NEWS

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549
(202) 272-2650

FOR RELEASE: Tuesday, October 29, 1985

RUMORS IN THE CASINO -- THE IMPACT ON THE SEC'S ENFORCEMENT PROGRAM OF THE USE AND ABUSE OF MARKET SENSITIVE INFORMATION

by Daniel L. Goelzer */
General Counsel
Securities and Exchange Commission

10th Annual Securities Law
for the Wisconsin Practitioner
Pfister Hotel
Milwaukee, Wisconsin

*/ The Securities and Exchange Commission, as a matter of policy, disclaims responsibility for any private publication or statement by any of its members or employees. The views expressed herein are those of the author and do not necessarily reflect the views of the Commission or its staff.

I. Introduction

Recently, Business Week magazine published as its cover story an article entitled "The Casino Society," by Anthony Bianco. 1/ This article -- borrowing a metaphor first employed by John Maynard Keynes -- argues that the contemporary American financial markets, with the proliferation of "junk bonds," hostile takeovers, stock index options, and financial futures, have become too speculative and volatile. In effect, the author says, our markets have become a gigantic casino. "More and more of what transpires on the trading floors of Wall and LaSalle Streets," he asserts, "has no direct connection to the factory floors of Main Street." 2/

By and large, I do not subscribe to Mr. Bianco's the-sky-is-falling thesis. I believe that Mr. Bianco has, however, put his finger on some important trends in the financial markets, particularly the increasing speed and efficiency with which the markets assimilate and react to information. Several of the trends which Mr. Bianco identifies -- hostile takeovers, insider trading, and financial fraud, for example -- can be analyzed as efforts to

---

1/ Bianco, The Casino Society: Playing With Fire, Bus. Wk., Sept. 16, 1985, at 78.

2/ Id. at 83.

exploit the market's reaction to information. The point about all this which I want to examine today is its impact on the Commission's enforcement program. The use, misuse, and dissemination of market sensitive information has increasingly become a focal point of the Commission's enforcement efforts.

II. Corporate Takeovers

Anyone who skims the financial pages will not be surprised by Mr. Bianco's statement that "big money's speculative ploy of choice at the moment is undoubtedly the corporate takeover." 3/ Not unexpectedly, the number and magnitude of takeovers has had an impact on the Commission's enforcement program.

The Williams Act seeks to impose some order and protections on the takeover process. In particular, Section 13(d) of the Act and Rule 13d-1 require anyone who acquires more than 5% of a company's stock to disclose that fact, and to make several other disclosures, including whether he seeks to acquire control. 4/ Those who commence tender offers must also make a disclosure filing with the Commission 5/ and must hold the offer open for

---

3/ *Id.* at 81.

4/ Securities Exchange Act, § 13(d), 15 U.S.C. 78m(d); Rule 13d-1, 17 C.F.R. 240.13d-1.

5/ Securities Exchange Act, § 14(d), 15 U.S.C. 78n(d).

twenty business days so that the disclosure can be assimilated and acted upon by the target company and its shareholders. 6/ However, in the increasingly volatile and highly information-efficient markets "The Casino Society" describes, the effectiveness of the Williams Act is being tested.

The Schedule 13D area is especially vexing because it calls for disclosure of something subjective -- the acquiror's intent. This was illustrated in June, 1985, when the Commission instituted an administrative proceeding against Cooper Laboratories 7/ based upon its purchases and sales of the stock of Frigitronics, Inc. Cooper had acquired 11.1% of Frigitronics' outstanding common stock as of August 9, 1984, at prices ranging from $22 to $24.25 per share. On August 20, 1984, Cooper Laboratories and its affiliate, Cooper Vision, Inc., filed a Schedule 13D, disclosing their acquisition of stock and stating that they might acquire additional shares "by tender with a view of gaining control."

Predictably, following the filing of Cooper's Schedule 13D, the price of Frigitronics' stock shot up in anticipation that Cooper would launch a tender offer for the company. However,

---

6/ Rule 14e-1, 17 C.F.R. 240.14e-1. There are also substantive protections, such as a requirement that an offer for less than all of a target's outstanding shares be prorated among tendering shareholders. Rule 14d-8, 17 C.F.R. 240.14d-8.

7/ _In re Cooper Laboratories, Inc._, Securities Exchange Act Release No. 22171 (June 26, 1985).

on August 29th, Cooper quietly began to <u>sell</u> its Frigitronics' shares. By September 6th, it had sold over 1% of Frigitronics' outstanding shares, and, between September 6th and 12th, Cooper proceeded to liquidate its entire interest in Frigitronics. On September 13th, the day <u>after</u> it had completed its sales, Cooper filed an amended Schedule 13D.

In its order, the Commission alleged that, given that Cooper had mentioned the possibility of a tender offer and that Cooper had begun its sale of Frigitronics' stock on August 29th, the filing on September 13th of the amended Schedule 13D was not filed "promptly" as the Commission's rules require. 8/ Cooper Laboratories consented to the entry of an order finding violations without admitting or denying the matters set forth in the order.

<u>Cooper</u> involved the market impact of information concerning the possibility of a tender offer which never occurred. Another recent Commission enforcement action dealt with massive stock purchases which did indeed occur -- in a market already ignited by the announcement of a competing offer. You might call it the case of the nontender-offer tender offer -- <u>SEC v. Carter Hawley Hale</u>.

8/ Under the Commission's Rule 13d-2, 17 C.F.R. 240.13d-2, a Schedule 13D must be amended "promptly" to reflect any material changes in the disclosures on the form, including, specifically, "any material increase or decrease in the percentage of the class beneficially owned."

The Limited commenced a hostile tender offer for 55.5% of Carter Hawley's shares, at $30 per share. Carter Hawley responded with a wide array of defenses, including the transfer of significant voting power to an ally, General Cinema. Carter Hawley also granted General Cinema a "crown jewel option" -- the right to purchase Carter Hawley's Walden Books Division. The net effect of these moves was to virtually assure the failure of The Limited's bid. Then, in the face of a market almost certain to decline, Carter Hawley announced that it would repurchase up to 15 million of its own shares in open market and privately negotiated transactions. The effect of this announcement was akin to shouting "fire" in a theatre with only one exit. In six frenzied trading days, Carter Hawley purchased about 17.9 million shares, 50.3% of its outstanding common shares, at an average price of $26.20. As soon as Carter Hawley stopped its purchases, the price plummeted to about $20.

The Commission commenced an injunctive action alleging that Carter Hawley's repurchase program constituted a tender offer and that the offer was unlawful since it failed to comply with the Commission's rules. In particular, the Commission's rules require that self-tenders remain open for at least fifteen business days and that the offer, if oversubscribed, be prorated among those shareholders who tender within the first ten business days. 9/

9/ Rule 13e-4(f), 17 C.F.R. 240.13e-4(f).

Carter Hawley extended its sellers none of these rights. The district court, however, disagreed with the Commission's contention that these purchases were tantamount to a tender offer, 10/ and the Commission appealed.

On appeal, the Commission argued that the important issue is whether shareholders are pressured to sell. In this case, the

---

10/ 587 F. Supp. 1248 (C.D. Cal. 1984). The district court applied an eight-factor analysis first set forth in Wellman v. Dickinson. 475 F. Supp. 783 (S.D.N.Y. 1979), aff'd on other grounds, 682 F. 2d 355 (2d Cir. 1982), cert. denied, 460 U.S. 1069 (1983). Those factors include:

(1) an active and widespread solicitation for shares of an issuer;

(2) a solicitation for a substantial percentage of the issuer's stock;

(3) an offer to purchase at a premium over the prevailing market price;

(4) terms of the offer that are firm rather than negotiable;

(5) an offer contingent on the tender of a fixed minimum number of shares and often subject to a ceiling of a fixed maximum number of shares to be purchased;

(6) an offer open for only a limited period of time;

(7) pressure on offerees to sell their stock; and

(8) public announcements of an acquisition program that precede or accompany the accumulation of stock.

pressure resulted because Carter Hawley's purchases were clearly the last chance for shareholders to sell at the premium prices generated by The Limited's offer. The Ninth Circuit, however, disagreed and affirmed the district court's decision, adopting the Wellman eight factors as the appropriate analysis for identifying an unconventional tender offer, but concluding that Carter Hawley's purchases did not constitute a tender offer.

A third case -- Hanson Trust v. SCM -- combines both the problem of the market impact of disclosure, as illustrated by Cooper, and that of large open market purchases outside of the tender offer regulatory scheme, illustrated by Carter Hawley. 11/ On August 21, 1985, Hanson Trust PLC announced a cash tender offer for all shares of SCM, an office products manufacturer, at $60 per share. Hanson's Schedule 14D, in standard boiler-plate, reserved the right to withdraw the offer and make further open market purchases. Nine days later, SCM and Merrill Lynch Capital Markets announced a leveraged buyout agreement to acquire SCM at $70 per share. Hanson responded by increasing its offer to $72 per share. SCM and Merrill Lynch then raised their offer to $74 per share, and SCM granted Merrill Lynch the option to purchase certain SCM assets, if any other person acquired over 33% of SCM's shares.

11/ Hanson Trust PLC v. SCM Corp., No. 85-7745 (2d Cir. Sept. 30, 1985).

That day, at 12:58 p.m., Hanson publicly announced termination of its offer. A few hours later, however, Hanson began acquiring SCM's shares in the open market. Within an hour and a half, Hanson had purchased approximately 28% of SCM's common stock, all at $73.50 per share, primarily from arbitrageurs. SCM thereupon obtained a preliminary injunction prohibiting Hanson from acquiring additional shares, and SCM appealed.

In the Second Circuit, the Commission, as amicus curiae, argued that the preliminary injunction should be upheld because factual issues existed as to whether Hanson's purchases constituted an unconventional tender offer or were a de facto continuation of Hanson's earlier tender offer. The Second Circuit rejected these arguments. The court stated that whether a solicitation constitutes a tender offer turns on whether the solicitees need the protections of the Williams Act. 12/ Noting that Hanson purchased primarily from arbitrageurs and other large investors, the court concluded that the protections of the Williams Act were unnecessary in this instance. 13/

12/ The court did not reach the Commission's other arguments, including an argument that the withdrawal of the tender offer and subsequent large open-market purchases denied SCM's thousands of small shareholders the protections of the Williams Act, including the right to best price and proration.

13/ Indeed, the court analogized to SEC v. Ralston-Purina, the 1953 Supreme Court decision holding that the private placement exemption from Securities Act registration applies only where the offerees are sophisticated and able to fend for themselves. SEC v. Ralston Purina Co., 346 U.S. 119 (1953).

Some observers have argued that the Second Circuit's decision eviscerates Commission enforcement of the Williams Act and that bidders can now simply announce their intent to acquire control of a target company, wait for arbitrageurs to accumulate large blocks, and then acquire those blocks in the open market, all without extending Williams Act protections to shareholders. The Wall Street Journal, in an editorial entitled "A Happy Jig," applauds this development and calls the new tactic "the Williams Act two-step." 14/ In contrast, Business Week has editorially deplored the result in Hanson and called for legislation to extend the Williams Act to open-market purchase campaigns. 15/

It is too early to tell how Hanson will affect the Act; indeed, SCM has filed a rehearing petition which is pending. Nonetheless, if not reversed or modified, the Hanson decision does seem to have the potential to limit the Commission's ability to enforce the tender offer requirements of the Williams Act against a bidder who is willing to exploit the market dynamics set in motion by the public announcement of a tender offer. At congressional hearings last week, members of the House subcommittee with responsibility for the federal securities laws made clear their concern over Hanson and Carter Hawley. In response, Chairman

---

14/ Wall St. J., Oct. 7, 1985, at 22.

15/ Giving Shareholders a Fair Shake, Bus. Wk., Oct. 14, 1985, at 170.

Shad indicated that the Commission will be considering, before the end of this year, whether regulatory action is necessary. Such action might include a definition of the term "tender offer" that would preclude some types of rapid, open-market accumulations which affect shareholders in the same manner as tender offers, without affording them the same protections.

III. Insider Trading

One aspect of the Commission's enforcement program that has received considerable publicity is the war against insider trading. The upsurge in insider trading, and hence insider trading cases, is closely linked to the takeover wave, since information about a tender offer obviously has a dramatic effect on the market value of an issuer's stock. Similarly, the creation of the options markets and the leverage they afford to multiply the value of non-public information have stimulated insider trading. Indeed, many observers believe, along with Mr. Bianco, that the takeover rage has resulted in insider trading becoming "institutionalized at the heart of the markets." 16/

The principal legal issues with which the Commission's enforcement program must grapple in these cases result from the

---

16/ Bianco, *supra* note 1, at 83.

Supreme Court's 1980 ruling in Chiarella v. U.S. 17/ The Court there held that trading while in possession of material, nonpublic information constitutes a violation of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder only where the trader acted in breach of a duty. Such a breach occurs in the ordinary case where a corporate insider trades because of the insider's duty to the corporation and its shareholders. Because Mr. Chiarella had acquired nonpublic information through his job with a financial printer, the Supreme Court's majority held that he did not breach any duty to the corporations in whose stock he traded. However, the various concurring and dissenting opinions left open the possibility that the Court would also recognize a violation where the trader "misappropriates" nonpublic information from someone, other than the issuer of the securities, to whom the trader owes some duty.

Thus, Chiarella launched the Commission's insider trading program on a search for breached duties. Recent cases have considered such scenarios as a crafty word processor at a major New York law firm who learned of takeover targets from his work; 18/ a prominent football coach who claimed that he had

---

17/ Chiarella v. United States, 445 U.S. 222 (1980).

18/ SEC v. Lal Madan, Civ. Action No. 83-5053 (S.D.N.Y. filed July 7, 1983), Litigation Release No. 10063 (July 7, 1983).

overheard news of a merger while sunbathing at a high school track meet, 19/ and an employee of a printer for a stock market newsletter who perused the publications' recommendations before they were mailed. 20/ I would like to describe several misappropriation cases that illustrate the success of our current insider trading enforcement efforts.

The Commission firmly established the misappropriation theory in the Second Circuit in SEC v. Materia. 21/ Mr. Materia, like Mr. Chiarella, was a member of a class of persons apparently subject to the temptations of insider trading -- financial printers. Mr. Materia, a participant in the proof-reading process, skillfully worked out the identity of tender offer targets based on the materials submitted to him to proof -- he deduced the targets from things like their dividend payment dates and state of incorporation. The Second Circuit affirmed the district court's holding that the defendant breached a duty to his employer by misappropriating the information for his own benefit, and that he therefore violated

---

19/ SEC v. Switzer, 590 F. Supp. 756 (W.D. Okla. 1984). The SEC alleged that a corporate insider had tipped the coach; the coach claimed that he had simply overheard the insider talking to his wife. The court found for the defendant.

20/ SEC v. Sarzynski, Civ. Action No. 85-3864 (S.D.N.Y. May 22, 1985), Litigation Release No. 10763 (May 22, 1985).

21/ 745 F.2d 197 (2d Cir. 1984), cert. denied, 53 U.S.L.W. 3757 (U.S. Apr. 22, 1985).

Section 10(b) and Rule 10b-5. 22/

The search for breached duties traveled from the print shop to the newsroom in the Wall Street Journal case. J. Foster Winans, formerly a Journal reporter, wrote "Heard on the Street" -- a sort of stock market gossip column. In both an SEC civil action and in a criminal indictment, 23/ it was alleged that Winans passed information to other defendants concerning securities that would be mentioned in the column. These persons traded in securities in anticipation of the effects the Journal stories would have on the market. Mr. Winans was charged with the misappropriation of confidential information in breach of a duty owed to his employer -- the Journal -- which prohibited employees from using the content of future stories for their personal benefit. Alternatively, the Commission in its civil complaint alleged that Winans breached a duty of trust which a reporter owes to his readers. The defendants, on the other hand, sought to distinguish their case from Materia

---

22/ The court also held that this conduct violated Section 14(e) of the Exchange Act and Rule 14e-3 thereunder. Mr. Materia was enjoined from further violations and ordered to disgorge over $99,000 in trading profits.

23/ United States v. Winans, No. SS 84 Cr. 605 (S.D.N.Y. June 24, 1985). In June, 1985, the United States District Court for the Southern District of New York convicted Mr. Winans and the other defendants of numerous counts of securities fraud, wire fraud, and mail fraud. In addition, two defendants were convicted of conspiracy to commit securities fraud, wire fraud and mail fraud and to obstruct the Commission's investigation.

on the ground that Mr. Materia had defrauded not only his employer, but also had defrauded the employer's tender offeror clients. By contrast, the Wall Street Journal had no relationship to the corporations that were the subject of the stories.

In the criminal action, the district court rejected this defense, holding that the government need not prove that the victim of insider trading fraud was a buyer or seller of securities. Appeals to the Second Circuit are pending. Last week, however, Mr. Winans and a codefendant in the Commission's companion civil action consented to injunctions and to disgorgement of their trading profits. 24/

From print shop and newsroom, the duty search has continued into the family living room. United States v. Reed 25/ involves a duty of confidentiality between father and son. Several years ago, the Commission brought a civil action against Thomas Reed, 26/ a former Presidential adviser. In a companion criminal indictment, it is alleged that Mr. Reed -- I'll call him "Reed junior" -- misappropriated secret merger information from his father, who

---

24/ SEC v. Brant, No. 84 Civ. 3470 (S.D.N.Y. Oct. 22, 1985).

25/ United States v. Reed, 601 F. Supp. 685 (S.D.N.Y. 1985), rev'd in part on other grounds, No. 85-1031 (2d Cir. Sept. 30, 1985).

26/ SEC v. Reed, Civ. Action No. 81-7984 (S.D.N.Y. Dec. 23, 1981), Litigation Rel. No. 9537 (Dec. 23, 1981). Mr. Reed consented to an injunction without admitting or denying the Commission's allegations and disgorged his trading profits.

was a director of Amax. Allegedly, Reed senior had innocently confided in his son about business developments, but Reed junior used his father's confidences to play the market. Reed junior argued that the misappropriation theory should not apply because no common law fiduciary or confidential relationship exists between a father and son. The district court rejected the defendant's argument, stating that the requisite confidential relationship could arise from mutual expectations of trust and confidence between the parties.

Insider trading will undoubtedly continue to be a focal point of Commission attention, both because of the evolving legal parameters and because the rewards the market offers to those who misuse confidences are great. Of course, Congress, at the Commission's request, upped the ante in this area last year when it enacted the Insider Trading Sanctions Act, which creates a civil penalty for insider trading of up to three times the trader's profits. 27/ The Commission has invoked this statute twice so far, 28/ and more cases are in the pipeline.

27/ Pub. L. No. 98-376, 98 Stat. 1264 (1984).

28/ SEC v. Ablan, Civ. Action No. 84-8532 (S.D.N.Y. July 23, 1985), Litigation Release No. 10830 (July 23, 1985); SEC v. Gaffney, Civ. Action No. 85-2967 (S.D.N.Y. Apr. 18, 1985), Litigation Release No. 10725 (Apr. 18, 1985).

IV. Accounting Issues and Financial Fraud

In "The Casino Society," Mr. Bianco also argues that "an epidemic of fraud" is sweeping the entire financial world. 29/ It is certainly true that, in the past few years, the Commission has brought an increasing number of enforcement actions alleging financial fraud against issuers, officers, and independent auditors. At its root, financial fraud is a predictable response to the increased speed at which the markets consume and react to information. Last year's and last quarter's financial results are increasingly believed to be the main determinants of whether institutional portfolio managers hold or sell a security. In such an environment, some corporations have apparently concluded that, when profits cannot be created from operations, they must be generated through creative accounting or downright phony financial statements.

One classic ploy is premature revenue recognition. For example, the Commission recently brought an action involving a $6 million loose-leaf notebook. The Commission alleged that Chronar Corp. improperly recognized revenue from an agreement to sell a photovoltaic cell manufacturing plant to a Swiss corporation. The sale price was $6 million. Chronar, just before the close of its fiscal year, delivered to the buyer a technical manual -- a

---

29/ Bianco, *supra* note 1, at 86.

looseleaf notebook of photocopies of blueprints and technical materials -- purporting to cover the operation of the plant. Chronar then recognized $1.8 million of the sale price in that fiscal year, on the theory that this notebook was the first installment of the $6 million sale. In the Commission's view, Chronar should not have recognized any revenue under the agreement during the fiscal year because the book was an insubstantial component of the total sale. 30/

Another example is Florafax, 31/ in which the Commission alleged that a floral supplier shipped unordered flowers to customers and recognized revenue at the time of shipment, when customers

---

30/ SEC v. Chronar Corp., Civ. Action No. 84-3069 (D.D.C.), Accounting and Auditing Enforcement Release No. 40 (Oct. 3, 1984). The Commission alleged that there existed substantial uncertainty as to the collectibility of the obligation and that Chronar's right to any payments under the agreement was contingent upon its ability to comply with certain performance guarantees. Chronar consented to an injuntion without admitting or denying the Commission's allegations. The Commission also instituted an administrative proceeding against Chronar's independent auditors in connection with its audits of the company. In re Seidman & Seidman, Accounting and Auditing Enforcement Release No. 78 (Oct. 10, 1985). The firm consented to a censure and agreed to adopt certain new auditing procedures without admitting or denying the Commission's allegations.

31/ SEC v. Florafax Int'l, Inc., Civ. Action No. 84-C-935 (N.D. Okla.), Accounting and Auditing Enforcement Release No. 44 (Nov. 27, 1984).

had no obligation to pay. The largest shipments went out around Mother's Day 1981 and Secretary's Day 1982. Returns for the various holidays ranged from 28% to 69% of the unordered flowers. Presumably, the rest of the recipients were grateful to Florafax for remembering the holidays for them. Florafax consented to an injunction without admitting or denying the Commission's allegations and agreed to restate certain of its financials. Its chairman agreed not to serve as an officer or chairman of Florafax for three years. 32/

32/ See also SEC v. Baldwin-United Corporation, Civ. Action No. C-1-85-1581 (S.D. Ohio, filed Sept. 26, 1985), Accounting and Auditing Enforcement Release No. 75 (Sept. 26, 1985). The Commission alleged that Baldwin improperly accounted for its sales of single premium deferred annuities ("SPDAs"). Baldwin treated its SPDAs as insurance products and recorded profits at the time of sale. The Commission alleged that Baldwin should have used an accounting model that treated SPDAs more like a certificate of deposit or a similar debt instrument and that recognized income only as it was actually earned. What Baldwin did instead was recognize revenue based on totally unrealistic assumptions. Each time Baldwin sold an SPDA that paid a certain guaranteed rate of interest, it invested the proceeds in tax exempt municipal bonds that paid a lower rate of interest. It expected that it would more than make up the difference by deducting its interest expense on the SPDA, thus reducing its taxable income. It then recognized the estimated tax benefit as current revenue. When Baldwin subsequently failed to generate sufficient taxable income, this hypothetical revenue disappeared. The corporate defendants consented to the entry of an injunction without admitting or denying the allegations. Trial against two individual defendants is pending.

Another variation is reflected in Broadview Financial Corp. 33/ Broadview, an Ohio savings and loan holding company, allegedly hit upon a device to turn a loan into a sale. It was alleged that Broadview financed a developer's purchase of a 3,200 acre tract by first purchasing the property itself and then assigning the contract to the developer for $4 million. Broadview's thrift subsidiary loaned the developer $20 million, from which the $4 million payment was made. Broadview then treated the $4 million -- which it had itself supplied -- as revenue in its financial statements. In the Commission's view, Broadview did not actually purchase and sell the property, but simply provided financing. Accordingly, the $4 million payment should not have been recognized as immediate revenue. 34/

33/ In re Broadview Financial Corp., Accounting and Auditing Enforcement Release No. 54 (Apr. 17, 1985). The company consented to the entry of an order without admitting or denying the allegations.

34/ Similarly, in PepsiCo, the Commission alleged that the company filed false financial statements that reflected the sale of $40 million worth of Pepsi Philippines' idle bottle inventory. PepsiCo meanwhile orally guaranteed to indemnify banks for extending credit to the purchaser. PepsiCo was also obligated to assume the purchaser's debt and had an understanding to buy back the bottles. SEC v. PepsiCo, Inc., Civ. Action No. 85-CIV-5022 (S.D.N.Y.), Accounting and Auditing Enforcement Release No. 65 (July 1, 1985). All defendants consented to the entry of an injunction without admitting or denying the Commission's allegations, except two defendants residing outside of the United States.

I mentioned earlier that, in some of these cases, the company's auditors are also the subject of enforcement action. As the accounting profession has become more competitive, opinion shopping has re-emerged as an issue. For example, when Broadview's auditors informed the company that its financial statements would have to be restated to account properly for the transaction, Broadview's management contacted four "Big Eight" accounting firms. Firms one through three agreed with Broadview's current auditor; number four saw things management's way. Not surprisingly, Broadview thereupon ousted its auditors and hired firm number four. The Commission has recently published a release soliciting comment on whether and how opinion shopping should be addressed through disclosure. 35/

V. Newsletter Publishers

The elements of the Commission's enforcement work which I have mentioned so far address the use or misuse of market sensitive information. The final facet of the Commission's activities which I'd like to touch on involves the purveyors of information -- financial newsletter publishers.

If you have heard of the Supreme Court's recent decision in Lowe v. SEC, 36/ your first reaction might be that this is an area in which the Commission no longer has a program. For reasons I will

---

35/ Securities Act Release No. 6594 (July 1, 1985).

36/ 105 S. Ct. 2557 (1985).

explain in a minute, that is not true. In Lowe, the Supreme Court did, however, significantly cut back on the scope of the Commission's enforcement reach over those who give market advice only via publications.

Christopher Lowe published a securities newsletter and offered a telephone "hot-line" service. In 1974, he registered with the Commission as an investment adviser. In the late 1970s, however, Mr. Lowe was convicted of various state offenses, including misappropriating funds, tampering with evidence, and check fraud. Mr. Lowe went to prison as a result. When the Commission learned of Mr. Lowe's state convictions, it revoked his registration as an investment adviser. Undeterred, Mr. Lowe continued to publish. Indeed, his main periodical -- which made recommendations concerning securities and precious metals -- had as many as 19,000 subscribers and was supposed to appear semimonthly -- although, in fact, it only came out eight times during a fifteen month period.

The Commission commenced an enforcement action to restrain Mr. Lowe's unregistered publication. The Investment Advisers Act makes clear -- the Commission thought -- that those who disseminate advice concerning securities by means of writings must register. However, when the case came before the Supreme Court, a majority of the Court concluded that newsletters like Mr. Lowe's fall within an exception from the definition of investment adviser for a "bona fide newspaper, news magazine, or business or financial publication of general and regular circulation." 37/

The Lowe opinion does not close the book on Commission enforcement actions against newsletter publishers. The majority made clear that only "bona fide" publications of "general and regular circulation" were exempt. This means, for example, that publishers who are paid to recommend a security are still investment advisers -- the Supreme Court called those publishers "touts." Similarly, "tip sheets" -- publications timed to particular market events -- must register, as must those advisers who give personalized advice by means of written documents.

In the wake of Lowe, the Commission is continuing to pursue its enforcement program against fraudulent newsletter publishers. Since the Supreme Court's decision in Lowe, the Commission has won several appellate victories against newsletter publishers. In Suter v. SEC, 38/ the Seventh Circuit affirmed a Commission order revoking a newsletter publisher's investment adviser registration for violations of the federal securities laws. The court held that Lowe did not prevent such a revocation, since the order did not bar publication. In SEC v. Blavin, 39/ the Sixth Circuit

---

37/ Investment Advisers Act, § 202(a)(11)(D), 15 U.S.C. 80b-2 (a)(11)(D).

38/ No. 83-3011 (7th Cir. July 12, 1985).

39/ 760 F.2d 706 (6th Cir. 1985).

affirmed a district court judgment granting summary judgment for the Commission and ordering a newsletter publisher to disgorge unlawful profits. The publisher had engaged in "scalping" -- the buying of securities, recommending them in a publication, and then selling them after the recommendation had caused the price to rise.

VI. Conclusion

I hope that this discussion has given you some feel for how the Commission is currently policing the financial "casino." I would not want to leave you with the impression that cases growing out of the misuse of information are the sole focus of the Commission's enforcement work. On the contrary, the great bulk of the Commission's cases deal, as they always have, with garden-variety fraud, failure to register securities offerings, and similar basic violations of the statutes the Commission administers. In fact, cases involving broker-dealers and other regulated entities make up the largest single part of the Commission's enforcement work.

The point I would like to leave you with is that the Commission's enforcement program is flexible. As "The Casino Society" indicates, our securities markets are constantly changing. I believe that one of the Commission's great strengths over the past 50 years has been its ability to keep pace with those changes.

Thank you.