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CORPORATIONS - SECURITIES EXCHANGE ACT - UNLISTED TRADING PRIVILEGES

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CORPORATIONS — SECURITIES EXCHANGE ACT — UNLISTED TRADING PRIVILEGES — Under the Securities Exchange Act of 1934, as amended in 1936, the Securities and Exchange Commission is empowered to extend unlisted trading privileges to any security upon application by an exchange and the fulfillment of the terms and conditions of the statute.¹ In addition to the requirements for full disclosure, the statute provides

“No application to extend unlisted trading privileges to any security . . . shall be approved unless the applicant exchange shall establish to the satisfaction of the Commission that there exists in the vicinity of such exchange sufficiently widespread public distribution of such security and sufficient public trading activity therein to render the extension of unlisted trading privileges on such exchange thereto necessary or appropriate in the public interest or for the protection of investors.”²

It is also provided that

“No application . . . shall be approved unless the Commission finds that . . . the extension of unlisted trading privileges pursuant to such application is necessary or appropriate in the public interest or for the protection of investors.”³

Recently the commission considered the application by the New York Curb Exchange for unlisted trading privileges in nineteen securities.⁴ Six of the applications were refused and thirteen were granted.

¹ 48 Stat. L. 881 (1934), as amended by 49 Stat. L. 1375 (1936), 15 U. S. C. (Supp. 1937), § 78-1(f).

² *Ibid.*

³ *Ibid.*

⁴ In the Matter of Applications by the New York Curb Exchange for Unlisted Trading Privileges, S. E. C. Release 1541 (1938).

I.

The commission had previously faced the problem of what is meant by "in the vicinity of such exchange," but had been satisfied to base its findings "upon the narrowest of reasonable meanings that can be given that term."⁵ In the instant case the Curb pressed its argument that its "vicinity" included all areas covered by ticker service, and printed or broadcast reports. In denying this contention, the commission defined "vicinity" as meaning "the particular geographical section or sections in which a particular exchange ranks as the, or one of the, national exchanges to which investors would look for an exchange market in the securities for which unlisted trading is sought."⁶ The commission regulations require that the applicant make clear what it deems to be the vicinity of the exchange.⁷ In one instance in the principal case this was described as "New York City, Northern New Jersey, Long Island and Westchester County." Other references were largely confined to New York City or the metropolitan area thereof. In previous cases, findings as to the vicinity of an exchange have been less restrictive. Thus the vicinity of the Pittsburgh Stock Exchange includes western Pennsylvania, West Virginia and eastern Ohio;⁸ that of the Boston Stock Exchange embraces all of the New England states except Fairfield County, Connecticut;⁹ the vicinity of the Philadelphia Stock Exchange covers the eastern half of Pennsylvania, southern New Jersey and northern Delaware;¹⁰ while that of the San Francisco Curb Exchange comprises northern California, Oregon and Washington.¹¹ In one recent case the commission held that the vicinity of the New York Curb Exchange "certainly includes the states of New York and New Jersey."¹² It seems clear that before this case "the vicinity of the exchange" was a very liquid concept and the definition herein has not crystallized it so as to make it less workable.

⁵ In the Matter of Edison Electric Illuminating Company of Boston, 1 S. E. C. 909 at 911, note 2 (1936).

⁶ In the Matter of Applications by the New York Curb Exchange for Unlisted Trading Privileges, S. E. C. Release 1541, p. 5 (1938).

⁷ S. E. C. Release 781 (1936); CCH STOCK EXCHANGE REGULATION SERVICE, p. 2695.

⁸ In the Matter of Applications by the Pittsburgh Stock Exchange, S. E. C. Release 1139, p. 8 (1937).

⁹ In the Matter of Applications by the Boston Stock Exchange, S. E. C. Release 1298, p. 9 (1937).

¹⁰ In the Matter of Applications by the Philadelphia Stock Exchange, S. E. C. Release 1312, p. 3 (1937).

¹¹ In the Matter of Applications by the San Francisco Curb Exchange, S. E. C. Release 1339, p. 4 (1937).

¹² In the Matter of Applications by the New York Curb Exchange, S. E. C. Release 1377, p. 2 (1937).

2.

When the applicant attempts to establish that there exists "sufficiently widespread public distribution of such security" in the vicinity, the problem presented is principally evidentiary. The regulations require information as to the public distribution to be included in the application, together with the source of such information.¹³ In only one of the applications before the commission in this case was there a "definite location" of the amount of securities in the vicinity. In the other cases "estimates" were made. These were based on interest payments made in New York, on the delivery of temporary forms in the vicinity, or on the fact that a large proportion of the issue had been underwritten by New York bankers. The latter factor is apparently weighted heavily by the commission, for in at least three instances where no estimate was made the evidence of New York underwriting was regarded as an adequate substitute for the deficiency. The statistics on retail distribution are acceptable evidence.¹⁴ In previous cases more complete evidence has been adduced and the amount of securities and number of holders has been stated accurately.¹⁵ If the estimate is grounded on any reasonable basis whatever, it will be given every consideration, and the standards are not prohibitively meticulous. The amount of distribution in terms of dollars is not controlling. Thus, in the case of Cities Service five per cent debentures of 1963 the application was granted, although only \$1,700,000 out of \$7,767,000 publicly held securities, or 21.8 per cent, was estimated to be distributed in the vicinity. In the case of Pacific Lighting Corporation four and one-half per cent sinking fund debentures of 1945 the application was rejected, despite the fact that out of \$10,000,000 publicly held it was estimated that \$2,856,000, or 28.5 per cent, was distributed in the vicinity.¹⁶ In this matter the commission has followed former cases where mere

¹³ S. E. C. Release 781, p. 3 (1936); CCH STOCK EXCHANGE REGULATION SERVICE, p. 2695.

¹⁴ In the Matter of Edison Electric Illuminating Company of Boston, 1 S. E. C. 909 at 910 (1936).

¹⁵ In the Matter of Applications by the Pittsburgh Stock Exchange, S. E. C. Release 1139 (1937); In the Matter of Applications by the Boston Stock Exchange, S. E. C. Release 1298 (1937); In the Matter of Applications by the Philadelphia Stock Exchange, S. E. C. Release 1312 (1937); In the Matter of Applications by the San Francisco Curb Exchange, S. E. C. Release 1339 (1937). In the instant case the commission made special remark on the poverty of the evidence. In the Matter of Applications by the New York Curb Exchange, S. E. C. Release 1541, p. 8 (1938).

¹⁶ In the case of Associated Gas & Electric Corporation 4½% debentures maturing in 1978, the application was rejected despite an estimated distribution of \$10,953,000 out of a total issue of \$18,821,730, or 58%. But the estimate was impeached before the commission by evidence showing that \$9,265,220 of the issue was held within the Associated Gas & Electric System, thus reducing the amount of public holdings to less than the estimate made.

size of local holdings was not conclusive. This conforms to the terms of the statute which makes public distribution a conjunctive requirement with public trading activity.

In meeting the requirement of establishing "sufficient public trading activity therein," the applicant is able to present figures of greater accuracy and dependability. The source most commonly relied on is the trading activity carried on by members of the applicant exchange over the counter. Trading on one or more exchanges where the security is listed, or has been admitted to unlisted trading privileges, is also used, but principally for the contrast afforded with figures on trading in the vicinity.¹⁷ Occasionally a contestant of the application will furnish figures as to its trading,¹⁸ and trading over the counter by others than members of the exchange is often used. In some instances the figures presented are unusually high because the period taken includes the period of original distribution. In one case the commission seems to have relied heavily on such a period.¹⁹ As an alternative, use has been made of the purchases and sales during this distribution period by banking houses other than those involved in the original underwriting.²⁰ Where there is no information from the sources mentioned, the commission has accepted evidence of trading in a predecessor issue on that exchange as an indicator of potential trading in the issue under consideration. This type of estimate is less desirable than the others mentioned, and it has only been used to supplement other sources, or in a case where better evidence was not available.²¹ No definite line can be drawn as to what minimum of trading activity is required before an application will be granted. In the principal case the lowest proportion of trading activity to amount of securities publicly held among the granted applications was 1.4 per cent per month.²² The highest proportion among the applications refused was 1.51 per cent per month,²³ excepting one unusual case which included the distribution

¹⁷ When the purpose of the application is to bring about discontinuance of the unlisted trading privileges, accurate information is available from the history of trading on the Exchange. In the Matter of Piedmont & Northern Railway Co., 1 S. E. C. 916 (1936).

¹⁸ In the instant case this was done by J. K. Rice, Jr. & Co. See S. E. C. Release 1541, p. 10 (1938).

¹⁹ See Atlantic City Electric Co. 3¼s, 1964, S. E. C. Release 1541, p. 9 (1938).

²⁰ In the Matter of Edison Electric Illuminating Company of Boston, 1 S. E. C. 909 (1936).

²¹ See Peoples Gas Light & Coke Company 4s, series D, 1961, S. E. C. Release 1541, p. 15 (1938).

²² See Associated Gas & Electric Corporation 4½s, 1973, S. E. C. Release 1541, p. 8 (1938).

²³ See Pacific Lighting Corporation 4½s, 1945, S. E. C. Release 1541, p. 14 (1938).

period.²⁴ The lowest amount of trading in the granted applications was \$59,000 per month,²⁵ while the highest trading activity in the rejected applications totaled \$77,500 per month,²⁶ excluding an abnormal figure of \$317,332 in a case including the distribution period.²⁷ Apparently applications may be granted where there is persuasive evidence of the desirability of exchange trading even though the amount of public trading activity in dollars or in terms of proportion to securities publicly held is lower than cases where applications have been refused.

3.

As is clear from the statute, the commission is vested with broad discretion in deciding whether the conditions therein have been fulfilled. An additional degree of discretion flows from the provision that before trading privileges may be extended the commission must find that "the extension . . . is necessary or appropriate in the public interest or for the protection of investors." The economic effects of exchange trading in a security are widespread. Prices are extensively quoted and exercise a strong influence in other markets. Although this may be desirable in some cases,²⁸ it may be harmful in others where the market is "too thin" and a relatively slight amount of trading will affect the price disproportionately. Exchange trading may also impose charges on the trading public not present in over the counter transactions. The findings of the commission under this clause of the statute take account of these and similar problems. The requirement may be disposed of by a negative finding that no factor is present which will prevent such trading from being in the public interest.²⁹ It is not necessary that the exchange be found to be the best market, or even more desirable than any other, but the requirement is to be taken in the light of the expressed intention of Congress "to allow each type of market to develop in accordance with its natural genius and consistently with the public interest."³⁰ The commission admits the necessity for further study of the nature of the market which develops in the case

²⁴ See *California Water Service Company* 4s, 1961, S. E. C. Release 1541, p. 10 (1938). The proportion in this instance was 45.4%.

²⁵ See *Cities Service Company* 5s, 1963, S. E. C. Release 1541, p. 10 (1938).

²⁶ *Associated Gas & Electric Corporation* 4½s, 1978, S. E. C. Release 1541, p. 8 (1938).

²⁷ *Cumberland County Power & Light Co.* 3½s, 1966, S. E. C. Release 1541, p. 11 (1938).

²⁸ In the *Matter of Edison Electric Illuminating Company of Boston*, 1 S. E. C. 909 at 913 (1936).

²⁹ S. E. C. Release 1541, p. 6 (1938).

³⁰ In the *Matter of Edison Electric Illuminating Company of Boston*, 1 S. E. C. 909 at 914-915 (1936).

of unlisted securities, particularly bonds, and its effect on the over the counter markets.⁸¹ Its discretion has been exercised thus far with caution and discrimination.

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⁸¹ S. E. C. Release 1541, p. 7 (1938).