October 7, 1954

MEMORANDUM

TO: The Commission
The Division of Corporation Finance

FROM: Clarence H. Adams and J. Sinclair Armstrong, Commissioners

RE: Canadian Securities

Attachments:
(1) Ontario Securities Law - Summary (in part from Martindale-Hubbell Law Digest) of
(2) Quebec Securities Law - Summary (in part from Martindale-Hubbell Law Digest) of
(3) Memo of Frank Uriell, dated October 1, re Regulation D Filings under Investigation
(4) Section 44, Ontario Securities Act
(5) News item, Wall Street Journal, October 6, 1954

At the session of the National Association of Securities Administrators on Tuesday, September 28, devoted to SEC liaison with State and Canadian Provincial Securities Administrators, one of the subjects discussed was the present operation of Regulation D and the condition of offerings emanating from Toronto and Montreal.

Mr. Honigman of Pennsylvania, who presidedat the session, stated that this subject was of intense interest to the State Administrators. After a general statement by Commissioner Adams, Mr. Woodside discussed some of the administrative problems in detail. He was followed by Chairman O. E. Lennox of the Ontario Securities Commission, who expressed dissatisfaction and made some of the points heretofore presented to this Commission in conferences with Commissioner Adams and Mr. Woodside in Toronto, and with Chairman Demmler, Commissioner Adams, Mr. Woodside and other staff members in Washington, and memorialized by Chairman Lennox's letter to Chairman Demmler, dated September 7, 1954.

It was felt that some good might result from further discussions between the two of us on the one hand and Chairman Lennox on the other, and, accordingly, a breakfast meeting was held the morning of September 30 from 8:45 a.m. to 9:45 a.m. We referred to the observations made in the speech which Mr. Demmler had delivered the previous day on the subject of settling difficult problems by mutual discussion around the table and expressed confidence that the problems posed by Mr. Lennox could be solved, but stated that we would be helped by a clear expression of exactly what his position is.

We stated it was our impression that he felt (1) that issues of companies incorporated in America with American directors and underwriters and owning property (hence "doing business") in Canada should not be permitted to use Regulation D (this problem in general is described by Mr. Lennox as the "Delaware problem"), and (2) that issues of companies incorporated in Ontario, owning property and doing business in Ontario, with

Canadian directors and American underwriters should not be permitted to use Regulation D (this problem in general is described by Mr. Lennox as "by-passing our statute").

Mr. Lennox stated that these two statements accurately reflected his position. He further stated, however, that the Ontario Commission had revoked the registration of at least three Ontario broker-dealers on the ground that they had violated the American Securities Act, and that he was not prepared to continue this policy unless the Securities and Exchange Commission would take action responsive to his two points above and would also endeavor to put a stop to the fraudulent sale of securities from Quebec to the United States.

Mr. Lennox also voiced his concern about the lack of cooperation he receives from the States. The only States cooperating with him are Pennsylvania, New York and New Jersey.

We inquired of Mr. Lennox whether it might not be appropriate, in view of the questions he had raised, for the Securities and Exchange Commission and the Canadian provincial authorities to take a complete new look at the basic philosophy underlying our efforts to police the sale of Canadian securities in the United States. We pointed out that it was something of an anomaly for the Ontario Commission, an agency of one Canadian Provincial Government, to be petitioning the Securities and Exchange Commission, an agency of the United States Government, to eradicate bad conditions presently alleged to be permitted to exist by the authorities of Quebec, another Canadian province. It would seem more natural for one Canadian province dissatisfied with the acts of another to suggest to that other Canadian province, directly or through the Canadian Dominion Government, that the other Canadian province improve the enforcement of its laws.

Mr. Lennox stated that this would be impossible because of the difference in the political complexion of the Ontario Provincial and Dominion Governments on the one hand and the Quebec Provincial Government on the other. We stated that, notwithstanding differences in politics, in a matter involving the relationship between provinces of another country and the United States, it would seem that there should be some unity of action among those provinces, and the United States should not be put in the position of intermediating their differences. Mr. Lennox's reaction, to the extent we could gather it, was surprise and negative.

We then suggested that perhaps the approach of the Securities and Exchange Commission should be to shift from the present emphasis on compliance with Section 5 of the American Securities Act and, where Section 3(b) permitted, compliance with Regulation D procedures, and to think more in terms merely of attempting to detect and stamp out fraud. Mr. Lennox's expressed dissatisfaction with Regulation D and the fact that the extradition treaty does not make extraditable a violation of Section 5, absent fraud, both suggested such an approach. This would

leave to the Canadian provinces the enforcement of their own broker-dealer registration, securities qualification and fraud provisions, would eliminate the awkwardness which Mr. Lennox found in the Provincial Commission's revoking a broker-dealer license for violating the American law, and, in general, would leave each jurisdiction full authority and freedom to enforce its own laws.

Mr. Lennox expressed objection to the idea of abolishing Regulation D, asserted that the Ontario Commission, the broker-dealer organization there, and the Toronto Stock Exchange by mutual effort had cleaned up the "Ontario situation" and it would be very unfair to take away Regulation D when the real trouble with Regulation D was the "Delaware situation" and the fraudulent offerings from Montreal to which the Securities and Exchange Commission should put a stop. I am informed that up to the present time there have been 68 Regulation D filings, 12 of which were of American companies, which have been through the administrative processing of our Division of Corporation Finance.

We stated to Mr. Lennox that it came with some surprise to us, and a good deal of concern, that after a month's negotiation in Toronto and Washington, he nevertheless rose in the State Securities Administrators' meeting and charged that the Securities and Exchange Commission had permitted fraudulent Regulation D filings. We pointed out to him that we had asked for specific instances of fraudulent Regulation D filings to be named so that our staff could look into them, and that in this month's time we had not been advised of any such cases other than three which we were already looking into. Mr. Lennox stated that of course he did not mean fraud in the technical legal sense; he merely meant offerings in which the investor had little chance of realizing any gain because the arrangements between the issuers and the promoters were such as to freeze out the investor. We called Mr. Lennox's attention to the provision of the American Securities Act which forbids the Securities and Exchange Commission to pass upon the merits of the securities and emphasized that we administered a disclosure statute and not a statute that permitted us to forbid a sale of securities by reason of the disadvantageous position of the public investor. Mr. Lennox stated he realized that, but nevertheless we ought to do something to stamp out fraud.

The discretionary authority of the Ontario Securities Commission to permit or deny the qualification of securities is stated in Section 44 of the Ontario Securities Act (Revised Statutes of Ontario, 1950, chapter 351), copy of which is attached.

Attached is a memorandum of Frank Uriell, dated October 1, describing three Regulation D filings which have been investigated by

this Commission. With respect to one of them, Northwest Uranium Corporation, File No. 27-5, the Commission suspended the exemption by order entered August 16, 1954.

We again emphasized to Mr. Lennox that any facts indicating fraud in any Regulation D filing should be immediately brought to the attention of our Division of Corporation Finance, and in the context of the present conversations between our Commissioners and him, we would assume that unless such situations were brought to our attention when he talked of "fraud" he meant fraud in something less than the legal meaning of the word.

This memorandum is written for the information of the other members of the Commission and the Division of Corporation Finance so that the conversations in New York with Mr. Lennox may form the basis for the development of the policy of this Commission on the Canadian problem.