mails were used, the actual selling usually resulted from the phone call touched off by a post card returned to the dealer requesting further information. The flagrant misrepresentations causing the purchases were the oral ones.

The written literature which went through the mails was artful and while creating an interest, often was not fraudulent per se.

By the fall of 1934, following the establishment of the SEC, a few securities salesmen, brokers, dealers and mail fraud artists had shifted their operations to Canada. These Americans had been enjoined or convicted of securities violations or were well known to Federal and state authorities. Their mail campaign into one state while sitting in another state in comparative safety were now dangerous as they could be prosecuted for such interstate commerce. Canada loomed as a happy hunting ground for them as there were no Federal or Dominion Securities laws covering inter-provincial commerce and the provinces apparently did not have any more jurisdiction outside their own borders than a state did here. Initially these American citizens settled in Toronto and Montreal. Those going to Montreal met with such vigorous enforcement by the Quebec authorities that they soon gravitated to Toronto where they were tolerated.

The Commission, realizing that those Americans now in Canada would probably violate our laws from there, did not abandon the extradition idea, but held it for [_____] consideration. It sensed future trouble because much of the fraud here had been in mining and oil securities and Canada was a frontier for such development. Historically, the extractive industries have been the source of many securities which in the hands of unscrupulous persons become the subject of fraud. The predilection of the public to "gamble" in the shares of oil and mining ventures has always been of assistance to dishonest persons in disposing of worthless or near worthless securities. While some "puffing" might be expected in the sale of anything, mining lends itself to optimism bubbling over with fraud. By using so-called "geological information", phoney

engineers' reports or by distortions of or omissions from legitimate engineers' reports "rosy pictures" are easily concocted by spell-binding fraud artists and the greedier the victim the bloodier the fraud.

In searching for ways to stop these anticipated frauds, the Commission decided to focus publicity on the habitual violators and their day-to-day activities. It promoted the idea, in 1934, among other Federal and state enforcement officers, Better Business Bureaus, stock exchanges, Chambers of Commerce, and dozens of other enforcement bodies and civic groups, that the SEC would become an exchange bureau for information on securities violators, both United States and Canadian. This central index and clearing house had compiled information by May 1, 1935, with respect to 15,351 persons against whom the provinces, the states, the Federal Government or the Dominion of Canada had already taken action for securities violations during the past 10 years. (The files at June 30, 1954, had information with respect to 59,625 such persons.) Securities Violations Bulletins prepared at the SEC and other data were circulated among more than 700 contributing groups and the violators were brought out into the sunlight.

Armed now with powerful laws and information as to known violators still in this country and with information from these sources pouring in whenever any activity began, a wholesale cleanup started and within a short period raids and enforcement actions drove many of the known racketeers out of business. The 1934 Act in requiring the registration of brokers and dealers and the identities of the owners or those in control relationship destroyed the so-called "front" set up and also barred those with injunctions and convictions relating to securities violations from continuation in the securities business. The fraudulent operators found it expedient to stop their activities, or to migrate to

Canada or to confine their activities to intrastate dealings where the state laws or state enforcement appeared to be weak.

This report as it progresses must not generate the impression that there were no honest brokers, dealers, or promoters in Canada. Most of the Canadians were honest and have remained so. They have attempted to comply with our laws despite many difficulties in doing so as will be discussed later in the report. During the period July 27, 1933 to June 30, 1934, a total of 19 registration statements of Canadian offerings under the 1933 Act became effective. Many related to offerings of mining securities. Four additional filings during this period were subjected to proceedings. One subsequently became effective and three were put under stop or suspension orders. Exhibit 2 shows by years from 1933 through 1954 the number of Canadian filings and the amounts; the number and amounts effective; the number and amounts withdrawn; and the number subjected to hearings. It is important to note that more than 89% of all the securities sought to be registered by Canadian industrial and mining companies in 1933 Act registration statements have become effective and more than 97% of all Canadian securities, if Canadian Government securities are included.

We have no record of any state or provincial actions which may have been taken against violators or violations from Canada in 1934. The SEC had taken only the two injunctive actions mentioned earlier.

1935

A sprinkling of mailings from Canada came to the Commission's attention soon after its formation and the Commission sent representatives to Ontario during the 1934-35 period on at least two occasions to meet with Ontario's Securities Commissioner and

discuss ways and means of stopping the offerings. Chairman Kennedy in a speech in New York City in March, 1935, (which in part related to but did not mention Canada) told of the Commission's awareness of the frauds and skills of the boiler room operators aided by their tipster sheets which spoke "carressingly of the golden dawn of tomorrow's wealth". He told of the appalling credulity of the public in these matters and the lures used --- "the government abolishes the domestic market for gold and mines long since abandoned are glorified in the language of fantastic promises to catch the unwary sucker, the only requisite being a hole, a ladder and a feverish imagination."

On February 5, 1935, the Michigan Securities Commission appealed to the SEC to aid in stopping some unlawful Canadian offerings which had been going on for two years but which Michigan couldn't proceed against because Michigan law and the Michigan courts held "agency" transactions to be exempt. Michigan believed the large numbers of transactions indicated planned distribution and not isolated agency transactions and that probably the SEC had power to step in. The Commission also began to receive many complaints from people being subjected to a fraudulent telephone sales campaign in Michigan. Its Chicago Office, although just opened, sent a squad of investigators and lawyers to Detroit to investigate these situations. It was found that Detroit was the last frontier in the United States for high pressure boiler room operations. One of the Detroit newspaper headlines was "50 Driven Out in SEC Quizz". Another, "U.S. Indicts 7 Brokers in Oil Stock Sales Here." Some of the fraud artists had miscalculated that they were safe. Their pattern was to pick up a small Michigan company and bombard Michigan people with fraudulent representations (all intrastate) so

the SEC couldn't touch them. However, they overlooked the prohibition against using the mails and the mails gave us jurisdiction.

In a book called "Protecting Your Dollars" written by one of the SEC attorneys sent to Detroit (Gosell) it is stated, "…Well over fifty salesmen left town as soon as it was known that the SEC inquiry had started. As the Commission's representatives went from brokerage house to brokerage house, it appeared that men indicted or convicted of security frauds in other states, persons under injunction for improper stock selling practices, fugitives from justice with rewards posted for their apprehension, and an assorted variety of dubious characters trading under the doubtful protection of aliases were licensed as qualified salesmen. Boiler rooms were in full swing, literally dozens of offices in the downtown financial district were rigged with telephones", etc. And then this sentence: "After the Commission's investigators entered the city, many brokers and dealers fled to Canada and across the river from Detroit, at Windsor, continued their improper practices, telephoning into Detroit and bringing pressure to bear in an effort to make further sales." Those gathering in Windsor soon migrated to Ontario [_____].

In 1935, the Commission sent Mr. Robert Kline, Assistant General Counsel to Toronto to discuss an illegal offering with Ontario Securities Commissioner Godfrey. The two men investigated the case together in Toronto and stopped the offering.

On July 19, 1935, the Commission's General Counsel had concluded (See July 12, 1935, memo F. T. Greene to Judge Burns – library) that the 4(2) exemption in the 1933 Act was not available to United States "brokers" who aided in a non-registered

Canadian distribution by effecting so-called "brokerage" orders in a security. This interpretation made hazardous another avenue of distribution into the U.S.

During 1935 there were 37 registration statements filed by Canadian companies, covering $32,327,000 – 20 of these for $26,243,000 became effective - 10 withdrew and the balance were subjected to Section 8 proceedings under the 1933 Act. In addition, two Canadian government offerings for $115,900,000 became effective.

In the year 1935, there were no provincial actions taken and Massachusetts and Michigan were the only states to take actions against Canadian violators, taking one administrative action each. The SEC, while it made investigations, had no enforcement actions against Canadian violators in 1935. Things were so quiet [_____] that the Commission's First Annual Report for the year ended June 30, 1935, and the Federal Trade Commission's Annual Reports covering fiscal 1933 and 3 months of fiscal 1934's operations by the Securities Division do not allude to any problems with Canada.

1936

In 1936 a little high pressure selling from Toronto into Michigan was noted. The SEC had established a branch office there and our men (Gosell) kept reporting on the violators and making investigations. He reported that he was getting splendid cooperation from the Better Business Bureaus, from the Ontario Commission, and others, but that having jurisdiction over the telephones and mails wasn't enough any more as he couldn't find a way to get jurisdiction over the sellers north of the border. Mr. John T. Callahan was sent to Detroit to see what he could do to stop the mail offerings.

A number of mail offerings were made into other states also. Our records indicate that practically all of these originated in Ontario, and specifically Toronto. No mailings

of significance were coming from the other provinces where the provincial laws were being rigidly enforced. Practically all illegal offerings encountered during the next 17 years were to be from Toronto.

While the law abiding element from Canada continued to file registration statements under the 1933 Act, year by year (see Exhibit 2) certain developments respecting some "disclosure" requirements in registration statements at the SEC were creating difficulties for many Canadian promotors. Canadian oil or mining companies were generally promoted following this pattern: The promotors would organize a corporation with 3, 4, or 5 million shares of $1 par stock. Having already acquired property or rights to property at varying costs, the property would be conveyed to the corporation for either (a) all of the capital stock, with 1/2, 2/3, or 3/4 donated back to the corporation as fully paid stock and such donated treasury stock then sold to the public to raise working capital, or (b) a portion, say 1/4 to 1/2 of the authorized stock went to the promotors, with the remaining portion, also called "treasury stock", sold to the public on behalf of the corporation.

There were innumerable possible variations of such general promotional patterns as there had been in the early 1900's in our western mining promotions. One common pattern involved the sale of "treasury" shares at increased prices for the corporations as the blocks of stock were taken down for sale to the public, and involved high mark-ups or spreads and stepped-up prices to the public. Generally the underwriters would enter into option agreements to take down the first 200,000 or 300,000 shares at say 10 cents per share. These shares would be offered to the public at say 30 to 40 cents. If the selling campaign looked successful, the next 200,000 or 300,000 share block would be taken

down from the company by the promotors at say 15 cents and sold to the public at say 45 to 60 cents, and so on up for several more "steps". These "step up price" options were sometimes "firm", i.e., the underwriters actually paid for the block of stock before receiving it, but were more often acquired on a "best efforts basis" or by the giving of a note or check, which often became good only if the sales campaign were a success.

The selling pattern in the 1930's was quite uniform. The victim was first solicited by mail, told of the great money-making possibilities of the mine or oil well involved and asked to merely send his name and address on a prepaid post card (no obligation) so as to be kept apprised of developments. Within a few days the victim received a phone call (or possibly a further piece of sales literature or telegram and then the phone call). The fraud artist then talked about new and great discoveries or oil strikes or gold or other rare metal strikes (depending upon the then current promotion) giving glowing accounts of the current status of the property, or describing its close proximity to someone else's great discovery. It was invariably hammered home that the victim must hurry; that the offering was below the market; or in advance of a public offering; or for a limited time only; or that only a limited number of shares were left at these ridiculously low prices. The victim was forever being let in on the ground floor. Of course, the shares were $1 par, fully paid, but with fast action could be had at only 70 cents each and of course the shares either just had been or soon would be listed on the stock exchange and they'd triple in price in a few days.

The fraud artists used any techniques which had been found successful and feasible in selling worthless securities and they were past masters at misrepresentation. Where the victims were "reticent" but "flirting" a number of follow up techniques were

used. Often confirmations were sent covering a certain number of shares, billing the victim at say 70 cents a share. A further phone call followed congratulating the victim who naturally complained that he didn't order or buy any shares. The victim was now told that the market was 90 cents and leaping up, but that the seller was honest and would go through with it at 70 cents as agreed, etc., and of course "we'll resell the shares for you at 90 cents or more just as soon as you have paid for them and they are yours", had become a technique which was hard to beat. The SEC has been told of such occurences and has told the intended victims that the offering is illegal (we cannot express an opinion as to the merits of the security) only to learn later that some of the victims decided to "take a flier" anyway. Why let $200.00 profit on 1,000 shares slip through ones fingers when it is so easy to make $200? We have yet to learn the identity of anyone who followed this course and did other than lose his money.

One other common technique (among endless techniques) should be mentioned here because of its subtlety. It involved the use of so-called "independent" mining magazines and newspapers, and so-called "independent" investment advisers. This aspect will be dealt with hereinafter, but the confirmation of earlier stories by such respectable "independent" sources no doubt misled many people into purchases where strikes were "independently" reported and glowing reports "independently" given.

The SEC in its early decisions out into some of the customary methods and techniques employed in these Canadian promotions. In the Unity Gold case (1934) it held that capital stock issued for property and concurrently "donated back" to the corporation was improperly included in the amount stated to be the cost of the property; in the Brandywine Brewing Company case (1935), it held that promotional services could

not be carried as an asset in the balance sheet where the value of the stock issued so far exceeded the value of the service as to constitute a donation to the promoter; and in the Snow Point mining case (1936) the Commission held that absent a showing of increased value in the underlying property, it was a fraud per se to offer securities to the public at arbitrary price step ups.

The SEC insisted upon full disclosure, proper accounting practices, and in general raised conduct and ethical standards. These new standards purportedly could not be met by the [_____] "share pusher" so he let forth a cry that it was too expensive, too complicated, and too time consuming to try to comply with SEC requirements. Although the [____] Canadians did and still do meet such standards, after 18 years the battle cry, echoed on occasion by some Canadian officials, still persisted as late as 1952. Moreover, exemptions under Section 3(b) of the 1933 Act from full registration were available to Canadians under release 182 beginning in June of 1934. There was little or no cost involved in such compliance. The exemption was not removed until December 1940.

In July, 1936, the SEC sent Mr. Callahan, armed with his Michigan experiences, to call on the Ontario Securities Commission head, Mr. John Godfrey. During July and again later in the fall they discussed the illegal offering problem and how to stop it. Mr. Godfrey, once convinced of the harmful end result obtaining both for Canada and the U.S., attempted to put a fast stop to illegal offerings. He inserted an advertisement in the Toronto Globe in 1936 informing all Ontario securities dealers that he would revoke any of their licenses if they offered or sold a security into the United States which was not registered with the SEC. This threat remained in force until January, 1938, when Mr.

Godfrey was succeeded by Mr. Whitehead. Mr. Callahan also called on Mr. Amoyt, Securities head in Quebec in the summer of 1936 to discuss illegal offering problems.

On July 22, 1936, the SEC Detroit office had written the home office that many complaints were being received from Michigan residents being subjected to 4 different Canadian offerings. The letter tells of the use of a phoney tipster sheet (put out by another firm, purportedly independent) and that skilled "send out" men were following up the prospects.

The files indicate that by August 11, 1936, we had complete details and backgrounds on 42 individuals, group or firms who were or recently had been offering unlawfully into the United States. The "fronts" for the principals, the criminal records and the cross tie-ins were shown.

Five Canadian broker-dealers obtained registration under the 1934 Act as broker-dealers during the year 1936.

The Commission's Second Annual Report for June 30, 1936, doesn't mention the Canadian problem except indirectly in referring to the fact that we had data on 21,775 persons against whom action had been taken for securities frauds in the U.S. and Canada.

Our records indicate that the only action reported by a state during 1936 was an administrative action by Minnesota. Ontario reported 3 criminal and 1 administrative action and Nova Scotia one criminal action.

1937

Despite Mr. Godfrey's good intentions, illegal offerings did continue. The record indicates that Mr. Godfrey was unable to get the cooperation needed. By 1937 conditions had worsened to such an extent that the Provincial Securities Administrators met to see

what could be done to improve conditions. They also attempted to work out a uniform registration statement which would be good through all provinces. It was found that the laws and the "interpretations" formulated over the years so differed as to preclude any possibility of uniformity.

Mr. Callahan was beginning to make regular trips into Ontario by 1937. He kept the U.S. Consul advised and worked primarily with the Ontario Securities Commission. In addition, the Commission in 1937 determined that it would promote good relations and better understanding to attend securities Administrators meetings and it sent representatives to Toronto to attend a convention. From these early contacts relationships developed where information and ideas could be exchanged.

On May 3, 1937, the Commission took the position that the mere insertion of the name and address of a Canadian broker or dealer and the fact that he was engaging in the securities business or was a member of an exchange, with nothing more, was not enough to be deemed a violation of Section 15(a) of the 1934 Act.

By the end of 1937, The Canadian problem although troublesome did not appear to be too far out of hand. We were having no real trouble from the Provinces except Ontario, and Mr. Godfrey was doing his all to stop the illegal offerings there. The promoters, however, kept changing fronts and Godfrey lacked the staff to keep up with these tactics. We had commenced a few investigations, the states and the Provinces had taken a few actions (see Exhibit 3 for state and provincial actions by type and by year covering 1935 – 1954), Callahan had made a few trips to Canada. A total of 134 Canadian industrial or mining registration statements had been filed, of which 73, covering $134,664,614, had become effective, 39 had been withdrawn and the remaining 32 were either subject to stop order (8b or 8d) or pending. In addition, 3 Canadian Government registration statements had become effective covering $161,912,800. Eleven Canadian broker-dealers registered with us during 1937, making a total of 16 registered at year end. There was a strong belief that time would solve the problem.

CHAPTER III

1938 – 1944

1938-9

Mr. Roy B. Whitehead succeeded Mr. Godfrey as Ontario Securities Commissioner in January of 1938 and was to remain actively in office until the fall of 1941. During his stay in office there were frequent violations despite the fact that a few measures of control were being attempted by him. On August 13, 1938, for example, he provided an investigator to go along with Callahan and Edward Jaegerman while an investigation was made of a Canadian broker-dealer who was fronting for an American operator. The Ontario Commission warned the Canadian broker-dealer he would lose his license if mailings continued into the United States.

While outwardly there were a few indications that Mr. Whitehead would "hold the lines" as Mr. Godfrey had done, it is apparent from a review of the files that conditions deteriorated considerably during 1938 and 1939. Many broker-dealers whose licenses were revoked by Mr. Godfrey were reinstated in this period. Mr. Whitehead refused to give State Securities Commissioners the kind of information they had freely gotten from Mr. Godfrey respecting the names and addresses of all persons within their states to whom sales had been made and the name of the telephone salesman. Mr. Whitehead took the position that absent [_____] of fraud by the requesting state he did not have the legal power to obtain information from the broker-dealers' records for transmission to the states. In commenting on these developments, Mr. Callahan wrote that Mr. Whitehead's lack of cooperation "when it became known to Ontario violators, as it did, gave great encouragement to them to continue to violate their criminal laws, which they have consistently done up to the present time."

The years 1938 and 1939 saw some developments which were unsettling. Offerings, largely from Toronto, began to increase and the New York Office commenced 11 investigations into these offerings in 1938. A sealed indictment was obtained in April of 1938, starting a new technique. It was hoped that we might apprehend the violator in this country if he did not have knowledge that he had been indicted.

Our General Counsel sent investigators into Canada in July of 1938 and as had been the case in 1936, the Ontario Commission put some of the violators out of business upon our evidence and at our request. We were successful in getting a consent injunction, February 16, 1938, against a Canadian promotion run from New York.

We had been convinced that extradition from Canada would not work, so we tried a new technique by going into Canada to seek deportation. However, on August 5, 1938, the Commission failed before Judge Manson of Vancouver, British Columbia to have a violator deported to Seattle. The proceedings had been instituted June 30, 1938 and having lost the deportation attempt, we had to be content to turn over our evidence to the Superintendent of Brokers for British Columbia. No action was taken by him because (we understand) the court had not found a violation of Canadian law, otherwise the deportation action would have been successful.

Mr. Callahan continued as the chief enforcement weapon of the Commission in Canadian matters. He adopted the practice in about 1938-39 of sending "warning" letters to the promotors, underwriters, dealers, and officers and directors of each company sending non-registered offerings into the United States as soon as he learned of them. Over the years he has sent thousands of these letters. Moreover, he undertook to advise the provincial authorities as to the identities of the violators. (see Exhibit 4 for sample warning letter).

During this 1938-39 era the Canadian Dominion authorities were active in efforts to obtain a better control over issuers. A strong drive was made for a Federal and

Provincial Uniform Companies Act. Although the movement had strong backing, it got nowhere possibly because the war in September 1939 consumed everyones thoughts.

The fourth annual report of the SEC (year ended June 30, 1938) doesn't mention the Canadian problem, but the fifth annual report (June 30, 1939) relates on page 89 that "Although frequently lacking jurisdiction over the individuals responsible and thus being unable to take punitive action against them, the Commission has been able to deal with manipulations having their origin in Canada due to the cooperation of various official and semi-official bodies in the Canadian provinces. . ."

The Commission started two criminal cases in 1939 for frauds by Americans involving Canadian securities. In one case the grand jury failed to indict, but in the other after about four years, four of the accused pleaded guilty, and all received prison sentences.

By the end of 1939 there had been or were more than 60 cases involving approximately 100 Canadian Mining or Oil Companies, broker-dealers, principals, etc.

At the end of 1939, there were 18 Canadian registrants under the 1934 Act who were promptly filing all required reports with respect to their securities registered on a U.S. Stock Exchange. Several of them were mining companies. By the end of 1939 a total of 35 Canadian broker-dealers had obtained broker-dealer registrations under the 1934 Act.

Between June 29, 1934 and July, 1940, 104 Canadian companies mostly mining companies, had availed themselves of the exemptive provisions of Rule 202 and 36 had availed themselves of similar provisions in Rule 210. Between 1933 and the end of 1939, a total of 161 Canadian industrial or mining companies had filed 33 Act registration statements. These figures tend to dispose of much of the argument that a Canadian desirous of complying with U.S. laws could not do so.

Fraudulent offerings were increasing to such an extent in 1938 and 1939, the SEC suggested to the State Department that conferences be held with the Canadian government respecting a new treaty to cover such offenses.[1]

1940

As previously indicated, the Commission in 1934 gave consideration to the need for inclusion in the extradition treaty (then being negotiated with Canada) of offenses arising from violations of the Securities Act of 1933 and the Securities Exchange Act of 1934. The Commission had been advised that [_____] the Canadian Courts (following the British cases) had held -- (1) that an offense is extradictable only when, if committed in Canada, it would be an offense against Canadian law; (2) the universal policy of extradition treaty makers had been to include only those offenses which were criminal both in the country making the requisition and the country of asylum (double-criminality) and (3) British policy had been to resist extradition when the crime charged would not be a crime in England. It had been decided in 1934 not to press for 33 or 34 Act violations as such. The counsel to the Commission had felt that even without specific inclusion many violations of the Acts would also constitute one or more of the crimes already included in the Webster-Ashburton Treaty of 1842 as amended by the Conventions of 1889, 1900, 1905, 1922, and 1925.

The treaty amendment program was given top priority by the Commission for another reason also. We had just attempted to extradite a fugitive and had learned that we couldn't [_____] under the existing treaty. When we first discussed the possible extradition of Mr. Edward P. Lamar from Canada with the Department of Justice in 1938-9 it advised us that the offenses were not extraditable. The U.S. Attorney, while conceding that mail fraud and conspiracy were not extraditable, argued that 17(a)(2) counts under the 1933 Act were the same as false pretenses under Canadian law and,

[1] See letter Chairman Frank to Hon. Cordell Hull, 1940 – Library.

therefore, extraditable. With respect to the allegations of sale of securities and use of the mails, he contended that these were solely for the purpose of giving the Federal courts jurisdiction and did not go to the gist of the offense. A review of the offenses was made and one clear-cut offense within the purview of "false pretenses" was selected.

Edward P. Lamar and Harris O. Bedford had sold securities in Texas by use of the mails and between 1934 and 1937 had defrauded victims of more than $100,000. Lamar and Bedford were indicted October 3, 1938. Bedford pleaded guilty and was sentenced to 3 years in prison. Lamar fled to Canada. Among the many frauds, they had sent fictitious or untrue confirmation slips or letters respecting agency transactions. To clearly come within the purview of the extradition treaty the case was pared down to one offense involving misrepresentation as to the cost price of securities in an agency transaction. The fraud cheated the victim out of 175 and was thought to involve "false pretenses" within Canadian offenses enumerated in the treaty. It should be noted that while each country had laws against securities frauds and false pretenses, these laws were couched in different terms and were not clearly specified in the extradition treaty enumerations of offenses which were extraditable.

An information was filed in Calgary, Alberta, by the U.S. Vice Consul, July 12, 1939, accompanied by properly drawn requests for extradition. Lamar was arrested and admitted he was the fugitive sought. Judge Howson of the Supreme Court at Calgary indicated that the demanding country was required to establish by evidence:

(1) that the imputed crime is a crime within the law of the United States of America;

(2) it is a crime within the Extradition Act;

(3) it is a crime within the Extradition Treaty; and

(4) that there is such evidence of criminality that if the crime had been committed in Canada, Canadian law would have justified the committal of the accused for trial.

Judge Howson on February 17, 1940 concluded that the evidence indicated a case of theft from the victim, but that the theft occurred before the mails were used in sending the untrue confirmation in the mail to the victim. Accordingly, the theft was completed before any representation was made to the victim so there was no evidence that the false representation induced the victim to part with his money.

The judge further held that the evidence did not establish that money was taken by false pretenses within the meaning of the law of Canada. Moreover, he gratuitiously added that the imputed crime had not been shown to be a crime within the U.S. laws either. The judge found that "use of the mails" involved a specific kind of offense under a particular law which was not included in the Extradition Act or the Extradition Treaty as between the two countries.

Thus it became confirmed that double criminality was an essential ingredient to extradition from Canada and that absent what would be a clear violation of Canadian law, no extraditions were possible. Violations of U.S. laws involving the use of the instrumentalities of interstate commerce and the mails were not ingredients of Canadian law offenses. (see Exhibit 5 for opinion in Lamar case). In summary, violations of U.S. laws were not extraditable offenses as federal offenses were not sufficiently similar to the Canadian crime of false pretenses to be considered within the existing extradition treaty.

The Commission on October 3, 1940 directed the staff to study the existing treaty with a view to determining amendments to be sought permitting extradition for violations of Section 17(a) of the 1933 Act. On January 30, 1941, a request was made to the State Department to consider needed modifications.

During 1939 and 1940, the Commission adopted a policy of aiding newspaper and magazine writers and others by supplying information concerning Canadian violations. The Commission encouraged these publicity articles, believing that such disclosures would deter purchasers of illegally offered securities. Our files indicate that concerted newspaper and magazine articles concerning these Canadian frauds were appearing in the late '30's. The financial editor of the Boston Post ran some articles about 1939 warning of the Canadian mail frauds. Beginning in the spring of 1940 Burton Crane wrote a series of articles respecting fraudulent offerings from Canada which series appeared in the New York Times. Titles such as "Mine Stock Fakes Thrive in Canada", "Stock Frauds Run from Canada Still" and "39 Canadian Issues Sold Illegally" were prominently displayed over his morning articles. Better Business Bureaus were running newspaper ads, radio programs, and issuing bulletins warning of Canadian frauds with some success by the end of 1940. We were circulating lists of offenders at request to all such sources.

Our records indicate that from 1933 to 1940, the Commission had received information of unregistered brokers offering non-registered securities into the United States in 123 cases. From 1940 through 1954 we were to encounter 801 more illegally offered Canadian issues.

On December 9, 1940, the Commission amended its Exemption Rules and excluded foreign issuers, etc. from 3(b) exemptions under the 1933 Act with this language in Rule 221(e):

> "Any securities issued by an individual who is a resident of a foreign country, a corporation incorporated in a foreign country, or any person organized under the laws of, or having its principal place of business in, a foreign country."

The amendment also removed the previous over-all $30,000 exemption from any requirements.

1941

In early 1941, Mr. Whitehead brought 5 administrative and caused 6 criminal actions to be brought against Ontario violators. He offered full cooperation and suggested that he would institute criminal proceedings against any fraudulent offerors if we would arrange to have United States citizens come to Ontario to testify. The cooperation looked so hopeful that Callahan wrote ". . . At the present time I know the illegal offering and sale of securities from Canada into the United States is well in hand". Mr. Edward Jaegerman worked on and off with Callahan during the 1939-1942 period. They usually investigated in Ontario, but made one investigation in 1941 in Nova Scotia.

Whether the decision in the Lamar Extradition case, the fact that Mr. Whitehead went to the Federal Wartime Price Board in the fall of 1941, or other reasons intervened, the Canadian picture suddenly changed for the worse in the latter part of 1941. The change is quite clearly seen in some correspondence in the files. An American citizen bought some stock as a result of mailings and phone calls from Toronto and when he realized he had been defrauded he wrote to the Ontario Commission. He got back an answer reading in part: "In view of the fact that these transactions were made in the United States, this Commission has no jurisdiction". The American answered that the literature had been mailed from Toronto, the phone calls initiated in Toronto and that the selling was done from Ontario. He contended that Ontario should be something about it. He received this further reply on September 15, 1941.

> "This Commission was formed to administer the Securities Act and its jurisdiction is limited to the Province of Ontario. There is nothing we can do in this matter, but if you feel you have a good cause of action, you are quite at liberty to take any proceedings your solicitor may see fit, and obtain your remedy in the court. Very truly yours, Ontario Securities Commission, Roy C. Sharp, Solicitor.

The Commission in late 1941 began in earnest to obtain secret indictments and instituted quite a number over the next few years. This weapon was partially effective for

even today many violators dare not come into the United States lest they be picked up and jailed, as happened to a Mr. Niditch, who was picked up in Vermont and was sent to the penitentiary for 10 years in 1944. Mr. Niditch and 9 other individuals as well as a gold mining company and a broker-dealer firm were indicted in 3 indictments in the Eastern District of Michigan in October of 1941. These were indictments charging fraud in the sales of securities into the United States from Toronto, failure to register the securities and failure to register as broker-dealers. Three of the individuals were convicted later and seven became fugitives. Niditch got 10 years and was fined $5,000, Kaufman got 7 years (later reduced to 2 years) and was fined $1,000 and Lewis received a $2,000 fine. The sentences were imposed in 1944.

Mr. Niditch gave an affidavit to us, February 14, 1945, while in prison, in which he contends that certain Ontario Commission employees in the 1938 – 1944 era were getting "pay-offs" from the big operators for letting people with records get salesman's licenses and for "overlooking" bucket shops and non-compliance with Ontario law. He names persons to whom he contends he personally made payments.

1942

It is important to the administration of the statutes entrusted to this Commission that those who violate them and those who resort to loopholes in international law to continue such violations must be apprehended to stand trial in this country.[1] An unsuccessful attempt was made in 1942 to close these loop-holes by amendments to the treaty, but Canada failed to ratify the 1942 proposals following ratification by the U.S.

[1] There were two informative legal memoranda by SEC attorneys, Weinbach and Seligman in our library dated November 14, 1940 and October 9, 1941, dealing with treaty problems, Canadian rulings and differences in U.S. and Canadian laws.

Senate May 27, 1942. Broadly, speaking, the revised treaty would have made extraditable violations of (1) the Federal Securities Acts, (2) the Federal Mail Fraud Statute, and (3) the State Blue Sky laws. It would have also covered refusal or failure to register or obtain licenses as required by various federal and state securities statutes. Moreover, the treaty contained a general provision that it was not essential to establish that the Acts charged also constituted a crime or offense under the laws of the requested country. In addition, as drawn, the 1942 treaty would have been retroactive, and would have allowed for the extradition of publishers of Canadian newspapers which carried advertisements selling securities if the newspapers reached into the United States.

Interested Canadian groups objected that among other factors such as further depreciation of the 90 cents Canadian dollar, upsetting economic balances, etc., the proposed treaty would stop the healthy flow of American dollars into Canadian development and that Canadian subjects innocently involved in purely technical violations of our very complicated Federal and numerous state laws should not be extraditable.

Certain elements of the Canadian press bitterly attacked the SEC and appealed in open letters to Secretary Hull to withdraw the amendment as it would be a death blow to Canada. One columnist feared the result saying that a large number of "SEC scouts" would be "loosed on Canada". He [_____ _____] – "most members of the investment community are well aware of the activities of one member of that Commission who comes here and tries to exercise inquisitorial powers over the books and records of Canadian companies." Mr. Lennox stated in 1951 that the 1942 treaty had been turned down because a purely statutory offense such as sending a piece of non-

fraudulent literature across the border would have been extraditable. Any kind of an offense against any state would have been extraditable. Many reputable groups, including the stock exchanges, Investment Dealers Association of Canada, Investment Bankers Association, Unlisted Dealers Association of Toronto, Mining Prospectors Association and the Public Utility Companies took up the fight against the treaty.

Our arguments that the treaty did not create any new laws or regulations but merely provided that violators of existing laws were to be extraditable fell on deaf ears. The Canadians particularly would not agree to the provisions, "It shall not be essential to establish that a crime or offense is a crime or offense under the laws of the requested country".

On January 26, 1942, the SEC revoked the broker-dealer registration of a Toronto firm, R. P. Clarke & Co. because its president was convicted on March 7, 1941 in Canada of felonies or misdemeanors involving the purchase or sale of securities. Following this revocation, there remained 25 Canadian broker-dealers registered with us.

In addition to the secret indictments, open indictments were obtained in instances where a better all around solution appeared likely. The United States Attorneys were very cooperative and helpful and through them, and of course, the Department of Justice, a number of actions began.

On August 5, 1942 (SEC Litigation Release No. 1) we announced the indictment in the District Court at Detroit of 4 individuals and two companies selling Canadian securities fraudulently into this country from Toronto. The indictment charged various misrepresentations were being made in sales and a failure to register the securities and to obtain broker-dealer registration.

On December 29, 1942 (Litigation Release No. 48) the SEC announced the indictments of 2 individuals and 3 companies for fraudulently offering securities into the United States from Toronto. The indictment was obtained in the Southern District of New York and charged false representations and failure to register. The defendants pleaded guilty and Forbes received 5 years and Dawson 4 years.

1943

On January 19, 1943 (Litigation Release No. 52) the SEC announced guilty pleas by two individuals and one company in the United States District Court at Syracuse, New York. They were indicted for misrepresentation in the sale of Canadian mining stock. The company was fined $2,500, Reynolds $2,000 and Thomas $500. A nolle prosequi was entered as to another defendant.

On April 15, 1943 an open indictment was obtained in the Eastern District of Michigan involving 3 persons violating the fraud and registration provisions of the 1933 Act. One of the persons was later arrested but the other two are fugitives and have continued to operate from Toronto.

On August 17 and 19, 1943 (Litigation Release Nos. 117 and 118) the Commission announced the apprehension of E. S. Harrison of Toronto as he was entering the United States from Fort Erie, Canada. He had been indicted April 15, 1943 in Michigan for violating the anti-fraud provisions of the 1933 Act. His bail was fixed at $5,000 and he was held for an appearance in Michigan.

Violations continued at an accelerating pace. While only 2 actions had been brought by the states in 1941, the number jumped to 10 in 1942, and 38 in 1943. Registration statements filed with the SEC dropped to zero in 1943. In connection with

the state actions reported prior to about 1943, it should be borne in mind that many states had not determined their powers respecting injunctions and the so-called cease and desist orders where the violator was located in another country. Our information indicates that in many instances no actions were taken in some states while the fact is that numerous mailings were occurring. While the information in this report is accurate as to the number of reported actions taken by the states, it is to be noted that the actions in no way reflect the quantity of violations occurring in most of the states. While we know that many Canadian offerings have gone into every state, 26 of the states have never even yet (1955) taken any actions against any Canadian illegal offering.

A review of our files indicates waves of publicity swept the country in the early 1940's warning of fraudulent offerings from Ontario, and of bucket stops, stockateers, fraud artists, telephone calls, etc. Newspapers, magazines, radios, were joined by advertisements and bulletins from the Better Business Bureaus. In 1943 the Investment Dealers Association of Canada and the Toronto Stock Exchange each warned U.S. investors against these fraud artists, carefully assuring the U.S. that such violators were not their members. On June 26, 1943 the editorial in the Toronto Financial Post bitterly attacked the Ontario Commission and called for an overhaul. The editorial read in part, "provincial security administrators, after a decade of fumbling, have shown they can't or won't enforce desirable business conduct. On December 8, 1943 the Toronto Better Business Bureau sent our a warning bulletin entitled "If its a Telephone Appeal, It's Always a Racket" and refers also to the large number of requests which have been received for copies of its Radio Broadcasts of November 23 and 30, warning against high

pressure stock salesmen and offering a free booklet “Facts you should know about Stock Selling Schemes”.

In 1942 and 1943 an investigation was made into the modus operandi of a purportedly independent factual Canadian mining service. It was learned that 1000 to 1100 copies per week were coming into the U.S. The investigation showed that by buying advertising and paying a fee for each copy mailed into the U.S. mining promoters were able to get stories planted, which provided a spring board for phone calls and illegal sales.

The Commission’s 9th Annual Report for the year ended June 30, 1943, makes the first reference in an annual report to Criminal proceedings. Under the heading “Litigation” page 59 and the sub-heading “Criminal proceedings” it says:

> “Mining company stocks were often involved in the fraud cases. In a number of these, the securities were sold by residents of Canada operating 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 obtain ratification of a pending treaty with Canada in order to permit extradition from Canada of those who violate our securities laws and other cognate statutes. The treaty was ratified by the United States Senate in 1942.”

With all this publicity going on the Globe and Mail on January 25, 1944 reports that the Ontario Mining Association was appealing for an easing fo the existing “burdensome restrictions”. The association wanted the Ontario Securities Commission abolished or its functions limited to fraud contending that it was “too strict”. Premier Drew, upon election, had created the Ontario Mining Commission in the fall of 1943 for the purpose of investigating mining conditions generally and the operations of the Ontario Securities Act and the Ontario brokers and dealers, among other things. The Ontario Mining Commission held hearings in January 1944 and it turned into a sounding

board for everyone's complaints. The Commission made many fine recommendations including recommendations that the Ontario Securities Act should be amended; that a three man Securities Commission should be created for Ontario; that surety bonds be required; that prospectuses be required; that no phone calls should be made, etc. There were 19 pages of recommendations.

The National Association of Securities Administrators met in St. Louis in 1944 and undertook a cooperative movement with the SEC to warn about and stamp out these illegal offerings by publicity. The association advertised, went on the air, and mailed letters to every kind of interested group in an effort to warn of the frauds. Many of the states began to send copies of their cases and desist or fraud orders to the provincial authorities in order to advise them also of the violations.

In 1944 the states took 34 actions and Ontario instituted 4 administrative and 6 criminal actions. Only one Canadian industrial registration statement was filed in 1944. The SEC records indicate there were 140 illegal offerings which were being or had been made from Canada by the end of 1944. Apart from the secret indictments only a few open indictments and convictions had been obtained. On January 27, 1944, two Americans who had been indicted for fraudulent sales of Canadian securities in 1939, plead guilty and received 6 months and two years probation respectively. (Litigation Release Nos. 160 and 190). Two other defendants subsequently plead guilty and received sentences of one year and one day.

As an indication of the intensity of the publicity campaign in 1944 against fraudulent offerings from Canada, the Seattle office reported that between February 14 and March 3, 1944, publicity articles warning Americans were run by the Seattle Times,

the Seattle Post-Intelligencer, the Tacoma Times, the Portland Oregonian, and the Spokane Daily Chronicle. Warnings were given by Radio Stations KFIO, Seattle, KVI Tacoma, and KVOS, Bellingham. Independent house organs such as the Todd Shipyards KEEL and the Lake Washington Shipyards "On the ways" also participated with warning articles.

CHAPTER IV

1944 - 1945

Mr. Whitehead (who had been on loan to another government agency and inactive in Securities work since 1941) was succeeded as Ontario Securities Commission head, in the summer of 1944, by Mr. William Brant, who had served as Registrar of the Commission for many years. Despite opposition in his staff, headed by one E.H. Clark, Mr. Brant attempted to cooperate fully with the SEC. He also began a revision of the Ontario Securities Act. Upon his untimely death in October, 1944, Mr. Clark succeeded him (in effect), remaining in office about 13 months until December, 1945. The unlawful sale of Securities from Toronto into the United States increased substantially during these 13 months.

One of the contributing factors to the increase of illegal and fraudulent offerings appears to have been caused by the Ontario Commission itself. It discarded the requirement in 1944 that selling literature be filed with the Commission. The reasoning was said to be that the Commission decided not to look at it lest people get the impression that the Commission had passed on it or stood behind the representations made in such literature. For the next 6 years, sellers were not required to file literature for perusal.

Conditions became so acrimonious that the Toronto Star in 1944 attacked Mr. George Drew, Premier of Ontario, for allowing the Ontario Securities Commission to get so out of hand. This newspaper campaign contained statements by various U.S. officials including spokesmen for the SEC respecting the floods of fraudulent offerings.

Of interest in reviewing foreign securities offerings is an action by the Commission against a Mexican Company selling into the States in 1944 without registration. The Commission obtained a consent injunction against further illegal sales (Litigation Release No. 221).

1945

In January of 1945, the Commission authorized Chairman Purcell and Messrs. Cashion and Callahan to attend a 3-day conference of Provincial Securities Administrators in Toronto to explore what could be done to stop the fraud artists. Representatives of Ontario, Quebec, New Brunswick, Alberta, and British Columbia attended. Our people told them of our problems and were promised cooperation. Attorney General Blackwell, also the acting Ontario Securities Commissioner, was present. It was agreed that Ontario was the oasis for violators and that these violators were neither complying with other Provincial requirements nor with U.S. requirements. Mr. Blackwell stated it was intended to remedy matters by scrapping the existing Ontario Securities Act, passed in 1935, for a new one aimed at full disclosure. Mr. Blackwell indicated that he would recommend that the new Act would prohibit offerings of non-registered securities into the U.S. The single exception to this would be where a security was listed on the Toronto exchange. It should be noted that prior to 1945, Ontario had no jurisdiction over issuing companies. It had a single form of control limited to those brokers and dealers who did business with the public. Even the new security law (drafted by Mr. Blackwell, following many conferences) while encompassing issuers, did not extend jurisdiction over promoters and underwriters or over listed securities.

Mr. Callahan was attempting to police the Canadian situation alone and through ingenious methods obtained information respecting violations by identifying people with large amounts of American dollars requiring Foreign Exchange Control Board approval; learned the identities of people who obtained postal meters and how much they were used; learned who fronted for the real violators; and picked up numerous other bits of information which helped in enforcement. Mr. Callahan wrote Mr. Blackwell frequently throughout 1945 and 1946, enclosing information on violators, but no action was taken by Mr. Blackwell.

In a further effort to stop the growing frauds, the Commission in early 1945 authorized Mr. Cashion of the SEC to make statements to the press naming the violators and identifying the issues being illegally sold; reversed its 1937 ruling allowing boiler-plate ads by non-registered Canadian brokers and dealers; authorized the staff to seek indictments where the facts warranted; encouraged public statements to focus attention on frauds; authorized the staff to make available information respecting violators, including names, to newspapers, magazines, etc.; urged the State Department to press Canada for Treaty acceptance, agreeing to less restrictive Treaty provisions; obtained secret indictments; and tackled the problem in whatever way it thought it could. But the frauds increased.

As Canadian offerings increased, more steps were taken in the publicity field to warn the public. On April 19, 1945, Clarence H. Adams, Director of the Securities Division of the State of Connecticut and President of the National Association of State Securities Commissioners, issued warnings, and his entire association used all their facilities to publicize the frauds.

On April 9, 1945, after a trip in Canada, Mr. Callahan wrote that the situation was becoming progressively worse.

> "The lack of action manifested by the Attorney General of the Province of Ontario would indicate his sympathies are reflected in the lack of action of the Ontario Securities Commission in permitting these vicious practices to continue."

He points out that there are no illegal offerings from the other provinces.

On May 7, 1945, the Investment Dealers Association of Canada warned of the frauds. It circulated a letter telling that all reputable firms deplore the existing state of affairs.

In June, the Canadian Press reported that the Acting Securities Commissioner for Ontario was of the opinion that the SEC was beating the publicity drums as part of a campaign to revive the Treaty project.

The Corporation Finance Division in July of 1945 indicated to a Congressman by letter (and in December to a Senator) that it estimated unlawful sales to Americans at approximately $1,000,000 a week. It related that one recent promoter spent $40,000 to send out 500,000 letters to Americans. It tells the Congressman that we send letters to all violators and copies to the Ontario Commission "but such communications are usually ignored."

Mr. Callahan sent a letter to Mr. Sise, President and Chairman of the Board of the Bell Telephone Company of Canada, on July 16, 1945. He explained our problem, identified for Mr. Sise eleven big telephone operations going on in Toronto, with names and addresses, and explained that the frauds were perpetrated by use of the long distance telephone originating in Toronto. He pointed out that the telephone company requires substantial deposits to cover these operations and knows who the violators are. While not

a company chargeable with enforcement of laws, Callahan asked whether it couldn't stop the illegal usage where it knew of such illegal use.

Mr. Sise answered July 24, 1945, that many legal complications were involved and that he would write later. On September 20, 1945, he wrote that the telephone company could not stop usage of the telephones where the calls were made for "any lawful purpose" according to Canadian statutes. He explained that this means "lawful" in Canada and inasmuch as there is nothing in Canadian law preventing sales of securities by telephone, the phones must remain open and free for use. He further explained the trouble the company had in shutting off the phones of a horse-racing ring, which appeared to be violating a specific Canadian law. The court ordered the telephone company to reinstate the service to the gambling ring. He explained that the telephone company is unable to stop sales of securities made through its telephones.

The Toronto Daily Star in an editorial June 15, 1945, talked of the mining promotion scandal and called for a probe. The editorial lauded the late John M. Godfrey for cooperating with the U.S. anti-fraud authorities and said,

> "But Attorney General Blackwell of Ontario when the present charges are brought to his notice, side-steps the charge . . ." and ". . . Anyone might think he had never heard what is going on." The paper calls for the Ontario government to quit stalling and ". . . to put an end to what is going on."

The Attorney General of the Province of Ontario is responsible for the enforcement of the Criminal Code of Canada in that province. He appoints all Crown Attorneys in the province. All of the criminal acts we complained of originated in Ontario and it was our view that the Attorney General should, in the public interest, originate investigations where criminal acts were occurring. Mr. Blackwell took the

position that he would act in those cases where we or the states brought proof of fraud to his attention. We felt strongly that he was shifting his responsibilities to us, who had no jurisdiction and couldn't even adequately investigate the criminal acts complained of. It should also be borne in mind that the Ontario Securities Commission itself is a part of the Attorney General's Department.

The 1944-45 publicity campaign and the law-abiding element in Canada no doubt prompted the passage of the new Ontario Securities Act in 1945. However, a portent of its effectiveness in stopping frauds into America came from the speech of Premier Drew of Ontario about its passage when he said that the new Act gives

> " . . . adequate protection to investors without stifling speculative investment."

The new Act was expected to help stop securities violations and was eagerly awaited. In the years 1943, 1944 and the first six months of 1945, the states had taken 190 actions against 355 Canadians and every action involved Ontario. Not one involved another province. The tempo increased during 1945 with the states taking 208 actions during 1945 alone. Ontario started six criminal actions and no administrative actions during 1945.

The Commission had decided against attempting injunctions in cases where Canadian broker-dealers doing business here by the mails and telephones had failed to register as broker-dealers under the 1934 Act because that type of action could not be successful in the absence of personal service. Moreover, where personal service might be obtained, the injunction could not be enforced so long as the named defendant remained outside the United States. By mid-July, 1945, however, it had obtained open indictments against 23 persons for fraudulent securities sales.

The regional offices were getting so many complaints and inquiries about fraudulent Canadian offerings in 1945 that the staff devised a form letter to save time in answering the letters.

In 1945, the Toronto Star continued its series of articles criticizing the frauds and the Ontario government. Premier Drew answered June 20, 1945, by a lengthy statement that new securities laws soon to be passed are the best in existence but that U.S. securities enforcement people want to operate in Ontario,

> "and that is something we have no intention of permitting now or at any other time."

Premier Drew contended that U.S. officials had never placed before him evidence of any fraud to support the claims they now make and stated he would be glad to act on any real evidence supplied him by U.S. officials.

> " . . . but we do not intend to enforce the laws of the United States or any state of the United States in Ontario anymore than we intend to enforce in this province the laws of England, of France, of Russia, or of any other country, no matter how friendly it may be . . ." and " . . . Canada is a sovereign nation and we do not intend to permit officials from outside this country to apply their laws to our business without proper proof before the courts that some wrong has been done . . .," and "We have no intention of adopting laws in Ontario similar to the costly and restrictive provisions of the SEC in the United States, and we have no intention of permitting officials from any other country to come here and interpret their own laws to suit themselves under loose authority to investigate the affairs of those engaged in business in this Province."

He ends up statement by saying –

> "Ontario has a proud record of law enforcement over the years."

Mr. Blackwell stated June 26, 1945:

> "we have, however, consistently refused and intend to continue to refuse to permit United States officials to come into Ontario to make investigations under their own statutes . . .," etc. (The Statements of Premier Drew and Attorney General Blackwell are attached as Exhibit 6.)

Some newspapers in Canada were in full agreement with Mr. Drew's views. Little reminders appeared in articles that America was built on hazards and speculations; that billions of dollars were lost by Canadians and Americans in the 1929 market crash; that the English maxim "Let the buyer beware" was the proper approach; that Canada should not be subject to the laws of 48 states and the U.S. Government; that the laws of the states and Federal government were too complicated for a dealer to follow and especially when the dealer wasn't offending Canadian law; that Uncle Sam should keep his nose out of Canadian legislation, etc.

The SEC commenced more than 100 investigations into illegal Canadian offerings from Toronto in 1945. The "independent" investment adviser technique of recommending issues was increasing in 1945 also and 22 investigations related to their touting activities.

At the 31st Annual Convention of the National Association of Better Business Bureaus, Inc., serving a population of more than 54,000,000 and held in June of 1945 in Buffalo, a resolution was passed respecting the unabated high pressure sales from Toronto by mail, phone, telegram and tipster sheets. The situation was declared deplorable. The Association delegated the Toronto Bureau to recommend nine steps to the Attorney General of Ontario in a clean-up effort. On September 27 a delegation called on him and presented their requests. He assured them that the new legislation would cover most of their suggestions. As to whether the mails should be used for illegal

offerings, Mr. Blackwell advised the delegation that the United States could, if it wished to do so, prohibit any Canadian mining firms from using the United States mail. He pointed out that up to the present, however, the U.S. postal authorities had not done this. Mr. Blackwell also suggested that too much importance should not be attached to cease and desist orders or SEC actions as the method of obtaining information and complaints "south of the border" was not conclusive. He further told them that the United States had never furnished him any real evidence of a fraud. If they ever did, he would prosecute immediately, he told them.

Publicity respecting Canadian frauds had some temporary effect on occasions. Mr. A.E. De Palma told Mr. Callahan in 1945 that he had 400,000 pieces of literature in the United States mails in July of 1945, when a Collier's Magazine article about him came out. The July 21, 1945 issue contained an article warning of Canadian frauds written by Lester Velie and the article coincidentally dealt at some length with Mr. De Palma's methods. Mr. De Palma attributed the failure of the sales campaign to the article.

Unfortunately all prospective investors were not being given timely warnings, however. On January 3 a "good report" came in as to the value of samples taken at a "mine" in northern Quebec. The stock selling operation was being handled by a Toronto dealer. With this good report the trader began to advise the financial district (Bay Street) and prospective customers and the stock began to rise as did interest in it. An investigation brought forth that the manager of the brokerage firm feeling that the market was "heavy" and that something should be done to relieve the "pressure" had sent a piece of high grade ore, normally used by him as a paperweight in his office, to the mine with

instructions to "make sure it got into the samples going out for assay". The fine assays on the samples injected needed life into the sales campaign and reaped a harvest of additional [____].

With the increasing fraudulent offerings, the Commission, during 1944 and 1945 pressed for some action on the 1942 treaty. The Commission having learned that the Canadians definitely would not accept the 1942 proposed revisions, shaved off a number of desirable provisions theretofore worked for. In effect, the retroactive aspect was dropped; extradition could only occur where a fraud, as defined by both countries, was involved or there were wilful and knowing violations of the laws of the requesting country; newspapers were removed; etc.

However, in late 1945, the House of Commons tabled the revised treaty. Only Ontario, of all the Provincial Securities Commissions, voiced objection to the adoption. However, the promotional element of the securities industry as a whole objected. The objections generally were based upon the proposition that no extra-territorial power should be allowed to extradite Canadians for acts which were not crimes in Canada. It was contended that such extradition could only be an incursion into Canadian sovereignty.

Nine of the most frequently raised objections to the Treaty voiced at the External Affairs Committee hearings were:

1. The doctrine of "double criminality" should not be removed.

2. The Treaty would stop the flow of American venture capital.

3. That the Treaty was unconstitutional because under the guise of being a Treaty it let the Dominion invade the jurisdiction of the provinces respecting the subject of security regulation.

4. That the provisions required the legal officers of the requested country to deny bail for persons arrested prior to the extradition proceedings.

5. That the Treaty required the requested country to return the fugitive with all property found in his possession when arrested, ignoring the rights of third persons.

6. That Canadians under Items 26, 31 and 32 would have to comply with all the technical requirements of Federal and State laws.

7. That Canadians could be extradited for any crime in the United States without physically performing the acts constituting the crime in the United States.

8. That the "participation" features of the conspiracy Item 33 exposed innocent officers and directors to extradition for technical Violations.

9. While newspapers were now to be outside the Treaty jurisdiction, no protection was afforded to lawyers, engineers, accountants, prospectors or advertisers in the newspapers.

A few Americans sent communications to Canada urging the Canadian government to throw out the proposed treaty.[1] For example, the Secretary of the Arizona Small Mine Operators Association wired that the SEC was unrealistic; had stifled mining in the United States; that we would have had no mines if the SEC had been in existence during early western developments, and –

> "Lord help the progress of development of Canada's mineral resources if SEC is permitted any part in the picture (stop) They almost completely fail to recognize that the early stages of all mining are speculative . . ."

A witness before the Standing Committee on External Affairs, considering the proposed Treaty on November 23, 1945 testified respecting SEC type legislation and small investors as follows:

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[1] This is a crime itself – see 18 U.S.C., 953, Chapter 45

> ". . .Small investors like a gamble, but it does what all legislation of that kind does, and this is the great vice of it. It makes it practically impossible to get speculative venture capital because you see once you say you are going to protect the small investor, then almost the first thing you say is that we must make quite sure that when he invests he gets something real, something substantial, but a mining venture in its early days is not real and is not substantial. It is a hope and a prospect. As soon as you pass legislation such as the SEC, you have virtually stopped that kind of investment because you have said to little investors 'We are not going to let you put your money into gambles of that kind.' There is no other answer."

Mr. Callahan had written Mr. Blackwell on November 17, 1945, and after listing 20 companies or persons currently engaged in fraudulent offerings into the United States, he said:

> "In my ten years' experience of investigating complaints pertaining to the sale of securities executed from Toronto into the United States, I know of no period of time when there have been more Ontario dealers and brokers engaged in the unlawful sale of securities into the United States than at the present time. I might also say that the problem of the unlawful offer and sale of securities from the Dominion of Canada into the United States is to be found only in the Province of Ontario, and in particular, from the City of Toronto. Where there have been isolated sales into the United States from other Provinces, the abuse has been eliminated immediately through the action of the Provincial Securities Commission.
>
> The unlawful sale of securities from Toronto into the United States was entirely eliminated several years ago but violations have continued to increase in spite of our attempts to control the matter from the United States, which you know we cannot do unless the unlawful sales are controlled from the source in the City of Toronto.
>
> Various views may be expressed as to why the Ontario Securities Commission cannot act immediately where the securities laws of the United States are being violated because no such provision is to be found in the Ontario Securities Act, Yet there is no provision in our several Securities Acts which seemingly would give us the right to interfere with a violation of the Ontario Securities Act from the United States, but we would

consider it to be our public duty to stop immediately and at the source, any broker or dealer from violating the laws of a friendly and neighborly Province or Country. Should any defendant seek to contest that right, we believe any court of equity in the United States would uphold our position that where the laws of a foreign country were being violated by brokers from the United States, it would be our duty to stop the violation immediately. Similarly, we believe you could act likewise and should any defendant appeal from any action you took to stop a broker or dealer from violating the securities laws of the United States from Ontario, your courts in equity would uphold you for your vigilance and action.

Over a period of ten years I have seen many frauds perpetrated upon American investors from Toronto resulting in financial ruin, breakdowns in the health and reductions in standards of living to appreciably lower levels. All of these examples could have been eliminated if immediate vigilance had been exercised in preventing brokers from selling securities into the United States where our laws were violated. The practice of punishing the frauds months, and sometimes years after they have been executed is, it seems to me a rather poor palliative after the moneys obtained have been spent or dissipated. Such latent action vitiates sound law enforcement.

In defense of the bona fide or legitimate broker or issuer, I can recall no occasion where our Commission has had cause to complain of the selling activities of reputable brokers and dealers operating from Toronto into the United States. All offenses have been committed by questionable over-the-counter brokers and some issuers more interested in obtaining moneys from the distribution of shares than in bringing the mines into production.

As Attorney General for the Province of Ontario and as Acting Ontario Securities Commissioner, I know you can do a great public service to your Province, to the United States to the legitimate brokers, dealers and miners of your Province and to investors generally, by making it impossible for Ontario brokers to sell securities into the United States unless they have complied with our laws.

It is with that hope I direct my appeal to you.

Very truly yours,

John T. Callahan
Special Counsel"

Mr. Blackwell answered November 25, indicating he would consider the request that licenses of brokers be revoked where United States laws are violated but said in part:

> "The fact remains, however, that the mere offering of securities for sale from Ontario into the United States is not unlawful under existing legislation and this is under consideration at the moment with regard to amending our Securities Laws.
>
> "In the meantime I find myself unable to agree with either the course you suggest or the probable results in our courts, namely that the Ontario Securities Commission or myself, as Attorney General, should require Ontario brokers to desist from inviting interest in the United States in Ontario securities and offering them for sale. This would be placing either the Securities Commission here or myself above the law, and the Courts of the Province of Ontario I am quite satisfied would not support such a course on behalf of an Ontario official or the Attorney General of the Province."

CHAPTER V

1946 – 1948

When Mr. Charles P. McTague took over as Chairman of the Ontario Securities Commission in December of 1945, upon the effectiveness of the new Ontario Securities Act, he immediately launched an investigation of all licensed brokers and dealers. He announced in the press that Ontario was going to clean up its "own backyard" immediately. His enthusiasm and integrity were almost enough to cause one to overlook the unfruitful experiences of the past and to make one forget the frailness of an enforcement foundation where everything depended upon the promises and good will of others. He revoked licenses right and left until he got Toronto [_____] cleaned up. He gave a splendid administration from December, 1945, to June 3, 1948. Assisting him were Deputies Lennox and Puckabie. Mr. McTague completely reorganized the internal operations of the Commission and obtained enough personnel to adequately supervise and enforce the Ontario Securities Act. It was this set up which Mr. Lennox inherited in 1948.

1946

During 1946 Mr. McTague's administration started 68 administrative and 31 criminal actions. He acted promptly on information supplied him and met here with the Commission November 15, 1946, to discuss ways and means of prohibiting and prosecuting frauds. The Canadian press began to blame him for the lessening of business and his iron-handed methods.

Mr. McTague reviewed all the licenses of the 400 registered broker-dealers and 2000 registered salesmen. He also looked into fraudulent circulars and illegal telephoning Broker-dealers were required to supply a bond of $10,000 and all salesmen one of $1,000. Mr. McTague publicly announced that he would look into all cease and desist orders issued by the states and would do something about them. McTague told the press in March, 1946, that he had just put 9 offenders out of business "…against whom were 27 United States Citations." He sent us a list of 10 actions taken in late February, 1946. He had taken 7 actions the first week in February. Mr. McTague kept us advised of all his actions as we were doing with him.

In July of 1946 Mr. McTague warned that the securities industry should organize for self government. He warned that continued offerings into the U.S. in contravention of SEC and state laws would lead to trouble and bureaucratic control.

Mr. McTague, on November 13, 1946, in conference with the Corporation Finance Division told Andrew Jackson that inasmuch as the treaty wouldn't pass in Canada, he had been urging an amendment to the Ontario Securities Act making it unlawful to violate the United States securities laws. He indicated he was making no great progress with members of the Ontario government.

Despite Mr. McTague's good intentions, he could not stop one of the practices which was largely responsible for the trouble. The law, custom and usage allowed options at ridiculous price step ups. This inherent weakness in the financing structure invited abuses. As an example of price step ups, note the following typical release by his Commission:

"Excerpt from Ontario Securities
Commission Release of Dec. 27, 1946

SUDORE GOLD MINES LIMITED By Agreement dated, November 14, 1946, J.E. Huard was granted an option on 2,000,000 shares being, 300,000 each at 5¢, 10¢ and 15¢; 200,000 each at 20¢, 25¢ and 30¢, 100,000 each at 35¢, 40¢, 50¢, 60¢ and 75¢; payable $1,000.00 per month commencing December 31, 1946. Company incorporated, November 1946. (Ont.) Authorized capital, 4,000,000 at $1.00 par. Issued, 883,394. Escrowed, 795,050. Accepted for filing, December 16, 1946."

1947

On June 11, 1947, the Commission had obtained an indictment against Albert Edward De Palma, an American, in the District Court in Cleveland, Ohio. Charges related to fraudulent offerings from Canada and failure to register. The indictment was secret. He was arrested in New York City December 18, 1947, (See Litigation Release 431) and the indictment was made public after his apprehension. De Palma, who was released on $50,000 bail, failed to appear for arraignment and forfeited his bail. He is presently a fugitive in Canada.

In a memorandum July 15, 1947, Callahan and Jaegerman list off several groups of bad offenders still operating in the Toronto area. They point out that no one has been able to stop them as they weren't selling or violating in Canada. Many were under indictment here but appeared to be operating through fronts and pushing sales through dishonest tipster sheets or were selling only into the U.S. on July 17, 1947, three men and two companies, all residents of Canada, were indicted in the Western District of New York and charged with making fraudulent offerings of securities into the United States and with failure to register such securities. In part, the indictment charged that the defendants rendered a purported free investment advisory service, the sole purpose of

which was to sell the stock of these companies, and that they falsely represented that the moneys received from the sale of such stock would be used for the development of the mining properties (Litigation release 417).

Mr. McTague was sustained by the Supreme Court of Ontario in appeals by four salesmen whose licenses he had revoked. The court opinion, delivered December 15, 1947, defines the power of the Ontario Commission to "suspend or cancel any registration where in its opinion such action is in the public interest." The court refers to these broad powers and the fact that the procedure to be followed by the Commission is "pretty much left to itself". The four salesmen operated telephones in what the judge characterized as "nothing more or less than a high-pressure boiler room". He points out that salesman A received $34,588 commission in about 3 months (not $10,708 as reported on the phoney books of the broker-dealer); Salesman B, $12,994 in 3 months (not the reported $6,200); Salesman C, $13,491 in 3 months (not the reported $7,032); and Salesman D, $12,404 in 3 months (not the reported $6,464). Salesman A also received an additional 2½% commission from the broker-dealer on all sales by all salesmen. Most of the commissions were found to have been paid in cash and not reflected in the books so as to deceive any investigators.

It is hard to escape the magnitude of the operations into the U.S. If 4 salesmen got around $80,000 for 3 months' work and the broker-dealer's half produced another $80,000, and dozens of these "boiler rooms" were in operation in 1945, 1948, 9.50 and 51, for example, much money must have been extracted from "investors" by these high pressure campaigns.

In 1947, Mr. McTague started 39 administrative and 34 criminal actions. A glimmer of hope began to emerge that with his continued pressure the problem would get solved. Our states took 83 actions and the SEC got a few indictments. Mr. Lennox was made Vice Chairman of the Ontario Commission following his first year's service as a Commissioner. During 1946 and 1947 Canadians resumed filings under the 1933 Act in increasing numbers. A total of 44 Canadian company registrations covering $152,000,000 of securities was filed.

Mr. McTague continued his vigilence until he resigned June 3, 1948. He issued a number of splendid opinions, particularly the Bradley opinion in March, 1948 (See Exhibit 7). In substance, Mr. McTague held that the licensing of brokers is not given to them for the express purpose of violating the laws of a neighborly country. Mr. McTague expressed that inasmuch as his country had failed to enunciate this principal, he felt that he had to. The opinion makes clear that licenses are privileges and those holding them, by grant from the Province, were required to meet higher ethical and business conduct standards than those not privileged to have licenses, etc. The principle was established that mail frauds into the U.S. would not be tolerated.

CHAPTER VI

1948 – 1952

1948

Mr. Lennox appeared to be walking hand in hand with Mr. McTague during the two years they served together, but within three months from the time Mr. Lennox became Chairman of the Ontario Securities Commission, things changed drastically. Callahan reported more frauds rampant than at any time since the SEC was founded. Everything constructive, from our viewpoint, built by Mr. McTague was changed. Mr. Lennox had the same staff, but a different philosophy. Mr. Lennox had held important posts in the government for many years, and was eminently qualified for the job.

Contributing to the enforcement collapse was a revision of the 1945 Securities Act. A new philosophy arose of self-regulation by the broker-dealer with the Ontario Commission standing by as a referee.

The present Ontario Securities Act (Chap. 351, Revised Statutes of Ontario 1950) was passed in 1947 and became operative March 9, 1948. The Broker-Dealers Act of 1948 passed at this same time, created the Broker-Dealers Association of Ontario. The Broker-Dealers Association was patterned upon the Maloney Act creating the NASD. Mr. McTague sponsored the idea and was convinced that such an association would largely eliminate unethical and illegal practices. The association was formed to provide self-discipline and self-management for its members. All brokers and dealers who deal with the public in Ontario were required to belong to the

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meeting was held and the membership agreed on a 60-day "truce" with no mailings to be made in that period, except where a mailing was stamped and already to go. Phenomenally, all of the high-pressure operators had literature "ready" to mail, the 60-day truce was not effective and a large segment of the membership who made no mailings cried "double-cross." Two of the Board members and 33 members resigned. At this point, one Canadian official said of the Association that it was " . . . not advancing a single constructive point." Conversely, the Association was urging more liberalization and the abolition of prospectuses. Certain of the Board purportedly "leaked out" information about the financial standing of some members, causing much bad feeling. In general, the type of enforcement visualized by Mr. McTague was not being tried by the Association.

Mr. Lennox has explained that he was "green" on the job and had left it up to the Association to correct its members. However, things got so bad that Mr. Lennox took action. On September 6, 1949, Mr. Lennox formally notified the Association that its self-policing had broken down and that the Ontario Commission would again exercise jurisdiction over the members. (See Ex. 8.) Lennox reported that the Association was much improved by 1951. Among other things, the Association began requiring salesmen to undergo a training period and six months' probation.

Not the least of the troubles encountered by the Ontario Commission and the Association were those caused by about 60 present or former U.S. citizens. These persons have been registered as either brokers, dealers or salesmen or without registration act through "fronts" and have given the Ontario Commission and U.S. citizens much more trouble than all others combined.

On June 18, 1948, Noel H. Knowles of Toronto, Canada, was arrested at LaGuardia Airport as he stepped off an airplane from Toronto. The arrest was at the request of the SEC, based upon a Callahan affidavit and a Federal Michigan District

indictment obtained October 1, 1946. Knowles was booked, fingerprinted and held overnight by New York police. Next day he appeared before U.S. Commissioner Edward A. Fay. The U.S. attorney requested $50,000 bail because the offenses were non-extraditable. Mr. Fay fixed $25,000 bail and the arraignment of Knowles before Judge Kennedy for June 21, 1948. When the secret indictment of October 1, 1946, was opened it developed that Knowles' Canadian attorney, one Ernest Newsom present to defend him, was named also as a defendant in the 1946 indictment. Newsom was called to the bar to enter a plea. Both Newsom and Knowles plead not guilty. The U.S. attorney requested $5,000 bail for Newsom but Judge Kennedy said no bail was needed because Newsom was a member of the Toronto Bar. Both were requested to appear on Monday, June 28, so a trial could be set for some time in September or October. Mr. Knowles skipped back to Toronto and forfeited bail. The indictment against the attorney was nolle prossed as Knowles' testimony was necessary to make out a case.

On August 31, 1948, the Commission discussed again with the Post Office Department a possible technique for stopping mail campaigns. One case was presented to it and the legal closing of the mails to violators was discussed and studied. It was determined that we could obtain postal fraud orders and fictitious name orders upon a proper showing and with proper affidavit evidence of violation.

On occasion a promoter from another Province would get some literature into the mails before the Province could stop it. A scheme from a "Scientific Research" agency located in Montreal in December of 1948 was unique. A chance was afforded to really make some money. This inventor gave you a chance with Electromagnetic-atomic-fusion, "the result of more than twenty years of scientific research and experimental work." The literature was very interesting, particularly these two paragraphs:

> "To prevent any possible misunderstanding, I wish to make clear that my system of Electromagnetic-atomic-fusion is not at all like atomic-fission; it will not need or use uranium, plutonium or

> any other mineral; will not give off any harmful rays or emanations; and because of its safety and convenience for everyday uses of mankind, will not be restricted by atomic-energy commissions or controls. It will function by fusing atoms from AIR -- plain atmosphere. In other words, when my system of Electromagnetic-atomic-power is commercialized, sir will become the fuel in general use throughout the world, replacing such present-day fuels as coal, oil, gasoline, etc., to produce power, heat and/or light, for all needs and purposes; to drive your auto or aeroplane or heat your home.
>
> "To give you something pertinent upon which you may base sound judgment, I will relate what a top-ranking physicist said some time ago. This physicist is the chief research-scientist for one of the large manufacturing corporations of the U.S.A. We were then discussing terms of a tentative royalty-contract; the chief engineer asked him what he thought my proposition was worth, when commercialized, and he answered without hesitation '100 BILLION DOLLARS.' Yes, he said all of that he was not trying to be funny. Now the point is this: If what I have is worth that much, on a royalty-basis, to one corporation, then what should it be worth to our proposed holding-company, when it has many such royalty contracts with hundreds of corporations all over the world? Several are awaiting my demonstrations now, and I shall go about closing such contracts, when I have the demonstration units ready. As stated above, that is what I now need money for."

During 1948, the States took 144 actions against Canadian violators. Ontario took 35 administrative and 33 criminal actions.

1949

An example of the urgency of making fast purchases before the market "ran away" from those being let in on the ground floor cheaply is typified by this telegram from Toronto dated March 21, 1949, to a prospective victim in Denver, Colorado. The telegram reads:

> "AM ADVISED FROM CALGARY NORTH CONTINENTAL WELL BLOWING WILD WITH NATURAL GAS FLOW-STOP-THIS CONSIDERED SPECTACULAR DEVELOPMENT AS REDWATER SUFFERING FROM GAS DEFICIENCY-STOP-WITH WELL ALREADY INDICATED PROLIFIC PRODUCER BEFORE REACHING MAJOR OIL BEARING FORMATION EXCITEMENT RUNNING AT PEAK-STOP-ADVISE YOU TO TAKE FULLEST POSSIBLE ADVANTAGE THIS EXCLUSIVE ADVANCE INFORMATION AND RUSH ORDER BY TELEGRAPH AT ONCE-STOP-MY PREDICTION STOCK WILL RUN WILD SO DO NOT SET CEILING ON PURCHASE INSTRUCTIONS.
>
> LEONARD L. McCARTHY"
>
> (Note: Mr. Lennox had suspended the registration of McCarthy October 28, 1948, because his paper "the Financial Analyst" had run an untrue balance sheet of Nicholson Mines Ltd. Mr. McCarthy then dropped the publication and operated on his own without being molested.)

Things got so bad a deputation of State Securities Commissioners called on Mr. Lennox in the spring of 1949 (Johnson of Nebraska, Merkel of Ohio and King of Virginia represented the National Association). They came back discouraged after two days in Toronto. Salesmen in Toronto were making $2,000 to $4,000 a week and many unlawful offerings were being made. A.H. Lund learned while in Hawaii early in 1949 that Chinese professional men there were being solicited by literature and overseas telephone calls from Toronto in perfect Chinese. The campaigning had reached a professional status.

During this period, the Toronto Broker-Dealers Association and others began to propose to the SEC that if a simplified exemptive arrangement could be worked out, the Ontario group would clamp down on its members and prevent any offerings subject to the 1933 Act which did not comply with the proposed new simplified requirement. Brokers, dealers and underwriters would also register with us as broker-dealers under the 1934 Act.

Mr. Hobart L. Brinsmade, representing the Association appeared at the Commission June 23, 1949 to discuss a potential Regulation D exemption and to arrange for future discussions between the SEC and Canadian officials and groups. On June 28, 1949 the Commission advised the Canadians it would enter into preliminary discussions. Brinsmade advised the Commission that in his opinion the Canadian courts would not give American investors the protection afforded by Section 12 of the 1933 Act. Also, that it would be impossible to get the Canadians to agree to the extradition treaty (absent some revisions) at that time.

The files indicate that the proposed Regulation D philosophy idea met with the hearty approval of all provincial officials. Canadian Exchanges and investment and mining groups. All seemed to feel that Regulation D would go a long way toward smoothing out the problems. However, certain newspapers, the Commercial & Financial Chronicle and a few others, expressed views that SEC regulations would still hamstring all speculative development.

At this same time, certain Canadians were bringing pressure on the State Department to stop the activities of Callahan and Jaegerman who were doggedly investigating violations in Canada. Complaints were lodged against them on May 27 and

again on June 8, 1949. The Complaints were from the Ontario Securities Commission and from accounting groups and mining and engineering groups. (Certain accountants and engineers acting as officials of promotional companies selling into the U.S. in violation had been recipients of Callahan's warning letters.) The Ontario Commission, through its Mr. Anundson, complained that our investigators were interfering with the financing of Canadian companies.

In substance he had eight things in mind as follows:

1. He deplored as "impertinent" the fact that U.S. officers were investigating in Canada. He wondered how the United States would like Canadian investigators running around investigating at will in the U.S.

2. He contended that the SEC pressures its investigators to bring Ontario brokers before U.S. Courts. Says SEC and various states feel that companies not resident in the U.S. must appear in U.S. before U.S. Courts.

3. He contends that Ontario brokers do not violate Canadian criminal code – might violate U.S. laws but not Ontario ones.

4. He says big brother (U.S.) trying to bully little brother (Canada) and Canada will not be bullied.

5. He contends that the SEC uses entrapment methods.

6. He resents "smear" campaigns being waged by U.S. newspapers.

7. He denies worthless securities are being sold. All offerings have been carefully screened by Ontario Commission.

8. All Canadian companies resent "probes" by SEC agents.

It is of note that Mr. Anundson procrastinated in 1949 and avoided for some months giving SEC information it requested from the Ontario Commission re 24 brokerage concerns in Toronto, which we advised Toronto appeared to be offering illegally into the U.S. He held off, asking us to await the outcome of a pending case (Chief Redwater).

The Commission, on June 28, 1949, decided to call the attention of the State Department to the seriousness of the violations and the difficulties of enforcement ". . . and the necessity of continuing the use of every means at its command to protect American investors."

The Commission's 15th Annual Report (for June 30, 1949) called to the attention of the Congress our inability to enforce adequately the laws in respect of Canadian violations. It relates that even where the violators have been apprehended they have jumped bail (De Palma and Knowles).

Having received the full cooperation of the Post Office Department, the Commission's new technique of obtaining Fraud Orders and Fictitious Name Orders was launched seriously with 12 cases referred July 6, 1949 for Fraud Orders.

In early July 1949 the National Association of Securities Administrators (Provincial Administrators also being members) met in [_____] Richmond, Virginia. Not only were the State Administrators critical of Ontario, but the other Provincial Administrators joined in. Stewart J. Smith, Administrator for British Columbia in his speech before the Association July 11, 1949 criticized the activities of the Ontario Commission. (See Exhibit 9 for text of Smith's speech.)

Although the SEC and the States had cooperated more or less in enforcement problems, the Richmond meeting kindled a new fire. We began to supply requests from some states for such information as we had respecting violations in their states. New York State on July 27, 1949 advised us it had secured injunctions against all persons on which we had given it information. It reported that it needed only a little more information to get some more injunctions. On September 22, 1949 the Commission authorized the transmission of information on 25 more cases to New York State and information on 21 cases to the State of New Jersey.

By mid 1949 nearly all of the provinces, following the load of Mr. Smith, had joined with the SEC in the fight against the unscrupulous brokers and dealers in Toronto. Mr. Lennox, however, fought back vigorously through the Toronto press contending that there was no such fraud as alleged. He challenged the proof of these "wild allegations." Part of the press picked up the cry that the SEC in Washington in order to expand its strangle held on business instigated such lies so as to convince the Congress that its appropriations should be larger. The accusation was made that we smeared everyone with charges of fraud when only minor technical violations -- such as failure to register -- were involved. The contention was made that there were no such frauds as the SEC was claiming.

The attacks upon violators became so frequent that the better elements in Canada were harmed. For example, Mr. Blackstock of the Alberta Securities Commission, wrote Mr. Felden July 28, 1949, in part:

> "There is one matter, however, with which I feel I must take issue with your Board. All of your files are labeled 'Canada'. I feel reasonably sure that you never receive complaints about literature from any Province other than Ontario. Why then should Canada as a whole be branded because of the sins of a bunch of shysters in Toronto?"

The law abiding element came to realize more and more that the whole of Canada was being harmed by the Toronto violators.

As indicated earlier, the pressures on Mr. Lennox became so great within Canada (and, according to our information, partly from the Attorney General's Office) that he "took over" the functions of the Broker-Dealers Association in September 1949. He threatened to revoke the registrations of dealers where their efforts were devoted ". . . almost entirely to effecting sales outside Ontario . . ." (See Exhibit 8 for text.) He accused the Association of not doing anything constructive and indicated that it had failed to control the activities of its members. In this connection, it should be borne in mind that at all times the Ontario Securities Commission had complete jurisdiction over the Association with authority to investigate, suspend and cancel the license of any offending broker or salesman. Mr. Lennox could have stepped in at any earlier date to correct conditions but he is reported to have kept "hands off" in order to give the Association [_____] its own corrective assurance.

Mr. Lennox set up some [_____] in September 1949 (not in writing, however, so far as we know). These four standards, according to our information were:

1. No brokers shall make any offerings of securities outside of the Province of Ontario.

2. All brokers must be [_____] or underwriters of the securities offered to the public.

3. No brokers shall have [_____].

4. Multicolored sales literature was no longer permitted.

The action and proposals of Mr. Lennox caused a breach in the theretofore pleasant relationships between the Commission and the Association.

Mr. Lennox was also having trouble with some of the 15 investment advisers registered with the Ontario Commission. He instituted investigations and threw 7 of them out of business. Some of these investment advisers had been touting securities for promoters and had urged the prospective purchasers to go to their own United States brokers to buy the shares. The New York Regional Office, learning of this type of activity, warned U.S. "brokers" in letters (see Exhibit 10 for sample) that they would be in violation if they aided in distributions of non-registered securities being offered from Canada.

Many American brokers complained that they had a right under Section 4(2) of the 1933 Act to effect unsolicited brokerage orders whether or not there was a distribution. Moreover, the brokers contended that they had no knowledge of whether a distribution was under way and that it was unrealistic to expect them to stop and investigate before accepting an "unsolicited" order. The New York Office contended that a proper interpretation of Section 4 had to be concerned with the desire of Congress that the public be protected. The issues under distribution usually were from companies formed within 1 year or from optioned blocks of securities. It contended that the exemptions for transactions were intended to apply to cases where the public does not require protection. [_____] the public needed protection from fraud in these distributions and no exemption could be available. Moreover, the "brokers" when

aiding in a distribution were doing more than merely acting as brokers, i.e. they were underwriters.

Many Americans, Canadians and Mr. Lennox did not like the New York Regional Office's interpretation. Mr. Lennox, in later testimony, said that the New York Regional Office's interpretation was contrary to the Commission's interpretation and was a deliberate attempt to prevent the sale of Ontario securities in the United States. He complained that Section 4 related to exemptions from prohibitions against selling securities, not buying securities. Hence, the New York Regional Office's interpretation was unfair as unsolicited buyers were merely buying. (After 20 years some people still seem to forget that if there is buying there must also be simultaneous selling by somebody and yet Mr. Lennox and others try to isolate buying from selling.)

Litigation Releases 536 and 565 tell of the indictment on September 15, 1949 of Ingwald S. Steensland, who entered a plea of guilty and got 5 years probation. He was charged with selling interests in an alleged lumber and pulp mill and coal mining project in British Columbia through false and misleading representations.

On October 10, 1949 the Richmond Virginia News Leader ran some publicity (typical of that promulgated throughout the U.S.) warning recipients of literature and phone calls and of the fraudulent aspects of the offerings from Canada. The article pointed out that between July 1, 1946 and June 30, 1949 a total of 688 actions by states and provinces had been taken against Canadian illegal offerings with 877 defendants. Virginia alone had taken 32 actions against 65 firms.

Mr. Lennox, testifying in 1951, said that in October 1949 and in 1950 trips were made to Washington in an effort to work out a simple regulation for the sale of Canadian Securities and said:

> "I went down alone in March of this year and I made a further approach saying if they would extend this privilege to Ontario, we would stamp out all forms of mailing or solicitation to the United States on the ground that it would be in the public interest to do so. If we found a legitimate avenue of trade, we would stamp out every other form of trade." (Underscoring supplied)

He further stated that all proposals to the SEC were met with the proposition that there must be an extradition treaty first. He went on

> ". . . and that is a Federal matter" – up to the Dominion and not the Provinces ". . . so we are stymied."

Lennox testified that although he probably did not have the legal power, he would have stamped out the registrations of those who did telephoning and mailing if a short form registration had been worked out. He said he would have done this under the "public interest" provisions of Section 8 of the Ontario Act. The Commission's files show that Mr. Lennox et al met with the Commission to discuss Regulation D in 1949, when a draft Regulation D was submitted for discussion.

In furthering their desires for a Regulation D exemption, the Broker-Dealers Association researched the law and its counsel advised us November 30, 1949 that

A U.S. Judgment based on the consent of a Canadian to submit to the jurisdiction of the SEC by designating an "Agent" in the United States would be enforceable in Canada as a judgment and not open to attack collaterally.

In late 1949, Mr. Callahan wrote to a Post-Office inspector friend to find out all possible ways and means to extradite a person from Canada, hoping for some leads or

new thoughts. The Post-Office inspector wrote back that extradition for security frauds under the existing treaty was just about impossible. He cited several abortive attempts of his over a 20-year period.

The Commission, somewhat elated at the initial success of the fraud order technique, got a setback when it developed that the fraud artists were as agile in this field as the selling field. The fraud artists began to supply printed envelopes to prospects with only a room number, or some address not similar to the fraud order address. Names were changed frequently to keep ahead of the post office orders. The step that made fraud orders useless, however, arose in the case where the subject of a fraud order printed his own Toronto office number as the return address. Thus, when the Post Office intercepted mail addressed to him and stamped it "Fraudulent, return to sender," the letter was turned over, the sender's address noted and the letter directed to his office in Canada anyway.

In substance, we were not effectively stopping the violators in 1949 despite all our efforts. The States took 377 actions and Ontario 12 administrative and 15 criminal actions. Two other provinces took one criminal action each. The Treaty was dead, the frauds were mounting and the cooperation previously enjoyed occasionally with Toronto was nowhere in sight.

The unlawful offerings of securities from other countries is not unique with Canadian offerings from Ontario or Quebec. In 1949 the Commission was asked by the Territory of Hawaii to send people out to aid it in stopping non-registered fraudulent offerings from the Philippines. Two SEC investigators found 22 unlawful offerings being made into Hawaii from the Philippines and Korea without Federal or Hawaiian compliance. A simple amendment to Hawaiian laws providing that no securities could be

registered or offered in Hawaii unless proof were furnished of compliance with or exemption from Federal law plus some jail sentences for a few Philippines caught before they could flee Hawaii did much in cleaning up Hawaii.[1]

With violations increasing, the Commission redoubled its efforts to get through a Treaty Amendment. Conferences were held with State Department and Canadian officials. With Regulation D as a prospect, it was believed that no responsible elements would fight a treaty covering what everyone on both sides of the border recognized as securities frauds. We pared down our 1942 and 1945 proposals even more and Canadian elements came toward us and we arrived at agreement, all hopeful it would in large part drive out the fraud artist. By hindsight it is still obvious that we would have gained nothing had we not lowered our threshold.

The only evidence found in our files indicating any official United States disagreement with our attempts to "clean up" fraudulent offerings is found in a copy of a letter from the late Congressman Charles A. Faton to Dean Acheson, Secretary of State, in October 1949. Mr. Faton complained strongly that the SEC had impeded the flow of American capital into meritorious Canadian enterprises.

1950

The year 1950 brought no change in the violation picture. We were learning more definitely as time went on that we were helpless without the cooperation of the Ontario officials and they claimed to be unable to cooperate because their laws related solely to frauds in Ontario where Ontario citizens were the victims.

[1] A.D. Llanos got 5 years and 6 other convicted defendants received varying lesser sentences. All were fined amounts ranging from $10,000 to $1,000 (See Litigation Release No. 685.)

A little inter and after much discussion, one partial solution came to the front in one area. To make it impossible for Americans to buy securities through their own brokers in instances where an illegal distribution was in process. With the cooperation of industry a study commenced as to ways and means to stop such purchases. This movement evolved from the N.Y.R.O. interpretation that "brokers" violated when participating in a distribution. Various representatives of the Exchanges, the NASD, the IBA, the State Commissioners and others joined in the study.

On February 2, 1950, a representative of the Ontario Broker-Dealers Association appeared before the Commission and indicated that his organization and others would look favorably on the Treaty if something comparable to a Regulation A exemption were given to the Canadians. The Commission took the position that it would consider an exemption amendment only in relation to overall Canadian problems.

The Ontario Commission, in an effort to prove that under certain conditions, it could control the situation, began by tightening up some of its requirements. For example, prior to 1950 the Ontario Securities Commission allowed the promoters to take 1/3 of the authorized stock for the property turned in to the corporation. After 1950, the percentage was reduced to 25% in a 3,000,000 share company, 20% in a 4,000,000 and 18% in a 5,000,000 share company.

Escrow stock was required to be placed in a pool, usually with a trust company and under normal conditions could not be released without the consent of the Ontario Securities Commission. If the stock was listed, the consent of the Toronto Stock Exchange was needed. Previously, one escrowed share was released for each one share the company sold, but the company was now required to sell three shares before one

promoter's share could be released. However, upon a showing of development, good financial condition, etc., a general release of the escrowed shares might be obtained. The escrow agreement was made a condition precedent to registration in Ontario. The escrow agreement philosophy was initiated as a reform. For example, it prevented the promoters from dumping their escrow shares on the public and leaving a "dead duck" enterprise.

The staff finished its study on the "Deficiencies in Extradition Arrangements between Canada and the United States for Securities Frauds" in March of 1950. The Commission approved the report March 15, 1950 (see Appendix 1). This 87 page study and 6 page supplemental report deal with all the legal aspects and deficiencies. The need for Treaty revisions are outlined. Boiled down, the study attempts to clarify the factual and legal aspects of the problem; to answer various objections theretofore raised; and contends for a way to bring the fraud artists before our courts in instances where United States citizens were defrauded by them. (Various legal documents with respect to the Treaty are also attached as Appendix I.)

In March of 1950, the United States Post Office authorities told us that the fraud orders were not as effective as they had hoped. Mr. Callahan then called on the Canadian Post Office authorities to see if they could collaborate.

On March 24, 1950, Mr. McEntire wrote a letter to Senator William Langer responding to the Senator's request for information regarding Canadian violations. The letter is important in reflecting our thinking at that time. It relates that a fringe group, operating largely from Toronto, has violated our laws and taken a large toll from American investors; that we have been unable to cope with it and that

> ". . . until the existing loophole in our extradition treaties with Canada is closed, there is little that the law enforcement authorities in this country can do to fully and effectively put a stop to these activities."

It relates that we have obtained indictments and secret indictments; that two apprehended violators jumped bail; that we have fostered publicity; and that we have gotten fraud and fictitious name orders. It says:

> ". . . However, after considerable study of the problem, we are convinced that effective and comprehensive protection against these securities frauds can be insured only if existing extradition arrangements with Canada are revised."

At this point our warnings to the public, coupled with those of state authorities, Better Business Bureaus, newspapers and magazines, both here and in Canada, and the warnings of business leaders had failed. Despite full cooperation from state authorities, we couldn't find existing laws or techniques to "break the bank" of the problem. Despite splendid cooperation from United States and Canadian postal authorities the fraud orders didn't work. Our investigation techniques didn't frighten anyone. As an example, A.P. Bryant, then an employee of the SEC, was a telephone victim of a phoney stock offer from a salesman in Toronto. The call came to the SEC offices. When Bryant cut short the pitchman with disclosure that this was the SEC and he was an enforcement attorney working on Canadian violations, etc., the salesman laughed out, "The boys up here will really get a bang out of this!"

Mr. Callahan vigorously attempted to find ways and means to stop the frauds. He got cooperation from many people and gathered information no one else could get regarding distributions, uses of postal meters, etc. His efforts were only partly effective. Everything now rested on an extradition treaty.

On March 25, 1950, the Canadian Dominion government stepped in to stop frauds. Without warning, the postal authorities at Ottawa denied use of the mails to 27 broker-dealers and underwriters on suspicion of fraud.

The fraud order campaign met with opposition from brokers, members of Parliament and broker dealer groups in Canada. There was opposition even from American victims. It was charged that the Department (Canadian P.O.)

> ". . .was not within its rights in prohibiting brokers and employees from receiving mail – especially personal mail – when they had not violated any regulations."

This action was denounced bitterly by the Bay Street financial center and Mr. Lennox invited those unable to receive personal mail through normal channels to have their mail delivered in care of him at the Ontario Commission and he would see that they got it. George Drew, former Premier and leader of the opposition, denounced the action in the Press on March 29, 1950. He said that the Post Office had no authority from Parliament to act and went on that the SEC wasn't authorized to instruct the Canadian Post Office what it should do, saying in part:

> "Let us remember that they have in the United States a practice of issuing orders in a loose way which deny certain rights to citizens and which do not bear any resemblance to any procedure we have.
>
> "In Canada, we insist that our citizens be able to have their rights determined before courts."

The Canadian Post Office action had constituted the most effective step ever taken against the swindlers.

In April 1950, Time magazine played up the Canadian Post Office action in barring the mails to 23 Toronto brokers and some 50 individuals. Time tells that:

> ". . . the gold-conscious Toronto Telegram and the Globe & Mail cried out against 'tyranny' and 'interference with civil rights'."

The article also told of Mr. Drew's attacks.

The law abiding element felt Ontario enforcement had been too lax and that reputable dealers were harmed by the unscrupulous few, and attacked the Ontario Securities Commission's laxity. On April 30, 1950, 28 broker-dealers, mostly Toronto Stock Exchange members, resigned from the Broker-Dealers Association explaining that too much "small" was getting on them.

In April, the CIO News ran a full page warning the public against Toronto stock salesmen. On May 30, the CIO ran a network broadcast warning the American public. In June of 1950 Harry A. McDonald wrote an open letter to Canadian securities dealers which was given wide publicity, including publication on June 19, 1950 in the Investment Dealers Digest. Despite cooperation everywhere (except for Ontario) the frauds continued. The frauds as always were directed at the inexperienced or people with small or moderate means – segments of the population most clearly in need of the protection of our securities laws.

Although the Canadian Post Office started our vigorously in getting fraud orders, it lost out. By June 9, 1950, mail privileges were restored to three and papers already prepared to file against eight more were not issued. By June 15 several more fraud orders were lifted and by year end, the mails were wide open again to the Canadian fraud artists.

On May 1, 1950, the National Better Business Bureau of New York City wrote the SEC Chairman regarding the unabated efforts of Canadian promoters. It says that in the first sixty days of 1950, B.B.B. offices in 10 of its 92 bureaus received 1,300 inquiries regarding Canadian promotions. In South Bend, Indiana, the bureau there received 285

separate pieces of mail from Toronto. These came from 28 dealers offering stock in 36 different ventures and relates to "flamboyant and reckless representations and promises which were so prevalent in the United States in the 1920's. . ."

Ontario reinstated the requirement in 1950 that copies of selling literature filed with the Broker-Dealers Association be filed with it. It had stopped requiring literature filings back in 1944 and even when the requirement was reinstated in 1950 did not examine the literature. It merely checked it, in the event of a complaint, to see if it were the same literature which the complainant had received. Mr. Lennox explained that in his opinion, it was better if Ontario did not look at the literature before its use, lest people get the impression that the Ontario Commission had been over it and backed up the representations.

On August 23, 1950, the Commission instituted action against two Texans selling Canadian securities in Texas without registration. Permanent injunctions were obtained September 6. (Litigation Release Nos. 611-612.)

During 1950 the states took 327 actions against Canadian violators and Ontario took 15 administrative and 10 criminal actions. The SEC obtained a number of fraud and fictitious name orders. By January 31, 1951 it had obtained a total of 61 such orders. The Broker-Dealers Association of Ontario advised us that it too had taken some disciplinary actions. While no names were given, it summarized 20 actions taken by the Association against its members. All 20 were found guilty of the offenses charged. It is not clear whether more than one was expelled, but several were fined as high as $1,000 and all were warned that repetition of the offense would be regarded very seriously by the Board.

The SEC continued to press for Canadian acceptance of a Treaty and was beginning to receive encouragement that such might occur in the near future. It was clear that many of the ideas worked for in 1942 and 1945 would have to be abandoned, but a treaty with lesser standards was shaping up.

1951

In March of 1951, the Ontario Commission cancelled the license of a broker-dealer on the grounds that he was making excessive mailings outside the Province of Ontario. The opinion reiterated the 1948 policy [_____] that registration "should not be granted in this Province in order to enable a registrant to devote substantially his entire effort to effecting sales outside Ontario". The Ontario Commission warned all broker-dealers that it alone would determine who was in fact responsible for the trouble which had arisen as a result of the volume of mailings from Toronto.

The Ontario Commission opinion in this cancellation was most revealing. It stated that responses were received from over 23% of the American citizens solicited by the violator. This seems incredible as the American citizens were being warned daily in the press about the Toronto frauds. At this time, The St. Louis Star Times was running a series called "Suckers in Swindle-Land" and portions or all of it were being reproduced, or other articles were being run by hundreds of newspapers throughout the land and in Canada. There were twelve articles and each exposed the rackets and warned of the potential loss. The Canadian element which feared harm from these articles countered bitterly that the newspaper articles were untrue. The Globe & Mail said that contrary to American representations that a substantial group was engaged in defrauding Americans,

not more than 20 houses were responsible for the mailings and phone calls into the U.S. The Globe & Mail (March 20, 1951) also ran a lengthy paraphrase of a letter from a mining engineer in Oklahoma City, one S.M. Stauffer, who was a bitter opponent of the SEC. (At one time Stauffer ran ads in United States papers pleading with people to send him a dollar each so that he could wage a battle to have the SEC abolished). The paraphrase developed the theme that the SEC had stifled American free enterprise and particularly the development of mines in the United States of America. [_____ _____].

The Financial Post on March 17 came out with a front page editorial heartily endorsing the American protests. It also was mad because some Toronto promotors had obtained a large number of the Post's special report on Canadian Oil developments and had doctored the paper by removing one page and had replaced it with a spurious one in the same format, touting a "moose pasture" oil company. These forged copies were mailed into the United States under the guise of being legitimate and United States citizens were urged to buy stock immediately at $1.00 which stock was currently selling in Toronto around 20¢ per share.

On March 20, 1951, the NASD sent out a bulletin to its 3,000 members warning them against participation in Canadian distributions by effecting customers' orders for such securities. The SEC was trying to counter the technique of Canadian "investment advisers" touting a security with instructions to hurry and place the order with your own broker.

Following a conference with the Federal Communications Commission on April 6, 1951, the Commission outlined its problems in writing and asked the Communications

Commission to consider whether it had jurisdiction to shut off the telephone from these illegal uses. On April 10, we were advised that the matter was to be explored with officials of the American Telephone and Telegraph Company.

The Broker-Dealers Association proposed a tightening measure to the Ontario government. Ontario would have to amend the Broker-Dealers Act of 1948, however, before it could become effective. The amendment suggested would require promotional securities to be designated ". . . the security is speculative" or "this is a speculative venture" in legible print. In May, the Association adopted the restriction as a "policy" of its own.

In April 1951, Mr. Wismer, counsel to the Broker-Dealers Association of Ontario, expressed surprise publicly that the United States had never tried to extradite any of these so-called fraud artists for false pretenses. The implication was that we could easily extradite if we had evidence of fraud. In June, Mr. Lennox told the press that the United States generally didn't have much "factual evidence" to support its claims of fraud, but he invited all Americans to send him evidence if they thought they were defrauded and he promised to investigate.

In April 1951, the National Association of Securities Administrators adopted a resolution condemning the fraudulent selling from Ontario and the President of the Association was authorized and directed to contact Ontario in an effort to stop such selling.

In May, the Financial Post called on Ontario to clean up the mess. The Financial Post openly called the share pushers "crooks". In part, it said,

> "Surely, we have enough honesty and integrity in our various governments to guarantee we can get this thing cleaned up promptly, despite the howls and the pressure that will develop."

It lays the blame on the Ontario Commission, saying it was adequately staffed but did not have the "will" to clean it up or keep it cleaned up.

On May 1 and 2, 1951, the Canadian Press reported rather fully the fact that SEC and United States Post Office officials, with Embassy officials, were meeting in Ottawa to discuss with various Canadian officials Treaty revisions to enable extraditions for securities offenses. [_____ _____ _____ _____] Each side generally agreed in principle, but the wording created innumerable obstacles, as did the effect and wording of a protocol in respect of the Treaty amendment. The United States agreed to drop from the Treaty amendment all offenses not involving fraud, such as failure to register, etc.

Mr. Lennox talked to the press on June 3 or 4, 1951, and on June 5, the New York Times ran this small piece:

"NO MEETING OF MINDS"

> "O.E. Lennox, chairman of the Ontario Securities Commission underlines once again the differences separating concepts of security regulations here and in Canada. Mr. Lennox dismissed Securities and Exchange Commission evidence of Canadian stock frauds by saying that it would not stand up in a court of law and added that "in view of the large numbers of firms operating there had actually been very few bona fide complaints against Ontario brokers and salesmen'. For years the S.E.C. has been working for an extradition treaty that would cover stock frauds across the Canadian border. Thus far it has found itself almost helpless to do anything other than publicize the fact that they are taking place through international telephone and international mails. Mr. Lennox countered with 'strong advocacy' of 'reciprocal registration' of securities, which would mean 'uniform acceptances of registration by one securities commission as obligatory

> on every other commission'. Such an agreement would legalize sales in this country of securities registered in Ontario – according to Ontario standards.'

In July of 1951, the Ontario Commission [_____] got a shot in its enforcement arm, if it wanted it, when the Ontario Supreme Court upheld its cancellation of a license by a broker for using misstatements in his literature. The Court told the Commission that it had untold power in this area. Nevertheless, fraudulent literature continued to fall across the United States.

The Financial Post and the Toronto Star continued through the spring of 1951 to air the American charges of fraud and criticized the Canadian enforcement. The Post charged flatly that the Broker-Dealers Association of Ontario had failed abysmally to curb the reprehensible activities of some of its members; that real frauds were being perpetrated on United States citizens; that other provinces considered these activities illegal, but they manage to flourish in Ontario; and that Canadian postal authorities had cooperated with United States authorities to get fraud orders through in the United States. The Post concludes that the divided authority of controlling broker-dealers between the Ontario Commission and the Association has not and cannot work. It pointed out further that legitimate houses with wires to New York markets had experienced a loss of 50% of their business and that such houses were indignant against their shady fellow-members of the Association and were anxious for a treaty to punish "sharepushers now sheltered safely from American wrath in Canada".

MacLean's Magazine (Canadian) ran an article June 15, 1951 respecting frauds by Toronto operators. It provides a full description of a fraud, starting with the purchase in Chicago for $6,000 of a list of heirs and heiresses compiled from probate court records and the techniques employed to get some of that money. Among other things, the article

implies that some of the "front" organizations are controlled by the United States underworld mob.

On April 27, 1951 McEntire, Kroll and Holden, had conferred with Canadian officials at Ottawa respecting the Treaty and Canadian frauds. The papers began to play this up again. On June 8, 1951, the Commission held a conference with industry representatives, and a committee was formed to study the problem of unlawful offerings into the United States. The so-called "Black List" idea began to ferment. The combined turmoil in the spring of 1951 caused the Ontario government to study the illegal offering problem. It held hearings through the summer of 1951. Although we were invited to participate, our participation took the form of a 17-page letter dated August 17, 1951 outlining our difficulties. The Commission felt that the inquiry by the "Select Committee of the Ontario Legislative Assembly, appointed to enquire into and report upon certain matters concerning the Administration of Justice in the Province of Ontario" should be an Ontario affair. Our presence might have lent credence to the complaint that the SEC was trying to run Canadian finances. Mr. Lennox testified for several days and the testimony clearly reveals his attitudes and beliefs and sharpens up the basic differences between his approach and ours. In brief, he brings an entirely different background to the problem than we have here in the SEC. Canada needs money for development and how it gets it is entirely secondary to the fact that with it Canada can boom and develop.

On June 30, 1951, the House of Commons of Canada, amended the Canadian mail fraud statute to make the "use of the mails for the purpose of transmitting or delivering" certain prohibited things a crime. Theretofore, Sec. 209 of the Criminal Code had related

to one – " . . . who posts for transmission or delivery by or through the post". This change more clearly defined mail fraud and brought it nearer to our statutes.

The Select Committee was in recess from July to October 1951 and when it resumed, Mr. Lennox explained that cooperation with the United States was much improved, in fact was now excellent. It is of note that before the Select Committee could make any recommendations, it was abolished by the calling of a new election for November 22, 1951.

On July 25, 1951, Mr. Lennox testified that he had come to the SEC with a proposal to end all mail stock sales but that the SEC had killed it. He told that in March 1951 he had proposed a uniform registration method where a stock or bond qualified in Ontario could automatically be sold in the United States. If this legitimate channel were open, then selling by mail could be stopped by Ontario as not being in the "public interest".

On August 6, 1951 an independent stockholders' group, Independent Investors, Inc. of New York City, wrote Attorney General Porter, Toronto and urged a clean up. The group told the Attorney General it was informed that 5,000,000 Americans owned worthless Canadian oil and mining stocks. While the number of owners appears exaggerated, the letter does reflect the concern growing among Americans that these frauds had to be stopped.

On August 13, 1951, the Commission authorized McEntire and staff members to confer with United States and Canadian Embassy officials respecting the enactment of a Treaty Amendment. The problem had reached big proportions. In two years the SEC had gotten 70 postal fraud orders and 19 so-called fictitious name orders. The ingenuity

of the recipients of the orders is shown by following the actions against A. Garfield Heyes, Ltd., Toronto. The fraud order issued August 2, 1950. The address was 7 Adelaide East. On October 2 he was providing United States citizens with envelopes addressed to "A.G. Heyes, 9 Adelaide East". On November 1, he was supplying envelopes addressed to "Heyes Limited, Ste. 1 Bank of Toronto Bldg." On February 19, 1951 he supplied envelopes addressed "D.G. Buck Secretary, 876 Eglington Ave. East" and on April 1, 1951 was supplying envelopes addressed "Accounting Dept., Suite One, Bank of Montreal Bldg., Leaside, Ontario." It was necessary to get for fraud orders to cover these shifts.

In the fall of 1951, two new developments were continuing. A short form of Exemption (Reg. D) to be considered when the Treaty passed and the promulgation of a "black list".

Informal discussions with the NASD, Stock Exchanges, and other responsible groups over some eighteen months culminated in the plan for the SEC to compile a list of all Canadian issues currently being illegally offered or recently so offered. All interested groups, including the aforementioned and state commissions and other civic organizations, were to contribute information. We would use this coupled with information in our files to keep such a list current. The various groups were to distribute the lists to their own members. The SEC undertook to revise and supplement the list as needed. The cooperating groups advised their members that securities on the list were not to be trafficked in either as principal or agent, and urged their members to forward promptly any literature respecting other Canadian offerings to the SEC. The list had the effect of eliminating or reducing the investigation efforts theretofore required of a broker

receiving an unsolicited order to buy Canadian securities. On October 1, 1951, the list was circulated. It was immediately [_____] "the black list". It contained the identities of 181 issues and there have been 10 supplements thereto to date. A number of new issues have been added and a number of issues have been removed upon a showing of continued compliance with our laws.

Regulation D was the subject of much discussion, but while preparing such a form, the Commission repeatedly made clear that absent an effective extradition treaty the exemption could not become available to Canadians. The first of fourteen discussions by the Commission in its meetings respecting the adoption of a Regulation D and matters connected with it took place November 20, 1951.

On September 6, 1951, the Commission instructed its General Counsel to consider and report whether by injunction proceedings or otherwise, the Commission might effectively bar the use of the telephone to Canadians engaged in fraudulent sales of securities by telephone to United States citizens.

In October 1951, there was a big sigh of relief around the Commission. A State Department release gave the long awaited news.

Statement Released to Press by State Department

> "On October 26, 1951, the United States and Canada signed a supplemental extradition convention. The purpose of this new convention is to supplement in certain respects the list of crimes on account of which extradition may be granted under the treaties and conventions enforced between the United States and Great Britain on December 13, 1900, so as to comprehend any and all frauds which are punishable criminally by the laws of both contracting states, especially those which occur in connection with transactions in securities. The substance of the convention is contained in Article I, which reads as follows:

'The enumeration numbered 11 in Article I of the supplementary extradition signed on December 13, 1900, between the United States of America and Her Brittanic Majesty is hereby amended to read as follows:

> 11A. "Obtaining property, money or valuable securities by false pretenses or by defrauding the public or any person by deceit or falsehood or other fraudulent means, whether such deceit or falsehood or any fraudulent means would or would not amount to a false pretense.
>
> 11B. "Making use of the mails in connection with schemes devised or intended to deceive or defraud the public or for the purpose of obtaining money under false pretenses."

Article II of the supplementary convention provides that it shall enter into force on the day of the exchange of the instruments of ratification.'

The Commission issued a statement on the Treaty as follows:

STATEMENT OF RICHARD B. McENTIRE

November 14, 1951.

"For some years, one of the major enforcement problems confronting the SEC has related to the activities of a fringe group of stockpushers who, operating from Ontario, Canada, have miloted U.S. investors of great sums of money. Although the Commission has endeavored to halt these illicit promotions by every available means, we have always maintained that revision of our extradition arrangements with Canada is necessary if any lasting and effective solution to the problem is to be achieved.

It would appear that the treaty agreement recently signed by both Governments is adequate on that score and will enable us to prosecute such offenses in this country where the investor-victims reside and the major part of the necessary evidence is to be found. We feel that if such treaty is ratified, it should represent a tremendous advance in terms of investor protection.

In a very real sense, the signing of this treaty is reflective of what seems to be a meeting of the minds on the part of securities regulators on both sides of the border as to the steps necessary to deal with this vexing problem. I think it can safely be said that our

> re-examination of the problem recently with Canadian officials and the new understanding which has developed between us has resulted in notable setbacks to the operations of the fringe group responsible for the perpetration of these fraudulent schemes. Our objective is to provide the fullest measure of protection to our investors without impediment to the free flow of capital into legitimate ventures in either country. The recently signed treaty if and when ratified and implemented by cooperative action of the type suggested above, should enable us to achieve that goal."

Many people thought that most of the Canadian problems would now be solved and the only delay would be ratification by Parliament and the Senate. The mere task of answering letters might now be solved. During fiscal 1951 the SEC received letters from 4,488 persons unlawfully solicited to purchase Canadian securities and each letter required a reply. Each day the 10 Regional Offices received many telephone inquiries respecting Canadian offerings. That there might be some difficulties and a long struggle ahead, however, was indicated by these three paragraphs taken from a letter written by the Assistant General Counsel about 45 days after the October 26, 1951 treaty announcement.

> "Before extradition can be had, the applicable rules of international law requires first, that the conduct for which the defendant is indicted be covered by one of the descriptions of extraditable crimes set forth in the treaty and second, that the conduct be such that if committed entirely within the boundaries of the requested country, it would provide a basis for prosecution under some one of their criminal laws. The name by which the crime may be known in one country or the other is not determinative; rather, the important thing is the substance of the conduct on which the indictment is based.
>
> "Our basic difficulty with the present treaty has been with the first of these principles. The present treaty designations insofar as they apply to fraud are restricted to the somewhat archaic crime of false pretenses which is universally recognized as being inadequate to cope with modern securities fraud techniques and to frauds by certain designated fiduciaries which is so limited in scope that it is of no use as a practical matter. The treaty

> amendment which has been agreed upon is designed to cure these inadequacies and to designate fraud in the broadest possible terms so as to cover the sort of fraudulent securities promotions which have troubled us over the years. Once this is done, we contemplate no difficulty in showing that the conduct would also constitute a violation of the terms of the Canadian Criminal Code, for the Code contains sections which in broad language appear to us to cover the very sort of conduct for which we return indictments under the anti-fraud provisions of the Securities Act and the Mail Fraud Statute. Incidentally, it might be noted that in June of this year the Canadian mail fraud provision was amended in order to make it more nearly like our own.
>
> "We are quite hopeful that if this treaty goes into effect – and at the present time we foresee no serious obstacles in our path – we will have gone a long way toward achieving our ultimate goal of providing the fullest measure of protection to our investors against the sort of fraudulent promotions with which Ontario promoters have been flooding this country."

The General Counsel's office concluded its study of enjoining the telephones and decided there was no clear precedent and no clear law on the proposition. However, the view was expressed that the telephone company could be enjoined from making its facilities available to known fraud artists. A question unsolved, however, was whether A T &T owning only 11.83% of the Bell Telephone Company of Canada, had the power to control in any way the Canadian facilities or interfere with the mechanics of operation. There was only one interlocking director according to Moody's.

In October 1951, the Ontario Broker-Dealers Association took another step forward. It promulgated a regulation providing for the disciplining of a member who sent out any return envelopes bearing a different name and address from the ones under which he was registered with the Ontario Commission. This had the seeds of plugging a loop hole in our fraud order efforts.

On November 28, 1951, a three-day conference of Provincial Securities Administrators began in Toronto. Many problems were discussed but no administrator had power to bind his province so no final decisions could be reached. The general thinking ran toward limiting promotion to 25% of capitalization; escrowing all oil promotion shares and 90% of those of a mining venture; cutting down on markups; setting up a minimum price step up to be received by the company from blocks taken down from the company under option; limiting the number of shares that could be taken down at one price; providing that the initial price to the company should not be less than 10¢ a share; etc. It was agreed there could be no overall acceptance of a registration in all provinces because it was registered in one. SEC officials attended the third day of these conferences and Regulation D problems were discussed. Mr. Lennox, in speaking of Canadian qualifications as a condition precedent to using Regulation D, contends in his November 16, 1954 statement that the provincial administrators

> ". . . .were assured at that time that although the condition in question could not be written into the Regulation for certain domestic reasons, it would, nevertheless, be enforced as a matter of policy." This matter will be discussed later.

There seemed to be agreement that Ontario was improving. In fact, by December 1951 it appeared that we were getting and would continue to get good cooperation from the Ontario Commission. The Broker-Dealers Association disciplined some members for sending out phoney envelopes where we sent them the proof.

During 1951, the states took 346 actions against Canadian violators while Ontario took 24 administrative and 5 criminal actions.

Mr. Lennox testified before Ontario officials in 1951 about the problems between Canada and the United States saying that all the trouble was caused by about 50 dealers

and promoters ("blowers") who sold from year to year into the United States. He said that the people in the United States suffer because they do not get a proper selection of securities to choose from. Mr. Lennox explained to the Committee that he inherited this situation. He explained - - "The trouble is, when you knock one down, another crops up".

Mr. Lennox testified there were about 400 registered broker-dealers, (89 being members of Toronto Exchange and about 105 being members of Investment Dealers Association) and 1100 salesmen in Ontario in 1951. Ninety-four percent of the broker-dealers confined their activity to law abiding sales in Ontario. Accordingly, only 6% or about 25 houses had mailing lists and were telephone pressure and extensive mailing houses. A large proportion of the 1100 salesmen, however, were employed by these "promotional houses". Mr. Lennox said the major problems involved offerings by non-registered people, i.e., people who do not act as brokers or dealers. About 60% of the properties financed in Ontario are located outside of Ontario. Lennox testified that a company should qualify in the province where the property was located as local people are in a better position to detect fraud.

During his 1951 testimony, Mr. Lennox told of the enforcement activities of his Commission,

> ". . . to counteract the idea in some quarters that the Commission in nothing more or less than a rubber stamp".

Mr. Lennox became chairman in July 1948 and in the next three years, 160 registrations were either refused, suspended or cancelled (92 of these appealed to full Commission and about 1/2 of the 92 were successful in their appeals). He stated that he refused about 10% of all applicants. The turn downs were largely for "bad pasts" according to his testimony.

The enforcement activities referred to were:

	Year ending 3/31/48	3/31/49	3/31/50	3/31/51
Broker-dealers				
	13	9	4	17
Cancellations or	9	11	9	12
suspensions	5	16	9	6
Refusals				
Abandoned				
Salesmen				
Cancelled or				
suspended	3	12	0	9
Refused	7	28	27	29
Abandoned	44	47	35	46

CHAPTER VII

1952 – 1954

1952

On January 16, 1952, President Truman transmitted the supplementary extradition convention signed at Ottawa, October 26, 1951, for senate action and ratification.

On February 18, 1952, Mr. Lennox told Mr. Callahan that he was really driving the "fringe" out. He related that since he became Chairman he had cancelled out 54 broker-dealers and had put 50 salesmen out of work as a result of closing out the fraud artists. He explained that many others had left the area. He stated that three or four mail order houses were still operating, but that he was investigating. He believed that they were losing money so might soon close, even before he got the necessary evidence to close them up. Mr. Lennox stated that he was very encouraged but that constant scrutiny was necessary to prevent a flare up.

On February 27, 1952, the Commission considered the question whether financial publications carrying institutional ads respecting Canadian broker-dealer firms would be in violation of Section 15(a) of the 1934 Act. The Commission determined to take no action, but to keep the ads under surveillance.

On March 11, 1952, representatives of the SEC met with Ontario Securities Commission and Ontario Broker-Dealer Association officials in Toronto for further discussions of a draft of Regulation D. Subsequently the completed draft was circulated for comment August 18, 1952.

On April 21, 1952, the Commission was apprised of "touting techniques" being employed to sell Canadian securities illegally and the staff undertook to study the problem. In this connection, a survey indicated that all adviser services available to us (some had national circulation) were from bullish to very bullish on future prospects in

Canadian oil and mining stocks. The consensus seemed to be that Canada was the last remaining frontier to be developed and fortunes could still be made by fast action.

On April 23, 1952, the Ontario Government took more restrictive steps by amending the Ontario Securities Act to require delivery of financial statements with a prospectus and to extend from a 6-month period to a 12-month period the time within which proceedings could be commenced for untrue statements.

While the Commission had mentioned the Canadian enforcement problem to the Budget Bureau and the appropriations subcommittees of the house and senate from time to time, no specific money for "Canadian" purposes were requested until the spring of 1952. In the 1953 budget we suggested that registration of issues and broker-dealers would increase and many issuers would seek to use Regulation D. It was indicated that additional personnel would be needed to process this new work. Somewhat the same matters were discussed in the '54 and '55 budgets.

On May 16, 1952, Mr. Keith Funston, President of the New York Stock Exchange critized the sale of "moose pasture" securities from Canada which "were riding the coat tails of legitimate business expansion in Canada". He attacked the unscrupulous methods of these "moose pasture" salesmen, saying, "They are literally stealing millions of dollars from the unwary." (It is of interest that this is approximately the same kind of attack made by Mr. Funston in 1954, which, among other things, caused Mr. Lennox in 1954 to break his [_____] with the SEC.) Mr. Lennox was given press space to comment on Mr. Funston's remarks and the press reports his saying that Funston's statement made "… a lot of common sense" and supplied a "keynote" for Americans dealing in Canadian securities. In commenting on Funston's remarks about "unscrupulous salesmen", Lennox said:

> "Know who you are dealing with. The unknown voice on the telephone is the root of the trouble so far as fraudulent selling is concerned.

> "Despite the actions of the unscrupulous, there is a vast amount of wise money coming to Canada. We have cut down on a lot of pressure houses and the situation in that regard has improved."

Mr. McEntire is quoted in the same paper (N.Y. Times, May 17) as saying that while there have been a great number of unscrupulous salesmen "…the ranks are slowly dwindling." Mr. McEntire stated that the problem should be further eased with the adoption of the pending treaty amendment.

In May, 1952, Congressman Heller inquired of the Commission whether the pending treaty amendment failed to give protection to U.S. citizens against the types of frauds then current. One or two American articles had implied that the new treaty would not stop the frauds. On May 28 a response to him relates that

> "…It is our firm conviction, which is shared by all those who have studied the provisions of the treaty, that it is adequate to cover the whole scope of offenses which have been prevelent in the past few years."

It is then pointed out that the treaty adds two separate designations to the list of extraditable crimes.

> "The first of these additions is the general fraud designation which parallels Section 17 of the Securities Act of 1933. The second designation relates to mail fraud. Prior to last June, there was a Canadian crime which involved 'posting of a letter' for the purpose of defrauding. At that time, their criminal code was amended by defining mail fraud in terms more nearly like our statute (specifically to make possible the inclusion of the mail fraud designation in the treaty)."

The letter cautions, however,

> "…On the other hand, those of us at the SEC have never contended that this treaty will of itself be a complete answer to the problem. Vigilant enforcement on both sides of the Border will be necessary and we are taking every possible measure to see that we get that kind of enforcement effort."

The U.S. Senate approved the supplementary convention for ratification in March, 1952, the Canadian House of Commons in May of 1952 and the Canadian Senate on June 26, 1952.

Of interest is the fact that when the Canadian House did pass the amended treaty on May 21, 1952, one "progressive-conservative" member, Donald H. Fleming, made a statement that it should be clear to all American government authorities that this writ did not open the door for Americans to run Canada. It was also reiterated by Justice Minister Garson that the principls of double criminality had been strictly observed in the convention.

The effect of the amended treaty as passed was very limited. No novel concepts were introduced but two existing types of illegal conduct in both countries were added to the designations in the treaty. Extraditable fraud in the broad terms already contained in Section 444 of the Canadian Code and the use of the mails to defraud were both made extraditable offenses although each was already an offense in each country.

The Canadian Parliament ratified the treaty July 11, 1952. Even before ratification, the press and magazines were hailing the amended treaty as a solution to a thorny long-lived problem and Newsweek for June 16, 1952, for example, pointed out "Last week, however, these borderline brokers were running for cover." The general concensus seemed to be that with the fraud artists out there would be more confidence in Canadian legitimate business and a free flow of needed American money into the development of Canada. The Toronto Daily Star on July 4, 1952, couldn't resist one last (_____) against the lax administration in Ontario however. In an editorial praising the treaty amendment it said,

> "Had the Ontario Securities Commission been on its toes, this same result could have been accomplished long ago. For the Commission has had ample authority to deal with the offenders."

Appended to this report as Appendix 1 are a number of legal treatises on the treaty amendment and its meanings. In plain terms the supplementary convention is simple and well-defined in scope. It does not purport to cover any offenses other than frauds. It purportedly will permit extradition of persons selling securities into this country from Canada by use of the mails, telephone and telegraph when they have engaged in such sales in a manner making them indictable under Section 17 of the Securities Act of 1933 or the mail fraud statute. Registration violations, or other such offenses sometimes characterized as "technical", definitely are not included, although initially in 1942 such registration violations were urged for treaty inclusion. (Few of the standards hoped for in 1942 remained [_____] In addition, it is clear that the principle of double criminality would continue to govern as far as any extradition proceedings under the amendment are concerned. One further aspect of the amended treaty is clear to everyone, i.e., no person extradited can be tried for other things than the offense or offenses for which extradited. Although the ultimate determination as to the scope of the amended treaty rests with the courts, the draftsmen of the amendment felt that the new treaty provision No. 11A "covers everything", and that if there were any "slack in 11B" it would be taken up in 11A.

On August 18, 1952, the Commission announced a proposed Regulation D. With recent extradition tools available, it was ready to consider a conditional exemption from Registration for offerings of Canadian securities. A series of conferences both here and in Canada, together with suggestions from many sources, provided the philosophy and the raw material from which Regulation D was distilled.

The SEC 20th Annual Report describes Regulation D as follows:

> "Regulation D provides a conditional exemption from registration under the Securities Act for offerings not exceeding $300,000 in any one year made by Canadian issuers or by domestic issuers having their principal business operations in Canada. The promulgation of this regulation followed the amendment of the

> extradition agreements between the United States and Canada. It is part of a comprehensive program designed to prevent fraud and remedy certain abuses in the sale of Canadian securities in this country in violation of American law.
>
> "Its adoption was an experiment in international cooperation in stamping out security frauds across the border. The Securities Commission of the Province of Ontario, after the close of the fiscal year, indicated its dissatisfaction with the operation of the Regulation and the Commission is presently studying whether it should be modified or withdrawn. The Commission is also studying other aspects of the overall problem of securities sales to United States Citizens from the Dominion of Canada and various provinces. Regulation D is merely one phase of a much larger over-all problem."

The Provincial Securities Administrators held a conference September 17, 18, and 19 in 1952 in Winnipeg, Manitoba. Some of the recorded conversation (so soon after the treaty amendment) is enlightening. For example, Mr. Lennox in talking about the use of the telephone in making sales (which is restricted by Ontario law to calls requested by a potential customer in writing), says (p 24)

> "…I agree with Mr. Tweedie that the use of the telephone is something we cannot fight. I would say that about 90% of the fraud that has been committed is through the use of the phone by people doing business with people unknown to them. You have to know who you are doing business with when you speak on the phone."

He explains that many U.S. fraud orders are based on phone conversations and says,

> "I don't know how we could prove a phone conversation."

Mr. Smith of BC suggests that when the license comes up for renewal Mr. Lennox could

> "make a provision on his new license that the agent does not sell by telephone",

to which Lennox replied,

> "It is very difficult to cancel a registration as a result of a phone conversation. It comes down to the question of a collection of circumstances."

Mr. McEntire participated on the 19th and discussed Regulation D explaining that it was about on a parity with Regulation A "which pertains to domestic offers in the United States." He explained that in some areas Regulation D would be more restrictive, i.e., 15 days on file instead of 10; the identifying statement with Regulation D would be more of a problem; no consent to service would be required in Regulation A, "because the offer is there and service can be had through the regular channels"; Regulation D would call for one more prospectus copy (four); etc. The provinces and the SEC all pledged cooperation to work out the new form D and other related problems.

The Commission held a conference on September 23, 1952, with a group of Canadian broker-dealers to discuss mutual problems. By October and November of 1952 things were looking up. Mr. Cook wrote to the Northern Miner, Toronto, on October 17, concerning Regulation D.

> "We are happy that at this time that these experiences appear to be largely a matter of history, but they bear reiteration if our proposed rule is to be understood."

Mr. McEntire in a letter sent out November 4, 1952, indicated that the fraudulent offerings had almost stopped completely.

The Commission asked Mr. Lennox on December 23, 1952, to help us investigate what appeared to be a manipulation on the Toronto Stock Exchange. The cooperation from him was splendid.

The lessening of fraudulent offerings was indicated by a lessening of state actions, 98 in 1952 --- contrasted with 346 in 1951. The number of registration statements filed under the 1933 Act increased rather substantially. Ontario took 20 administrative and 3 criminal actions in 1952.

1953

With the long sought goal in sight of being able to stamp out fraudulent Canadian offerings, the Commission started in 1953 to open the Canadian doors to American dollars raised by legitimate means.

On February 11, the staff completed a study of ways for Canadian Investment Companies to sell shares in the States. On February 25, 1953, the Commission announced that with needed conditions attached, such investment companies could register under the 1940 Act.

On March 6, 1953, the Commission announced the adoption of Regulation D, opening legitimate avenues for Canadian issuers to raise up to $300,000 in one year in the U.S. under the exemption provisions of Section 3(b) of the 1933 Act.

With the adoption of Regulation D, both the Ontario Securities Commission and the Broker-dealers Association of Ontario issued policy statements on March 26, 1953 (See Exhibit 11). Mr. Lennox warned that any registrant who violated the United States laws (during the period needed to give Regulation D a fair trial) would place his registration in jeopardy. The Association urged all its members to register as broker-dealers with the SEC and warned that future violations of U.S. Securities laws will constitute "unethical conduct."

An indication that Mr. Lennox could and would try to stop fraudulent offerings arose about this time. A bulletin issued by the Ontario Commission is of interest, not only because of the colorful language of the judge quoted, but because it showed the court backing available to the Ontario Commission. The May, 1953, bulletin reads:

"REGINA vs. MAURICE EUGENE POITRAS

> "In the month of April, 1953, the trial of Maurice Eugene Poitras before His Worship, Magistrate Arthur Hanrahan, resulted in convictions and sentences in the Magistrates' Court for the County of Essex of great importance in respect of penalty and of enforcement of The Securities Act.

"Following registration of convictions for breaches of Sections 53 (58) of The Securities Acts involved and for trading without registration in breach of s. 6 of The Securities Act, His Worship passed sentence:

> 'These prosecutions concern provisions of Section 58 of the Securities Act that forbid a person, with the intention of effecting a trade in a security from promising he will re-purchase the stock or refund the amount paid for it or to give any undertaking relating to its future value.
>
> 'Extravagant claims and promises were made by this accused.
>
> 'These provisions in the Act seek to control the over-enthusiasm of the legitimate stock salesman or to prevent the deliberate guile of the unscrupulous posing as such.
>
> 'It is true the fabulous wealth of the mining country would have remained untapped without the investor willing to take a chance in that highly speculative field. There is nothing to prevent him doing so today. But this legislation, recognizing the lambs, requires he be given facts upon which to decide, not the taffy-coated deceit of white-collared rogues whose ultimate aim is the same as any other thief.
>
> 'In other words, it is permissible to dangle the succulent carrot before the unsuspecting donkey, but not his human counterpart in the investment world. At least an attempt must be made to protect this type.
>
> 'I do not think the circumstances disclosed before me can be adequately dealth with by a money penalty. I am not losing sight of the fact that these charges, numbering twenty-one, actually concern eight transactions in which improper promises were made.
>
> 'You are sentenced to four months' imprisonment on each of the charges other than the one for dealing without a license. Those sentences will run concurrently. On the latter charge you will be fined $200.00 and costs or an additional three months.'

> "These prosecutions are noteworthy also by reason that Poitras was a resident of the United States whose person was secured after he had spent many months as a fugitive beyond the jurisdiction of the Provincial authorities. These prosecutions should serve as a warning to expatriates that The Securities Act will be enforced against them not less vigorously than against persons resident in and operating from Ontario.
>
> Roger J. DesRosiers for the accused.
>
> H.S. Bray for the Crown."

On May 29, 1953, Commissioner Adams and Mr. Barlock conferred in Toronto with Mr. Lennox concerning cooperation and problems. Mr. Lennox and the Association were being severely criticized by certain elements in Canada for their cooperative attitude with American Officials. In particular, one indecent cartoon being circulated showed the extreme bitterness present because Mr. Lennox was "selling out" to the Americans in "buying Regulation D."

In a further cooperative effort to smooth and widen the roads for dollars to travel to Canada, the Commission sponsored a meeting of the Liaison Committee of the National Association of Securities Administrators and others. State commissioners Hueni, Johnson, Honigman, Ofstedahl, Carter, Smith, and Kiraly comprised the committee and most of them met with Mr. Lennox and key SEC people to explore means of expediting applications for securities licenses by Ontario broker-dealers and consideration of whether a uniform registration policy might be adopted by all states. The meetings took place June 23 and 24, 1953, in Washington, and all participating were encouraged by the outlook for honest future dealings. It was brought out that fraudulent offerings were decreasing; that broker-dealer licenses in Ontario had dropped from 212 to 145 within the past-year as a result of actions by Mr. Lennox; and that Canadian and U.S. cooperation was fast improving. The Liaison Committee following the conferences reported by memo to all state commissioners and recommended to the various states on August 17, 1953, that state licenses be granted in all proper cases, thereby giving Ontario

a chance to prove its good faith based on its promise to proceed against any licensee who violated the terms or conditions under which licenses were granted. The Committee further expressed its belief that Mr. Lennox was doing an outstanding clean-up job and that his cooperation could be depended upon in the future. The Committee urged that in each instance where the SEC registered a broker-dealer, if state laws would permit, the state should also license such person.

In the spring of 1953, a high pressure area began to form east of Toronto, in the area of Montreal. Mr. Adams wrote to Mr. Routhier in Montreal advising him that it had come to our attention that some illegal offerings were being made from Montreal. The letter reads in part

> "Now that the situation appears well in hand insofar as the Province of Ontario is concerned, we certainly would not want to see some of the boys go to other provinces and start up their activities."

The letter requests a conference to discuss plans of cooperation for the protection of investors.

By July of 1953, Mr. Lennox was very concerned about the operations of some fraud artists (notably T.M. Parker, Inc.) from Montreal. The Parker frauds had commenced some months earlier, about April or May. He was also concerned about the difficulties certain Ontario broker-dealers were having in obtaining exemption with the SEC.

By July 8, 1953, 47 applications for United States broker-dealer registration had been received from Canadian broker-dealers. Of these, 24 had become effective, proceedings were brought against one, one was withdrawn and 21 were pending. The hope was expressed to Mr. Lennox by letter that the 21 cases would be disposed of by August. The Commission in November 1952 had granted the application of I. Nelson

Dennis & Company of Ontario and had set forth fully its views respecting applicants who were suspected of committing securities violations from Canada. (1934 Act Release 4769) - In the opinion it is stated that the Commission "--will not grant the benefits of broker-dealer registration to any persons who have in the past engaged in practices by which the American investing public has been over-reach and defrauded" – However, it is made clear that no automatic door closing is intended solely on the basis of past violations where applicants seek to meet our legal requirements. Each case is to be considered in the light of its own facts and circumstances according to the opinion.

In July of 1953, Mr. Adams went to Montreal and while there discussed with Quebec officials the Parker Case and other unlawful offerings from Quebec. The province stepped in and cancelled the registrations of T.M. Parker, Inc., and others so it appeared that Quebec could be counted on for full cooperation.

The General Counsel after a study of the problem advised the Commission in July of 1953 that Sections 16(a) and (b) of the 1934 Act probably could not be enforced as to Canadian "insiders". A suggestion was made that registration of issues on United States exchanges should be conditioned upon a contractual undertaking to comply with the statute.

The Commission on July 30, 1953, suggested to the Department of Justice that it favored making public the names of all violators against whom secret indictments had been obtained. This proposal met opposition and the names were not released.

On August 26, 1953, the Commission received word that five or six salesmen driven from Ontario by Mr. Lennox were now in Saskatchewan [_____ _____]

Mr. Lennox about this time expressed his concern that unless Regulation D proved workable it was feared that difficulties would be encountered in holding the broker-dealers in line.

On September 14, 1953, the Commission issued a release (4937) to the effect that due to splendid cooperation from Mr. Lennox et al "…there has been a virtual cessation of fraudulent Canadian stock promotions." The release states that in 1953 a total of 52 broker-dealer registration applications had been filed with 29 effective, 6 being processed, 1 withdrawn, and 16 the subject of proceedings instituted to determine whether they should be denied.

On October 15, 1953, the Commission wrote the Quebec Officials that a Montreal broker was violating our laws and on November 5, 1953, they responded with information that the registration had been cancelled because of illegal mailings into the U.S.

During October 1953, Mr. Cottrelle, alias Lloyd J. Moore, under indictment since 1943 (and a fugitive since) for fraud in the sale of Fitsum Mining Company and Lost Wheelbarrow Mining Company securities returned voluntarily from Canada at the urging

of one of our Seattle office attorneys (Weber). Mr. Weber advanced the money for the trip to Great Falls, Montana, Cotrelle plead guilty and was sentenced to three years and fined $2,000.

By year's end 1953, the Canadian situation seemed largely cleaned up from our viewpoint. The states had started only 41 administrative actions, Ontario had 14 administrative and 6 criminal actions and 3 of the provinces took some actions. Alberta had 1 criminal, British Columbia 2 criminal actions and Quebec had 3 administrative actions. Upon information furnished by us, the Ontario Commission refused to grant a license in December to a fugitive from American Justice saying that it could not accept responsibility for registering a person who

> "…just happened to settle in Canada following transactions which resulted in charges being laid in his own country, and he failed to return to his country to plead his innocence."

Except for the following few incidents violations appeared to be stopped. Stanley and Co. of Regina, Saskatchewan was selling unlawfully; and two Canadian investment advisers (both registered with us) were recommending the purchase of unregistered shares. Two illegal offerings from Montreal which had flourished earlier in 1953 had been shut off by revocation actions there.

By the end of 1953, 26 filings had been made under Regulation D. One was suspended, one withdrawn after clearing, 2 were withdrawn and 20 others ultimately cleared. Two are still pending. All took considerably more time than anticipated, the fastest clearance taking 15 working days and the slowest (excepting the two not yet cleared) 186 working days. An analysis will be found later in this report as to the time taken to clear the Regulation D's and the reasons.

On December 22, 1953, Mr. Lennox wrote Mr. Adams expressing gratitude for the efforts the SEC was making to cooperate and instill confidence. He trusts that there

will be marked progress in relations between Ontario and the individual states … "in the immediate future in order to assist this Commission in keeping matters under control."

1954

On January 15, 1954, we received information that a Montreal firm had commenced unlawful offerings into the U.S. Callahan sent warning letters and notified the Quebec Registrars. In February Mr. Routhier gave Mr. Callahan a memorandum outlining the problems of stopping sales into the U.S. (See Appendix). In brief the memorandum indicates that the framers of the Quebec Securities Act (not visualizing violations of the laws of other jurisdictions by persons resident in Quebec) related the provisions of the Act to transactions inside of Quebec. They did not legislate against sales to people outside the province of Quebec. One section of the law (Section 36) was, however, framed to do the reverse of this. It relates to transactions from people outside the province where the purchaser is inside Quebec. The suggestion is made by Mr. Routhier, "If a similar provision were inserted in the Federal and State legislations of the United States, this might possibly paralyze some activities of American outlaws operating from Canada across the border."

Mr. Routhier goes on that this is primarily a U.S. problem because most of the trouble makers are American subjects and most of the victims are also American subjects. He relates that Quebec has just been invaded by trouble makers from elsewhere and is inexperienced in dealing with "fronts" and "underground writers" and "telephone operators" and although Quebec has suspicions, it has no "positive proof".

Mr. Routhier feels that Quebec should not be critized because of this new development. Quebec didn't create the problem. The problem started in the U.S. and when the problem moved up into Canada, Canada never had any control over the circumstances. Mr. Routhier feels that U.S. officials, U.S. stock exchanges and other

groups should spend more time instilling confidence in Canadian development and that such efforts should relieve the "existing tension and over-activity."

Mr. E. Le Bouf, co-registrar with Mr. Routhier resigned February 12, 1954, and was replaced by Mr. Rene Hebert.

On February 24, 1954, Mr. Lennox wrote us critical of the Regulation D program. He cited an instance where one issuer had to wait ten days to two weeks to even get an acknowledgement to an amendment; had filed 21 amendments to date; and can't send out general information selling material to keep customers informed while waiting for Regulation D clearance. Mr. Lennox says that some local brokers feel that the requirements occasionally involve matters of very little consequence and that the whole Regulation D plan may collapse if those attempting to meet the requirements become discouraged and withdraw their offerings. He further tells us that a recent Regulation D offering has been discontinued because it couldn't be sold. He urges that we devise a more satisfactory system for handling these matters. We answered that while we were doing all we could to cooperate, the delays were being caused by the underwriter's insistance upon using misleading supplemental sales literature. We explained that we would not give clearance to misleading sales literature and that we had advised the underwriter a number of times of the need for revision.

In a press statement March 12, 1954, Mr. Lennox reported that his administration had placed financing on a sounder footing. Registration of broker-dealers had dropped from 212 to about 130. He stated that his problem is a big one because distribution methods are different that those in the U.S. insofar as exchanges are concerned. He says his Ontario Act is stronger but "…it could not govern every detail and all phases of the promotional field." He told that a special committee of engineers was aiding the commission and that "…a lot of engineers will be more careful in the preparation of their reports of mines and so on."

CHAPTER VIII

REGULATION D MISUNDERSTANDING

At this point it may be helpful to change the chronological development format heretofore used and to develop briefly the Regulation D misunderstandings with Mr. Lennox and their causes.

In the course of discussions begun in 1949 and 1950, when the Canadians first proposed an exemption for Canadian companies similar to Regulation A for American companies, the terms "American offerings", "American securities", "Canadian offerings", and "Canadian securities" came into frequent use. Loosely speaking, Regulation A was not available to "Canadians" but only to "Americans".

Regulation A at that time provided that the exemption was not available (Rule 221(e)) for:

> "Any securities issued by an individual who is a resident of a foreign country, a corporation incorporated in a foreign country, or any other person organized under the laws of, or having its principal place of business in, a foreign country…"

Thus, a Canadian individual or other person resident in Canada, a Canadian corporation or organization could not use Regulation A. Moreover, any person, Canadian or American, or other who had its principal place of business elsewhere than in the United States could not use Regulation A. Principal place of business meant place of principal operations or intended operations.

The discussions with the Canadians sought to provide a way for Canadian individuals, corporations, organizations and those persons with principal business operations in Canada to also have the exemptions on the other side of the coin. By hindsight, it seems clear that initially, at least, the Canadians, quite unfamiliar with the ramifications of Regulation A, thought only in terms of "Canadians" now being allowed to have an exemption.

The discussions generally appear to have related to "Canadian offerings", "Canadian securities", "Canadian companies" and "offerings from Canada". Messrs. McEntire and Kroll, fully cognizant of the meaning of the words in Regulation A, undoubtedly expected the Canadians to have the same awareness when the words were read or used in discussion. Even though the subject of American companies using Regulation D (the "Canadian" exemption form) was specifically referred to, it seems clear that the Canadians, or at least Mr. Lennox, never fully understood the import of such discussions.

While most of the discussions were informal, on two occasions that we know of a transcript was made and pertinent parts therefrom will be quoted.

Mr. Lennox had written the Commission on October 16, 1951, that he had some recommendations to make respecting the draft of Regulation D which he was working on. There were six recommendations and numbers 1 and 6 which are pertinent read:

> "1. We repeat the Regulation should only apply to securities accepted for filing in the Province of Canada from which they are being offered and that offerings should only be made by registrants of the Province in question. No doubt you are fully in accord, but we feel that in our common interests the matter should be specifically covered.
>
> "6. We further suggest that a copy of the letter of notification be sent to the appropriate Province…etc."

He continued that he regrets he neglected to

> "cover these points fully when Mr. McEntire and Mr. Kroll visited Toronto. We consider that they fairly indicate the trouble which might be anticipated locally, if not clarified, and they are accordingly put forward in your interests as well as our own."

When Messrs. McEntire and Kroll met with Mr. Lennox and other provincial securities administrators, November 30, 1951, (some 45 days later) in Toronto the problem of Regulation D was discussed in some detail. A transcript was kept by the provincial administrators. The portion dealing directly or indirectly with the problem of

whether a certificate from a province would be needed before Regulation D could be used covers pages 361 to 378 thereof. A transcript of these pages is attached as Exhibit 12.

The most pertinent portion of the discussion reads:

> "Mr. Smith: Is it the intention of the Commission that the applicants for these exemptions will have to produce evidence that the securities are registered in one of the provinces?
>
> "Mr. Kroll: I will take that up. Chairman Lennox and Mr. Cameron were very helpful, when we had an opportunity to talk to them. I am sorry we could not have seen all of them, but the distance was too great.
>
> "We did talk with Mr. Routhier, and we got some very good suggestions, which we have not had time to incorporate in here (indicating).
>
> "When securities are offered from Canada, the exemption would not apply unless such securities have been accepted for filing in a province of Canada from which the offer is made, and any person making the offer is duly registered in such province.
>
> "That is the sort of provision, but it will not work, unless we work with you, and you work with us.
>
> "Mr. Smith: With minor alterations, it is, 'those who are registered in Canada?'
>
> "Mr. Kroll: We have a provision such as that in mind, and, Mr. McEntire, I think this might be appropriate time to talk about the problem which I think is the hub of the thing, the heart of it.
>
> "Mr. McEntire: I want to say parenthetically that it is our intention in regard to registration, that anything allowed to be registered in this short form would be registered under the laws of the appropriate province. I want to again speak in absolute confidence to you.
>
> "We have a little problem of that kind, because regarding the exemptions we have in the States, as they apply to our own 48 States – we do not have the same requirements for reasons which I do not want to go into now, but they are good and sufficient.
>
> "This may be the exception, and whether or not we put that in there (indicating), you will have to accept on faith the fact that we will see that it is done, or that some good reason 'put the blocks to it'.

> "I trust you understand our reasons for asking you to keep it confidential, and for that reason I cannot tell you whether or not in the final form we will be able to articulate.
>
> "I will, however, promise you that it will be administratively handled, and it may be that we will find a way to put it in specifically.
>
> "You will understand the problem we have in connection with your domestic situation, and our domestic administration.
>
> "Mr. Kroll: Sir, administratively we have always contemplated that as soon as one was filed, we would send a copy to the province to find out 'Who is this fellow?' 'Has he registered with you?', and 'Is the underwriter or dealer making the offer registered with you?'. We will help in that way. Your control applies only to those who are registered with you.
>
> "Mr. Lennox: You would have some funny characters registering with you, unless you imposed some restrictions."

It should be apparent that Mr. Lennox or anyone else could properly draw the inference from this conversation that a certificate from a province respecting "qualification" would be required before Regulation D could be used or the SEC would "put the blocks to it". However, if the Kroll statement is read again, it doesn't necessarily say that. He said (and one word only is underlined for emphasis). "Where securities are offered from Canada…", etc. Now, in this light Mr. McEntire's and Mr. Kroll's statements may have a different meaning from that inferred by Mr. Lennox.

There can be no question that there was some confusion and no "meeting" of minds. However, a further discussion some ten months later, in September of 1952, respecting this same problem clarifys the matter and is here related.

On the closing day of a three-day conference of Provincial Securities Administrators at Winnipeg, Mr. McEntire spoke of the proposed Regulation D and differentiated it from Regulation A. Mr. Lennox spoke up that before Regulation D could be cleared in Washington it should have Provincial clearance, saying (page 68),

> "It occurs to me that that would be a requirement, to disclose the fact that registration in the province of origin had been obtained would be necessary for registration under Regulation D."

"Mr. McEntire: Yes, let me back up for a minute. I may have spoken too fast. I don't know whether you have in mind the fact that one or more United States companies incorporated in the United States are operating properties in Canada and they do not have to register under Regulation A. I just had that brought home to us forcibly. We have a United States corporation incorporated in the State of Maryland with its principal offices in Washington but its chief assets are some mining claims. They wanted to use Regulation A. They cannot do it because they came up with a company that had mining claims in Peru with their offices in Nevada. With everything they had they were going to buy machinery and take it to Peru…

"We will have United States Companies with Canadian assets who will want to use Regulation D and who will probably never desire to sell anything in Canada. The way we propose to handle that is to keep the provinces where the assets are, informed, to acquaint it with the situation, not to require registration as a condition precedent."

"Mr. Lennox: I was thinking of that."

"Mr. McEntire: Anyone doing business in Canada is going to be registered in the province where they are going to make an offering from, and if they did not we would notify you."

"Mr. Smith: I think you should require a certificate of registration before you accept the filing."

"Mr. McEntire: You wrote me and I have that under consideration. How we will frame it, I don't know. However, we certainly do not want selling in the United States by people who cannot muster on their home grounds. Don't think we are anxious to expedite sales in the United States of stuff that you won't have. We don't propose to let that happen."

"Mr. MacPherson: If you are going to send that fourth copy (Note: He is speaking of an extra prospectus required by Regulation D) as soon as you get it, the provinces can notify you whether the applicant is registered in that province."

"Mr. McEntire: He has to file the prospectus he has to use up here."

A careful reading of the foregoing makes clear that the SEC was not going to require provincial registration as a condition precedent despite the word "yes" used by Mr. McEntire to start his answer. However, it is not unreasonable to assume that a listener to this conversation, peering through his own background and desires, might have

latched on to a phrase like "…anyone doing business in Canada is going to be registered in the province where they are going to make an offering from…" and to have inferred that provincial qualification would be a condition precedent, without realizing the importance of the word "from". Surely, Mr. Smith's comment after Mr. McEntire said "…not to require registration as a condition precedent" shows his confusion. In any event the transcript does not appear to have reported accurately the words of each speaker, and even if it did there is ample room for an honest misunderstanding as to the usage limitations of Regulation D.

The confusion appears to have been compounded when Regulation D came out. Even the title on the release of March 6, 1953, says:

"ADOPTION OF REGULATION D FOR CANADIAN OFFERINGS"

and the Regulation D form itself reads:

"EXEMPTION FOR CANADIAN SECURITIES"

and Item 1 of the notification Form 1-D reads:

"ITEM 1: PROVINCE FROM WHICH OFFERING IS TO BE MADE"

"State the name of the Province from which the offering is to be made and attach four copies of any official prospectus filed with such Province covering the securities proposed to be offered hereunder." It is also of interest that the regulation provides for a written irrevocable power of attorney to be given so the Commission can accept service for the "foreigners" using the Regulation.

Despite these headings and references to Canadian offerings and Canadian securities, a careful reading of the release and form covering Regulation D disclose that it is available to "Americans".

It is not important to attempt to pin down whether the SEC or Mr. Lennox is right or wrong as to what was said or what was intended. The important thing is to realize that there was ample room for honest misunderstanding and that Mr. Lennox is completely

honest in believing that Regulation D was only to be used as he understood it. It is important to find a solution to this problem and this can be done.

One other aspect of Regulation D, which has been a basis for misunderstanding should also be clarified. When Mr. Lennox "severed" relationships with us in November, 1954, he charged that the wording in the August 18, 1952, draft "domestic issues having their principal place of business in Canada" was altered to "domestic issues having their principal business operations in Canada". He contended that this alteration "without consulting Ontario" was very significant and the "loophole" created invited U.S. promoters to "exploit their public".

On the same date Regulation D was adopted, March 6, 1953, Regulation A was amended. Among other things the language theretofore in Regulation A "…or having its principal place of business" was changed to "…its principal business operations".

There was nothing sinister or deceptive in this language change as applied to both Regulations A and D. The phrase "principal place of business" had always been interpreted to mean "principal business operations" and as the latter term more nearly described our interpretation we merely clarified the Regulations to harmonize. For example, if a company came in and related that it had offices in New York and that its manufacturing facilities were in Canada and asked "where is our principal place of business?" or "where are our principal business operations?", the answer would be "Canada" in either event. The phrases are intended to mean the same thing. Here again we have an honest misunderstanding, and it is similarly important that we find a solution to this related problem so that there will be no further misunderstandings.

The first filing under Regulation D occurred March 30, 1953. On March 31, copies of the material went to Mr. Lennox and on April 15, 1953, he gave us his comments. It appeared that Regulation D was "getting off" on the right foot. As additional Ontario filings, i.e., offerings to be made from Ontario, came in we promptly

sent him copies and received from him comments helpful in each instance (see files 27-8; 27-9; 27-11; 27-19; 27-27; etc.).

On June 23, 1953, --- at a time when McEntire and Kroll had both left the Commission --- Mr. Lennox in conference with Woodside, Thorson, King, and Cohen of Corporation Finance, as to the operation of Regulation D, did not raise any questions as to which persons were eligible to use Regulation D. Up to that time only one issuer not resident in Canada had availed itself of Regulation D, it being a Delaware corporation (Northwest Uranium Corporation), and it filed May 12, 1953. While the staff had been sending the "fourth" prospectus to the applicable province, it didn't send the Delaware company prospectus anywhere. In fact, it didn't send copies of the early U.S. company prospectuses as it apparently did not know of the pledge of McEntire and Kroll to do so. It was not until June, 1954, when filing 27-54 was filed that the "fourth prospectus", regarding a Delaware company, was sent to Canada. The fourth copy of the prospectuses on the previous eight Delaware companies had not been sent anywhere.

Not having received such prospectuses, it is fair to assume that the provincial administrators had no knowledge that Americans were using Regulation D. In fact, Mr. Lennox's letter to Mr. Adams in December of 1953 thanking him for the part he played "…in placing Regulation D and the Canadian situation squarely before the State Commissioners" at the recent state Administrators' convention leads to the belief that his first knowledge came when he received a list from us following February 26, 1954, of all Regulation D's filed to date and wrote to us on March 26, 1954, to ask why U.S. companies were using Regulation D.

It is not clear from our records just when the list was sent. In Mr. Adams letter to Mr. Lennox of February 26, 1954, he points out that he has asked the staff to furnish Mr. Lennox with an up-to-date list of such filings because Mr. Adams has just learned that

Mr. Lennox apparently receives notices of actual filings --- "but what happens thereafter is not known to you."

Excerpts from some letters received from Mr. Lennox in response to our letters requesting his views and comments are of interest. These letters were written following his realization that Regulation D was being made available to "Americans" and that certain Ontario corporations were sending Regulation "D's" to us without prior qualification in Ontario.

Re: 27-39, April 5, 1954

> "We consider that it would not be in your interests to accept filings from Ontario which have not been first qualified in this province, and we are writing to the company advising them accordingly."
>
> Lennox then wrote the company:
>
> "The Commission is most concerned about your procedure, as every effort has been made both by the Commission and the organized industry in Ontario to place international trading in securities on a sound basis, and applications such as this are likely to jeopardize Ontario's position."

(The offering was not public and it was a private company, so Mr. Lennox reversed his position later in this case.)

Re: 27-36, May 10, 1954

> "In accordance with the new policy agreed upon by this Commission and the Broker-Dealers Association to the effect that issues should be currently qualified in Ontario even if the offering is not being made in Ontario, but under Regulation D, I have received an undertaking from [---the underwriter---] to immediately take steps to bring the filing up-to-date."

On May 19 he wrote us completely reversing his May 10 position, saying,

> "Further to our correspondence herein, I have now been advised that these securities if accepted under Regulation D will not be offered for sale from Ontario, but will be offered by a registrant or registrants in the United States. Under these circumstances the policies agreed upon by this Commission and the Broker-Dealers' Association are not applicable."

Re: 27-44, May 24, 1954 – Mr. Lennox wrote respecting this Ontario Company:

> "Upon inquiry I have been advised that this company's offering will be made in the United States by United States dealers, with the result that the Ontario Commission has no jurisdiction in this particular issue. The issue has never been offered for filing in Ontario."

Re: 27-48, May 31, 1954 – Mr. Lennox wrote respecting this Ontario Company:

> "This issue is not qualified in Ontario, nor is the offering to be made from Ontario. Accordingly this Commission has no jurisdiction.
>
> "We are concerned about the proposed offering, and the same observations will apply to a great many under similar circumstances, namely that the vendor's consideration is apparently far in excess of anything that would be allowed in Ontario, and apparently no arrangements have been made to escrow any part of the vendor's stock. In the result it would be extremely doubtful if the company could obtain registration in Ontario later on, which of course raises the question of how it will be able to obtain further financing."

On June 2, 1954, we wrote Mr. Lennox that Mr. Adams had indicated some concern by Mr. Lennox respecting certain aspects of the proposed offering and asked for his further views, particularly as to the basis upon which subsequent qualification would be refused in Ontario.

On June 4, 1954, Mr. Lennox answered that Ontario's policy was to limit the amount of promotional shares issued and to require an escrow of these shares. He indicates he expects to soon write a letter dealing with the several aspects involved when an issue has not been previously qualified in Ontario. The issuer in this case did not intend to make any offering in or from Ontario, so did not seek qualification there. The offering circular was cleared July 7 after disclosure that the issue could not qualify in Ontario and why.

Mr. Lennox had raised the identical objections in the Regulation D for Lake Huron Uranium Mines, 27-50, by letter May 31, 1954.

Mr. Lennox probably best summed up the problems facing him in a letter to the Commission dated June 7, 1954. Omitting the names of the companies referred to, the letter reads –

> "When Messrs, McEntire and Kroll first discussed Regulation D., the importance of previous qualification of Canadian issues in the jurisdiction of their origin was stressed. The subject companies provide a good illustration of what may be expected in the absence of any such safeguard, inasmuch as the vendor's allowance in each case appears to be exorbitant. In the uranium promotion for instance the nominal allowance would be 900,000 shares, and there is nothing to warrant an increase, as it is comitted that the only expenses incurred were the costs of staging, common to all similar promotions. The absence of any escrow agreement is more serious, because even if the Commission saw fit to accept the issue later, no local dealer would consider the proposition with over 1,000,000 cheap shares out against his market, and possibly no vendor's shares would then be available to bonus a new underwriter. These considerations are known to those primarily responsible for these applications. Accordingly I would question the bona fides of the entire undertakings.
>
> "The situation respecting companies incorporated under United States laws may be even more serious. If you would send me a copy of the material filed in the case of . . . I believe I could demonstrate that the corporate financing is unconscionable within the meaning of section 44 of the Ontario Act.
>
> "The combined effect of these conditions will eventually discredit Canadian issues, based on considerations beyond our control, i.e., to my knowledge we have never been confronted with a situation comparable to that of . . . in which the treasury received absolutely nothing following a public offering.
>
> "The matter of prior registration in the jurisdiction in which the property is situated was discussed on practically every occasion when Messrs. McEntire and Kroll attended. The matter was definitely brought to a head on November 30th, 1951 when they both addressed representatives of the Toronto Stock Exchange, the Broker-Dealers' Association and representatives from eight of the Provinces. You should have a transcript of these proceedings which were part of the 1951 Provincial Conference held in Toronto. I refer to pages 365 – 367 inclusive, covering the matter, the gist of which is that although for certain domestic reasons the appropriate provision could not be written into Regulation D, such a condition would definitely form part of the administrative policy, with the result that Canadian issues could not bypass their own Provincial Commissions.
>
> "I would also like to repeat what I said over the telephone, namely, that Ontario undertook to stamp out illegal offerings and solicitations in the United

States, which we have done, and that our activities should be directed towards this objective, as intervention in the case of minor collateral matters will only tend to defeat our purpose.

"Hoping to hear that you will be able to visit Toronto as suggested, I am,

Yours very truly,

/s/ O.E. Lennox

(O.E. Lennox)
Chairman"

On June 18, 1954, we sent Regulation D material to Mr. Lennox respecting a company formed in Delaware. The material was sent to him because the Delaware Company (27-54), organized May 14, 1954, owned all the stock of a mining company organized in Ontario May 5, 1954. The holding company proposed to sell its own securities in the U.S. No qualification was made in Ontario. We requested his comments. While the file does not indicate that we received a written reply, Mr. Lennox at least orally expressed concern at a later date.

In June 1954, the Commission in an effort to obtain better disclosure and to meet the objections of Mr. Lennox thereby, required the following statement to be included in a Regulation D prospectus:

> "The present offering has not been qualified in the Province of Ontario. Such qualification could not be obtained because (1) the number of shares issued to the Vendor exceeded the amount which would have been permissible under the laws of such Province, and (2) no vendors shares were placed in escrow subject to the jurisdiction of the Ontario Securities Commission. As a result of the failure to qualify, there is a question whether future issues could be qualified in the Province of Ontario for the purpose of raising any additional capital in that Province that may be required."

The Commission notified the Ontario Commission of this step and advised Mr. Lennox that the applicant had been told that we were submitting the matter to the Ontario Commission. Our letter to Mr. Lennox stated in part:

> ". . . in the event that your Commission should take any action with respect to the non-qualification of the Tidelands Copper Mines stock in the Province of Ontario—we reserved the right to take whatever additional action might be deemed to be appropriate in the light of action, if any, which your Commission might take. Therefore, we would appreciate it if you would review this matter and advise us what your views are with respect thereto."
>
> The Ontario Commission responded in part:
>
> ". . . it seems to hold the possibility of an effective solution to this unfortunate situation which has developed and might get completely out of control."

It made no suggestions and did not indicate that it proposed to take any action in the matter. Some two weeks later in conference, he expressed dissatisfaction with this solution admitting, however, that it was better than nothing.

That straws were being added to Mr. Lennox's back is indicated by his letter of August 9, 1954, responding to our request for his comment on Regulation D filing 27-60. He wrote us:

> "The subject company is not qualified with this Commission, nor could it be in view of the excessive vendor's consideration, etc. The same applies to most, if not all of the issues from the same source.
>
> "I have stated my opinion fully to Commissioner Adams with reference to issues being offered under Regulation D in the guise of being Canadian issues which are not qualified in Ontario, and which would probably be rejected in any other Canadian jurisdiction.
>
> "The statement – 'The company has qualified to do business in the Province of Ontario, Canada' is misleading and probably intended to be misleading, as the company is not qualified to sell securities in Ontario, but only has a license to own property.
>
> "I am further puzzled to note the use of the word 'Limited' in relation to a United States company, as I was not aware of the fact that this term was in use in your country."
>
> (Note: Section 102(a) (1) of Delaware Code of 1953 allows use of the word "Limited").

On August 23, we thanked him for his comments and advised him that we were requiring the issuer to point out that if it had been incorporated in Ontario, it could not meet Ontario's standards, etc. We suggested that the impact of such disclosure would be sufficient to negate the misleading implications.

In connection with Regulation D notification filed September 24, 1954, Mr. Lennox was asked to comment. He replied that the material was misleading and told of negotiations with this Ontario company in May respecting the number of shares to be allowed the vendors, etc. He explained that he had been under the impression that the company would qualify in Ontario. Additional information was to be supplied, etc. The company had by-passed him and filed on Regulation D [_____], among other things, that "The vendor's allowance has been approved by the Ontario Securities Commission." Mr. Lennox points out that the vendor's share allowance was tentative and covered different properties in part than those described in the Regulation D prospectus. He also explained that the proposed escrow agreement did not meet Ontario standards and that there was a mispresentation in the statement in the prospectus that no Ontario rule or regulation would prevent the offering from being accepted for filing in Ontario. He concludes with this paragraph:

> "Apart from these considerations, the fact remains that if Ontario companies continue to finance in the United States without having been previously qualified in this Province, it will inevitably spell doom to the success of Regulation D".
>
> (Note: This issuer subsequently became qualified in Ontario before its Regulation D cleared).

In substance, Regulation D exemptions were being made available to (a) American companies and (b) Canadian companies without prior qualification with a Province. Moreover, we were not sending all "fourth" copies of prospectuses to the pertinent province. Additionally, companies which could not qualify in a province were getting clearance so they could sell "stuff" that Canada wouldn't have.

Mr. Lennox was of the firm opinion that this was not the way he understood Regulation D was to operate.

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Because of mounting pressure on Mr. Lennox and because other events were occurring some months prior to Mr. Lennox's November 16, 1954 "severance", it appears appropriate to go back to certain chronological happenings, which incidentally relate in large part to Regulation D matters.

CHAPTER IX
1954 – March 1955
continued misunderstanding

Meanwhile, in 1954, the Commission on April 27 after one year's investigation, instituted action in the T.M. Parker, Inc. case. It obtained indictments against 13 individuals and 2 companies, all engaged in fraudulent sales from Montreal involving issues of Stampede Petroleum, Cavalcade Petroleum, Bison Petroleum, Candos Metals and Oils, Ltd., Oakridge Mining Corporation, Ltd. and Falgar Mining Corporation, Ltd. (Litigation Release No. 842). On June 28, 1954, one of those indicted was also indicted for perjury (Litigation Release No. 847). The victims resided in some 40 states and the District of Columbia and the fraud exceeded $300,000. Nine of the individual defendants who were in the United States have been arraigned. A conspiracy count included the aforesaid 15 defendants and one other person.

On May 23, 1954, the press ran the story that the SEC had barred 5 Canadian firms from registration as broker-dealers. The article reads in part:

> "The SEC said the five black-listed companies wilfully violated United States law by making 'false and misleading representation' in the sale of various Canadian securities."

Buried in this article is the statement that the Commission cleared forty-three other Canadian firms to engage in security trading in this country.

On May 20, 1954, the Commission's attention was called to the fact that some 9 mining offerings had been recently commenced from Canada,[1] Cease and Desist orders on each had been issued by one or more states and four postal fraud orders had been obtained by us. Information on these violative issues was furnished to Quebec and other appropriate officials.

Mr. Adams discussed those offerings with Mr. Herbert, Department of the Attorney General in Montreal on July 15, 1954. Mr. Adams pledged our cooperation to aid them in every way possible to stamp out these illegal offerings and confirmed the assurance later by letter dated July 23, 1954. On July 26, 1954, Mr. Hebert answered in part, "This situation is being studied by our Department and I trust we shall be able to arrive at a mutually satisfactory solution of the problem."

That things were not easy for our cooperative efforts was indicated by a piece in the Financial Times of Montreal, July 2, 1954, datelined Toronto. The piece is long, but is reproduced in its entirety as an indicator of the unrest in Toronto and the problem of whether Mr. Lennox and Ontario could continue to "hold the line".

"ONTARIO BROKERS HOPE FOR EASING OF BARS, U.S. SALES

"Toronto -- Shortly after Labor Day, there should be some definite indication as to whether brokers, currently operating under licenses issued by the Broker Dealers' Association of Ontario will be able to continue swimming --- or sink.

"For that time, according to information and opinions picked up here and there along Bay Street, it should be known to what extent Ontario provincial authorities will permit promoters and underwriters to increase their activities in the United States, in which field they have been restrained for several years by a mutual Washington-Ontario

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[1]
1. Beaumont Mining Corporation, Montreal, Quebec.
2. Besupas Mines Ltd, Montreal, Quebec.
3. Calumet Uranium Mines Ltd, Quebec.
4. Calumet Contact Uranium Mines Ltd, Quebec
5. Casa Loma Uranium Mines Ltd, Regina Saskatchewan (Ontario Corp.)
6. Lake Paudash Uranium Prospecting Syndicate, Toronto, Canada.
7. Maniwaki Kid Uranium Mining Corp. Montreal, Quebec.
8. Trans-Dominion Mining & Oils Corp., Montreal, Quebec.
9. Dolsohn Bathurst Mines Ltd, Montreal, Quebec.

pact restricting the operations of Ontario brokers in the United States without American licenses.

"According to current speculation along the street, any changes for the better in regulations here aimed at a freer distribution of shares across the border would have immediate effects in Ontario and Quebec province as well.

"The Quebec angle is unusually interesting and may be summarized as follows: Shortly after Ontario imposed a ban against telephone calls to the United States until a local brokerage office and its salesmen became licensed with the SEC in Washington, a large number of the easy-money boys in Toronto drifted Montrealward. This was due (a) to the fact that their records would not enable them to obtain SEC licenses and (b) they couldn't maintain their usual income and living standards by operating solely on Canadian prospects out of Toronto.

"WORKING ON A SNEAK

"Many of these salesmen went to Montreal, although they still had licenses to work in Ontario, and did not advise the Ontario Securities Commission of their move. In other words, and in their own lingo, they were working in Montreal on the sneak. Others, a little more honourable perhaps, advised the OSC of their move to Montreal and surrendered their Ontario licenses.

"The OSC and the SEC for that matter, knows the names of the salesmen working in Montreal, either on the sneak or legitimately. And, come September, this knowledge will work to the advantage of these law enforcement agencies as well as to the brokerage business as a whole. Here's why:

"Before the Ontario ban on selling to the U.S. was imposed the OSC often found itself stumped because, while it knew that certain brokers and salesmen were breaking existing regulations convincing proof of the fact was difficult to obtain. The feeling was that the OSC couldn't be expected to take drastic action, by cancelling licenses and depriving persons of their livelihoods, on suspicion alone. Hence, license cancellations were relatively few.

"The ban on selling in the United States has led to certain brokers, promoters, and salesmen migrating to Montreal, where restrictions haven't been so severe and where it has been (and still is) possible to telephone to the U.S.A. For others whose bank accounts haven't been too strong the line of least resistance was followed; existing licenses were allowed to lapse and other fields of useful or gainful employment were sought and found.

"REGISTRATION CUT 50 PERCENT

"The sum effect of both of these developments has been to reduce by at least 50 percent the total number of registrations filed annually with the Broker Dealers'

Association of Ontario. And, insofar as the OSC (the supervising body in Ontario) is concerned, an effective job of housecleaning has been completed. The undesirables who formerly caused all the trouble in the business have either gone to Montreal or they quit of their own accord. The better type of broker and salesman remains.

"The feeling now exists that something should be done, and immediately, to help those who still remain in the underwriting game and who want to stay. That's why the word is so strong that September will see a number of slight, but important, changes in Ontario regulations which will permit easier access to the American markets for speculative securities being offered here. The OSC is one of the first to admit that there is a rightful place in our economy for a promoter or underwriter in the financing of new mining and oil companies, and the odd industrial as well.

"The OSC also is one of the first to admit that there has been a serious decline in the underwriting and financing of new companies since the ban on sales of shares to the U.S.A. was imposed.

"What will the changes be? Nobody with any official standing seems to know--- and if they do they aren't talking. But the stories making the rounds are extremely interesting.

"CHANGE FOR LENNOX"

"One is to the effect that since O.E. Lennox has effectively completed his task of housecleaning the undesirables out of the Broker Dealers' Association, he is being pinpointed for another important government office. It could be in the Highway's Department, where recent scandals have been uncovered and where his eagle eye would be a decided asset. Who his successor would be is not known, except to the extent that it will not be anyone currently in his department.

"A new securities commissioner would be the most logical person to bring new regulations into effect that would permit freer sales of shares in the United States, since it would not be too easy for Mr. Lennox to ask for or bring such a development into being. For, after all, he was the one who went to the SEC and helped bring current regulations about. He could not be expected to ask the SEC for their easement.

"Immediately it is know that Ontario will once again be able to sell to the U.S.A. on a greater scale than currently prevailing, two things are likely to result: (a) ex-Toronto promoters, brokers and salesmen currently working in Montreal may start meandering back again; for it doesn't cost as much to operate here as it does in Quebec province, (b) many who permitted their licenses to lapse voluntarily will seek to have their licenses restored.

"Current wagering is that the vast majority of these, the undesirables that the OSC wanted out of the business in the first place will NOT be accommodated. Automatic refusal will be given immediately to those who worked on the sneak in Montreal, because

they broke the Ontario regulation which stated that they must advise the OSC of any change in their employment. The others will be told of the offenses which the OSC knew were being committed while under license here previously; and since they have since proved they can make a living in other fields, they will be asked to stay out of the promotional field altogether by adopting this method of refusal, the OSC (and hence the government) cannot be accused of depriving a man of his livelihood.

"WILL REFUSE LICENSES

"Furthermore, the OSC will definitely refuse licenses to operators in Montreal whose business tactics in Quebec have not been all that is required and who, if they had applied for licenses here, would have been rejected. A number of Canada's biggest promotional operators come under this heading, as do a number of the smaller pieces in the St. James-Notre Dame-Craig-Sherbrooke St. puzzle. A few cases in point are:

"(a) A former hotel manager, currently operating in Montreal, who is known to be financed by a strong promotional group out of Toronto and who is sending out extremely large quantities of expensive literature.

"(b) A former newspaper woman, who was granted a license in Quebec, whose personal financial statement (submitted to Quebec authorities) would not stand up under scrutiny before the OSC. In fact, there have been complaints in Toronto that the latter's office has been indulging in switching operations of a serious nature (which are under investigation) and has been running up hotel accounts in Montreal under a name other than her own.

"It's been a tough two years for Ontario underwriters and promoters but it has been fruitful in an important way: Since it has served to weed out those who have been hurting the business for more than a decade. That they will be kept out goes without question. And those who are left, and who have an important job to do in the financing of new companies, may now begin to anticipate rosier and more profitable days ahead."

The Toronto Daily Star had a column, July 20, 1954, respecting the growth of the mining industry in Canada. The tenor of the article is that the mining industry is sound and that although there is too much government regulation, it will grow. "It takes a lot of red tape to strangle a healthy industry and there is not that much tape around." The article develops that the "red tape" has driven out "…shady stock deals that were making people shy away from speculation." It points out that many mining people feel that there must be some relaxations however.

With this kind of journalism and pressure it is reasonable to assume that Mr. Lennox's problems in holding a tight rein on the Ontario promoters were increasing. However, he was of a mind to keep right on. On August 20, 1953, he wrote to Mr. Adams about the difficult position of the Ontario Commission as follows:

> "You probably will appreciate more than anyone else the difficult position of the Commission in continuing its rigid control in the matter of full compliance with United States securities laws. Every issue which is qualified in the United States lends additional support to the Commission, as the issuing companies and dealers who have been able to meet your requirements feel that they now have something worthwhile and certainly will raise a strong protest if we revert to former conditions."

Mr. Lennox concludes with the hope that better conditions will exist between his Commission and the state Commission following the National Securities Administrators Convention in December.

On August 31, 1954, Messrs. Adams, Woodside and Barlock met with Messrs. Lennox, Collins and Wetmore in Toronto. Mr. Lennox reviewed the history of Regulation D, indicated that there was a great deal of unrest among dealers in Ontario who were not satisfied with operations under Regulation D; related that two Ontario companies using American underwriters had used Regulation D and didn't attempt to qualify in Ontario (and that there was an unconscionable consideration paid for the vendors interest and a failure to enter into an escrow agreement which would have prevented qualification in Ontario); that he had been assured during the negotiations in 1951 that qualification in a province would be a condition precedent to the use of Regulation D; that the SEC allowed a man to register as an investment adviser who though operating from Toronto couldn't get registration in the Province of Ontario; and that a general lack of "integration" between Canada and the U.S. was causing concern in

Ontario. Mr. Lennox continued that the change in Regulation D from "principal place of business" in the proposed Regulation D to the language "principal business operations" had created a very unsatisfactory condition.

Mr. Lennox also expressed concern over what he termed the "Delaware corporation" problem, i.e., where U.S. corporations were using Regulation D's with no effort to file in the province where their principal business operations were. He said this was contrary to the "condition precedent" promises he had received. He contended one of these Delaware offerings was "one of the greatest frauds ever perpetrated" and being made under the guise of being an Ontario enterprise, gives Ontario a bad name.

No amount of discussion seemed to change the views of Mr. Lennox that qualification in the province should be a condition precedent.

Mr. Lennox indicated during this discussion that unless some solution could be found to the problem, the whole program would break down.

In an afternoon session August 31, 1954, a number of stock exchange and Broker-Dealer Association officials joined in. Mr. Lennox reported on the morning discussions and suggested Regulation D be amended to exclude "Delaware Corporations". More discussions ensued respecting the delays and high costs of getting a Regulation D cleared and the unfair competition from "Delaware Corporations". Further discussion indicated dissatisfaction at the "Montreal" situation as Regulation D was promulgated on the assumption all Provinces would cooperate. The abuses of recent origin in Montreal constituted unfair competition and left a stigma.

Mr. Woodside's statement that he had advocated a lenient construction of Regulation D as to "Delaware" companies in the hope that the development of Canadian

resources might be facilitated thereby and Mr. Adams's statement that the Quebec authorities were vigorously instituting actions to stop the illegal offerings and that extradition procedures had been brought apparently did not satisfy the feeling of the Canadians that all "Canadian offerings" should be controlled by Canadians and that the SEC should stop the Montreal frauds.

Mr. Lennox contended that disclosure alone was not enough, and that "Delaware" companies should meet at least Ontario standards. The discussions continued through September 1, 1954, with Mr. Lennox and Mr. Cameron of his staff and involved a number of specific cases. In most instances we received full cooperation, but in one case Mr. Lennox explained his reasons for refusing our request to investigate an offering. Mr. Lennox said no violation of Ontario law was involved and an investigation would be bad for business.

In a discussion as to whether it might not be better to abolish Regulation D because of the apparent dissatisfaction, Mr. Lennox said that to do so would put the problem "right back to where we started", but assured that even so he had cleaned up Ontario and would keep it clean. He commented that if provisions were added to Regulation D requiring the escrowing of stock or proceeds until sufficient had been raised to get the venture started, such provisions would not be a solution as they would create many administrative problems.

Mr. Lennox indicated that difficulties were being encountered with the states and that only New York, New Jersey, and Pennsylvania were cooperating. He said that if the SEC continued to process Regulation D filings, Ontario would "keep faith" with the SEC and the three states, but no more. Those present at the conference understood that Mr.

Lennox had in mind at least a partial repeal of his March 26, 1953, directive prohibiting Ontario brokers from selling in the states in violation of Federal and State laws. Mr. Lennox said he and the Toronto brokers found it impossible to combat different thinking and different laws encountered throughout the states.

During the discussion Mr. Lennox raised the complaint of an Ontario broker that the broker was convinced that someone in the U.S. was tampering with his mail as large numbers of letters sent by him had not reached their destination. Mr. Lennox was assured that we had investigated the matter and were convinced there was no tampering with him mail. (This broker claimed to have sent 497,000 pieces of mail into the U.S. between April 28 and May 6, 1954, receiving only 505 replies.)

Mr. Lennox was invited September 3, 1954, to submit his specific complaints and suggestions to the Commission in order that the Commission could have an opportunity to study them and to explore solutions to the problems.

Mr. Lennox wrote Chairman Demmler September 7, 1954, that he had had three days of discussions with SEC people and that a general review of problems had been made. He pointed out that if Delaware companies were to have continued free use of Regulation D, the situation would get worse. He said,

> "in our considered opinion if something is not done without further delay, it will eventually spell ruin to Regulation D and defeat all the efforts which have been made to correct an unsatisfactory international situation."

He complained that two of the "Delaware" companies with mining claims in Ontario had obtained Regulation D clearance, but wouldn't be able to clear Ontario because the representations made were not true and the promoters were getting too much stock.

He then says that in addition to allowing "Delaware" companies to use Regulation D, he is concerned because Ontario issuers can use Regulation D without clearing in Ontario. Mr. Lennox urges an amendment to Regulation D to cause issues to be qualified in the Provinces even if offered by U.S. underwriters. Mr. Lennox asks for an opportunity to discuss these problems in Washington on Friday, September 24, 1954, saying he believes the success of Regulation D is at stake. He doubts he can hold the line set out in his March 26, 1953, directive much longer. Lastly, he feels we should be more aggressive in stopping illegal Quebec offerings.

All touting of Canadian issues being distributed or recently distributed did not originate in Canada. Some [_____] touting was done by Walter Winchell on his Sunday night television program. On September 5, 1954, he said that an oil strike had been made on the company's property in Cuba; that the shares of American Le Duc Company had been issued at 30 cents per share; were recently traded on the Toronto Stock Exchange at about sixty cents; and were expected to reach $5.00 per share.

Following the broadcast the shares jumped to $1.50, with about 300,000 shares traded the first hour on September 7, and then dropped to 90 cents before the day ended. The previous day's close had been at 60 cents. It seems that Mr. Winchell passed on information received from a friend. The friend had called Mr. Winchell over to his table in a night club on Saturday night, September 4, and told him of an oil discovery in Cuba. He called Mr. Winchell's attention to an article in the August 30, 1954, issue of the Oil and Gas Journal, underlined in parts by the friend. Mr. Winchell inferred from what was said that the discovery was on the Le Duc property. He did not read the article carefully or he would have known that the oil was on another company's property. Without

verification he touted the stock and told of the discovery on the property of the company. The 300,000 shares bought at $1.50, only to fall to 90 cents hours later, were bought by people who lost 60 cents a share in a few hours through following his "tip".

Mr. Lennox was at the Commission September 24, 1954, to discuss these Regulation D problems.

On Saturday, October 2, 1954, Quebec's Provincial government announced it was taking steps to curb the "unscrupulous operators." Premier Duplossis announced new legislation would be introduced. It was hoped to find ways to stop the "schemes" of the stock-pushers.

On September 28, 1954, at the National Association of Securities Administrators liaison meeting with the SEC, a general discussion of Regulation D and the condition of offerings from Toronto and Montreal was had. Mr. Lennox expressed dissatisfaction resulting from Regulation D and referred to two recent conferences with SEC people to clarify matters.

In an effort to further the discussions and achieve better relations, Commissioners Adams and Armstrong had breakfast with Mr. Lennox September 30. Mr. Lennox again indicated his opposition to the use of Regulation D for either Canadian or American corporations unless they qualified their securities in the appropriate province. He related that he had recently cancelled three licenses for violations of U.S. laws, but wasn't going to continue this policy unless Regulation D made certain requirements and unless the SEC tried to stop fraudulent sales from Quebec. Mr. Lennox further voiced his concern about failure of the states to cooperate with the provinces.

When asked whether his position was sound that one province of Canada should be petitioning the U.S. Government to eradicate bad conditions in another province of Canada he contended that the Dominion Government, the Ontario Government, and the Quebec Government were of different political complexions and that it was impossible for one province to suggest to another province either directly or through the Canadian Dominion Government that the enforcement of its laws be improved. He seemed to expect the U.S. Government to mediate the differences.

While Mr. Lennox had characterized certain "Delaware" corporation offerings as fraud, he said he realized that the SEC could not pass upon the merits of a security and that "fraud" as he used it was in the broad sense, not the technical legal sense. However, he continued with the theme that the "Delaware" offerings were fraudulent and should be stamped out.

On October 6, 1954, the Wall Street Journal carried a piece that Quebec might adopt a new Securities Act to prevent so-called "schemes". It indicated that Premier Duplessis was asking interested parties for suggestions. The piece goes on that during the previous week the Montreal and Canadian Stock Exchanges had issued warnings about dealings with high pressure stock promoters. These warnings were issued September 25, 1954, to members of the exchanges.

In the October 9, 1954, issue Newsweek relates that the dealers in fraudulent stocks have moved ahead of the Toronto clean-up and now are finding suckers from operations centered in Montreal despite warnings to beware of high pressure salesmen. It tells of a crackdown by the State of New York on a fraudulent $5,000,000 sale of

mythical oil gushers with four corporations and nine individuals enjoined. The article tells of SEC efforts to stamp out illegal offerings and quotes Mr. Demmler, respecting ". . . people who dream of fortunes are discouraged by nothing that is said in the cold print of a prospectus." The article goes on, "The gullibility of the get-rich-quick investor is still perhaps the biggest obstacle to cleaning up fraudulent securities dealings, most enforcement agencies find. When a phoney broker calls a likely mark and offers some hot uranium stock for a few cents a share, the sucker bites."

On October 15, 1954, U.S. News and World Report ran a one-page story of facts and warnings re Canadian frauds and American suckers. It tells of get-rich-quick schemes from Montreal now that Ontario is cleaned up.

A survey of the illegal offerings current between January 1 and October 18, 1954, showed actions by states against 21 offerings. These 21 offerings involved 92 such actions. Inasmuch as those actions involved Montreal persons or dealers, the list was sent to the Quebec authorities in October. The SEC obtained three post office fraud orders and one injunction during this period.

On October 27, 1954, Mr. Lennox wrote Mr. Adams re Northwest Uranium Corporation (27-5), an American company using Regulation D, after pointing out that Canada had no jurisdiction over the issuer and that this and similar things may be damaging to ventures located in Canada, he said, "You will further appreciate that the most serious aspect of this situation could scarcely have developed if issues under Regulation D were first qualified in the Canadian jurisdiction of their origin, in keeping with the original intention when the Regulation was first discussed.", and "If the offenses

in this instance were prosecuted to the limit, it might serve as a real warning to those who are discrediting the new Regulation."

The New York Stock Exchange publishes a pamphlet entitled "The Exchange". The November, 1954, issue (out early in November) has a four-page lead article by President Funston entitled "It's your money". He warns that "operation sucker is rolling down from Canada's largest city at high speed" and flooding the U.S. with high pressure sales literature and telephone calls from Montreal. He is very critical of the "rat hole" salesmen and their get-rich-quick schemes. Mr. Funston praises Mr. Lennox and carefully makes clear that the seat of the trouble is Montreal. He calls on the public to refuse to buy these gold bricks. He says law can't stamp operation sucker out unless the public cooperates. The American press gives Mr. Funston's comments lots of space.

On November 16, 1954, Mr. Lennox issued a statement to the press and, in enclosing a copy of it to the SEC, covered it with a short letter reading:

> "I am enclosing a copy of a press release which should come as no surprise to your Commission. I regret that matters turned out as they did, but there was no alternative. I had hoped for more time, but my hand was forced through newspaper publicity which was sparked by the New York Press. I also realized the danger of local dealers taking matters into their own hands by ignoring the directive. Such action in my position would have placed Ontario in a most embarrassing position .
>
> It is of course a matter of utmost concern that the efforts of a few states which were in a position to cooperate and did cooperate wholeheartedly, have also proved abortive.
>
> "You will note from the enclosed statement that some hope still is held out for a workable solution.", etc.

The long press statement proceeds to review the difficulties encountered in attempting to cooperate with U.S. officials (see Exhibit 13 for full text). Briefly, he contends that the restrictions placed on the local securities industry cannot be maintained;

the efforts to solve the problem have proved a ". . .dismal failure from any point of view;" that initially negotiations started out favorably with complete understanding that qualification in the appropriate province would be a condition precedent to the use of Regulation D; that without consulting Ontario the SEC changed language in the Regulation D draft which invited U.S. promoters to exploit the public (which they are doing) with issues identified as Canadian issues but which could not meet the standards of the provinces and obtain qualification there; that upon discovery of such a loophole even provincial issues got clearance under Regulation D without qualification in the province; that the present SEC either didn't know about the early assurances and understanding, or enterprets them differently or intends to disregard them; that Montreal operations are discrediting "Canada;" that absent better cooperation the restrictions imposed on Ontario broker-dealers should be removed; that efforts to better conditions were not helped much by meetings with SEC officials; that local broker-dealers have virtually abandoned efforts to use Regulation D; that unfair competition has developed; and that all theretofore applied restrictions on brokers and dealers are off but Ontario will not tolerate the type of pressure operations which it has "consistently combated in the past."

Mr. Lennox holds out some hope for a solution to the problem "provided it is approached fairly and squarely." However, while the SEC could correct the obvious defects there remains a big problem because the states don't allow sales automatically even when an issue has cleared the SEC. More uniformity would help solve the problem. He concludes with the thought that most people will eventually share his views that ". . . the best way to combat stockateering is to drive it out by fair competition."

Mr. Lennox's statement produced widespread comment in the press and magazines with varied degrees of agreement or disagreement. That Mr. Lennox was under great pressure to take such a step is shown by Toronto Newspaper articles appearing in early November 1954 before his statement was released. It is understood that the Toronto press queried brokers and dealers respecting their reactions to Mr. Funston's article with the result that some of the criticisms contained in Mr. Lennox's statement were brought to light. On November 9, Mr. Lennox was quoted in the Toronto Star as saying it was a "distressing fact" that American investors were being swindled at home without any "outside" assistance and that Canada was taking the blame for the practices of these concerns allowed to use Regulation D. However, editorially the Star on the same day called for a discontinuance of the practice of the unscrupulous promoters referred to by Mr. Funston.

On November 9, Mr. Weir, Chairman of the Montreal Stock Exchange agreed with Mr. Funston's views and warned the public against unethical salesmen during a television interview in Montreal.

The Telegram on November 9 sided with Mr. Lennox and stated that there was no reason for Ontario to prevent the sale of honest speculative stocks in the U.S., but that the U.S. authorities should police their own regulations. The editorial concluded:

"Strict enforcement of Ontario securities laws is enough for now. If dealers want to cross the border with their Ontario-approved wares, and we are sure the deal they are offering is a fair one, then let them do so. If they break United States laws designed to hamper Canadians while Americans clean up, then let the Americans deal with that situation. It will be one of their own making."

The Globe and Mail ran 3 articles November 11, 12 and 13 critical of the results of Regulation D. A "spokesman" for Ontario brokers said he "was sorely tempted to

believe that the SEC authorities do not really want our broker dealers infringing on the territory of their own financial groups." The same source related it to be a known fact that an offering ". . . by one of our broker-dealers was sabotaged by post offices in the United States."

Mr. Lennox is reported to have said that the failure of Regulation D to work and the publicity (among other things) forced him to his position of ending the trial period undertaken to give Regulation D a fair trial. Two paragraphs from the Toronto Telegram editorial of November 9, 1954 are of interest:

"Mr. Lennox has been a very patient man with mudslingers. He has taken a lot of abuse from local promoters because they thought he favored the Americans. He knew better, but he kept his own counsel and pursued his course of action without time off to protect himself from that unfair attack.

"Mr. Lennox also has taken a lot of abuse on official visits to the U.S., and there also he pursued the wise policy of swallowing his bitterness and working quietly toward his goal--the promotion of a sound relationship between mine-maker, stock seller, and stock buyer."

It was in this atmosphere that Mr. Lennox announced his break-off of cooperation.

We are advised that his action was generally applauded in Toronto brokerage circles, which had been finding it increasingly difficult to get expedition of their Regulation D filings and increasingly difficult to make sales once the Regulation D was cleared through the SEC.

Business Week in its November 27, 1954 issue comments:

"Lennox, forthright administrator, decided it was useless to impose SEC rules on its brokers while these big holes elsewhere in the dam stayed wide open."

The Toronto Daily Star on December 1 ran an article about SEC fears of a return to fly-by-night actions as a result of Mr. Lennox's action plus the possibility of losing the extradition case pending and concludes that Mr. Lennox's assurances that Ontario laws will be adequate saying,

"It is hardly reassuring for U.S. officials to hear Mr. Lennox's protestations that O.S.C. laws will be enforced to prevent a return of stockateering despite his decision to break off the cooperative agreement. The same laws were in effect before 1953 and they weren't enforced then."

On December 7, 1954, the Toronto Star carried an article referring to an attack by New York State against Quebec for failure to cooperate in stamping out frauds. The article relates that Quebec had no securities Commission and no "blue sky" laws like Ontario and that observers noted that under strict Ontario supervision the "sharpshooters" had moved to Quebec where there was no agreement with the SEC. Mr. Goldstein, New York attorney General, is reported to praise Ontario's cooperation but criticizes Quebec's saying that stockateers appear to have found a comfortable haven there.

On December 8, Mr. Duplessis fired back in the Toronto Star. He calls Goldsteins' charges wild; says Quebec has cancelled a "half dozen" permits to brokers; intends to get new stronger legislation; but does not intend to put "hand-cuffs" on legitimate private enterprise. Premier Duplessis says that he estimates that

". . . about 20 boiler rooms are now operating in New York City and accross the river in New Jersey," and "They are selling tons of promotional securities to a gullible public that feeds avidly on glowing promises of prospective profits," and further, these "Phonies are laying the groundwork for a loss of prestige to the industry."

On December 6, 1954, Barrons reported that the SEC admits the truth of Mr. Lennox's charge that language was changed in a draft of Regulation D ". . . but regards it as debatable whether the minor changes made affected the sense of their understanding

with Toronto." The article then explains the disparity between SEC's disclosure laws and Ontario's stricter compliance laws, saying that U.S. promoters of Canadian ventures

". . . may deal themselves better cards than can Canadians themselves. Under those circumstances, it is hard to see how real reciprocity could exist across the border. The gap between Ontario and Washington will not easily be bridged despite the atmosphere of conciliation noticeable here last week."

On December 7, a New York Herald Tribune article reviews the breakdown and calls for an end to name calling. The article indicates that

"A sane review of conditions that have led to this temporary rift appears to be in the making, and one feels confident it will be an honest effort with satisfaction guaranteed."

On December 22, 1954, the SEC announced it was restudying the regulations and policies governing the sale of Canadian securities for the purpose of formulating a more effective program ". . . for the prevention of fraudulent offerings or other unlawful sale of such securities in this country." The release outlines the study program. (Exhibit 14)

Mr. Lennox wrote on December 29 that the proposed study outline was a most constructive approach to the problem. He makes a number of suggestions as indicated by the second paragraph of his letter which reads as follows:

"It is a most constructive approach to the problem. In my view one of the basic difficulties is that although the principle of full disclosure no doubt is adequate in the case of industrial financing, some form of control such as is provided by Section 44 of the Ontario Act is essential in the case of new mining promotions when the assets, if any, are merely potential as opposed to tangible assets. Then again in attempting to meet the requirements of the different regulatory States we are met with inflexible specific restrictions such as limiting selling commissions to fifteen percent. These restrictions apparently are imposed with industrial financing in mind, without regard to the risks involved in the distribution of speculative mining issues. At the same time it appears that improvident long term options are permitted in favor of inside interests even by these same regulatory States. Ontario has consistently taken the stand that options of this type are much more damaging to the success of a mining venture than a generous selling commission, and that they really indicate a lack of good faith on the part of those responsible for the success or failure of the venture. It seems if we really went to the roots of the problem, something could be worked out in the best interests of all those who

wish to speculate in mining issues and who are now being subjected to all known perils and hazards of one of the greatest gambles in the world."

On December 26, 1954 the late Robert P. Vanderpoel told about a previous article criticizing a "Toronto" offering and that Mr. Lennox has reported that this was a Delaware company over which Toronto has no jurisdiction and he sides with Mr. Lennox regarding weaknesses in Federal disclosure laws and calls for a ". . . full cooperation in securities matters, a co-operation that will protect investors" between the two countries.

During 1954, 18 Canadian industrial or mining registration statements were filed covering $333,086,242 and at the date of this report, 1 had been withdrawn 2 were pending, and 15 had become effective covering $287,972,242.

In 1954, 46 notifications under Regulation D were filed for $11,334,350. a total of 29 of these were cleared, two were withdrawn and 15 pending. On August 16, 1954, the Commission issued its first Regulation D suspension order.

While our records show that 35 Canadian firms or individuals were registered with us as broker-dealers in 1939, relations and other factors had reduced the number so that on January 1, 1953 only 8 had effective statements. During 1953 and 1954, 56 additional applications became effective.

On November 23, 1953 there were 10 Canadian investment advisers registered - 2 are investment counsellors but 8 publish reports on Canadian securities or general economic and market conditions. Four of these were in Montreal, 3 in Toronto and 1 in Calgary. We have had no problems with 7 of these firms. On March 8, 1955 there were 14 Canadian firms so registered.

During 1954 the states took 131 actions against violative offerings from Canada; Ontario took 6 administrative and 1 criminal actions. Quebec took 11 administrative

actions; and Alberta and British Columbia each took one criminal action. The U.S. post office issued four fraud orders.

1955

U.S. securities industry leaders met with Mr. Lennox in New York Wednesday, January 5, 1955 to discuss the problem and a solution thereto. The conference was an off the record exploratory conference. In brief, the three hour conference produced:

1. The belief by the Canadians that Regulation D's should be cleared within 15 days and that speed up methods should be found.

2. The belief by the Canadians that Regulation D should be used only by Canadians with provincial qualifications. Suggests language in Regulation D go back to that in March 11, 1952 draft re principal place of business.

3. The "black list" should be brought up to date with additions from Quebec and deletions of cleaned up companies from Toronto.

4. The "black list" should be retained but kept up to date at all times.

5. Contact be made by U.S. representatives with Quebec officials for assistance in problem.

6. Further exploration be made for a workable solution.

On January 16, 1955, the Better Business Bureaus of Canada (operating in 7 cities) issued warnings to beware of phoney securities offerings by contacts using long distance telephone calls, telegrams, or tipster sheets. The Better Business Bureaus of Canada (and also throughout the U.S.) have periodically issued such warnings.

On January 16, 1955, a draft of the proposed new Quebec securities Act was released providing for a 3 man Commission and purportedly having enough "teeth" to stamp out the recent boiler room tactics.

On January 17, 1955 (thanks to the furnishing of information by Mr. Lennox earlier) we were able to complete our investigation of a Canadian company and get enough evidence to get a temporary restraining order against the company, whose Vice President lived in Iowa.

On January 22, 1955, at the Seventh Annual Meeting of the Broker-Dealers Association of Ontario, the Chairman of the Board of Governors addressed the meeting. He referred to the continuing decline in membership (131 members down to 115 members and 235 associate members down to 165 all within 1 year) due to natural causes, to lack of business and to the weeding out of undesirables. He speaks of the accomplishments in the fields of price spreads, better screening of new applicants, and the training of inexperienced salesmen (he suggests that the 6 weeks training period could be shortened to two weeks). He regrets the breakdown of relations with the U.S. but takes satisfaction that the Association complied with its agreements even though the advance benefits contemplated didn't materialize and good money was spent in some instances for poor results.

He continues that the Americans understand the problems better than before; that the Association has proved it can "play ball;" that things generally are healthy; and that he feels we all are getting closer to a really "workable solution to the problem of legitimate selling of securities to Americans who undoubtedly want them."

He exorts the Association to become a useful service organization.

On March 1, 1955 the New York Times ran an article respecting permanent injunctions obtained by the New York Attorney General against 2 Montreal dealers (Paul Payette and John Vanier) and four oil promotions. The action began September 20, 1954 with temporary injunctions. The permanent injunction was consented to by the two defendants. Initially there were nine defendants, some Americans and some Canadians. The two consented through their New York attorneys.

At the time the material for this report was being gathered in January and February our records indicated no illegal offerings coming from Ontario. A last minute check shows a number of recent illegal offerings coming from Ontario, mostly Toronto. While some of these offerings were being made in December, January and February, information about them is just now reaching us, so there may be more. Five of these 13 known offerings relate to securities from the "Bancroft Area" and could be fraudulent if the experts are correct that there is probably no uranium in commercial quantities in that area.

The 13 offerings are:

Broker	Issuer
R. W. Brown	1/ Dino Mines Ltd.
IAMCO Corp Ltd.	1/ Hercules Uranium Mines Ltd.
R. V. Wilson & Co.	1/ Panaramic Uranium Mines Ltd.
*Harold V. Graham & Co.	1/ Canada Radium Corp.
------	1/ Jim Exploration Corp. Ltd.
*W. McKenzie Securities Ltd.	Pickering Metals Mines
" " " "	New Marlon Gold Mines

Fleetwood Financial Corp.	Skyline Uranium and Minerals
H.R. Cory & Co.	Pacemaker Mines and Oils
*R.P. McKay & Co.	Surety Oils & Minerals
" " " "	2/ New Bristol Oils (Listed co.)
*A.C. McPherson	Ameranium Mines Ltd.
-------	Mattawan Gold Mines Ltd.

1/ Bancroft Area Securities.

* Recently withdrew 1934 Act Broker-Dealer Registrations.

2/ The securities may be exempt but the broker is not registered.

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The foregoing review of happenings shows many of the difficulties encountered, and the preventive steps taken. It should show us where we have erred in judgment or action. It should aid in the finding of a solution.

In order therefore to sharpen the matter up, the balance of the report will do four things:

a. briefly sum up the steps taken to stop unlawful offerings,

b. briefly describe the results achieved and what we have learned,

c. briefly describe the problems faced today, and

d. suggest solutions.

CHAPTER X

A. Brief Summary of Steps Taken since 1933 to Stop Illegal Offerings from Canada.

Having the duty to detect and stop securities fraud, whether originating from within or without, the Commission and its staff have expended considerable effort and money in such fraud prevention work. Some success has been achieved on all fronts, if only periodically, but nothing yet tried has effectively stamped out illegal offerings from Canada or the continued threat of such offerings. Among other things, the following steps have been taken:

1. Investigations: More than 500 cases have been docketed respecting illegal and fraudulent Canadian offerings.

2. Injunctions: In a few instances where we could get jurisdiction over the violator, because of his presence in this country, we have gotten injunctions or restraining orders against continued violations.

3. Indictments: With the cooperation of the Department of Justice, we have been able to secure indictments against individuals and companies for violations. Excluding the T.M. Parker case, open indictments are currently pending against 17 individuals and five companies or firms.

4. Secret Indictments: A substantial number of secret indictments against violators have also been obtained beginning with 1941.

5. Treaty Revisions: Beginning in 1934 and continuing into 1952 the Commission studied and worked for revisions to the extradition treaty. Although our aims were thwarted in 1942 and again in 1945, we did obtain an amendment in 1952.

6. Clearing House Facilities: The SEC in 1934 instigated a plan for the exchange of information respecting securities violators and violations. The SEC compiled the data and interchanged it with 700 contributing Federal, State, local, business fraud prevention groups. The list of Canadian violators has increased yearly.

7. Conferences: Scores of conferences have been had with Dominion, Federal, Provincial, state, local, business, stock exchange, Better Business Bureau, and other officials seeking solutions to the problem of illegal offerings from Canada.

8. Publicity: A number of speeches, articles and statements by the Commission and its staff have warned against such illegal offerings.

9. Source Material for others provided: Violation information has been made available to the provinces, states, stock exchanges, local enforcement officers, and others to aid and encourage them in enforcing their laws or requirements. Moreover, such information likewise has been provided to Better Business Bureaus, the press, radio, and magazines with encouragement that it be used to warn the American public against illegal offerings.

10. Fraud [_____] and Fictitious Name Orders gotten: With the fullest possible cooperation from the Federal Post Office Department, Fraud and Fictitious Name orders have been obtained. For a period of a few months in 1950, the Dominion Postal authorities also cooperated in an effort to close the mails to these violators.

11. Sent Warning Letters: As soon as we learned of a violation Mr. Callahan would send a warning letter to the issuer, the underwriter, participating brokers and dealers, officers and directors explaining the registration and other requirements and warning against further violations. He also conveyed the information to the appropriate province. No attempt has been made to total such letters, but they ran into the thousands.

12. Kept abreast of occurrences: The Commission has continuously sent Mr. Callahan and others into Canada to observe operations going on and to detect violations. Through these visits and secret sources much has been learned respecting the real operators behind the "fronts"; about preparation of mail campaigns; about use of postal meters; about exchange of American dollars for Canadian; and other helpful matters.

13. Attempts to close telephones to violators: Unsuccessful attempts have been made to close off telephones where used by known boiler-room operators. The aid of the Federal Communications Commission was enlisted, but to no avail.

14. Created so-called "Black Lists": In conjunction with interested parties created and maintained (although not always current) a list of those securities which were being or had recently been offered illegally.

15. Interpreted laws to prevent distribution under brokerage exemption (4-2) 1933 Act.

In order to prevent distributions through a scheme to have solicited purchasers (solicited by Canadian offeror or "investment adviser") use [__] the facilities of their own broker to effect the "unsolicited order", the Commission ruled that the broker aiding in such distributions was exceeding his brokerage function and had no exemption.

16. Created Regulation D.: The SEC promulgated an exemption under 3(b) of the 1933 Act to give Canadian companies a cheap and easier way to offer securities

legally into the United States than theretofore existed when any amount offered from Canada required full 1933 Act registration.

17. Eased Broker-Dealer Registration: Coincidentally with the Treaty revision, and Regulation D, the Commission simplified its broker-dealer registration form (although primarily for Americans, it aided Canadians also). During 1953 and 1954 a total of 74 applications for broker-dealer registration were filed by Canadians. Of these 56 obtained registration, 12 withdraw and 6 were denied registration or registration was cancelled.

18. Allowed Canadian Investment Companies to Register: Opened the door, with appropriate restrictions to Canadian investment companies. According to Barron's (February 7, 1955) a sustained flow of funds from the United States has poured into Canadian industry through these companies. It says that more than $100,000,000 was raised for the Canadian market in 1954.

19. Sought Cooperation: We have encouraged and joined with every step or program that any state, exchange, or other body has taken to urge a clean up in Canada and have directly plead with provincial officials for better cooperation.

20. Have warned prospective purchasers: Frequently we have warned individuals, upon a request for information, that the issue was not registered and that United States laws were being violated in its offer in the United States. We have consistently urged recipients of Canadian offerings to get in touch with us, their bankers, brokers or Better Business Bureaus.

21. Didn't object to lifting of Fraud Orders: In instances where Canadian firms subject to Post Office fraud orders indicated a desire to comply with our laws, we

did not object to the lifting of such orders, which lifting often opened the way to State and Federal qualification otherwise impossible.

22. Have worked hard to clear legitimate Canadian offerings: A total of registration statements covering $1,576,120,073 have been filed by Canadian companies. In addition, statements covering $939,666,222 have been filed by the Dominion or other Canadian governments. The staff has given these filings the same treatment accorded United States filings. It is of interest that more than 97% of these Canadian offerings have become effective.

While the SEC has been combating these illegal offerings, the states have been very active, issuing 1517 so-called "cease and desist" or fraud orders, getting 417 injunctions, and starting 54 criminal actions. The provinces, other than Ontario, have acted 14 times administratively and 29 times criminally, and Ontario alone has instituted 269 administrative and 163 criminal actions. It is somewhat disillusioning to consider that despite all the steps and efforts made by everyone, including nearly constant bombardment by the press and magazines and the Better Business Bureaus for some 15 years, nothing to date has stopped the frauds.

CHAPTER XI

(b) General Results achieved and what we have learned:

The important thing learned is that despite all our efforts, plus the cooperative efforts of nearly everyone, the problem of illegal and fraudulent offerings from Canada stands not much nearer solution today than when first encountered. The hundreds of investigations and actions and the repeated frustrations can, however, form the foundation of new approach, because through them much knowledge has been gained, the problem has taken on a clear outline and it should now be obvious to us that much more than faith and reliance on the good-will, cooperation and assurances of a few Provincial Securities Administrators (plus a few shattered arrows in our quiver) is required to subdue this problem. This is not to disparage the benefits gained by the American public which were achieved through the good-will and cooperation of 8 of the 10 Provinces at all times and from Ontario and Quebec a substantial part of the time. Without this cooperation and good-will, conditions could and would have been much worse. Nor is the conclusion that such cooperation has not been enough to solve the problem intended to imply that full cooperation is not sought and needed in the future. Without the full cooperation and the good-will of our Canadian friends, the problem can never be solved, or even substantially minimized, regardless of the steps we take to combat it.

We have learned that the [_____] of the past 20 years that all would be solved by a treaty amendment effecting extradition of violators was “wishful thinking.” Whether we win or lose the appeal in the T.M. Parker, Inc., case, we must realize that at best this

extradition approach is slow, expensive and will be whipped by ingenious fraud operators shaping their operations on the perimeter of the law. We now know that bigger and more effective weapons are needed to stop violations originating in foreign countries.

We have learned that publicity and warnings are ineffective. No more active campaigns of press and other warnings are conceivable than those generated in 1945. Leading newspapers, magazines here and in Canada, State Commission, Stock Exchanges, Better Business Bureaus, police, radios, private concerns and many others warned and plead with the public to investigate before investing.

We have learned that the overwhelming majority of Canadians are honest and law-abiding. They resent the presence among themselves of dishonest American operators (and their Canadian pupils) who with their "fronts" constitute the core of the high-pressure, fraud artists selling illegally. The law abiding element in Canada stands frustrated, however, because of the inadequacy of the Provincial securities laws, or their enforcement, and because of the complete absence of Dominion securities laws. That Canada does not create a Dominion Securities Commission and that the Provinces do not have stricter laws is not understood by many people. However, Canada is undergoing the same growing pains now which were experienced here 50 years or more ago. Much of our growth resulted from fraudulent securities offerings and swindles and the cries in the wilderness for securities legislation on both State and Federal levels were not heeded here for scores of years. Possibly Canada will have to experience a "1929" before awakening to the over-all benefits of securities regulation.

We have learned that there is no sound basis for the continued contentions of some people that it is either impossible, impractical, too costly or too time-consuming for

a Canadian company to comply with the SEC regulations. A total of 343 registration statements covering aggregate offerings of $1,375,120,073 were filed by Canadian companies during 1933-1954. While 103 statements covering $115,155,105 were withdrawn, some were placed under stop order and a few are still pending, a total of 211 statements covering $1,225,852,051 have become effective. This 89% is a rather convincing figure. If all Canadian issues were considered, the percentage of proposed dollar offerings to those effective would increase to 97%, because 34 Canadian Government issues covering $939,666,222 have been filed and 33 covering $937,136,222 have become effective. One issue for $2,440,000 is still pending.

We have learned that even postal fraud orders only partly solve the problem. There are some 200 "ports of entry" of mail into Canada and the mere mechanical problem of policing the mail is gigantic. While partly effective, an experience of the Shreveport Better Business Bureau is enlightening. On November 3, 1950, it mailed plain sheets of paper to the 55 firms against which the post office department had issued fraud orders and which 55 firms had been the subject of much newspaper publicity. The Bureau hoped to get a story by running publicity showing the intercepted envelopes returned with "Fraudulent" marked upon them. It got an unexpected story. First, only 21 of the 55 letters were returned and second, not a single one bore the word "fraud." The markings on the envelopes indicated they were returned because (a) of "insufficient address" or (b) they were "non-transmissible." The BBB wrote, "Frankly we were stunned when we discovered that over half of our 55 envelopes reached the addressee instead of being stopped by the post office department."

We have learned that many so-called "independent" investment advisers and a large number of purportedly "independent" mining journals or periodicals were involved in fraudulent distributions. Our records indicate that in 45 instances between 1940-1954 our investigations found investment advisers working along with the share-pushers in their recommendations. More startling perhaps is the fact that of a total of 34 purportedly independent mining periodicals, our investigations have shown 21 of them to have collaborated with the high-pressure boys, one or more times, by running untrue "news" articles in the midst of a selling campaign.

We have learned that constant vigilance and continuing investigations on this side of the border are not enough. Our records indicate that we reaped a very small harvest indeed from the investigation of 924 issues offered into this country in violation of our laws between January, 1934, and December, 1954. The few fraud orders, indictments, injunctions and very few convictions may have slowed down the stream, but provided no permanent solution to the problem. More discouraging is the fact that after the new extradition treaty was signed, violations increased.

We have learned that people in different environments and with different backgrounds think differently. The SEC and the American people favor the free flow of capital from the U.S. into Canada and have no prejudice against any kind of speculative or sound investment made legally by our citizens. Our laws have reached a high threshhold of perfection and differentiate between speculation and peculation. Some people in an environment of speculative boom fail to see what difference it makes whether legal methods are used in selling securities so long as the money, or part of it, ultimately develops the projects for which it was sought.

The difference in views stemming from different backgrounds and philosophies is clearly shown from statements made in the record of a conference of Provincial Securities Commissioners held in November 1951 in Toronto and represent a thought pattern prevalent in Canada. One commissioner was explaining that generally the securities rules are strict but to help development an exception might be made. Another commissioner spoke up:

> "Of course, Mr. Chairman, I have always been under the impression--although apparently I am mistaken--that the primary duty of a Securities Commission is to protect the public, and not to promote the interests of the promoters, brokers and stock exchanges. Apparently I am wrong."

A leading lawyer said, “I would say you are not right.” Later, another leading lawyer commented that there had been an overemphasis on securities legislation aimed at fraud and that while the securities business had many aspects, the overemphasis on fraud had thrown the whole picture out of balance.

The differences of viewpoint between honest peoples viewing the same problem do not present an insurmountable obstacle. We all want the fly-by-night securities operator driven out. Our approaches are different and much give and take from both sides is indicated.

While Mr. Lennox has stated that he believes fraud in securities selling means the same thing on both sides of the border, we have learned through extradition failures and experience that it really means different things to different people, depending on background and philosophy.

Another thing we have learned concerns the differences in views as to how to handle a fraud once it is detected. The SEC view has been to prevent or stop it before it gets well started. Conversely, Mr. Lennox testified in 1951 that it was better to let a man have enough rope to hang himself, then get caught, and be punished. He contends this is a better solution than to attempt to stop the fraud initially by examining his literature and preventing its use. In this general connection he further stated that the people of Ontario were getting excellent securities protection and ". . . I do not see why the United States people cannot adapt themselves to protect themselves in the same way."

We have learned that two administrators with approximately the same laws interpret them very differently. Mr. Godfrey threatened to throw out any broker-dealer who sold into the U.S. without compliance with U.S. laws. Mr. Lennox says it is not illegal to mail and phone into the U.S. if no Ontario citizen is defrauded whether such actions violate U.S. laws or not. Moreover, he says that no provincial authority can stop the mails or telephones. Only the Dominion Government has such powers for cause. In testifying in 1951 he emphasized that things would be different if he could run things by "whim" instead of by statute, as required, saying of licensing:

> "You are granting a privilege, but it is based on statutory consideration. It is not subject to any whim. If it was, I can assure you there would be 140 broker-dealers out." (There were about 200 broker-dealers registered at this time.)

We have learned that the equipment and badges of his trade easily identify the patently dishonest broker and dealer. His equipment is the mimeograph and printing machine, lurid literature with dramatic illustrations and maps (which are generally false

or at least misleading), a sucker list and telephone directories. He sells securities. Legitimate brokers and dealers do more than merely sell securities. Realizing that a satisfied client remains a good client, they prescribe an investment program to meet his personal needs. The mark-ups or commissions are somewhere near reasonable, not the 200%, 300% or 400% or more type mark-ups extracted by the dishonest boilershop operator.

Many people have expressed the view that because some of Mr. Lennox's predecessors identified the operators and "picked up" the licenses of certain high-pressure fraud artists offering into the U.S., that it would not be possible for such people to operate without the "permission" of Mr. Lennox. [_____] Mr. Lennox (who deplores the frauds) says that he does not have the legal power to "pick up" licenses absent harm to Ontario citizens. Since the treaty he has been doing it under a "general welfare" clause, but unless he has changed his mind, he still is of the opinion he does not have the legal power to act as he does. His actions have been prompted by an effort to "cooperate" with Americans and open the way for legitimate financing.

We have learned that many decent law-abiding citizens in Canada while deploring the fraudulent activities in their midst, resent U.S. efforts to stop such activities and "our meddling." For example, many feel

1. That Canada should not be asked to enforce U.S. laws or standards.
2. That the provincial securities administrators should not be criticized because they are doing the best they can.
3. That U.S. investigators have no right to come snooping around inside Canada.

4. That we have no right to interfere with mail to or from Canada.

5. That U.S. efforts are to prevent U.S. sales by Canadians so as to provide a monopoly for American broker-dealers.

6. That "chance taking," "honest gambling," "grass roots developments" or "risking a dollar to make a dollar" are not frauds and that in stopping these speculative developments we are interfering with free enterprise and stopping the needed development of Canada.

7. That our Federal Government should cause the States to adopt uniform securities laws so that a Canadian offering doesn't strangle in the 48 qualifications necessary to meet United States requirements (47 State and 1 Federal).

8. That there is too much delay and expense in registering under the 1933 Act, with an undertone that this is deliberate.

9. That the SEC has deliberately made Regulation D unworkable and has "double crossed" Canadian broker-dealers.

10. That the Federal Government has not caused the States to "fall into line" to the extent of accepting a Federal broker-dealer registration as good in each State with nothing more.

11. That we don't understand or appreciate their problems and try too much to act like a "big brother." Many contend things will right themselves in time if we will just be patient.

Having thus a better understanding of the thinking, philosophies and backgrounds of some provincial officials, Canadian broker-dealers and citizens and how they view the problem, we probably are in a better position to view the problem and devise solutions.

CHAPTER XII

(c) The Problem We Face Today:

The problem we face (and have for 20 years) can be stated rather simply. It is this: How can we perform the duty placed upon us by the Congress of detecting and preventing illegal and fraudulent offerings of securities? The immediate problem relates to such offerings from Canada.

Canada with its vast untapped natural resources has been described as the "last frontier". New industrial plants, the development of hydro-electric power, dams, roads, railroads, oils and minerals require large amounts of capital. There is a ready American market for products and materials which come from the mines and forests of Canada. The biggest investors in these enterprises are the Canadians themselves. The U.S. public has supplied the major portion of foreign capital. The moneys which have been siphoned off in fraudulent promotions are needed for legitimate Canadian enterprises. While the U.S. investor is willing to take a chance he should know what sort of chance he is taking and that the gamble is an honest gamble, that the cards are not marked and the dice loaded. A chance to assess a risk must be afforded to investors. We must do everything possible to insure that Americans who put their capital to work will be secure in the knowledge that they will be dealt with fairly and that their risks will be informed risks.

Our geographical contiguity with Canada and the advanced state of mail deliveries and telecommunications make it possible for offenders in Canada to operate all over the United States without ever setting foot in any state.

A review of our efforts to stop these illegal offerings indicates that as an agency "in business" for the purpose of putting illegal and fraudulent operators "out of business" we have not made the progress hoped for. Indeed, there may be some basis for the thought that we have made no real or lasting progress and that whatever successes have come have been momentary and have resulted solely from the goodwill or cooperation extended from outside our jurisdiction. The peaks and valleys of violation statistics indicated by Exhibit 3, mirror the philosophic backgrounds and enforcement propensities of a few men. There is nothing in our experience to point to any lasting solution when our whole enforcement structure depends for success upon the cooperation of provincial administrators who alone possess the keys which can open or close the flood gates and control the tides. The most cooperative administrator today could die, be replaced or lose the key overnight.

The action of Mr. Lennox on November 16, 1954 in unlocking the Ontario flood gates by removing restrictions of 18 months standing toppled a structure built up over many years by adding a plank here or a piece there. He demonstrated by his action that we had built a structure upon the sand. We must no longer depend solely upon any provincial administrator to interpret and enforce his laws as we think they should be interpreted and enforced (or possibly "over-interpret" the laws as some Canadians claim) as the only way to protect the American public. This approach has been unrealistic and we must build a structure on solid ground, on ground under our own jurisdiction, and we must possess the keys to the flood gates.

Whether Mr. Lennox is properly within his rights to abrogate his assurances to the SEC and whether he is wholely justified in so doing, is not nearly so important as is the

fact that such agreements can be broken unilaterally, thereby undoing years of effort. Mr. Lennox is a fine man and no doubt (having the public interest in mind) will be glad to enter into negotiations and conclude a new agreement. If he does we must know that such misunderstanding could arise again with him or with others, with either or both parties to blame. To expect to be able to see eye to eye at all times on all problems with ten different provincial administrators administering ten different laws is plain wishful thinking.

Dominion & Provincial Securities, Registration and Fraud Laws.

We are faced with the fact that the Dominion government has no securities act; that the provincial securities laws although following a general pattern differ considerably; that the interpretations applied differ; that the degree of enforcement varies; that criminal offenses for violation of provincial laws are not tried by the provinces but by the Dominion; and that enforcement in part therefore depends upon the philosophy and agressiveness of the Dominion.

(1) Dominion:

There is a Dominion Companies Act, passed in 1934, which allows charters to companies whose objects are not exclusively provincial in scope. The general effect is that a company obtains a patent. The Dominion has no powers in the securities field except with respect to such Dominion chartered companies. Such companies if making an offering of securities must file a prospectus with the Secretary of State of Canada seven days before its use and must provide the prospective purchaser with one at least 24 hours before he may purchase. If there is a violation the purchaser has a right of

recission. There is no special commission or group detailed by the Dominion government to administer these provisions.

Except for prestige and the fact that some provinces will accept this prospectus in lieu of one meeting their own requirements there appear to be few advantages for Dominion chartered companies. The provinces require compliance if such companies desire to sell securities in the provinces.

The Dominion government has a criminal code which encompasses securities frauds and applies to all 10 provinces. Among the 15 sections of the Code applicable to securities frauds are 209(c) (mail fraud); 213A (sale of margin stock by a broker); 404 and 405 (false pretenses); 414 (false prospectuses); 444 (defrauding the public); 444A (manipulation); and 573 (conspiracy). Details of these sections will be found in appendix 2.

In addition there is the Dominion Post Office Act section 7 of which appears to prohibit the use of the mails for unlawful purposes.

The provincial acts generally provide that fraudulent conduct other than that prescribed by the Canadian Criminal Code shall be an offense (see e.g. Section 25(1) The Securities Act of Alberta).

In Canada, unlike this country, both the Dominion government and the provinces have incorporation powers for any type company.

Provinces:

Each of the provinces has a securities fraud prevention or “blue sky” law. Each has certain registration requirements for either companies, issues, brokers, dealers,

salesmen, or investment advisers or for all of these. The requirements, the fees, and the performance bonds, if any, vary among provinces.

Prior to 1930 the provinces controlled securities activities by various types and forms of blue sky acts. In February 1930 delegates from each of the provinces met at an interprovincial conference in Toronto. As a result of the discussions, each province almost immediately adopted the "Security Frauds Prevention Act" of Ontario as its model for new legislation. While all cut from the same holt of cloth, there were different designers, tailors and needs to be met producing different looking end products. When another 25 years of interpretations and numerous amendments are added, it becomes rather obvious that the laws now vary among the provinces. However, many basic concepts run through all, or nearly all. For example, each administrator appears to have complete life and death power over registrants. These vested powers are such as to allow the administrator to clean up his province and keep it clean. Each of the 10 provincial laws enables the administrator to set conditions and to deny, cancel or revoke any registration in his discretion and it would appear even without cause. While it may be true that the courts have not ruled adequately to remove all doubt, the rulings we have seen lead to the belief that adequate powers exist and that what has been lacking has been the will to fully use these powers. Whether the powers should be arbitrarily used is another matter, for other considerations, equities and pressures always exist.

Each provincial statute exempts certain classes of securities from registration and registration as a broker (which usually is defined to include a dealer) or salesmen is often not necessary except when trades occur in non-exempt securities. Some provinces have a different treatment for "private companies" (those with 50 or less stockholders for

example) and some make exceptions for or give advantageous treatment to prospectors or prospecting syndicates. The uniform threads running through the statutes are: (The new Quebec Act is dealt with here as though it had already passed.)

(a) certain acts constitute fraud;

(b) no person shall trade in non-exempt securities without registration as a broker or salesman for a broker;

(c) that such registration, unless the attorney general directs otherwise, shall be granted at the absolute discretion and under such conditions as the securities administrator of the province prescribes;

(d) that registration is for 1 year only;

(e) that a minimum bond is required and that additional bond may be required (exception Ontario);

(f) that the bond is forfeited if an offense occurs (exception Ontario);

(g) that the financial condition of the broker-dealer is checked into;

(h) a detailed description of the applicant is required (exceptions Manitoba, New Foundland and Nova Scotia);

(i) a call to a prospect's house by telephone is prohibited (exceptions Alberta, Manitoba, New Brunswick, New Foundland, Nova Scotia and Prince Edward Island);

(j) a confirmation of each transaction must be given (exceptions New Brunswick and Prince Edward Island);

(k) investment advisers must register (exceptions Manitoba, New Brunswick, New Foundland, Nova Scotia and Prince Edward Island);

(l) non-exempt securities must be qualified (exception Manitoba where qualification of securities is not necessary if broker is registered);

(m) a prospectus must be filed:

(n) all advertising material must be filed (exceptions Prince Edward Island and Saskatchewan);

(o) audits of broker-dealers mandatory;

(p) full credence given to warrant from another province for a securities violation and aid given to deport violator;

(q) either the governing securities body or the attorney general or minister has full investigation powers and

(r) it is an offense for the person under investigation to not give full cooperation.

It is noted that the provinces do not accept filings or registrations from another province (exception appears to be Alberta which may waive registration if the securities are registered in another province). Some of the provinces exempt securities from registration if the same class is listed on a recognized exchange, including some American exchanges.

Details of the various provisions will be found in Appendix 2.

An entirely different, equally important problem faced today (as for the past 20 years) is to find ways to prevent the American public from buying fraudulent and illegally offered securities. It must be conceded that our attempts to educate and warn the public adequately have failed. While it appears rather impossible to legislate against greed and stupidity we must be keenly aware that little, if any, securities fraud would

exist if the "get-rich-quick" victims were not "ripe for the taking." (See cartoon next page.) While it has been proved that laws will not prevent the alcoholic from drinking, other laws for the protection of the public have been workable and beneficial even though many personal "rights" and liberties have been disturbed. Citizens are not allowed to run through red lights and stop signs; to possess unstamped whiskey or tobacco; to haul stamped whiskey across a state line; to have more than 3 bottles of whiskey in one's ear; to have more than 4 ducks in possession; to own fireworks, explosives or firearms without specific license; to possess narcotics; to possess counterfeit currency; to spend a fully legal $20 bill, backed by gold; to send Lysist___ through the mail; to send certain products or chemicals through the mail; to drive cars above certain varying speeds; to honk an auto horn; to drive a car with a broken windshield or tail light; to fish on Sunday; to bet; to sell colored margarine; to misrepresent the ingredients in or curative powers of medicines; to smoke in bed; to sell unclean or impure food; to sprinkle lawns and flowers, etc.

It is of course clear that no amount of legislation and strict enforcement can completely stop securities frauds. However, as one of the spokes in the enforcement wheel some preventive legislation against buying or owning securities not registered (if registration is required) is worthy of consideration. It is not illogical to make it illegal for a person to purchase or possess a foreign security unless that security has met the registration requirements and paid the fee or tax imposed by U.S. law.

Being aware now that we must deal with and seek cooperation from Canadian people equipped with different mental and emotional backgrounds and

THRILL THAT COMES ONCE IN A LIFETIME

[CARTOON PICTURE]

NO MORE WORK FOR US, EFFIE. LISTEN TO THIS – BEAR TAIL MINES LIMITED – THE GREATEST NAME IN CANADIAN GOLD MINING – LOCATED ON THE RICHEST FRONTIER OF NORTH AMERICAN GOLD MINING. BEAR TAIL ADJOINS BIG PAYOFF, THE SHARES OF WHICH ADVANCED FROM 35¢ EACH TO $11.63, GIVING MINE-WISE INVESTORS A PROFIT RATIO OF OVER 3300% OR $11.28 PROFIT NET ON EACH 35¢ INVESTED. THE FABULOUS POLE CAT MINE LIES ONLY 132 MILES N.E. OF BEAR TAIL. $1000 INVESTED IN 1922 IN POLE CAT WOULD BE WORTH $2 BILLION 4 HUNDRED MILLION TODAY. THE GROUND FLOOR PRICE OF BEAR TAIL IS 46¢ PER SHARE. EFFIE, OUR GOVERNMENT BONDS WILL BUY A LOT OF BEAR TAIL SHARES AT 46¢ WE'RE RICH!

THE LURE OF
SOMETHING FOR NOTHING

experience from ours, poses a further problem. Can effective cooperation ever be achieved unless we go more than half-way towards the solution? While it is true we cannot administer the laws entrusted to us on the basis of a "double-standard" with less requirements for those from across the border than for our own residents, we must consider whether any United States citizen will really be harmed if, for example, Regulation D is revised to meet the desires of Mr. Lennox.

We have always expressed the view that it would be unconscionable for an American securities dealer to engage in transactions in Canada absent compliance with all applicable Canadian laws, whether or not the American happened to agree with all aspects of those laws. We had hoped Canadian administrators would have the same views from their side of the border respecting sales into the United States. We provide to all Canadians the full protection of our criminal and civil provisions respecting securities offered from the United States (Sections 5, 11, 12 and 17 among others of the Securities Act of 1933). American citizens get no similar protection when purchasing securities from Canada. The question arises as to whether in this one-sided situation we should confine Regulation D to Canadian enterprises. One view exists that Regulation D and other benefits given to Canada were promised upon the understanding that a workable treaty would exist and such benefits should now be taken away. Another view is that we should further attempt to solve the problem by making more concessions. This latter view if followed would in part revive our prior relationships and certainly aid in preventing illegal offerings. It should be noted that of the 77 Regulation D's filed up to December 31, 1954, 63 of them were actually "Canadian." It is contended that the successors to the 14 "Delaware Companies" (2 were actually New York Corporations)

could use a different form, with exemptive provisions applied which would make competitive conditions equal to Canadian requirements. An amendment to Regulation A or a new Regulation E could accomplish this.

While a few Ontario dealers have resumed offerings, the Ontario broker-dealers generally appear to have continued to comply with our laws. The warnings of Mr. Lennox along with those of the Ontario Broker-Dealers Association are in large part responsible. He warned:

> "The restrictions imposed are now removed, but each individual registrant must decide on his own future course of conduct bearing in mind that the type of operation which the Commission has combated in the past, including excessive mailings, excessive telephoning and other high pressure methods prejudicial to the industry at large will not be tolerated. These views are, I believe, shared by all responsible members of the organized industry."

Three days later, November 19, 1954, the Ontario Broker-Dealers Association similarly warned all its members. It threatened immediate expulsion of any member who did not comply fully with the letter and the spirit of the Ontario securities law.

We must also bear in mind that many day to day normal operating patterns employed in Canada in distributing securities were deemed to be fraudulent per se here 20 or more years ago. For example, the Canadian development is almost always tied to price step-ups and exhorbitant commission or profit step-ups. Market manipulation is controlled only by self-regulation in the exchange and exchange facilities are used there to distribute new issues, a technique generally not used in this country for 30 years or more. Many things viewed as illegal here are "custom and usage" there and not deemed either illegal or unethical.

If we are going to find lasting ways and means to prevent a recurrence of Canadian illegal offerings, we will have to review our methods of processing Regulation D's and broker-dealer applications and seek "speed up" techniques. The record shows that the statements are often poorly prepared and that it is not unusual for 60 or more calendar days to pass before clearance in the case of Regulation D's and broker-dealer registrations. Maybe the forms could be clarified. Maybe a pre-exam method of aid might be worked out or lecture courses provided in Canada on specific dates.

The elapsed time (calendar days) used in processing the 77 Regulation D's filed 1953-1954 is accounted for in large measure because they came in poorly prepared and Corporation Finance does not have enough people to provide a speedier examination:

	1st letter out	1st amendment back	Regulation D's cleared
1-15 days	26	24	0
16-30	40	20	8
31-45	2	9	7
46-60	1	1	13
61-90	0	5	13
91-120	0	2	5
121-180	0	1	2
181-270	0	0	3
271-365	0	0	1
Over 365	0	0	0

Note: 7 deficiency letters were never answered; in 5 instances we sent no letter but discussed with applicant its eligibility to use Regulation D; 3 letters were in preparation; 4 statements were withdrawn before clearance and 1 after; 20 were pending at year end; in 9 filings we received reports 100% of the offering was sold (7 Canadian & 2 Delaware); balance of the 43 cleared appear to have sold from 0 up to about 1/2.

The elapsed time (calendar days) between the filing of a broker-dealer application and its clearance is shown below for the processing during 1953 and 1954:

Days in Processing	Number Cleared
1-30	36
30-60	9
60-90	9
90-180	5
180-270	2
270-365	6
365-545	7
Total effective	74

Of the 14 investment adviser applications filed in 1953-1954, 12 were cleared within 30 days, one before 60 days and one before 90 days.

Our present problem is aggravated because many broker-dealers have dropped their registrations. On November 1, 1954, there were 53 Canadian broker-dealers registered with the S.E.C. On March 15, 1955, there were 46. Thus, with 8 holdovers and 56 cleared in 1953 and 1954, only 46 remain.

Moreover, one of our regional offices reports that it has been unable to obtain certain information from the Ontario Securities Commission which is needed to complete an investigation. In view of the fact that we cannot officially investigate or inspect brokers and dealers in Canada, we are made quite helpless without Mr. Lennox's cooperation.

One further problem we will face, which indicates a need for full understanding and cooperation with provincial officials, is just over the horizon. As the thousands and thousands of Americans learn that they have been defrauded, a friendly receptacle must be available in Canada to aid us in processing the complaints. Whether the illegal sales ran $1,000,000 a week as we estimated or only $27,142,333 in three years as estimated by Mr. Lennox based on his own studies, the potential seeds planted could provide a bumper crop of complaints.

Another prospect for complaints may arise from past violations, where mining has actually been attempted and ore found, because of practices which have diluted the interest of the purchaser. Many companies have gone through reorganizations or "adjustments" many times. One of our complainants related this experience. He bought 1,000 shares in 1932 in Casey Summit Mine. In 1935, it was reorganized as Argosy Gold Mine and 4 old shares got a little less than 1 new one (he received 225 shares); in 1938, Argosy was reorganized into Jason Mines Limited and 5 Argosy shares got 1 Jason share (he received 45 shares); in 1943, New Jason Mines was formed and 3 Jason shares got 1 new Jason share (he received 15 shares). New Jason Mines and its predecessors actually produced more than $2,000,000 of gold gross. The complainant who had 1,000 original

shares now had only 15 shares and the 12 cents per share paid as total dividends for 18 years gave him only a $1.80 total return on his investment.

Consideration has been given to the approach that a Regulation D exemption is not needed. A total of 343 Canadian enterprises (not including Governments) had filed registration statements covering $1,375,120,073 up to 1955 and most of this amount (89%) became effective. From such data it might be concluded that registration can be achieved and it has not been deemed too expensive or time-consuming by those doing it. However, if such an exemptive provision will help remove the lawless element and insure Canadian cooperation, its retention must be seriously considered.

We are faced with the knowledge that the extradition machinery will not operate as smoothly and quickly as hoped, if it will work at all. Moreover, the SEC will never have the funds to try more than one "Parker" type case a year.

Facing the problem of finding permanent relief from illegal Canadian offerings calls for different actions than those heretofore employed in finding the temporary relief enjoyed for a couple of brief periods during the past 20 years. It would be extremely shortsighted to abandon the relationships made or to not work for the further good-will of all Canadian officials. It would be equally shortsighted not to attempt also to set up a structure in the United States which would be in some measure effective in and of itself in stopping illegal offerings. We must remember that less than 2 years ago illegal offerings had dropped to a negligible trickle, only to spring forth again.

CHAPTER XIII

(d) – Solutions to the Canadian Problem

The record indicates the futility of operating under an enforcement program where we lack the jurisdiction to enforce our laws. While some of the solutions here proposed may appear at first glance to be drastic, it must be realized that the continued violations from Canada and the threat of further continuations call for drastic action if an effective solution is to be found. A way must be found so that we can acquire jurisdiction to deal with the foreign offering problem.

1. New Federal Legislation

We should discuss with the State Department and propose to the Congress completely new legislation to be known as the "Foreign Securities Registration Act," or in the alternative a revision of the 1933 Act to embrace the same type of provisions needed in such new legislation. This legislation should provide that no securities from a foreign country may be offered or sold in the United States, its territories or possessions unless registered and proper registration fees paid, or unless an exemption from registration has been obtained by order of the Commission. The Commission is to be empowered to certify to the appropriate departments or agencies that it has reasonable grounds to believe that violations are taking place or are about to take place and such departments or agencies shall prevent or suspend the use of the mails (Post Office Department), telephones or telegraphic communication (Federal Communication Commission), to any person or persons upon such certification. The certification would provide for a 20-day suspension with the right of any aggrieved person to be heard. The

order would automatically become final if not contested, or if the Department or Agency found such action necessary after a hearing.

This type of step is necessary to acquire adequate jurisdiction over the problem of illegal offerings. As long as we are saddled with split jurisdiction and split enforcement and are dependent on others, we face breakdowns. Our Federal government may deal with authority with the Dominion government. However, our States may not by-pass the Federal government and deal with the Dominion or its provinces. The provinces similarly may not by-pass the Dominion government and deal with our Federal government or our States. Neither the Dominion nor the U.S. Federal government tells the provinces or the States what kind of securities legislation they should have. There are no Dominion securities laws but there are Federal U.S. laws. In this hodge-podge of different laws and philosophies, administered at different levels with no power in the SEC even to investigate facts respecting violations of our laws occurring in a province, we must realistically seek a method of controlling the problem from within our own jurisdiction. There is no solidity to a reliance upon the provincial administrators to prevent at all times what to us are securities violations. Even where specific in terms, laws mean nothing if they are administered by men without capacity for or intent to enforce them.

In the case of promotional companies, i.e., those without a 3-year earnings record, whether mining ventures or not, consideration might be given in the new legislation to the adoption of certain minimum standards dependent upon the type of company or security of (a) maximum selling commission, (b) minimum percentage of proceeds of sales to be used for exploration or development, (c) escrow arrangements respecting

promoters' shares, (d) options to be granted with prices, and (e) other "blue sky" qualification standards. "Seasoned" companies, whether listed on a foreign exchange or not, would be eligible to use our present standard registration forms, provided offerings were not made through the facilities of a stock exchange.

Exemptive provisions comparable to 3(b) in the '33 Act could be provided with conditions for smaller offerings. Dominion government, provincial, state, or municipal government securities from a foreign country would be made exempt from such laws if there was a compliance with 1933 Act requirements.

In connection with the contemplated effectiveness of such proposed new legislation, the remarks of Mr. Murray Caldough, a long-time Canadian mining promoter and share pusher are of interest. Mr. Caldough told Callahan and Irving Pollack during the T.M. Parker case (his son George Caldough is a defendant) that the shutting-off of the mails really worried the promoters. He said in effect that if the chances of getting back the money expended on a mail campaign are jeopardized because of "returned" mail, the promoter will think twice before making the initial outlay. A failure or two to get mail returns can really put a mail campaign organization out of business. Mr. Caldough said that our mail fraud order had "wrecked" him. (Mr. Lennox testified in 1951 that a solution to illegal offerings would be to catch up with the high-pressure methods early because ". . . then it is not a paying business, either for the 'front' or the principal.")

While it is true that our trouble respecting illegal offerings have been largely "Canadian," a "Foreign Securities" Act would anticipate problems which might arise elsewhere. Who can say that Mexico or Yucatan or the Amazon River Basin will not have a uranium or other boom any day? We have no working liaison with such countries

and would be dependent solely upon our own resources to stop illegal offerings at our borders. At present we could no more stop such offerings than we have been able to stop Canadian offerings, where we have had the advantage of splendid cooperation from most administrators.

Even with strong legislation, it will be a never-ending task to prevent illegal offerings and frauds. We have hundreds of them every year right here in the United States where our laws have "teeth" and where we have unlimited powers of investigation.

The problem of stopping extensive mailings, phone calls and telegrams into the U.S. could be made more easy if we could close those three avenues and it is contemplated that a "Foreign Securities" Act could retard or stop such offerings by making them unprofitable or by at least injecting a risk element which might discourage such promotions.

2. Prevent Purchases of Non-Registered Foreign Securities

The new legislation should also cover the other half of the coin by making it illegal for a U.S. citizen to buy or possess foreign securities offered or sold illegally into this country, i.e. securities not properly registered and on which the required registration fee had not been paid. The new legislation could impose a fine or imprisonment (for repeated violations) for owning or possessing such "contraband" securities.

The fraud artists are immeasurably helped by human nature in the form of greed. Obviously, no legislation can stamp out greed. When discussing his operations a fraud artist in Hawaii told one of our officials that initially he had been unsuccessful because he hadn't promised enough. He told that a promised 5 or 6% return didn't interest people. But, to hold out a 50 or 100% return made the listener all ears. While a person must have

a right to invest or lose his money without government approval, the 1933 Act disclosure philosophy must be maintained and the person must have available to himself (whether used by him or not) a prospectus containing the truth about the securities he is asked to purchase. Absent this disclosure he must be prevented from buying. A citizen is presently prevented from buying or possessing stolen goods, narcotics, unstamped liquor, forged currency, etc. He would lose certain "rights" as he does when he can't drive a car legally unless it has been "inspected" even though in perfect mechanical condition, or as he does when he cannot engage in unlawful gambling unless he registers as a person whose business is that of unlawful gambling and he pays a $50 tax. It is not an alarming deprivation of one's "rights" to provide that no one shall traffic in foreign securities unless the security has been registered, and registration fee paid, or an exemption therefrom obtained.

3. Cancel Passports of U.S. Violators.

Include in this new legislation a provision that U.S. citizens operating in the promotional or securities fields in foreign countries will have their passports cancelled if they do not return to this country to meet any United States court action based upon or connected with fraudulent, illegal or unlawful dealings in securities occurring in the United States.

4. Prevent Sales of "Sucker Lists"

Include in this new legislation a provision making it a crime to sell or otherwise furnish for consideration or value a list of names or what is commonly referred to as a "sucker list", knowing or having reasonable grounds to believe it is to be used to solicit securities sales by a foreign offeror.

5. Further Amend Treaty with Canada or Possibly Call for International Convention.

We should promptly notify the State Department and the Congress of our difficulties. If possible, the U.S. should consider calling an International Convention or Extradition in order to iron out the "bugs" and effectively prevent a judge or magistrate from questioning the good faith of the friendly nation requesting extradition.

If an international conference is deemed unwise, this area should be explored with Dominion officials and if further treaty amendments are required to effectuate this philosophy, such amendments should be sought. Any revision of the treaty should clearly cover the use of telephones, telegrams, and oral expressions as well as use of the mails.

6. Revise the Regulation D Philosophy.

Amend the form to comply with Mr. Lennox's points so that a condition precedent to use would be compliance with provincial law. In short, make Regulation D applicable to "Canadian" situations only.

The Commission could revise Regulation A or create a new Regulation E, to cover the "Delaware" company situation. The Commission has the power to establish escrow, mark-up, refund, or other restrictions and provisions which would put "Delaware" companies on a competitive basis with "Canadian" enterprises. There is precedent for such provisions, for in old Federal Trade release #158, the Commission provided that under certain circumstances shares received by promoters could not be resold "until the issuer has earned a profit over a period of one year"; release #330 required court approval to get the 3(b) exemption; release #182 set minimum sales prices

per share at $500; release #158 said that in liquidation nothing is to be paid to promoters until all cash purchasers are paid off in full, etc.

We have everything to gain by letting Mr. Lennox have his position. Whether he is right or wrong, he believes he is right and we need his help to stamp out illegal sales. Only 14 American companies have filed on Regulation D in two years. Not more than eleven of these have become effective and only two of these have sold their offerings 100%, according to our records. One of the 11 is under a suspension order.

The use of Regulation D, or any other exemptive provision, is a matter of privilege. No one has a right to an exemption as such. We may establish whatever standards we feel are necessary in the public interest in connection with the granting of an exemption from the established legal requirements.

7. Explore ways and means to Speed up Regulation D Examinations and Broker-Dealer Applications.

While it is true that the principal cause of delays in the clearance of Regulation D's resulted from inadequate disclosure and poor initial preparation, we should explore whether the forms can be made clearer, and whether consultations with provincial authorities and people in the industry by way of an educational program would relieve the situation. Both Mr. Purcell and Mr. King have written memos. containing suggestions for clarifying and improving Regulation D.

Certainly, a way can be devised to cut down the present 18-calendar-day average before the first "deficiency" letter goes out and to cut down the 30-calendar-day average time taken thereafter before the first amendment comes back.

The same general considerations have some application to broker-dealer registrations. However, the past performances of certain of the applicants was the sole

cause of the delay and, faced with future similar filings, the speed-up could be achieved only by a clear-cut announced Commission policy as to how these should be handled. The Dennis case philosophy could be restated as is or in revised or reversed form.

8. Keep "black list" current.

We should continue the so-called "black list" but keep it more up to date by additions and deletions. Revisions, where required, should be made within ten days.

9. Work for a Dominion Securities Commission.

Protocol might prevent a direct effort by our State Department to urge the Dominion Government to create a Canadian SEC with inter-provincial powers. Indirectly, we can work for this. The fact that violators can move from one province to another, as they did here in the States in the twenties and early thirties, should bring home to the Dominion Government that some inter-provincial legislation is a must. The Dominion Government must be made cognizant of the fact that our Federal laws protect Canadian citizens who buy American securities while American citizens who buy Canadian securities have no protection. The Canadians should give consideration to reciprocal treatment to our citizens by affording protection similar to those in Sections 5, 11, 12 and 17 of the Securities Act of 1933.

10. Coordinate the "Canadian" work here in the Commission.

To avoid any more misunderstandings and to keep all interested persons apprised of developments, one person familiar with the broad aspects should be assigned to coordinate the "Canadian" dealings at least until we get the misunderstandings straightened out and an outline designed for the future handling of Canadian matters and coordination with Canadian officials

11. Should meet often with Provincial officials and industry groups

All prior contacts should be maintained and strengthened. Whether we get new legislation or not, it is essential to work closely with the Canadians. By frequent contacts we will better understand the problems and no problem can be solved unless its ingredients are understood. It would appear advisable for the Commissioners to invite Mr. Lennox, et al., to Washington for an informal discussion of the problems promptly and to continue frequent contacts.

Another matter to be considered is Mr. Lennox's position that most of the 47 States are not realistic. He points out that most State legislation contemplates industrial developments and when applied to venturesome mining enterprises, prohibit them. While he recognizes that the SEC and the Federal government do not and cannot tell the States what securities laws they should have, he hopes we can take the lead in urging a more realistic approach. To this end, the Commission might consider either calling a conference with a representative group of State Administrators (SEC Liason Committee), or reserve the subject for discussions at the next NASA convention. The alternatives of continued Canadian non-registered offerings or a Canadian clean-up might be developed in an effort to suggest to the States the need for a more realistic approach.

12. Miscellaneous things to work for:

In connection with better liaison with Canada, we should suggest and work for:

(a) agreements or understandings that if we supply facts or prepare cases and aid by producing "victim witnesses" and experts, the provinces will recommend action or take action against the violators;

(b) a better method of notification by us where we have reason to believe violations are occuring. Mr. Lennox testified in 1951 that we didn't keep him informed. We thought we were doing so, but to avoid any future problem, we should employ a "return receipt" device with each province and set up mechanics here to give immediate notice to the subject province of any suspected violation with a request for the views of the province;

(c) Canadian Post Office actions comparable to our fraud order actions. Failing that, we should attempt to get information as to the users of postal meters and monthly readings where the user is engaged in the securities business. Since the Canadian mails are used initially to start sales literature on its route to United States investors, there should be discussions to learn whether there might be a basis for Canadian Post Office intervention where it can be established that false representations or omissions of material facts are made to obtain money from American investors. Upon proof by us, possibly the Dominion postal authorities might find ways (as they did in 1950) to close the mails to such violators.

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We must meet more often with Canadian officials, Canadian industry and American industry and obtain their views and aid and we must double our past efforts to arrive at a workable solution. It will not be easy and we must not be discouraged if it takes fifty years. Frauds in securities have persisted for hundreds of years and it would indeed be unreasonable to expect any "over-night" solution. We must continue to work at it and work hard.