December 9, 1954

MEMORANDUM

TO: Chairman Ralph H. Demmler

Attached is a memorandum in regard to my New York trip of December 6. I would like to make copies available to the other Commissioners and Messrs. Patterson, Woodside and Orrick because of their interest in some of the problems discussed in New York. Please let me know if such distribution would be satisfactory to you.

I have made copies available to the participants in the meetings described herein, namely Messrs. Bowser, Timbers and Purcell.

JSA

J. Sinclair Armstrong
Commissioner

Make copies available
Reg D. Timbers
Woodside
Chelsea

December 9, 1954

MEMORANDUM

TO: Chairman Ralph H. Demmler

The following report is submitted on my visit to New York City on December 6.

After a brief preliminary meeting with Mr. Purcell, he and I held a conference with representatives of the press. Speaking from memory, the following New York newspapers or press associations were represented: Times, Herald Tribune, Wall Street Journal, Daily News, World Telegram, Journal of Commerce, Commercial and Financial Chronicle and Associated Press. Mr. Leslie Gould, of the Journal American, had stated to Mr. Purcell that he would not be present but might send somebody. I believe a Journal American representative was present.

The principal lines of questioning were on Follansbee and the Canadian situation. The Follansbee discussion lasted at least an hour, the Canadian situation half an hour, and both of these, needless to say, were somewhat difficult to handle.

Briefly I stated re Follansbee that I could not comment on an opinion of any Federal judge, although I observed in the opinion a paragraph taking a position that offers submitted near the time of the meeting were late; that the Commission's staff and the Commission itself had spent an enormous amount of time studying and investigating the case; that there was always a possibility in any proxy litigation that the Commission might intervene in such litigation or commence litigation of its own; that the only basis for intervention would be to protect the integrity of Section 14(a) of the Exchange Act and our proxy rules thereunder; that I could not say when or whether the Commission would intervene in the Follansbee litigation or start litigation of its own, notwithstanding the fact that the Commission had been importuned to intervene by many people; that the traditional approach of the Commission in private litigation where parties were represented by able counsel on both sides was not to intervene, unless the integrity of the statute and the rules was threatened; that the Commission had no jurisdiction to require resolicitation or to stop the holding of a meeting as the statute only gave such jurisdiction to the court; that in a sense this was different from the Commission's powers under Section 8(a) of the Securities Act in which the Commission can suspend a registration statement or enter a stop order; and that the Commission was extremely concerned by the welfare of the people of Follansbee, West Virginia, but such concern could, in fulfillment of our statutory duties, only be taken into consideration in the context of the jurisdiction given us by the Exchange Act.

It was my impression that the press representatives were friendly and understood the subject matter reasonably well.

On the Canadian situation, I stated by way of background and not for direct quotation that the Commission expected within a short time, probably a week or so, to announce the commencement of a study broad and general in its scope of the whole problem posed by the sale of securities of Canadian issuers in the United States; that this study might necessarily involve other agencies of the Federal Government in that the Treasury and Commerce Departments might be concerned with the exportation of capital and the development of trade with our good neighbor to the north; that, as international relations were involved, the State Department might be interested and their help would be needed in any negotiations that might develop through the Department of External Affairs of the Dominion; and that, after all, in regard to the pronouncement by Chairman Lennox of the Ontario Securities Commission, such Commission was only an agency of a provincial government whereas the problem was one involving other provinces and the Dominion, particularly as the fine work of the Ontario Commission in the past year and a half had brought about the result that many "fringe operators" had moved from Ontario to Quebec.

I further stated that in his comments on the SEC, Chairman Lennox had omitted any reference to his problems as they might exist with state securities commissions; that it was my impression from attending the National Association of Securities Administrators' convention in New York in September that a number of states, as a matter of policy, would not qualify Canadian securities regardless of whether such securities were qualified by the Ontario Commission; and that this non-reciprocity, so to speak, was an even more serious concern to Canada in that it prohibited and blocked the exportation of American capital for the development of Canadian enterprises.

I further stated that the complaint which Mr. Lennox made in regard to the use of Regulation D by companies incorporated in American states, such as Delaware, but having principal business operations in Canada, did not seem to me to be the kind of thing that could provoke much of a controversy. I mentioned that in earlier years companies of this kind had been permitted to avail themselves of Regulation A, but that it appeared that when Regulation D was adopted the Commission had decided to use the Regulation D procedures for these companies. Whether Regulation A or Regulation D was used seemed to me a matter of very little moment so far as the enforcement of the American Securities Act was concerned. I expressed conviction that this problem could be easily worked out. I stated that the study to be inaugurated by the Commission would include a close scrutiny of the Regulation D filings in the past and, from a preliminary examination that we had made of this problem in the last week or two, I was of the impression that the Commission had been slow, or at least slower than was necessary in processing filings.

However, I stated that an important reason for the relative slowness in processing Regulation D applications, as compared with processing Regulation A filings, was because very often the Regulation D applications were submitted in almost hopelessly deficient form, and after the staff had sent a letter of comments to the applicant and the underwriter, it often took weeks or months for a revision of the Regulation D application to be filed with the Commission. I didn't see how the Commission could be charged with this part of the total time lag between the filing and the time when the Commission permitted the offering to be made.

I concluded by pointing out that so far as our administration of the Federal securities laws were concerned, we intended to go on administering the Act and the regulations until they are in some way changed, but Regulation D is still in force and will be until we change it, if we do, in the light of the study now being commenced. I stated that we had no cause for or desire to quarrel with the officials of the Dominion Government, or of any province thereof, and I was sure that any further negotiations that might be carried on between the United States Government, or the Commission as an agency thereof, and the Dominion, or any province thereof, would be conducted in a spirit of friendliness and amicability and a desire to solve mutual problems, which was in conformity with the traditional and proper relations between the United States and Canada.

Follansbee and the Canadian situation appeared to be the only subjects in which the press was interested. However, as the meeting broke up, at about 12:15 p.m., there appeared to be general good feeling between Mr. Purcell, Mr. Bowser (who had come in during the course of the conference) and myself, and the press representatives, all of whom expressed extreme appreciation at having a chance to talk to a member of the Commission. I was impressed by the apparent good relations that existed between the press representatives and Mr. Purcell. Mr. Purcell's participation in the conference was extremely helpful.

In the afternoon, from 2:15 to 3:30, Mr. Purcell, Mr. Bowser and I conferred with members of the staff of the New York Regional Office. Among those present were Messrs. Glavin, Posner, Parlin, O'Brien, Hoopmann, Ferrall and Moran. There may perhaps have been one or two others present from time to time whose names I do not recall at the moment because the pressure of business required some staff members to come and go during the course of the discussion. The matters which I will now mention were the subject of intensive and animated discussion.

I inquired if the present roaring market indicated any new or additional problems of manipulation, and whether manipulation was now being conducted in any new or unusual ways. I had a general sense that

there are no new or unusual methods of manipulation which the staff is concerned about, and that the most difficult problem is not so much manipulation but rather the thinness of the market. This makes possible wider fluctuations in individual stocks than would occur if the market were more liquid. The DuPont stock is a prime example.

It was noted that brokers' loans have expanded and it was the feeling that foreign buying of stocks, including purchases for foreign accounts on credit, have increased. There was a suggestion that possibly this Commission should confer informally with the Federal Reserve Board on the problem whether or not margin requirements were adequate in view of these developments. The suggestion was also made that the haircut be increased. The high market levels, plus wide fluctuations resulting from non-liquidity, might make advisable an increase in the size of the haircut. The two thousand percent rule on exchanges and over-the-counter securities was mentioned, and there was some feeling that the capital requirement should be increased in view of the high market levels.

The problem of Walter Winchell's touting was discussed in reference to a Venezuelan company. A registration had become effective in reference to this company after false information contained in the original filing thereof had been corrected by an amendment. The New York office had recommended a delay in making effective the registration statement, and I was questioned as to why it had been made effective promptly. I did not know the answer. The touting which Winchell did was based on the false information in the original filing, and didn't reflect the corrected information. This is pretty frustrating for the New York staff and I wish the matter could be gone into by those who are familiar with it here.

Patterson 12/17

The subject of investment advisers was discussed. There was a feeling that investment advisers are even more important in leading movements in particular stocks than are brokers or institutional investors. This is particularly true outside the area of the one hundred or so stocks regarded by the New York banks as proper media for conservative investment. It was strongly suggested that a study of the whole operation of investment advisers be undertaken, and it was stated that there is legislative authority for this in the Investment Advisers Act.

The question of the burden of proof in denial proceedings was discussed in a situation involving Canadian securities. If the regional office can prove that the stock came in from Canada, was unregistered, and there was no compliance with Regulation D, the regional office should not have to prove in addition the actual source of the securities, that is whether newly issued or ex-control or promoters. This is the position of the New York office. However, in the Robbins & McNichol

denial proceeding, Johnson, Hearing Examiner, ruled that the New York office must also prove the source of the stock. This is a virtually impossible burden because there is no way the New York office can tell where the stock came from. The rule should be changed, it was argued, so that at this point the burden would be on the respondent to show either that the stock was registered, or Regulation D complied with, or that the registration provisions of the Act were not applicable; in other words, that the stock was not new or ex-control or promoters. It was earnestly requested that consideration be given to this situation promptly by the General Counsel, and possibly this is a procedural or evidentiary point that should be taken up in the Canadian study.

There were several "housekeeping" comments. The interpretive attorneys objected to the fact that opinions written by the Division of Corporation Finance to New York counsel were not furnished to the New York office (by means of information copies) as a matter of routine. This had recently embarrassed the New York office in the case of a ruling issued to Cravath, Swaine & Moore, counsel for Republic Steel Corporation, in the matter of whether registration was required in connection with stock issuable on the conversion of certain convertible debentures. The applicable provision was Section 3(a)(9) of the Securities Act and the New York interpretive attorneys expressed shock at the ruling from Washington.

It was mentioned that a memorandum had just been received to the effect that there would be a 2-day delay on all enforcement matters because of the Commission's sitting in the Mississippi Valley Generating Company case and needing this much time to digest memoranda and staff presentations in Washington. I personally am not very sympathetic to such a 2-day delay because it never has seemed to me that we were given two days by the Washington staff to consider memoranda on enforcement matters, and it very well may be that enforcement matters have got to be considered promptly if the work of the regional offices is not to be crippled. In view of the fact that the Commission can meet at 9:30 in the morning for half an hour, and can meet after 4:30, I do not know why it is necessary to frighten the regional offices into thinking that we won't act on emergency enforcement matters with the promptness with which we have acted on them in the past.

In general, satisfaction was expressed by the New York staff with the Washington staff, good relations are being maintained, the loss of Jerry O'Leary is felt, there is sympathy for Manny Cohen's overwork, and a wish that there were more high level staff people in the Division of Corporation Finance because it is difficult to get decisions from Messrs. Woodside and Cohen in view of their necessary extreme preoccupation in other matters. In no sense is this a criticism of Messrs. Woodside and Cohen. The New York office felt them to be most cooperative.

From 3:45 to 4:30, Mr. Purcell, Mr. Bowser and I conferred with Keith Funston and Ed Gray, President and Executive Vice President, respectively, of the New York Stock Exchange. Proposed Rule 154 was discussed in detail. Mr. Funston again asked that we abandon the distribution concept. Mr. Purcell and I both explained that that was simply out of the question and why. Mr. Funston begged that we adopt some sort of rule promptly and stated the stock exchange would be satisfied if two weeks' trading were the standard rather than one week's. Mr. Purcell and I both made a fairly detailed explanation to Mr. Funston as to the whys and wherefores of our present position on 154. Mr. Funston came close to apologizing for having made the charge of discrimination. The subject was closed on a very amicable and friendly basis, at least so far as I am concerned. I assured Mr. Funston that when our present duties were completed, either late this month or early in January, we would definitely adopt some rule and he was pleased at this.

Mr. Funston mentioned that he was expecting with pleasure a visit from Mr. Patterson on the subject of specialist participation in exchange distribution, and he welcomed an opportunity to discuss any other subjects that Mr. Patterson might have in mind.

We mentioned MIP and advertising and I stated that I did not know whether his study or our study of these matters had been completed, but I suspected that they had not and that this ought to be gone into further promptly.

We discussed legislation. Mr. Funston and Mr. Gray both stated that they wished their 1954 legislative proposal, that additional issues of stocks which have been listed for three years be exempted from the registration requirements, could have been adopted, and that in any future legislative program they would come forward again with this. I pointed out that legislation of that kind, in my opinion, would probably not be adopted by the Congress. I mentioned Representative Rayburn's interest in this whole field of legislation. I pointed out his appearance on the floor of the House and referred to his probable accession as Speaker in the next Congress. Under the circumstances, I indicated that whether or not the Commission took a position on a matter of this kind was really irrelevant. I referred to the basic position we took a year ago, that we would advise and consult with Congressional Committees, but that we were not the proponents of legislation.

I asked Mr. Funston if the Exchange had any interest in the Frear Bill. This was discussed back and forth in some detail. Mr. Funston's answer, boiled down, was that the Exchange would like Frear Bill type legislation, but would fear to propose it lest other more limiting and hampering legislation be tacked on to it. The advisability of their consulting with Senator Frear was discussed by them. I indicated

my viewpoint. I said, however, that in general I thought one of the great contributions of the securities acts over the years had been in making available the great body of financial information that results from the annual reporting requirements in the Exchange Act, and that I personally incline in the direction that, as a matter of public policy where broad investor interest is involved, a company should make financial information available. Mr. Funston stated, in view of this discussion, and the fact that the Exchange's interest was heavily concentrated on seeking reduction or elimination of the capital gains tax, that the Exchange would not seek any amendments of the securities laws in the next session of the Congress.

Mr. Funston volunteered the observation that he thought the Commission had no case in the Helser matter. I told him I thought if that was his impression he had better get into it in some detail because it was the impression of the Commission that a very enormous fraud had been perpetrated on the American public. In a telephone conversation with Downey Orrick on Tuesday, December 7, I mentioned this to Mr. Orrick. He stated that there is no matter in which the United States Government is involved in San Francisco that has such uniform support from the business and financial houses of the city as the Commission's action in the Helser case. He said that the situation in that case has taken a drastic turn for the better since the filing of the Commission's affidavits in support of its motion for a preliminary injunction.

Mr. Purcell, Mr. Bowser and I met with Mr. J. Edward Lumbard, United States Attorney for the Southern District of New York, in his office at 4:45 p.m. and conferred for about three-quarters of an hour. Mr. Lumbard immediately inquired of us as to the Canadian problem. We discussed it in as much detail as we could. He offered to make his services available and requested that he be informed of the outcome of the extradition case. His Assistant United States Attorney, Mr. Martin Carmichael, Jr., was brought into the conference and it was understood that we would request Mr. Timbers to advise Mr. Carmichael of the final development in the extradition proceeding promptly. Mr. Lumbard inaugurated the discussion of the Canadian matter and, in my opinion, can be extremely helpful. Also, the possibility of cooperation between Lumbard and Javits will be greater than the cooperation between Lumbard and Goldstein.

Thereafter, at 6:30 p.m., Messrs. Timbers, Bowser, Purcell and I had dinner before the Bar Association meeting, at which were also present Chester T. Lane, Chairman, Committee on Post-Admission Legal Education of the Section of Administrative Law and Procedure, and formerly General Counsel of the Commission; Robert Benjamin, Chairman of the Section of Administrative Law and Procedure of the Association of the Bar of the City of New York, and also presently a public member of the President's

Conference on Administrative Procedure; Dean Niles of New York University; Walter E. Beer, Jr., partner of Mr. Lane; Gerald J. O'Leary of Shields and Company, formerly on the staff of the Division of Corporation Finance; Joseph P. McMurray, Executive Director of the New York City Housing Authority; and Edward T. McCormick, President of the American Stock Exchange, formerly a Commissioner.

Thereafter, at 8:00 p.m., Mr. Timbers and I addressed the Association of the Bar. The attendance numbered approximately fifty people, many of whom were familiar in the field of securities practice.

After coming down on the sleeper, Mr. Timbers and I had a breakfast meeting with Mr. Lumbard, in which there was further detailed discussion of the Canadian problem, and his offer of cooperation with our Commission was again extended.

Attached are clippings of various newspapers resulting from the press conference. If other clippings are brought to my attention, copies will be sent to you.

JSA

J. Sinclair Armstrong
Commissioner