Securities Regulation -- Unlisted Tradings: A Vanishing Art?

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DUTY OF FAIR REPRESENTATION

Regardless of the technique used by the majority of the Board to conclude that it is an unfair labor practice to breach the duty of fair representation, the courts should hesitate to accept this result. Under its present course of action, apparently approved in Rubber Workers, the Board seems to have established itself as a fair employment practice committee. This development is undesirable for the expansion of the Board's jurisdiction to include fair employment practices has an adverse effect on the primary function of the Board, that of supervising the collective bargaining process. Setting up fair employment standards to be applied by the Board while labor and management engage in collective bargaining would destroy much of the flexibility and perhaps the effectiveness of the collective bargaining process. The extensive supervision required might amount to little less than governmental control of labor-management relations. To those who contend that only the administrative remedy offered by the NLRB is sufficient, one might reply that a potent fair employment practices committee with power to institute court action on a complaint or to give effective remedies for discrimination in employment could achieve the same end as the NLRB without interfering with the present function of the Board.

JAMES NATHAN DUGGINS, JR.

Securities Regulation—Unlisted Tradings: A Vanishing Art?

The historical background of unlisted trading reflects the development of our national securities exchanges. Prior to the evolution of exchanges, local brokers, gathering on street corners, would trade in any available securities. In 1817, the New York Stock Ex-

48 For methods used by the courts to reach desired results see Blumrosen, The Worker and Three Phases of Unionism: Administrative and Judicial Control of the Worker-Union Relationship, 61 Mich. L. Rev. 1435, 1445-46 (1963).

49 Murphy, The Duty of Fair Representation Under Taft-Hartley, 30 Mo. L. Rev. 373, 385-86 (1965).


2 [1958-1959] 25 Sec. Ann. Rep. 71. As early as 1752 American merchants established an "exchange" at Broad Street in New York City, for dealings in meal and water borne produce. At the tip of Wall Street nearest
change, moved indoors and permitted trading in thirty listed stocks by seven member firms and thirteen individual brokers. Any security could be temporarily inserted for trading on the exchange "list" on paying a twenty-five cent fine. A majority vote of members present was required for full listing. In 1869, the newly formed New York Stock Exchange Committee on Stock List promulgated listing requirements and passed on applications for those securities which sought exchange privileges. The strict listing requirements of this committee is an indirect source for modern unlisted trading privileges and practices.

The New York Stock Exchange was primarily a railroad stock market; industrials were considered speculative securities and many could not qualify for listing. When the "Unlisted Department" was created in 1885 securities unable to meet the rigid requirements of the Committee on Stock List were traded on an unlisted basis. The Department, however, was abolished in 1910 pursuant to recommendations made by the Hughes Committee which studied speculation in securities. Today all trading in unlisted securities takes place either on the American Stock exchange or the regional stock exchanges registered under the Securities Exchange Act of 1934. Unlisted trading prior to the enactment of specific legislation consisted of brokers trading in a security, generally without regard to the issuer's wishes, at the request of exchange members. The issuers of these securities were not required to, nor did they undertake to make the informational disclosures required of securities listed on the wharves, a more sophisticated market was developed. Here incoming cargoes of European manufactured goods were auctioned off to local merchants. Meeker, The Work of the Stock Exchange at 61 (rev. ed. 1930) [hereinafter cited as Meeker].

3 Meeker 64.
5 Now the Board of Governors of the New York Stock Exchange.
6 With the creation of the Securities and Exchange Commission, the requirements for listing on the national securities exchanges were supplemented by those for registration. Meeker 451. See also [1958-1959] 25 Sec. Ann. Rep. 72 n.21.
7 Meeker 71.
8 The title of the committee was the New York Governor's Committee on Speculation in Securities and Commodities; however, it is popularly called the "Hughes Committee." Most stocks in the Unlisted Department in 1910 were industrials and were subsequently admitted to listed status. 2 Loss, Securities Regulations 1133 (2d ed. 1961) [hereinafter cited as Loss].
exchanges although the trading mechanics for listed and unlisted issues were identical. A listed security, for comparison, is admitted to trading on an exchange upon the issuer's application to the exchange on which listing is desired. The issuer must file information generally related to corporate and financial organization as a condition to listing. In contrast, unlisted issues will be traded although investors lack the information available as to listed securities.9

A rule of practice on the Philadelphia Stock Exchange in 1876 was that "members may call up the various stocks of any chartered company, whether on the regular list or not."10 Some regional stock exchanges limited this practice and others completely banned it; however, an amended rule of the same stock exchange in 1932 was adopted in substance by the other regional exchanges.11 It provided that "no securities could be admitted to unlisted trading which were not listed on the New York Stock Exchange, New York Curb Exchange, as it was then styled, or the Boston Stock Exchange, Pittsburgh Stock Exchange, or Chicago Stock Exchange."12

The New York Curb Exchange13 was the largest market in unlisted securities in both share and dollar volume prior to the Exchange Act; however, the number of securities enjoying unlisted trading privileges was drastically reduced in the years between 1933 and 1934 resulting from an examination conducted by the New York State Attorney General.14 Findings of speculation and manip-
ulation in unlisted trading prompted Congress to consider legislation.

The original congressional proposals in 1934 were vigorously opposed by the "Curb" and the regional exchanges as they sought immediate abolition of unlisted trading privileges as the solution to the regulatory problem. The exchanges' contended that outright abolition of unlisted trading would result in unwarranted federal regulation. The substance of the retort was four-part. First, the criticized manipulatory practices had been modified after the two year investigation by the New York Attorney General. Second, the exchanges desired to maintain the dollar generating commissions for its member firms and brokers from the existing volume of unlisted trading. Third, regional markets for nationally known issues listed on the New York Stock Exchange were desired where sufficient demand and trading activity was present. And, finally, unlisted trading was an integral and established exchange procedure of long standing.

nated due to inactivity; nevertheless, the "Curb" market retained its position as the largest market for trading in unlisted securities. Loss, 1133.

One such bill was H.R. 7852 to Provide for the Registration of National Securities Exchanges... and to Prevent Inequitable and Unfair Practices on such Exchanges, and for other Purposes. Several eloquent speeches in defense of unlisted trading privileges on the "Curb" were made by its chief executive officer. But E. Burd Grubb, then President of the New York Curb Exchange confessed that:

In the past, the exchange has itself too freely admitted securities to unlisted trading, particularly... where, at the time of admission, no active market in the security existed in the East or in New York. The exchange has recognized these mistakes, and on its own volition, since January 2, 1933, has removed from dealing by reason of inactivity 696 issues of stock and 247 issues of bonds.


Hon. John Dickenson, Assistant Secretary of Commerce and Chairman of the Interdepartmental Committee on Stock Exchange Regulation, stressed the necessity that disciplinary powers over the members and over security issues shall be left primarily for each exchange, each to be responsible to the Federal Stock Exchange Authority for the enforcement of its regulations. If this is not done the moral of the exchange may be destroyed and the Stock Exchange Authority overwhelmed with the policing of alleged violations on all the exchanges of the country.

Id. at 515. Mr. Grubb, President of the "Curb" Exchange, presents a powerful argument for the preservation of the unlisted department on the New York Curb Exchange. Hearings on S. 84, S. 56 and S. 97 Before the House Committee on Banking and Currency, 73rd Cong., 1st Sess., pt. 15, at 7115-23 (1934).
The basic objective of the Exchange Act was to compel public disclosure about exchange-traded securities to investors, the exchanges, and the Securities and Exchange Commission. Section 12 of the Exchange Act imposed the additional requirement of registration of securities with the Commission upon the listing requirements of the national exchanges. Subsection (f) however, excepted securities admitted to exchanges with unlisted trading privileges.

In 1934 Congress directed the SEC to study trading in unlisted securities for two years and then to make recommendations. During this time the Commission could extend until July 1, 1936 unlisted trading privileges for securities so traded prior to March 1, 1934, and extend until July 1, 1935 unlisted trading privileges for any security registered on any other exchange prior to March 1, 1934.

The Commission's 1936 report was submitted by Chairman James M. Landis to the Senate Committee on Banking and Currency. The Commission found that the problem was significant. On the sixteen exchanges permitting trading in unlisted securities during 1935, security issues of listed companies exceeded those of unlisted companies by 365 issues; however, the volume of shares of securities traded on an unlisted basis exceeded those of listed securities by 548,514,503 shares. Also, bonds admitted on the same exchanges with unlisted trading privileges had a total face value exceeding that of listed bonds by 675,293,516 dollars. The "Curb," the largest primary market for unlisted trading, had 753 issues of stock, comprising 600,051,527 shares, and 522 bond issues, with a total face value of 6,381,843,636 dollars, appearing on the exchange with unlisted trading privileges. The Commission concluded that the solution to the problem of regulating unlisted trading did not lie in termination. It observed that issues not admitted to unlisted trading privileges were traded on the over-the-counter market. Many issuers would not attempt to comply with exchange listing requirements but if the issues retained unlisted trading privileges, there would be a great degree of surveillance than if the

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17 Report on Trading 1.
18 Trading in Unlisted Securities upon Exchanges, Hearings on S. 4023 Before the Senate Committee on Banking and Currency, 74th Cong., 2d Sess. at 1, 3 (1936).
19 Report on Trading 4-5.
20 Id. at 7-16.
securities were traded solely on the over-the-counter market where no means were yet devised to register the securities or compel needed disclosures. Thus the imperfect status quo would better serve the investing public than would abolition of the privilege.\textsuperscript{21} Furthermore, the Commission found that if unlisted trading were to be terminated, there would be a danger of decline in security values due to section 7(c) of the Exchange Act and Regulation T of the Federal Reserve Board and the smaller exchanges would be endangered.\textsuperscript{22} Also, the Commission favored the opportunity to extend the scope of exchange trading in securities for which an exchange market is appropriate and where full information is available.\textsuperscript{23} The recommendations contained in the Commission's report\textsuperscript{24} were

\textsuperscript{21} Ibid.
\textsuperscript{22} Ibid.
\textsuperscript{23} Ibid.
\textsuperscript{24} 1. Subsection (f) of section 12 of the Securities Exchange Act of 1934 should be amended to provide—
   a) That unlisted trading privileges on any exchange to which any security had been admitted prior to March 1, 1934, may be continued beyond June 1, 1936, on such terms and conditions as the Commission may by rules and regulations prescribe as necessary or appropriate for the protection of investors or to prevent evasion of the purposes of the Act. No expiration date should be expressly set, but the Commission should continue to have the power to bring about the termination of this situation in part or as a whole.
   b) That securities the issuer of which has duly registered any security on an exchange pursuant to section 12 may, during the period when such other registration is effective, be admitted to trading on any exchange in accordance with such terms and conditions as the Commission may by rules and regulations prescribe as necessary or appropriate for the protection of investors and to prevent evasion of the Exchange Act.

2. The Commission should thereupon proceed expeditiously to perfect regulations and a program of administration designed to make effective for all securities traded on an unlisted basis on exchanges requirements concerning adequacy of public distribution, degree of local trading activity, minimum information to be supplied, and other requirements necessary to assure a properly functioning market on such exchanges for such securities. Such a program could be put into effect pursuant to section 6(a) section 12(f) and section 19(b) of the Securities Exchange Act of 1934.

3. The existing power of the Commission to bring about adequate reporting by issuers of substantial size, whose securities have a wide public distribution, should be perfected to the end that there be information supplied by these issuers comparable to that now furnished by those who have registered their securities on an exchange. That end being attained, the Commission should then be empowered to prescribe terms and conditions under which the securities of these issuers should be permitted to enjoy an exchange market, where the public interest, not subjected to the sole control of management, would be furthered by the creation of an exchange market.

Three categories of the securities can be traded on an unlisted basis on national exchanges without registration. The privilege can only be continued or extended by the applicant exchange. Commission approval will follow, if the security meets the requirements of one of the three categories. The first category ("clause 1 securities"), adopting the recommendations of the Commissions study, provides for continuation of unlisted trading in a security if such security was admitted to the applicant exchange prior to March 1, 1934. Clause (1) is a "grandfather clause," as it represents "historical or classical" unlisted trading. The first category is restricted and admissions to it are necessarily unavailable. For the second category (so-called "clause 2 securities"), also recommended by the Commissions study, unlisted trading privileges in any security may be continued or granted by the applicant exchange if the security is also duly listed and registered on any other national securities exchange. There, multiple or dual trading, on more than one national exchange, is available under clause (2). This privilege remains in effect only so long as the security remains both listed and registered on another national securities exchange. The third category ("clause 3 securities") permits unlisted trading privileges for securities which are not listed on any other national exchange if they comply with the registration requirements of either the Exchange Act or the Securities Act of 1933. The theory of this privilege is that the information concerning these issues is "substantially equivalent to that available in respect to a security duly listed and registered on a national securities exchange." Clause (3) is self-policing as the privilege remains effective only so long as the informational disclosures are kept current. The aim of clause (3) was to "enhance the scope of unlisted trading" because securities previously traded solely over-the-counter could now seek an exchange market; hence


See note 24 supra.

See note 24 supra.

"The terms 'multiple' and 'dual' are used more or less interchangeably in this context, the former, of course, implying that the phenomenon of 'dual' trading may extend to several different markets." SEC, Report of Special Study of Securities Markets pt. II, at 809 (1963).

it represented a compromise between the exchange and the over-the-counter market.\textsuperscript{29} It was found that the "public interest would be served by exchange trading although the issuer did not itself seek it."\textsuperscript{30} Clause (3) ties in with section 15(d) of the Exchange Act since it extended unlisted trading privileges to securities traded on the over-the-counter market. Through this section, Congress perfected the Commission’s power to bring about reliable disclosures of widely distributed securities generally unavailable to the public prior to section 15(d).\textsuperscript{31}

The general policy of subsection 12(f) is that the Commission shall continue or extend unlisted trading privileges by approving only those applications which are "necessary or appropriate in the public interest or for the protection of investors." When approval of applications to extend unlisted trading privileges is sought pursuant to clauses (2) and (3), a hearing is held by the Commission at which it is determined whether the general policy of Subsection 12(f) is met. The applicant exchange must demonstrate that in the "vicinity of the exchange"\textsuperscript{32} there is sufficiently widespread public distribution and trading activity\textsuperscript{33} in the issuer’s securities that un-

\textsuperscript{29} Loss 1134.
\textsuperscript{30} Report on Trading 25.
\textsuperscript{31} Hearings on S. 4023 Before the House Committee on Interstate and Foreign Commerce, 74th Cong., 2d Sess. at 4 (1936).
\textsuperscript{32} The concept of "vicinity of the exchange" has resulted in a multitude of litigation by the various securities exchanges. The interpretation originally given in the Matter of Applications by the New York Curb Exchange, 3 S.E.C. 81 (1938) was later adhered to. There, the Commission concludes: "that the claim of the Curb Exchange to a vicinity including the whole United States is not sustained. . . . Rather, we interpret 'vicinity' to mean 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." Id. at 85. The Commission has consistently held, as did the Third Circuit in National Ass'n of Securities Dealers v. S.E.C., 143 F.2d 62 (3d Cir. 1944), that the vicinity of the New York Curb Exchange is Massachusetts, Rhode Island, Connecticut, New York, New Jersey, Pennsylvania and Ohio with respect to certain bonds. Compare In the Matter of Application by the Baltimore Stock Exchange, 12 S.E.C. 516 (1942) (State of Maryland held the vicinity of the Baltimore Exchange); In the Matter of Application by the Boston Stock Exchange, 12 S.E.C. 658 (1943) (vicinity of the applicant exchange held all of New England except Fairfield County, Conn.); In the Matter of Application by the Chicago Stock Exchange, 9 S.E.C. 805 (1941) (State of Illinois held vicinity of the Chicago Stock Exchange). The vicinity of substantially every stock exchange has been litigated. For a complete list of the decisions and a review of their holdings, see 2 CCH Fed. Sec. L. Rep. ¶ 23, 241 (1966). See also Loss 1136-1137.
\textsuperscript{33} In the Matter of the Boston Stock Exchange, 3 S.E.C. 691 (1938).
listed trading privileges for such securities is "necessary or appropriate in the public interest or for the protection of investors." The Commission is neutral in this determination and is in no way influenced by the fact that an exchange files under clause (2) (because such security also enjoys listed and registered trading status on another national exchange) or clause (3) (where an issue has traded on the over-the-counter market). The SEC criteria do not favor clause (2) over clause (3) applicants or vice versa; however, the ultimate determination to be made is "whether under the statutory standards a market on the particular exchange is an appropriate medium for trading in the particular security."

An application under clause (3) will be granted only upon terms and conditions which will subject the issuer, its officers and directors, and any beneficial owner of more than ten percent of the security to duties substantially equivalent to those applicable to securities listed and registered on a national exchange. For example, if a certain security is subject to a regulatory standard other than the Exchange Act, the periodic reporting, proxy solicitation and insider trading provisions of that other statute would be compared to sections 13, 14 and 16 of the Exchange Act to determine whether the substantially equivalent test is met. This requirement is best illustrated by In the Matter of Applications by the New York Curb Exchange for Unlisted Trading Privileges in American Gas and Electric Company, Public Service Company of Colorado and The Washington Water Power Company. Here the "Curb" sought

Here, an application for extension of unlisted trading privileges under subsection 12(f), Clause (2) of the Exchange Act was granted. Of the 1,500,000 shares that were outstanding, 245,100 or approximately 16 2/3% were held by 3,299 shareholders in New England. For the twelve months ended on April 30, 1938 the volume of trading in the security was 7,325 shares as contrasted to the volume in 1937 of 11,309 shares. This volume was compared to that in the same security on the New York Stock Exchange which amounted to 514,000 shares for the same 1937 period. The Commission found that there exists sufficient public distribution and trading activity in the vicinity of the applicant exchange to render the extension of unlisted trading privileges.

*Footnotes*

34 Loss 1135-1136.
35 In the Matter of Applications by the New York Curb Exchange, 7 S.E.C. 672 (1940). The securities represented were three series of multi-interest-bearing sinking fund debentures and cumulative preferred stock of American Gas and Electric Company, mortgage bonds and sinking fund debentures of Public Service Company of Colorado, and mortgage bonds of The Washington Water Power Company. Later it was agreed between the Commission and counsel for the New York Curb Exchange that first
SEC approval under section 12(f)(3) of the Exchange Act of unlisted trading privileges of securities of an issuer subject to section 15(d) of the Exchange Act and registered under the Public Utilities Holding Company Act of 1935. Although the bonds and debentures would not normally be subject to the proxy solicitation requirements of section 14 of the Exchange Act, the companies were already subject to equivalent proxy regulation under the Holding Company Act. Only the preferred stock of American Gas was an equity security as defined in section 3(a)(11) of the Exchange Act. Section 16 of the Exchange Act would be inapplicable to transactions by the officers, directors and beneficial holders of more than ten per cent of the bonds and debentures. The Holding Company Act by section 17(a) and (b) imposed restrictions upon officers and directors similar to those of sections 16(a) and (b) of the Exchange Act. However, section 16(c) of the Exchange Act did not have a regulatory counterpart in the Holding Company Act, so that short term trading as well as short selling of equity securities by "insiders" was not regulated. Counsel for the "Curb" produced a letter from American Gas which stated that the corporate records disclosed that no shareholder held in excess of ten per cent of the preferred stock. Furthermore, the manager of the "Curb's" Unlisted Trading Division testified that short selling in the preferred stock could not readily be anticipated due to the quality investment grade of the stock and the market price; this indicated that the security was selling at a substantial premium. The Commission found that since the investment grade of the preferred stock negated a potential for speculative short selling by "insiders" and since the corporate records disclosed no shareholders owning more than ten per cent of the equity security, the applications for extension should be approved.

and refunding mortgage bonds in Pennsylvania Electric Company be included as a part of the applications.


7 In the Matter of Applications by the New York Curb Exchange, 7 S.E.C. 672, 675 (1940).

8 It is interesting to note that when the Curb attempted to procure an agreement from the issuer, American Gas and Electric Company, to the effect that its officers and directors would not sell its preferred stock short, the issuer responded that "it would not in any way associate itself or become obligated in connection with the application of the New York Curb Exchange for the extension of unlisted trading privileges to this preferred stock." Id. at 677.
The Commission may suspend the privilege of unlisted trading for a period not exceeding twelve months if for the protection of investors. If an exchange seeks to continue or extend unlisted trading privileges under clause (1) for a security which its issuer has withdrawn from exchange listing, the Commission may terminate trading in that security unless the issuer can establish that de-listing was not designed to evade the policies of subsection 12(f) of the Exchange Act.

Prior to the Exchange Act brokers traded in securities not listed upon exchanges without regard to the issuer’s wishes. The Exchange Act responded by providing that an issuer, market making broker or dealer or anyone having a bona fide interest in terminating or suspending a security’s unlisted trading privileges may apply to the SEC for an order to that effect. The Commission may also on its own motion suspend or terminate such privileges on finding this is necessary for investor protection. General objection to exchange trading, inadequate public distribution of the security in the “vicinity of the exchange” and insufficient trading activity are specifically assigned as reasons for suspension or termination.

When an applicant exchange seeks unlisted trading privileges under clause (1) for a security which has delisted from a national exchange, or when an application is filed under clauses (2) and (3), or whenever the Commission or others would suspend or terminate unlisted trading in a security, appropriate notice and opportunity for a hearing must be given to parties directly affected by the Commission not later than ten days prior to the hearing.

Securities for which unlisted trading privileges have been continued or extended are deemed to be registered on a national securities exchange and the rules of that exchange will be subject to review by the Commission by virtue of its power under section 19(b) of the Exchange Act. This section provides that the Commission may make a written request to a national securities exchange suggesting that the exchange effect a change in its rules and procedures. If the changes suggested by the Commission are not effectuated and the Commission feels that the changes are necessary to insure fair dealings in securities traded on the exchanges, it

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40 Exchange Act § 12(f) (3).
41 Exchange Act § 12(f) (4).
42 Exchange Act § 12(f) (2).
43 Exchange Act § 12(f) (3-4).
44 Exchange Act § 12(f) (3-4).
or for the protection of investors," either unconditionally, upon specified terms and conditions, or for stated periods exempt such securities from the operation of any provisions of section 13, 14 or 16 of the Exchange Act.\textsuperscript{45}

The Securities Acts amendments of 1964 extended registration and the requirements formerly applicable only to securities listed on national securities exchanges under the Exchange Act, to many securities traded on the over-the-counter market. As for unlisted securities, the 1964 amendments modified clause (1), left substantially unchanged clause (2) and eliminated clause (3). These changes made by the amendments reflect the recommendations made by the Report of the Special Study of Securities Markets of the Securities and Exchange Commission.\textsuperscript{46}

Clause (1) was an anomaly and remains so. Although section 12(f)(6) declares that securities admitted to unlisted trading privileges shall be deemed registered, clause (1) securities are not so at all. These securities admitted to trading on a national exchange on an unlisted basis prior to March 1, 1934 may today continue to be traded on that basis with Commission approval upon application by the exchange which originally admitted the security.\textsuperscript{47} With the class limited by statute and continuation of the privilege resting in the Commission's discretion, time alone by means of "retirement, redemption, liquidation, reorganization, or the transition of seasoned securities to a listed status\textsuperscript{48}" will gradually eliminate clause (1) securities. Congress found no reason to change the general pattern in respect to clause (1) securities even though pursuant to law disclosures provided for in sections 13, 14 and 16 of the Exchange Act need not be made. Furthermore, the Special Study in its 1963 report noted that if a clause (1) security was required either to register or make disclosures substantially equivalent to securities listed and registered on national exchanges pursuant to sections 12(g) or 15(d) of the Exchange Act, the initial clause (1) exemp-

\textsuperscript{45} Section 13 is concerned with periodic reports; section 14 with proxy solicitation requirements; and section 16 deals with duties in regard to officers, directors and principal shareholders of issuers.

\textsuperscript{46} SEC, REPORT OF SPECIAL STUDY OF SECURITIES MARKETS pt. II, at 809 (1963).

\textsuperscript{47} EXCHANGE ACT § 12(f)(1)(A).

tion from sections 13, 14 and 16 of the Exchange Act would be meaningless. This is because the disclosures made under sections 12(g) and 15(d) of the Exchange Act are substantially equivalent to those under sections 13, 14 and 16. The unfortunate anomaly of clause (1) securities still exists, but only in the minutest detail.

The amendments left clause (2) securities substantially unchanged. The reason for maintaining the status quo can be explained by statutory interpretation. The statute provides that unlisted trading privileges on a national exchange may be extended "to any security duly listed and registered on any other national securities exchange." If the Commission has available section 13, 14 and 16 disclosures, by virtue of the fact that the security admitted to unlisted trading privileges is also listed and registered on another national exchange, the information need not be duplicated. However, if admission to the privilege of unlisted trading was originally predicated upon the fact that a security was listed and registered on another national exchange and delisting subsequently follows, unlisted trading privileges on all exchanges must terminate.

The Commission in its 1936 report emphasized the importance of securing registration of securities traded on the over-the-counter market. If listed and registered securities are subject to the provisions of sections 13, 14 and 16 of the Exchange Act, it is arguable that securities traded over-the-counter should be as well as they have no exchange surveillance. Prior to the amendments few exchange applicants filed pursuant to clause (3) and fewer were granted. It was the least used and legally the most troublesome of the three clauses. By extending sections 13, 14 and 16 of the Exchange Act

50 Section 15(d) of the Exchange Act, as amended, provides that the obligation of an issuer to file periodic reports is suspended if, and so long as, the issuer has a class of securities registered pursuant to section 12 of the Exchange Act. Section 12(g) of the Exchange Act requires an issuer of securities traded on the over-the-counter market, with total assets exceeding 1,000,000 dollars and a class of non-exempt equity security held of record by 750 or more persons to be reduced to 500 after July 1, 1966, to register such security by filing a registration statement with the Commission within 120 days after the last day of its first fiscal year ended after July 1, 1964 on which it meets the above standards. The revision of section 15(d) and the addition of section 12(g) necessitated certain amendments to Rule 12f-4, which provides exemptions from sections 13, 14 and 16 of the Exchange Act for issuers having securities admitted only to unlisted trading privileges. See SEC Exchange Act Release No. 34-7491 (1965).
to cover certain issuers whose securities are not listed on a national exchange by means of sections 12(g) and 15(d), it would follow that those securities traded on the over-the-counter market would immediately qualify for unlisted trading privileges under clause (3). Numerous applications would be filed by exchanges seeking to extend unlisted trading privileges for these securities; hence, clause (3) was deleted by the amendments. \(^5\) The extension of the registration requirements of the Exchange Act to 12(g) over-the-counter issuers not only was consistent with the policy of the Exchange Act but by subjecting large over-the-counter issuers to the same requirements as issuers of listed securities, it eliminated many of the immunities formerly enjoyed by over-the-counter securities and thus made formal listing more attractive.

The amendments eliminate the criteria of public distribution and trading activity in the "vicinity of the exchange" in determining whether or not to extend or continue unlisted trading privileges although these remain factors to weigh in the Commission's decision. The main question now is whether or not the privilege is "necessary or appropriate in the public interest or for the protection of investors." \(^6\)

The 1964 amendments delete the provision requiring differentiation between listed and unlisted security quotations, \(^5\) because the Commission's authority under the Exchange Act could not be extended to enjoin "outsiders" from withholding the "U" and "L" designations which were required by law when an exchange published the transactions and quotations. \(^5\) In determining if the public interest is best served by suspending, terminating, continuing and extending unlisted trading privileges, the Commission is provided leeway by the liberalized investor protection approach provided for by the amendments.

I. Rule 12(f)-1: Applications for Permission to Extend Unlisted Trading Privileges

To extend unlisted trading privileges under subsection 12(f)(1) of the Exchange Act, \(^5\) an application executed by a duly authorized


\(^6\) Exchange Act section 12(f) (prior to 1964 Amendments) second paragraph.


\(^5\) See note 42 supra.

officer of the exchange must be filed with the Commission. It must identify the issuer as well as the security and contain data, and its source, in respect to public distribution and trading volume in the security in the "vicinity of the exchange" for a specified period preceding the date of the application. The Commission also requires that other information "pertinent to the question of whether the continuation or extension of unlisted trading privileges in such security is necessary or appropriate in the public interest or for the protection of investors" be included in the application.

II. Rule 12(f): Changes in Securities Admitted to Unlisted Trading Privileges

When there is a change in a clause (2) security, it shall be considered the same security admitted to unlisted trading privileges if, under Regulation 12B and Regulation 12D, its issuer need not file a new application for registration with the SEC to continue listed registered status on a national securities exchange.

The following Illustrations will be utilized to clarify the remaining provisions of this rule:

Illustration 1: XYZ Corp.'s charter authorizes 1,000,000 shares of five dollar par value Class "B" common stock of which 100,000 are outstanding. On January 1, 1966, XYZ's securities have been admitted to unlisted trading privileges on a national exchange. The securities do not enjoy trading privileges on any other national exchange. The corporation has paid a quarterly dividend of twenty-five cents per share for the past two years. On July 1, 1966, the majority of the Board of Directors, in accordance with the provisions in the by-laws, resolves the following:

A) Due to dissatisfaction with the corporate name, XYZ changes its name to ABC Corp., and changes the name of the class "B" common stock to class "A" common.
B) Due to substantial non-recurring losses sustained in the preceding calendar year, the quarterly dividend is reduced to ten cents per share.
C) Due to contemplated expansion, the par value of class "B"

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68 17 C.F.R. § 240.12B (1964). These rules are concerned with registration and reporting.
69 17 C.F.R. § 240.12D (1964). These rules specify the effectiveness of registration and exchange certificates.
common stock (now class "A") is reduced from five to 2.50 dollars per share and the number of shares authorized is correspondingly increased to 2,000,000 shares.

The Secretary of XYZ Corp. notifies the national exchange on which the securities are enjoying unlisted trading privileges, and the exchange notifies the Commission of such changes on Form 27. XYZ's securities are deemed the same securities theretofore admitted to unlisted trading privileges on such national exchange.61

Illustration 2. Assume all facts in Illustration 1 are true, but the Board also resolves that:

D) The newly named ABC Corp. and DEF Corporation will consolidate on July 30, 1966 into the ABF Corporation.

E) In honor of the Chairman of the Board, on July 8, 1966, 125,000 shares will be issued as a gift to him for fifty years of service to ABC Corp.

The exchange and the Commission are notified of the changes as in Illustration 1, but in addition the exchange, through a duly qualified officer, files an application with the Commission which identifies the issuer and the security and gives a brief description of each change in the security together with a copy of all the written matter submitted to shareholders relating to the changes. If the Commission determines that after the resolved changes are completed the security is substantially equivalent to that which was originally granted unlisted trading privileges, the security shall be deemed the same, and unlisted trading privileges in it may continue on the applicant exchange. The Commission should find that the security is the same in each illustration.62

III. Rule 12(f)-3: Termination or Suspension of Unlisted Trading Privileges

The applicant desiring suspension or termination of unlisted trading privileges in a security traded on a national exchange must

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62 17 C.F.R. § 240.12f-2(a) (3), (b) (1964). Note that a major change in the capitalization of the issuer can be accomplished by merger, consolidation, or acquisition of assets or securities as well as a similar transaction. A sale of securities for cash, a stock dividend or stock split is not included in that category; however, where the number of shares of the issuer's outstanding stock has been increased by more than 100% within any twelve consecutive calendar months, this will be considered a major change in capitalization. Also, if an application is filed pursuant to Rule 17 C.F.R.
identify itself, the issuer, and the security and must state its interest in the security and reasons for suspension or termination. Information, and its source, regarding the character and volume of trading activity and public distribution of the security for specified periods must also be furnished. Furthermore, if the exchange desires to suspend or terminate unlisted trading privileges in such security, it may do so according to its own rules after which it must notify the Commission promptly on Form 28 as to the action it has taken.

IV. Rule 12(f)-4: Exemption of Securities Admitted to Unlisted Trading Privileges From Sections 13, 14 and 16

Section 12(f) (6) of the Exchange Act provides that a security admitted to unlisted trading privileges on a national exchange shall be deemed registered, but the Commission may exempt any security from the operation of section 13, providing for periodic disclosures of the issuer’s financial and managerial operations, section 14, relating to proxy solicitation requirements, and section 16, protecting against “insider” dealings in the issuer’s securities.

Rule 12(f)-4(a) exempts a security traded on an unlisted basis from the requirements of section 13 of the Exchange Act unless it falls within either of two categories. The first group includes the original security for which the privilege has been granted or another security of the same issuer listed and registered on another national exchange, or registered under section 12(g) of the Exchange Act. The second encompasses those securities which, but for the “deemed-registered” provision of section 12(f) (6), would be required to file data under section 15(d) of the Exchange Act.

Rule 12(f)-4(b) provides that clause (2) securities or those required to register under section 12(g) of the Exchange Act are not exempt from section 14, but all other securities for which unlisted trading privileges have been extended or continued are so exempt.

Rule 12(f)-4(c) (1) provides an exemption from section 16 of the Exchange Act in respect to equity securities for which unlisted trading privileges have been continued or extended. Equity securi-

§ 240.12f-2(b) (1964), Form 27 of the Securities and Exchange Commission need not be filed.

63 17 C.F.R. § 240.12f-3 (1964).
64 17 C.F.R. § 240.12f-4 (1964).
ties in the first category, however, are not exempt. "Any equity security for which unlisted trading privileges on any national securities exchange have been continued or extended pursuant to section 12(f) of the Act and which is not listed and registered on any other such exchange or registered pursuant to section 12(g) of the Act shall be exempt from section 16 of the Act insofar as that section would otherwise apply to any person who is directly or indirectly the beneficial owner of more than 10 per cent of such security, unless another equity security of the issuer of such unlisted security is so listed or registered and such beneficial owner is a director or officer of such issuer or directly or indirectly the beneficial owner of more than 10 per cent of any such listed or registered security."\textsuperscript{95, 96}

V. RULE 12F-6: CONTINUANCE OF UNLISTED TRADING PRIVILEGES IN MERGER EXCHANGES:\textsuperscript{87}

If a clause (1) security is traded on a national exchange which is absorbed by another, the privilege continues without further order of the Commission if the vicinity of the absorbed exchange includes that of the surviving exchanges. The same rule is applicable to clause (2) and (3) securities. The vicinity of the exchange is determined by the United States Bureau of the Census.\textsuperscript{98}

The statutes have been analyzed, the regulations set forth and the effects of the amendments have been noted. What is the future of unlisted trading privileges? Clause (1) securities admitted to unlisted trading privileges prior to July 1, 1964 may continue to enjoy the privilege.\textsuperscript{99} The repeal of clause (3) does not in any way affect the extension of unlisted trading privileges to a security already listed and registered on another national exchange;\textsuperscript{100} in fact, the

\textsuperscript{95}17 C.F.R. § 240.12f-4(c)(2) (1964). See also SEC Exchange Act Release No. 34-7491 (1965), amended paragraphs (a), (b), and (c) of Rule 12f-4, and added paragraph (d) which provides, "Any reference in this rule to a security registered pursuant to section 12(g) of the Act shall include, and any reference to a security not so registered shall exclude, any security as to which a registration statement pursuant to such section is at the time required to be effective."


\textsuperscript{97}17 C.F.R. § 240.12f-6 (1964).

\textsuperscript{98}17 C.F.R. § 240.12f-7 (1964). See also SEC Exchange Act Release No. 34-7397 (1964). This rule served a transitional purpose. It is of no importance today.

\textsuperscript{99}Exhibit Act § 12(f)(1)(A).

\textsuperscript{100}Exhibit Act § 12(f)(1)(B).
amendments proscribe admission to the privilege if the issuer's securities are not listed and registered on at least one other national exchange.\textsuperscript{71}

Commission surveys for the preceding four years\textsuperscript{72} validated the SEC's forecast in its 1936 report that clause (1) securities would gradually diminish in number and importance. Some issuers have chosen to list their securities on national exchanges, and others whose securities previously enjoyed the privilege have liquidated, merged or in other ways terminated an unlisted trading status which at one time existed. Today almost all trading in clause (1) securities is conducted on the American Stock Exchange (formerly the "Curb").\textsuperscript{73}

The future of unlisted trading lies in clause (2) securities which are registered and listed on one national securities exchange but enjoy unlisted trading privileges on another. All securities traded on the New York Stock Exchange are listed only after approval by the Exchange's Board of Governors. No securities traded on any other exchange may be traded on an unlisted basis on the New York Stock Exchange. However, securities listed and registered on the "Big Board" may be traded on an unlisted basis on regional securities exchanges. The American Stock Exchange, on the other hand, does not trade in securities listed and registered on the New York Stock Exchange, under a firmly established policy. The American Exchange is the home of clause (1) securities and many issues of old established nationally known securities still enjoy exchange trading there without complying with the registration requirements of section 12 of the Exchange Act.

Although the American Exchange does not trade in securities listed and registered on the "Big Board," it does trade in issues listed and registered on the various regional exchanges. However, trading volume in clause (2) securities on the American Exchange is apt to remain relatively constant, if not decrease. The reason stems mainly from the exchange's policy decision. Moderate size issuers considering listing on a national exchange will tend to prefer the New York Stock Exchange. The "Big Board" is the largest national exchange and is located closest to the major sources of

\textsuperscript{71} Ibid.
\textsuperscript{72} See generally [1961-1965] 28-31 SEC. ANN. REP.
\textsuperscript{73} See Chart 1 supra.
world capital. The regional exchanges have a self-imposed monopoly on trading in clause (2) securities listed and registered on the "Big Board."

Many smaller issuers will list their securities only on a regional exchange because they are known only in the exchange vicinity. If the American Exchange trades only in the latter class of securities on an unlisted basis, most share volume of clause (2) securities will be transacted on the regional exchanges. The liquidity of regionally listed issues on the American Exchange will most probably be less impressive than that of nationally traded issues also traded on regional exchanges. This is because the "float" of outstanding securities of an issuer listed on the "Big Board" proportionally exceeds that of securities listed on regional exchanges, and also because the supply and demand factor would be similar to that of the New York Stock Exchange. It seems clear that the future of unlisted trading lies on the regional securities exchanges where securities listed and registered on the New York and American Stock Exchanges can be traded on an unlisted basis pursuant to clause (2).

Statistics for the calendar years ending June 30, 1962 through 1965, indicate a positive increase in clause (2) securities. Seven regional exchanges have more stocks traded under clause (2), and four have a greater volume of shares traded in this category than the American Exchange. In view of the trends reported by the Commission, it is not inconceivable that in the next two decades no clause (2) securities will be traded on the American Exchange. However, the American Exchange will continue to be the home of unlisted trading in "historical" clause (1) securities, but over the years this class will be eliminated.

The evidence to date indicates that within the next two decades all clause (2) trading will be transacted on the regional exchanges. Aside from the statistically demonstrable trends, this statement finds further support in the strong policy of the American Exchange to encourage full listing.

Even so, the regional exchanges favor multiple trading. The President of the San Francisco Stock Exchange recently declared that:

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*74 See note 72 supra.
*75 See Chart II infra.
*76 The statement was presented before the Senate Committee on Banking and Currency of the 84th Congress. See note 77 infra.
"[T]rading in dual issues by our exchange does not constitute a duplication of trading on the New York Stock Exchange, but on the contrary provides an important supplementary market which has proven to be in the public interest. Members of our exchange generate orders in these securities for the very reason that they are traded here. If they were not listed locally, member firms might well recommend to their clients other securities of equal value that were listed locally rather than those traded only in Eastern markets." 77

A similar view is taken by the Vice President and Secretary of the Midwest Stock Exchange.

There is no doubt that dual trading will benefit the regional exchanges; in fact, the increase in dual trading activity in the past few years has raised internal standards of supervision of trading on the regional exchanges, and undoubtedly the regional exchanges will perfect and enforce their rules and regulations so as to minimize the opportunity for manipulation in unlisted securities.

Although the volume of trading in unlisted stocks and bonds is decreasing yearly on the American Stock Exchange, unlisted trading on the regional securities exchanges is only beginning to exhibit its importance. Clearly the practice of unlisted trading is not a vanishing art, but rather a mushrooming innovation presently emerging on the regional exchanges which might cause regulatory concern to the SEC in the years ahead.

STEVEN H. LEVENHERZ

### Chart I

#### Part I

**Number of Stocks on the Exchanges in the Various Unlisted Categories as of June 30, 1965**

<table>
<thead>
<tr>
<th>Exchanges</th>
<th>Unlisted Only</th>
<th>Listed and Registered on Another Exchange</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Clause (1)</td>
<td>Clause (2)</td>
</tr>
<tr>
<td></td>
<td>Clause (3)</td>
<td>Clause (1)</td>
</tr>
<tr>
<td></td>
<td>Clause (2)</td>
<td>Clause (3)</td>
</tr>
<tr>
<td>American</td>
<td>113</td>
<td>2</td>
</tr>
<tr>
<td>Boston</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Chicago Board of Trade</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Cincinnati</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Detroit</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Honolulu</td>
<td>13</td>
<td>0</td>
</tr>
<tr>
<td>Midwest</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Pacific Coast</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td>Phila.-Balt.-Washington</td>
<td>2</td>
<td>0</td>
</tr>
<tr>
<td>Pittsburgh</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Salt Lake</td>
<td>2</td>
<td>0</td>
</tr>
<tr>
<td>Spokane</td>
<td>3</td>
<td>0</td>
</tr>
<tr>
<td>Wheeling</td>
<td>4</td>
<td>0</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>134</strong></td>
<td><strong>2</strong></td>
</tr>
</tbody>
</table>

1. SEC, 31st Ann. Rep., Table 9, 171 (1965). The categories used reflect Clauses (1), (2), and (3) of section 12 (f) of the Exchange Act, as in effect prior to the 1964 Amendments.

2. None of these issues have listed stocks on domestic exchanges.

3. These have become listed and registered on other national securities exchanges subsequent to the time they were admitted to unlisted trading privileges.

4. The Wheeling Stock Exchange dissolved and terminated its exemption from registration as a national securities exchange effective 4/30/65.

5. Duplication of issues among exchanges bring the figures to more than the actual number of issues involved.

### Chart I

#### Part II

**Unlisted Share Volumes on the Exchanges—Calendar Year 1964**

<table>
<thead>
<tr>
<th>Exchanges</th>
<th>Unlisted Only</th>
<th>Listed and Registered on Another Exchange</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Clause (1)</td>
<td>Clause (2)</td>
</tr>
<tr>
<td></td>
<td>Clause (3)</td>
<td>Clause (1)</td>
</tr>
<tr>
<td></td>
<td>Clause (2)</td>
<td>Clause (3)</td>
</tr>
<tr>
<td>American</td>
<td>23,574,054</td>
<td>16,940</td>
</tr>
<tr>
<td>Boston</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Chicago Board of Trade</td>
<td>0</td>
<td>2,190,933</td>
</tr>
<tr>
<td>Cincinnati</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Detroit</td>
<td>0</td>
<td>548,502</td>
</tr>
<tr>
<td>Honolulu</td>
<td>65,180</td>
<td>0</td>
</tr>
<tr>
<td>Midwest</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Pacific Coast</td>
<td>23,429</td>
<td>0</td>
</tr>
<tr>
<td>Phila.-Balt.-Wash.</td>
<td>3</td>
<td>6,010,126</td>
</tr>
<tr>
<td>Pittsburgh</td>
<td>0</td>
<td>243,426</td>
</tr>
<tr>
<td>Salt Lake</td>
<td>406</td>
<td>0</td>
</tr>
<tr>
<td>Spokane</td>
<td>841,300</td>
<td>0</td>
</tr>
<tr>
<td>Wheeling</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>24,504,389</strong></td>
<td><strong>16,940</strong></td>
</tr>
</tbody>
</table>

1. SEC, 31st Ann. Rep., Table 9, 171 (1965). The categories used reflect Clauses (1), (2), and (3) of section 12 (f) of the Exchange Act, as in effect prior to the 1964 Amendments.

2. None of these issues have listed stocks on domestic exchanges.

3. These have become listed and registered on other national securities exchanges subsequent to the time they were admitted to unlisted trading privileges.

4. The Wheeling Stock Exchange dissolved and terminated its exemption from registration as a national securities exchange effective 4/30/65.

5. Duplication of issues among exchanges bring the figures to more than the actual number of issues involved.
In previous reports attention was called to the fact that since the enactment of the Securities Exchange Act of 1934, with its prohibitions and restrictions against the admission of new securities to unlisted trading, the volume of trading in fully listed securities (particularly stocks) is coming to represent an ever-increasing proportion of the total trading volume of the Exchange. This trend continued in 1965 as evidenced by the following table, from which it will be noted that the percentage of trading volume in fully listed stock issues on the Exchange in 1965 amounted to 92.82%, compared with 91.15% in 1964.

<table>
<thead>
<tr>
<th>Year</th>
<th>Listed</th>
<th>Unlisted</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1965</td>
<td>495,858,689 (92.82%)</td>
<td>38,363,810 (7.18%)</td>
<td>534,221,999 (100%)</td>
</tr>
<tr>
<td>1964</td>
<td>341,066,678 (91.15%)</td>
<td>33,117,164 (8.85%)</td>
<td>374,183,842 (100%)</td>
</tr>
<tr>
<td>1963</td>
<td>286,826,110 (90.56%)</td>
<td>29,908,952 (9.44%)</td>
<td>316,735,062 (100%)</td>
</tr>
<tr>
<td>1962</td>
<td>276,090,210 (90.47%)</td>
<td>32,519,094 (10.53%)</td>
<td>308,609,304 (100%)</td>
</tr>
<tr>
<td>1961</td>
<td>436,162,950 (89.82%)</td>
<td>30,659,043 (10.18%)</td>
<td>466,822,000 (100%)</td>
</tr>
</tbody>
</table>

**BONDS**

<table>
<thead>
<tr>
<th>Year</th>
<th>Listed</th>
<th>Unlisted</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1965</td>
<td>$141,748,000 (90.48%)</td>
<td>$7,562,000 (5.62%)</td>
<td>$149,310,000 (100%)</td>
</tr>
<tr>
<td>1964</td>
<td>98,246,000 (94.57%)</td>
<td>5,494,000 (5.43%)</td>
<td>103,740,000 (100%)</td>
</tr>
<tr>
<td>1963</td>
<td>71,662,000 (92.71%)</td>
<td>5,651,000 (7.29%)</td>
<td>77,313,000 (100%)</td>
</tr>
<tr>
<td>1962</td>
<td>72,186,000 (93.12%)</td>
<td>5,335,000 (6.88%)</td>
<td>77,521,000 (100%)</td>
</tr>
<tr>
<td>1961</td>
<td>49,127,000 (80.63%)</td>
<td>5,977,000 (19.37%)</td>
<td>55,104,000 (100%)</td>
</tr>
<tr>
<td>1960</td>
<td>27,003,000 (82.65%)</td>
<td>5,667,000 (17.35%)</td>
<td>32,670,000 (100%)</td>
</tr>
<tr>
<td>1959</td>
<td>15,435,000 (79.46%)</td>
<td>6,068,000 (20.54%)</td>
<td>21,503,000 (100%)</td>
</tr>
<tr>
<td>1958</td>
<td>15,533,000 (68.16%)</td>
<td>7,257,000 (31.84%)</td>
<td>22,790,000 (100%)</td>
</tr>
<tr>
<td>1957</td>
<td>10,536,000 (62.71%)</td>
<td>6,002,000 (37.29%)</td>
<td>16,538,000 (100%)</td>
</tr>
<tr>
<td>1956</td>
<td>13,534,000 (60.74%)</td>
<td>8,748,000 (39.26%)</td>
<td>22,282,000 (100%)</td>
</tr>
<tr>
<td>1955</td>
<td>15,911,000 (65.04%)</td>
<td>9,419,000 (34.96%)</td>
<td>25,330,000 (100%)</td>
</tr>
<tr>
<td>1954</td>
<td>12,029,000 (25.30%)</td>
<td>35,500,000 (74.70%)</td>
<td>47,529,000 (100%)</td>
</tr>
<tr>
<td>1953</td>
<td>11,316,000 (6.76%)</td>
<td>166,017,000 (93.24%)</td>
<td>167,333,000 (100%)</td>
</tr>
</tbody>
</table>