PUBLICITY AND THE SECURITY MARKET:
A CASE STUDY

Economists have always considered public opinion as an important supplementary sanction to legal action, but few have ever concerned themselves with the mechanics of dissemination necessary to make it effective. The doctrine of laissez-faire economics, envisioning the regime of free competition in which everyone acts rationally to promote his own interests, rests on the assumption that economic man has a complete knowledge of the facts. According to classical writers, the state fulfils its responsibilities by providing means for the en-
The government is not expected to initiate the steps to stamp out fraud, misrepresentation, or the employment of unfair methods in trade and commerce, all of which operate to prevent economic man from playing the role which laissez-faire theorists create for him. Such considerations make it difficult to sustain the theory today because of social stratification based on wealth, and the resulting modifications in economic relationships. It is only in comparatively recent years that public opinion has been such that the government has taken the view that if any kind of free enterprise system is to be approximated, channels for dissemination of economic facts must be kept open, and standards furnished by which men operating in the market places may evaluate available information.

Although this view has application generally throughout the structure of our economic life, it is especially significant in relation to mechanisms of exchange. In an economy in which a large proportion of the wealth of individuals and institutions is represented by securities, there must be a ready market for exchange. Since the influence of such exchange transactions directly or indirectly permeates our national economy, Congress has deemed it necessary to regulate transactions in securities, both on organized exchanges and over

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1 Adam Smith described the four objects of government as justice ("security from injury"); police ("cheapness of commodities, public security and cleanliness"); revenue; and arms, Lectures on Justice, Police, Revenue and Arms 3 (Cannan's ed. 1896).


3 Cf. Adam Smith, Wealth of Nations 508 (Cannan's ed. 1904): "The natural effort of every individual to better his own condition, when suffered to exert itself with freedom and security, is so powerful a principle, that it is alone and without any assistance, not only capable of carrying on the society to wealth and prosperity, but of surmounting a hundred impertinent obstructions with which the folly of human laws too often incumbers its operation." And see the poem, "The Fable of the Bees," by Bernard de Mandeville, criticized by Smith, in which the author describes society as a grumbling hive prospering greatly so long as it was full of vice.

4 Knight, Exchange, 5 Encyc. Soc. Sci. 668 (1931). Cf. Adam Smith's observation that "the authority of fortune . . . is very great even in an opulent and civilized society," Smith, op. cit. supra note 3, at 672. Note also his statement: "Till there be property there can be no government, the very end of which is to secure wealth and to defend the rich from the poor," Smith, op. cit. supra note 1, at 15.

5 Consider the position of the consumer, whose interests are analogous to those of the ordinary individual investor. For a concise, suggestive discussion of consumer problems, see Modlin & McIsaac, op. cit. supra note 2, at 81-99. Compare the need for wide dissemination of information which the working man can understand about industry, e.g., economic conditions affecting his job, comparative data about wages and hours. Note also the value of disclosure of labor espionage, such as was produced by the LaFollette committee investigating civil liberties, S. Rep. 6, pts. 1-3, 76th Cong. 1st Sess. (1939); Harris, American Labor 274 (1939).

the counter. Likewise, the exchanges themselves have been subjected to control, both by the government and by their own memberships.7

That such controls have been imposed is due in part to a growing awareness of the implications of the effect of the modern corporation on our economy.8 It is the purpose of this article to indicate the actual working of regulation upon the corporation in the light of the notions of free enterprise in an exchange economy. This examination will deal with the sanctions imposed by the superior law of the state and the internal law of the marketplace, not as they work toward a direct prohibition of certain practices, but rather as they tend to readjust the factual maze in which buyers and sellers operate.9 The ideal security exchange should set prices which truly reflect present and future earnings of corporations, provide the facility for easy exchange of ownership, and induce a more productive flow of savings into the nation's enterprises.10 The market value of a stock depends primarily upon security traders' estimates of earnings, revaluations of which are constantly made on the basis of varying business prospects and other available information. It is here intended to examine the methods of assembling and disseminating publicity about a corporation, and further, to show how publicity affects market activity and prices in the interest of a freer and more honest exchange.

REGULATION IN THE INTEREST OF INFORMATION

The market is today surrounded by an involved mechanism for the collection and dissemination of facts. Naturally much of what is disclosed, particularly through unofficial sources of information such as financial services, magazines, newspapers, and underwriters' and brokers' circulars is not necessarily true; and much that is true may not reach the market. However, the methods and practices today sanctioned by corporations themselves furnish investors and speculators a much greater quantity of reliable information on which to base

7 Twentieth Century Fund, Stock Market Control 25 passim (1934). But, as the authors of this valuable study say, "Whether or not the existing Exchange rules, or the power of its governors to formulate new rules in the future, are sufficient to protect the public interest is another matter."

8 Berle & Means, The Modern Corporation and Private Property (1932). See also National Resources Committee, The Structure of American Economy pt. 1, c. ix (1939), which develops the concept of "control" exercised by corporations, and expands and brings down to date the work of Professors Berle and Means on the 200 largest corporations; The Securities Act of 1933, the Modern Corporation and the Theory of Free Enterprise, 6 Univ. Chi. L. Rev. 399 (1939).


10 Twentieth Century Fund, op. cit. supra note 7, at 75; Berle & Means, op. cit. supra note 8, at 293. Compare Chase, Shadow over Wall Street, 180 Harper's 564 (1940), with the dissent of Mr. Justice Brandeis in New State Ice Co. v. Liebmann, 285 U.S. 262, 306-10 (1932).

11 For a classic discussion of early corporate publicity and financial reports, see Ripley, Main Street and Wall Street c. vi (1929). See also Sears, The New Place of the Stockholder (1929); Berle & Means, op. cit. supra note 8, at 317-25. A cogent, critical study of present
their appraisals than was formerly available. Likewise, the history of organized stock exchanges shows a growing tendency toward internal reforms—especially at times of great public criticism—apart from any regulations imposed by state and national governments. Thus, the New York Stock Exchange has required publication of more frequent and informative financial reports. Reforms instituted by that exchange in the interest of placing more information in the hands of buyers and sellers, particularly since the passage of the Securities Act of 1933 and the Securities Exchange Act of 1934, are emphasized in the exchange's publicity in describing the advantages of an organized market with list requirements: (1) prompt publicity to transactions by ticker; (2) broad disclosure in listing applications and supporting documents as to the corporate setup, preferences of securities, rights of security holders, business records of past performance; (3) provision for notice to the public of significant development and changes in the business of a corporation; and (4) provision for advance notice of record and dividends dates. Furthermore, purchasers of securities have the benefits of the deterrent effects of stricter accounting techniques and governmental control of credit for margin transactions in stock through the Federal Reserve System.

Corporate reporting is to be found in Kaplan & Reaugh, Accounting, Reports to Stockholders, and the SEC, 48 Yale L. J. 935 (1939).

2 Twentieth Century Fund, loc. cit. supra note 7. Cf. the remarks of Richard Whitney, then president of the New York Stock Exchange, during the Pecora investigation. The exchange's refusal to pay heed to popular demand for reform was, he said, simply a manifestation of "courage to do those things which are right, regardless of how unpopular they may be for the time being," Pecora, Wall Street under Oath 259 (1939).

3 State legislation has not been concerned with direct exchange regulation, but the passage of state securities laws has had an immediate effect on what the exchanges do. See Smith, The Relation of Federal and State Securities Laws, 4 Law & Contemp. Prob. 241 (1937).

4 Since 1932 one condition for listing on the New York Exchange has been an agreement by the listing corporation to have its financial statements sent to stockholders audited by independent public accountants. Ninety per cent of the companies having active securities listed issue reports quarterly or semiannually, The Exchange, No. 2, at 11 (January, 1940).


8 Sanders, Accounting Aspects of the Securities Act, 4 Law & Contemp. Prob. 191 (1937). That there is still much to be desired in the adequacy of corporate accounting reports to stockholders cannot be denied, Kaplan & Reaugh, loc. cit. supra note 11. These authors examined seventy corporate balance sheets and income statements for 1937, and came to the conclusion that there is a serious gap in the regulation of accounting reports under the Securities Exchange Act.

Nevertheless, there is still a large area in which the availability of information is the decisive factor in determining how the investor will act. The Securities Act and portions of the Securities Exchange Act are grounded on the theory that corporations which want to sell securities in interstate commerce or through the mails must file registration statements and annual reports telling the whole truth about them or face the consequences of the civil and criminal liability provisions of the acts. The legislation does not proceed on the notion that a government agency is to say whether or not it is wise to buy securities. The Securities and Exchange Commission determines only whether the registering of new securities fulfils the requirement that no essentially important element attending the issue shall be concealed from the buying public, and whether the form in which the story is told accomplishes this end. Although such registration statements are to be on file with the commission, in Washington and in the commission's regional offices, it is obviously impossible that these statements be read by each prospective purchaser. Therefore, the Securities Act provides that no offering of a security, or delivery of it after sale, may be made unless accompanied or preceded by a prospectus; and such a prospectus should be reasonably understandable to the average investor. Prospectuses are selling documents in the hands of underwriters and brokers, and provide material for newspaper and radio advertisements and releases to investment services, newspapers, and magazines. While it is impossible to minimize the personal element

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22 § 5(b) (1) and (2). See also, § 2 (10) read together with § 10; SEC Ann. Rep. 23 (1939); Sec. Act Rel. 70 (1933).

23 The "problem of the prospectus" has not yet been solved. See Dean, The Lawyer's Problems in the Registration of Securities, 4 Law & Contemp. Prob. 154, 178-9 (1937). Shorter and less complicated prospectuses should be achieved without a complete sacrifice of vital information. See p. 698 infra. The commission and underwriters have recently arrived at a more satisfactory "long form" newspaper prospectus. See the advertisement for an offering of Safeway Stores stock, New York Times, § 2, cols. 6-8, p. 37 (April 9, 1940).

24 Where a prospectus consists of a radio broadcast, copies of the transcript must be filed with the commission, Securities Act, § 10. This section was drawn as a result of disclosures at Congressional investigations showing how radio has been used to "plug" stocks. See, e.g., testimony regarding the "Old Counsellor," a professor of public speaking at the University of Chicago, who broadcast a "canned" speech extolling Insull securities, Twentieth Century Fund, op. cit. supra note 7, at 118. But note the unheeded warnings of Professor Paul H. Douglas about Insull's maneuvering in Chicago's traction muddle, and about the improper valuation of utilities in Illinois, Douglas, Chicago's Persistent Traction Problem, 18 Nat'l Municipal Rev. 669 (1929), and Report to Consumers of and Investors in the Public Utilities of Illinois (1932).
in the selling of securities, it can be said that knowledge of the fact that the truth is to be found in the prospectus is a kind of a deterrent upon the salesman’s enthusiasm. The securities acts do not pretend to keep an individual from speculating, but the average investor who deals with a reputable broker receives a further safeguard because such firms carefully analyze prospectuses with a view to protecting their customers. While an individual may not read a prospectus, banks, insurance companies and other institutional investors will.

If a corporation desires to have its securities listed upon a national exchange, under the provisions of the Securities Exchange Act it must file certain additional information with the commission. These preliminaries may constitute all the relations a corporation has with the commission until it files its annual report. Publicity given to these steps is merely routine and adds to information pertaining to the corporation available in the market place.

**COMMISSION PROCEDURE AND PUBLICITY**

Annual reports, registration statements, and other documents filed by corporations with the SEC are scrutinized by members of the commission staff. Deficiencies are usually discovered in this way, although many complaints are received from outside sources. Furthermore, the constant inspection of stock market trends and prices conducted by the commission’s Trading and Exchange Division often reveals irregularities in certain stock issues. In all cases of

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25 Cf. Rodell, Douglas over the Stock Exchange, 17 Fortune, No. 2, at 64 (February, 1938) (the government cannot “save a fool from his folly”), with the results of a recent poll conducted for the New York Stock Exchange, The Exchange, op. cit. supra note 14, at 16. A nation-wide survey showed that sixty per cent of the “sample” believed that “anyone who buys stocks and bonds is speculating.”

26 For a complete discussion of these features of the Exchange Act, see Hanna, op. cit. supra note 20, at 256. E.g., § 16(a) of the Exchange Act provides for the filing with the commission of statements of changes in ownership by persons owning more than ten per cent of any class of equity securities registered on an exchange. The public demand for the summaries of security transactions by officers, directors, and principal stockholders has increased 600 per cent since 1935, SEC Ann. Rep. 128 (1939).


28 By § 12(b)(K) of the Exchange Act a company may be required to file “any further financial statement which the Commission may deem necessary or appropriate for the protection of investors.” § 15(d) provides for the filing of periodic information with regard to securities not traded on an organized exchange. For summary of various required forms, see C.C.H., Stock Ex. Reg. Service ¶¶ 2371 A–U, 2531 A–P.

29 For a brief description of the commission’s examination procedure and a cross-section of the kind of disclosures resulting from examinations, see SEC Ann. Rep. 24–8 and 46–8 (1939).


31 For a description of market surveillance by the commission and the scope of trading investigations, see SEC Ann. Rep. 91 (1939). Investigation of market operations may be accompanied by inspection of registration statements. See In the matter of Bellanca Aircraft Co., Sec. Act Rel. 815 (1936).
deficiencies or irregularities an informal investigation is made first, and if further proceedings are warranted, a formal order for hearing before a trial examiner is issued. This order usually will be a telegraphic notice to those concerned, and, in addition, will be sent in release form to newspapers.

Procedure adopted by the commission is similar to that used by other administrative bodies. Although hearings are public and reports of them may reach the newspapers through regular correspondents, no attempt is made to issue formal releases concerning the progress of a case between the time the order for hearing is issued and the final opinion of the commission and order disposing of the case are filed. The trial examiner's report, which is advisory only, is not made public in release form, but is available for inspection in the reference rooms of the commission.

Although the Securities and Exchange Commission has the power to delist from organized exchanges 'after appropriate notice and opportunity for hearing' the securities of corporations which do not comply with standards established by the acts, it has exercised this power primarily to remedy and publicize defects rather than to punish violators. Since it is vested with the authority to suspend trading upon any exchange that condones illegal practices, the commission has the means to force exchanges to become true public market places. The promulgation of orders by the commission, although directed at a single violation by one corporation, establishes standards for the guidance of other corporations. Stop orders may issue against a registration statement at any time after it is effective and the commission does not limit issuance of stop orders to situations where the last sale by the corporation or underwriters

32 A so-called "deficiency letter" is sent to the registrant, and often this is all that is necessary to effect a correction, SEC Ann. Rep. 24 and 48 (1939).

33 Rules of Practice, Rule III.

34 In addition to the press, the commission's releases are sent to banks, insurance companies, brokerage firms, investment services, financial services, stock exchanges, industrial and public utility companies, law, accounting, and engineering firms, and libraries. In 1938-39, 493 orders of the commission were issued, and the total number of releases was 1,648, SEC Ann. Rep. 147 (1939).


36 The manner in which this report becomes public is set out in Rule IX of the commission's Rules of Practice. After the trial examiner's report is filed the opinion section of the general counsel's office re-examines the entire record before the commissioners receive the case formally.

37 Exchange Act, § 19(a) (2). In its first five years the commission has ordered the delisting of fourteen securities issues, SEC Ann. Rep. 2 (1939).

38 Cf. Shulman, op. cit. supra note 20, with speech of Chester T. Lane, general counsel of the commission, Association of American Law Schools (1938). Consider notes 108 and 109 infra and accompanying text.

39 Exchange Act, § 19(a) (1).

40 Securities Act, § 8(d).
is yet to be made. Since "supplementary and periodic information" has to be filed under section 13 of the Securities Exchange Act, continued public reliance on disclosure by a corporation to the Commission is contemplated. The importance of a commission order, preliminary or final, in a delisting or a stop-order proceeding is that it puts the investor on inquiry, helps him revise his appraisal of price, and, especially, serves to guide prospective investors and creditors.

An order for hearing issued by the commission may have more effect upon the market prices of a security than a later or final order. Releases by the commission are news of primary importance to the financial pages of newspapers and to financial tickers and services. Because of the nature of the stock exchange mechanism, the market effect of a proceeding by the commission, short of delisting, may be largely discounted before a final order is issued. Although a preliminary release, such as an order for hearing, may have a greater detrimental effect than the outcome of the proceedings warrants, it is submitted that holders of securities affected who do not sell immediately will not be harmed in the event that the action is not of a serious nature. On the other hand, prospective purchasers are protected at the earliest possible moment, even before insiders can shift their holdings. It must also be remembered that newspaper editors often give undue emphasis to a prospective disclosure of wrongdoing which does not always materialize—explaining why an order for hearing issued by the commission may receive a full column, a stop order three inches, and the lifting of a stop order no mention at all.

**CALLAHAN ZINC-LEAD COMPANY: A CASE HISTORY**

The preceding discussion has sketched in broad outline the advantages of corporate disclosure, together with the means of obtaining and utilizing it to guide investors in the market. The applicability of this analysis can be demonstrated to a certain degree by a detailed consideration of the history of a corporation which has had numerous points of contact with the Securities and Exchange Commission. An attempt will be made to relate the publicity ac-

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41 Oklahoma-Texas Trust v. SEC, 100 F. (2d) 888 (C.C.A. 10th 1938), aff'g In the Matter of Oklahoma-Texas Trust, 2 SEC 764 (1937); In the Matter of Bankers Union Life Co., 2 SEC 63 (1937); In the Matter of Nat'l Boston Montana Mines, 1 SEC 639 (1936).


43 Lane, op. cit. supra note 38.

44 7 Univ. Chi. L. Rev. 158, n.46 (1939). 45 Note 142 infra.

45 Note 142 infra, and accompanying text.


47 Cf. the results of the poll of more than one hundred Washington newspaper correspondents on two questions: sixty-three per cent said that "the press devotes too much space to trivialities: scandals, sensations, etc."; ninety-one per cent said that "comparatively few papers give significant accounts of our basic economic conflicts." Rosten, Washington Correspondents 345 (1937).

48 Note 95 infra, and accompanying text.
corded the business and financial activities of the corporation, and the com-
mision proceedings against it, to changes in the market price of the listed
securities of the corporation. In some ways the corporation—the Callahan
Zinc-Lead Company—is not typical because it has been the subject of a dis-
proportionate amount of litigation under both the Securities Act and the Se-
curities Exchange Act. Two hearings were held within a period of four years
and three opinions rendered. The corporation is a good one for study, how-
ever, because it is not one in which there is great national interest and the
market effects of various proceedings are measurable because they are not sub-
ject to unusual outside influences. Finally, a study of the case history illus-
trates the general pattern of mining ventures and promotion methods, the
importance to a corporation of being listed on a stock exchange, and the atti-
dtude of a certain type of corporate manager toward the role of securities in the
American economy.

Callahan Zinc-Lead Company, organized as an Arizona corporation in 1912,
has periodically engaged in the business of mining and concentrating lead, zinc,
and silver ores, and marketing ores and concentrates. The company made large
profits during the World War because of the high prices paid for non-ferrous
metals; but during the twenties the market declined so that it became unprofit-
able to operate the company’s properties in Idaho. By 1931 the company had
completely shut down. In order to be able to raise additional funds, and to
wipe out an accumulated operating deficit, the corporation in 1934 changed the
par value of its capital stock from $10 to $1, and doubled the number of author-
ized shares. Each of the 724,592 outstanding shares was exchanged for one
new share. The old $10 shares were delisted from the New York Stock Ex-
change and the new shares put on the board. The price of the new stock
ranged from $0.625 to $1 per share and 31,100 shares were traded during the

49 In the Matter of Callahan Zinc-Lead Co., 1 SEC 115 (1935), Sec. Act Rel. 2061 (1939),
Sec. Ex. Act Rel. 2313 (1939).
50 Berle, op. cit. supra note 9. “Much of the information [coming into the market] is so
general as to have no causative bearing on the market, or at least none that is traceable.”
51 Compare the principal case with In the Matter of Unity Gold Corporation, 1 SEC 25
(1934) and 3 SEC 618 (1938); MacChesney & O’Brien, Full Disclosure under the Securities
Act, 4 Law & Contemp. Prob. 133 (1937).
52 The company’s Interstate (Callahan) mine was closed down in 1923, the Galena mine
in 1931.
53 The original authorization of 500,000 shares in 1912 was increased to 1,000,000 in 1922.
Of the 724,592 shares outstanding on May 24, 1934, 724,167 had been issued for property.
More than half of these shares had been reacquired at different times, including 160,000 by
donation, and had been reissued. The operating deficit as of December 31, 1933, was $3,393,-
797. The consideration given for arranging the 1934 refinancing was 24,000 shares of stock.
Prospectus, at 14 (July 27, 1936).
54 The trading in the $1 par stock started August 24, 1934. Between January 1 and July
1 only 15,300 shares were traded on the New York Exchange; during July 70,000 shares.
The $10 par stock was quoted at $1 when it was removed, having been as low as $0.25 in
1933, 7 Bank & Quotation Record (1934).
last four months of 1934, during which time the company was not operating. In addition, a registration statement was filed with the Securities and Exchange Commission under the Securities Act of 1933 covering the issuance of an additional 747,518 shares of the $1 par stock.55

Because of the indefiniteness of the facts concerning the proposed new financing and the consideration to be received for the new shares from persons designated as underwriters, the commission required the filing of a number of pre-effective amendments. When, after the filing of several amendments, it appeared that the deficiencies were not being cured, a stop order proceeding was instituted,56 but was dismissed upon the filing of a further amendment which the commission thought eliminated the deficiencies.57 Callahan then filed a final amendment seeking to accelerate the effective date of the registration statement. The commission, in a formal opinion,58 denied this privilege because the company had acted "with so little caution" for the interests of the stockholders. Thereafter, on April 17, 1935, the registration of the 747,518 additional shares became effective, but the marketing operations were unsuccessful and subscriptions amounting to $50,000 held in escrow pursuant to an agreement with the New York Stock Exchange (as a condition of listing) were returned to subscribers. Although trading in those shares of Callahan already listed became active after the effective date of the registration statement, the market price did not rise above $1 except once; therefore, the reason for purchasing shares out of the market being eliminated, the offering was not taken. It may be supposed that publicity attendant to the commission's formal opinion describing the state of company affairs was at least partially responsible for buyer reaction.

Early in 1936 a group of outside promoters with experience in the mining business of the region around Wallace, Idaho, where the Callahan offices are located, became interested in the rehabilitation of the company. This interest became known and trading on the New York Stock Exchange in Callahan stock increased to 122,200 shares in February, with prices from $1 to $1.875, although the company's operations were at a standstill. On the basis of reports submitted in March by one Frank Eichelberger, recommending rehabilitation and further development of the properties owned by the company,59

55 The statement was filed July 28, 1934, followed by a series of amendments the last of which was March 28, 1935, 1 SEC 115 (1935).

56 Sec. Act Rel. 294 (1935). This was a § 8(d) proceeding. During the month preceding this order the commission had made an investigation under the authority granted by § 8(e) of the Securities Act.


58 In the Matter of Callahan Zinc-Lead Co., 1 SEC 115 (1935), promulgated as Sec. Act Rel. 334 on April 11, six days before the registration became effective. The fact that the company had "petitioned" for the acceleration gave the commission an opportunity to give publicity to facts behind the flotation.

59 Speaking of the Interstate (Callahan) mine which had not been worked since 1923—although this was not stated—, the report said: 'I feel this group offers great possibilities
Callahan on May 5 filed with the Securities and Exchange Commission an amendment to its 1934-35 registration statement. Covering the same 747,518 shares, the statement declared that there would be no public distribution of the stock, but that it was to be issued under an option to Eichelberger, subject to a prior offering to existing stockholders according to their pre-emptive rights. The market for Callahan in April, May and June was thin—there being no news of developments from the company—and the price of the stock falling below $1. After the new registration statement became effective on July 25, however, and the additional shares were put on the market, there was increased activity in the stock. Aided by a boom in metal prices, a rising stock market and a favorable business outlook, the price of Callahan on the New York Stock Exchange rose from $1.25 on July 15 to $6.125 in February, 1937, despite the fact that the company had not resumed operations. The marketing of the new stock was successful and $672,000 was added to Callahan’s treasury.

By the terms of Eichelberger’s agreement with the company he became general manager, with power to nominate at least a majority of the directors. On September 3, 1936, the old officers resigned, and the promoters took active charge of the business. One of the old directors, Henry B. Kingsbury, had been instrumental in attracting the promoters to the company and as head of the brokerage house of Pennaluma and Company in Wallace, Idaho, he was able to promote interest in the stock. In July the brokerage house distributed a puff sheet entitled “News and Views of the Coeur D’Alenes” which contained information about mining ventures and stocks, including a particularly favorable report about the new developments in Callahan, and a news story reporting the interest of Eichelberger in the reorganizations. Although such puff sheets and brokers’ circulars presumably are effective selling documents in the distribution of the stock, any liability for misrepresentation can arise only from the common law rules. In addition to the known interest of Kingsbury in the success of the distribution of Callahan’s securities, Herman Marquardt, an

for future development and certainly with such large holdings in a well-known mineral district intensive development work is justified. . . . I have not been underground in the property as the lower workings are all under water. . . .” Prospectus, at 20 (July 27, 1936).

Eichelberger was to receive 75,000 shares for “his services heretofore rendered to the company in connection with the development of its mining properties.”

29 Time, No. 12, at 75 (March 22, 1937).

Prospectus, at 2 (December 30, 1937). Only 93,515 shares were taken by the stockholders, Sec. Act Rel. 2061, at 4 (1939). For the disposition of the other stock, see infra note 82.

Proceedings before the Securities and Exchange Commission, at 32 (June 22, 1939).

Kingsbury “took” 137,000 shares of Callahan stock through the Eichelberger option, although this fact was not revealed, Sec. Act Rel. 2061, at 4 (1939). The stock was promoted as “the only Wallace stock on the New York Stock Exchange.” Wallace had a population of 3,034 persons in 1930.

Proceedings, op. cit. supra note 63, at 48-54.
employee in the brokerage house, was the record titleholder of a $30,000 first mortgage on all the tangible assets of the company. The mortgage note was to become due a few days after the registration statement became effective. At this time, before the registration statement became effective and the new stock was sold, the company showed on its balance sheet only $1,633.46 in current assets.

In 1937, some of the funds realized through the sale of stock were used to explore the possibilities of reopening the Callahan Idaho properties, but after considerable sums were spent it became evident that these properties would be uneconomical to mine. In June the company's Interstate mine began producing some ore, but in February, 1938, this property was closed down again.

During 1937 a record turnover of 1,903,000 shares of Callahan stock was posted on the New York Exchange, and at the year's end the price had again fallen below $2, due in part to the collapse of metal prices.

During this period, while the metal market was still favorable, and there were funds in the Callahan treasury, the management began looking around for other mining properties. A substantial stock interest in the New Park Mining Company was acquired, and several contracts to develop other properties were entered into during 1937. Late in 1937 the company took an option to purchase the controlling interest in an Alaskan gold-mining project, Liven-good Placers, Incorporated. To exercise the option additional funds were needed, so 498,413 more shares of authorized but unissued stock were registered

66 Proceedings, op. cit. supra note 63, at 39. See infra note 84.

67 Balance sheet, March 31, 1936. Fixed assets were carried at $2,362,383, investments at $200,175, other asset items at $2,023: total $2,564,581. Liabilities: capital stock at par $748,592, current liabilities (including the mortgage) $73,363, capital surplus (arising from the reduction of the par value of the stock in 1934) $5,273,486, less operating deficit of $3,530,- 860: total, $2,564,581.

68 Proceedings, op. cit. supra note 63, at 57. The annual report of the company for 1937 said merely: "On the whole the results at the Interstate mine have proved disappointing in that no new large commercial ore bodies have been found." The 1938 report, sent to stockholders after the SEC's investigation was started, said: "These studies [at the Galena mine] have indicated that the original hopes for the disclosure of a large ore body beneath and adjacent to the old mine workings are not likely to be realized due to geological conditions. . . . The exploration program at the Interstate has failed to disclose large ore bodies."

69 Proceedings, op. cit. supra note 63, at 63. The company's report for 1938 said: "Treatment of 22,899 tons . . . . between July 1937 and February 1938 demonstrated that this ore could not be profitably mined with lead and zinc selling at less than 5.25 cents per pound." The 1938 report said: "In 1937 [the company] attained the most favorable position it has enjoyed for many years."

70 Callahan Ann. Rep. (1937); Prospectus, at 11 (December 31, 1937). A total of 890,287 shares of New Park stock was acquired for $101,061. The 1938 balance sheet carries the interest in New Park at $81,294 (695,287 shares) and notes receivable for $18,350, secured by 124,000 shares of New Park. In March, 1940, the company sold 179,000 shares of New Park, some of it to directors, 6 SEC, Summary of Securities Transactions and Holdings, No. 7 (1940).
with the Securities and Exchange Commission. Another issue of "News and Views" was distributed by Pennaluma and Company describing the bright prospects of the Alaska properties. Callahan stockholders were given an opportunity to subscribe to this stock at $2 per share during the first twenty days of January, 1938. The stock stayed around this price until spring, when it slipped to below $1.50, influenced by the continued decline in zinc and lead prices. In July the company reported that it had disposed of 106,000 more shares at $3 per share privately by terms of its option agreement with Goldfield Consolidated Mines Company, the promoters of the Livengood property, although the market at this time did not rise above $2.50 per share.

Early in 1938 the management decided that it should "make more attempts to furnish the stockholders with information more frequently, and in such a manner that it would be more understandable than that published in the annual report." A publicity man was hired and gave advice which led to the publication of "The Cap Lamp," a two-color broadside containing general information about mining and the operations of the company, illustrated by charts, maps, and attractive drawings. Two issues of this "house organ" were distributed to stockholders and others interested in Callahan stock, the first issue containing a chart comparing the trend of various non-ferrous metal stocks, including Callahan, with the price of lead and zinc ores. Callahan was selling ore concentrates at a loss at this time.

By the end of 1938 the Callahan Zinc-Lead Company had completed a refinancing plan and had, by the issuance of 1,053,817 shares of stock, increased its assets by almost $900,000 of cash and securities in new mining ventures. Because it had an established name, stock listed on the New York Stock Exchange and an active group of promoters, a company with assets of doubtful value was transformed into a company with a cash reserve and holdings of other mining stocks of promise. However, the mere fact that the company had

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71 The company originally registered 503,890 shares (Sec. Ex. Act Rel. 1475 (1937)), but later decided on the smaller figure.

72 Callahan Ann. Rep. (1938); Prospectus, at 7-11 (December 31, 1937) (detailing the option agreement). The company had followed up its prospectus with a post card announcement of the progress of the Alaska deal (February 7, 1938).

73 Proceedings, op. cit. supra note 63, at 71-73 and 134.

74 Proceedings, op. cit. supra note 63, at 127-30.

75 Cf. Proceedings, op. cit. supra note 63, at 60. Other material in "The Cap Lamp": "Zinc, its alloys and derivatives make life more comfortable and enjoyable for everybody, every day, every year! . . . . Buster and Sis have been in close contact with this universal metal even though they are not consciously zinc-conscious." There was no mention of either the Galena or Interstate mine in the second issue, although these properties were carried on the books of the company at $2,651,131 at that time.


77 Note 80 infra.

78 Interests in two other mining companies which had cost Callahan $400,000 were written down to $2 in 1937. The investment in Livengood was carried at $487,411 at the end of 1938.
increased its assets through the sale of stock does not necessarily indicate that its overall financial position was sound. The balance sheet of December 31, 1938, showed that no adequate provision for depletion had been made for the old mining properties, still carried at $2,651,131.79. Furthermore, there was no possibility of a dividend payment, since the balance sheet indicated that the company's capital was impaired by more than $375,000.

THE SEC INVESTIGATION AND EFFECT ON THE MARKET

The Securities and Exchange Commission instituted proceedings against the company on February 13, 1939, under section 8(d) of the Securities Act and section 19(a)(2) of the Exchange Act to determine whether the effectiveness of the registration statement should be suspended, and Callahan stock de-listed from the New York Exchange. The order for hearing charged that the company's registration statement contained untrue statements of material facts with regard to (1) underwriting and stock subscriptions by directors, (2) the condition of the business, (3) the beneficial ownership of the Marquardt mortgage, and was otherwise deficient. On the day that the order for hear-

This item was followed by the accountants' notation: "The known ore in properties owned by the company is insignificant in amount. . . . Unless substantial additional ore reserves are developed the provision for depletion is inadequate."


As set forth in the stipulation filed subsequently by the company: Eichelberger and three others had agreed to pay the expenses of the promotion and share in the benefits of the undertaking as to a block of 370,000 shares; the 75,000 shares given to Eichelberger "for services" was divided equally with these three; Marquardt took 150,000 shares of a block of 302,518 shares, and fourteen individuals, including Eichelberger, took the remainder. The commission found that all of those named were underwriters under the meaning of § 2(11) of the Securities Act. See note 89 infra, and accompanying text.

Eichelberger's report (commented on supra note 70) stated that production on known ore bodies could be resumed as early as thought advisable. The SEC charged, and it was admitted by the company, that there was no intention of doing so, Sec. Act Rel. 2061, at 8 (1939). As to the condition of the mine, see infra note 90.

The company finally stipulated that two former officers, including Kingsbury, were beneficial owners of the mortgage, which carried eight per cent interest, Sec. Act Rel. 2061, at 8 (1939). At the hearings in Washington, however, the secretary-treasurer of the company testified: "We have never been able to obtain, despite repeated requests, any statement of any kind from Mr. Kingsbury." Counsel for the SEC asked the witness if the company had voted Kingsbury a bonus for obtaining the mortgage, to which the reply was: "That I could not tell you without looking at the minutes. . . ." Proceedings, op. cit. supra note 63, at 38

The item questioned here was the "contingent fees" to be paid to the lawyers who rendered an opinion that the stockholders had no pre-emptive rights, Sec. Act Rel. 2061, at 9 (1939).
ing was made public, February 15, the price of Callahan on the New York Exchange broke from $2 to $0.625, the lowest the stock had been since January, 1936. Contemporaneously with the SEC release, Callahan issued a press statement prepared by its lawyers stating that the commission "appears to have focused its attention primarily on matters relating to the old management," a fact which the hearings proved to be untrue. The company release, printed in both the New York Times and Wall Street Journal, said further: "Nothing in these proceedings should adversely affect the present position of the company." Between February 26, when this statement appeared, and September 1, when war was commenced in Europe, the price of Callahan stock on the exchange shifted narrowly between $0.75 and $1.125.

Before the hearing scheduled for March 28, the Callahan management filed a stipulation with the commission admitting substantially all of the deficiencies alleged in the order, but denying their materiality. The trial examiner's report concluded (1) that although the registration statement said that there were no underwriters of the 1936 issue, the facts were that Frank Eichelberger and three others, including the president of the company, took stock through the Eichelberger option and sold it to the public; (2) at the time of the 1936 registration statement all of the Callahan properties were shut down and on a caretaking basis, that one mine was badly caved and the major portions of the workings inaccessible, and that another was full of water to within fifty feet of the mine shaft; (3) that the Marquardt mortgage for $30,000 on all of the corporation's fixed assets was in part owned by two directors of the company despite statements that "the lender is an individual not an officer or employee"; and (4) that the 75,000 shares of stock said to be issued to Eichelberger for pro-

Counsel for the commission asked the secretary-treasurer of the company if he had not prepared and signed a number of the statements filed with the SEC. When the witness answered affirmatively, the trial examiner interposed: "That statement [to the newspapers] is disingenuous if it is anything." The witness: "I don't think so, sir." Proceedings, op. cit. supra note 63, at 116. When the president of the company was a witness, the trial examiner asked: "Since you consented to the filing of the stipulation of facts which are different from those released, have you . . . . made any further statements [to newspapers]?" The witness answered that the company thought that the next statement should be after the commission's proceedings were completed.

The denial of materiality was a defensive measure in view of the wording of § 11 of the Securities Act, which provides for liability where there has been an "untrue statement of a material fact or [omission of] a material fact required to be stated." As for what is a material fact, see Shulman, loc. cit. supra note 20.

Filed April 27. Story carried in the New York Herald-Tribune, April 28.

Cf. In the Matter of Sweet's Steel Co., Sec. Act Rel. 1899, at 4 (1938) ("arrangements" for underwriters and the distribution of securities are among the most important data concerning which investors should be accurately and adequately informed).

The commission found: "The statement of the registrant's operations in terms which indicated that they were continuing, without disclosing that the mines were not being worked and were in fact unworkable without substantial repairs and further development, was materially deficient," citing In the Matter of Canusa Gold Mines, Ltd., 2 SEC 548 (1937).
professional services as a mining engineer were in fact issued to him as an underwriting commission which was split with three others. The trial examiner stated: "While most of the untrue statements and omissions may be considered individually of no great importance, combined they tend to present an exaggerated picture of the operations and prospects of the registrant. The cumulative effect . . . should deny . . . the registrant's motion to . . . dismiss the [§ 8(d)] stop order proceeding." Counsel for Callahan then filed a brief in support of exceptions to the trial examiner's report, and also requested oral argument on the delisting proceeding under section 19(a)(2) of the Securities Exchange Act. Hearings were held for several days in June; there was no publicity and no market reaction. The commission issued a stop order under section 8(d) of the Securities Act, accompanied by its formal opinion, on September 27, and publicity was given to the order in the morning newspapers of the next day. On September 27 the price of Callahan had ranged between $1.75 and $2.50; on September 28 between $1.625 and $2. The stop order release was "top" news on the first financial page of the New York Times, receiving more than a full column. The effect of the order was explained in a company release which was duly printed. This stated that Callahan had filed new amendments to its registration statement designed to cure the deficiencies which the commission had announced it would consider after the issuance of the stop order. On October 11 the commission declared these amendments effective and lifted the order. The price of the company's stock, which had been around $2 for the duration of the suspension, advanced to $2.25 and $2.50. It should be noted that the lifting of the stop order received no notice in the New York Times or Wall Street Journal, although the SEC release presumably was carried on news tickers. The only matter remaining for the commission to dispose of was the delisting proceedings.

On November 24 the commission dismissed these proceedings, stating that, as in other delisting cases, it was necessary to weigh the disadvantages to pres-

91 Cf. In the Matter of Austin Silver Mining Co., 3 SEC 601, 608 (1938) (combination of the misstatements and omissions present an exaggerated picture of operations and prospects); In the Matter of Mutual Industrial Bankers, 1 SEC 268 (1936), note 99 supra.

92 The company sought dismissal of the stop order proceeding because of the filing of the stipulation and proffered amendments. The commission held that it had discretion to do this, or proceed, citing In the Matter of Cornucopia Mines, 1 SEC 364 (1936); In the Matter of Equity Corp., 2 SEC 675 (1937); In the Matter of Consolidated Corp., 2 SEC 724 (1937). Sec. Act Rel. 2061, at 3 (1930). Dismissal of the proceeding at this time would have saved the company the unfavorable publicity contained in the stop order.

94 The market in Callahan was quiet all summer. The week before the war in Europe began transactions had only numbered 1,400 shares; the first week of the war trading was 258,900, and the price rose to $3.25.


ent security holders against the protection which might be afforded to future purchasers by withdrawing the registration and the consequent notice given to the public thereby of the unreliable nature of the information furnished by the management. Disregarding the trial examiner's advisory report that the stock be delisted, the commission reasoned that because (1) the company had admitted deficiencies and filed corrective amendments; and (2) the new management of the company had endeavored to cooperate fully with the commission after the order for hearing had issued, the interests of the stockholders would best be served by keeping the stock of Callahan Zinc-Lead Company listed on the New York Stock Exchange.

Thus was brought to a close five years of intermittent contact between the Securities and Exchange Commission and the company. The original registration statement had indeed enjoyed a "long and unimpressive history." The investigation served to provide more exact standards by which investors could re-appraise the value of Callahan stock, and by which the management of the company could orient their financial and promotional policies to the present-day economic ideas which find expression in the federal securities legislation. Because full disclosure was not given to the option agreement voted by the directors for the benefit of themselves and others, prospective purchasers of the stock were led to believe that an experienced and successful mining engineer (Eichelberger) stood ready to invest more than $500,000 in the revived venture. The investigation also disclosed the equivocal nature of the company's prospectus and publicity. The prospectus had given a misleading impression of the condition of the company's Idaho properties by not clearly indicating that the commercial ore reserves therein were only nominal; statements that the company's operations were continuing, without disclosing that the mines were not being worked, and were in fact unworkable without substantial repairs, left the investor with false expectations. Information issued by the company to financial publications at various times that "the new management has succeeded in finding enough ore to finance energetic exploration in the old workings" were shown not to be founded in fact. Furthermore, distribution of interpretative publicity such as "The Cap Lamp," published for the avowed purpose of making the company's activities more understandable than an earnings statement, served to gloss over the fact that each period of operations added to an already large deficit.

99 The characterization is the commission's, Sec. Act Rel. 2061, at 10 (1939).
100 Note 65 supra, and accompanying text. Cf. In the Matter of Austin Silver Mining Co., 3 SEC 601 (1938) (false statement that large stockholder not connected with management had lent money held material misstatement).
102 Proceedings, op. cit. supra note 63, at 76 and 137–8.
NOTES

The investigation demonstrated that buyers of securities, particularly those of a speculative nature, will be attracted to a certain stock because of the trend of the market as a whole, prospects of the industry represented, and commodity prices, rather than by "actual knowledge of the operations of the individual company." The prices of other non-ferrous metal stocks, of zinc and lead ore, and of Callahan common stock moved together prior to the investigation despite the fact that during the period of the steepest rise in the market Callahan was not producing. At the SEC hearing a witness for the company stoutly denied that this condition was a result of manipulation. Even manipulation would not explain the similarity in both up and down swings of the market. Thus, it may be suggested that before the commission's investigation investors and speculators were buying and selling "zinc-lead stock," and not Callahan stock, when they bought and sold the securities of the company on the New York Stock Exchange.

The commission's investigation apparently had a beneficial effect upon the mining corporation. Early activities of the commission had revealed to the old management the flimsy nature of the scheme they were seeking to effectuate under the original registration statement. The new management, taking over the company in September, 1936, attempted to satisfy the requirements of the Securities Act with regard to disclosure; the lack of success, it was indicated at the commission hearings, was partially due to fact that the company's lawyers did not clearly indicate what the requirements of the act were.

The issuance of the stop order in the Callahan case illustrates the commission's use of its power to "bring notice of the existence of the deficiencies to purchasers of . . . stock more effectively than would the mere promulgation of an opinion" permitting a post-effective amendment to cure the deficiencies. A shorter "time lag" than the three years that elapsed after the registration statement became effective in this case is perhaps desirable, but not always attainable. In any event the civil liabilities provisions of the Securities Act remain available to injured stockholders, and publicity to the commission's

Cf. testimony of the secretary-treasurer of the company, Proceedings, op. cit. supra note 63, at 68.


At the hearing in the § 19 (a)(2) proceeding the trial examiner asked the treasurer of the company: "If the company had no production at all during this period, any fluctuations in the market . . . . would be the result of manipulation, would it not?" The witness: "I cannot see that at all." Proceedings, op. cit. supra note 63, at 68.


The president of Callahan testified: "The new attorney . . . . put the matter . . . . in a different light. . . . I took the position from the start . . . . that we would always supply the information requested [by the commission] and in the way they requested," Proceedings, op. cit. supra note 63, at 147.

In the Matter of Callahan Zinc-Lead Co., Sec. Act Rel. 2031, at 10 (1939). Notes 42 and 92 supra, and accompanying text.

§ 11. Note 20 supra.
activities puts before prospective purchasers a complete picture as to the true state of the company’s affairs. The commission’s decision to keep the shares listed in effect affirmed the hope of the president of Callahan that the 9,500 Callahan stockholders would have “a free market . . . . to get an appropriate price for their stock.” Although there was strong evidence that the misleading statements in the prospectus were responsible for the success of the 1936 stock sale, the commission, by not invoking its full sanctions, allowed the company to try to improve its financial position by outside leases and investments.

MARKET REACTION TO COMMISSION ACTION: OTHER EXAMPLES

The reactions of Callahan stock caused by the investigation of the company’s registration statement and annual reports are not to be regarded as atypical. Other stocks react similarly, although the character of the movements may vary with the type of proceeding, the seriousness of charges, the true condition of the company charged, and factors in the industry. A manipulation proceeding instigated by the commission against a broker dealing in the stock of a company does not have the same effect as a stop order or a delisting proceeding. A manipulation proceeding against a broker need cast no reflection upon the worth of a company’s securities; the company involved may have excellent possibilities of earning large dividends, and the price of its stock before and after the manipulation may make it an attractive “buy.” These facts were present in one case. The company had announced a new process for manufacturing steel pipe. Playing upon the market interest in the company, as well as on certain undisclosed information, a large brokerage house attempted to rig the market in order to sell a large block of stock on which it had a favorable option. When the interest of the brokers and others subsided, the market began to slide.

Proceedings, op. cit. supra note 63, at 159. President Van Sinderen, describing himself as a merchant in non-ferrous metals, testified that he owned 30,000 shares of Callahan stock in his own name, and an interest in Harrison White, Inc., which owned 216,000 shares, Proceedings, op. cit. supra note 63, at 159.

This was the opinion of the trial examiner in a supplementary report filed along with the commission’s opinion not to delist Callahan stock.

In its latest annual report the commission states that “it has become increasingly evident that if the public is to receive adequate protection [from manipulation of the market] the Commission’s enforcement activities, so far as possible, must be preventive rather than punitive,” SEC Ann. Rep. 87 (1939). Cf. In the Matter of Richards, Sec. Ex. Act Rel. 2032 (1939) (suspension of broker from Exchange; the commission’s rapidity of action ended a manipulation being engineered from England before any of 40,000 shares of Simplicity Pattern common under option could be sold). Where direct action is impossible because the manipulation is completed, publicity given to a punitive proceeding against a broker is relied on.

In the Matter of White and Weld, 3 SEC 466 (1938) (manipulation of the stock of the A. O. Smith Corporation). Appendix C to this opinion (3 SEC 466, 530) contains a valuable collection of cases on the powers of the commission.
off, and when the order for an investigation\textsuperscript{114} was issued it was still moving downward. It is impossible to tell whether the order affected the price. A few months later, a sharp rise in the price of the company's stock followed a general rise in steel stock prices,\textsuperscript{115} and an announcement of several large orders by the company.\textsuperscript{116} Thereafter, an order for hearing\textsuperscript{117} caused the price to slip downward markedly,\textsuperscript{118} although the industry index was rising at this point. Since manipulation proceedings usually are pending for a long time\textsuperscript{119} the final order will have no noticeable effect upon the market.

In a delisting case\textsuperscript{120} there is a clearer resemblance to the Callahan reactions. On March 29, 1935, the New York Stock Exchange announced that it would seek the delisting of the stock of the Hupp Motor Car Corporation because the Hupp management had failed to cooperate with the exchange. On the day this announcement was made the price of Hupp stock fell from $1.75 to $0.875. A few days later a stockholders' suit was instituted against the management\textsuperscript{121} and on April 5 the SEC was formally asked to delist Hupp stock. On the same day a strike was called at the company's Detroit plant.\textsuperscript{122} The market fell to $0.75, the lowest since July, 1933. In June the SEC decided not to delist the stock because it felt that the management, which had been changed in a compromise with the stockholders, would be more cooperative with the exchange and consider stockholders' interests.\textsuperscript{123} Hupp stock started to rise along with other automobile stocks in July.

In two other cases stop order proceedings were instituted against aircraft companies and manipulation proceedings against the brokers dealing in their stock. The cases differ: in the one involving Bellanca Aircraft Corporation\textsuperscript{124}
Stock Market Reactions to Activities of the Securities and Exchange Commission

These graphs show the market trends of four corporation stocks during the period of the Securities and Exchange Commission. The trend of each stock is depicted on the accompanying charts.

A.O. Smith Corporation
Index of Twelve Steel Stocks
Monthly Price Range of Smith Stock
Volume of Transactions on New York Stock Exchange

Kinner Aircraft and Motor Corporation
Index of Ten Aircraft Stocks
Monthly Price Range of Kinner Stock
Volume of Transactions on Los Angeles Stock Exchange

Key to symbols used in millions of dollars of SEC activity:
- Order for hearing
- Proceedings estabished
- Proceedings dismissed
- Final opinion and order of SEC.

Proceedings under Section 6(b)(5) of the Securities Exchange Act:
- Market manipulation
- Manipulation of market apparatus ordered
- Order for hearing
- Final opinion and order of SEC

Proceedings under Section 6(b)(5) of the Securities Exchange Act:
- Full to end (there)
- Manipulation of market apparatus
- Final opinion and order of SEC

Source: Standard Statistics and Bank and Quotation Record.
the stop order and manipulation proceedings were commenced at the same time; in the one involving Kinner Airplane and Motor Corporation the two were instituted separately and for different reasons. In the Bellanca case the market reactions were similar to those in the Callahan case. However, the stock rose to meet the market trend, not when the proceeding was dismissed and the registration statement made effective, but previously when it was abated following the resignation of an officer who had been involved with the broker-underwriter in the manipulation. A preliminary opinion on a procedural point in the manipulation proceedings did not affect the market price, nor did the final opinion which came twenty months later.

In the Kinner case a marked depression in the price of the stock occurred after the manipulation and during the SEC investigation of transactions in the stock. The stock was highly speculative, a fact which partially accounts for the deviation of its price from the aircraft stock index. Likewise, the price of the stock at the time of the order for hearing in the stop order proceedings was falling ahead of a receding market. The effect of the final order upon the market cannot be measured, as a reorganization petition had been filed a few weeks before, but it seems probable that the stop order was the final blow, as the price fell to its lowest point ($0.10) in more than three years. When the opinion in the manipulation proceedings was promulgated two months later, the stock was no longer classed with the active issues upon the exchange.

The study of a number of case histories of companies in a controversy with the Securities and Exchange Commission reveals, as might have been anticipated, considerable market responsiveness to any commission activity. However, as has already been pointed out, the general state of the market and other external factors, such as war or an election, complicate any consideration of these reactions.

\textsuperscript{125} In the Matter of Charles C. Wright, 1 SEC 482, 1 SEC 560, and 1 SEC 901 (1936), 3 SEC 190 (1938) (the manipulation proceeding); In the Matter of Kinner Airplane and Motor Co., 2 SEC 943 (1937) (the stop order proceeding).

\textsuperscript{126} In the Matter of Bellanca Aircraft Co., Sec. Act Rel. 815 (1936); Wall Street Journal, May 28, 1936.

\textsuperscript{127} In the Matter of Michael J. Meehan, 1 SEC 232 (1935).

\textsuperscript{128} In the Matter of Michael J. Meehan, 2 SEC 588 (1937).

\textsuperscript{129} The manipulation was between September 11 and October 1, 1935. The price of the stock started falling at the end of this period, from $0.775 to $0.43. During most of the period here concerned the stock had the largest turnover of any on the Los Angeles Stock Exchange.

\textsuperscript{130} In the Matter of Kinner Airplane and Motor Co., Sec. Act Rel. 1393 (1937). The registration statement had been filed July 23, 1936, and the order for hearing was announced April 19, 1937 (see graph).

\textsuperscript{131} In the Matter of Kinner Airplane and Motor Co., 2 SEC 943 (1937), December 17.


\textsuperscript{133} In the Matter of Charles C. Wright, 3 SEC 190 (1938), February 28. The company has since been reorganized.
CONCLUSION

Unlike other legislation which has been proposed from time to time for the regulation of private enterprise,134 the Securities Act and the Securities Exchange Act depend almost entirely upon the effectiveness of publicity to achieve the purposes for which they were enacted. Furthermore, the type of publicity employed does not involve a direct expression of evaluation by the commission, as to the economics of the enterprise. If the present securities acts should prove ineffective, the substitutes proposed would undoubtedly rely on the technique of advisory evaluation by a commission135 or more drastic prohibitions. Whether such steps will be taken eventually would seem to depend upon the development of devices which will give greater effect to the present publicity requirements of the acts.

The present case study indicates that there are areas within the present framework in which the sanction of publicity might be more effectively applied.

Prospectuses.—Since the prospectus is the mainspring of publicity concerning new issues of securities, the understandability of the document may in many cases be increased by the inclusion of an introductory summary, more attention to arrangement, and the elimination of as much technical or legal phraseology as possible. In the Callahan prospectus the emphasis on favorable past history effectively disguised the present condition of the property.136 No explanation of depreciation policy was made, and the terms of the Eichelberger option would be unclear to many readers.

Annual reports.—The present Securities Exchange Act does not require corporations filing annual reports with the commission to follow commission standards in reports which are sent to the corporation’s stockholders.137 The balance sheet use of “original cost plus additions” for the fixed assets of Callahan, without an adequate provision for depletion, is difficult to accept.138 In not dissimilar cases the commission has indicated that the asset figure should be based on “sound” appraisal methods competently and honestly applied.139 Furthermore, since Callahan’s most promising assets at the end of 1938 were

134 E.g., H.R. 6968, 75th Cong. 1st Sess. (1937) (the so-called Lea Committee bill).
135 Cf. § 11(g) of the Public Utility Holding Company Act (49 Stat. 823 (1935), 15 U.S.C.A. § 79k(g) (Supp. 1939) ), which provides that in the solicitation of proxies in behalf of any plan for reorganization there must be mailed to the security holders a copy of the SEC’s advisory report on the plan; and furthermore, that such an analysis be the only one circulated in such a manner.
136 Notes 59, 90 and 101 supra.
138 Notes 79 and 80 supra.
the interests in other properties, it might be expected that the annual report contain the profit and loss statement of affiliated companies. 140

*News releases.*—The authors of the Twentieth Century Fund's study of stock market control suggested that the Securities Act be strengthened with regard to the publication of news matter about corporations. 141 It may be suggested that certain types of releases, e.g., business forecasts or data on new processes, 142 should be filed with stock exchanges or the commission for the deterrent effect they would have on intentional misrepresentations. The issuance of an erroneous news release in the *Callahan* case indicates how such material is designed to affect the market. 143

*Brokers' puff sheets and circulars.*—The use of "News and View" to promote *Callahan* stock 144 is a minor example of how unofficial documents are used in stimulating interest in a certain enterprise. While few regulations could be drawn to cover all situations, much can be accomplished where the brokers are members of large organized exchanges. The Twentieth Century Fund report recommends that copies of all such matter distributed to the public by members of the New York Stock Exchange be submitted to the exchange prior to issuance. 145 Such a suggestion perhaps goes too far, but certainly rules could be established by the exchanges, and copies of all literature be kept on file.

*Commission releases.*—In the first *Callahan* opinion the commission took advantage of the company's "petition" to accelerate the effective date of the registration statement to give publicity to a situation where otherwise no wide dissemination of information would have resulted. 146 In the opposite situation the commission is sometimes called upon to issue an order for hearing because of some deficiency in a registration statement where the matter does not raise any real question affecting the value of a company's securities. Such an order may get more publicity than it deserves, with resulting market reaction. It may be suggested, therefore, that the commission take cognizance of traditional methods used by newspaper editors in judging news values, 147 and, by minor changes in procedure and the preparation of releases, minimize the dangers of too much publicity. There could be two classes of orders for hearing, one identical with the present order (which contains a rather full specification of the deficiencies involved), and the other a "formal notice of need for correction."

Finally, it may be suggested that the form of releases such as those lifting stop orders might be altered. The lifting of the stop order in the *Callahan* case

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141 Twentieth Century Fund, op. cit. supra note 7, at 201.
142 Cf. In the Matter of White and Weld, 3 SEC 466 (1938), discussed supra p. 694.
143 Note 86 supra.
144 Notes 65 and 71 supra, and accompanying text.
145 Twentieth Century Fund, op. cit. supra note 7, at 201.
146 Note 58 supra, and accompanying text.
147 Note 47 supra, and accompanying text.
received no mention in the principal New York financial pages. Judging their interest in the case on the basis of what they had printed previously, it may be that the papers would have printed a notice of the removal if the commission release had concisely summarized the background of the case insofar as it pertained to the lifting of the stop order. Such a situation merely supports the suggestion that the commission consider carefully the “weighting” of their releases, and the effect they have on newspaper publicity.

EFFECT OF THE NATIONAL BANKRUPTCY ACT ON STATE POWER OVER CORPORATE REORGANIZATION

Since Congress has provided for corporate reorganization under the bankruptcy power, a question is raised as to the effect of this action upon state power over corporate reorganization. The question may become especially important if reorganizers seek state court reorganizations in order to avoid the reform provisions of Chapter X of the National Bankruptcy Act. This path is open to reorganizers not only through the equity receivership but through recent amendments to state corporation acts. The grant of power under these statutes

148 Note 95 supra, and accompanying text.


2 See discussion of reform provisions in Rostow and Cutler, Competing Systems of Corporate Reorganization: Chapters X and XI of the Bankruptcy Act, 48 Yale L. J. 1334 (1939); Levi, Corporate Reorganization and a Ministry of Justice, 23 Minn. L. Rev. 3 (1938).